Western Retirement Plans
Operational Implications of Adding Private Equity

Background

This document provides information on the main operational concerns that have to be dealt with when adding private equity to a defined contribution pension plan. They include redemption risk, valuation, handling of capital calls, the impact of the J-Curve and how to fund the allocation to private equity.

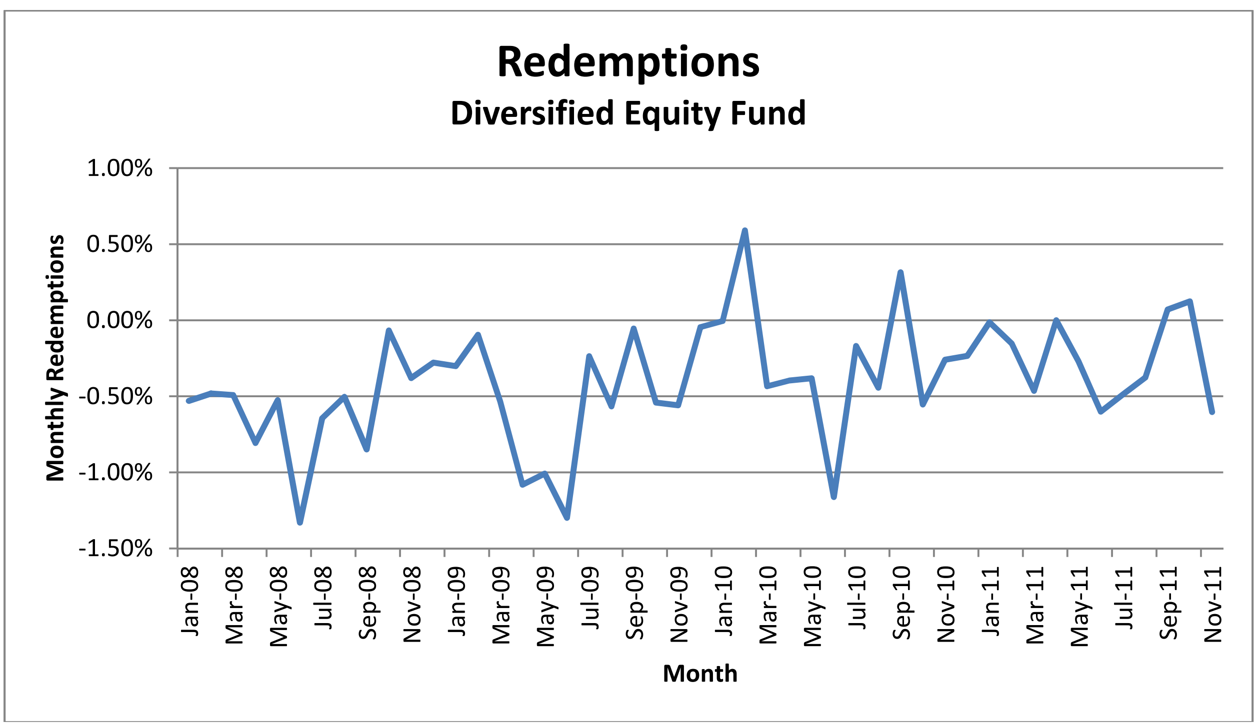
Redemption Risks

The main risk related to adding private equity to a defined contribution pension plan is being unable to fund members' redemptions due to the illiquid nature of private equity investing.

In order to assess that risk and how to manage it, we reviewed historical redemptions, the proportion of assets that have to remain in the plan and the possibility of selling some of our private equity holdings in the secondary market to fund redemptions.

1) Redemption History for the Diversified Equity Fund

The chart below shows the net redemptions (contributions minus redemptions) for the Diversified Equity Fund since January 2008. Net redemptions from the Diversified Equity Fund have never accounted for more than 1.3% of assets in the fund, despite the stock market meltdown of 2008/2009. Typically redemptions are larger in June, ahead of the July faculty retirements. Note that contributions were not allowed in the Diversified Equity Fund from January 2008 to November 2009, which increased the size of net redemptions.



2) Proportions of Western Retirement Plan Assets that are Locked-In

Although plan members can technically redeem all of their Diversified Equity Fund investments at any point in time, most of the assets must remain in the Western Retirement Plans. Approximately 72% of the assets in the Western Retirement Plans as of November 30, 2011 were “Regular” Pension Plan assets. This means that those assets can’t be moved out of the plan as long as the member is employed by the University.

