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TITLE 2 PUBLIC FINANCE
CHAPTER 60 INVESTMENT AND DEPOSIT OF PUBLIC FUNDS
PART 20 VENTURE CAPITAL INVESTMENT ADVISORY COMMITTEE POLICIES AND PROCEDURES MANUAL

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[Recompiled 10/01/01]

2.60.20.8 THE NATIONAL VENTURE CAPITAL INVESTMENT PROGRAM (VCIP):
A. PROGRAM STRUCTURE:
(1) The national venture capital investment program of the state of New Mexico's severance tax permanent fund (STPF, or fund) is intended to produce significant capital gains to the fund corpus and additional diversification for the fund's assets. The venture capital investment program is managed by the New Mexico state investment council (SIC, or council) with the advice of the venture capital investment advisory committee (VCIAC, or committee) and a fiduciary advisor. Currently, the advisor is brinson partners inc. (BPI, or the advisor). The STPF is a permanent trust fund, and all market-rate fund investments are subject to the prudent man rule. Since the council is also required to retain investment discretion over all fund assets, the advisor has been retained on a non-discretionary basis to advise the committee and council on venture capital investments. Historically, the average returns on well structured venture capital investment programs have been 6 percent to 10 percent above that achievable in the traditional U.S. equities market.
(2) The venture capital asset class entails a high degree of risk, which must be managed very carefully to avoid significant losses. Based on historical data, even the most experienced and successful venture capitalists expect that 30 percent of their direct investment portfolio companies will fail. This fact necessitates prudent selection and proper diversification of venture capital fund investments.
(3) Venture capital has been accepted as a prudent asset class for investment both by the financial markets and by the federal government. Most institutional investors limit their exposure to venture capital to between 2 percent and 5 percent of their total portfolios. Subsection A of 7-27-5.6 NMSA 1978, as amended during the 1990 legislative session, specifies that the total investment in the VCIP may not exceed one and one-half percent of the book value of the STPF.
B. DIVERSIFICATION:
(1) Due to the riskiness of venture capital investments, prudent diversification is necessary to minimize risk and maximize return. The VCIP initially committed to invest in a minimum of fifteen venture partnerships (from $1.0 million to $2.0 million each) over a three year period beginning in late 1988. Since each partnership will in turn invest in 25 to 30 portfolio companies, the STPF should have approximately 400 small, rapidly-growing, potentially high yielding investments underlying its venture capital portfolio from these initial

phase fund investments. While many of these companies will fail, historical experience indicates that many of the successful companies will generate significant multiples on their original investments, and will provide very attractive returns for the overall portfolio.

(2) The VCIP portfolio will be diversified with respect to time, geography, industry, and stage focus. Of these four variables, time diversification is the most important. The venture capital industry goes through cycles much like all the other investment asset classes. Given the illiquid nature of venture capital investments, attempting to "time the market" is not a realistic alternative. Most sophisticated investors average into the market with new commitments on a steady, annual basis. This insures that the investment of the majority of their funds does not occur at a time when private company valuations are high, when existing technologies are about to be superseded, or when specific industries are in favor. Additionally, adequate time diversification insures that six to seven years from the investment period, an investor is not vulnerable to a depressed stock market when the majority of the portfolio investments might be ready to go public.

(3) The initial commitment process to venture capital partnerships for the severance tax permanent fund required three years to complete (late 1988 - late 1991). Since the fifteen partnerships selected during this time period will take an additional three to five years to make all of their investments, the STPF venture capital investment program has committed to investments that will be made over about five to eight years, providing substantial time diversification. In late 1992, (four years from the initial commitments), distributions to the SIC from these venture capital fund investments have become significant. These increasing distributions, and the growth of the STPF, should allow investing in two to four new partnerships annually on a continuing basis, which will further enhance time diversification. To provide adequate diversification in geography, stage, and industry, the VCIAC and the advisor have recommended the following weightings for the overall VCIP portfolio:

(4) SEVERANCE TAX PERMANENT FUND PARTNERSHIP GUIDELINES, revised December 1992.

