

Tennessee Consolidated Retirement System

Private Equity Investment Guidelines

Approved by:

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A. Introduction

TCRS is authorized to invest in private equity investments by Tennessee Code Annotated Section 8-37-104(a)(10), with the terms established in the TCRS Investment Policy. These Guidelines are intended to clarify and expand on those documents.

These guidelines establish standard operating procedures to be used by the TCRS Private Equity staff for the initiation and management of private equity investments.

In addition to these guidelines, all Private Equity staff will adhere to the current version of the TCRS Investment Policy.

B. General Fund Targets, Limits, & Restrictions

The Private Equity portfolio is limited to 5% of the market value of the total TCRS portfolio. No investment may be acquired which would, at the time of the acquisition, cause the aggregate book value of all the retirement system's holdings and investments in private equity to exceed more than 5% of the market value of the total assets of the retirement system. This market value limit is intended to limit the actual value of assets invested and is not intended to limit commitments which will typically be larger than the actual invested value, particularly during the initial development stages of the private equity investment program. Although that the total value of the aggregate commitments to private equity will likely be significantly larger than the actual amount invested, the actual invested value will be managed to remain within the maximum investment permitted by these Guidelines. The target allocation is 3% of the market value of the total TCRS portfolio.

The goal of the Private Equity portfolio is to outperform the S&P 500 Index by 300 basis points, net of fees and expenses, over a full private equity investment cycle (10 years).

Vintage year concentration will be avoided by targeting less than 25% of the fund's private equity program value in a given vintage year. General Partner concentration risk will be controlled by having less than 20% of the private equity program allocation invested with a given private equity partner. Strategy concentration risk will be controlled by closely monitoring the range of investment strategies available in the private equity universe. The Private Equity portfolio will be restricted from owning more than a 15% economic interest in any one vehicle without written approval from the Treasurer. The Private Equity portfolio shall not invest in funds or strategies that focus on emerging market economies.

C. Investment Review Process

Prospective funds will be introduced to the Private Equity staff and Private Equity Advisor in several ways, typically including calls or emails to staff, direct receipt of offering memoranda from general partners, calls by placement agents representing general partners, as well as notification from existing TCRS general partners that a new fund is being raised. All placement agents must file with TCRS all required written disclosures and otherwise strictly comply with all TCRS policies.

In addition to Private Equity staff processing of fund offerings, the Private Equity staff shall forward selected offerings for review to its Private Equity Advisor. Staff will coordinate producing a pipeline report that lists fund offerings that Private Equity staff and its Private Equity Advisor believe warrant further due diligence and potential underwriting.

As discussed in the TCRS Investment Policy, Private Equity staff must record the names of all persons or entities that bring specific private equity investment proposals to any retirement system employee or board member who has a role in determining whether retirement system assets should be invested in the private equity investment. These records will be disclosed to the audit committee of the TCRS Board of Trustees.

D. Due Diligence Process

Guidelines for the due diligence and underwriting of potential commitments to fund investments and co-investments are summarized in the attached Appendix A. TCRS's Private Equity Advisor will review prospective investments and confirm that new investments meet a prudent investor standard.

E. Investment Approval and Closing Process

Approval Process

TCRS Private Equity staff, with agreement of the Private Equity Advisor, has authority to recommend private equity investments that meet the Investment Policy set by the TCRS Board of Trustees. The Director of Private Equity will submit a written investment recommendation for all private equity investments to the Chief Investment Officer and the Treasurer for written approval. The Director of Private Equity and staff shall follow the various procedures set forth herein when approving and closing investments.

Closing Process

The Director of Private Equity will coordinate the closing process. In order to proceed with closing, several documents are required to be secured by the Director of Private Equity:

- Legal Counsel’s written certification of Counsel’s review of key documents and authorization to close
- TCRS standard side letter requirements (if applicable)
- Offering Memorandum (if available) or investment description
- TCRS Investment recommendation
- TCRS Private Equity Questionnaire
- TCRS Placement Agent Questionnaire, if applicable
- Private Equity Advisor recommendation
- Written approval from the Chief Investment Officer and the Treasurer approving the investment recommendation
- Further specific written approval from Treasurer to own more than 15% economic interest in a single vehicle, if applicable

Legal counsel representing TCRS shall review the partnership agreement, subscription agreement, and other documents for compliance with all applicable laws and other legal matters related to the transaction. TCRS Private Equity staff may elect to retain outside counsel, if approved by the Tennessee Attorney General or designee, to perform these tasks.

