

NEW MEXICO EDUCATIONAL RETIREMENT BOARD STATEMENT OF INVESTMENT POLICY

FOR HEDGE FUND INVESTMENT VEHICLES – EXTERNALLY MANAGED

August 26, 2007

I. PURPOSE

This document sets forth the investment policy (“the Policy”) for Hedge Fund Investments and Investment Advisors. The design of this Policy ensures that investors, managers, consultants, or other participants selected by the New Mexico State Educational Retirement Board (“NMERB”) take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the global capital markets.

II. STRATEGIC OBJECTIVE

The strategic objective of investments in Hedge Funds is broadening the opportunity set of the NMERB investment portfolio, and generally providing for reasonably stable returns that are uncorrelated with other asset classes, especially in a rising rate environment. Hedge Fund Investment Services are offered in a limited partnership or limited liability company (LLC) form. Hedge Funds may include, but are not limited to, relative value funds, market neutral strategies, arbitrage funds, or long/short equity funds. Hedge Fund Investment Advisory Services shall be selected to accomplish the following:

- A. Enhance the NMERB long-term total return.
- B. Provide diversification to the NMERB overall investment program.
- C. Consider solely the interest of the NMERB beneficiaries in accordance with New Mexico State Law.

III. RESPONSIBILITIES AND DELEGATIONS

- A. The **New Mexico Educational Retirement Board** (“the Board”) is responsible for approving and amending this Policy. The Board delegates the responsibility for administering Hedge Fund Investment Advisory Services to the NMERB Investment Staff.
- B. The **System’s Investment Staff’s** (“the Staff”) duties include, but are not limited to, the following responsibilities:
 - 1. Developing and recommending this Policy to the Board.
 - 2. Implementing and adhering to this Policy.
 - 3. Evaluating hedge fund investment opportunities and recommending actions for new investments to the Board.
 - 4. Monitoring selected Investment Partner(s) to determine if the partners’ actions and investment results are consistent with the NMERB manager monitoring policies. Monitoring may be accomplished through the NMERB

General Consultant or a Hedge Fund Strategic Partner(s) or Staff.

5. Reporting to the Investment Committee concerns, problems, material changes, and all violations of Guidelines and Policies immediately and in writing, along with explanations and appropriate recommendations for corrective action.

C. The **General Partner(s)** is responsible for all aspects of portfolio management as set forth in the investment partner's contract with the NMERB and shall fulfill the following duties:

1. Communicate with Staff, as needed regarding investment strategy and investment results. The investment advisor(s) is expected to monitor, analyze, and evaluate performance relative to the agreed-upon benchmark.
2. Cooperate fully with the NMERB Staff, Custodian, and Investment Consultant or Hedge Fund Strategic Partner(s) on requests for information.
3. Comply completely with the NMERB mandated reporting requirements, including but not limited to, accounting for fees, expenses, capital investments, and dispositions.

D. The **Investment Consultant or Hedge Fund Investment Advisor(s)** shall conduct the initial screening of investments, perform due diligence and evaluate hedge funds as directed by the Staff, prepare independent recommendations regarding partnerships for the staff and Board and monitor and evaluate performance relative to individual benchmarks and this Policy, in accordance with its contract with the NMERB.

IV. **PERFORMANCE OBJECTIVE**

Hedge Funds are highly specialized investments; therefore, the NMERB shall establish performance objectives for each individual Hedge Investment vehicle. These objectives shall be set at levels that are consistent with the strategy employed by the hedge fund.

V. **INVESTMENT APPROACHES AND PARAMETERS**

A. **Approach**

1. Hedge Fund Investments may include exposure to leverage or short selling of securities or both. Funds for investment in Hedge Funds may come from the active or passive management allocation in each asset category. The Hedge Fund allocation may range from 0-percent to 8-percent of ERB Fund on a market value basis.
2. The negotiation of terms in Hedge Funds shall protect the interests of the NMERB, and shall address at a minimum the following issues:
 - a. Alignment of Interests: Vehicle terms including fees shall be negotiated to ensure the alignment of the General Partner's interest with the NMERB. The management fee, carried interest, performance objective, return of capital, lock-up period, clawbacks, and other relevant terms shall protect the NMERB in the event of adverse performance results, while ensuring that the limited liability status is maintained. Where appropriate, a return of capital commitments shall be negotiated.

- b. Leverage: It is recognized that Hedge Funds may expose the Board's assets to leverage, meaning that a partnership's market exposure may exceed the market value-adjusted capital commitment by the amount of borrowed capital.
 - c. Reporting Requirements: To appropriately account for fees, individual expenses, invested capital, and any other items affecting the investment, Staff shall prescribe a standard reporting format, which all the General Partners shall follow.
 3. The Staff and consultant shall continually review the efficacy of Hedge Fund investment vehicles. The Staff shall present a formal review of the approach to the NMERB at least every three years.

B. Investment Selection

1. Hedge Fund Investment Advisors may be selected if they enhance the overall investment program and may include investments in domestic and international equity and fixed income asset classes in strategies allowable under New Mexico statute and may include, but are not limited to, the following areas:
 - a. Relative Value Funds
 - b. Market Neutral Funds
 - c. Arbitrage Funds
 - d. Long/Short Equity Funds
2. The Staff shall develop and maintain selection guidelines for Hedge Fund Investment Advisors to include the following:
 - a. Minimum requirements with respect to the following:
 - (1) General Partner Investment Experience-Firm and specific strategy must have at least a three year track record
 - (2) Basic Investment Vehicle Terms, including the management of at least \$300 Million
 - (3) Investment Goals and Objectives
 - (4) Degree of Leverage
 - b. Performance Criteria
 - c. Due Diligence Process
 - d. Legal Constraints or Requirements, including registration of the hedge fund investment advisor under the Investment Company Act of 1940.
 - f. Reporting Requirements, including the reporting of holdings and transactions to a third party risk aggregator or consultant, reviewable by staff and the consultant.
 - g. Quality control processes including, but not limited to, investment monitoring and risk control
 - h. Other relevant parameters that may apply

VI. BENCHMARKS

Due to the wide range of markets in which these investments shall be made, appropriate benchmarks shall be established for each specific hedge fund investment vehicle. They shall reflect the investment opportunity set or risk profile of each investment. These

benchmarks shall be established prior to investment and shall be documented with each hedge fund manager.

VII. PERFORMANCE REPORTING

Due to the wide range in the ability of GPs to report timely investment performance figures, staff may elect to report investment performance on a one month delay.

VIII. GENERAL

- A. This Policy contains a glossary of terms in Section VIII of this document
- B. Investors, managers, consultants, or other participants selected by the NMERB shall make all calculations and computations on a fair-market-value basis as recorded by the System's Custodian. In the case of private investments, calculations and computations shall be made consistent with the partnership agreement, unless otherwise approved by the Board.

IXI. Contract Execution.

After legal review of all appropriate documents the following will have contract execution authority for said documents: Chief Investment Officer, Executive Director and Deputy Executive Director.