(a) Geography:
- (i) Northeast......25-30 percent
- (ii) Southeast.......05-10 percent
- (iii) West Coast......35-40 percent
- (iv) Midwest..........10-15 percent
- (v) Southwest.......15-20 percent

(b) Stage:
- (i) Seed Startup....10-25 percent
- (ii) Growth...........45-60 percent
- (iii) Late...............20-35 percent

(c) Industry:
- (i) Diversified.......85-95 percent
- (ii) Specialized.......05-15 percent

(d) Notes:

(i) It is important to note that these are only general guidelines, and deviations from these guidelines should be expected as market conditions warrant. Deviations must be expected in order to select the best venture capital funds when they are in the market. The best indicator of risk and return is the performance of general partnership teams on prior funds.

(ii) Since the SIC began investing in venture capital in late 1988, the venture capital industry has evolved. The geographical concentrations of venture capital have not changed significantly, but the stage and industry focuses have. More funds are moving to later stage investing, and fewer funds are specializing on one specific industry. The weightings above have been amended to reflect these evolutionary changes. In sum, the venture capital industry is continually changing its focuses in order to reduce risk and enhance returns.

(iii) Many of the guidelines above have wide ranges to allow taking advantage of opportunities that may occur within New Mexico. The most significant example of this is the seed/startup stage category.

(5) The geographic guidelines above reflect where significant venture capital opportunities currently occur on a national basis. Industry results indicate that restricting the investing focus to one particular geographic area reduces the return. With the exception of California, funds that focus entirely on one state have typically not done well. A 15 percent to 20 percent focus on the Southwest may seem small, but in fact is an overweighting in the region. Over the last several years, only 10 percent of the dollars invested nationally have gone into the southwest, which includes Arkansas, Arizona, Colorado, Louisiana, New Mexico, Nevada, Oklahoma, Texas and

Utah. This overweighting in the southwest region is a conscious decision on the committee's part to encourage venture capital investment in New Mexico.

(6) Subsection D of 7-27-5.6 NMSA 1978 states, "In making investments pursuant to this section, the council shall give consideration to investments in venture capital funds whose investments enhance the economic development objectives of the state, provided such investments offer a rate of return and safety comparable to other venture capital investments currently available." New Mexico is fortunate to have many scientific, technical and academic resources. The VCIAC has tasked the advisor to review for investment every venture capital organization with interests in New Mexico that applies under the VCIP, and to not reject any such funds without first consulting with the committee and SIC staff. The VCIAC and the advisor will maintain open minds regarding all opportunities in New Mexico, and will identify partnerships that have the early stage, seed, and startup skills that are needed to succeed in the state without compromising expected return.

(7) The committee and the advisor do not advocate the use of venture capital investment programs solely for economic development purposes, since historical data indicate that venture capital programs focused on economic development have done poorly, and in many cases, have been notable failures. The committee and the advisor will, however, be sensitive to the needs of the state of New Mexico in this area. One criterion used in selecting the advisor was the extensive data base it maintains on groups outside the state with significantly successful investment track records to use in evaluating all proposed investments for the VCIP. This will insure that any New Mexico related fund selected by the committee and council for investment will have a high probability of succeeding in the high risk venture capital environment.

(8) In another effort to increase the probability of attracting venture capital to the state, the VCIAC and the advisor have recommended a mild overweighting with respect to stage focus on the seed and startup category. Typically, only 5 percent to 10 percent of the money raised by venture partnerships goes into this category due to its high risk.

(9) The majority of the selected partnerships will have an opportunistic or diversified industry focus, since this approach has historically been the most successful. However, with the continually increasing technological sophistication in today's more competitive business environment, some specialized funds focusing on specific industries may make sense. Industries of particular interest are biotechnology, telecommunications, military and defense, health care, advanced materials, and specialty retailing. The advisor's data base tracks numerous funds that have been successful in each of these industries, and the committee will use this information to select individual specialized funds with high probabilities for success.

(10) In summary, the VCIAC and the advisor believe that these diversification guidelines will provide the maximum return and safety of principal that are required by both Section 7-27-5.6 NMSA 1978 and the prudent man rule.