Private Equity investment staff shall compile all relevant documents and place them into a single, comprehensive file. In addition, staff shall distribute all relevant information, including the final amount of TCRS’s capital commitment, to the Private Equity Advisor, the Custodian, and TCRS Investment Accounting.

F. Placement Agent Policy

The use of external private equity placement agents shall not be permitted in the sourcing of private equity partnerships or other investments, unless:

1. The placement agent completes and signs the TCRS Placement Agent Questionnaire to the satisfaction of the Private Equity staff,
2. The placement agent is a broker-dealer registered with the Securities and Exchange Commission or Financial Industry Regulatory Authority (FINRA),
3. The placement agent has been retained on a general basis to represent the partnership or product (regional assignments are acceptable, provided that they not be so specific as to include TCRS and few other potential investors), *and*
4. Any fees or expenses of the placement agent are ultimately borne entirely by the general partner (either directly or through management fee rebates).

If all of the preceding criteria are not met, TCRS staff retains the right to proceed with an investment, provided:

1. The placement agent agrees to waive all compensation related to TCRS’s investment, *and*

2. The Treasurer and CIO provide written approval of the issue and the circumstances.

G. Investment Monitoring Policies and Procedures

1) Private Equity Advisor generated reports

On a quarterly basis, TCRS will receive a detailed quarterly portfolio report from its Private Equity Advisor. The quarterly report will typically contain several items that include:

- Portfolio Overview
- Portfolio Performance
- Portfolio Analytics
- Cash Flow Analysis
- Portfolio Highlights
- Private Equity Market Update
- TCRS Commitments to Funds
- General Partner Investments in Portfolio Companies

Also on a quarterly basis, the Private Equity staff will review the Private Equity Advisor's detailed report of individual Fund Investments. This report will address several topics that include:

- Performance Summary
- Diversification
- Detailed Portfolio Holdings

The Private Equity staff will review and analyze the quarterly portfolio report and the detailed report of individual Fund Investments, and review them with the Chief Investment Officer.

2) Regular financial reports and audits

The Investment Accounting staff shall send to each general partner with whom TCRS invests a standard notification page that instructs general partners to send all relevant investment valuation information to the Investment Accounting staff, Private Equity staff, the Custodian, and the Private Equity Advisor (standard notification requirements should already exist within the closing documents of some Fund Investments).

The Investment Accounting staff will verify and reconcile valuations provided on the financial statements, and will bring to the Private Equity staff's attention any valuation discrepancy. TCRS Private Equity staff will resolve any valuation discrepancy with the general partner of the specified fund.

3) Fund visits and advisory board duties

The Private Equity staff should, at a minimum, communicate semi-annually with the general partner of each fund in which it invests and should attend, subject to staffing resources, annual partnership meetings (if applicable). Private Equity staff may also participate on advisory boards to gain insight on investment strategy, benefit from access to industry insight, and to better understand current market opportunities. In cases where travel expenses are paid in part or in whole by the investment partnership, Private Equity staff should ensure that TCRS is reimbursed for those expenses. Ongoing communications with general partners is viewed as an integral part of the due diligence process as TCRS considers the general partners' subsequent fund offerings.

H. Disposition of Assets

TCRS may, based on portfolio management or other rationale, choose to sell either its partnership interests or any interests in directly owned securities.

Prior to the sale of an asset, the Private Equity staff will analyze and summarize the sale event. If necessary, staff may request counsel or other experts for advice. The Private Equity staff will provide a written summary outlining the rationale of the asset disposition to the Chief Investment Officer. The Chief Investment Officer will present the Treasurer with the sale recommendation. Private Equity staff will inform the Investment Accounting staff, the Private Equity Advisor, and the Custodian of the disposition.

Sale of securities issued to TCRS as part of a normal private equity distribution (in lieu of cash) shall not be subject to this process, and may be sold at the discretion of the Private Equity staff as discussed below.

