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PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

INVESTMENT COMMITTEE

OPEN SESSION

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JAMES F. PETERS, CSR
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APPEARANCES

COMMITTEE MEMBERS:

Mr. Henry Jones, Chairperson

Mr. Richard Costigan, Vice Chairperson

Ms. Margaret Brown

Mr. John Chiang, also represented by Mr. Steve Juarez and Mr. Frank Moore

Mr. Rob Feckner

Mr. Richard Gillihan, also represented by Mr. Danny Brown

Ms. Dana Hollinger

Ms. Priya Mathur

Mr. David Miller

Mr. Ramon Rubalcava

Mr. Bill Slaton

Mr. Theresa Taylor

Ms. Betty Yee

STAFF:

Ms. Marcie Frost, Chief Executive Officer

Mr. Ted Eliopoulos, Chief Investment Officer

Mr. Matt Jacobs, General Counsel

Mr. Eric Baggesen, Managing Investment Director

Ms. Natalie Bickford, Committee Secretary

Ms. Elisabeth Bourqui, Chief Operating Investment Officer

Ms. John Cole, Investment Director

Ms. Sarah Corr, Interim Managing Investment Director

APPEARANCES CONTINUED

STAFF:

Ms. Kit Crocker, Investment Director

Ms. Alison Li, Investment Manager

Ms. Simiso Nzima, Investment Director

Ms. Beth Richtman, Managing Investment Director

Ms. Christine Reese, Investment Manager

Mr. Clint Stevenson, Investment Director

ALSO PRESENT:

Mr. Jim Baker, PE Stakeholder Project

Mr. Al Darby, Retired Public Employees Association

Ms. Christy Fields, Pension Consulting Alliance

Mr. Alex Gammelgard, California Police Chiefs Association

Mr. Steve Hartt, Meketa Investment Group

Mr. Andrew Junkin, Wilshire Associates

Ms. Colleen Kleven, Toys"R"Us

Mr. Derick Lennox, School Employees Association of California, Small School Districts Association

Ms. Sandra Lopez, Toys"R"Us

Dr. Ashby Monk, Stanford Global Projects Center

Mr. Michael Ring, Service Employees International Union

Ms. Nadia Romo, Toys"R"Us

Mr. Steve Silberstein

Mr. Tom Woelfel, Pacific Community Ventures

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P R O C E E D I N G S

CHAIRPERSON JONES: We'd like to call the Investment Committee meeting to order. And the first order of business is roll call, please.

COMMITTEE SECRETARY BICKFORD: Henry Jones?

CHAIRPERSON JONES: Here.

COMMITTEE SECRETARY BICKFORD: Richard Costigan?

VICE CHAIRPERSON COSTIGAN: Here

COMMITTEE SECRETARY BICKFORD: Margaret Brown?

COMMITTEE MEMBER BROWN: Here.

COMMITTEE SECRETARY BICKFORD: John Chiang represented by Steve Juarez?

ACTING COMMITTEE MEMBER JUAREZ: Here.

COMMITTEE SECRETARY BICKFORD: Rob Feckner?

COMMITTEE MEMBER FECKNER: Good morning.

COMMITTEE SECRETARY BICKFORD: Good morning.

Richard Gillihan?

COMMITTEE MEMBER GILLIHAN: Here.

COMMITTEE SECRETARY BICKFORD: Dana Hollinger?

COMMITTEE MEMBER HOLLINGER: Here.

COMMITTEE SECRETARY BICKFORD: Priya Mathur?

COMMITTEE MEMBER MATHUR: Here.

COMMITTEE SECRETARY BICKFORD: David Miller?

COMMITTEE MEMBER MILLER: Here.

COMMITTEE SECRETARY BICKFORD: Ramon Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Here.

COMMITTEE SECRETARY BICKFORD: Bill Slaton?

COMMITTEE MEMBER SLATON: Here.

COMMITTEE SECRETARY BICKFORD: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Here.

COMMITTEE SECRETARY BICKFORD: Betty Yee?

COMMITTEE MEMBER YEE: Here.

CHAIRPERSON JONES: Okay. Thank you.

The next item on the agenda is approval of the June 18 Investment Committee timed agenda. This is a new process that's being used for all committees to help us manage our time during the day, and to try to stick to a predetermined time of how long we're going to be meeting and how much time we're going to take on each item.

So if --

VICE CHAIRPERSON COSTIGAN: I'll move it.

CHAIRPERSON JONES: Moved by Mr. Costigan.

COMMITTEE MEMBER HOLLINGER: Second.

CHAIRPERSON JONES: Second by Ms. Hollinger?

All those in favor say aye?

(Ayes.)

CHAIRPERSON JONES: Opposed?

Hearing none. The item passes. Thank you.

The next item is Executive Report, Chief Investment Officer briefing. Mr. Eliopoulos.

CHIEF INVESTMENT OFFICER ELIOPOULOS: All right. Good morning, Mr. Chair, members of the Investment Committee. We do have a very full and timed agenda for us -- in front of us today, including some time constraints for outside presenter who will be presenting on our private equity business model item a little later in the morning. So I'm very mindful of that time, and I'll keep my comments brief as a result.

I did want to take a few minutes at the outset to frame our discussion on private equity business models up front. Just for some framing of the issue, I wanted to start by really reiterating something that we have discussed quite at length over the course of the last three years, both the importance of private equity in our portfolio, and the rising importance of private markets within the overall global capital marketplace.

It seems like a long way back. But looking back at November of 2013, we spent a full day together with the Investment Committee in a workshop on private equity. I think many members of the Committee remember. And we spent that day digging, you know, very deeply into the components of private equity. And some of the highlights I think of that day are worth mentioning again as a frame of reference.

Number one, private equity has the highest return profile in the total fund, both from a perspective of looking backwards at the actual results that we've achieved. It has achieved the highest rate of return in the portfolio. And prospectively looking forward, it is projected to earn the highest rate of return in our portfolio going forward.

Two, in that workshop, we estimated that at the low end, our private -- our actual private equity portfolio added more than is $11 billion of added value over and above what we otherwise would have been able to achieve in our public equity portfolio. And those are -- that's $11 billion that we didn't have to make up in either contributions or other sources of return.

Three, private equity expands our investable universe dramatically beyond what's available in the public equity marketplace.

Fourth, private equity represents really the most growth in the capital markets over the last decade. It's grown to almost a $4 trillion marketplace today, and projections are for it to continue that growth into the future.

And last -- and last, in that workshop, we, the Investment staff, really have concluded that there are no obvious public market substitutes for our private equity portfolio.

So why is that all important and why is that frame of reference important?

Well, we're currently 71 percent funded status. And we have a return target going forward of seven percent, which is a relatively high rate of return to achieve, especially thinking about this period -- current period we're in of relatively low interest rates.

In addition over the next 10 years, we have, you know, rather muted expected returns going forward. In fact, in our last asset allocation exercise, private equity is the only asset class in our asset allocation, which is projected to deliver returns greater than seven percent over the next 10 years.

You know, therefore, during our most recent ALM exercise, we considered and we concluded that private equity was an important and essential part of our asset allocation. We set a target of eight percent for private equity really recognizing where we are today, which actually today we're at about seven and a half percent weighting to private equity.

And the challenge of maintaining even an eight percent level, given the scale of CalPERS overall portfolio of $350 billion. So in a world and marketplace where private companies are staying private much longer, and growing to be much larger, and where public companies are choosing to go private - in fact, we've looked at the statistic as a Committee together - that the number of U.S. public companies is roughly half where they were 20 years ago.

The opportunity is presenting itself to find effective ways for CalPERS to participate in that growth in the private markets, at an appropriate scale for CalPERS.

The good news is that the private market trend is providing CalPERS with this opportunity, the opportunity to invest at the scale we require to be meaningful. Now, we have confidence that the strategy we'll be proposing later in the agenda will allow CalPERS to responsibly invest at scale, and allow us to reach a future target of 10 percent of the portfolio.

It's important to underscore that this is not without risk. We've discussed the risk, and we'll be discussing risks in a more detail a little later this morning. But the alternative is staying put on our current course, which will lead to an allocation to private equity much more like five percent of the total portfolio.

Now, we've done a back-of-the-envelope estimate of the impact of that difference between having a five percent allocation to private equity versus a 10 percent hoped for allocation to private equity on a $350 billion portfolio that we project, and hope to earn seven percent over a long period of time. And the difference between having a five percent allocation and a 10 percent allocation over the next 20 years, assuming we earn the return projections in our asset allocation, is approximately 15 to 20 billion dollars.

And that 15 to 20 billion dollars, if we don't earn in our private equity portfolio, and we're not able to think of other components within our asset allocation, and to date we have not, then that means that 15 to 20 billion dollars needs to be made up elsewhere, either through additional contributions from our employers or employees, or through new and different asset allocation techniques that we, to date, have not identified.

Now this is a window of opportunity for CalPERS, but you need to be comfortable, as comfortable as your staff is, that this strategy is the right path for CalPERS. The very long term, multi-generational nature of private equity investments require a long-term commitment that we all own, as an organization.

And that's why I think it has been worthwhile for us to spend the last three years in the deliberations around private equity, and the strategy that we'll be discussing in more detail later in this morning.

So with that, Mr. Chair, I'm glad to finish my remarks and move on to the rest of the agenda, or take any questions that might come up.

CHAIRPERSON JONES: Yes. I'm going to ask that if there are questions related to private equity, they be held until we get to that item. But if there are any other questions you have of Mr. Eliopoulos, it certainly can be entertained. So seeing no questions.

Okay.

Okay. The next item on the agenda is consent action item for approval of the May 14, 20 --

COMMITTEE MEMBER MATHUR: Move approval.

COMMITTEE MEMBER TAYLOR: Second.

CHAIRPERSON JONES: Moved by Mrs. Mathur, second by Mrs. Taylor.

All those in favor say aye?

(Ayes.)

CHAIRPERSON JONES: Opposed?

Seeing none. The item passes.

I have not been -- I have not been asked to take anything off of the information consent item.

So we will now move on to the next item, which is the action agenda item, Real Estate Investment Opportunity.

(Thereupon an overhead presentation was

Presented as follows.)

CHIEF INVESTMENT OFFICER ELIOPOULOS: Actually, no. We're in the open session agenda Item 6A, which is the Affiliate Trust Asset Allocation.

CHAIRPERSON JONES: A page was missing.

(Laughter.)

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yes.

CHAIRPERSON JONES: 6A.

CHIEF INVESTMENT OFFICER ELIOPOULOS: And Eric Baggesen and team are making their way up. I think you just gave Paul a little bit of a heart attack.