C. PARTNERSHIP SELECTION CRITERIA:

(1) The committee seeks to prudently invest in individual partnerships with at least the following characteristics:

(a) partners that have significant venture capital experience;

(b) partners that are well known to each other and have worked together as partners;

(c) partners that have demonstrated successful investment performance records;

(d) partners that have appropriate experience for the proposed industry focus of the fund;

(e) partners that have appropriate experience for the proposed stage focus of the fund;

(f) partners that are raising a fund that has a size consistent with their investment strategy and human resources capabilities;

(g) partners that have the abilities to source many of their own deals;

(h) partners that have the time, experience and interpersonal skills to work effectively with their portfolio companies;

(i) partnerships in which the compensation plan for the general partners is fair, creates the proper incentives, and rewards the general partners for superior long-term performance;

(j) partnerships that have as their primary business activity the investment of funds in return for equity in businesses for the purpose of providing capital for start-up, expansion, new product development, or similar business purposes;

(k) partnerships that hold out the prospects for capital appreciation from such investments comparable to similar investments made by other professionally managed venture capital funds;

(l) partnerships with a minimum committed capital of $5,000,000;

(m) partnerships that accept investments only from accredited investors as that term is defined in Section 2 of the Federal Securities Act of 1933, as amended, (15 U.S.C. Section 77(b)) and rules and regulations promulgated pursuant to that section;

(n) partnerships that have full-time management with at least five years of experience in managing venture capital funds; and

(o) partnerships that receive at least 40 percent of the fund's capital from institutional investors.

(2) Many institutional investors seek only to invest in the oldest, most well-known partnerships. While this may be effective, the advisor has indicated several concerns with this strategy if it is used as the sole approach. First, the individual general partners who are responsible for the track record may be retiring or spending less than full time with the partnership. Second, the large size of the new funds may make duplicating the earlier track record unlikely. Third, the growth in management fees may have tempered the general partners' desire to work hard to generate capital gains. Fourth, the growth in the general partners' organization and staff may cause communication and investment decisions to be less consistent and less thorough than that experienced on earlier partnerships. Finally, the wealth the general partners have derived from their previous investment successes may dampen their enthusiasm to work as diligently on the new partnerships.

(3) The advisor has recommended that the committee consider younger venture organizations where the general partners have the right combination of venture capital experience and youthful (mid 30's to mid 40's) drive and ambition, which will often produce the best venture capital performance. The committee and advisor will therefore select fewer well-known megafunds (where the above mentioned problems may be significant) and more smaller-sized ($40MM-$80MM) funds with experienced and still aggressive general partners.

(4) The committee and advisor will follow a balanced approach in selecting partnerships. It is expected that the severance tax permanent fund portfolio will ultimately contain some "first time" funds as well as some large, well-known funds. The key ingredient throughout the selection process will be the backing of experienced people. All "first time" fund investments will be based on excellent managers with significant venture capital experience. It should be emphasized again that the only significant data that may be evaluated to indicate the probability of success on any proposed fund investment is the performance of the general partners on previous funds. It is thus no accident that the criteria listed above focus almost totally on the general partners, their experience and their proposed strategies, and compare these factors to the previous funds managed by the same general partners and the strategies that were successful on those funds. The only collateral on venture capital investments is the general partners themselves.

(5) Paragraph (2)of Subsection F of 7-27-5.6. NMSA 1978 provides the applicable definition of a venture capital fund for the venture capital investment program. For the purpose of defining "five years of experience in managing venture capital funds" the VCIAC and the advisor will include prior experience in other venture capital fund organizations.

D. INVESTMENT DECISION PROCESS:

(1) The investment decision process will begin with a thorough review and analysis of each proposal by the advisor. Those proposals recommended by the advisor for investment, and/or those related to New Mexico, will be forwarded to the committee to evaluate. Those proposals recommended by the committee for investment will be presented to the council for approval. The council may then authorize the state investment officer to make specific investments.