Asset Distribution
As of November 30, 2011

	Assets	%
Total Pension Plan Regular Assets	764,553,097	72.0%
Total "moveable"[1] assets	296,696,893	28.0%
Total Retirement Plan Assets	1,061,249,990	100.0%

[1] Moveable assets include Voluntary accounts, Life income Fund (LIF) accounts and Registered Retirement Income Fund (RRIF) accounts

In the unlikely situation that members decide to make redemptions that are larger than the liquid assets in the Diversified Equity Fund, they would still have to leave their most of their assets in the Western Retirement Plans. If this is the case, management could then merge the Diversified Equity Fund with another fund on the Western Retirement Plans and still not have to fund redemptions through selling the private equity holdings.

3) Secondary Market

The process of selling a private equity investment with Adams Street Partners (ASP), the private equity manager on the Operating & Endowment Fund, on the secondary market would work as follows: The University would notify ASP of our desire to sell, then ASP would survey their other clients to create a market. Western would try to negotiate a price with the potential buyers. Over the years, ASP has only conducted the process about 6 to 8 times. The negotiated pricing has gone from par of NAV to a slight discount to NAV (80 to 85% of NAV at most). Market conditions will dictate the demand, and thus the timing of the process and the price of the deal. With strong demand the pricing could be negotiated over a month, with another month lag for transfer and signing legal documents. ASP has to approve the sale, which is standard in the industry.

As such, although possible to accomplish, selling a private equity investment on the secondary market should be used as a last resort only, given the potential price discount and the amount of time necessary to complete the transaction.

Monthly Valuation

Adams Street Partners has confirmed that they can provide monthly estimated valuations to adjust the regular valuations that are provided on a quarterly basis. As such, members would not be able to “arbitrage” the Diversified Equity and buy or sell units when the fund is undervalued or overvalued because of the lag in portfolio valuation.

Capital Calls

Capital calls have to be funded within 10 calendar days. Although it would be impossible to manage through the monthly cash flow process (where contributions are sent on the fifth last business day of the month), it would be easily manageable for the pension team. Assets from other managers can be easily redeemed with a three business day notice and then wired to ASP to meet the capital call.

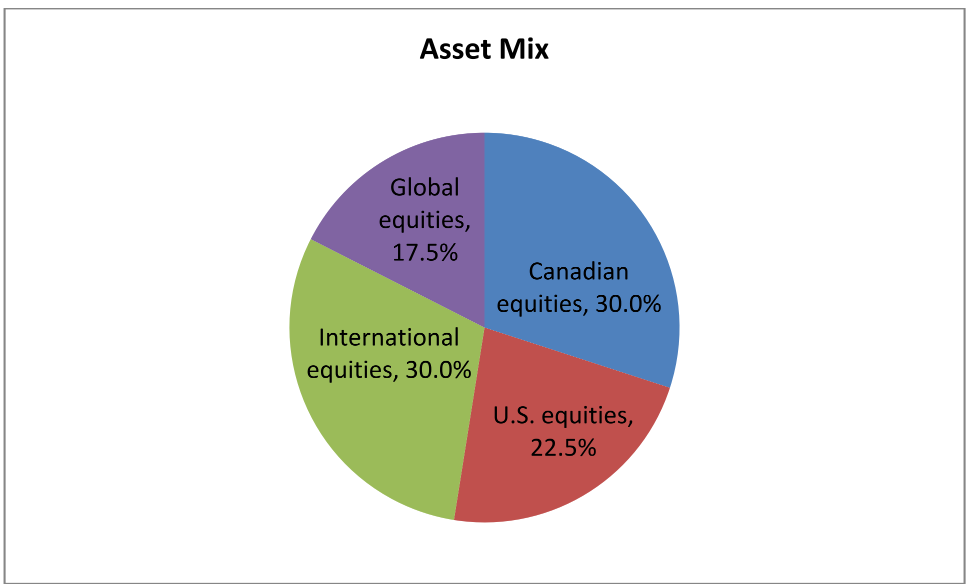
Impact of the J-Curve

In private equity, management fees are calculated based on the commitments to the program, not the amounts actually invested. In the early days of the program, this could cause existing unitholders of the Diversified Equity Fund to pay fees even though there are no assets invested. One way to mitigate this risk is to invest in private equity through secondary partnership. The target allocation would be reached sooner and the negative impact on members redeeming from the Diversified Equity Fund would be alleviated.

Allocation to Private Equity

Any allocation to private equity must be meaningful enough to have an impact on the portfolio and justify the time and effort to manage the allocation. As such, 5% should be the minimum allocation considered.

The table below shows the regional allocation of the Diversified Equity Fund.



The U.S. VS international equities ratio is 22.5% / 30%, which represents 42.9% U.S. and 57.1% international equities for the component of the portfolio that is not invested in a Canadian or global equity mandate. This was the approximate distribution of the world equity markets in the fall of 2008 when the last rebalancing was done. As of February 2012, the U.S. represented 47.3% of the MSCI World All-Country Index (ex-Canada) and international equities (including emerging markets) 52.7%. As such, I would recommend to fund a 5% allocation to private equity by reducing the allocation to international equities.