

**APPENDIX - B -**

**PRIVATE EQUITY/DEBT INVESTMENT POLICY**

**I. PURPOSE**

This document sets forth the strategic investment objectives and policies for IPERS' private equity/debt (private equity) portfolio. The rate of return objective for this portfolio is to achieve a high real rate of return in excess of the returns available in the public equity market over the long term. The allocation to the private equity portfolio shall be determined through the asset allocation review process based on its contribution to the Fund return, subject to an acceptable level of risk.

The execution of this strategy within IPERS' total portfolio shall be accomplished in a manner that fulfills the statutory definition of prudence, as found in Iowa Code §97B.7.

**II. DEFINITIONS**

"Board" shall mean the IPERS Investment Board.

"Consultant" shall mean the general investment consultant engaged by IPERS.

"Manager" shall mean an investment manager engaged by IPERS to manage the private equity portfolio.

"Staff" shall mean the IPERS investment staff.

**III. INVESTMENT PHILOSOPHY**

Traditional public equity markets have become increasingly efficient. The private equity market, however, remains inefficient and illiquid partially because of privately negotiated, nonauction pricing mechanisms. Return premiums exist for investors who accept the illiquid and inefficient characteristics of the private equity market, and who are willing to take an opportunistic investment approach. Therefore, the long-term expected returns from private equity markets are substantially greater than those from public equity markets.

Controlling risk in the private equity portfolio is as important as seeking higher returns, and will be effected through diversification of investment type and thorough due diligence during the evaluation, acquisition, and monitoring stages of the investment process.

Because of the inefficiencies found in the private equity market, successful investment requires an active, targeted, and opportunistic approach. In an inefficient market, passive investment in a broad array of market segments is likely to lead to underperformance. Therefore, IPERS will delegate investment selection to an experienced, qualified manager. The manager will utilize a systematic approach to the identification of and participation in specific investments. The following screening criteria will be utilized by the manager as a key element of the systematic approach to the identification of suitable venture capital and special equity investment opportunities for the System:

- Experience, qualifications, and responsibilities of the general partners
- Past investment results of the general partners
- Quality of the general partners' deal flow sources
- Demonstrated deal-exiting capability on the part of the general partners
- Special expertise of the general partner, unique deal flow source, or other competitive advantage
- Limit of liability by the pension fund to the amount of their investment (for example limited partnerships)
- General contribution of the opportunity to the diversification of the program

To strengthen diversification of the investments, several diversification criteria will be utilized when evaluating each opportunity. These criteria include geographic location of the partnership, geographic location of the investees, industry investment orientation of the partnership, financial funding stage orientation of the partnership, source of the partnership's deal flow, and investment size.

#### **IV. INVESTMENT OBJECTIVES**

##### **A. Total Portfolio**

The long-term return objective is 300 basis points (3 percent) greater than the Wilshire 5000 Index, net of investment management fees, calculated on an internal rate of return (IRR) basis over rolling ten-year periods.

Performance on both the portfolio and the benchmark shall be calculated on an internal, or dollar-weighted, rate of return basis. In recognition of the fact that IRRs are not meaningful in the early years of a private equity investment's life, the IRR performance calculation for the benchmark may be adjusted so that contributions made in the most recent three years of the rolling ten-year period are assumed to earn 91-day U. S. Treasury Bill returns.

IPERS shall continue to actively invest in private equity to the extent that the returns available from new investments are expected to exceed public equity market returns by at least 300 basis points (3 percent), net of investment management fees.

B. Individual Investments

The specific performance objective for each investment shall be established by the manager based on the risk and strategy involved. Returns shall be calculated on an internal rate of return basis.

V. INVESTMENT POLICIES AND GUIDELINES

A. Market Characteristics and Segment Definitions

The private equity markets cover a broad spectrum of equity-oriented investments. Unique investment characteristics include:

- Privately negotiated transactions.
- Active participation in companies by general partners/managers.
- Long-term, illiquid commitments.
- Superior expected returns in excess of public market returns over the long-term.

IPERS' private equity portfolio will be composed of the following segments, each with the following subcategories:

- U.S. and non-U.S. venture capital
  - Early venture  
Focuses on initial financing of start-up and early-stage companies. Companies at this stage often do not have fully formed management teams or completely defined products, and usually do not have sales or earnings.
  - Growth venture  
Aims to provide expansion capital to mid- and late-stage companies that are increasing capacity and expanding market share.
  - Established growth venture  
Focuses on investments in mature companies which are well-established in the market, operating profitably or at cash flow

break-even and growing at an above-industry growth rate. Investment is made due to an opportunity for further expansion.

- U.S. and non-U.S. special equity/debt
  - Corporate finance:  
Includes leverage buy-out, management buy-out, and influence-block investment strategies.
  - Recovery securities:  
Includes equity and debt instruments of companies involved in turnaround, restructuring, deleveraging, or bankruptcy situations.
  - Mezzanine securities:  
Placed between debt and equity in a company's capital structure, mezzanine securities are typically subordinated debt instruments for late-stage venture and mature companies, and offer income through a current coupon and equity participation through a warrant.
  - Other investments:  
Includes those investments not defined above and also not included in the Investment Policy Statement of other IPERS managers. This category is designed to capture those innovative investment opportunities created by the marketplace that do not fit an existing category. The manager may not invest in investments that would fall within this subcategory without specific approval from the staff.

