**Pension Fund Committee**

Meeting to be held on 6 September 2013

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| Electoral Division affected:  All |

**Private Equity Strategy**

(Appendix 'A' refers)

Contact for further information:

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| Executive Summary The Fund has a long standing private equity programme and as part of its programme of work to review the investment strategy in relation to each asset class the Investment Panel has reviewed the Fund's strategy in relation to private equity, which encompasses a wide range of investments from start ups and venture capital to large scale buy outs.    The report at Appendix 'A' reviews the private equity portfolio, the current strategy and proposes a new private equity strategy, including authorisations required for its implementation. Recommendation The Committee is asked to approve the new private equity strategy and the authorisations required to implement it. |

**Background and Advice**

Appendix 'A' is a review of the private equity (PE) strategy, highlighting the nature of its investments, the portfolio's construction and risk management. A new strategy is proposed, which the Investment Panel believes will enhance returns without taking materially greater risk.

Key characteristics of the current private equity portfolio and strategy include:

1. The portfolio is highly diversified, possibly overly diversified;
2. The portfolio has allocated to some products that require less active involvement from the pension fund, but which are more expensive;
3. The portfolio has some allocation to strategies that have historically been more volatile than others, without sufficient compensation for this risk;
4. The portfolio has re-invested a majority of capital with the same fund managers;
5. The fund has committed unevenly on an annual basis;
6. The nature of the relationship between the pension fund and its external fund manager has been passive.

The recommendation for a new private equity strategy requires the following approvals:

1. Confirmation of the PE allocation at 7.5% Net Asset Value (NAV) (not commitments) as a percentage of the pension fund;
2. Formally target PE net Internal Rate of Return (IRR) of FTSE All Share + 3% (with informal use of additional or alternative benchmarks where appropriate, as stated in section 2.2) (the internal rate of return equates to an annualised return on the capital invested);
3. Confirmation of the PE Strategy Limits (set out in section 2.4A);
4. Confirmation of the Concentration Limits (set out in section 2.4B);
5. Authority to purchase individual funds in the secondary market, subject to external advice;
6. Authority to invest in co-investment funds, subject to external advice;
7. Authority to invest in secondary funds, subject to external advice;
8. Authority to make co-investments that replicate those made by co-investment funds that LCPF has committed to;
9. Authority to make co-investments offered by LCPF's primary or secondary PE funds, without external advice, but subject to due diligence from the PE manager offering the co-investment.

# Consultations

This strategy has been developed in consultation between officers and the Fund's Independent Advisers.

**Implications**:

This item has the following implications, as indicated:

**Risk management**

Private equity is illiquid and increasing the allocation from 5% of assets under management (AUM) to 7.5% reduces liquidity on these additional assets. This is compensated by the potential for superior returns (i.e. an illiquidity premium).

The new strategy proposes allocating more capital to fewer funds, thereby reducing diversification. However, these investments may be shared across a wider range of managers. It is the opinion of the Investment Panel that the portfolio risk will not be materially higher.

Co-investing in individual deals alongside a fund manager risks negative selection bias, whereby the fund managers offer co-investments in the less attractive opportunities. This risk appears modest and is offset by the fee reduction.

Changes in the strategy are expected to be gradual over a number of years, such that there will be no sudden changes in the portfolio.

**Financial**

The proposed increase in the allocation to private equity will be financed by a reduction in the allocation to public (listed) equities.

Any identification of investment opportunities without the assistance of the external fund manager/adviser is likely to result in lower fees.

Any co-investments are likely to be undertaken without paying significant fees to the fund manager or consultants.

A more active management of relationships with external advisers has the potential to reduce fees and/ or improve returns on investments, and is likely to provide access to a range of better opportunities and this is already becoming apparent as a range of opportunities for investments with different managers, or managers with whom LCPF has only previously dealt through a fund of funds route are now being brought forward for the Fund's consideration.

**Local Government (Access to Information) Act 1985**

**List of Background Papers**

None

Reason for inclusion in Part II, if appropriate

N/A