
Oregon Investment Council

~ Agenda ~
September 30, 2009 - 9:00 AM

**PERS Headquarters
11410 S.W. 68th Parkway
Tigard, OR 97223**

**Oregon
Investment
Council**

Katy Durant
Chair

**Office of The
State Treasurer
Ben Westlund**
State Treasurer

Ronald Schmitz
Chief Investment Officer



OREGON INVESTMENT COUNCIL

2009 Meeting Schedule

Meetings Begin at 9:00 am

at

PERS Headquarters Building
11410 SW 68th Parkway
Tigard, OR 97223

January 28, 2009

February 25, 2009

April 17, 2009 Workshop

April 29, 2009

May 6, 2009 Telephonic Meeting

May 27, 2009

June 15, 2009 Telephonic Meeting

July 20, 2009 Workshop

July 29, 2009

September 30, 2009

October 15, 2009

October 27, 2009

December 2, 2009



OREGON INVESTMENT COUNCIL

Agenda

September 30, 2009
9:00 AM

PERS Headquarters
11410 S.W. 68th Parkway
Tigard, Oregon

<u>Time</u>	<u>A. Action Items</u>	<u>Presenter</u>	<u>Tab</u>
9:00-9:05	1. Review & Approval of Minutes July 29, 2009	Ron Schmitz <i>Chief Investment Officer</i>	1
9:05-10:00	2. Lone Star Real Estate Fund II and Fund VII <i>OPERF Real Estate</i>	Brad Child <i>Senior Investment Officer</i> Nori Gerardo Lietz <i>Chief Strategist Private Real Estate, Partners Group</i> John Grayken <i>Managing Partner</i> Lou Paletta <i>Director of Investor Relations</i>	2
10:00-10:15	3. Real Estate Consultant Contract	Brad Child	3
10:15-10:45	4. Private Partnership Investment Principles <i>OPERF Private Equity</i>	Ron Schmitz	4
<u>B. Information Items</u>			
10:45-11:00	5. Asset Allocations & NAV Updates a. Oregon Public Employees Retirement Fund b. SAIF Corporation c. Common School Fund d. HIED Pooled Endowment Fund	Ron Schmitz	5
	6. Calendar—Future Agenda Items	Ron Schmitz	6

Katy Durant
Chair

Harry Demorest
Vice-Chair

Ben Westlund
State Treasurer

Richard Solomon
Member

Keith Larson
Member

Paul Cleary
PERS Director
(Ex-officio)

7. Other Items

**Council
Staff
Consultants**

C. Public Comment Invited

15 Minutes

TAB 1 – REVIEW & APPROVAL OF MINUTES

July 29, 2009



STATE OF OREGON
OFFICE OF THE STATE TREASURER
350 WINTER STREET NE, SUITE 100
SALEM, OREGON 97301-3896

OREGON INVESTMENT COUNCIL
JULY 29, 2009
MEETING MINUTES

Members Present: Ben Westlund, Paul Cleary, Harry Demorest, Katy Durant, Keith Larson, Dick Solomon

Staff Present: Andrea Belz, Darren Bond, Tony Breault, Brad Child, Stacey Dycus, Jay Fewel, Wendy Finley, Sam Green, Ellen Hanby, Andy Hayes, John Hershey, Brooks Hogle, Julie Jackson, Kyle Johnson, Edie Kessel, Perrin Lim, Tom Lofton, Ben Mahon, Mike Mueller, Kevin Nordhill, Jen Peet, Jo Recht, Ron Schmitz, James Sinks, Michael Viteri

Consultants Present: Allan Emkin and Mike Moy (PCA), Eliza Bailey and Nori Gerardo Lietz (Partners Group), Mike Beasley and John Meier (SIS), and Tom Bernhardt (PCG)

Legal Counsel Present: D. Kevin Carlson, Oregon Department of Justice

The OIC meeting was called to order at 9:00 am by Katy Durant, Chair.

I. 9:00 a.m.: Review and Approval of Minutes

MOTION: Ms. Durant brought approval of the May 27, June 15, and July 20, 2009 OIC minutes to the table. Mr. Solomon moved to approve the minutes. The motion was seconded by Mr. Demorest and passed by a vote of 5/0.

II. 9:01 a.m.: Real Estate Annual Plan

Brad Child, Sr. Real Estate Investment Officer, and Nori Gerardo Lietz and Eliza Bailey of the Partners Group presented the 2008 Real Estate review and the 2009 Real Estate overview. Mr. Child went through the 2008 year in review, including the 2008 fund activity and the 2009 fund activity, year-to-date. Many factors affected the real estate portfolio last year:

- REIT's were down 38% in 2008, but up 29% in the second quarter of 2009
- Value declines related to overall market trends
- The global economic downturn
- Leverage

Ms. Lietz presented a brief market overview. She then gave a summary of the portfolio investments: Direct Property, Value Added, Opportunistic and REIT portfolios as well as outlining manager performance. Ms. Lietz

also reviewed the current real estate markets in Western Europe, Asia Pacific, and emerging markets and analyzed the impact on the U.S. market.

The general investment themes for the second half of 2009 are:

- **VALUE:**
 - Capitalize on distress across all phases of the crisis through investments in distressed debt, distressed equity, and secondaries.

- **GROWTH:**
 - Capitalize on strong mid and long term fundamentals in the emerging markets, through equity.

There was a brief question and answer period following the presentation.

III. 10:24 a.m.: Oregon Savings Growth Plan (OSGP) Consultant

Staff recommended the OIC hire Arnerich Massena to provide consulting services for the OSGP, subject to the successful negotiation of the contract. At the February 26, 2009 OIC meeting, staff presented a review of the plan and requested authorization to conduct a search for a full retainer consultant for the OSGP. Staff, with the aid of the Department of Justice, constructed a request for proposal (RFP) that was ultimately released on May 21, 2009. A total of seven consulting firms tendered responses to the RFP. An evaluation team comprised of Tom Lofton (OST – Investment Officer), Jen Peet (OST – Contracts and Governance Officer), Michael Viteri (OST – Investment Officer), Gay Lynn Bath (OSGP - Plan Manager), and Jason Evers (Deferred Compensation Advisory Committee Chair) each completed an independent scoring assessment of the seven responses to the RFP. Three semi-finalists were invited to interview with the evaluation team which took place on July 13, 2009.

All semi-finalist consultants have significant experience with defined contribution plans, and specifically with 457 plans. The three semi-finalist firms were all deemed very capable of providing the desired consulting services. Staff checked numerous references for all three semi-finalists, all of which came back positive. The evaluation team was unanimous in its recommendation to hire Arnerich Massena who had the most favorable fee proposal.

MOTION: Mr. Demorest moved approval of the staff recommendation to hire Arnerich Massena to provide consulting services for the OSGP. Treasurer Westlund seconded the motion. The motion was passed by a vote of 5/0.

IV. 10:31 a.m.: Internal Equity Management Policies and Procedures

Michael Viteri, Public Equities Investment Officer brought the following recommendations to the Council:

- Adopt the red-line changes to OIC Policies 4.01.02; 04.01.05; and the OIC Statement of Fund Governance for OPERF.
- Adopt new OIC Policies 04.05.03 and 04.05.04.

MOTION: Mr. Solomon moved approval of the policy updates. Mr. Demorest seconded the motion. The motion was passed by a vote of 5/0.

- Authorize staff to commence management of the internal equity index funds.

MOTION: Mr. Demorest moved approval of staff recommendation to commence management of the internal equity index funds. Treasurer Westlund seconded the motion. The motion was passed by a vote of 4/1 with Mr. Solomon voting no.

V. 10:43 a.m.: Annual Audits Update

Andrea Belz, Chief Audit Executive, presented an update on the investment-related audit engagements completed by OST's Internal Audit Services during the past year in accordance with OST Policy 4.01.12. Ms. Belz summarized the findings of the following four audit reports:

- All findings identified in the OPERF Public Equities Internal Controls audit report have been resolved.
- Two findings identified in the operational review of the OPERF portfolio are still outstanding, but are expected to be resolved by the end of the year.
- One finding identified in the Internal Controls Audit of Investment Portfolios, that covers all portfolios other than OPERF, is still outstanding. This issue is expected to be resolved by the end of September.
- The issues identified in the Valuation and Financial Reporting audit have all been resolved.

***VII. 10:46 a.m.: Asset Allocation and NAV Updates (*taken out of order)**

Mr. Schmitz reviewed the Asset Allocations and NAV's for the period ended June 30, 2009. OPERF and SAIF are basically right on target; CSF and HIED are also within range.

***VIII. 10:48 a.m.: Calendar – Future Agenda Items (*taken out of order)**

Mr. Schmitz highlighted future agenda topics.

***VI. 10:57 a.m.: Annual Proxy Voting Update (*taken out of order)**

Jennifer Peet, Corporate Governance Officer, and Robert McCormick, Vice President of Proxy Research and Operations, Glass, Lewis and Co. provided a summary of the votes that Glass, Lewis & Co. cast on the OIC's behalf for the period July 1, 2008 to June 30, 2009, and provided a review of the recent proxy voting season in accordance with OST Policy 4.05.06.

Mr. McCormick stated that 2009 was dominated by the TARP (Troubled Asset Relief Program) companies and the related fallout. Companies were affected in two ways: the risk controls and significant regulatory control changes affecting compensation practices.

IX. 11:25 a.m.: Other Business

Mr. Schmitz asked that Council e-mail him any feedback they may have regarding the updated Private Equity Principles.

Also, Mr. Schmitz shared with the Council that there is a group of other public funds, endowments and corporate funds that have been working on their own Private Equity Principles. Their principles are not much different than Oregon's. Council asked that Mr. Schmitz e-mail Council with the key differences.

11:28 a.m.: Public Comments

There were no public comments.

The meeting adjourned at 11:28 a.m.

Respectfully submitted,



Julie Jackson
Executive Support Specialist

TAB 2 –
LONE STAR REAL ESTATE FUND II AND FUND VII

Lone Star Fund VII, L.P. Lone Star Real Estate Fund II, L.P.

Purpose:

Staff recommends approval of a \$100 million commitment to Lone Star Fund VII, L.P. ("LS Fund VII") and \$300 million to Lone Star Real Estate Fund II, L.P. ("LS Real Estate Fund II"). The two global funds target combined equity of \$20 billion and will be run side-by-side. Their combined portfolios will be "opportunistic" in nature with a target IRR return at the investment level of 25%.

