ASSET ALLOCATION – CONSIDERING PRIVATE EQUITY

PRESENTATION TO THE PENSION REFORM TASK FORCE
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Private Equity Considerations

Key Areas of Focus

1. Alternative assets – private equity
2. Historical investment returns
3. Past performance of private equity asset class
4. Feasibility of investing in private equity

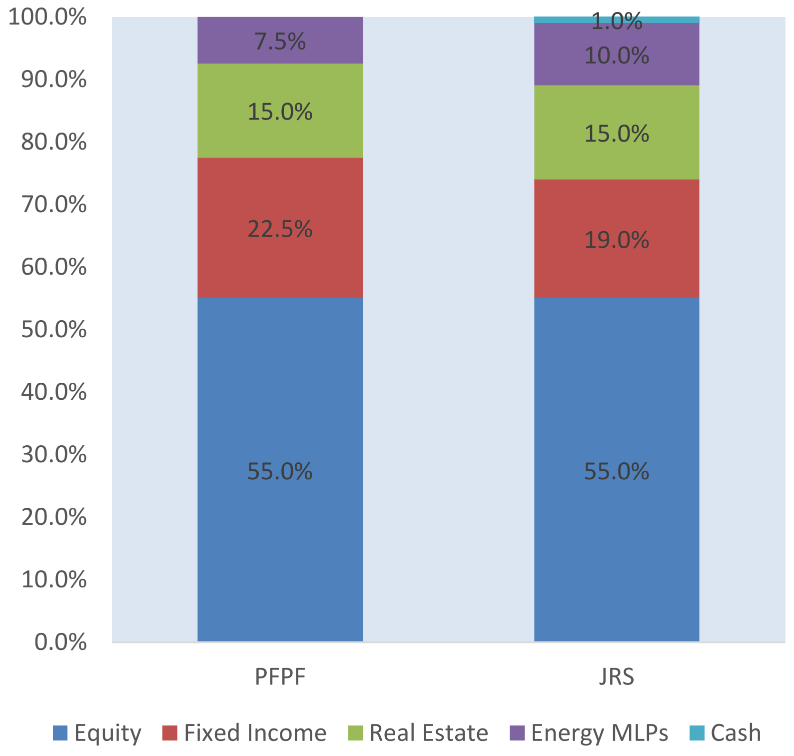
Private Equity Considerations

- Private equity is an asset class consisting of equity and debt in operating companies that are not publicly traded
  - There are numerous investment strategies utilized by private equity firms
- Investments are made through funds or collective investment vehicles used to acquire various securities of companies
  - Private equity funds are typically limited partnerships with a fixed-term of 10 years
  - The fee structure for private equity firms varies, but typically consists of a management fee (often 2% of assets managed) and a performance fee or carried interest (in some cases, up to 20% of gross profits from investments)
  - Governance rights for limited partners in private equity funds are minimal
  - Distributions may be made only as investments are converted to cash
- Private equity has become *en vogue* for institutions and wealthy individuals
  - The tradeoff is having capital locked up for long periods and engaging in potentially riskier investments (i.e., highly leveraged, early stage)