(2) The first eight steps in the evaluation process below are internal procedures followed by the advisor's staff. These steps are presented below in order to fully describe the thorough and prudent process required to select any venture capital fund proposal for investment. While the SIC staff may be advised of proposals currently under consideration by the advisor and informed of progress on specific proposals, active involvement by the SIC staff and the VCIAC will not begin until step 9 below [now Subparagraph (i) of Paragraph 5 of Subsection D of 2.60.20.8 NMAC].

(3) The advisor's venture division is organized in a manner that will facilitate efficient and informed investment decisions. Several individuals currently share the primary responsibility for handling partnership investment opportunities. Although these specific individuals shepherd each partnership through the decision process, all of the professionals in the division are actively involved in each investment decision.

(4) The advisor will keep the council's venture capital portfolio manager (VCPM) fully informed during the following process, particularly during steps1 through 8 [now Subparagraphs (a) through (h) of Paragraph 5 of Subsection D of 2.60.20.8 NMAC], and especially on those proposals that are related to New Mexico. The actual procedure used will be as follows:

(5) ADVISOR'S INTERNAL INVESTMENT DECISION PROCESS:

(a) The advisor receives/solicits an offering/investment proposal from a partnership raising money. Should the state investment council receive any proposals directly, they will be forwarded to the advisor for the initial review.

(b) The advisor's professionals will review the proposal. Careful attention is paid to each opportunity, particularly groups organized, operating, or focusing in New Mexico.

(c) Should the decision be to not recommend investment, a letter will be sent or a phone call made to inform the partnership of the decision. If the opportunity is one which was referred by the committee or council, or one which is related to the state of New Mexico, the advisor will discuss the decision with the state investment officer and the VCPM prior to any notification of the partnership; if the opportunity merits further evaluation, rigorous due diligence is performed. Reference checks are made, the track record is analyzed, and meetings are held with the general partners. Numerous internal discussions are held and issues are raised and addressed.

(d) The advisor's venture division reaches a consensus on whether to pursue the investment further or to reject it. If the decision is negative at this point, the notification procedures in paragraph 3 [now subparagraph (c)] above will be followed.

(e) If the decision is to continue, an Investment memorandum is written by the advisor's venture partnership investment professionals. This memo summarizes the opportunity and the factors leading to the decision to pursue the investment.

(f) The investment memorandum is sent to the advisor's venture capital subcommittee (not related to the VCIAC). The subcommittee is comprised of the advisor's chief investment officer, all of the advisor's venture investment professionals, and senior management from the advisor's legal, equity, and account management divisions.

(g) If a majority (which must include the chief investment officer) of the advisor's subcommittee approves the investment, a commitment is made to the partnership. The advisor will then notify the VCPM of the amount that will be recommended to the committee for investment under the VCIP. All recommendations are still subject to successful negotiation of the partnership documents.

(h) At this point, a copy of the investment memorandum, as well as the offering/investment proposal will be mailed to the VCPM. The time frame in which an investment decision is needed will be indicated in the cover letter, as well as in a follow-up phone call.

(i) When the advisor's investment memorandum and the fund offering / investment proposal are received by the VCPM, the SIC staff will decide, based on the time available until an investment decision is required, whether to schedule consideration by the committee and the SIC by:

(i) including the proposal for consideration at the next regularly scheduled VCIAC and SIC meetings if this procedure will produce a timely investment decision; or by

(ii) distributing the materials to the VCIAC members by regular or express mail as necessary, and scheduling a special committee meeting. In either case, if the committee's recommendation is favorable and time then permits, the proposal will be included on the agenda for the next regularly scheduled SIC meeting (normally the last Wednesday of each month). If an investment decision is required prior to the next regularly scheduled council meeting, the state investment officer will make a decision, based on the committee's evaluation of the relative attractiveness of the proposal, on whether to request a special meeting of the SIC in order to meet the decision deadline, or to notify the advisor that the proposal will be held until the next regular SIC meeting and that additional time is required to reach a decision. If the necessary additional time is not available, the proposal will not be considered further, and the advisor will be notified of a negative decision. Special meetings of the SIC may be called upon a minimum of 72 hours notice.