Background:

These two funds represent a continuation of the successful series of funds offered by Lone Star Partners ("Lone Star"), investing globally in distressed debt, distressed real estate and real estate entities such as banks and finance companies where real estate can be obtained opportunistically. Lone Star has elected to bifurcate its previous strategies into two funds, allowing investors the opportunity to allocate to either, based on the investors' needs. In this case, the LS Real Estate Fund II will house all commercial real estate activity and LS Fund VII will focus on residential distressed debt and acquisition of real estate rich entities such as banks.

Lone Star has offered seven funds since 1995 investing a total of over \$24 billion. OPERF has invested in all of the previous funds. These funds are projected to produce a total gross IRR of 32% and a net to investors of 29%. Lone Star has seven offices in Europe, Asia and North America. Hudson Advisors, a Lone Star affiliate with over 865 employees globally, will manage much of the real estate investment for Lone Star as they have for previous funds.

Issues for Consideration:

- OPERF has committed \$1.37 billion to previous Lone Star funds (Lone Star Funds I-VI and Real Estate Fund I). Of this amount, approximately \$820 million remains as net asset value and about \$162 million remains as unfunded commitment. Lone Star has become OPERF's largest real estate investment manager currently representing approximately 16.5% of our real estate holdings. Given Lone Star's global diversification and its property type and investment type diversification, these investments offer substantial diversification to our portfolio.
- The Opportunistic sector of OPERF's real estate portfolio had a 35% weighting at June 30, 2009 versus a target weighting of 30%. Staff and consultant believe that Lone Star's long successful track record investing in distressed debt and equity real estate warrants investment at this time to take advantage of the distressed market conditions. As the financial markets stabilize, we will restructure the portfolio to the desired balance.
- Global investment has political and currency risk not associated with domestic investing. The Lone Star team has years of experience investing for international institutions in these ex-U.S. regions.

- Lone Star is targeting \$10 billion capital raise for the LS Fund VII and \$10 billion for LS Real Estate Fund II. The Funds have been split into one with a focus on a variety of distressed commercial real estate debt and equity strategies and the other focused on residential distressed debt, financial products and institutions. Lone Star has pursued most of these strategies in the past. Both funds will have the same target yield and should have about the same risk pattern. Staff and consultant recommend two commitments, overweighting Lone Star's historic strength in commercial real estate and underweighting the residential and entity investments in LS Fund VII. The entity investments targeted for LS Fund VII may also be found in OPERF investments with Fortress, Blackstone and GI Partners.
- Staff and Consultant have reviewed Lone Star's adherence the OIC investment principles. Lone Star has offered to revise its long standing fee structures and governance procedures to make their funds more LP friendly. We believe that Lone Star adequately meets the desired principles set forth by the OIC.

Recommendation

Staff recommends approval of a \$100 million commitment to Lone Star Fund VII, L.P. ("LS Fund VII") and \$300 million to Lone Star Real Estate Fund II, L.P. ("LS Real Estate Fund II"), subject to the satisfaction negotiation of the required legal documents, working in concert with the Department of Justice.

TAB 3 – REAL ESTATE CONSULTANT CONTRACT

Renewal of Real Estate Consultant

Purpose

To address the expiring contract of the OIC's real estate consultant, effective December 31, 2009: PCA Real Estate Advisors.

Background

The current real estate consulting contract with PCA Real Estate Advisors runs through December 2009 (with a two-year OIC extension option). The fees for 2010 and 2011 have already been agreed to in the existing contract, and represent minor increases over the current fee. Further, the OIC retains the ability to terminate the agreement at any time, with a 30 days advance notice.

Notes on Other OIC Consultants

SIS was initially hired, and PCA (Emkin) was re-hired to new three-year contracts in December 2003. The initial new contract periods started January 1, 2004 and ended December 31, 2006. In December 2006, the contracts were each renewed by the OIC for a two-year period. In September of 2008, the contracts were additionally extended through December 31, 2010.

Consistent with Treasury Policy 4.01.13, new contracts are awarded for three year-periods and can be renewed twice for additional two-year periods. At the end of seven years, contracts must be re-bid and a new seven year cycle can begin. Therefore, the SIS and PCA contracts will require a new Request of Proposal process, next year.

The current private equity contract with PCG runs through December 2010 (may be extended through December 2013 at OIC option).

Discussion

The OIC may take the following action:

1. Extend the PCA Real Estate Advisors contract for a period of two years, under existing terms and conditions, ending December 2011; or
2. Require staff to conduct a search (Request for Proposals).

FUNCTION: General Policies and Procedures

ACTIVITY: Consulting Contracts

POLICY: All consultants of the Council, including but not limited to, full-service consultants as well as specific asset class advisors (e.g. real estate, alternative equities) shall be engaged by the Council through a form of written contract. These contracts shall have specified expiration dates, termination clauses and renewal/extension terms. Before the end of the contract term (including any renewals or extensions granted) a formal “request for information” (RFI) process shall be undertaken by Staff for the purpose of identifying new candidates, upgraded services, competitive pricing and any other information considered relevant to Staff and the Council.

PROCEDURES:

1. Consulting contracts shall be negotiated and executed in compliance with Council policy 4.01.10.
2. Consulting contracts shall expire on a date not to exceed three years from the effective date of the contract.
3. Consulting contracts shall include a “no-cause” termination clause with a maximum 90 day notice period.
4. It is the policy of the Council to continuously review all contractors.
5. Consulting contracts may be renewed or extended beyond the original expiration date no more than twice and limited to a final expiration date that is no more than four years beyond the original expiration.
6. Upon the final expiration of the original contract, or whenever directed by the Council, staff shall undertake and complete an RFI process which shall include the following:
 - a. Identification of those potential candidates who may reasonably be believed to perform those services under examination;
 - b. Directing of an RFI which shall include, but not be limited to:
 1. Description of services requested;
 2. Description of the potential or preliminary standards required by the Council of the candidates; and
 3. Request for pricing or fee schedule information.

SAMPLE FORMS, DOCUMENTS, OR REPORTS (Attached): None

TAB 4 –
PRIVATE PARTNERSHIP INVESTMENT PRINCIPLES

Private Market Principles

Purpose

To propose amendments to the existing Private Market Principles.

Background

The Council has previously seen a draft of amendments to the formerly approved documents (enclosed). These changes are operational in nature – making the Principles conform to reality on issues such as whether audits need to be performed annually or at the occurrence of each individual distribution.

Shortly after these amendments were distributed to the OIC, the Group of 12 (G12, a confederation of public, corporate and endowment/foundation sponsors) released their own draft of Private Equity Principles (also enclosed). These were also shared with the OIC. The G12 document was one of the sources, along with a PREA best practices policy on real estate investing, that staff and SIS used to write the Principles approved earlier by the OIC. Additionally, the Institutional Limited Partners Association (ILPA) released its “Private Equity Principles” (attached) which are very similar (identical in most cases) to the G12 document.

Discussion

The G12 has requested that OPERF consider endorsing their language. Since there are many similarities and no substantive differences, this could easily be done by the OIC with little effect on current or future negotiations with our GPs. The G12 language is a bit more detailed than our current document but is not substantively different.

Consideration should also be given to the ILPA Private Equity Principles. This represents a much broader affiliation of LPs. The language in the ILPA document is very similar to the G12, but there are some differences – especially in the reporting of financial information.

It has been suggested that we have a better chance of close coordination with other LPs if we adopt similar language to theirs. Staff is unconvinced that this will make a material difference in negotiations with GPs but has no strong objection to such a move by the OIC. But which group’s language do we adopt? We would be in closer harmony to the vast majority of LPs with the ILPA language.

That said, it is likely that any fund sponsor will tweak the language no matter which model they use. Perhaps this argues for keeping our own language as already adopted with the few tweaks as suggested in the amendments herein. This course would be recommended by OIC counsel (DOJ and the SAAGs).

The only real cautionary note on adopting the G12 or ILPA language comes from the concern from counsel on the issue of collusion. They state that in any possible collusion lawsuit, OPERF would be better insulated if our Principles language is different from the rest of the LPs that might be involved in any legal action. While certainly true, the question is what likelihood is there of such a lawsuit? This seems a fairly remote

probability. But we should not ignore the cautionary comment especially since at least some of the consultants agree with the attorneys.

Requested Action

The OIC is asked to take one of the following courses of action:

1. Modify the language in our own document as previously suggested by staff; or
2. Adopt the G12 document;
3. Adopt the ILPA document.

Staff has a preference for Option 1 given that it is more focused on the most critical issues for the OIC as well as that it satisfies the potential legal concerns raised by DOJ and consultants.

Option 2 has language a bit more in line with the current OPERF language but has a smaller base of funds endorsing it.

Option 3 makes some more onerous demands on GPs, some perhaps not totally practical, but offers the likelihood of a broader range of adoption in the LP community.

OREGON INVESTMENT COUNCIL
PRIVATE PARTNERSHIP INVESTMENT PRINCIPLES

PRIVATE PARTNERSHIP INVESTMENT PRINCIPLES

The purpose of this document is to formulate a general view that institutional investors should seek when making private equity and real estate partnership investments. Private market partnership terms and conditions that have gradually evolved should receive renewed attention in order to better align interests between general partners and limited partners, enhance fund governance, and provide greater transparency to investors. Below is a summary of the issues that we believe will lead to the modification and improvement of specific terms and best practices for new commitments. While there is no panacea for optimal contract terms, these principles should be considered as a guide, and not as absolutes, recognizing that partnership agreements and terms are complex, and must be considered in whole.

Areas for Improvement in Private Partnerships

Alignment of Interests

- The 80/20 profit split in commingled funds works well to align interests, but tighter distribution provisions should become the norm to avoid clawback situations or other forms of “leakage” that allow general partners to earn more than 20% of profits due to the timing of distributions or creative drafting of the partnership agreements.
 - The carry should be on net profits generated after taxes, management fees, transaction costs, and all other ancillary expenses, rather than on gross profits.
 - A European-style waterfall is preferable. Ideally, the carry should only be in effect after 100% of capital, net of all fees and expenses, has been returned to the investor who has provided the vast majority of risk capital. However, interim tax distributions can be paid to cover the general partner’s tax liabilities. These distributions should be considered advances to the general partner.
 - ~~Each time a carried interest payment is proposed to be made to the general partner or any GP affiliate, the books and records of the partnership shall be audited at partnership expense to confirm the amount of such payment.~~
 - If clawbacks are required; they should be fully and timely repaid. The risk of clawback non-payment should be mitigated through escrow of a portion of the carry distributions, interim look-backs, and/or personal guarantees of the carry-receiving partners.
 - Clawback non-payment should be mitigated through joint-and-several coverage by all members of the GP.
 - Carried interest to the GP should not exceed 20% unless there are overriding economic considerations deemed favorable to the LP.