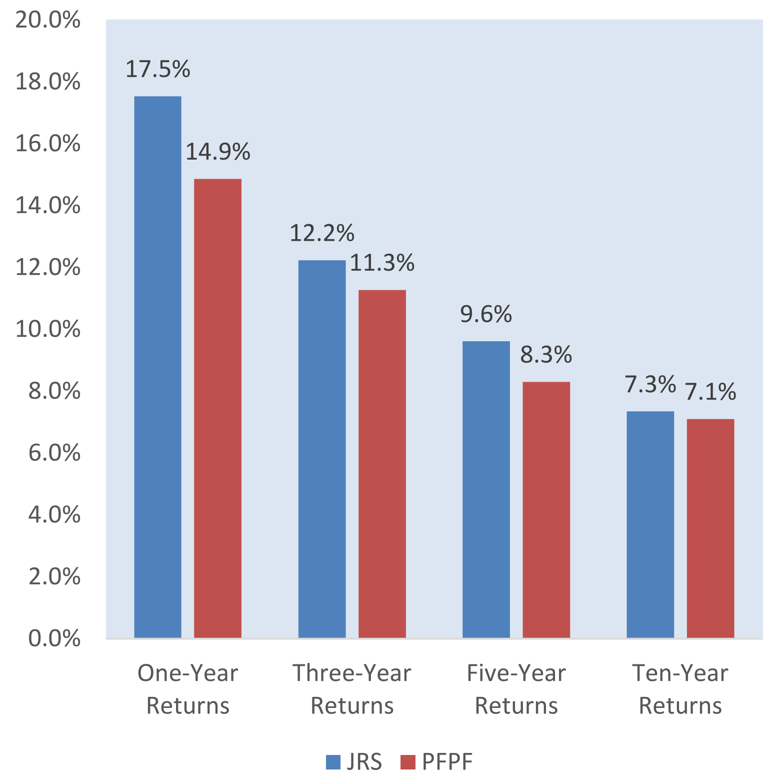
Historical Returns – JPFPF vs. JRS

- While the target asset allocations for JRS and PFPF are fairly similar, the returns for JRS have consistently exceeded those of PFPF

