

STATE INVESTMENT COUNCIL

ALTERNATIVE INVESTMENTS PROCEDURES

INTRODUCTION

The New Jersey State Investment Council (the “SIC”) hereby adopts the following procedures (the “AIP Procedures”) to implement the policy (the “AIP Policy”) governing the Alternative Investment Program (the “AIP”) which was adopted by the SIC on January 20, 2005. The AIP calls for the establishment of a new common trust fund to be known as “Common Pension Fund E.” Common Pension Fund E shall be a fund created for the purpose of investing monies from the pension funds (the “Pension Funds”) in alternative investments (the “Alternative Investments”) specified in the AIP.

The Alternative Investments specified in the AIP consist of investments in various asset classes (each, an “Asset Class”). In order to meet its long-term performance objectives, the AIP will be comprised of a mix of customized and standardized funds-of-funds, direct investments, co-investments, joint ventures and separate accounts. These investments will be made by the Division of Investment (“DOI”) with the assistance of investment consultants, including the general consultant engaged by the DOI to provide advice concerning the overall AIP (the “General Consultant”) and special consultants engaged to provide advice regarding specific Asset Classes and Sub-Asset Classes (the “Asset Class Consultants”).

These AIP Procedures are designed to ensure that the DOI follows the AIP Policy in the selection of Alternative Investments, and to follow, to the extent applicable, a public and competitive process in such selection. All actions of the DOI are subject to review and approval by the State Treasurer. It should be noted that these AIP Procedures may be amended from time to time by the SIC, which amendments may include but are not limited to, changes in allocations and sub-allocations of Asset Class and Sub-Asset Classes.

GENERAL INVESTMENT STRATEGY AND PLAN GUIDELINES

To maximize the risk-adjusted performance of the AIP, the DOI will follow a variety of investment guidelines. These guidelines provide for the types of investment vehicles that can be utilized, control risk through prudent diversification, and align the interests of the DOI and the investment managers selected for the Alternative Investments.

- **Use of Consultants:** In implementing the AIP, the DOI will obtain the services of the General Consultant and the Asset Class Consultants. Such Consultants shall be engaged in accordance with the State’s procurement law.
- **Investment Size:** Common Pension Fund E shall not own more than a 25% economic interest in any individual Alternative Investment. This limitation applies to the underlying investments so as to permit customized and separate accounts. Common Pension Fund E’s investments cannot comprise more than 20% of any one investment

manager's total assets. The planned annual total investment commitments will be made to meet the diversification guidelines above.

- **Investment Timing:** The investing in Alternative Investments will be staggered to coordinate maturity dates, returns and cash flow for each of the Alternative Investments. No such investments will be made until a careful review of Common Pension Fund E's liquidity implications for the broader pension system is completed.
- **Alignment of Interests:** The DOI shall actively negotiate investment management agreements on behalf of Common Pension Fund E with a prime directive to ensure that interests of the manager are aligned with those of Common Pension Fund E and supported by other similar investors. This should include a competitive fee structure.
- **Manager Diversification:** Due to their specialized expertise, external managers will be utilized for Alternative Investments. The DOI shall select a variety of external managers for the Alternative Investments in order to obtain exposure to a diverse universe of external managers. Staff of the DOI will process, support and monitor all Alternative Investments.
- **Custody and Other Services:** In order to implement the AIP, the DOI shall retain service providers to perform a variety of management and monitoring functions, including the management and execution of cash flows, capital calls, and distributions.

RISK PARAMETERS

The SIC, DOI, and State Treasurer, with the assistance of the Asset Class Consultants and the General Consultant, will monitor and control the overall risk of the AIP and its subcategories and will monitor compliance of the AIP with the AIP Policy and these AIP Procedures.

The risk parameters which shall be considered include:

- **Financial Risk:** The use of leverage in financing, which can increase the volatility of returns of Alternative Investments.
- **Operating and Business Risk:** Some types of Alternative Investments are in untested industries or markets, resulting in high operating/business risk. Also, some Alternative Investment managers may be small and new entities which may increase the operating/business risk of the manager.
- **Liquidity Risk:** Alternative Investments often lack liquidity, making it potentially difficult to exit investments before the expiration of the investment vehicle.
- **Diversifiable Risk:** Risks specific to certain styles, industries, geographies, and strategies that can be reduced through diversification within the AIP.