- Management fees are intended to cover reasonable operating costs and should not be a material profit-center, or a funding source for staff bonuses or business expansion for the firm. Fees should be reduced for all but the most modest funds with larger funds taking larger reductions in “standard” fees, acknowledging economies of scale.
 - Larger investors in a fund should receive fee or carry concessions, particularly when the general partner has multiple funds or follow-on funds in the market at the same time.
- Ideally, the general partner should avoid charging transaction, monitoring fees, and other fees to a deal or portfolio company/investment entity in the fund. ~~In addition, all fees~~ If such fees are earned by the general partner, they should offset management fees and partnership expenses during the life of the fund and at the end of the life of the fund. Any remainder should be distributed as profit pursuant to the distribution provisions with a split of no less than 80 percent to the LP/20.
 - Transaction, monitoring and other fees, if charged, should be escrowed against future management fees, subject to a split of no less than 80 percent to the LP/20.
- In no event shall the partnership be required to bear, directly or indirectly expenses of the general partner or manager for entertainment, publicity, fund raising, office space, information technology, employment, personnel or other matters that are generally considered to be corporate overhead. All partnership expenses shall be limited to those third party out-of-pocket expenses reasonably incurred directly in connection with the partnership business.
- The general partner’s capital commitment to the fund should reflect a substantial amount of the net worth of the principals making up the general partner and a high percentage of the amount should be contributed in cash.
- Changes in tax law that personally impact members of a general partner should not be passed on to investors in the fund.

Governance

- Recent scandals have again highlighted the need for and the importance of an independent auditor who should be firmly focused on the best interests of the partnership and its limited partners, rather than the interests of the general partner.
 - The auditor should be an independent, nationally recognized firm and should provide no other services to the general partner, unless explicitly approved by the Advisory Board.
- Because partnership terms are generally long (10-~~12~~5 years) and withdrawal rights are virtually nonexistent, a super-majority of outstanding limited partnership ownership interests should be able to effectuate the following, without cause:
 - Suspend the commitment period
 - Terminate the commitment period

- Remove the general partner
- Dissolve the fund
- General partners should reinforce their duty of care. The “gross negligence, fraud, and willful misconduct” indemnification and exculpation standard should be a minimum in terms of what is agreed to by limited partners. Recent efforts by the general partner to: (1) reduce all duties to the fullest extent of the law; (2) demand the waiver of broad categories of conflicts of interests; and (3) allow it to act in its sole discretion, even where a conflict exists, should be strongly resisted.
- General partners should be required to seek approval of the limited partners to change the investment strategy promoted when the fund was raised.
- Advisory Board meeting processes and procedures should be adopted and standardized across the industry to allow this sub-body of the limited partners to more effectively serve its role.
 - All limited partners should receive a list of the names and contact details of Advisory Board members.
 - The Advisory Board should be able to call for a meeting with the general partner at any time.
 - The Advisory Board should be allowed “private time” with the auditor, on at least an annual basis, ~~if requested~~ desired.
 - The Advisory Board should not be asked to approve specific investments and will serve the limited partnership investors best by reviewing audit results, portfolio holdings updates (including valuation methods), and addressing issues relating to potential conflicts-of-interest.
 - Any significant transaction between multiple funds of the same general partner should be subject to Advisory Board approval. The Advisory Board shall have the right to put particular matters to a vote of all limited partners.

Transparency

- Fee, carry and all other ancillary fee calculations should be transparent and subject to limited partner and independent auditor review in a standardized form.
- All placement agent and fundraising fees should be fully disclosed. The scope of work provided by placement agents should be disclosed. Campaign contributions or other payments made to individuals that may influence the decision-making process should be disclosed.
- Accurate disclosure around uses of leverage at both the fund and the investment entity levels should be provided.

- All limited partners should be notified when/if the general partner receives any SEC inquiries or meaningful legal actions.

GROUP OF 12
PRIVATE EQUITY PRINCIPLES

Private Equity Principles

Historically, the private equity partnership structure has been effective in aligning the interests of investors (the “limited partners”) with those individuals managing the money (the “general partner”). By sharing a substantial portion of profits with the general partner and requiring the general partner to have a meaningful equity interest in their own funds, a business culture was created where most private equity firms were able to maintain a single-minded determination to maximize returns on the underlying investments. The principles contained herein are a means to restore and strengthen the basic “alignment of interests” value proposition in private equity.

Certain terms and conditions that have gradually evolved should receive renewed attention in private equity partnership agreements entered into prospectively in order to (i) correctly align interests between general partners and limited partners, (ii) enhance fund governance and (iii) provide greater transparency to investors. A summary of private equity principles is provided below. Appendix A contains details on preferred private equity terms, and Appendix B contains best practices for limited partner advisory committees.

The concepts contained in these documents reflect suggested best practices and are intended to serve as a basis for continued discussion among and between the general partner and limited partner communities with the goal of improving the private equity industry for the long-term benefit of all its participants. With the typical limited partnership agreement and related documents numbering well over a 100 pages and containing thousands of clauses it has become increasingly difficult to focus on what aligns the interests of the limited partner with the general partner. These documents will serve as an educational medium. The authors and sponsors of these documents are not seeking the commitment of any private equity investor to any of the outlined terms.

Areas for Improvement in Private Equity Partnerships

Alignment of Interests

- The agreed profit split in commingled funds has typically worked well to align interests, but tighter distribution provisions must become the norm in order to avoid clawback situations.
- Clawbacks must be strengthened so that when they are required they are fully and timely repaid.
- Management fees should cover normal operating costs for the firm and its principals and should not be excessive.
- All transaction and monitoring fees charged by the general partner should accrue to the benefit of the fund, including offsetting management fees and partnership expenses during the life of the fund.

- The general partner should have a substantial equity interest in the fund to maintain a strong alignment of interest with the limited partners, and a high percentage of the amount should be in cash as opposed to being contributed through the waiver of the management fee.
- Changes in tax law that personally impact members of a general partner should not be passed on to limited partners in the fund.
- Fees and carried interest generated by the general partner of a fund should be directed predominantly to the professional staff and expenses related to the success of that fund.

Governance

- General Partners should reinforce their duty of care. The “gross negligence, fraud, and willful misconduct” indemnification and exculpation standard should be the floor in terms of what is agreed to by limited partners. Recent efforts by the general partner to (1) reduce all duties to the fullest extent of the law, (2) demand the waiver of broad categories of conflicts of interests and (3) allow it to act in its sole discretion even where a conflict exists should be avoided.
- Investments made by the general partner should be consistent with the investment strategy that was described when the fund was raised.
- The general partner should recognize the importance of time diversification during the stated investment period as well as industry diversification within the portfolio.
- A supermajority in interest of the limited partners should have the ability to elect to dissolve the fund or remove the general partner without cause. A majority in interest of the limited partners should have the ability to elect to effectuate an early termination or suspension of the investment period without cause.
- A key-person or “For Cause event should result in an automatic suspension of the investment period with an affirmative vote required to reinstate it.
- The auditor of a private equity fund should be independent and focused on the best interests of the partnership and its limited partners, rather than the interests of the general partner.
- Limited Partner Advisory Committee (“LPAC”) meeting processes and procedures should be adopted and standardized across the industry to allow this sub-body of the limited partners to effectively serve its role. Appendix B serves as a model.

Transparency

- Fee and carried interest calculations should be transparent and subject to limited partner and independent auditor review and certification.
- Detailed valuation and financial information related to the portfolio companies should be made available as requested at least semi annually.
- Investors in private equity funds should have greater transparency as requested with respect to relevant information pertaining to the general partner.
- All proprietary information should be protected from public disclosure.

APPENDIX A
PRIVATE EQUITY PREFERRED TERMS

ALIGNMENT OF INTEREST

Carry/Waterfall

- **Waterfall structure**
 - Industry best practice should be a standard of the all-capital-back-first plus preferred return model.
 - Enhance the deal-by-deal model:
 - Return of all realized cost for given investment with continuous makeup of write-offs, and return of all fees and expenses to date (as opposed to pro rata for the exited deal),
 - For purposes of waterfall, all unrealized investments should be valued at lower of cost or market,
 - Escrow all carry other than tax distributions.
 - Carry would only be paid on recapitalizations once full amount of invested capital is realized on each investment that was recapped.
 - The preferred return should be calculated from the day capital is contributed to the point of distribution.

- **Calculation of carried interest**
 - Ensure that carried interest is calculated on the basis of net profits (not gross profits).
 - No carry should be taken on current income.
 - Ensure that carried interest is calculated on an after-tax basis (*i.e.*, foreign or other taxes imposed on the fund should not be treated as distributions to the partners).

- **Clawback**
 - Interim clawback calculations should be completed the lesser of (i) every two years or (ii) 4 quarters after recognition that there is a profit allocation/distribution imbalance with a provision guaranteeing payment to limited partners.
 - Internal general partner escrow until all committed capital is returned to investors.
 - Joint and several clawbacks should exist to encourage effective escrows and other general partner mechanisms to ensure clawback repayment.
 - All clawback amounts should be gross of taxes paid.

Management Fee and Expenses

- **Management Fee Structure**
 - The General Partner should provide prospective limited partners with a fee model for the fund at formation to be used as a guide to set management fees.
 - Management fees should be based on reasonable operating expenses and reasonable salaries, so that fees are not excessive.

APPENDIX A
PRIVATE EQUITY PREFERRED TERMS

- Management fees should step down significantly upon the formation of a follow-on fund and at the end of the investment period.
- **Expenses**
 - The management fee should encompass all normal operations of a general partner to include, at a minimum, overhead, staff compensation, travel, and other general administrative items as well as interactions with limited partners and prospective limited partners.
 - The Limited Partner Advisory Committee should review partnership expenses annually.
 - Placement agent fees and general partnership insurance should be an expense borne entirely by the general partner.