(j) If a negative investment decision is reached at any point during the VCIAC/SIC consideration process, the advisor will be immediately notified by telephone. If the outcome is a favorable decision, the advisor will be notified of the approval and the amount of the SIC commitment; and

(k) After the council reaches a decision and the advisor has been notified, the advisor will then be responsible for notifying the partnership of the decision and the firm commitment amount, if any, pending agreement on document terms.

E. PARTNERSHIP DOCUMENTATION PROCEDURES:

(1) Each venture capital limited partnership is created and governed by a partnership agreement. Each partnership agreement covers and defines all relevant terms for the affected partnership, including fees, distribution policies, purposes of the partnership, limited partners' rights and duties, and a myriad of other matters.

(2) The advisor will begin reviewing the major terms of the partnership early in the decision process. Review of the actual documents begins after an investment decision has been made. The advisor will act as the council's agent in assuring that the partnership documents are complete and meet all of the SIC's legal requirements. The process for review of the legal documents is as follows:

(a) the partnership legal agreement is received by the advisor;

(b) a copy of the agreement, as well as any other documentation (e.g. management agreement, subscription agreement, side letters), are sent to the advisor's legal counsel;

(c) both the advisor's legal counsel and venture partnership investment professionals will review the documents;

(d) the advisor will negotiate the most favorable terms possible with the partnership;

(e) after final documents are drafted by the partnership's counsel and approved by the advisor, the initial closing will occur;

(f) the advisor's legal counsel or the applicable general partners' legal representative, as appropriate, will include a cover letter on all partnership agreement documents sent to the SIC stating that the agreement conforms to Section 7-27-5.6 NMSA 1978 as well as to prudent management and normal business practices prevailing in the venture capital industry. This will allow execution of the documents without further review by the New Mexico attorney general's office or by any other state agencies. If there are unknown factors at the time the cover letter is issued, they will be clearly stated; and

(g) each partnership will provide a side letter indicating their views on investing in New Mexico and on assisting the venture capital industry in the state when opportunities occur and/or if so requested by the SIC staff.

F. CLOSING PROCEDURES:

(1) After a commitment has been made and acceptable documents are submitted by the partnership, the first closing will occur. A closing requires execution of the necessary partnership documents and, usually, a transfer of funds. All appropriate documents (and any subsequent amendments) will be sent by the advisor to the VCPM f or execution. The advisor's legal counsel or the applicable general partners' legal representative, as appropriate, will include a cover letter as described under Partnership document procedures [now Subsection E of 2.60.20 NMAC] above. The SIC will execute the partnership documents, and provide wiring instructions and all other information necessary for the STPF's fiscal agent bank to deliver the amount of the initial drawdown if /as required. After the closing, all executed documents will be sent to the VCPM for review and transmittal to safekeeping.

(2) The advisor will notify the VCPM of all subsequent drawdowns and provide wiring instructions a minimum of five business days prior to each drawdown date. Using the procedures described above, the SIC will instruct the fiscal agent bank to wire funds to the partnership in accordance with the STPF's investment obligation.

G. DISTRIBUTION MANAGEMENT PROCEDURES:

(1) The successful outcome of a venture capital investment program will be the distribution of cash and securities to the limited partners. The advisor will be responsible for returning, or directing the return of, all distributions, both cash and securities, to the STPF. As the partnership interests mature and distributions, or notices of distributions, are received, the advisor will notify the VCPM and the STPF's fiscal agent bank. For cash distributions, the advisor will insure that the proceeds are delivered directly by wire or check to the fiscal agent bank. The advisor will provide information as to the components of the cash distributions (i.e., return of principal, realized gains, and interest/dividend income). Securities will be delivered directly to the STPF's custodian bank. In some cases, partnerships will manage distributions through brokerage firms. In those cases, arrangements will be made by the advisor to transfer custody of the securities to the custodian bank. The advisor will contact the VCPM as necessary to obtain current delivery instructions.