Overall Target Asset Allocation: PFPF vs. JRS

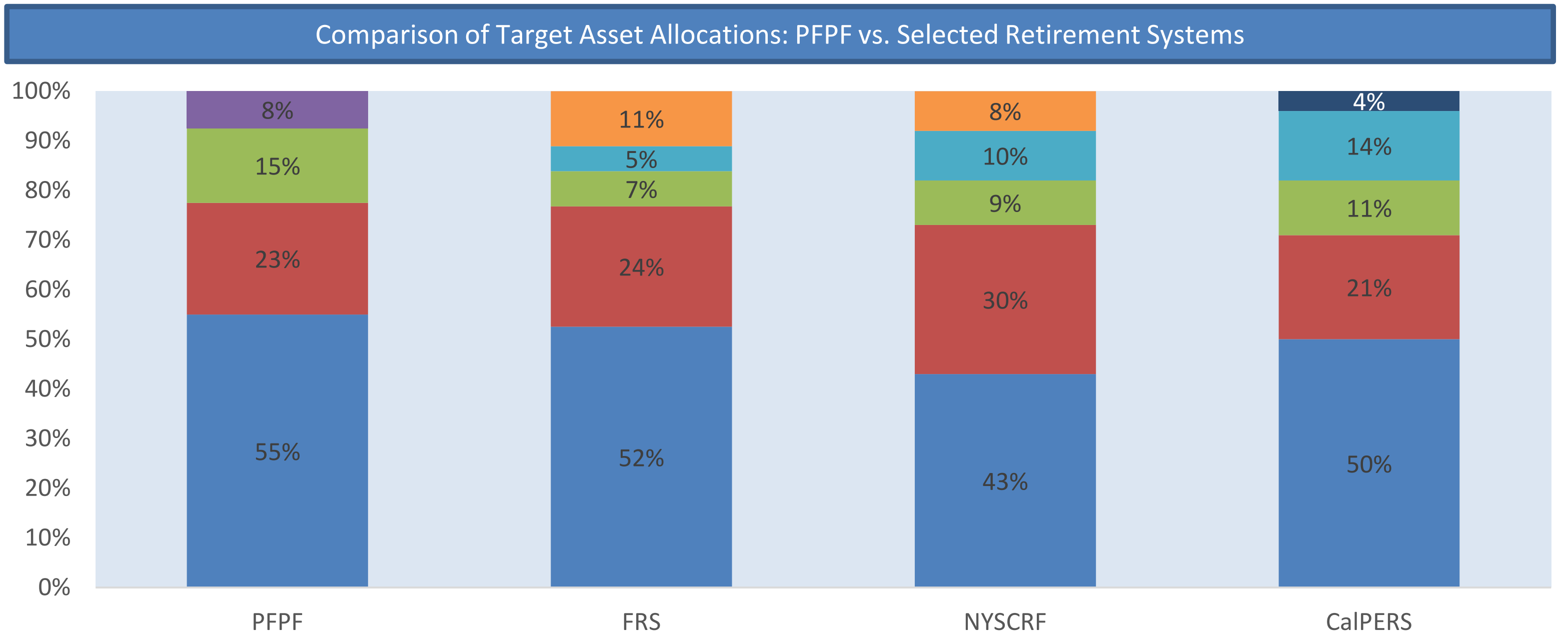


Total Fund Returns (FY04-FY13): PFPF vs. JRS



Sources: Summit Strategies Group Memo December 2012, Summit Strategies Group PFPF Sept. 2013 Flash Report, Summit Strategies Group JRS Sept. 2013 Flash Report
Note: The Jacksonville Retirement System is a fund that jointly manages the assets of the General Employees Pension Plan and the Corrections Officers Pension Plan.

Comparable **Target** Asset Allocations



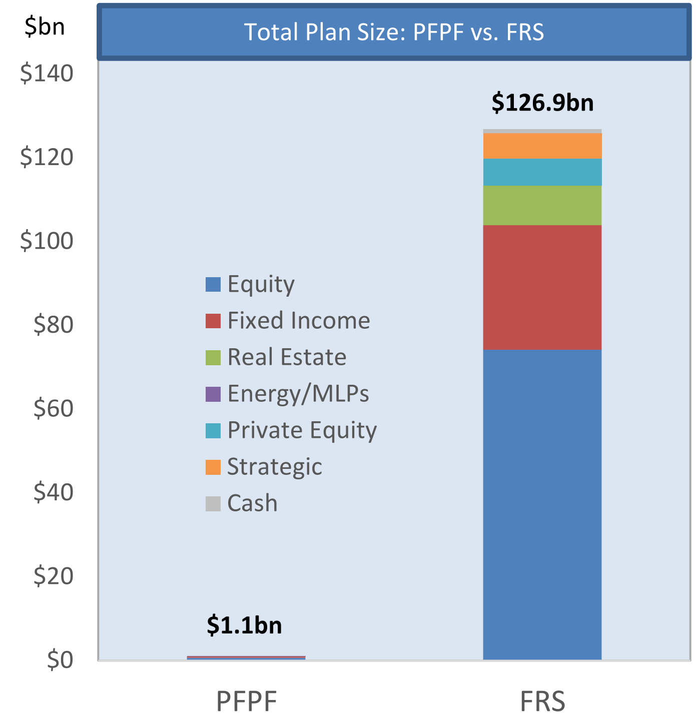
Total Plan Size	$1.3bn	$132.3bn	$160.7bn	$277.2bn
	(as of 9/30/13)	(as of 6/30/13)	(as of 3/31/13)	(as of 10/31/13)
Private Equity	-	5%	10%	14%
Strategic	-	11%	8%	-
Real Estate	15%	7%	9%	11%
Total Alt. Investments	**15%**	**23%**	**27%**	**25%**

Equity   Fixed Income   Real Estate   Energy MLPs   Private Equity   Strategic   Liquidity/Cash

Sources: Summit Strategies Group Memo December 2012 , State Board of Administration of Florida Quarterly Report to the Trustees (June 2013), New York State and Local Retirement System 2013 Comprehensive Annual Report, CalPERS February 2014 Facts at a Glance Report
Notes: NYSCRF Fixed Income allocation includes cash and mortgages. CalPERS Fixed Income allocation includes inflation-linked assets and Real Estate allocation includes forestland and infrastructure assets.