Term of Fund

- Fund extensions should be permitted in 1 year increments only.

General Partner Fee Income Offsets

- All transaction, monitoring, directory, advisory, and exit fees charged by the general partner should accrue to the benefit of the fund.

General Partner Commitment

- The general partner should have a substantial equity interest in the fund to maintain a strong alignment of interest with the limited partners, and a high percentage of the amount should be in cash as opposed to being contributed through the waiver of management fees.
- Principals should be restricted from transferring their interest in the general partner in order to ensure alignment with the limited partners.

Standard for Multiple Product Firms

- Key persons should devote substantially all their business time to the fund and its parallel vehicles. No general partner or any principal may close or act as general partner for a fund with substantially equivalent investment objectives and policies until after the investment period ends, or the fund is invested, expended, committed or reserved for investments and expenses.
- Fees and carried interest generated by the general partner of a fund should be directed predominantly to the professional staff and expenses related to the success of that fund.

APPENDIX A
PRIVATE EQUITY PREFERRED TERMS

GOVERNANCE

Fiduciary Duty

- Generally, reinforce the fiduciary duties of the general partner.
- Avoid provisions that allow general partner to reduce all fiduciary duties to the fullest extent allowed by law.
- Avoid provisions that allow general partner to use its sole discretion and weigh its own self-interest against the interest of the fund.
- Avoid provisions where limited partners acknowledge and waive broad category of conflicts or affiliated transactions.
- Require a review of all affiliated transactions and approval by the limited partner advisory committee.
- Allow removal for bad acts upon preliminary determination, not by a final court decision not subject to appeal.
- Cap indemnification expenses as a percentage of total fund size.
- Situations impacting a principal's ability to meet the specified "time and attention" standard should be disclosed to all limited partners and discussed with, at a minimum, the limited partner advisory committee.

Style Drift/Investment Purpose

- The investment purpose clause should clearly and narrowly outline the investment strategy.
- Any changes or modifications to investment strategy should be disclosed and approved by a supermajority in interest of the limited partners.
- The general partner should recognize the importance of time diversification during the stated investment period to avoid over-concentration in short time periods by considering limitations on the amount of capital that can be called on an annual basis from limited partners.
 - Funds should have appropriate limitations on investment and industry concentration.
- Explicit limitations or restrictions should be placed on investments in debt instruments, publicly traded securities, and pooled investment vehicles.

APPENDIX A
PRIVATE EQUITY PREFERRED TERMS

Stronger No-Fault Rights and Withdrawal Rights

- No fault rights upon majority in interest vote of limited partners for the following:
 - Suspension of commitment period
 - Termination of commitment period

- No fault rights upon a two-thirds in interest vote of limited partners for the following:
 - Removal of the general partner
 - Dissolution of the Fund

Key Man, Time & Attention, and For Cause Provisions

- Automatic suspension of investment period, which will become permanent unless 2/3 of limited partners vote to re-instate within 180 days, when a key man event is triggered or for cause (fraud, material breach of fiduciary duties, material breach of agreement, bad faith, and gross negligence).

Independent Auditor and Independent Fund Counsel

- The external auditor of the fund should not perform other services for the general partner and/or its affiliates whenever practicable.

- Limited partners should ratify any change in the independent external auditor of the fund.

- The external auditor should certify that allocations and distributions have been done pursuant to the partnership agreement and that the capital accounts are correct. Management fee and carried interest calculations should be reviewed and certified by the auditor.

- The external auditor should review the partnership expenses charged to the partnership and certify that any charges were consistent with the partnership agreement.

- In addition, the fund should make available to the Limited Partner Advisory Committee, as requested, separate counsel that is independent from the general partner and does not perform work for the general partner or its affiliates.

Limited Partner Advisory Committee Meeting Best Practices

- See Appendix B.

APPENDIX A
PRIVATE EQUITY PREFERRED TERMS

TRANSPARENCY

Management and Other Fees

- All fees generated by the general partner should be disclosed quarterly and classified in each audited financial report and with each capital call and distribution notice (transaction, financing, monitoring, redemption, etc.).

Capital Calls and Distributions

- With each distribution, the general partner should disclose the exact amount of carry and provide build-up to carry calculation.
- Greater detail on all capital calls should be provided, including percentages for each limited partner and detail in calculation (including offsets) of management fees.

Disclosure Related to the General Partner

- As requested, the economic arrangement of the general partner, the principals and any other 3rd party investors in the general partner as well as the organizational structure of the general partner and its affiliates shall be fully disclosed to prospective limited partners as part of the due diligence process. Specifically, the following should be disclosed as requested:
 - The capitalization of the fund
 - Profit sharing splits among the principals, including vesting schedules
 - Individual commitment amounts by the principals making up the general partner commitment
- Carried interest and other general partner related cash or stock incentives taken by the general partner as a part of its roles and responsibilities on partnership investments should be disclosed to the limited partners.
- The economic arrangement of the general partner and its placement agents should be fully disclosed as part of the due diligence materials provided to prospective limited partners.
- Any inquiries by SEC or other regulators must be immediately disclosed to investors.
- Limited partners should be notified of any additions/deletions to personnel and immediately notified when “key-person” provisions are violated.

APPENDIX A
PRIVATE EQUITY PREFERRED TERMS

Financial Information

- Financial statements of the fund should be provided to limited partners on a quarterly basis, within 45 days of quarter end. The annual audited financial statement of the fund should be provided within 70 days of year end.
- Full disclosure about leverage should be provided.
- Full disclosure about placement agent fees should be provided.
- Detailed valuation and financial information related to the portfolio companies should be made available as requested at least semi-annually.

Limited partners receiving sensitive information as described above must keep such information confidential. Limited partners should support the general partner in taking appropriate sanctions against any limited partner that breeches this confidentiality.

APPENDIX B
Limited Partner Advisory Committee
Best Practices

BACKGROUND

Due to inconsistency in Limited Partner Advisory Committee (“LPAC”) practices including, but not limited to, the lack of uniformity in the size, formation, role, responsibilities and effectiveness of the LPAC, attached is a set of “Best Practices” to improve effectiveness and efficiency both for the LPAC and the overall fund.

LPAC FORMATION

During the formation of the LPAC, the general partner should adhere to the following protocol:

1. Simultaneously with each closing, the general partner should compile a list of LPAC members and their contact information and circulate this list to all limited partners, providing an updated list if and when any information is changed, to limited partner.
2. The LPAC should be limited in size (8 to 15 members). A reasonable number of observer seats should be made available.
3. At any time during the life of the partnership, any additions/substitutions of new LPAC members should be done by mutual consent of the LPAC and general partner with timely notification to all limited partners.
4. A standing LPAC meeting agenda should be developed and a calendar established as far in advance as possible.
5. Clear voting thresholds and protocols should be established, including requiring a quorum of 50% of LPAC members when votes are taken.

LPAC MEETING PROTOCOL

The general partner should use the following protocol during the organization and holding of LPAC meetings:

1. LPAC meetings should be held in person at least twice a year with an option to dial-in telephonically.
2. There should be separate LPAC meetings for separate funds as opposed to meetings that cover multiple funds. Any meeting requiring a vote of the LPAC should be held with only the members of that specific fund’s LPAC in attendance. For convenience, LPAC meetings and/or members may be pooled when general topics are discussed.

APPENDIX B
Limited Partner Advisory Committee
Best Practices

3. A portion of each LPAC meeting will be set aside for an “in camera” session with only the limited partners present. Limited partners may elect one to three members of the LPAC to lead the discussion and report back to the general partner.
4. At any time, the LPAC should have the right to call for an LPAC meeting. This meeting should be arranged by the general partner if requested by the LPAC.
5. At any time, any member of the LPAC may add an agenda item to the LPAC meeting agenda subject to a reasonable notice requirement (10 days) to the general partner.
6. With any request for consent or approval by a fund’s LPAC, the general partner will send to each LPAC member a memorandum providing background information on the matter at least 10 days in advance of the meeting.
 - i. A conference call should be scheduled by the general partner with the fund’s LPAC members to discuss the consent or amendment under consideration and address any questions or comments.
 - ii. The LPAC should reserve the right to request that the general partner send consent or amendment to the broader limited partner base for vote even if the limited partnership agreement allows the LPAC to make the decision. The LPAC reserves the right to express their opinion on the matter to other limited partners.
7. All decisions made by the LPAC shall be provided to all limited partners within a reasonable time period.
8. The LPAC should have access to partnership auditors to discuss valuations. A representative from the audit firm should attend each year-end LPAC meeting.
9. The LPAC should have access to independent auditors and legal counsel at the expense of the partnership or of the general partner.
10. The partnership should indemnify members of the LPAC.
11. The general partner should take minutes at all LPAC meetings. LPAC meeting minutes should be circulated to LPAC members for approval at the next LPAC meeting.
12. A formal record of votes by the LPAC for or against, formal abstentions, and members who did not respond to an amendment or consent will promptly be made available to all LPAC members upon request.
13. The general partner will record the votes during conference calls or at meetings and will maintain a copy of consents obtained in writing, by facsimile, or by email.

APPENDIX B
Limited Partner Advisory Committee
Best Practices

LPAC DUTIES

Limited Partner Advisory Committees should have the core responsibilities of approving transactions that pose conflicts of interest, such as cross-fund investments, and approving the methodology used for portfolio company valuations]. In addition, the LPAC is ideally suited to engage with the general partner on discussions of partnership operations, including but not limited to:

- Auditors – disclosure of conflicts, discussion regarding changes
- Operations – disclosure of general partner’s operating budget, income statement and balance sheet
- Compliance – with the partnership agreement (e.g., investment purpose and restrictions)
- Partnership expenses – disclosure of costs expensed to the partnership versus absorbed as part of the management fee
- Investments by the general partner outside of the fund that create or may create conflicts with their fiduciary duty to the fund.
- Fees and carried interest calculations – disclosure to LPAC and subject to independent auditor review and certification
- Human resources – disclosure of material changes in personnel
- Strategy – discussion of changes to the investment strategy
- New business initiatives of the firm – discussion with LPAC in advance
- Valuation of portfolio companies – Valuation policy and practices should be documented by the general partner and reviewed with the LPAC. Changes in policy, practices, or application should be discussed with LPAC. Valuation of portfolio companies should be reviewed with LPAC no less than quarterly.