- **Country Risk:** Political, economic, and currency risks exist when investing outside the US.
- **Valuation Risk:** The valuation methodologies for many types of Alternative Investments lack the transparency of publicly traded securities. The DOI will review valuations provided by the managers of Alternative Investments to assess the reasonableness of their valuation methods.
- **Disappointment Risk:** The risk that the AIP will fail to meet the Common Pension Fund E's risk and return objectives.

SPECIFIC GUIDELINES BY ASSET CLASS

PRIVATE EQUITY

- **Investment Vehicles:** The DOI may utilize a variety of investment vehicles within this Asset Class: limited partnerships; separate accounts; funds-of-funds; co-investments; direct investments and joint ventures.
- **Investment Timing Risks:** The DOI shall limit the potential for any one investment to negatively impact the long-term results of this Asset Class by investing across business cycles and vintage years. Investments shall be selected with the goal of gaining exposure to the array of financing stages by opportunistically exploiting the best investments at different stages of the business cycle.
- **Industry/Geographic Concentration:** The DOI shall limit the potential for any one investment to negatively impact the long-term results of this Asset Class by investing across a variety of industries and geographic locations. For venture capital, however, it is recognized that opportunities may be most readily realized in a relatively limited number of industries.
- **Legal Services:** Legal services will be provided by the Attorney General. It is recognized, however, that in certain instances, it will be necessary for the Attorney General to engage special counsel to provide advice with respect to this complex Asset Class.
- **Special Services:** From time to time the DOI or its Consultants, as agreed to in their contracts with the DOI and at the DOI's cost, may be required to engage private investigative services in order to investigate principals for integrity, ethical problems, tax-related issues, etc. prior to an investment subscription.

REAL ASSETS

- **Investment Vehicles:** The DOI may utilize a variety of investment vehicles within this Asset Class: separate accounts; commingled funds; co-investments, joint ventures and direct investments.
- **Investment Timing Risks:** The DOI should limit the potential for any one investment to negatively impact the long-term results of this Asset Class by investing across the different stages of the business cycle. Investments will be made across core, value-added, and opportunistic real estate opportunities, with the timing of these investments intended to maximize the risk-adjusted return of this Asset Class.
- **Segment Concentration:** Investments shall be made across a variety of property types, geographic areas, and capital structures.
- **Legal Services:** Legal services will be provided by the Attorney General. It is recognized, however, that in certain instances, it will be necessary for the Attorney General to engage special counsel to provide advice with respect to this complex Asset Class.
- **Special Services:** From time to time the DOI or its Consultants, as agreed to in their contracts with the DOI at the DOI's cost, may be required to engage private investigative services in order to investigate principals for integrity, ethical problems, tax-related issues, etc. prior to an investment subscription.

ABSOLUTE RETURN STRATEGIES

- **Investment Vehicles:** The DOI may utilize a variety of investment vehicles within this Asset Class: separate accounts, funds-of-funds and direct investments in individual hedge funds (limited partnerships).
- **Investment Timing Risks:** The DOI should limit the potential for any one investment to negatively impact the long-term results of this Asset Class by investing across business cycles and capital market environments.
- **Strategy Concentration:** This Asset Class will be exposed to funds having a variety of absolute return strategies. The DOI will rely on its managers and consultants to opportunistically adjust allocations to these various strategies to maximize the long-term risk-adjusted return of the AIP.

- **Legal Services:** Legal services will be provided by the Attorney General. It is recognized, however, that in certain instances, it will be necessary for the Attorney General to engage special counsel to provide advice with respect to this complex Asset Class.
- **Special Services:** From time to time the DOI or its Consultants, as agreed to in their contracts with the DOI and at the DOI's cost, may be required to engage private investigative services in order to investigate principals for integrity, ethical problems, tax-related issues, etc. prior to an investment subscription.

