

**POLICY NUMBER:** 2.10.700**EFFECTIVE DATE:** 12/16/21**TITLE:** Private Equity Investment Program**SUPERSEDES:** 6/21/18**BOARD ADOPTION:** 12/16/21**APPROVED:****PURPOSE**

This policy sets out the general objectives and guidelines for the Washington State Investment Board's (WSIB) private equity investment program. This policy applies to the existing WSIB private equity portfolio, as well as new investments.

**POLICY****Standard of Care**

Under Revised Code of Washington (RCW) 43.33A.030, trusteeship of funds under the authority of the WSIB is vested in the voting members of the Board. The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the Board and its staff must comply with other state laws, such as the Ethics in Public Service Act, Chapter 42.52 RCW, as it makes its investment decisions and seeks to meet the investment objectives below.

**Objectives and Goals**

The objectives and goals of the private equity investment program are to:

1. Prudently employ the assets that the Washington State Investment Board (WSIB) has allocated to private equity investments to produce a well-diversified profitable portfolio that will enhance the total return of the WSIB portfolio and ultimately pay benefits to participants and beneficiaries and meet actuarial requirements.
2. Diversify away from traditional capital market risks.
3. Employ consistent strategies that contain sufficient flexibility to take advantage of opportunities available to the WSIB due to changes in the private equity or debt marketplaces.
4. Endeavor to provide ancillary benefits to the WSIB including, but not limited to:
  - a. Negotiation of special terms based on the WSIB's size, its attractiveness to any one general partner, and its ability to attract other investors.
  - b. Establishment of strong general partner relationships that may enhance later direct investment deal flow.
  - c. Promotion of staff-consultant interaction to leverage the consultant's private equity investment experience.
5. Invest as a limited partner in a variety of carefully chosen limited partnerships, each with a successful track record, consistent investment strategy, and stable management.
6. Develop secondary market capabilities to enhance the WSIB's ability to minimize losses and maximize returns by 1) enabling it to sell its interest in a private equity asset prior to maturity or liquidation, if prudent to do so, or 2) alternatively, to invest in established partnerships in the secondary market.
7. Emphasize professional and timely handling of private equity investment proposals in order to present the WSIB as a sophisticated, cutting-edge investor in the private equity investment field.
8. Implement a standardized and thorough method of proactively monitoring portfolio investments to maximize profit realization.

9. Develop in-house expertise and resources for the prudent employment of funds in private equity investments and refine the use of consultants/outside experts to augment staff's capabilities.
10. Assess the private equity investment program's performance, strategies, and objectives on a continuing basis to permit flexible responses to changing circumstances.
11. Maintain the stability of the private equity investment program by following established guidelines and procedures, only altering policies and strategies after careful consideration.
12. Comply with all applicable laws and regulations concerning the investment of the WSIB's pension assets.

### **Return Benchmark**

In addition to the objectives and goals stated previously, the private equity investment program seeks to achieve a superior total return as compared to traditional asset classes and exceed the return of the MSCI All Country World Investable Market Index with USA Gross by 300 basis points in the long run. For inclusion in the CTF performance report the benchmark will be lagged one calendar quarter in line with the valuation lag.

### **Scope of Investing**

The WSIB may invest in any appropriate private equity investment opportunity that has the potential for returns superior to traditional investment opportunities and is not prohibited by the WSIB's policies or by law. These investment types are generally divided into venture capital, corporate finance, growth equity, special situations, distressed debt, and other investments. Private equity investments are made through either limited partnerships or direct investment vehicles and in a manner consistent with RCW 43.33A.110, which mandates that "the Board shall establish investment policies and procedures designed exclusively to maximize return at a prudent level of risk."

### **Allocation and Diversification**

The following provides a prudent and disciplined approach to achieving a well-diversified portfolio of private equity investments that should realize superior investment returns as an asset class.

#### A. Overview

To meet return and plan objectives, it is prudent to diversify the private equity portfolio over time throughout the universe of private equity investment types. Specific guidelines for each category will vary over time, depending on conditions in the macro environment and specific opportunities available.

#### B. Diversification Categories

In selecting specific investments, it is important to seek an appropriate balance among the following categories of diversification:

1. *Stage* - A diversified portfolio of companies in a variety of stages of growth should be sought. These stages, for example, can include, but are not limited to
  - a. Early Stage
    - i. Seed Financing
    - ii. Start-Up Financing
    - iii. First Stage Financing
  - b. Expansion
    - i. Second Stage Financing

ii. Third Stage or Mezzanine Financing

c. Later Stage

i. Bridge Financing

ii. Corporate Finance

2. *Concentration* - Attention must be paid to the amount that the WSIB, or any limited partnership in which it invests, should place in any one investment opportunity. Typical limited partnership agreements have limitations on the percentage of the partnership's committed capital to be invested in any one company. The WSIB should not consider taking more than 25 percent of any single partnership, except in unusual circumstances.
3. *Industry Sector* - The portfolio should be diversified across a broad cross-section of opportunities in different industries.
4. *Geographic* - The private equity portfolio should be broadly diversified by geographic region and may seek to include investments in Europe and the Pacific Rim, as well as other areas of the world, as appropriate opportunities are identified.
5. *Time/Term of Commitment* - To avoid excess exposure to any one economic or investment cycle, it is important to structure a private equity portfolio in such a way that a significant number of its investments are not made at the same time and do not mature at the same time. Accordingly, the private equity investment portfolio should be designed to seek a spectrum of investment and maturity dates.