Alternative Investments

- FRS is over 100 times the size of the PFPF and gives out alternative investment mandates of ~$100mm each
  - That affords FRS access to invest in top-performing funds and the ability to diversify
- For diversification, the PFPF would need to award ~$5 to $10mm mandates across 10 to 20 funds
  - This would not afford the PFPF access to large, top-performing funds
    - » PFPF investments would be limited to emerging funds, which is very risky
    - » The alternative is to invest in fund of funds ("FoF"), which is expensive



Comparison of Total Plan Fees: PFPF vs. FRS			
	PFPF (FY13)	**PFPF (FY12)**	**FRS (CY11)**
Total Fees	$9.20mm	$8.29mm	$376.72mm
Beginning Assets	$1.17bn	$1.12bn	$126.58bn
Fees as % of Assets	78 bps	74 bps	30 bps

FRS's scale allows it to access alternative investments at much more favorable terms than the PFPF. If PFPF tried to match the FRS approach, they would have a harder time investing in the top funds and would pay higher fees.

Sources: PFPF 2012 Annual Report (p. 4) and document supplied by PFPF: Attachment Detail for Page 6, Item 4; Florida Retirement System 2011-2012 Annual Report (pp. 24 and 27)

Pensions & Exotic Investments

- There is no shortage of salespeople eager to market complex investment schemes to public pension funds
  - Unfortunately, many public pension funds do not have the tools or expertise to properly evaluate complex financial investments

Pension Funds Sue on a Deal Gone Cold

By RACHEL ABRAMS, *New York Times*, February 24, 2014

Sitting around a table in Baton Rouge, La., in February 2008, a handful of board members of the Firefighters' Retirement System of Louisiana heard an investment pitch that would later come back to haunt them.

Their consultant…said that others had already jumped at the chance to invest with Alphonse Fletcher Jr., a flashy Wall Street financier…described as a long-established hedge fund manager…. The fund was offering essentially a 12 percent guaranteed return, according to Mr. Meals, secured by a third-party investor, and the opportunity was so hot the board would have to make a decision that day….

The firefighters' system eventually said yes, and along with two other pension funds…invested a combined $100 million….The details sounded, as one board member put it, "too good to be true." In fact, they were.

Mr. Fletcher's hedge fund has since been described by a court-appointed bankruptcy trustee as having elements of a Ponzi scheme, and four retirement systems are fighting to recover their money…. The pension funds…can only hope to get their money back through various civil lawsuits….

"In many ways, the fraud here has many of the characteristics of a Ponzi scheme, where, absent new investor money coming in, the overall structure would collapse due to an inability to meet existing redemption and other obligations," the report says.

When the pension money ran out, the trustee said, "the scheme was sustained for a time by continued use of inflated valuations," resulting in a "serious loss" for the pension funds and other creditors. "There's a lot of things I wasn't aware of until I read the trustee's report," said Robert L. Rust, the executive director of the municipal pension fund. "Like where the money went."…

Further, Mr. Davis revealed that [the Fund's advisor]… received a fee from Citco for pitching the Fletcher investment, something the pension funds say they did not know at the time.

In the recordings, [the Fund's financial advisor] is heard telling the firefighters that its money would be secured by $50 million from a third-party investor. If the cash returns dipped below 12 percent, that $50 million would make up the difference. As a trade-off, the pension funds agreed to forgo any return above 18 percent….