CHAIRPERSON JONES: Yeah.

(Laughter.)

MANAGING INVESTMENT DIRECTOR BAGGESEN: Okay. Good morning. Eric Baggesen, Manager Investment Director for Trust Level Portfolio Management.

This agenda item, 6a, continues in the line of agenda items that we've had for the last several months basically going through the various affiliate funds, and extrapolating the information that we developed during the ALM process for the PERF into those funds, and moving the asset allocation forward.

We've covered so far basically the various Defined Benefit Programs, the Defined Contribution Program, the Savings Program. And today, we're going to be touching upon the Health Care Fund Reserve Portfolio and the Long-Term Care Portfolio.

Consistent with what we've done for the last couple of a agenda items, Christine Reese, an Investment Manager within the Global Equity Program, is going to provide some background around the structure of those two funds. Although, we have organized this information where we're going to cover the Health Care Fund first, and then move back into the Long-Term Care Fund. So we're basically going to separate it into two sort of distinct little parts.

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MANAGING INVESTMENT DIRECTOR BAGGESEN: One of the things I'd just like to take a moment to do and recognize though is that in order to move this asset allocation work forward for the affiliate funds, it actually requires a tremendous cooperation across many different parts of the organization, as well as with external entities.

Slide number 3 in the attachment starts to list out some of the various teams that are involved in this. So you literally have dozens of people within CalPERS that are attached to the work-product that you see in front of you, and the information that is developed basically for you to make a decision on in relation to that asset allocation.

And that cooperation is not to be trivialized. There's many, many different points of view that are brought to the table in any of these agenda items.

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MANAGING INVESTMENT DIRECTOR BAGGESEN: As I said, we're going to separate the health care reserve from the Long-Term Care Program. And I think without any further yacking at you, I'll turn it over to Christine.

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INVESTMENT MANAGER REESE: Thank you, Eric. Christine Reese, CalPERS team member.

So to start -- let's see. Woops.

I think I'm missing one of my pages.

Okay.

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INVESTMENT MANAGER REESE: There it is. Sorry. Okay. So we're going to start with the characteristics for the Health Care Fund reserve. And before I get started on the details, I just want to basically describe that the Health Care Fund reserve that we are reviewing today is the reserve for the self-funded plans for our Health Care Program.

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INVESTMENT MANAGER REESE: And looking at slide 6 is a brief history of the Health Care Fund. So in 1989, the self-funded health care plans were established. And at that time, reserves were held by the Treasurer's Office in the Surplus Money Investment Fund, which is a short-term investment fund.

In 1997, the reserve fund was moved into CalPERS Investment Office for management. And at that time, a bond allocation was approved. That bond allocation remains in place today.

In 2013, we moved the bond allocation from an active management to a passive management. And in 2016, we reviewed the asset allocation, confirmed it. And although it's only been two years since that time, we are back again in order to sync up the timing of this asset allocation with the timing for the PERF. So on a go-foward basis, it will be reviewed every four years, after the PERF has been -- has gone through it's strategic asset allocation review.

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INVESTMENT MANAGER REESE: So moving on to the purpose of the Health Care Fund reserve. Again, this is for the self-funded plans, there are three primary purposes. And they're meant to cover worst-case scenarios in some cases. So, for example, expenses that have been incurred, but not yet paid in the event of a PPO shutdown to cover claims that might exceed premiums, and to cover any sort of catastrophic or unforeseen event, such as a pandemic.

So with these purposes in mind, in terms of investment strategy, we would want to keep the reserve conservatively invested to keep it a shorter duration and highly liquid.

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INVESTMENT MANAGER REESE: The investment policy objectives, which are shown here, they've been designed to align with the purpose of the reserve, so really to focus on that stability of principles, so that the reserve is there when it's needed; to generate some returns, but within a highly prudent level of risk; and then to maintain the liquidity in order for those reserves to be called on short notice.

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INVESTMENT MANAGER REESE: And this is the last slide for my section for the Health Care Fund. This shows the reserve investment performance over the last 10 or so years. The blue line is the performance of the reserve. The red line shows the benchmark performance. And you'll notice that in June of 2013, when we moved from active to passive, the performance is in much closer alignment with the benchmark. So we expect that to carry forward. And, in general, the performance of this reserve is in alignment with the allocation that we've selected.

So at this point, I'll turn it over to Alison, who kill continue with the strategic allocation.

INVESTMENT MANAGER LI: Good morning. Alison Li, Investment Manager from CalPERS Trust Level Investment Portfolio Management Team.

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INVESTMENT MANAGER LI: So the strategic asset allocation for the Health Care Fund reserve is directly dictated by its investment objective, which are stability, liquidity, and modest return over cash.

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INVESTMENT MANAGER LI: So staff recommend to maintain the current 100 percent allocation to U.S. fixed income. So based on the BarraOne risk model, the Bloomberg Barclays U.S. Aggregate Bond Index is forecasted to maintain a relatively low level of volatility of five percent. Staff believes this level of volatility is suitable for the health care -- Health Care Fund reserve, because of its requirement for liquidity to pay for health care claims and the program's requirement to preserve capital.

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INVESTMENT MANAGER LI: So here, staff did analysis about whether capital would be preserved in three scenarios of changes in interest rate over a 12-month period, if the fund is invested in the Bloomberg Barclay U.S. Aggregate Bond Index Found.

So the three scenarios are, first, is a steepening of the yield curve with 100 -- sorry 100 business point increase basis point increase the 30-year maturity.

The second scenario is a twist of the yield curve, with one percent increase at three-month maturity, and the one percent decrease at the 30-year maturity. The third scenario is a one percent parallel shift at throughout all maturities.

So the pressed impact on row 2 is estimated using the Bloomberg fixed income from the mental factor model. So the impact on the bond price estimated to be an investment loss of 4.6 percent for scenario 1, 5.5 percent for scenario 2. It will also provide investment gain of 3.9 percent for scenario 2.

However, if you look at the impact over a 12-month period, the relatively stable income return portion, row three, will alleviate the value -- the value reduction to 0.7 percent for scenario 1, to 1.2 percent for scenario 3, and will actually provide a value increase of 6.9 percent for scenario 2.

So based on this scenario analysis, staff believes the current allocation is within tolerance for the Health Care Fund reserve.

So now we are ready to ask -- to answer any questions on the Health Care Fund reserve.

CHAIRPERSON JONES: Yes. We do.

Mrs. Mathur.

COMMITTEE MEMBER MATHUR: Would you like us -- would you like a motion on this portion of the item now?

MANAGING INVESTMENT DIRECTOR BAGGESEN: I would suggest we could hold the motion basically until all the materials have been presented, if that would work for you?

COMMITTEE MEMBER MATHUR: All right. Thank you.

MANAGING INVESTMENT DIRECTOR BAGGESEN: Okay. Are there any further questions --

CHAIRPERSON JONES: No.

MANAGING INVESTMENT DIRECTOR BAGGESEN: -- Mr. Jones on this one?

Okay. I think we're going to turn it back to Christine to go into the long-term care.

INVESTMENT MANAGER REESE: Thank you, Eric.

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INVESTMENT MANAGER REESE: Okay. So the Long-Term Care Program starting off with the program objective.

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INVESTMENT MANAGER REESE: So the objective of this program is to provide program members with financial protection for the high cost of care caused by chronic illness, injury, or old age. And the costs are associated for care provided for those who have difficulty managing the daily activities of life, or supervision for those who may have cognitive impairment. So much different cost than strictly medical costs.

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INVESTMENT MANAGER REESE: Again, page 15, a little bit of history on the program. So the program has been around for about 23 years, launched in 1995. In 2008, the program was closed to new applicants in order to go through a stabilization period in which many elements of the program were adjusted and modified, one of those being the asset allocation.

And that asset allocation is the same asset allocation that we have in place today. So we've held it since 2012. We did reaffirm that asset allocation in 2015, and today's presentation, again, is to align it with the four-year sequence with the PERF.

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INVESTMENT MANAGER REESE: Slide 16 shows some key statistics. These are as of June 17th -- I'm sorry, June 30, 2017, really just to show the size and scale of the program. So the program currently has 128,000 plus participants, of which 7,200 plus are currently in claim.

Benefits on an annual basis are around 300 million. And in looking at fiscal year 2017 over '16, there was an eight percent increase in those claim costs -- or in terms of benefits paid. And then program size and total, we've paid out 2.2 billion in benefits since inception. And the asset value in the fund is 4.4 billion. And we are one of the larger programs in the nation.

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INVESTMENT MANAGER REESE: So in looking at the characteristics that will help us derive the strategic asset allocation, slide 17 shows the historical number of active enrollees and claimants.

So if we look at the blue line, which is the top line, in 2007, there were approximately 170,000 participants, and that has declined to approximately 120,000. So we're taking in fewer premium dollars into the program. The lower line shows the claimants. And in 2007, there were about 3500. And present time, actually, 6/30/2017, there are about 7300 claimants.

So we're paying out higher claim dollars, we're taking in fewer premium dollars, which indicates that the fund has a lower ability to absorb any market volatility.

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INVESTMENT MANAGER REESE: Looking at slide 18, this shows the historical assets and liabilities, along with the discount rate. So the discount rate is the green line that starts off higher on the left, and reduces down to the right. And basically what this shows is that currently we're at a 5.25 percent discount rate. And over the last several years we've brought it down in alignment with expectations.

The red line is the present value of future benefits less premiums, and then the blue line is the fund asset market value.

So where I want to focus is on the current -- current state, which those two elements are almost virtually equal. We're at a margin of negative 1.45 percent with the discount rate at five and a quarter. And what this again indicates that the fund has a lower ability to absorb market volatility.

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INVESTMENT MANAGER REESE: The last -- the last graph I'll cover is the historical and projected premiums versus claims. And so what this shows is for the population that is currently in the program, it shows expected premiums over time, and expected claim payouts.

And the -- you know, the important time period is in 2017/2018, there's a point of inflection where the fund starts to -- not the fund, but sorry premiums versus claims starts to become cash flow negative. Again, an indicator, that we would want to minimize market volatility within the fund.

So that is the conclusion of my part, and Alison will continue.

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INVESTMENT MANAGER LI: Thank you.

So staff's still obtain policy portfolio through strategic asset allocation process is similar to what we discussed last month for LRS, JRS II, and CERBT. It's also similar to PERF as we discussed the last year during the asset liability management process.

However, long-term care has its specific characteristics. For example, instead of contributions, the process actually estimate premiums that all current enrollees are required to pay.