(2) When stock distributions are received, the advisor's post-venture public stock managers will analyze the public companies and determine the optimal time to sell the stock. The advisor will advise the VCPM of the hold/sell recommendations, and act only as authorized by the VCPM. If stock under the advisor's control is sold, sales proceeds will be delivered to the fiscal agent bank as directed by the VCPM.

(3) Stocks distributed by venture capital partnerships may be restricted under the SEC's Rule 144 or under an underwriting lockup provision. The council will rely on the advisor, who has had significant experience in dealing with these issues and has personnel on its staff dedicated to the evaluation of these securities, to advise the SIC on the most prudent disposition in each case.

H. MONITORING PROCEDURES: The advisor will be responsible for monitoring the activities of all venture capital partnerships in the SIC portfolio. Specifically, the advisor will:

(1) attend annual meetings. As notices of meetings are received, the advisor will notify the VCPM in writing. The VCPM or other SIC representative(s) will attend these meetings when possible;

(2) review all amendments to the partnership agreements and forward to the SIC with recommendations for approval or disapproval;

(3) evaluate all partnership activities for compliance with partnership documents;

(4) serve on advisory boards on behalf of the council as appropriate;

(5) consolidate the partnership reports into uniform statements on a quarterly basis;

(6) measure and evaluate partnership return data;

(7) evaluate and manage the distributions of public stocks; and

(8) conduct periodic meetings with the general partners on an individual basis.

I. REPORTING PROCEDURES: The advisor's portfolio status and performance reports will be provided to the council staff on a quarterly basis. These reports will be sent within six weeks following each calendar quarter end. Verbal reports of valuations only are available on the fifth business day following the quarter end. The advisor's reports will be compiled from data in the quarterly statements received from the individual partnerships, which normally are received by the advisor from one to three months following the end of each partnership's fiscal quarter (which may also vary). Due to these delays, the performance reports received by the council staff will be dated four to five months following the end of the period the data covers. Since venture capital valuations are very imprecise and uncertain, this delay is not considered significant. These reports will summarize the status of the portfolio and each individual partnership with respect to total commitment, drawdowns, cost, valuations, distributions, total value and internal rate of return. A separate performance page will illustrate the returns of the partnerships listed in chronological order to provide a better perspective on the returns. The following regularly updated facts will then be reported for each partnership: client capital account information, ownership percentage, internal rate of return, a summary of terms, the names of the general partners, a listing of all investments (including those written off), and a distribution table. All return information will be calculated on a quarterly basis by the advisor. The returns are based on cash on cash [sic] plus adjusted residual value to the limited partner. This requires an accurate record of all distributions, a review of the portfolio company valuations for accuracy, an adjustment for the net unrealized gains on the general partners' carry, and an update on the public stocks, if any, for the quarter end value less appropriate discounts for trading (i.e. Rule 144) restrictions.
[Recompiled 10/01/01]

2.60.20.9 NEW MEXICO VENTURE CAPITAL INVESTMENT PROGRAM (NMVCIP):

A. INTRODUCTION:

(1) The 1990 New Mexico legislature passed an amendment (House Bill 140) to the original 1987 venture capital statute which created a New Mexico-oriented venture capital program, and authorized up to one-half percent of the severance tax permanent fund for potential investment in New Mexico based venture capital funds. This amended statute is contained in Section 7-27-5.15 NMSA 1978.

(2) This new program is the New Mexico venture capital investment program (NMVCIP) of the STPF, and is a differential rate program which was intended by the legislature to encourage development of a venture capital industry within the state. The NMVCIP has several provisions that differ from the original 1987 program (the venture capital investment program, or VCIP) contained in Section 7-27-5.6 NMSA 1978 and implemented by Section I [now 2.60.20.8 NMAC] of this Manual. These amended provisions are listed below under New Mexico venture capital fund requirements. The policies and procedures contained in Section I [now 2.60.20.8 NMAC] will also apply to NMVCIP investments except where changed in Section II [now 2.60.20.9 NMAC]. The NMVCIP investments are required to be prudent investments and are subject to the exercise of good business judgement by the VCIAC and state investment council. The sub-sections listed below will correspond by title to those in Section I [now 2.60.20.8 NMAC] and contain any changes applicable to the NMVCIP.