#### B. Investment Vehicles

The manager may utilize the following investment vehicles within the private equity portfolio: private limited partnerships, group trusts, limited liability companies, and coinvestments in companies alongside of IPERS' current general partners. In addition, the manager may also participate in secondary offerings or purchase private equity interests from other investors on the secondary market.

#### C. Controlling Investment Risks

To reduce portfolio risk by limiting the potential of any one investment to negatively impact long-term results, IPERS and its manager will diversify the portfolio in the following areas:

1. Financing Stage

The portfolio shall gain an exposure to the array of financing stages by opportunistically exploiting the best investments at different stages of the economic cycle. IPERS shall make every effort to ensure that the allocation between the venture capital and special equity segments provides proper diversification.

2. Time

Commitments shall be made over the full course of the business cycle and will not be concentrated in any one year.

3. Geographic and Economic Region

In the selection of private equity investments, the portfolio shall not favor particular economic or geographic regions.

4. Industry

The portfolio will be exposed to companies in a variety of industries. For venture capital, however, it is recognized that opportunities may be most readily realized in a selected number of industries.

5. General Partners

The manager will seek to work with a variety of general partners because of their specialized expertise in particular segments of the private equity market and source of their deal flow, as well as to mitigate the potential over-reliance upon a few key investment professionals.

6. Investment Size

The maximum investment in any limited partnership, group trust, or limited-liability company vehicle shall not exceed 20 percent of the total capital committed by all partners at the time of the final closing for each fund, and shall not exceed \$80 million without the prior approval of the Board. The maximum investment in any direct investment shall not exceed \$5 million. Total investment commitments for a calendar year, which shall be subject to Board approval, shall not exceed 2 percent of the total IPERS portfolio market value as of June 30 prior to the beginning of the calendar year, plus an amount equal to the net proceeds returned to

IPERS from portfolio asset sales during the twelve-month period ending on June 30 prior to the beginning of the calendar year.

D. Alignment of Interests

The manager shall actively negotiate partnership agreements on behalf of IPERS. The foremost duty of the manager in negotiating partnership agreements shall be to ensure that the interests of the general partner are aligned with the interests of IPERS and the other limited partners. The manager shall negotiate terms that adequately compensate the general partner for its efforts, while ensuring that the partnership is structured so that IPERS is treated fairly and is adequately compensated for the risk taken by investing in the partnership.

**VI. MANAGEMENT OF STOCK DISTRIBUTIONS**

The manager shall have responsibility for selling stocks received as in-kind distributions from the System's private equity investments. The liquidation of stock distributions shall occur in an orderly manner according to written guidelines mutually agreed upon by the manager and the System. The written guidelines shall specify the maximum number of days the manager may defer liquidating a stock, and shall also specify rules designed to limit the downside risk of holding the stock.

**VII. ROLE OF THE BOARD, STAFF, MANAGER, AND CONSULTANT**

A successful private equity program requires good communications between the Board, staff, manager, and consultant. Each will have specific responsibilities in the management and oversight of the program.

*Role of the Board*

- Annual adoption of the asset allocation target and permissible ranges
- Annual adoption of the Private Equity/Debt Investment Policy
- Selection of managers
- Annual review of managers' guidelines
- Annual portfolio review and discussion
- Approval of commitments to segments in excess of those described in Section V.C.6

*Role of the Staff*

- Annual proposal of asset allocation targets and ranges, and the Private Equity/Debt Investment Policy to the Board
- Annual portfolio monitoring for guideline compliance
- Monthly cash flow audit

- Annual review and discussion of investment strategy and other issues with the manager
- Annual review of stock liquidation process and procedures with the manager
- Review of new partnership agreements and amendments to existing ones prior to their execution to ensure compliance with established policies and investment restrictions
- Review of prospectuses and offering memoranda, and meetings with prospective partnership management as needed
- Meet with existing partnership management on an as-needed basis
- Provision of funds for new investments committed to by the manager
- Recommend commitments in excess of those described in Section V.C.6 to the Board
- If necessary, terminate the manager and recommend the hiring of a replacement to the Board, and negotiate business terms and compensation packages
- Approve commitments to the Other investments subcategory within the special equity/ debt segment

*Role of the Manager*

- Investment selection in accordance with policies and guidelines established by the Board
- Negotiating partnership agreements
- Supplying staff with required information to fulfill their responsibilities
- Ongoing monitoring and review of investment vehicles for adherence to objectives and guidelines
- Quarterly performance reporting
- Annual portfolio review and discussion of investment strategy with the Board
- Annual review and discussion of investment strategy and other issues with staff
- Renegotiating deal terms and exit strategies for troubled investments
- Liquidation of in-kind distributions from partnerships in an orderly manner
- Obtain approval from staff prior to making commitments to the Other investments subcategory within the special equity/ debt segment

*Role of the Consultant*

- Participate with staff in establishing private equity asset allocation targets and ranges
- Ongoing monitoring and review of the private equity portfolio for compliance with this Investment Policy, and recommending revisions to same
- Performance measurement and evaluation of the portfolio
- Ongoing monitoring of the managers and recommending termination and/or replacement of the managers to staff. Participate with staff in conducting manager searches and negotiating business terms and compensation packages with same