



Agenda Item 5c

October 15, 2012

ITEM NAME: Revision of the Role of the Private Asset Class Board Investment Consultants Policy

PROGRAM: Private Equity

ITEM TYPE: Policy & Delegation – Action

RECOMMENDATION

Approve the revised CalPERS Role of the Private Asset Class Board Investment Consultants Policy (“the Policy”) to eliminate the requirement to obtain a Prudent Person Opinion (PPO) subject to a fiduciary standard of care for certain Private Equity investments. Staff recommends the proposed revision to enable the Private Equity Program to have a pool of advisors with broad and deep resources, and who can provide in-depth industry, geographic and other expertise to assist staff in the execution of CalPERS investment strategies. A copy of the current Policy with proposed revisions is provided as Attachment 1.

EXECUTIVE SUMMARY

Large investment consulting firms with significant revenues and assets have historically raised major concerns about providing PPOs subject to a fiduciary standard of care. In the past few years, the number of such firms unwilling to be engaged to provide PPO's has grown so large that, particularly for Private Equity, the pool of advisors is insufficient to provide the needed technical expertise to assist staff in the execution of CalPERS investment strategies. In addition, the value of the PPO has diminished over time because: (a) the qualifications to the PPO language demanded by advisors in various cases may limit CalPERS recourse, and (b) once engaged it is extremely rare for advisors to be unwilling to write a PPO. Staff recommends removing the PPO policy requirement for all Private Equity investments within staff's delegated authority, with the exception of Direct Investments and some Customized Investment Accounts.

BACKGROUND

The current Policy adopted by the Investment Committee in 2011 requires a PPO for all investments over \$50 million. There is a large group of advisors, whose expertise is critical for staff to perform their duties, who are unwilling to engage with CalPERS to provide a PPO subject to a fiduciary standard of care. Firms are reluctant to take on the potential of hundreds of millions of dollars in liability in exchange for fees of tens of thousands of dollars. Due to the lack of advisors willing to be engaged to provide a PPO, CalPERS is increasingly unable to act upon investment opportunities that could help the System achieve its desired rate of return.

ANALYSIS

Investment Office staff surveyed over 20 advisors and asked them if they would be willing to accept the requirement of a fiduciary standard for services provided to the Investment Office. None of the large firms were willing to provide a PPO under a fiduciary standard, and others were only willing to do so with limitation on liability, cross-indemnification, and/or other provisions which would limit CalPERS recourse against the firms.

Staff believes that CalPERS policies with regard to conflicts of interest and the professional standards of conduct applicable to professionals in these firms which mandate these advisors provide service to CalPERS with care, skill, prudence and diligence under the circumstances then prevailing, make the PPO unnecessary. Failure to remove the requirement for the PPO restricts staffs' access to a pool of expertise and thereby reduces staff ability to fully achieve the System's investment strategies and related return objectives. By removing the requirement to receive a Prudent Person Opinion, staff believes the pool of available advisors can be broadened to include advisors with the needed technical expertise.

BENEFITS/RISKS

The benefits associated with this policy change include enhancing the resources available to staff, in the form of professional and financial expertise, to develop and inform investment decisions. Staff believes the existing investment policies mitigates the risks associated with removing the PPO requirement.

ATTACHMENTS

Attachment 1 – Role of Private Asset Class Board Investment Consultants policy with proposed revisions

Attachment 2 – Pension Consulting Alliance Opinion Letter

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