



**Commonwealth of Pennsylvania  
State Employees' Retirement Board**

**Private Equity Statement of Investment Policy**

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**Commonwealth of Pennsylvania**  
**State Employees' Retirement Board**  
**Private Equity Statement of Investment Policy**

Pursuant to Title 71, Section 5931, the Board of the Pennsylvania State Employees' Retirement System ("SERS") establishes this Private Equity Statement of Investment Policy (the "Policy Statement") that sets forth the long-term objectives and policies for managing SERS' Private Equity program. The Policy Statement ensures that managers, advisors, and other third party service providers selected by the Board adhere to SERS' investment principles and guidelines. Additionally, the use of the Policy Statement assures sufficient flexibility in managing investment risks and returns associated with Private Equity. The Board may provide for exceptions, or amend this Policy Statement, in whole or in part.

**1. Introduction**

Private Equity is largely comprised of non-traditional investments made in limited partnerships organized to make domestic and international private market investments such as venture capital, leveraged buyouts, distressed debt, and special situations acquired in primary or secondary markets. Venture capital investments generally involve the financing of young, non-public growth companies. These investments are made in: (i) seed stage companies in their conceptual phase, (ii) early stage companies after a product has been developed but before revenues are realized, and (iii) late stage companies with demonstrable revenue and attraction for strategic sale or initial public offering of stock. The term "private equity" is employed to describe private market investments in the equity and subordinated debt of established companies.

The members of the Board, SERS' employees, and SERS' agents shall stand in a fiduciary relationship to the members of the System within the constraints of the "prudent investor" standard.

**2. Investment Objectives**

Private Equity investments are expected to provide return premiums over publicly traded securities, improve the Fund's diversification, and enhance the Fund's asset base over long periods of time. SERS' long-term performance objective for Private Equity is to achieve a risk-adjusted return, net of fees, in excess of the 10-year average annualized return of the Russell 3000 Index plus a 300 basis point risk premium.

**3. Asset Allocation**

Asset allocation is a critical driver of the long-term success of Private Equity. Since it is not possible to rebalance quickly in Private Equity, pacing and manager selection have heightened importance as tools to influence allocation. Long-term asset allocation targets are established in SERS' Investment Plan.

Fund investments should be planned and executed in a manner that adheres to the asset allocation targets (transitional and long-term) specified for Private Equity in SERS' Investment Plan. Rather than using discrete percentages, these targets are combined with those targets for global public equity and are expressed as a desired asset allocation range for all of SERS' equity-like investments entitled "Total

Equity.” By allowing acceptable allocation ranges, the Fund is not forced to constantly rebalance its assets, thus improving the Fund’s operational efficiency. Likewise, commitments to the Private Equity asset class may exceed carrying values since committed capital is typically drawn down over a long time period. During this period, some investments will be realized, resulting in distributions of capital back to SERS.

#### **4. Pacing**

SERS’ Investment Plan may recommend annual commitment ranges to be made by the Fund within each strategy as well as a total target commitment for the Fund (the “Pacing Analysis”) in order to achieve both the target strategic allocation and the overall allocation to the Private Equity asset class. The Pacing Analysis shall take into account the Fund’s overall allocation to and investments in the Private Equity asset class, within each strategy, across industries and geography, and by vintage year, as well as the market environment and other appropriate considerations. The Fund shall strive to avoid concentrations in strategies, industries, geographic areas, funds, managers, or vintage years.

#### **5. Investment Guidelines**

In an attempt to control the risks inherent in Private Equity, SERS strives to invest with private equity managers (“Manager(s)” or “Firm(s)”) capable of attaining SERS’ long-term investment objectives. Selection shall be predicated upon a comprehensive review of each prospective investment Manager’s current abilities and investment track record to determine if the investment return objectives are likely to be achieved, as articulated in SERS’ Investment Plan. Collectively, these Fund investments will be broadly diversified in terms of vintage year, industry focus, geographic focus, venture capital stage (e.g., seed, early, growth, or later stage), and private equity focus (e.g., buyouts, distressed, secondaries, or other). Exposure to Pennsylvania-based Managers may be a component of SERS’ Private Equity program if achieved within the fiduciary constraints of the “prudent investor” standard. SERS may invest in “fund-of-funds,” separately managed accounts, or other vehicles, if by doing so SERS achieves access to investment opportunities and/or information that might not otherwise be attainable.

SERS’ Private Equity investments shall satisfy the following minimum criteria:

##### **a. Investment Strategy**

The investment strategy must target investments that satisfy SERS’ definition of Private Equity. There must be a sufficient universe of potential investments to accommodate institutional investing. The investment strategy must be set forth in sufficient detail to permit substantive and meaningful review of the opportunity, verification of investment concept, and comprehensive analysis of risk factors. The investment strategy shall also outline the Firm’s corporate governance policies and procedures with respect to management of the Firm and its underlying investments. Finally, there must be sound evidence that the investment will provide reasonable probability of achieving the return and risk objectives of SERS.

