


**Commonwealth of Pennsylvania  
Public School Employees' Retirement System**

DATE: May 1, 2014

SUBJECT: Internal Co-Investment Program Guidelines Approval

TO: Members of the Finance Committee

FROM: Charles J. Spiller   
Managing Director, Private Markets and Real Estate

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Staff is recommending a minor change to the Private Markets In House Co-investment and Secondary program guidelines. We have determined that when investing in Secondaries and Secondary Co-investments approximately 60% of the commitment actually gets funded, many times cash flow coming out of these investments is used to make capital calls. In order to insure that approximately \$15 million actually is funded, we are recommending the commitment amount be changed to up to \$25 million from the current \$15 million.

c. Political/Tax

Legislature and/or regulators may change laws or regulations that impact the asset class.

d. Lack of Liquidity

The time horizon for private markets co-investments is 3 to 7 years and a secondary purchase is typically 5 to 10 years. Private markets investments should therefore be considered an illiquid investment.

e. Blind Pool

In the secondary partnership investments, control is vested with the general partners. Investments already made are known while future investments are generally unknown at the time the purchase is made.

**3. Co-Investments and Secondary Purchases Portfolio Diversification**

In order to reduce the risks associated with private markets co-investments or secondary partnership investments, a well-diversified portfolio is highly desirable. Each investment should be evaluated relative to the characteristics within the existing portfolio.

The following types of diversification should be considered:

a. Size of Restructured Companies (private markets)

(i) Large companies with revenues in excess of \$1 billion

(ii) Medium companies with revenues between \$250 million and \$1 billion

(iii) Small companies with revenues below \$250 million

b. Sectors – Private markets investments will be diversified among industry groupings. Non-cyclical investments will be favored over cyclical investments

c. Maximum Investment - an investment by PSERS will be limited to no more than \$15 million into a portfolio company.

Secondaries and secondary co-investments will be limited to no more than \$25 million.

- d. Time - PSERS will endeavor to invest in a consistent manner over time, unless markets are extremely over-valued.
- e. Investment per year – Investments are estimated to be \$100 million per year but will fluctuate based on availability of desirable opportunities.

#### **4. Total Portfolio Diversification**

Correlation with the returns of other asset classes is low although the private markets asset class has become more correlated to the public equity market since the implementation of FASB 157.

### **C. CONSTRAINTS AND GUIDELINES**

#### **1. Evaluation Criteria**

- a. A due diligence review by the staff comprising the following, as deemed appropriate:
  - (i) Review of whether the proposed investment falls within PSERS' investment plan, constraints and guidelines, and if it complies with applicable investment policies.
  - (ii) Background check of principals.
  - (iii) Discussions with principals of the proposed investment.
  - (iv) Review and analysis of all pertinent offering documents including: (1) offering memoranda, (2) subscription agreements, (3) private placement memoranda, and (4) operative investment agreements.
  - (v) Consideration of potential conflicts of interest, if any, posed by the proposed investment and prior investments and activities of the principals.
  - (vi) Review and analysis of investment:
    - Concept - including entry and exit strategies