SELECTION OF MANAGERS OF ALTERNATIVE INVESTMENTS

Criteria

In selecting Alternative Investments, the DOI shall comply with these AIP Procedures and the AIP Policy and shall endeavor to select the highest quality managers available that will enable the Common Pension Fund E to meet its long-term return objectives within the parameters established by the AIP Policy and these AIP Procedures. In addition, managers selected to participate in the AIP program must comply with the applicable prohibitions on campaign contributions.

Selection of managers will take into consideration the following important characteristics:

- Quality and stability of the investment team
- Previous investment track record
- Proposed investment strategy
- Ability of investment manager to demonstrate its ability to generate superior returns
- Legal and economic terms governing the Alternative Investment
- Alignment of interests between the manager and the State
- Structural fit within the AIP
- Contribution to the diversification of the AIP and the Pension Funds

Procedure for Selection

Investment opportunities are expected to be sourced jointly by employees of the DOI who specialize in Alternative Investments and the Asset Class Consultants engaged, from time to time, by the DOI for Alternative Investments. The DOI shall maintain an open door policy in order to review all potential Alternative Investments that may be appropriate for the AIP.

Step 1: Opportunities shall be initially evaluated by the Head of Alternative Investments of the DOI and the applicable Asset Class Consultant in coordination with the DOI Investment Committee. The DOI Investment Committee shall be comprised of the Director of the DOI, the Deputy Director of the DOI, the Head of Alternative Investments and a representative of the State Treasurer's office. The applicable Asset Class Consultant shall assist the DOI Investment

Committee. A record shall be kept by the DOI and the applicable Asset Class Consultant of meetings held and materials received (including private placement memoranda, term sheets, process descriptions, etc.).

Step 2: If there is a sufficient level of interest so that an opportunity warrants further due diligence, as determined by the DOI Investment Committee, a Preliminary Due Diligence Memo will be drafted jointly by the Head of Alternative Investments and the applicable Asset Class Consultant. The DOI will provide to the SIC Investment Committee (the “SIC Committee”) at that time, a summary of all investments under consideration.

Step 3: If after reviewing the Preliminary Due Diligence Memo the DOI Investment Committee indicates interest in the investment opportunity, the DOI and applicable Asset Class Consultant will proceed to conduct full and comprehensive due diligence. This shall include, but is not limited to, interviewing the manager; on-site visits; contacting other limited partners and various industry contacts; reviewing and evaluating partnership agreements and term sheets; assessing and negotiating market terms and conditions and amendments to any partnership agreements; if necessary, employing Special Service providers, as detailed above; and providing the manager with an indication of interest, including the projected amount of the commitment.

Step 4: A. The Division will give the SIC Committee a formal written due diligence report for every planned Alternative Investment, irrespective of the anticipated size of such investment. The SIC Committee will establish the necessary disclosure and due diligence materials appropriate for the SIC Committee to evaluate investments. Such materials, which might include confidential information where public disclosure could impede the effectiveness of the program, would normally encompass raw work product material prepared by the Division and its consultants in its due diligence process. At its discretion, the SIC Committee may seek more background information when warranted.

B. For proposed investment commitments of \$50 million or more, prior to any binding commitment, the SIC Committee shall provide a report to the SIC, which report shall include a written due diligence report by the Director. On a timely basis after receipt of such report, the SIC may adopt or otherwise act upon the report. In any given calendar year, and at any point within such year, at least 80% of the number of investments which are approved and 80% of the dollar amount of total investment commitments that year must be eligible for a report by the SIC Committee to the SIC. For investments under \$50 million, so long as such investments constitute no more than 20% of the number of investments approved and 20% of the total investment dollars committed, the SIC Committee will not issue a report to the SIC. Once the Division has exceeded its 20% “exemption” in any given year, all proposed investments shall be subject to the SIC Committee providing a report to the SIC until the number and dollar value of “exempt” investment again falls below the 20% threshold. The Division shall give the SIC Committee timely notice as to when the SIC Committee will receive due diligence materials to facilitate the scheduling of SIC Committee meetings, which shall take place at least on a monthly basis.

C. On investments of less than \$50 million, the Director shall provide an informational due diligence report to the SIC of every investment made, which shall be provided on a regular basis subsequent to the date such investment has been made.