Limited partners serving on the advisory committee and receiving sensitive information as described above must keep such information confidential. LPAC members should support the general partner in taking appropriate sanctions against any limited partner that breeches this confidentiality.

LPAC MEMBER RESPONSIBILITIES

Limited partners that accept a seat on the LPAC should commit the necessary time and attention to the fund. LPAC members should participate in all LPAC meetings, be properly prepared, and responsibly fulfill the duties of their role.

INSTITUTIONAL LIMITED PARTNERS ASSOCIATION
PRIVATE EQUITY PRINCIPLES

Institutional Limited Partners Association

Private Equity Principles



Contents

ILPA Private Equity Principles	2
Best Practices in Private Equity Partnerships	3
Alignment of Interest	3
Governance	4
Transparency	5
Appendix A - Private Equity Preferred Terms	6
Alignment of Interest	6
Governance	8
Transparency	10
Appendix B - Limited Partner Advisory Committee	13
Background	13
LPAC Formation	13
LPAC Meeting Protocol	14
LPAC Duties	15
LPAC Member Responsibilities	15

ILPA Private Equity Principles

Historically, the private equity partnership structure has been effective in aligning the interests of investors (the “limited partners”) with those individuals managing the money (the “general partner”). By sharing a substantial portion of profits with the general partner and requiring the general partner to have a meaningful equity interest in their own funds, a business culture was created where most private equity firms were able to maintain a single-minded determination to maximize returns on the underlying investments. The principles contained herein are a means to restore and strengthen the basic “alignment of interests” value proposition in private equity.

Certain terms and conditions that have gradually evolved should receive renewed attention in private equity partnership agreements entered into prospectively in order to (i) correctly align interests between general partners and limited partners, (ii) enhance fund governance and (iii) provide greater transparency to investors. A summary of private equity principles is provided below. Appendix A contains details on preferred private equity terms, and Appendix B contains best practices for Limited Partner Advisory Committees (“LPAC”).

The concepts contained in these documents reflect suggested best practices and are intended to serve as a basis for continued discussion among and between the general partner and limited partner communities with the goal of improving the private equity industry for the long-term benefit of all its participants. These documents were developed through the efforts, contributions and collaboration of many institutional private equity investors and their senior investment officers, the Institutional Limited Partners Association (“ILPA”) and the Private Equity Principles and Best Practices Committee of the ILPA Board of Directors. They reflect the input and feedback from these market leaders and from discussion amongst limited partners at ILPA roundtable events and from a comprehensive survey/questionnaire of the ILPA membership. A list of organizations that endorse the ILPA Private Equity Principles will be posted on the ILPA website (www.ilpa.org).

With the typical limited partnership agreement and related documents numbering well over a 100 pages and containing thousands of clauses it has become increasingly difficult to focus on what aligns the interests of the limited partner with the general partner. These documents will serve as an educational medium. The authors and sponsors of these documents are not seeking the commitment of any private equity investor to any of the outlined terms.

Best Practices in Private Equity Partnerships

Alignment of Interest

- The agreed profit split in commingled funds has typically worked well to align interests, but tighter distribution provisions must become the norm in order to avoid clawback situations.
- Clawbacks must be strengthened so that when they are required they are fully and timely repaid.
- Management fees should cover normal operating costs for the firm and its principals and should not be excessive.
- All transaction and monitoring fees charged by the general partner should accrue to the benefit of the fund, including offsetting management fees and partnership expenses during the life of the fund.
- The general partner should have a substantial equity interest in the fund to maintain a strong alignment of interest with the limited partners, and a high percentage of the amount should be in cash as opposed to being contributed through the waiver of the management fee.
- Changes in tax law that personally impact members of a general partner should not be passed on to limited partners in the fund.
- Fees and carried interest generated by the general partner of a fund should be directed predominantly to the professional staff and expenses related to the success of that fund.

Governance

- General Partners should reinforce their duty of care. The “gross negligence, fraud, and willful misconduct” indemnification and exculpation standard should be the floor in terms of what is agreed to by limited partners. Recent efforts by the general partner to (1) reduce all duties to the fullest extent of the law, (2) demand the waiver of broad categories of conflicts of interests and (3) allow it to act in its sole discretion even where a conflict exists should be avoided.
- Investments made by the general partner should be consistent with the investment strategy that was described when the fund was raised.
- The general partner should recognize the importance of time diversification during the stated investment period as well as industry diversification within the portfolio.
- A supermajority in interest of the limited partners should have the ability to elect to dissolve the fund or remove the general partner without cause. A majority in interest of the limited partners should have the ability to elect to effectuate an early termination or suspension of the investment period without cause.
- A “key-person” or “for cause” event should result in an automatic suspension of the investment period with an affirmative vote required to reinstate it.
- The auditor of a private equity fund should be independent and focused on the best interests of the partnership and its limited partners, rather than the interests of the general partner.
- Limited Partner Advisory Committee meeting processes and procedures should be adopted and standardized across the industry to allow this sub-body of the limited partners to effectively serve its role.

Appendix B serves as a model.

Transparency

- Fee and carried interest calculations should be transparent and subject to limited partner and independent auditor review and certification.
- Detailed valuation and financial information related to the portfolio companies should be made available as requested on a quarterly basis.
- Investors in private equity funds should have greater transparency as requested with respect to relevant information pertaining to the general partner.
- All proprietary information should be protected from public disclosure.

Appendix A

Private Equity Preferred Terms

Alignment of Interest

Carry/Waterfall

- **Waterfall structure**
 - A standard all-contributions -plus-preferred-return-back-first model should be recognized as a best practice.
 - Enhance the deal-by-deal model:
 - Return of all realized cost for given investment with continuous makeup of partial impairments and write-offs, and return of all fees and expenses to date (as opposed to pro rata for the exited deal),
 - For purposes of waterfall, all unrealized investments should be valued at lower of cost or market,
 - Require carry escrow accounts with significant reserves (30% of carry distributions or more) and require additional reserves to cover potential clawback liabilities.
 - Carry should only be paid on recapitalizations once full amount of invested capital is realized on each investment that was recapitalized.
 - The preferred return should be calculated from the day capital is contributed to the point of distribution.
- **Calculation of carried interest**
 - Carried interest should be calculated on the basis of net profits (not gross profits).
 - No carry should be taken on current income.
 - Carried interest should be calculated on an after-tax basis (i.e., foreign or other taxes imposed on the fund should not be treated as distributions to the partners).
- **Clawback**
 - Clawback liabilities, if any, should be determined and clearly disclosed to the limited partners as of the end of every reporting period. The disclosure should be accompanied by a plan by the general partner to resolve the clawback.
 - All clawback amounts should be gross of taxes paid and paid back no later than two years following recognition of the liability.
 - Joint and several clawbacks should exist to encourage effective escrows and other general partner mechanisms to ensure clawback repayment.

Management Fee and Expenses

- **Management Fee Structure**
 - The General Partner should provide prospective limited partners with a fee model for the fund at formation to be used as a guide to set management fees.
 - Management fees should be based on reasonable operating expenses and reasonable salaries, so that fees are not excessive.
 - Management fees should step down significantly upon the formation of a follow-on fund and at the end of the investment period.
- **Expenses**
 - The management fee should encompass all normal operations of a general partner to include, at a minimum, overhead, staff compensation, travel, and other general administrative items as well as interactions with limited partners.
 - The Limited Partner Advisory Committee should review partnership expenses annually.
 - Placement agent fees and general partnership insurance should be an expense borne entirely by the general partner.

Term of Fund

- Fund extensions should be permitted in 1 year increments only.

General Partner Fee Income Offsets

- All transaction, monitoring, directory, advisory, and exit fees charged by the general partner should accrue 100% to the benefit of the fund.

General Partner Commitment

- The general partner should have a substantial equity interest in the fund to maintain a strong alignment of interest with the limited partners, and a high percentage of the amount should be in cash as opposed to being contributed through the waiver of management fees.
- Principals should be restricted from transferring their interest in the general partner in order to ensure alignment with the limited partners.

Standard for Multiple Product Firms

- Key-persons should devote substantially all their business time to the fund and its parallel vehicles. No general partner or any principal may close or act as general partner for a fund with substantially equivalent investment objectives and policies until after the investment period ends, or the fund is invested, expended, committed or reserved for investments and expenses.
- The general partner should not invest in opportunities that are appropriate for the fund through other investment vehicles unless such investment is made on a pro-rata basis under pre-disclosed co-investment agreements established prior to the close of the fund.
- Fees and carried interest generated by the general partner of a fund should be directed predominantly to the professional staff and expenses related to the success of that fund.

Governance

Fiduciary Duty

- Generally, reinforce the fiduciary duties of the general partner.
- Avoid provisions that allow general partner to reduce all fiduciary duties to the fullest extent allowed by law.
- Avoid provisions that allow general partner to use its sole discretion and weigh its own self-interest against the interest of the fund.
- Avoid provisions where limited partners acknowledge and waive broad category of conflicts or affiliated transactions.
- Require general partner to present all conflicts of which it is aware of to the Limited Partner Advisory Committee for review and seek prior approval for any material conflicts and/or non arm's length interactions or transactions.
- Require a review of all affiliated transactions and approval by the Limited Partner Advisory Committee.
- Allow general partner removal for bad acts upon preliminary determination, not by a final court decision not subject to appeal. The termination of the individual responsible for such actions should not be deemed to be a cure or remedy.
- Avoid provisions that allow general partner and its affiliates to be exculpated or indemnified for conduct constituting a material breach of the partnership agreement, breach of fiduciary duties, or other “for cause” events.
- Cap indemnification expenses as a percentage of total fund size.
- Situations impacting a principal's ability to meet the specified “time and attention” standard should be disclosed to all limited partners and discussed with, at a minimum, the Limited Partner Advisory Committee.
- Any amendment to the limited partnership agreement should require the approval of a supermajority in interest of the limited partners.

Style Drift/Investment Purpose

- The investment purpose clause should clearly and narrowly outline the investment strategy.
- Any changes or modifications to investment strategy should be disclosed and approved by a supermajority in interest of the limited partners.
- The general partner should recognize the importance of time diversification during the stated investment period to avoid over-concentration in short time periods by considering limitations on the amount of capital that can be called on an annual basis from limited partners. Funds should have appropriate limitations on investment and industry concentration (excluding sector-focused funds).
- Explicit limitations or restrictions should be placed on investments in debt instruments, publicly traded securities, and pooled investment vehicles.