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INVESTMENT MANAGER LI: Again, capital market assumptions are the same as we discussed the last month for LRS, JRS II, and CERBT. Also, the minimum constraints on inflation sensitive assets, such as TIPS, commodities, and REITs to enforce more diversification in the potential policy portfolios.

One additional constraint that's unique to Long-Term Care Fund is the maximum 15 percent exposure to global equity. This constraint was established in 2012 after the long-term care market started and detailed analysis jointly conducted by Wilshire Associates, United Health Actuarial Services, who are our consultant on the actuarial side, and the CalPERS Actuarial Office, and the CalPERS Investment Office.

The analysis still applies to the liability attributes of the Long-Term Care Fund, as we shall see in the next slide.

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INVESTMENT MANAGER LI: So here, there are four characters that staff examined, which all support the staff's recommendation to keep the existing level of volatility.

First, is the funded status. So when a fund is well funded, it's predicted that it's able to satisfy its future liabilities at the existing level of expected mean return. Furthermore, the lower the existing level of volatility, the tighter would be the distribution of the final outcomes around this mean estimation.

So for the Long-Term Care Fund, which is currently funded at 99 percent, also with the 15 percent maximum exposure to the risky assets global equity, it's prudent to keep the existing level of volatility.

The second character is the duration of liabilities. This character is similar to that of the pension fund. When the claims liability are due in the further future, the fund has time to ride out any market turbulence.

However, as we see from the previous slides, the participants in the Long-Term Care Fund have aged, so the claim payments are due in the near future, so the fund need liquidity and does not have time to wait for the market to come back if there's a market drawdown.

And the third character, the cash outflow, is closely related to the previous one. As more and more claims payment becomes due, the fund sustains cash outflow. Thus the fund need liquidity, and is not in a position to take more market risk.

The fourth one, diversity of contributions, is unique to Long-Term Care Fund, which is its singular funding source, members' premiums.

Because risk cannot be shared among multiple funding sources, the risk tolerance of its single funding source is relatively low. So all the four characters we examined will support staff recommendation to keep the existing level of volatility.

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INVESTMENT MANAGER LI: So as you can see on the efficient frontier, the recommended policy portfolio is very similar to the current policy portfolio, because they have the same level of volatility. There is a slight redistribution among fixed income, commodities, and REITs because of change in capital market assumptions. But the gain in efficiency is not significant, so staff would recommend a gradual rebalancing to the new recommended policy portfolio taking advantage of the routine cash flow and the market gyrations.

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INVESTMENT MANAGER LI: So as you can see from this table, the expected returns from year one to 10 is based on the CMAs from the Investment Office, the expected return from year 11 to 60, based on CMAs from the Actuarial Office, and volatilities from year one to 60 at the same agreed upon by the Actuarial and Investment Office.

The blended return is based on the forecasted net cash flow of the Long-Term Care Fund. This is consistent with industry practice, so the blended return supports the discount rate of 5.25 percent that has been approved by the Investment board in February 2018.

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INVESTMENT MANAGER LI: The recommended asset class ranges are based on the practical knowledge accumulated in manage this fund and is consistent with the current implementation practice.

It is believed that those ranges will reasonably reduce any frictional transaction cost on the back-drop of the routine cash flow, and the market gyrations. So that conclude my part of the presentation.

CHAIRPERSON JONES: Okay. Thank you very much. If you can go back to slide 17.

INVESTMENT MANAGER LI: Yes.

CHAIRPERSON JONES: In that, the data shown here is through 2017, but it appears that there's a path that's occurring in the future that these will cross. And what is -- what are those projections of when that would occur, if that's a correct assumption.

INVESTMENT MANAGER LI: Oh, they will not cross. I think there used to be a graph that actually showed them cross, because actually the axis on both sides are at different scale.

CHAIRPERSON JONES: Oh, okay. I see. I see. Okay. Thank you.

Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

If you can go to slide 19. And I just noticed that apparently according to my own demographics, when I hit age 90, I'm probably going to get much beyond that, because of the steepness of the curve in the red line.

My question is, is that because the pool of enrollees are essentially, in my generation, so that group is going to pass and we don't have a large group coming beyond it? Is that the reason for that sharp decline?

INVESTMENT MANAGER LI: Yes. This estimate is only based on the current enrollees. There's no projection about new enrollees joined the Long-Term Care Fund.

COMMITTEE MEMBER SLATON: But we do have new enrollees --

INVESTMENT MANAGER LI: Right.

COMMITTEE MEMBER SLATON: -- coming in?

INVESTMENT MANAGER LI: Right. But the practice of such projections is all based on whether we have enough fund to pay the current enrollees.

COMMITTEE MEMBER SLATON: So are -- are contribution rates that we have for new enrollees, as we've made adjustments over time, we're confident that those contributions can cover those liabilities, at least as currently projected. So they're not -- is that why they're not part of this calculation? Because it seems like it's just part of the universe that we're looking at here.

MANAGING INVESTMENT DIRECTOR BAGGESEN: Why don't I take a shot at that one, Mr. Slaton. Eric Baggesen, CalPERS staff.

What you have in this graph, just to be clear for everybody, is that middle block, the annual projections are annual projections. That last right-hand block are 10 year projects. So you're literally seeing that steep drop-off in the line basically is because you're literally looking at things decade by decade, so --

COMMITTEE MEMBER SLATON: Oh, I see. You're right. We're changing the scale.

MANAGING INVESTMENT DIRECTOR BAGGESEN: -- please recognize that there's a -- yeah, there's a change in the scale, which basically --

COMMITTEE MEMBER SLATON: Okay. I got worried, but now I -- maybe I don't have to worry quite so much.

(Laughter.)

MANAGING INVESTMENT DIRECTOR BAGGESEN: But I think in relation to your real question though about whether future contributions basically are adequate to cover the liabilities, it is believed that that is the case, but that is -- those future contributions are calculated across a whole array of assumptions.

In other words, so there are assumptions about the -- the proportion of beneficiaries that will go into claim status. The costs of the medical care that they'll receive, the duration of that care, all of those elements basically are all estimates. And all of those estimates are absolutely subject to being mis-estimated as well as being accurate.

So one of the realities of this type of a program is that the actual -- the actual premiums paid by the beneficiaries will adjust to reflect whatever reality is. And that's obviously been one of the elements that have impacted this program and virtually every long-term program out there is that, initially, most of these programs, I think, underestimated the utilization and the costs of that utilization.

So all of them have been adjusting their premium structures. So it is unclear whether or not the assumptions that we're currently operating with, will ultimately result in the ability to do that. But the plan does have the ability to adjust itself basically, given whatever -- whatever reality we end up with.

COMMITTEE MEMBER SLATON: Okay. Very good. Thank you.

CHAIRPERSON JONES: Okay. Mr. Costigan.

VICE CHAIRPERSON COSTIGAN: Thank you, Mr. Chair.

An excellent report. The detailed -- I know we didn't go through all the slides, but I just -- a great report. Love the data.

Just a couple questions. One is you said we have 128,276 participants, but we're actually seeing a drop in the number of participants to about 120,000. Did I hear that correctly?

INVESTMENT MANAGER REESE: Yes. So the -- let's see. Yeah. So the data on page 16 was from the September 2017 Health and Benefits Committee agenda item.

VICE CHAIRPERSON COSTIGAN: Um-hmm.

INVESTMENT MANAGER REESE: The page 17 is from the actuarial valuation report, so there might be a slight time difference there.

VICE CHAIRPERSON COSTIGAN: And -- I'm sorry. All I was saying I'm with fine with the numbers. I was just trying to get is the drop-off due to people dying off or no longer paying their premiums? Do we have data that shows which it is? Because actually the benefit structure is only about $40,000 per claimant, which is exactly pretty good, given the cost of long-term care in California.

But is the -- what's the -- what do we attribute the drop-off too?

INVESTMENT MANAGER REESE: By and large, it is due to death.

VICE CHAIRPERSON COSTIGAN: Okay. So we're not seeing that with the increase in premiums or with the program itself, what we're seeing is the drop off is due to people aging out of the system, passing away in the system, and benefiting from it?

INVESTMENT MANAGER REESE: Correct.

VICE CHAIRPERSON COSTIGAN: Okay. And then I was looking at the chart going out to 2077. And is that just -- why did we pick 2077? Is that -- I mean, I know sometimes we talk about 75 years lives and being or is that just -- we just projected it out that way taking the first person in the system and assuming they're going to live 70 years?

So taking someone -- I'm just trying to get at, why 2077? Did you take an 18 year old, add 70 years, and say that's when they're going -- because I'm like Mr. Slate, I've actually planned on passing considerably sooner to any of this, at least that's why my financial plan says, but...

INVESTMENT MANAGER REESE: Yeah. In terms of the methodology, in terms of the -- in terms of the projection, that's part and parcel of the actuarial valuation report. So we're showing that data. And in terms of the methodology going out that -- to that year, we'd probably need to check back in with them.

VICE CHAIRPERSON COSTIGAN: Oh, because I was -- just as Mr. Slaton raised, I mean, that's -- it's 70 years worth of data, 60 -- 59 years from today, and we're projecting a drop-off in 2047.

INVESTMENT MANAGER REESE: Um-hmm.

VICE CHAIRPERSON COSTIGAN: So you're just trying to look at the class of folks, who's in there, and what caused it to drop off?

But the claims, I mean you would certainly hope you would see as each year goes out that a number not have the drop-off, because you'd have more people coming into the system. I mean, it just kind of refreshes itself going forward. So I know there's a drop-off, but the assumption is this significant drop-off is the population of today.

INVESTMENT MANAGER REESE: Exactly.

VICE CHAIRPERSON COSTIGAN: Okay. Thank you.

INVESTMENT MANAGER REESE: Um-hmm.

CHAIRPERSON JONES: Ms. Mathur.

COMMITTEE MEMBER MATHUR: Thank you.

Yeah, I want to commend you on a really thoughtfully prepared agenda item. I thought this was really excellent work, and gives this Committee a strong basis for making a decision on both of these funds, the asset allocation.

So with that, I will move the staff's recommendation regarding the asset allocations for both the Health Care Fund and the Long-Term Care Fund.

COMMITTEE MEMBER SLATON: Second.

CHAIRPERSON JONES: It's been moved by Mrs. Mathur and the second was Mr. Slaton.

Okay. So all those in favor say aye?

(Ayes.)

CHAIRPERSON JONES: Opposed?

Hearing none. The item passes. Thank you very much for the report.

We will now move to revision of the Total Fund Policy, second reading. Item 7a.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Great. Mr. Chair, I am going to turn this -- turn this over to Elisabeth Bourqui, our Chief Operating Investment Officer. She has been -- she joins us from Zurich, Switzerland. And she's been here in Sacramento on the job now for one month.