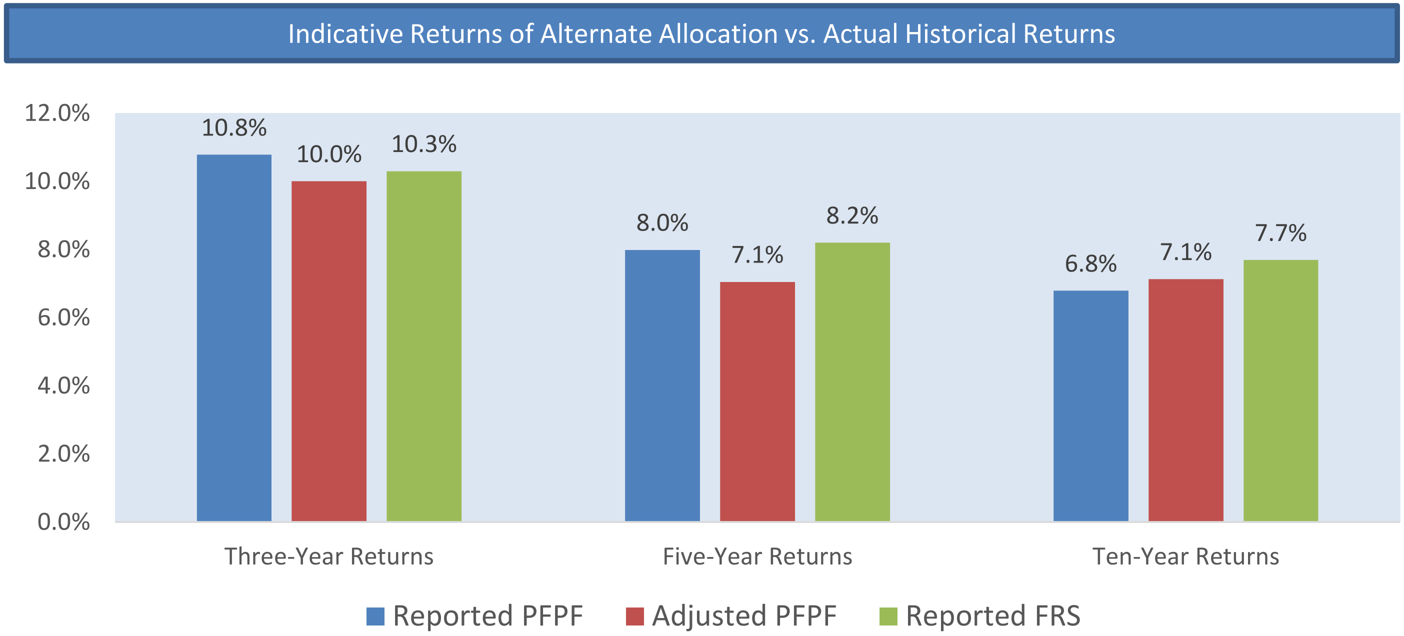
FRS Resources for Diligence

- Internal controls
  - Investment consultants
    - » Money manager recommendations come from staff and proceed to FRS investment consultants, who must provide a prudent man recommendation/letter
      - ► The staff does due diligence
      - ► Recommendation goes to the executive director for additional scrutiny
      - ► The ED "staffs the contract," at which point legal negotiates terms
      - ► A new money manager may remain in the FRS pipeline for 1 or 2 years
        - † They must acknowledge they are fiduciaries to the FRS
      - ► Annual investment report lists every fund and returns by individual manager
      - ► Fees are grossed by asset class, but public requests for individual fees are easy enough

- Internal Audit Department
  - Trustees each appoint a member to the audit committee, to which the internal audit department is responsible
    - » Audit committee assigns audits all year long (hundreds in the last few years)
  - Risk and Compliance Department
    - » Monitors investment compliance in real time, including asset allocation
    - » Outside annual commercial audit (published)