Stronger No-Fault Rights and Withdrawal Rights

- No fault rights upon majority in interest vote of limited partners for the following:
 - Suspension of commitment period
 - Termination of commitment period
- No fault rights upon a two-thirds in interest vote of limited partners for the following:
 - Removal of the general partner
 - Dissolution of the Fund

Key-Man, Time & Attention, and For Cause Provisions

- Automatic suspension of investment period, which will become permanent unless two-thirds of limited partners in interest vote to re-instate within 180 days, when a key-man event is triggered or for cause (fraud, material breach of fiduciary duties, material breach of agreement, bad faith, and gross negligence).

Independent Auditor and Independent Fund Counsel

- The external auditor of the fund should not perform other services for the general partner and/or its affiliates whenever practicable.
- Limited partners should ratify any change in the independent external auditor of the fund.
- The external auditor should certify that allocations and distributions have been done pursuant to the partnership agreement and that the capital accounts are correct. Management fee and carried interest calculations should be reviewed and certified by the auditor.
- The external auditor should review the partnership expenses charged to the partnership and certify that any charges were consistent with the partnership agreement.
- Upon request of the Limited Partner Advisory Committee, the fund should make available to the Limited Partner Advisory Committee separate counsel that is independent from the general partner and does not perform work for the general partner or its affiliates.

Limited Partner Advisory Committee Meeting Best Practices

- See Appendix B.

Transparency

Management and Other Fees

- All fees (i.e., transaction, financing, monitoring, management, redemption, etc.) generated by the general partner should be periodically disclosed and classified in each audited financial report and with each capital call and distribution notice.

Capital Calls and Distributions

- With each distribution, the general partner should disclose the exact amount of carry and provide build-up to carry calculation.
- Greater detail on all capital calls should be provided, including percentages for each limited partner and detail in calculation (including offsets) of management fees.

Disclosure Related to the General Partner

- As requested, the economic arrangement of the general partner, the principals and any other third-party investors in the general partner as well as the organizational structure of the general partner and its affiliates shall be fully disclosed to prospective limited partners as part of the due diligence process. Specifically, the following should be disclosed as requested:
 - The capitalization of the fund
 - Profit sharing splits among the principals, including vesting schedules
 - Individual commitment amounts by the principals making up the general partner commitment

- Carried interest and other general partner related cash or stock incentives taken by the general partner as a part of its roles and responsibilities on partnership investments should be disclosed to the limited partners.
- The economic arrangement of the general partner and its placement agents should be fully disclosed as part of the due diligence materials provided to prospective limited partners.
- Any inquiries by the United States Securities and Exchange Commission (SEC) or any other regulatory bodies in other jurisdictions must be immediately disclosed to limited partners.
- Limited partners should be notified of any changes to personnel and immediately notified when “key-man” provisions are violated.

Management Company Activities

- Other activities related to the management company of the general partner should be disclosed in writing to limited partners. Such activities include but are not limited to:
 - Formation of public listed vehicles
 - Sale of ownership of management company to other limited partner(s)
 - Public offering of shares in management company
 - Formation of other funds dedicated to alternative strategies

Financial Information

- **Annual Reports.** Funds should provide the following information at the end of each year (within 75 days of year-end) to investors:
 - Audited financial statements (including a clean opinion letter from auditors and a statement from the auditor detailing other work performed for the fund);
 - Internal Rate of Return (“IRR”) calculations prepared by the fund manager (that clearly set forth the methodology for determining the IRR);
 - Schedule of aggregate carried interest received;
 - Breakdown of fees received by the manager as management fees, from portfolio companies or otherwise;
 - Breakdown of partnership expenses;
 - Certification by auditor that allocations, distributions and fees were effected consistent with the governing documentation of the fund;
 - Summary of all capital calls and distribution notices;
 - Schedule of fund-level leverage, including commitments and outstanding balances on subscription financing lines or any other credit facilities of the fund;
 - Management letter describing the activities of the fund directed to the LPAC but distributed to all investors; and
 - Political contributions made by placement agents, the manager or any associated individuals to trustees or elected officials on investor boards.
- **Quarterly Reports.** Funds should provide the following information at the end of each quarter (within 45 days of the end of the quarter) to investors:
 - Unaudited quarterly profit and loss statements also showing year-to-date results;
 - Schedule showing changes from the prior quarter;
 - Schedule of fund-level leverage, including commitments and outstanding balances on subscription financing lines or any other credit facilities of the fund;
 - Information on material changes in investments and expenses;
 - Management comments about changes during the quarter
 - If valuations have changed quarter-to-quarter, an explanation of such changes; and
 - A schedule of expenses of the general partner

- **Portfolio Company Reports.** A fund should provide quarterly a report on each portfolio company with the following information:
 - Amount initially invested in the portfolio company (including loans and guarantees);
 - Any amounts invested in the portfolio company in follow-on transactions;
 - A discussion by the fund manager of recent key events in respect of the portfolio company;
 - Selected financial information (quarterly and annually) regarding the portfolio company including:
 - Valuation (along with a discussion of the methodology of valuation);
 - Revenue;
 - Debt (terms and maturity);
 - EBITDA;
 - Profit and loss;
 - Cash position; and
 - Cash burn rate
- litigation;
- Performance information for prior funds using both IRR calculation and multiple of invested capital model;
- IRR information for prior funds on both a gross and net basis;
- An explanation of the derivation of IRR;
- Whether the general partner provides performance information to be included in any standard private equity benchmarks;
- Disclosure of agents and sub-agents used; and
- Political contributions made by placement agents, the manager or any associated individuals to trustees or elected officials on investor boards.

Due Diligence

- **Fund Marketing Materials.** Marketing materials in respect of a fund should include the following information:
 - Values for each unrealized portfolio company in prior funds based on most recent audited financials;
 - Explanation by general partner of those values that deviate from the audited statements;
 - Description of any pending or threatened

- **LP Information.** A fund should provide the following information to all limited partners promptly upon closing, and should update such information when it changes:
 - A list of limited partners, including contact names and contact information, excluding those limited partners that specifically request to be excluded from the list; and
 - Closing documents for the fund, including the final version of the partnership agreement and side letters.

Limited partners receiving sensitive information as described above must keep such information confidential. Agreements should clearly state that limited partners may discuss the fund and its activities amongst themselves. Limited partners should support the general partner in taking appropriate sanctions against any limited partner that breaches this confidentiality.

Appendix B

Limited Partner Advisory Committee

Background

Due to inconsistency in Limited Partner Advisory Committee (“LPAC”) practices including, but not limited to, the lack of uniformity in the size, formation, role, responsibilities and effectiveness of the LPAC, attached is a set of “Best Practices” to improve effectiveness and efficiency both for the LPAC and the overall fund.

LPAC Formation

During the formation of the LPAC, the general partner should adhere to the following protocol:

- 1 The general partner should issue a formal invitation to those limited partners it has agreed to invite. Such invitations should provide
 - Information about the meeting schedule;
 - Expense reimbursement procedures;
 - An outline of the LPAC’s responsibilities under the partnership agreement; and
 - A statement of indemnification.
- 2 Simultaneously with each closing, the general partner should compile a list of LPAC members and their contact information and circulate this list to all limited partners, providing an updated list if and when any information is changed.
- 3 The LPAC generally should be made up of seven to eight voting representatives of limited partners, with larger funds having as many as 12 members, representing a diversified group of investors. A reasonable number of non-voting observer seats should be made available to certain limited partners.
- 4 At any time during the life of the partnership, any additions/substitutions of new LPAC members should be done by mutual consent of the LPAC and general partner with timely notification to all limited partners.
- 5 A standing LPAC meeting agenda should be developed and a calendar established as far in advance as possible.
- 6 Clear voting thresholds and protocols should be established, including requiring a quorum of 50% of LPAC members when votes are taken.
- 7 LPAC members should receive no remuneration, but the partnership should reimburse their reasonable expenses in serving on the LPAC.

LPAC Meeting Protocol

The general partner should use the following protocol during the organization and holding of LPAC meetings:

- 1 LPAC meetings should be held in person at least twice a year with an option to dial-in telephonically.
- 2 There should be separate LPAC meetings for separate funds as opposed to meetings that cover multiple funds. Any meeting requiring a vote of the LPAC should be held with only the members of that specific fund's LPAC in attendance. For convenience, LPAC meetings and/or members may be pooled when general topics are discussed.
- 3 A portion of each LPAC meeting will be set aside for an "in camera" session with only the limited partners present. Limited partners may elect one to three members of the LPAC to lead the discussion and report back to the general partner.
- 4 At any time, any two members of the LPAC should have the right to call for an LPAC meeting. This meeting should be arranged by the general partner if requested.
- 5 At any time, any member of the LPAC may add an agenda item to the LPAC meeting agenda subject to a reasonable notice requirement (10 days) to the general partner.
- 6 With any request for consent or approval by a fund's LPAC, the general partner will send to each LPAC member a memorandum providing background information on the matter at least 10 days in advance of the meeting.
 - i. A conference call should be scheduled by the general partner with the fund's LPAC members to discuss the consent or amendment under consideration and address any questions or comments.
 - ii. The LPAC should reserve the right to request that the general partner send the consent or amendment to the broader limited partner base for vote even if the limited partnership agreement allows the LPAC to make the decision. The LPAC reserves the right to express their opinion on the matter to other limited partners.
- 7 All decisions made by the LPAC shall be provided to all limited partners within a reasonable time period.
- 8 The LPAC should have access to partnership auditors to discuss valuations. A representative from the audit firm should attend each year-end LPAC meeting.
- 9 The LPAC should have access to independent auditors, advisors and legal counsel at the expense of the partnership or of the general partner.
- 10 The partnership should indemnify members of the LPAC.
- 11 The general partner should take minutes at all LPAC meetings. LPAC meeting minutes should be circulated to LPAC members within 30 days and submitted for approval at the next LPAC meeting.
- 12 The general partner should record all votes taken during conference calls or at meetings and maintain a copy of consents obtained in writing, by facsimile, or by email. Detailed voting records should promptly be made available by the general partner to any LPAC member upon request.