I. Miscellaneous Operations

1) Capital Calls

Capital calls are processed by the Private Equity staff. See Appendix B, Processing of Capital Calls, for procedures.

2) Distributions

All distributions are monitored by the Private Equity staff. See Appendix C, Processing of Distributions, for procedures.

3) Security Distribution Policy

TCRS will periodically receive distributions of public securities from limited partnerships. The Private Equity staff should make certain that the Investment Accounting staff is aware of the security distribution. The Private Equity staff will coordinate with the Public Equity or Fixed Income staff to determine the best strategy for maximizing the value of the distributed securities. The Director of Private Equity will notify the TCRS Investment Accounting and the Custodian following the sale or transfer of the assets.

Alternatively, the TCRS Private Equity staff may assign the task of tracking and liquidating stock distributions to a designated distribution manager.

Appendix A: Due Diligence Guidelines

The following outline will serve as a guideline for the due diligence and underwriting to be completed by Private Equity staff. Staff is required to submit an investment recommendation to the Chief Investment Officer and Treasurer that addresses, at a minimum, each of the following items. Private Equity staff will retain a written record of its due diligence, as well as retain any due diligence provided by third party experts.

Due Diligence Fund

- 1) Fund Size
- 2) Investment Type
- 3) Fund Strategy
- 4) Strategic Fit
- 5) Past Performance Summary
- 6) Investment Period
- 7) Term
- 8) Fees
- 9) Fee Offsets
- 10) Profit Sharing
- 11) Key Person
- 12) Clawback
- 13) Sponsor Investment
- 14) Major Participants in Prior Funds
- 15) Investment Sourcing
- 16) Investment Rationale
- 17) Investment Concerns
- 18) Recommendation

Due Diligence Co-Investment

The following due diligence outline is intended to serve as a summary of possible due diligence topics. Because each Co-Investment will be unique, the actual focus of due diligence is likely to vary from investment to investment. Private Equity staff will retain written record of its due diligence, as well as retain any due diligence provided by third party experts.

- 1) Industry Analysis
- 2) Management Team
- 3) Financing
- 4) Strategy Overview
- 5) Financial Review
- 6) Plan Review
- 7) Business Operations
- 8) Legal
- 9) Capital Expenditures
- 10) Acquisitions
- 11) Competitive Advantages/Sustainable Barriers
- 12) Potential Concerns
- 13) Exit Strategy

Appendix B: Processing of Capital Calls

Note that these instructions are for capital calls directed by TCRS Staff. As an alternative, capital calls can be monitored and executed by the Custodian at TCRS Staff's direction.

- 1) The general partner issues the capital call which is distributed to the TCRS Private Equity staff, the TCRS Investment Accounting staff, the TCRS Cash Management staff, the Private Equity Advisor, and the Custodian.
- 2) The Private Equity staff verifies that the funds being drawn down by the general partner do not exceed the original commitment amount. In the case of a drawdown exceeding the commitment amount, the capital call notice is referred to Chief Investment Officer for authorization. After authorization is obtained, the Advisor is to be updated to reflect these changes.
- 3) Next, the Private Equity staff produces a capital call cover sheet. Once the cover sheet is completed, the cover sheet is attached to the original capital call notice and signed by the Director of Private Equity. If the Director of Private Equity is unavailable, the Chief Investment Officer, Deputy Chief Investment Officer, or the Assistant to the Treasurer may sign.
- 4) The Private Equity staff then forwards the completed capital call with signed cover sheet to the TCRS Cash Management staff for final review and processing.

Appendix C: Processing of Distributions

Note that these instructions are for distributions routed directly to TCRS. As an alternative, distributions can be monitored and received at the Custodian with notification to TCRS Staff.

- 1) The general partner issues a distribution notice to the TCRS Investment Accounting staff, the TCRS Private Equity staff, the TCRS Cash Management staff, the Private Equity Advisor, and the Custodian.
- 2) The TCRS Private Equity staff reconciles the notice to ensure that the amount being distributed to TCRS is accurate, and notifies all parties if a discrepancy is identified.
- 3) The TCRS Cash Management staff confirms to TCRS Investment Accounting staff, the TCRS Private Equity staff, the Private Equity Advisor, and the Custodian that the cash has been received.