(3) It should be noted that a New Mexico venture capital fund could apply for investment consideration under either the VCIP or the NMVCIP.

B. NEW MEXICO VENTURE CAPITAL FUND REQUIREMENTS:

(1) New Mexico venture capital funds which wish to qualify under Section 7-27-5.15 NMSA 1978 must meet certain statutory requirements. Specifically, each New Mexico venture capital fund must be a limited partnership or corporation organized and operating in the United States and maintaining its principal active office in New Mexico that:

(a) has as its primary business activity the investment of funds in return for equity in businesses for the purpose of providing capital for start-up, expansion, new product development or similar business purposes;

(b) holds out the prospects for capital appreciation from such investments;

(c) has a minimum committed capital of $1,250,000;

(d) has full-time management with at least three years of professional experience in assessing the growth prospects of businesses or evaluating business plans, and who has established permanent residency in the state;

(e) is committed to investing in New Mexico one hundred percent of the investment made by the state investment officer pursuant to this section in businesses with a principal place of business in the state and holds promise for attracting additional capital from individual or institutional investors nationwide to businesses in the state;

(f) accepts investments only from accredited investors as that term is defined in Section 2 of the Federal Securities Act of 1933, as amended, (15 U.S.C. Section 77(b)) and rules and regulations promulgated pursuant to that section; and

(g) receives at least forty percent of the fund's capital from institutional investors other than the state of New Mexico, which includes pension funds, insurance companies, corporations, trust funds, foundations, venture capital funds and financial institutions.

(2) If an investment is made under this section, not less than $500,000 or more than $3,000,000 may be invested in any one New Mexico venture capital fund, and such investment shall not exceed forty percent of the committed capital of that fund. Investments shall be made only in the initial offering of a New Mexico venture capital fund, provided that any investment may be made in one or more increments. The state investment officer is authorized to make investments pursuant to this section contingent upon a New Mexico venture capital fund securing paid-in investments from other accredited investors for the balance of the minimum committed capital of the fund.

(3) In making investments pursuant to this section, the council shall give consideration to investments in New Mexico venture capital funds whose investments enhance the economic development objectives of the state.

C. PROGRAM STRUCTURE: Total investment in the New Mexico venture capital investment program is limited to one-half percent of the book value of the STPF by Section 7-27-5.15.

D. DIVERSIFICATION: The general comments on diversification in Section I., Paragraph B. [now Subsection B of 2.60.20.8 NMAC] are also applicable to the New Mexico venture capital investment program. Proper diversification is the most basic and essential requirement of any prudent investment program, and in order to control risk adequately in the venture capital investment class (the riskiest of all major investment classes), the NMVCIP will be considered as one element in the overall VCIP for diversification purposes. Since some diversification parameters such as geography will be necessarily restricted by the in-state requirements of the NMVCIP, the remaining diversification parameters will become much more critical.

E. PARTNERSHIP GUIDELINES: The NMVCIP is restricted to funds that maintain their principal active office in New Mexico. In addition, each New Mexico fund selected under the NMVCIP for investment will be required to certify in the partnership documents that it will maintain its principal active office in the state for the life of the partnership.

F. PARTNERSHIP SELECTION CRITERIA:

(1) In addition to the basic statutory requirements listed under New Mexico venture capital fund requirements [now Subsection B of 2.60.2.9 NMAC] above, the committee seeks to prudently invest in New Mexico partnerships with at least the following characteristics:

(a) partners that have significant venture capital experience;

(b) partners that are well known to each other and have worked together as partners;

(c) partners that have demonstrated successful investment performance records;

(d) partners that have appropriate experience for the proposed industry focus of the fund;

(e) partners that have appropriate experience for the proposed stage focus of the fund;

(f) partners that are raising a fund that has a size consistent with their investment strategy and human resources capabilities;

(g) partners that have the ability to source many of their own deals;

(h) partners that have the time, experience and interpersonal skills to work effectively with their portfolio companies; and

(i) partnerships in which the compensation plan for the general partners is fair, creates the proper incentives, and rewards the general partners for superior long-term performance.