LPAC Duties

Limited Partner Advisory Committees should have the core responsibilities of approving transactions that pose conflicts of interest, such as cross-fund investments and approving the methodology used for portfolio company valuations. In addition, the LPAC is ideally suited to engage with the general partner on discussions of partnership operations, including but not limited to:

- **Auditors** – disclosure of conflicts, discussion regarding changes.
- **Operations** – disclosure of general partner’s operating budget, income statement and balance sheet.
- **Compliance** – with the partnership agreement (e.g., investment purpose and restrictions).
- **Partnership expenses** – disclosure of costs expensed to the partnership versus absorbed as part of the management fee.
- Investments by the general partner outside of the fund that create or may create conflicts with their fiduciary duty to the fund.
- **Fees and carried interest calculations** – disclosure to LPAC and subject to independent auditor review and certification.
- **Human resources** – disclosure of material changes in personnel.
- **Strategy** – discussion of changes to the investment strategy.
- **New business initiatives of the firm** – discussion with LPAC in advance.
- **Valuation of portfolio companies** – Valuation policy and practices should be documented by the general partner and reviewed with the LPAC. Changes in policy, practices, or application should be discussed with the LPAC. Valuation of portfolio companies should be reviewed with LPAC no less than quarterly.

Limited partners serving on the advisory committee and receiving sensitive information as described above must keep such information confidential. LPAC members should support the general partner in taking appropriate sanctions against any limited partner that breaches this confidentiality.

LPAC Member Responsibilities

Limited partners that accept a seat on the LPAC should commit the necessary time and attention to the fund. LPAC members should participate in all LPAC meetings, be properly prepared, and responsibly fulfill the duties of their role. LPAC members should be able to take into account their own interest in voting on the LPAC.

TAB 5 – ASSET ALLOCATIONS & NAV UPDATES

Asset Allocations at August 31, 2009

Regular Account								Variable Fund	Total Fund
OPERF	Policy	Target	\$ Thousands	Pre-Overlay	Overlay	Net Position	Actual	\$ Thousands	\$ Thousands
Public Equity	41-51%	46%	18,985,396	39.9%	2,030,349	21,015,745	44.1%	901,568	21,917,313
Private Equity	12-20%	16%	8,255,616	17.3%		8,255,616	17.3%		8,255,616
Total Equity	57-67%	62%	27,241,012	57.2%	2,030,349	29,271,361	61.5%		30,172,929
Opportunity Portfolio			911,679	1.9%		911,679	1.9%		911,679
Fixed Income	22-32%	27%	12,412,943	26.1%	(322)	12,412,621	26.1%		12,412,621
Real Estate	8-14%	11%	5,007,217	10.5%	-	5,007,217	10.5%		5,007,217
Cash*	0-3%	0%	2,059,669	4.3%	(2,030,027)	29,642	0.1%	4,072	33,714
TOTAL OPERF		100%	\$ 47,632,520	100.0%	\$ -	\$ 47,632,520	100.0%	\$ 905,640	\$ 48,538,160

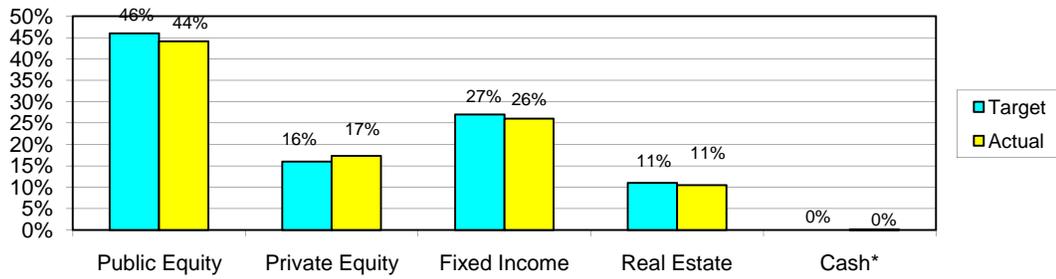
*Includes cash held in the policy implementation overlay program.

SAIF	Policy	Target	\$ Thousands	Actual
Total Equity	10-20%	15.0%	594,104	15.5%
Fixed Income	80-90%	85.0%	3,228,522	84.1%
Cash	0-5%	0%	16,629	0.4%
TOTAL SAIF		100%	\$3,839,255	100.0%

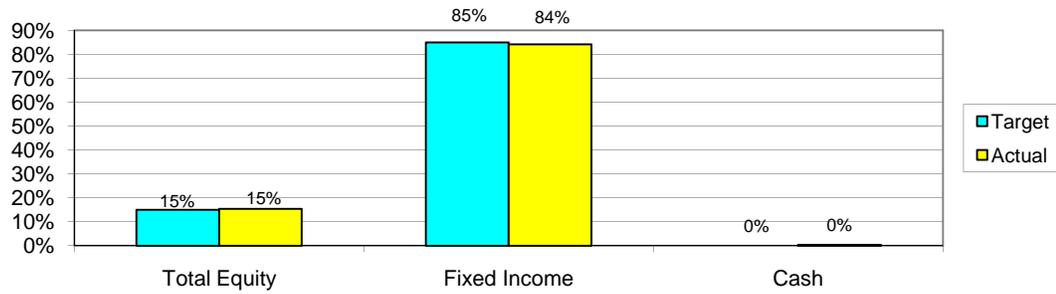
CSF	Policy	Target	\$ Thousands	Actual
Domestic Equities	25-35%	30%	\$298,622	33.4%
International Equities	25-35%	30%	319,687	35.8%
Private Equity	0-12%	10%	17,748	2.0%
Total Equity	65-75%	70%	636,057	71.2%
Fixed Income	25-35%	30%	251,084	28.1%
Cash	0-3%	0%	6,622	0.7%
TOTAL CSF			\$893,763	100.0%

HIED	Policy	Target	\$ Thousands	Actual
Domestic Equities	25-35%	30%	\$16,393	28.7%
International Equities	25-35%	30%	18,235	31.9%
Private Equity	0-10%	10%	5,649	9.9%
Total Equity	65-75%	70%	40,277	70.4%
Fixed Income	25-35%	30%	15,954	27.9%
Cash	0-3%	0%	972	1.7%
TOTAL HIED			\$57,203	100.0%