And I'm giving a little bit of time for Kit and team to get up here. And with the assemblage, I am very happy to hand this item over to Elisabeth.

CHIEF OPERATING INVESTMENT OFFICER BOURQUI:

Thank you and good morning. Elisabeth Bourqui, CalPERS Chief Operating Investment Officer. There are two investment policy items on today's agenda.

Item 7a is a second reading of staff proposed changes to the Total Fund Policy arising out of this year's annual review. The annual review is part of our routine review process, and serves primarily as an opportunity to make necessary updates in order to reflect Board direction, and organizational changes.

Following feedback from this Committee at the May 14th, 2018 first reading of the policy, staff has returned with a revised version of the policy for consideration by the Committee.

Kit Crocker, our Investment Director for Investment Compliance and Operational Risk, will provide an overview of the proposed changes since the first reading.

INVESTMENT DIRECTOR CROCKER: Thank you. And good morning. Kit Crocker, CalPERS staff.

As this is a second reading, I will focus my prepared remarks for this item on the -- just the changes made in response to the feedback from this Committee last May, and also on the updates importantly that were required to reflect the Board's approval in May of the new asset allocation targets and policy benchmarks.

The new changes are described as such in the agenda item, and indicated with yellow highlighting within the enclosed markup of the Total Fund Policy.

I should also note that if and when we receive final approval for the proposed private equity business model, alternatives, staff will come back to the Committee with any indicated updates to the Total Fund Policy.

Moving to the changes, the most material of these new changes are the revisions to appendices 4, 5, and 6 to reflect the outcome of the recent ALM process, namely the updating of the asset allocation targets and policy benchmarks, and also the revisions to appendix 2 to the policy to require prudent person opinions, or PPOs, for certain transaction types within private equity.

The proposal is to require PPOs for all co-investments and customized investment accounts in an effort to improve consistency between our private asset classes.

Finally, to say a word about the Investment Beliefs, while staff thinks it appropriate that the policy reflect the Board's lead role and ownership in terms of the beliefs, we also recognize, of course, the important role staff plays in the process. And if there is any desire to strengthen the language around staff's role, we would propose to revise the applicable sentence, which appears at page 36 of page 104, to read that staff will facilitate this process as requested by the Committee. We will look for the Committee's direction in that regard.

As this is a second reading, we are seeking action by the Committee, at this time. And with that, I'll pause for any questions, and also ask and invite PCA, Meketa, and Wilshire to comment.

Thank you.

CHAIRPERSON JONES: Okay. Before we get to questions, I want to ask the consultants to make their comments.

MR. JUNKIN: Andrew Junkin with Wilshire. I think Kit just hit on the one issue that we really wanted to draw out for some discussion, which was about the Investment Beliefs, and how that process will look the next time around. We do believe that the Committee really is the owner. That is the Investment Committee's job is to set the Investment Beliefs that staff should obviously facilitate.

And I think the proposed language change makes sense. And it is collaborative, I understand that. But really this is this Committee of 13 saying this is what we believe, and giving instructions for all sorts of stakeholders, consultants, staff, outsiders about how you're planning to invest in the very long run for the PERF.

CHAIRPERSON JONES: Thank you.

MR. HARTT: Steve Hartt with Meketa Investment Group. I think Kit pointed out the key thing that we have in our letter as well, talking about the PPOs being required for all the transaction types, except for funds, and that is outlined in there.

Also, recognizing that as their continues to be change, should there be change in the Private Equity Program, that certain portions of the policy will need to be revised to reflect that.

CHAIRPERSON JONES: Okay. PCA.

MS. FIELDS: There weren't any terribly material changes to the real estate portion of the policy between the first and the second reading, but I'm happy to answer any questions.

CHAIRPERSON JONES: Okay. Thank you.

Ms. Taylor.

COMMITTEE MEMBER TAYLOR: Yes. Thank you. I wanted to thank you for the report. It was great work, and thank you for your first report.

So I appreciate it. I had a couple of questions. We had -- or I had seen some thing that we announced, The great work we're doing with other large investors, where we're managing our risks and exploring other market opportunities on climate, gender equality, and infrastructure.

So I was wondering if we wanted and -- I done know this, if there are any policy changes that we needed to include to reflect this work that we're now doing, that we announced earlier this month, or is it already covered here? I mean, I read it, but I didn't think I saw it, so. Said.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Sure. Yeah I'll jump in. It's referring to the invitation we received from the G7 convening in Canada.

COMMITTEE MEMBER TAYLOR: Right, than the work we're doing.

CHIEF INVESTMENT OFFICER ELIOPOULOS: I don't believe we need any policy -- Total Fund Policy changes. We believe we have the policies in place that reflect our Investment Beliefs --

COMMITTEE MEMBER TAYLOR: Oh, good.

CHIEF INVESTMENT OFFICER ELIOPOULOS: -- and those areas of prior actually within our sustainability five-year plan, as well as the delegated authority for staff to work on those areas. So I think we're covered.

COMMITTEE MEMBER TAYLOR: Great. Great. And I know that I had initially thought everybody was -- somebody was going. So then, when I was advised that it's a work team, I was pretty impressed that we'd even been asked.

And then I had a last question. I just read, and I can't remember where -- which publication I read it in, that Warren Buffett and Jamie Dimon basically are talking about getting rid of quarterly reporting. And I'm wondering what's your opinion on that? And if you agree that the change -- that we should, you know, work on changing this -- like apparently they seem to be doing in the market.

Should it be reflected in any of our policies here? I don't know. Does it -- because we do the quarterly reporting anyway. I just thought it was interesting that these two big corporate, you know, heads have decided maybe that they shouldn't be looking at long-term risk, rather than this short-term quarterly reporting risk, so...

CHIEF INVESTMENT OFFICER ELIOPOULOS: It's a very interesting topic, and one that we're collectively very interested in as long-term investors. And we've often discussed the dangers of the preoccupation at looking at quarterly results.

So we, you know, applaud all efforts to look at ways to focus companies and shareowners on longer term investing. Again, I don't think the policy is the spot to put in place any language today.

COMMITTEE MEMBER TAYLOR: Would that be more our engagement process?

CHIEF INVESTMENT OFFICER ELIOPOULOS: But within our -- within our Governance and Sustainability Strategic Plan, there's definitely a section on long-term sustainability and that would be a good topic for us to come back to again and again, but in the near term to discuss approaches that might be taken. And at some point in the future, perhaps there is a policy change that could be recommended, but we're not prepared for that today.

COMMITTEE MEMBER TAYLOR: Okay. Great. Thank you.

CHAIRPERSON JONES: Thank you.

Mrs. Mathur.

COMMITTEE MEMBER MATHUR: Thank you.

So my first comment is with respect to the Investment Beliefs language on page 36. I'm wondering if that last sentence should read something more like, "Staff will consult with the Board Chair to facilitate this process". So something more affirmative, because I think leaving it up to the Board Chair to remember that every four years we need to review the -- I think it's appropriate within the staff workplan to just consult with the Board Chair about reviewing. So I would suggest some language along those line.

INVESTMENT DIRECTOR CROCKER: That sounds good.

COMMITTEE MEMBER MATHUR: Not the Board Chair, I'm sorry, the Committee Chair.

INVESTMENT DIRECTOR CROCKER: Yes, understood.

COMMITTEE MEMBER MATHUR: I mean the Investment Committee Chair.

INVESTMENT DIRECTOR CROCKER: Understood.

COMMITTEE MEMBER MATHUR: And then on page 76, which I know is the Governance and Sustainability Principles, which I know we've reviewed already. In light of the most recent -- or recent Supreme Court decision around forced arbitration, and basically allowing companies to require arbitration of -- with individuals and sort of prohibiting collective -- prohibiting litigation and/or prohibiting collective action by employees.

I'm wondering if -- I'm sorry, I'm just moving myself to page 76, so just bear with me one second.

Under the corporate culture language that we added, it talks about -- so this is D3 on page 76, Disclosure. "Companies should ensure all settlements are reported to the Board, and financial reporting standards generally require disclosure of material settlements".

I'm not suggesting a change right now, but I would like us to think about whether, in aggregate -- sort of an aggregate disclosure of settlements, if they reach a material level, because my -- I mean, the data shows j-

CHAIRPERSON JONES: Ms. Mathur, 76 of the iPad or --

COMMITTEE MEMBER MATHUR: I'm sorry, of the document, which is page 261 of the iPad.

CHAIRPERSON JONES: Okay. Thank you.

COMMITTEE MEMBER MATHUR: So it's attachment 2, page 76 of 104.

I would just suggest that we review that language again. Again, not suggesting that we make any changes today, but think about aggregating -- because the evidence is that if people are arbitrating, those settlements are going to be lower, and it's not necessarily because there's less merit, but because of their ability to achieve an appropriate settlement.

CHIEF INVESTMENT OFFICER ELIOPOULOS: That would certainly be appropriate direction for us. And I know our Sustainability team can take up that topic in future agenda items.

CHAIRPERSON JONES: Okay. So directed.

COMMITTEE MEMBER MATHUR: Thank you. Appreciate that

CHAIRPERSON JONES: Ms. Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chairman. I appreciated the suggestion by Meketa to perhaps review the real assets policy with regard to how the use of independent opinions, and also perhaps extending it to certain private equity investments of a material size. And I was just wondering what the staff response to that might be, in terms of the appropriateness and the feasibility of doing so?

CHIEF INVESTMENT OFFICER ELIOPOULOS: I'm sorry, Madam Controller, in terms of --

COMMITTEE MEMBER YEE: The appropriateness and the feasibility of so.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Of doing -- I didn't here. Of doing what?

COMMITTEE MEMBER YEE: Of the use of independent opinions in the real assets.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Oh, in the real assets, that's the part I didn't here. Thank you so much.

I do think it's always appropriate to look through, you know, our practices. I think this -- this conclusion or this -- the conclusion of this review that we just did with the consultants and staff. In this case, PCA and our real assets team led us to believe we're comfortable with the level of amounts therein. It's a fairly conservative and aggressive use of PPO opinions within that area.

The risk categorization of our real estate strategy is core commercial real estate, which is a -- you know, on the lower end of the risk spectrum of all the potential types of real estate strategies. So that all leads us to believe we have an appropriate level today, and if anything, we would probably discuss with the Committee and real estate consultant as we look forward, whether it's, you know, perhaps overly -- overly tight would be -- would be in consideration for the future. So I think that's the conclusion for today.

COMMITTEE MEMBER YEE: Okay.

CHIEF INVESTMENT OFFICER ELIOPOULOS: And I think it's always good for us as a committee and staff and consultant to be thinking through it. But I completely concur that there's no need -- you know, why fix something that's not broken.