Alternate Allocation Scenario 1

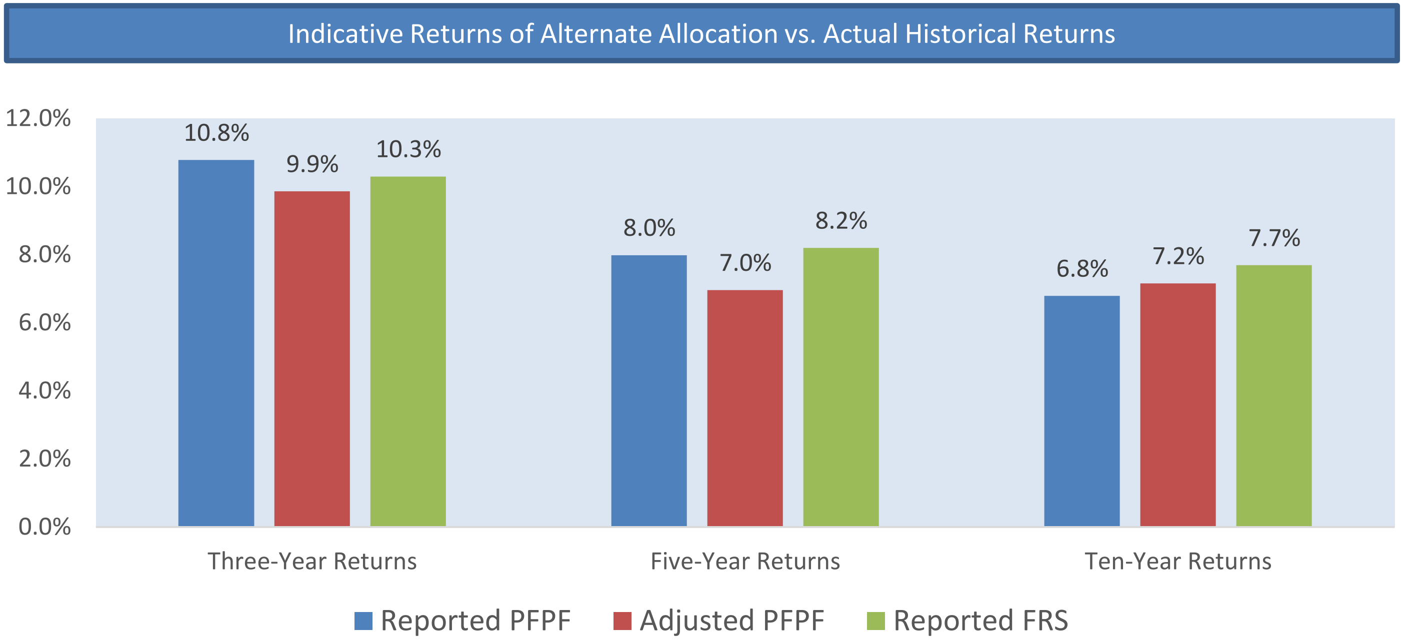
- The adjusted (alternate) PFPF returns shown below assume 5% of assets were reallocated from domestic equities to private equity at the beginning of the indicated time horizons



Sources: Summit Strategies Group PFPF Sept. 2013 Flash Report, State Board of Administration of Florida Quarterly Report to the Trustees (Sept. 2013), Thomson Reuters
Note: Alternate PFPF returns are estimates which incorporate adjustments for recent Energy MLP and Real Estate investments.