(2) The primary goal of the committee's selection process will be to identify and invest in people that have the necessary experience to succeed in the New Mexico venture capital environment. This effort will be highly critical for the NMVCIP, since most venture capital investment opportunities in New Mexico will probably occur in early stage (seed/startup) high technology companies. These highly specialized investments are the riskiest in the venture capital universe. The partnership criteria listed above define the basic standards of prudence used by the venture capital industry in evaluating venture capital fund investments. The same comments on the importance of selecting experienced and successful general partners expressed in Section I.C. above [now Subsection C of 2.60.20.8 NMAC] will apply to the NMVCIP, and will be even more critical in this New Mexico only program.

G. INVESTMENT DECISION PROCESS:

(1) The investment decision process will be essentially the same as that contained in Section I., Paragraph D. [now Subsection D of 2.60.20.8 NMAC]. The advisor will conduct a full evaluation on each New Mexico based fund applying for investment consideration under either the NMVCIP or the VCIP. The advisor will not reject any New Mexico funds without first consulting with the committee and investment office staff. The advisor will not be required to make any recommendations for or against investment on any New Mexico funds applying under the NMVCIP or the VCIP. A comprehensive evaluation report (investment memorandum) on each fund will be forwarded by the advisor to the VCPM when complete, and the fund proposal will be placed on the agenda for consideration by the committee at the next scheduled meeting. All New Mexico based funds will receive a complete hearing before the committee. The committee will make the investment decision using the advisor's investment memorandum as well as all other information available on each proposal.

(2) If a New Mexico based fund is recommended for investment by the committee and the investment is subsequently approved by the state investment council, the council, if so requested by that fund, may authorize the state investment officer to issue a contingent letter of commitment to that fund. The contingent letter of commitment will require that the fund obtain the balance of the required minimum committed capital prior to the commitment taking effect, and will contain a clause indicating that the council may cancel the contingent commitment at any time if there is any change in the circumstances that led to its issuance.

H. PARTNERSHIP DOCUMENTATION PROCEDURES: The advisor will process all NMVCIP partnership documents in exactly the same manner as outlined in Section I., Paragraph E [now Subsection E of 2.60.20.8 NMAC]. For NMVCIP proposals, the statutory reference will be Section 7-27-5.15 NMSA 1978.

I. CLOSING PROCEDURES: Closing procedures will be exactly as stated in Section I., Paragraph F [now Subsection F of 2.60.20.8 NMAC].

J. DISTRIBUTION MANAGEMENT PROCEDURES: Distribution management procedures will be exactly as stated in Section I., Paragraph G [now Subsection G of 2.60.20.8 NMAC].

K. MONITORING PROCEDURES: The advisor will be responsible for monitoring the activities of all NMVCIP partnerships in which investments are made in exactly the same manner as outlined in Section I., Paragraph H [now Subsection H of 2.60.20.8 NMAC].

L. REPORTING PROCEDURES: Reporting procedures will be exactly as stated in Section I., Paragraph I [now Subsection I of 2.60.20.8 NMAC].

M. CHANGES AND REVISIONS: This policy and procedures manual will be reviewed at least annually and revised as necessary.

[Recompiled 10/01/01]

HISTORY OF 2.60.20 NMAC:

Pre-NMAC History: The material in this Part was derived from that previously filed with the State Records Center and Archives:

SIC Rule 88-8, Venture Capital Investment Advisory Committee Policies and Procedures Manual, 12-22-88.
SIC Rule 90-1, Venture Capital Investment Advisory Committee Policies and Procedures Manual, 1-29-90.
SIC Rule 90-2, Venture Capital Investment Advisory Committee Policies and Procedures Manual, 12-10-90.
SIC Rule 92-2, Venture Capital Investment Advisory Committee Policies and Procedures Manual, 3-29-93.

History of Repealed Material: [RESERVED]