COMMITTEE MEMBER YEE: Right.

CHIEF INVESTMENT OFFICER ELIOPOULOS: And the process, both the application of the process, the choreography of the process, is working well within real estate.

COMMITTEE MEMBER YEE: Okay. All right. And then we'll consider the appropriateness when we talk about the private equity class separately.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Exactly.

COMMITTEE MEMBER YEE: Okay. Thank you.

CHAIRPERSON JONES: Well, Mr. Junkin.

MR. JUNKIN: I'm going to apologize. My mother was a grammar teacher. And as Ms. Mathur drew my attention to (d)(iii) on page 76, I think the wording might need to change in that last sentence. If this weren't an action item, I wouldn't be bringing it up, but since you're about to vote.

I think right now it says CalPERS supports settlements. And I think what CalPERS supports is disclosure. So I think it should read, "CalPERS supports disclosure of settlements, including sexual harassment involving an executive or member of the Board".

CHAIRPERSON JONES: Okay. I think that's appropriate.

MR. JUNKIN: I apologize for being nitpicky, but...

CHAIRPERSON JONES: And that change will be made, Mr. Eliopoulos --

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yes

CHAIRPERSON JONES: -- when we take action on that.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yes, we agree completely.

CHAIRPERSON JONES: Okay. Before we vote on this

Item 7A, we do have a request to speak from Mr. Silberstein.

MR. SILBERSTEIN: Thank you very much. My name is Steve Silberstein. Although I am a trustee of a county pension fund here in California, I am speaking for myself just personally here.

I'm very interested, as some of you know, in the guidelines for voting on the CEO pay in these corporations that we're invested in, particularly the S&P 500 corporation where the pay goes up year after year. The guidelines that we have are quite good here, and I commend the staff and the Board for them.

The problem is that the actual proxy voting on the pay packages I don't think has followed the guidelines properly. There are other pension funds who do a better job in speaking out against some of the excesses in CEO pay.

But one of our guidelines is that the salary should be no more than a million dollars. And that's what it says in the guidelines. So I would assume that in the proxy voting, any time there is a salary of more than a million dollars, we would be voting against it.

That -- of course, the total pay is usually about 15 to 18 million dollars, which is all bonuses. So this doesn't affect the fact that the pay is higher than a million dollars. On the bonuses, the -- it says that -- our guidelines say that they should be considered in the condition text of the entire corporation, in the entire compensation structure within the corporation.

So as we now know, the corporations are disclosing the pay ratio between the CEO and the median worker. And there's quite a bit of variation. The average is about 300 to 400 times the average worker for the CEO. But there are quite a few big corporations where the aver -- where the ratio is more than a thousand. So I hope that when the ratio gets out of whack there, that that would generate a negative vote.

The last thing I would like to point out is stock buybacks, a lot of corporations are spending a lot of their money on stock buybacks. Of course, when you buy back the stock, then the earnings per share go up, because there's less shares. So if the CEO is -- his bonus is computed on a growth in the earnings per share, but yet the corporation is buying back its stock, there's actually no change in the real earnings, it's all financial engineering using corporate cash.

So when the bonus is calculated on earnings per share, but the corporation is increasing that just by buying back the stock, I think that should generate a negative vote.

And then finally, a lot of studies know --

CHAIRPERSON JONES: Mr. Silberstein. Your time is up.

MR. SILBERSTEIN: -- that when these corporations buy back their stock --

CHAIRPERSON JONES: Mr. Silberstein.

MR. SILBERSTEIN: -- the CEO's are selling --

CHAIRPERSON JONES: Your time is up.

MR. SILBERSTEIN: -- the stock at the same time. And that also should generate a negative vote.

Thank you.

CHAIRPERSON JONES: Okay. Thank you. Thank you for your comments.

This is an action Item.

Mrs. Mathur.

COMMITTEE MEMBER MATHUR: Oh. I'm sorry, I didn't realize I had -- I don't think I pressed it, but I'm happy to move the item.

CHAIRPERSON JONES: Okay. Moved by Mrs. Mathur.

COMMITTEE MEMBER TAYLOR: Second.

CHAIRPERSON JONES: Second by Mrs. Taylor -- Ms. Taylor. Okay. Thank you.

All those if favor say aye?

(Ayes.)

CHAIRPERSON JONES: Opposed?

Hearing none. The item passes. Thank you very much for the report.

We now will move to item -- information Item 8, Policy Delegation -- and Delegation, Revision of Private Equity Program Policy, First Reading.

CHIEF OPERATING INVESTMENT OFFICER BOURQUI:

Thank you. Elisabeth Bourqui, CalPERS Chief Operating Investment Officer.

Turning now to our next policy item. Item 8a is a first reading of staff's proposed update to the Private Equity Investment Policy. This is an information item only at this point. Staff will be returning to this Committee in August for a second reading incorporating the feedback received today.

With that, I'll turn the item over to Kit Crocker and Sarah Corr from the Investment Office, who will review the proposed changes.

Thank you.

INVESTMENT DIRECTOR CROCKER: Thank you. Kit Crocker again, CalPERS staff. And I'm joined now by the Interim MID for the Private Equity Program, Sarah Corr.

The proposed changes to the Private Equity Policy are largely intended to streamline and simplify several aspects of the policy. With one or two exceptions, overall the combined effect of these changes represents, if anything, a slight contraction rather than an expansion of staff's authority. I would also like to take this opportunity to clarify that if and when we receive final approval for the proposed business model alternatives, staff will, of course, return to this Committee with corresponding policy updates for consideration.

Moving on to the changes. One significant change is the way in which the staff authority limits are expressed to convert to the previ -- the currently percentage-based limits to limits expressed in absolute dollar terms.

This brings staff's expression of its authority limits in line with the way in which the real assets authority is expressed, and also importantly eliminates the moving target aspect of the old percentage of target approach.

We're also proposing updates to the permissible transaction types and staff limits to bring them more in line with the current business model. And in at least one instance, we're proposing a change simply to eliminate a potential ambiguity and achieve greater overall simplification of the policy constraints.

To address some of the more substantive changes then, first, we propose the elimination of direct investments as a transaction type. And I should note in this regard, that there's no connection with the CalPERS direct. Rather, direct investments are a legacy structure that permitted CalPERS to invest directly in select GPs. The last time, however, that CalPERS made such a direct investment in a GP was in 2007.

Second, as a result of the move to a single authority limit for first and second quartile commingled funds, the proposed new limit represents a significant lowering of staff's per commitment authority for top quartile fund investments, while increasing that authority slightly for second quartile funds.

Third, we are proposing to add a cumulative fiscal year limit for MID commitments similar to the one in real assets.

Fourth, there is the elimination of the CIO's unilateral ability to increase committed capital to existing top quartile customized investments accounts.

And finally, we propose an adjustment of the targets and ranges for the buyouts and credit-related strategies to reflect the transition of the credit-related strategies to the opportunistic team.

In the pure clean-up category, we're suggesting a handful of changes to improve clarity and remove duplicative content.

Today's item is a first reading, so we're looking for this Committee's feedback. And with that, I'll pause for any questions and also seek comment by Meketa.

CHAIRPERSON JONES: We have a couple of course. Mr. Juarez.

ACTING COMMITTEE MEMBER JUAREZ: Yeah. It's clear to me by the write-up what the advantages and benefits are to staff. What are The advantages and benefits from these changes to the Board from your perspective?

INVESTMENT DIRECTOR CROCKER: I think that it's easier on both sides frankly to assess what the limits are, and how they're applied. You know, one problem, for example, with the percentage of target expression of staff's authority was that it could look in hindsight like staff had exceeded its authority, because assume if the fund were to temporarily fluctuate downward.

So it is across the board we think better both for the oversight function, and then for staff in trying to make sure we stay in line with the dictates from this Committee, that we simplify and clarify where possible.

ACTING COMMITTEE MEMBER JUAREZ: And then specifically to -- you made mention of the fact that we're lowering certain limits for the CIO in given areas and then raising them in secondary investments, you said. Just can you give me a little bit more elaboration on the purpose for that?

INVESTMENT DIRECTOR CROCKER: Yes. I mean, as part of the simplification, we thought it didn't really make sense to distinguish for staff's authority limits between first and second quartile funds. And the -- the significant -- the change for first quartile is -- currently, the MID has 1.7 billion, assuming a certain fund -- you know, a certain level of funding at the fund. That's being reduced significantly to just 500 million, so that comes down significantly.

The CIO limit we're prosing now in absolute dollars is one billion. It would -- currently doing the math be with over 3 billion.

And as -- so that's a significant reduction compared to then the second tier funds are -- would be currently 330 million for the MID, and 660 million for the CIO as opposed to 500 and a billion.

ACTING COMMITTEE MEMBER JUAREZ: Okay. And just to close. So from your perspective by lowering those limits, what do -- what does the system get out of that. I mean, is it more scrutiny, less discretion on behalf of the Investment Office, maybe -- and appropriately so, I assume --

INVESTMENT DIRECTOR CROCKER: Um-hmm.

ACTING COMMITTEE MEMBER JUAREZ: -- or you wouldn't be recommending it.

Is that what we're getting out of those changes?

INVESTMENT DIRECTOR CROCKER: Maybe I should let Sarah respond to that.

INTERIM MANAGING INVESTMENT DIRECTOR CORR: Sarah Corr, Investment staff. The -- decreased the limits for the first quartile funds is mostly limited to -- or dictated by the allocations that staff can get anyway. So getting an allocation of over a billion dollars to a commingled fund is highly unlikely, and that was why we put the billion dollar cap in there.

CHAIRPERSON JONES: Okay. Ms. Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chairman. I guess to follow on to Mr. Juarez's questions. So will you still be reporting out private equity managers by quartile?

INTERIM MANAGING INVESTMENT DIRECTOR CORR: Yes in the -- in the write-ups that staff produces for each new investment it would say what quartile it is in.

COMMITTEE MEMBER YEE: Okay. All right. And then -- so the limitations that are in place for funds that rank below the top, so the Investment Committee -- Investment Committee will still be required to approve those investments that are third level and below.

INTERIM MANAGING INVESTMENT DIRECTOR CORR:

Anything below second quartile would require a prudent person opinion, which was discussed in the Total Fund Policy item previously.

COMMITTEE MEMBER YEE: Okay. So that -- okay. So that would -- Okay. Good.

INTERIM MANAGING INVESTMENT DIRECTOR CORR:

Correct.

COMMITTEE MEMBER YEE: Good. And -- so I was curious about the emerging manager change, does this allow you more flexibility to invest more than originally planned in the emerging manager program under the revised limit?