Alternate Allocation Scenario 2

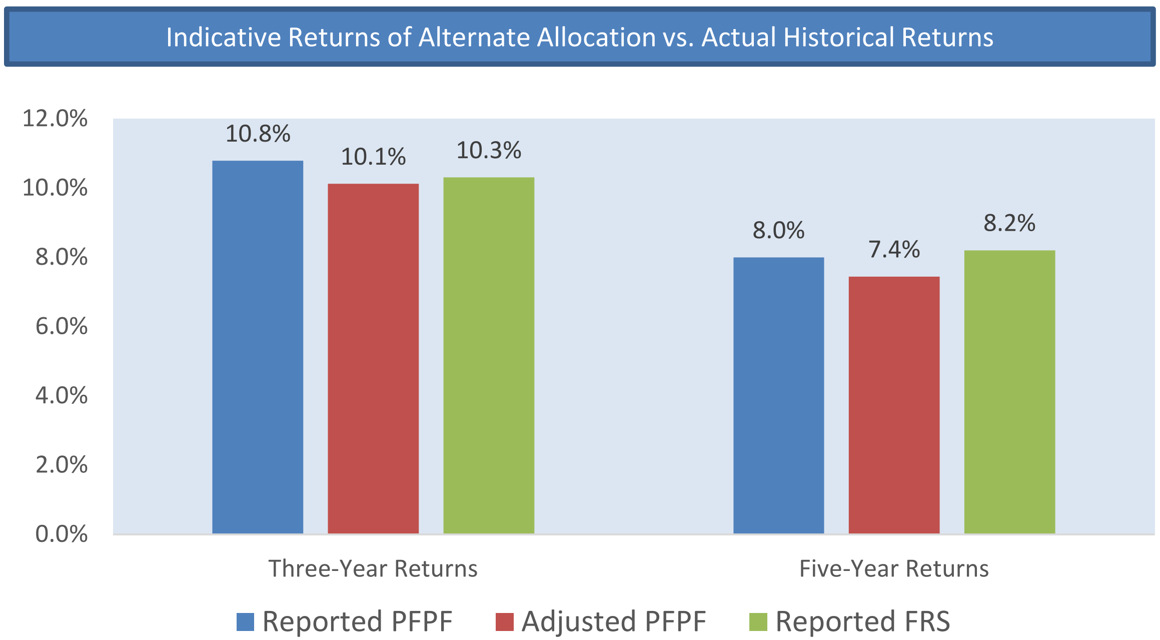
- The adjusted (alternate) PFPF returns shown below assume 7% of assets were reallocated from domestic equities to private equity at the beginning of the indicated time horizons



Sources: Summit Strategies Group PFPF Sept. 2013 Flash Report, State Board of Administration of Florida Quarterly Report to the Trustees (Sept. 2013), Thomson Reuters
Note: Alternate PFPF returns are estimates which incorporate adjustments for recent Energy MLP and Real Estate investments.

Alternate Allocation Scenario 3

- The adjusted (alternate) PFPF returns shown below assume 5% of assets were reallocated from real estate to private equity at the beginning of the indicated time horizons



Sources: Summit Strategies Group PFPF Sept. 2013 Flash Report, State Board of Administration of Florida Quarterly Report to the Trustees (Sept. 2013), Thomson Reuters
Note: Alternate PFPF returns are estimates which incorporate adjustments for recent Energy MLP and Real Estate investments.

Historical PE Asset Class Returns

- In recent years, private equity as an asset class lagged behind overall PFPF returns, largely driven by rebounding equity and real estate markets
  - However, during the past 10 years, private equity generally outperformed other asset classes in which PFPF invested

	Three-Year Return	Five-Year Return	Ten-Year Return
PE Performance Index	**10.16%**	**6.65%**	**9.62%**
Total PFPF Fund	**10.78%**	**7.99%**	**6.79%**
U.S. Equity	16.79%	10.80%	8.40%
International Equity	5.10%	5.22%	7.08%
Fixed Income	3.09%	5.65%	4.54%
Real Estate	14.78%	2.98%	NA

Sources: Summit Strategies Group PFPF Sept. 2013 Flash Report, Thomson Reuters

Conclusion

- Private equity investments are:
  - Illiquid
  - Expensive
  - Risky
- JPFPF would not have access to top-performing private equity funds
  - Historically, aggregate private equity returns have not outperformed the market significantly – or even at all – over recent horizons
- JPFPF does not have the resources or expertise to properly evaluate exotic investments
- JPFPF currently can invest up to 20% of its assets in alternative assets in the form of real estate (with 15% as its recommended target)
  - This is a large allocation for a public pension fund of only $1bn in assets
- Should the Task Force conclude that JPFPF should also have access to private equity funds, a reasonable cap on all alternatives (inclusive of real estate) should be considered
  - At the high end, a reasonable cap on alternatives might be 20% (inclusive of real estate) with a 5% cap on private equity