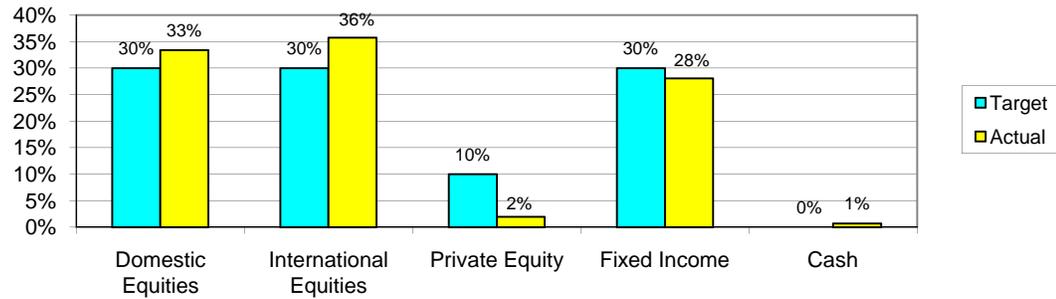
OPERF Asset Allocation



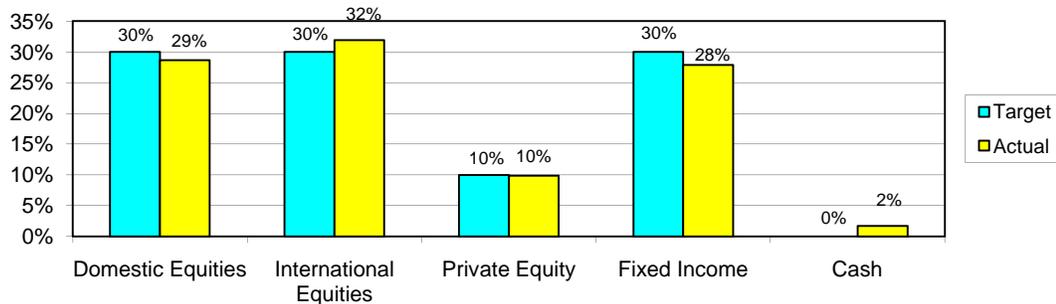
SAIF Asset Allocation



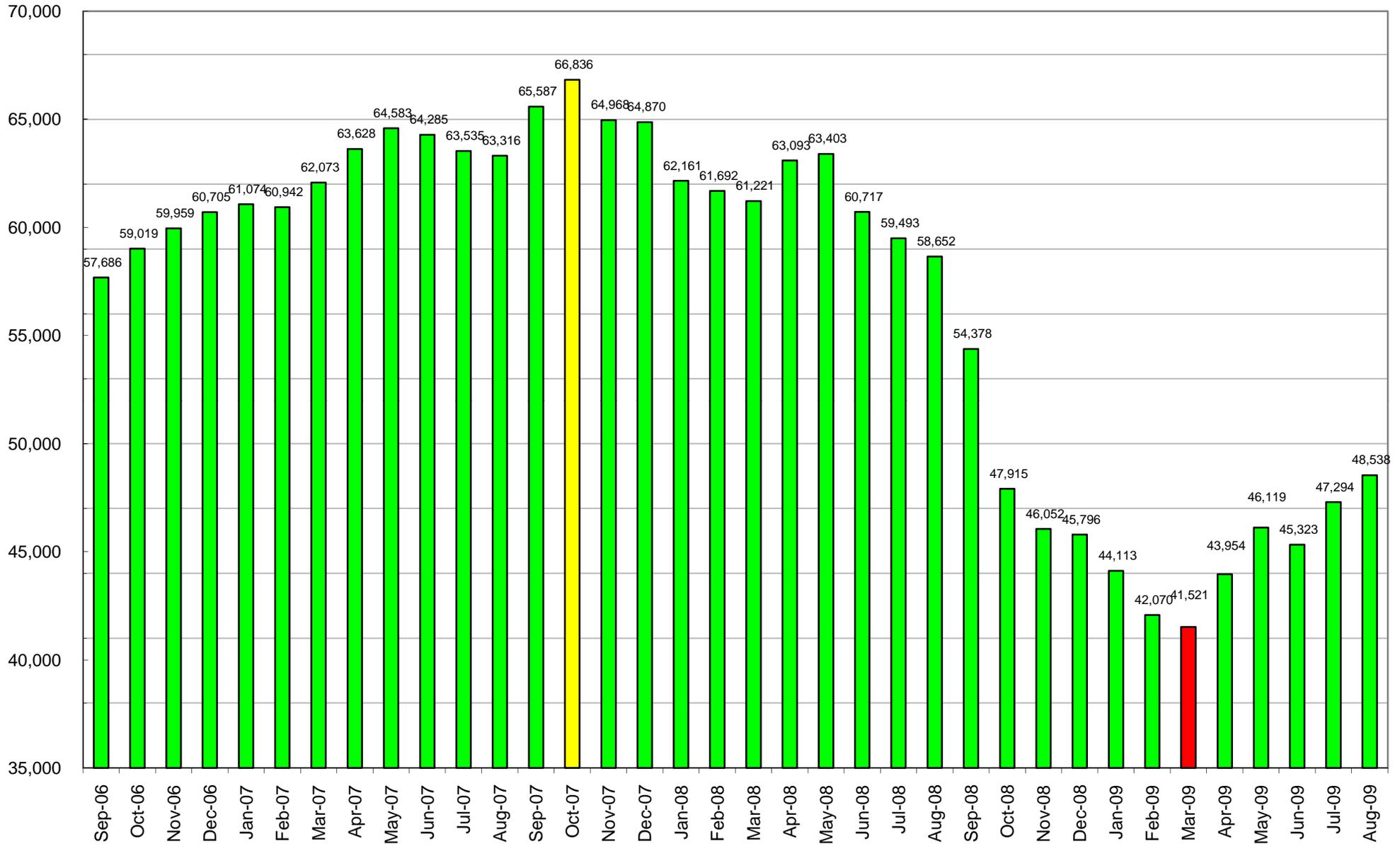
CSF Asset Allocation



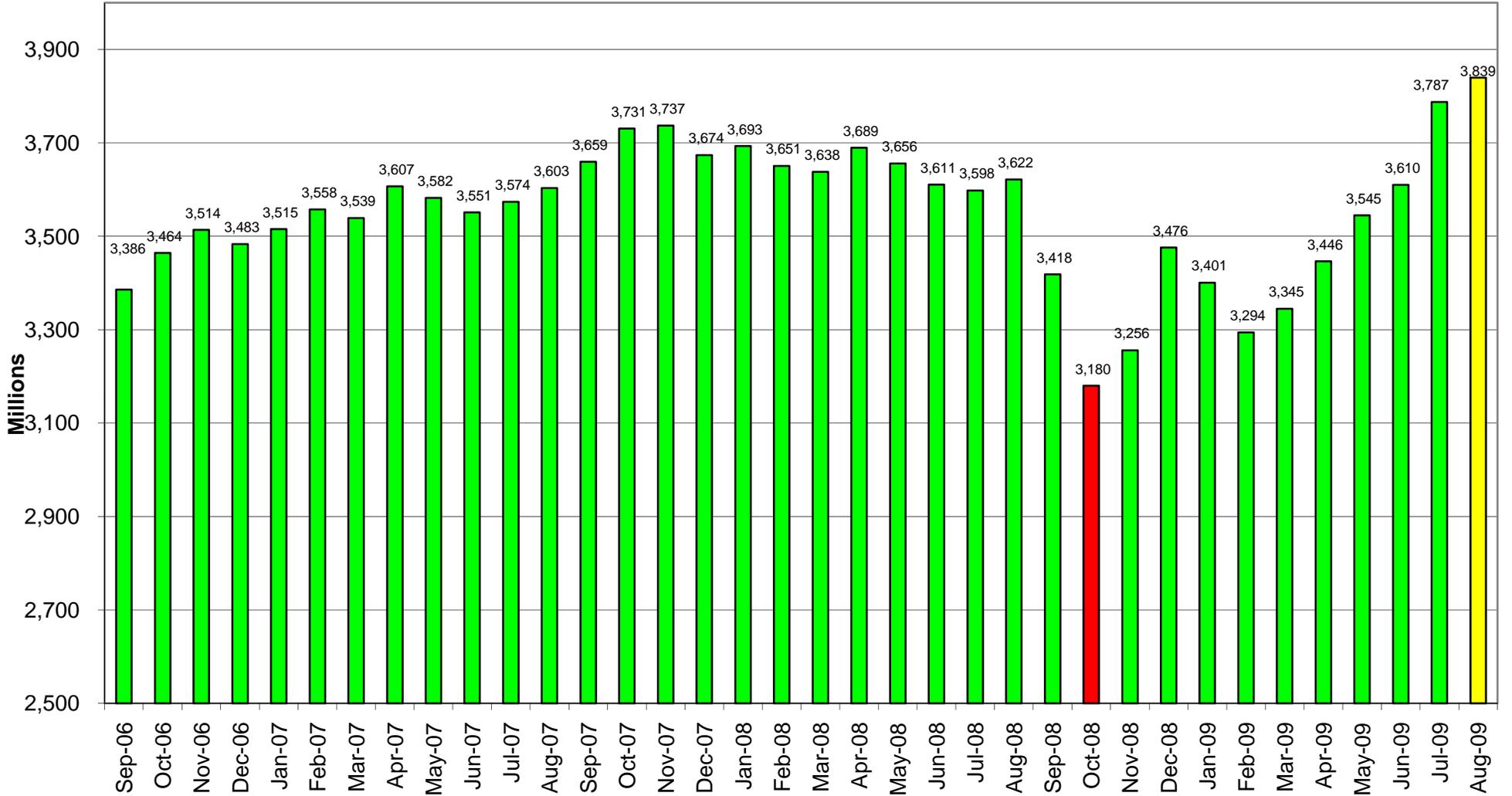
HIED Asset Allocation



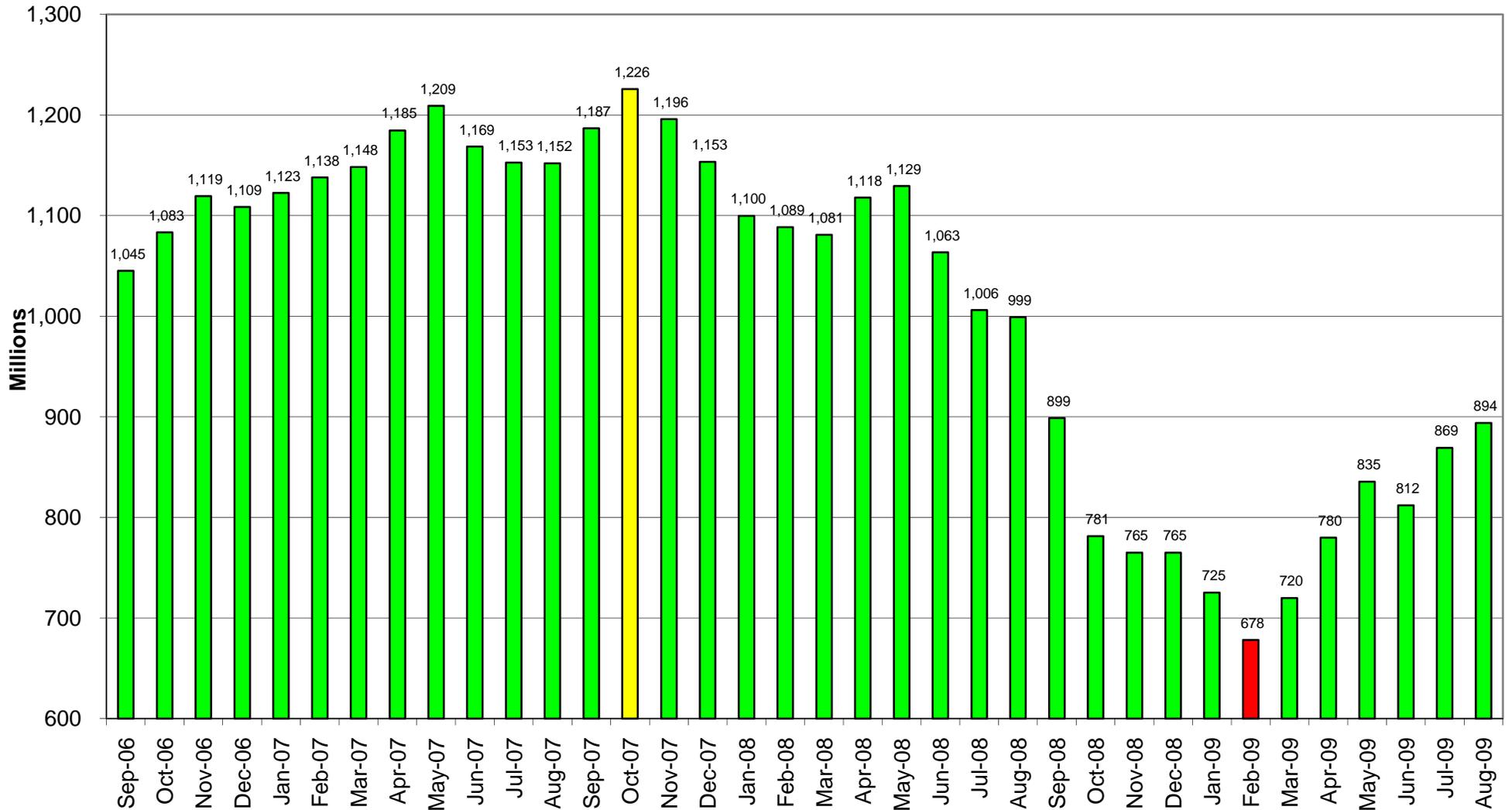
OPERF NAV
Three years ending August 2009
(\$ in Millions)



SAIF NAV
Three years ending August 2009
(\$ in Millions)



CSF NAV
Three years ending August 2009
(\$ in Millions)



TAB 6 – CALENDAR – FUTURE AGENDA ITEMS

2009 OIC Forward Agenda Topics

October 27: Opportunity Portfolio Annual Review
Fixed Income Structure
CEM Annual Review
CSF Annual Review

December 2: HIED Annual Review
SAIF Asset/Liability Recommendations
OPERF 3rd Quarter Performance Review

Jan/Feb 2010: Asset Liability Study
Election of Officers
OPERF Private Equity Annual Plan
Public Equity Review