

June 18, 2018

**Item Name:** Revision of the Private Equity Program Policy – First Reading

**Program:** Private Equity

**Item Type:** Information

### **Executive Summary**

Staff seeks feedback from the Investment Committee (Committee) on proposed changes to the Private Equity Program Policy (Policy).

Attachments 1 and 2 provide “clean” and “mark-up” versions of the proposed Policy with staff’s recommended changes. An opinion letter from Meketa Investment Group, the Board’s Private Equity Investment Consultant, is provided as Attachment 3.

Following feedback from the Committee, staff will plan to return at a subsequent meeting for a second reading of the Policy.

### **Strategic Plan**

This item does not directly support the CalPERS 2017-22 Strategic Plan. The proposed revisions, as part of a clear and actionable policy framework, will contribute to the effective management and oversight of investment activities.

### **Investment Beliefs**

This agenda item supports CalPERS Investment Belief 10 that strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives.

### **Background**

#### *Private Equity Program Policy Background – Format and Content*

The current iteration of the Policy reflects changes approved through the 2014-16 Policy Revision Project, namely:

1. Application of a new template and organizational framework, and
2. Integration of specific investment constraints and limitations previously codified in the delegation resolution for the Private Equity Program’s Senior Investment Officer<sup>1</sup> (PE-MID).

Additional information regarding these changes can be found in Agenda Item 7a of the December 14, 2015 Committee meeting<sup>2</sup>.

<sup>1</sup> The “Senior Investment Officer” classification is now known as the “Managing Investment Director” classification.

<sup>2</sup> [CalPERS Investment Committee Meeting Archive, December 14, 2015](#)

Subsequently, in September of 2016, the direct Committee-to-PE-MID delegation was rescinded along with all other such direct board-level delegations to Investment Office staff. The rescissions were in recognition of:

1. The centralization of CalPERS' Board of Administration (Board) reporting lines to the Chief Executive Officer, replacing the previous governance model, which had several direct-to-the-Board reporting lines (such as the Chief Investment Officer, Chief Actuary, etc.), and
2. The prior migration of investment constraints and limitations from the delegations to CalPERS' statements of investment policy.

Additional information on the restructuring of the delegation resolutions for senior Investment Office staff is available in Agenda Item 3b of the September 19, 2016 Committee meeting<sup>3</sup>.

## **Analysis**

### *Today's Item and General Policy Maintenance and Refinement Goals*

As discussed in Agenda Item 6a at the May 14, 2018 Committee meeting (proposed revision of the Total Fund Policy), staff endeavors to continue refinement of our policy framework consistent with prior policy revision projects, seeking to:

- Increase consistency and clarity,
- Remove duplicative or procedural content, where appropriate, and
- Ensure alignment with business enhancements.

The proposed revisions to the Policy outlined in this item support the above-mentioned goals, with key changes redlined in Attachment 2, on pages:

1. 6 of 8 – Adjustment of the targets and ranges for the “buyouts” and “credit-related” strategies.
2. 6 and 7 (of 8) – Simplification of how staff-level authority limits (per commitment) are depicted.
  - a. Staff proposes to express staff's authority limits in dollar terms rather than “percentage of the Total Fund” terms, consistent with the approach taken in the Real Assets Program Policy, which expresses staff's authority limits in terms of set dollar thresholds. This change is expected to provide several benefits:
    - i. It is generally more intuitive to use and easier to read and interpret.
    - ii. It eliminates the “moving target” aspect of staff's authority created by fluctuations in the day-to-day size of the Total Fund.
  - b. As an additional control point, the proposed table on page 6 of 8 of the Policy also includes a new, cumulative fiscal-year limit for the Managing Investment Director, which is consistent with the structure used for the Real Assets Program.



<sup>3</sup> [CalPERS Investment Committee Meeting Archive, September 19, 2016](#)

- c. Staff proposes further simplification in the form of 1) a reduction in the number of investment categories assigned authority sub-limits, and 2) deletion of the “Direct Investment” category. These changes are summarized in Table 1 below.
  - i. This change aligns with CalPERS’ initiative to reduce the number of external managers (from over 300 to 100 across the Total Fund), and is more compatible with a shift toward fewer, potentially larger commitments overall.
  - ii. Additionally, while the new “funds” grouping eliminates the “top quartile/second quartile” distinction and associated sub-limits, the proposed reformulation of staff’s authority limits remains fully consistent with the Private Equity Program strategic plan and business model. The focus on fewer, high-quality managers will continue, and performance will remain a key consideration for the Program.

Table 1: Investment Category Consolidation

Prior grouping/types	Proposed groupings/types
Top quartile funds	Funds
Second quartile funds	
Emerging manager funds	
Customized Investment Accounts	<i>No change</i>
Co-investments	<i>No change</i>
Direct investments	<i>Strike/Remove</i>
Secondary market purchases	Secondary

Proposed Changes – Dollar Terms vs. Percentage Terms

The changes proposed on pages 6 and 7 (of 8) are not anticipated to increase portfolio risk.

- The proposed change to dollar-terms do not expand staff’s authority limits, and
- For “fund” investments staff is recommending that the per commitment limits be reduced for both the Managing Investment Director and Chief Investment Officer.

Revised Private Equity Business Model Implications

It should be noted that upon Committee approval of any Private Equity Program business model alternatives, staff expects to return with changes to the Policy for consideration by the Committee.

**Budget and Fiscal Impacts**

Not Applicable.

**Benefits and Risks**

Staff does not anticipate any risks associated with the proposed policy revisions.

As discussed in the sections above, the proposed changes are anticipated to provide a number of benefits, including:

- Reducing complexity within the document



- Improving the “ease of use” of the document in reflecting staff authority limits
- Updating ranges and limits to reflect the current Private Equity Program strategic plan and business model

**Attachments**

Attachment 1 – Revised Private Equity Program Policy – Clean Version

Attachment 2 – Revised Private Equity Program Policy – Mark-up Version

Attachment 3 – Board Investment Consultant Opinion Letter – Meketa Investment Group

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