D. Any private asset manager seeking to invest pension fund assets shall disclose in writing any intermediary or consultant to be compensated in connection with facilitating investment from New Jersey and the terms of such compensation. Such disclosure would include any “indirect” intermediary to be compensated by the primary consultant. That disclosure would be part of the material to be reviewed by the SIC Committee and the SIC.

Step 5: If after the completion of final due diligence the investment is approved by the DOI Investment Committee, and as applicable, the State Treasurer and SIC, the DOI and the Asset Class Consultant shall negotiate the final agreement for the Alternative Investment with the advice of the Attorney General.

MONITORING:

Each Alternative Investment made by the DOI will be monitored on an ongoing basis throughout the life of the Alternative Investment.

ROLES AND RESPONSIBILITIES

SIC:

- Review and approve the policy for the AIP, including Asset and Sub-Asset Class allocation targets and ranges.
- Review and approve the Alternative Investments Procedures.
- Review and approve plans and strategies for Alternative Investments.
- Monitor the AIP quarterly to assess compliance with these AIP Procedures and the AIP Policy.
- Annually review the performance of the Asset Class Consultants.
- Review the performance reports for the AIP submitted by the General Consultant and the Asset Class Consultants.
- Participate in manager selection as described in the Procedure for Selection section.

DOI Investment Committee:

- Establish Sub-Asset Class allocation targets and ranges.
- Review the investment strategy with the Asset Class Consultants.
- Monitor the AIP quarterly to assess compliance with these AIP Procedures and the AIP Policy.
- Review and approve specific Alternative Investments within their applicable authority.
- Recommend to the Director of the DOI renegotiated deal terms and exit strategies for troubled investments.

- Review performance reports issued by the Asset Class Consultants.
- Approve the use of Special Services when needed.
- Review the log and record of all opportunities for Alternative Investments which have been considered.

DOI:

- Maintain a log and record of all opportunities for Alternative Investments which have been considered and provide the log to the DOI Investment Committee.
- Provide a summary of all investments under consideration to the SIC Committee.
- Where appropriate, on at least an annual basis, provide recommendations to the Committee of changes to the AIP Policy and these AIP Procedures.
- Source, review, and evaluate all opportunities for Alternative Investments. Rejection of specific Alternative Investments shall be made by the DOI.
- Source, review, and approve investment opportunities, in compliance with the AIP Procedures and the AIP Policy.
- Monitor and review investment vehicles for adherence to objectives and guidelines.
- Meet regularly with partners and as appropriate review with the SIC Committee opportunities to sit on advisory boards on behalf of Common Pension Fund E.
- Oversee the liquidation of in-kind distributions from partnerships in an orderly manner.
- Provide the status of the AIP to the SIC on a regular and periodic basis.
- Annually evaluate performance measurement and record keeping systems.
- Review the performance of the providers of Special Services.

Asset Class Consultants:

- Annually review the AIP and evaluate the Common Pension Fund E's investment strategy, as it relates to the applicable Asset Class.
- Provide performance reports to the DOI and the DOI Investment Committee on a quarterly basis.
- Provide the SIC and the DOI with relevant, reliable and timely research and information requests to fulfill their responsibilities.
- Assist the DOI in establishing appropriate Asset Class allocation targets and ranges.
- Monitor and review Alternative Investments for the applicable Asset Class on an ongoing basis, for adherence to objectives and guidelines and, when appropriate, recommend their sale, dissolution or replacement to the DOI.
- Assist the DOI in conducting manager due diligence and in negotiating business terms and appropriate structural incentives.

General Consultant:

- Annually review the AIP and evaluate the Common Pension Fund E's investment strategy, as it relates to Alternative Investments.

- Provide the SIC and the DOI with relevant, reliable and timely research and information requests to fulfill their responsibilities, in addition to that provided by the Asset Class Consultants.
- Work with the Asset Class Consultants, as needed, in assisting the DOI in establishing appropriate Asset Class allocation targets and ranges.
- Annually assist the DOI and SIC in evaluating the Asset Class Consultants' success in meeting their roles and responsibilities, as detailed above.