

**SANTA BARBARA COUNTY  
EMPLOYEES' RETIREMENT SYSTEM**

**PRIVATE EQUITY INVESTMENT POLICY**

**I. Purpose**

This Private Equity Investment Policy (“Policy”) is designed to ensure that investment managers, consultants, and SBCERS Board/Staff take prudent and careful action while investing the SBCERS Private Equity Program (“Program”). Additionally, use of this Policy provides assurance that there is sufficient flexibility in managing the investment risks and returns associated with this segment of the Total portfolio.

The Program is designed to meet SBCERS’ long-term actuarial target through the identification and participation in private equity opportunities that are expected to generate high rates of return while also providing diversification benefits.

**II. Strategic Objective**

The strategic objective of the Program is to develop a diversified private equity portfolio capable of achieving investment returns commensurate with Program targets. Private equity investments are expected to achieve attractive risk-adjusted returns and, by definition, possess a higher degree of risk with a higher return potential than traditional investments. Accordingly, total rates of return from private equity investments are expected to be greater than those that might be obtained from conventional public equity or debt investments. They have a low correlation to other investment classes and therefore may contribute to enhancing the risk-returns of a total portfolio.

Private equity investments shall be considered solely in the interest of the System’s participants and their beneficiaries in accordance with applicable law, and shall be selected to accomplish the following:

- A. Enhance the System’s performance result by generating strong long-term results.
- B. Hedge against long-term liabilities.
- C. Provide added diversification to the System’s overall investment program.

**III. Performance Objective and Benchmark**

The long-term (5-10 years) expected performance objective of the Program shall be the return of the Russell 3000 Index plus a 300 basis point risk premium. Use of the Russell 3000 Index reflects the opportunity cost of investing in alternative investments versus publicly traded common stocks. Given the nature of the asset class and the difficulty benchmarking shorter-term results, there may be significant deviations between Program results and benchmark performance over shorter time periods.

#### **IV. Responsibilities and Delegations**

- a. The Board shall approve and amend this Policy and potential investment opportunities for the Program. In addition, the Board shall oversee program performance and will act in a fiduciary capacity in the exercise of its duties.
- b. Staff shall:
  - 1. Manage day-to-day operations
  - 2. Review consultant's work for reasonableness
  - 3. Assist Consultant in making recommendations to the Board
  - 4. Execute agreements
  - 5. Assist Consultant with on-going monitoring
  - 6. Coordinate on-going reporting to the Board
- c. Consultant shall (i) assist in the development and implementation of the Program, (ii) conduct due diligence on investments opportunities under consideration, and (iii) will act as an investment fiduciary to SBCERS.

#### **V. Investment Approaches and Parameters**

##### A. General Approach

The Private Equity Program, in total, is expected to be diversified by economic sector, vintage year, number of transactions, geographic location, and by stage of company maturity. Fund-of-Funds have been identified as efficient vehicles for gaining diversified exposure to private equity investments. In particular, secondary market fund-of-funds provide diversification across prior vintage years allowing SBCERS to access limited partnerships that raised capital prior to the formation of the Private Equity Program. Direct investments in limited partnerships may be considered on an opportunistic basis once a diversified Program of secondary fund-of-funds is established.

##### B. Specific Risk Parameters

The Program will be exposed to specific risk parameters that are associated with investing in private equity, including, but not limited to:

- 1. Operating and Business Risk: Certain private equity investments entail above average operating and business risk.
- 2. Liquidity Risk: Private equity investments lack liquidity and typically have time horizons of 5-to-10 years. Secondary markets for such investments are limited; and, often, there is no current income.
- 3. Structural Risk: Specific fundamental rights and protections are negotiated, which include mechanisms for taking remedial action. These basic protections may include specific termination provisions in partnership transactions or the removal of general partners.
- 4. Valuation Risk: Partnerships shall be evaluated to determine if the general partner employs an appropriate valuation discipline.

### C. Quality Control Processes

The Program shall employ a quality control process, which includes Staff and Consultant, to track investment performance, manage risk, and monitor Program efficiency.

1. Monitoring Portfolio Performance: Actual returns will be compared to the benchmark(s) as appropriate, and to the expected return for the investment.
2. Risk Control: Program standards are maintained through the following processes-
  - a. Assessing the level of diversification in the portfolio on a continual basis, including the level of diversification across investment style, geographic distribution, industry concentrations, and across other ranges as appropriate.
  - b. Documenting due diligence activities.
3. Process Monitoring: monitor transaction processing to insure timely decision-making and an effective process.

### D. Guidelines for Evaluating Proposals

Proposed partnership opportunities shall be evaluated relative to their fit with the Program's Investment Policy.

### E. Types of Investments

The Program is expected to initially emphasize secondary fund-of-funds. Underlying partnerships held by the fund-of-funds shall generally fall within the categories defined below.

1. *Buyout and Corporate Restructuring Capital*: Investments in leveraged buyouts, management buyouts, equity buyouts, employee buyouts, buy-and-build, other acquisition strategies and restructurings, and related uses of capital.
2. *Expansion Capital*: Investments in established companies for the purpose of growing their businesses.
3. *Venture Capital*: Investments in relatively small, rapidly growing, private companies in various stages of development.
4. *Energy and Natural Resources*: Investments in the exploration, extraction, accumulation, generation, movement or sale of energy (e.g., oil, gas, coal, electricity), and other natural resources and related service companies.
5. *Distressed Securities*: Debt or equity securities investments in troubled companies, under the assumption that the securities will appreciate in value following a restructuring of the company's obligations. This includes, but is not limited to, investments in companies that are insolvent or unable to pay their debts as they come due. This may include companies subject to the Bankruptcy Reform Act, specifically Chapter 7 (Liquidation) and Chapter 11 (Reorganization), and companies under-going restructurings outside of Bankruptcy Court.
6. *Turnarounds*: Investments in companies experiencing financial or operating difficulties. These companies may or may not be insolvent.
7. *Special Situations*: This includes all other types of investments, e.g., mezzanine strategies, active minority positions, secondary investments, governance strategies, industry specific strategies, and unconventional investments.
8. *International*: Investments that are located in countries other than the United States, or have significant portions of their operations outside of the United States.

## **VI. General**

### Reporting

#### A. Reports received from investment managers

Staff shall require periodic reports (i.e. quarterly) from investment partners to facilitate monitoring.

#### B. Monitoring Investments

Staff and Consultant shall monitor individual partnerships as part of its process for monitoring the total portfolio. The Program portfolio should exhibit reasonable diversification across partnership types, vintage years, and economic sectors.

#### C. Performance

Investment performance of partnerships shall be assessed relative to the following areas:

1. Objectives established by the partnership
2. Risk undertaken
3. The long-term performance objective, with appropriate interpretation if applied to the short-term.