INTERIM MANAGING INVESTMENT DIRECTOR CORR: The -- it allows for more dollars to be deployed per manager. So the limit previously would have been 330 for the MID, and 660 for the CIO. It's now being increased to 500 and a billion.

COMMITTEE MEMBER YEE: Okay. So hopefully more. All right. Good.

And then with respect to co-investment, would all of the co-investment opportunities require a PPO?

INTERIM MANAGING INVESTMENT DIRECTOR CORR: Yes, they would.

COMMITTEE MEMBER YEE: Okay. Good. All right. Thank you.

CHAIRPERSON JONES: Okay. Thank you. Seeing no further questions. This is a first reading information item. So thank you for the report.

And now, we will move on to the next item on 9a, CalPERS for California and California Initiative.

(Thereupon an overhead presentation was presented as follows.)

CHIEF INVESTMENT OFFICER ELIOPOULOS: Mr. Chair, members of the Committee, I'm just giving time for the team to get up here. Clint Stevenson will be -- Investment Director on our team will be leading this, as well as having Sarah Corr from the private equity fund here as well. So, Clint.

INVESTMENT DIRECTOR STEVENSON: All right. Sorry.

So the CalPERS for California Report is a look at -- Oh, Clint Stevenson, Investment Director.

The CalPERS for California Report is a look at the market value of CalPERS investments in California. At the end of June, 2017, we had just over nine percent of the CalPERS fund was invested in California. The report also looks at the ancillary benefits of CalPERS investments, including supporting local communities, local businesses and workers.

We have a report on the private equity class investments in the California Initiative. That initiative supported over 266,000 jobs in California. This will be the last report of the California Initiative. Many of those investments have been realized and the company sold.

And as the Investment Committee may recall, at the December 2013 Private Equity Program review, Réal Desrochers, Sarah's predecessor, explained that we were closing out the California Initiative. And looking at other ways we might achieve attractive returns, and also support underserved communities.

So Réal identified clean technology, mezzanine debt, and co-investments. And so five years later, what have we done?

Clean technology staff didn't identify any investments in the portfolio that warranted followed-on capital in mezzanine debt. Staff did invest $80 million in California focused mezzanine funds. However, this isn't a scalable strategy, so we won't pursue that going forward.

And co-investments, this is a scalable strategy, and we'll -- it will be looked as apart of Pillar 2 of the private equity business model. John Cole will touch on Pillar 2 in the next agenda item 9b when he updates the committee on the private business model alternatives.

But I should remind the Committee that we'll continue a report on private equity investments in California, just as we will report investments in California and other asset classes.

And with that, I'd like to hand the discussion over to Tom Woelfel of Pacific Community Ventures, PCV. PCV prepared both the CalPERS for California Report, and the California Initiative Report in tab 9a. Tom is the director of PCV's global research and consulting practice in impacting investing. In this role, Tom leads and manages PCV's impact evaluation consulting services.

Tom.

MR. WOELFEL: Hello. Good to be with you all. And thanks for the introduction, Clint.

So today, I'm going to walk through findings from the 2017 CalPERS for California Report, as well as 2017 California Initiative Report, which Clint mentioned will be the last examination of the ancillary benefits of the California initiative.

And so both of these reports are really intended to support CalPERS efforts to engage with stakeholders across California and nationally. And the intention is to not only document CalPERS investment presence in the state of California, but also the resulting ancillary benefits of those investments.

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MR. WOELFEL: So looking at the 2017 CalPERS for California report, this is 8th consecutive year that this report has been published. And it documents CalPERS investment presence in the State including exposure to companies, properties, and projects statewide.

And like all of CalPERS investments, CalPERS in-state investments seek to achieve appropriate risk-adjusted financial returns. So the top-line figure in this year's report is that as of June 30th, 2017, or fiscal year-end, CalPERS had invested $30.1 billion across the state. It represents 9.3 percent of the total fund as a whole.

In addition to looking at the investment exposure in-state, the CalPERS for California Report also documents the underlying ancillary benefits that are generated through these in-state investments, including things like support local job creation for California communities and residents. So in looking at CalPERS private markets asset class investments in real estate, private equity, infrastructure, over 266,000 jobs have been supported statewide.

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MR. WOELFEL: This is a new chart within the CalPERS for California Report that documents CalPERS total capital as a whole, as well as capital in California since the report was first prepared in 2010. So you can see that over the last eight years, there's been a rise in the amount of assets that CalPERS has a whole, as well as the amount of capital invested in California.

And the horizontal line shows the percentage of capital that's been invested in the State. And 2017, represents the high mark in terms of preparing this report at 9.3 percent of CalPERS assets in-state. Since the report was begun, CalPERS has had at least eight percent of capital invested in California.

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MR. WOELFEL: In addition to looking at the amount of capital invested in the state, we also identify the individual locations of CalPERS investments across the state to understand which types of communities are benefiting from CalPERS capital. But what this map shows is the location of each of CalPERS investments with the different colored dots representing the various asset classes in which CalPERS invests, and the different sized dots depicting different sizes of investment amounts.

And as you can see on surprisingly the majority of investments are concentrated in the Bay Area and greater Los Angeles areas, the areas of the state with the largest regional economies.

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MR. WOELFEL: Now, moving to private equity's California Initiative, the California Initiative was established in 2001 and had two capital commitments with phase 1 and phase 2, notice the Golden State Investment Fund that was managed by Hamilton Lane. And in that time, over $1 billion has been invested among 569 companies within the California Initiative.

And the California Initiative was created to generate appropriate risk-adjusted financial returns that meet or exceed industry benchmarks through investing in traditionally underserved areas of California where investment opportunities may have been bypassed.

So in order to generate ancillary benefits, the California Initiative targeted investments in portfolio companies that had limited access to institutional equity capital, employed workers, living in economic disadvantaged areas of the state, and also companies that had provided employment opportunities to women, minority entrepreneurs, and managers.

And as Clint mentioned, this is the last year of reporting. And so there's a currently a few remaining active investments within the California Initiative, and we would expect limited data should we collect additional data moving toward on those investments. So by and large for the past 13 years in which we've been collecting data on the California Initiative, we've captured sufficient data on the ancillary benefits.

And so this report represents the final examination of the those ancillary benefits, and combines that 13 years worth of data to really look at since-inception results. So this year's report is a little different than past years' reports, which had focused on more of an annual look.

So this provides kind of a full look back across the California Initiative over those 13 years that data has been collected.

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MR. WOELFEL: And so in summarizing those since-inception results, for the California Initiative, they fall across four primary ancillary benefit areas, first focused on job creation and promoting economic opportunity; next focusing on areas that have been traditionally underserved by institutional equity capital; supporting workers in economically disadvantaged areas; and then providing employment opportunities to women, minority entrepreneurs, and managers.

So in terms of job creation, the California Initiative has supported 176,000 workers statewide. In addition, those jobs that have been created in the time of the California Initiative have also tended to be higher quality jobs with health benefits and retirement levels outpacing both State and national averages.

In terms of capital deployment to underserved areas of the state, the first capital commitment of phase 1 approximately 16 percent of capital was invested in companies located in those underserved communities. And then for phase 2 the Golden State Investment Fund, 46 percent of capital had been invested in underserved areas of California.

And then also in terms of supporting low to moderate income workers or workers from those types of underserved communities, the California Initiative employed approximately 49 percent of workers from those types of communities.

And lastly, looking at opportunities for women and minority entrepreneurs and managers, we saw representation of women and minority entrepreneurs and managers in leadership and management positions at levels that outpaced national benchmarks.

So as a whole, the California Initiative has delivered significant ancillary benefits across the State of California with phase 2, or the Golden State Investment Fund, driving a lot of those results, given a larger number of companies had been invested through phase 2.

And so with that, this concludes my presentation.

I'm happy to take any questions on both the CalPERS for California Report, and California Initiative Report and welcome your feedback.

Thank you.

CHAIRPERSON JONES: Yeah. Thank you. Yeah, I have a question. And I think I may have heard the answer. But when I read the report, it says the final report of final program year.

And I'm suggesting to myself why are we having a finalization in this program when we look at the jobs that are created 176,000, as you said. You look at the risk-adjusted returns that you mentioned, you look at the underserved people that are employed, women and minorities, so why would we be canceling this program. But I also -- I want to be sure I heard you correct that this program -- the tenets of this program will be embodied in our private equity -- one of the pillars going forward. Is -- did I hear that correctly?

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yes. Let me -- let me address both of those clearly.

CHAIRPERSON JONES: Okay.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Number one, we have tried to move away from separate small programs within all of our asset class -- classes, but including in private equity. And I think the approach that Réal signaled in 2013 to this Committee was to reposition this effort -- as your comments are underscoring, Mr. Jones, reposition this effort into the more mainstream of the overall portfolio rather than having a separate smaller scale program.

So that repositioning was attempted, as Mr. Stevenson worked through. Now, going into the future, there are really two -- two pillars that -- of the four-pillar strategy that we'll get to later in the morning, perhaps even next.

One is the Emerging Manager Program, where that program, one of its main benefits -- main ancillary benefits is the diversity of managers that we find within the Emerging Manager Program.

That is an area that we're in the midst of our search. And is an area our staff will explore this very topic of whether or not the quite substantial increase the number of diverse managers, women and minority managers, within that program also leads to investment opportunities in underserved areas or not.

But that is the investment thesis and we'll be exploring that as we select a fund of fund manager for that area. In addition in Pillar 2, where one of the main goals of the -- of that part of the strategy, the Pillar 2 part of the strategy, is for a much larger and substantial co-investment program.

And, yes, one of the aspects of that will be to explore and ultimately conclude with an investment program and thesis around co-investments, that would include the consideration of co-investments in companies, not only in areas that are well represented within private equity's traditional space, but also underserved. So it's a little longer answer to your question, but I want to make sure to take time to take us through the history of it, but those are the two areas that would be covered going forward.

CHAIRPERSON JONES: Okay. Thank you.

Mr. Juarez.

ACTING COMMITTEE MEMBER JUAREZ: Yes. Thank you for the presentation. Excellent. But I did -- I was caught by at least one of your graphs, which was I think three of six showing the map. And I know in the Treasurer's Office, we try to reach out to areas that are traditionally underserved by state investment, and try to make sure that the double-barreled benefit that you mentioned here extends to those in, what we would call, the hinterlands, which includes Delta California, the Central Valley, the Inland Empire.