In selecting private equity investment opportunities, diversification also requires recognition of the need to balance niche opportunities in a specific market area with generalist approaches. A well-balanced portfolio should contain both niche and generalist type investments.

**Implementation and Due Diligence**

The investment strategy and guidelines embodied in this plan are carried out by the Private Markets Committee, staff, and the consultant, with due regard for the private equity investment policies adopted. The WSIB is, by virtue of this plan and its guidelines, well-positioned and flexible enough to act on private equity investment opportunities as they arise.

One of the most critical phases of the private equity investment process is the due diligence performed by staff and the consultant. To facilitate this phase, the staff and consultant have each developed standard due diligence procedures to evaluate proposed investments across a wide range of factors.

Due diligence includes, but is not limited to, the following:

1. Analyzing the investment track record of the principals.
2. Evaluating the proposed investment strategy and the fit of the proposed investment within the WSIB private equity portfolio.
3. Reviewing the use of financial leverage.
4. Assessing the ability and stability of the investment management team and the investment organization.
5. Reviewing market conditions.
6. Identifying potential competitors and evaluating sources of deal flow.
7. Conducting reference checks.
8. Conducting face-to-face meetings with the principals to discuss important aspects of the offering.

9. Reviewing the offering memorandum and related documents, including the most recent partnership financial statements and the most recent audited financial statements.
10. Reviewing the proposed business plan and exit strategies.
11. Identifying and resolving key issues.
12. Reviewing the proposed terms, conditions, and fees of the partnership.

All private equity investments must be approved by the Board following the recommendation of the Private Markets Committee, with the following exceptions:

1. The Chief Executive Officer is authorized to execute investment transactions, consistent with policies and directives adopted by the Board, with general partners and entities that have an existing relationship with the Board. Executed transactions will be reported to the Board at its next regularly scheduled meeting.
2. The Board may periodically authorize allocations to managers for discretionary investments.
3. The Chief Executive Officer shall have authority to invest up to \$500 million annually in secondary market opportunities in existing private equity limited partnerships managed by general partners with whom the WSIB has an existing relationship, subject to the following restrictions:
  - a. No single investment (defined as purchase price plus unfunded commitment assumed) shall be greater than \$200 million.
  - b. Authority shall only be exercised with a unanimous recommendation by the Chief Investment Officer and the private equity Senior Investment Officer, acting upon a favorable due diligence determination by the WSIB's private equity investment consultant.
  - c. Proposed investments in the secondary market may only be considered when staff and the consultant believe that the investment has a risk/return profile appropriate for the private equity program.
  - d. The favorable due diligence determination, including the underlying rationale, market conditions, and portfolio impact, shall be furnished to the Private Markets Committee and the Board at their next regularly scheduled meetings.

## **ROLES AND RESPONSIBILITIES**

### **Board**

1. Monitor the performance of the overall private equity investment program.
2. Approve Board private equity policies.
3. Approve the Private Equity Annual Plan.
4. Approve or delegate pursuant to Board-adopted Delegation of Authority policies.
5. Select qualified private equity consultants.
6. Approve commitments to new private equity investment partnerships and material changes to existing investment partnerships, except as delegated by the Board.

### **Private Markets Committee**

1. Recommend to the Board commitments to new private equity investment partnerships and material changes to existing investment partnerships, except as delegated by the Board.
2. Recommend to the Board changes to Board private equity policies.
3. Provide oversight and review of the private equity investment program in order to report and provide recommendations to the full Board.

### **Staff**

1. Implement Board-adopted private equity policies.
2. Develop private equity portfolio strategies.
3. Develop the Private Equity Annual Plan.
4. Source, underwrite, and present new relationship investment proposals for the Private Markets Committee and Board approval.
5. Perform due diligence on investment transactions for investment opportunities with general partners and entities that have an existing relationship with the Board.
6. Ensure compliance of all contractual partnership obligations.
7. Represent the Board with respect to all matters related to private equity investment partnerships.

#### **Private Equity Consultants**

1. Provide the Board, Private Markets Committee, and staff with written opinions regarding new relationship investment proposals sourced and underwritten by staff and make an oral presentation to the Private Markets Committee regarding the same.
2. Provide the Chief Executive Officer and staff with written opinions regarding investment proposals sourced and underwritten by staff for investment opportunities with general partners, entities, and other relationships previously approved by the Board.
3. Conduct specialized research as directed by staff.
4. Provide strategic advice to the Board, Private Markets Committee, and staff as requested regarding the private equity portfolio.

#### **Back Office Service Provider**

1. Provide quarterly portfolio performance measurement reports.

#### **POLICY REVIEW**

The Board shall review this policy at least once every three (3) years to ensure that it remains relevant and appropriate.

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Formerly Policy Number 2.05.300 dated 12/15/92  
Supersedes Policy 2.10.400 dated 6/13/88  
Board Adopted Policy 2.10.700 dated 12/15/92  
Revised 2/20/97  
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