## **b. Investment Process**

The Firm shall demonstrate a sound process for sourcing, performing due diligence, selecting, monitoring, and exiting investments. This investment process shall describe the Firm's internal investment and management controls, and should provide for regular monitoring and valuing of existing investments, as well as a strategy and procedure for exiting investments. The Fund shall have carefully documented its investment processes, including those related to hiring managers to manage the Fund's investments. These processes and due diligence tools are available for review on the SERS' intranet web page and are incorporated by reference into this policy.

## **c. Management**

The Manager must have expertise and experience in sourcing, pricing, selection, structuring and negotiating private equity investments. It is preferable that the Firm's key investment personnel have direct experience investing for institutional investors, a history of working together, a successful track record of implementing the strategy proposed for the particular investment, and are managing portfolios of capital similar in size to the amount currently being sought. Depending on the strategy, operational experience in target industries is desirable.

## **d. Terms and Conditions**

Each partnership agreement shall be negotiated such that SERS receives competitive terms and conditions. SERS' leverage to negotiate terms may be reduced when it commits relatively modest capital or if the Firm's offering is heavily oversubscribed.

## **6. Risk Management**

SERS will seek to minimize risk through investment due diligence and portfolio diversification. Before any investment is recommended to the Board and an investment is made, SERS' Investment Office staff and/or its Private Equity consultant will rigorously review the investment opportunity. A due diligence review by SERS' Investment Office staff and/or Private Equity consultant includes without limitation, meetings with the investment principals, reviews of pertinent offering documents and supporting materials, the Manager's completion of a due diligence questionnaire, and reference checks. Such reviews allow SERS to more effectively evaluate the soundness of the investment opportunity, and its adherence to SERS' investment guidelines as to investment strategy, process, management, and terms and conditions (see Section 5 above).

SERS will also seek to minimize risk within its Private Equity portfolio by diversifying its investments. Diversification will be achieved by investing with Managers in funds with differing vintage years, industry focuses, geographic focuses, venture capital stages, and private equity focuses. In addition, individual funds will be diversified by limiting the amount of capital that can be invested in any one company.

## 7. Manager Monitoring and Evaluation

Each Manager will provide SERS' Investment Office with quarterly unaudited reports (or semi-annual reports if customarily produced by the Manager) and annual audited reports in sufficient detail to allow SERS' Investment Office staff to assess the performance of each Private Equity investment. Each Manager is expected to timely report on all material developments including, but not limited to, personnel changes, contractual problems or amendments, distribution issues, and any other items required for appropriate monitoring by SERS' Private Equity staff. Each Manager, as part of its investment report to SERS, is expected to provide information concerning its Pennsylvania portfolio activity (if any), including employment statistics.

Semiannually, the Private Equity consultant will submit to the Board a Private Equity performance report. Performance measurement will utilize an Internal Rate of Return metric ("IRR"). The IRR is based on inflows and outflows of partnership capital, giving consideration to the residual value of investment holdings, and calculated net of management fees, expenses, and the Manager's share of carried interest. The IRR calculation is an annualized-since-inception measure, updated quarterly, and along with cash-on-cash return multiples, serves as the primary objective measurement of a Manager's performance. The performance of each investment will be compared against Burgiss' relevant Vintage Year Median Returns (or other relevant relative return data made available by SERS' Private Equity consultant).

The Board understands that Private Equity investments are long term in nature, illiquid, and generally involve a duration of 8 to 15 years. Therefore, investment performance must be viewed over a longer time horizon than the assessment period used for publicly traded securities. Although the final performance of a Private Equity investment cannot be known until its termination, it is recognized that the performance of a more mature investment (7-10 years) provides a more accurate indication thereof.

For SERS' Investment Office staff to more actively monitor a Manager's investments for compliance with the terms and conditions of the limited partnership agreement as well as SERS' expectations, SERS often seeks a seat on the fund's advisory board or valuation committee. In such capacity, SERS' Investment Office staff will generally participate in the review and/or approval of: (i) the Manager's valuation policy, (ii) underlying investments remaining in the portfolio, (iii) the Manager's valuation of such underlying investments, and (iv) whether potential conflicts of interest exist. As the size of SERS' commitments shrinks, so does the likelihood that it will be offered opportunities to serve on their advisory boards and valuation committees.

**8. Separate Documents Incorporated by Reference into this Policy Statement**

- a. Hiring Investment Managers Process**
- b. SERS' Master Due Diligence Questionnaire**
- c. Due Diligence Questionnaire for Private Equity**