And so my question is sort of two-fold. One is that do we -- have we heard any pushback or are they even aware -- of these regions are even aware of their representatives that there may be opportunities for investment that they could bring to your attention? And do we have any specific outreach that we do in areas that -- geographic areas that are traditionally underserved that would help sort of create the picture with a little bit more distribution outside of L.A., and San Diego, and Southern California -- or San Francisco?

MR. WOELFEL: Yeah. That's a great question. I think I'll defer to staff. But the one thing that I would mention in terms of a new development that I think has significant benefits potentially for California's underserved communities is in federal tax reform, the Investing in Opportunity Act had been included in this tax reform.

And so recently, the governors of all 50 states have submitted census tracts identified as opportunity zones. And these opportunity zones enable investors to deploy money, their capital gains-free money into these census tracts. And so the belief is that by essentially getting a very large tax break, there could be new investment opportunities that are generated within these opportunity zones.

So I think, you know, that's a development certainly to keep an eye on, in terms of potential benefits for California's underserved communities.

ACTING COMMITTEE MEMBER JUAREZ: I think that's right. Only I would just comment, because I'm a little familiar with the opportunity zone, most of those are outside of the traditional areas that have received like enterprise funds and the like. So you actually will be able to tap into communities that heretofore have not received the benefit of public funding. So I appreciate that comment.

INVESTMENT DIRECTOR STEVENSON: The only thing I'd add -- Clint Stevenson. The only thing I'd add is that the vast majority of the value of CalPERS private equity investments are in high minority areas, and that's pretty -- that's outstanding.

CHIEF INVESTMENT OFFICER ELIOPOULOS: And then the last, just to finish off, yeah, our managers, I think, are always out looking for portfolio company investments in every -- in very part of the state and the globe. They're motivated to find investment opportunities. In addition to that, this focus that we've had and the focus we'll have going forward really underscores our interest in making sure our managers are doing just that.

On the outreach piece, part of this California -- CalPERS for California Report, our Legislative Affairs team uses this report, you know, quite extensively at the legislature. We really -- they do a really good job of briefing legislators in many of these communities that -- that we're interested in investment all over the state, and do a good job of getting the word out in that form as well. I just wanted to add that as another a component of the outreach.

ACTING COMMITTEE MEMBER JUAREZ: Yeah. Just as an aside, it may turn it completely on its head if this three-state California proposal were to move forward as to what constitutes where you consider to be California versus outside of California.

(Laughter.)

CHAIRPERSON JONES: With that, Ms. Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chairman. Really appreciate the report. And I'm actually really sorry this is going to be the last of them. It's been a tremendous success in the program. And I appreciate that this has been before the legislature with our orientation to members.

But we consistently get requests from legislators, as Mr. Juarez suggested, particularly in -- even greater underserved areas. And so I was wondering if out of this report is there a way to talk about some, I guess, sustained or lasting impacts, you know, as we kind of transition out of our involvement in the program itself, that could then be the genesis of some additional thinking by the legislature or outside parties?

CHIEF INVESTMENT OFFICER ELIOPOULOS: Just to reemphasize to make sure, we will continue this CalPERS for California report annually.

COMMITTEE MEMBER YEE: Right, yeah.

CHIEF INVESTMENT OFFICER ELIOPOULOS: And I think looking at an opportunity in that report to emphasize our both past and hopefully long-lasting impact --

COMMITTEE MEMBER YEE: Yeah.

CHIEF INVESTMENT OFFICER ELIOPOULOS: -- in the underserved areas is an area we should -- we can take back and look at how we report that going forward.

COMMITTEE MEMBER YEE: Okay. Or even I don't know if there is a way to even assess some models that might work in different parts of the state. There's just an unending appetite, as you know, up the street with respect to wanting capital to be deployed in different parts of the state, and unfortunately, a shortage of it.

But we've done such great work here. We've been able to make some sizable investments. Obviously, the impacts have been great, but just not to kind of lose, you know, kind of the thrust of what's begun here.

Okay. Thank you.

CHAIRPERSON JONES: Ms. Taylor.

COMMITTEE MEMBER TAYLOR: Yes. Thank you. I also wanted to thank you for the report. And I'm going to miss the report. However, I agree with my co-Board members here, I think of a -- as we work through private equity on emerging managers, I'm just wondering how are we going to break-out that report, so that we are, you know, reporting directly on -- in infrastructure being invested in, or underserved populations here in California, are we going to be able to do that?

CHIEF INVESTMENT OFFICER ELIOPOULOS: The key is -- as Sarah was reminding me as we were preparing this information, the key is if we want reporting from an external manager, we have to ask for that ahead of time. So certainly in our emerging manager and co-investment program, we'll do that. It gets a little more difficult when you look at the broad spectrum of all of our general partners, as it's not a standardized request.

So sort of directly answer your question, within the emerging manager --

COMMITTEE MEMBER TAYLOR: That's a no basically?

CHIEF INVESTMENT OFFICER ELIOPOULOS: No, in the Emerging Manager Program, it's a yes. Our co-investment program, and separate account program, and direct vehicle program is a yes. In our more generalized commingled fund arrangement, that's not something we ask for, so that's -- that's a no on that front.

COMMITTEE MEMBER TAYLOR: Okay. Okay. I just want to make sure that we are highlighting some of these investments, and that we -- as everyone has said here, we continue to be investing in California. So thank you.

CHAIRPERSON JONES: Yeah. Thank you. You know, also, I think it's important that the numbers that you cite, the 266,000 jobs, and 176,000 jobs, and the economic benefit, I think it's important that we remind the public that this is in addition to the $21 billion that we pay out to our retirees that create a significant economic benefit to the State of California, including jobs and -- et cetera.

And so we just need to make sure the public is aware this -- that his is in addition to all that economic benefit that's going on. So, okay.

Mr. Miller.

COMMITTEE MEMBER MILLER: Yeah, I'm -- I will probably be talking a little bit more about how we integrate as we look at our new PE models something like this, where we've got a very powerful program, we've got fantastic staff that are doing a great job with this kind of work, and that we don't foreclose opportunities in terms of long-term capabilities and capacity to do this kind of thing, not strictly through the third-parties who we're going to be partnering with.

But I think there's potential to keep this kind of work going, where at least not foreclose those opportunities. And so just as I've questioned before, how do we do our long-term workforce planning, how do we do our really strategic workforce planning, and integrate that into these new approaches and new models to make sure that we have the flexibility, that we don't foreclose those opportunities, and that we don't kind of walk away from very successful approaches that we've already got in hand.

So just something I'm sure we'll be able to talk about more as we talk more about our PE models and other approaches.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yes. We absolutely will have opportunity to talk about that in that context and going forward. And one of the things we'll be underscoring is, you know, these are domains of risk. And our experience on the -- on the performance side of these programs, in phase 1 of the program, I believe we had nine external managers.

INTERIM MANAGING INVESTMENT DIRECTOR CORR: Ten.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Ten. And out of the 10, you know, nine underperformed, you know, quite significantly from a return standpoint. One manager performed quite exceptionally, and actually that exceptional performance, including the selection of one particular portfolio company is what brought the overall performance of phase one from a negative five percent to a positive return, but still underperformed our benchmark, even with that significant approach.

Phase two, through a fund-of-fund manager selecting different external managers, has improved. It improved as you saw in the ancillary statistics, in terms of penetration into underserved markets. And the performance improved into the second quartile, but still underperformed our overall benchmark.

So part of the overall strategy for private equity is to make sure, as we look at strategies going forward, we have both the resources, whether it's internal or external, and the capabilities for appropriate underwriting for the types of risks that we're taking.

And that's the approach that we're trying to layout in that -- in the private equity strategy. And at the heart of it is what you've underscored, which is to be very clear when -- where and when are there resources that we have internal to do this type of underwriting, and when and where do we need to partner with external resources, and what's the plan over time.

And I think you'll be pleased to see within the -- within the timeline that that's one of the checklist items to make sure we have workforce planning to think through that.

But my -- I just wanted to underscore this is a domain of quite a bit of risk -- active risk to the program, and huge variability between managers, and huge variability between each individual company. And that's -- that's the domain for private equity as a whole, not in terms of California versus New York, or underserved areas versus regular areas. And our approach is to try and consolidate all of that risk taking into -- into, you know, main -- you know, main drivers of programs and return that we can really focus on the expertise to make sure we have it without losing track of the policy goals that we have.

INVESTMENT DIRECTOR STEVENSON: Clint Stevenson.

The only thing I would add is it is a domain of enormous risk, but it's also a domain of enormous opportunity. We will -- we will be looking at Pillar 2 and co-investments, and continue some of the work that we've done. But there are also opportunities in Pillar 1. I mean, just last week I was in New York talking to a manager that focuses on the Hispanic community that's had fabulous returns. And so -- so again, an enormous risk, but opportunities as well.

CHAIRPERSON JONES: Okay. Good. So that

concludes this report.

I'm going to take a 10-minute break now, because the next item when we are about half way through will approach the two-hour threshold, so we'll take a 10-minute break. We'll reconvene at 11:00 o'clock, and then we'll start the next item. And that way we can have the continuity of continuing.

(Off record: 10:51 a.m.)

(Thereupon a recess was taken.)

(On record: 11:01 a.m.)

CHAIRPERSON JONES: I'd like to reconvene the Investment Committee meeting.

(Thereupon an overhead presentation was Presented as follows.)

CHAIRPERSON JONES: Okay. This is Item 9b. And the purpose today is to publicly share the process and work that is underway by our staff in considering and planning our future private equity business model.

It is an effort that looks ahead five to 10 years and beyond seeking to position CalPERS competitively to invest at a scale, and meet the long-term needs of our fund.

Staff has provided a roadmap with appropriate checkpoints during the course of approval and implementation. The Investment Committee unanimously approved last month in closed session to proceed down the roadmap where -- while continuing to provide interim checkpoints for review.

Further, the staff has committed to maintain and fulfill a checklist of items required future clarity for the Investment Committee. This is a very important project for the fund, one that is forward looking and aimed at providing high net returns at scale, and better long-term alignment between our long-lived liabilities to our members and our assets necessary to fund those commitments.

And so, again, the Board has not adopted this plan to be implemented. We adopted a process to continue to pursue and bring back to the Board checkpoints before we reach that point of actual approval for implementation.

So with that, Mr. Eliopoulos.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Okay. I am going to turn it over to our CEO Marcie Frost, Marcie, for some opening comments.

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CHIEF EXECUTIVE OFFICER FROST: All right. Thank you, Ted. And thank you, Chair Jones.

So I thought it might be worthwhile for us to spend a little bit of time this morning talking about purpose, and why we're looking at these models. CalPERS has had conviction in private equity for quite some time. We actually entered that space in the early 80s, along with the other two west coast states Oregon and Washington, and had great success early on in this asset class.

We are looking at an opportunity that really puts CalPERS in a leading position for institutional investors in the United States, but we're not alone, right? So this is -- these concepts are new for CalPERS, but they're not new, necessarily, in the space.

Some of you have talked to me about the Canadian plans, the Canadian model, if you will, which is more of a direct-style model, and comparing this program to that one.

We also have other State pension plans, such as Texas Teachers, who's done this a little bit differently than what we're looking at. CalSTRS, our sister organization across the river, just launched a concept before their board about a month ago.

So again, we're not alone, but it does put us more in this leading position, which means there's a lot of white space, and that's the term we've been using, is there's a lot of white space to fill-in as these are new concepts for CalPERS.

We do have Dr. Ashby Monk with us today. And so

I'm really excited that he was able to clear his calendar to join us today. And he's an expert in this area, and will talk with you about a concept that he calls aligned intermediary. And I think you'll find that very fascinating.

So just again to recap, we have been talking about private equity models since our off-site in July. And at that point in time, we had a panel come in and really talk with you about the different ways that we could access private equity.

And since that time, since that open session item, we've been talking over the last year in closed session predominantly about how we could structure these models for CalPERS. Now, last month, there was a decision made to make this more public, as Mr. Jones had indicated.

I think that's really important for the trustees on the Board that you're able to go out and do your own due diligence, talk to your own advisors, be able to get more information so you can ask the staff the questions that you are most interested in, so you can get comfortable with the concept.

And we felt that that was important that you were able to do that, because that is beyond staff, and it's; even, frankly, beyond your independent consultants.

We also wanted an opportunity for stakeholders to give public comment. And I think we'll have some stakeholders today who will likely do so.

In this packet, one of the items, the deliverables that we had come up with is a checklist. And this was in response to the questions and actual direct requests for additional data, additional information. And we put that together in a checklist.

So looking forward to getting your feedback today, on whether that checklist is complete, or whether you would like us to add more items to it?

Ted did mention that our asset allocation work, our target -- our policy target is to have a 10 percent allocation to private equity. And under our traditional models, our skill is our friend. It can also be our foe. That under our current traditional style of private equity, it would be very difficult to achieve that kind of policy target. And again, he spoke about that briefly in his CIO report this morning.

I think the other item that we pay very close attention to, we're very much in tune to the employers, as well as our members. So you have all heard, via public comment, both from member associations, retirees associations, and the employers, is that we have to find a way that we get close or -- or close to or exceed our seven percent return target on an ongoing basis, that we have to find ways to look at risk in the system.

Being 71 percent funded means that we do have some limited opportunity -- limited opportunities because of that less-than-desirable funded status. So we have to keep that in mind. But the other is that seven percent return hurdle is very difficult to accomplish. Private equity is the one asset class that has exceeded that seven percent over the long run. And it is a competency of this organization that I think we should attempt to leverage even more.

So as Mr. Jones indicated, this is the first public agenda item. And the Board has not made its go/no-go decision. But again, the work starting today more publicly is to help everyone get comfortable with what this concept really means, and what additional data and questions can we address as we move forward.

So with that, I will turn it back over to Mr. Eliopoulos.

CHAIRPERSON JONES: Okay. Yes. Before you proceed, Ted, I'm going to ask Committee members to hold their questions until the complete presentation is done, and then we'll open it up to questions.

COMMITTEE MEMBER BROWN: Mr. Chair, I just had a friendly point of order.

CHAIRPERSON JONES: Okay. Just a minute, let me

-- okay. Go ahead.

COMMITTEE MEMBER BROWN: I just want to get some clarity about the fact that, you know, we have been discussing this in closed session up until now, the private equity reorganization. And I'd just like to get confirmation specifically about anything that we are not allowed to ask in open session. And I think it has to do with the negotiation strategy, and our competitive position. And I just want it -- I don't know if it's for you, Ms. Frost, or Mr. Eliopoulos, but what are we not allowed to ask?

CHIEF EXECUTIVE OFFICER FROST: That's a good question.

CHAIRPERSON JONES: Yeah, I'm still going to go through the presentation first, and then we'll circle back.

CHIEF EXECUTIVE OFFICER FROST: All right.

CHAIRPERSON JONES: Ms. Brown, we'll circle back.

COMMITTEE MEMBER BROWN: Thank you.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Okay. Mr. Chair, am I free to start?

CHAIRPERSON JONES: Yes, I'm sorry.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Okay. I just want -- terrific. All right.

Well, this part of the agenda is -- I'm going to take us through the frame -- the framework and the four pillars. And we allotted about five minutes for me to do that, and then I'll be turning it over to John, and then Ashby, and then Elisabeth, and then back to Marcie for conclusion.

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CHIEF INVESTMENT OFFICER ELIOPOULOS: In thinking about the framing of the strategy, really after this three-year period of intense review and analysis, we're proposing this strategy of four pillars. This strategy reflects our conclusion that CalPERS needs to substantially add to our current business model, and to our internal resources to achieve our objective of a substantial and successful private equity portfolio over time.

In the aggregate...

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CHIEF INVESTMENT OFFICER ELIOPOULOS: In the aggregate, these four pillars would allow us to responsibly invest about 10 to 13 billion dollars per year. This is the amount that's needed to initially get to and maintain a 10 percent exposure to private equity over time.

And many times when dealing with percentages at CalPERS the sure scale gets lost in the equation. So a 10 percent private equity portfolio translates to a private equity portfolio on a net asset value basis of, you know, roughly 30 billion, 35 billion dollars today. But looking over the course of the next 10, 20 years, that private equity portfolio we would need to maintain an exposure of 30, 40, 50, 60 billion dollars over time.

That is both the opportunity and the challenge for CalPERS from a strategy standpoint and from a business model standpoint, how do you have in place the resources and talent to invest in that domain?

The four pillars, and I'll go through each one, are a mix of old and familiar business models, and new business models for CalPERS that we're proposing. In addition, they would add significant new resources and capabilities that we currently do not possess.

I want to underscore that our current private equity business model is really rooted in the selection of external general partner fund -- commingled fund managers. And what that means is that our Private Equity Program, our team, our systems, our methods are really geared all towards performing this function of selecting an external general partner.

The four pillars, in their aggregate, really seek to add to this capacity, to select -- to add to this capacity the ability to select and invest in individual portfolio companies. This is a new domain. And as we've discussed many times before, and even came up in the conversation today, this is a domain of really the highest active risk within our portfolio.

As a result, we are recommending new partnership structures within these pillars to ensure that we have the appropriate skill sets, experiences, and information sets to succeed in this area over time. So turning now to each of the four pillars.

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CHIEF INVESTMENT OFFICER ELIOPOULOS: And this is a bit of a technology enhancement for me, so we'll -- there we go. I'll highlight Pillar number 4 on the screen.

This pillar is mostly identical to our current business model. This is our Emerging Manager Program, and we execute that program through a fund-of-fund structure. And we are proposing to maintain and continue that fund-of-fund structure.

The only real strategic addition in this area is that we hope to expand the amount of capital within our private equity -- or within our Emerging Manager Program, and we hope to add a co-investment capability within the fund-of-fund manager's capacity.

This is an area, just by the way, as you know, we think about other international investors, whether Canadian or sovereign wealth fund, where we actually think U.S. pension funds, and CalPERS in particular, has a competitive advantage; where we, CalPERS, as leaders in the area, and the U.S. in particular, are really the leaders of thinking about who are the new and next generation managers within the United States, and particularly finding new and diverse managers to invest with, who we firmly believe will be the established managers of our program in the future, and contain the seeds for great new ideas in the future.

So Pillar 1, something we have great experience with, same business model expanded to do these things that I just mentioned.

Pillar number 2, this pillar really is a mix of our current business model, and the addition of some new capacity. Far and away the biggest part of Pillar 2, this partnership model, the biggest part of it is something that we already do, and I just underscored in my introductory remarks, and that's select private equity general partners. This is right in our wheelhouse of expertise that we have, and we'll continue to have as we go into the future.

And if we wanted to do nothing other than maintain our current process of selecting general partners, and not add any new capabilities, then we wouldn't really need to consider adding some new -- a new partner into the mix, a new partnership model.

Our approach in Pillar 2, however, is to seek some important new areas of investment to augment our traditional fund -- commingled fund investing. And this new capacity is to have a much deeper and stronger co-investment capability to be able to invest in secondary opportunities coming out of our fund investments, and lastly, be able to structure separate account relationships in the private equity arena.

And as has been mentioned a few times now, the capabilities to undertake a co-investment and secondary investment program at scale requires a different underwriting capability than selecting general partners.

The ability to underwrite and invest in an individual portfolio company, or a whole portfolio of portfolio companies is quite different skill set experience set than underwriting the capabilities of a general partner. So accessing some new talent and expertise in that area is really necessary for us to put billions of dollars into these categories going forward.

We also believe that the private equity marketplace is really set for some disruption in change over the next decade. Many of the old-line private equity firms, the founders of those companies are nearing the end of their professional careers. There's succession planning within those firms, and there's, you know, pretty dramatic explosion of new firms on the horizon.

As a result, we expect there to be opportunities to create separate accounts, both with the old-line firms and new business strategies that might be mutually beneficial, or to find new firms and new talent that is spinning out of these firms as disruptions in succession planning occur.

For those reasons, to invest in scale and co-investments, to invest in secondary opportunities coming out of our fund investments, to take advantage of the disruption that we believe is coming in the private equity marketplace over the next decade and have the capacity to form separate accounts, we propose forming a strategic partnership in Pillar number 2, which we believe will be very additive and very necessary to add to our internal resources to successfully invest in these new areas.

Pillars 3 and 4 are really the new business models for CalPERS -- for CalPERS private equity. Each of these pillars seek to invest directly into portfolio companies, and to hold these portfolio companies for a longer time period than traditional private equity funds currently do.

Similar to pillar number 2, this type of investing requires a thorough analysis of individual companies, as compared to our current business model of selecting a fund manager.

Our approach is to identify two segments of the market that we wish to target as most complementary to our overall private equity portfolio.

Pillar number 3 will target the innovation segment of the economy: Technology, life science, and health care. These are both attractive areas for go-forward future growth in our and the global economy, and also importantly has been an area that CalPERS, really over the last 20 to 25 years, has been shut out in the venture capital area.

And for that reason, we think it's a very complementary opportunity for us to both invest in a portion of the market we've been shut out in, and one that we think has significant growth into the future.

Pillar number 4 is really a segment of investing to look at multi-generational long-term investments in the core economy. While this approach is new to CalPERS, both in terms of duration and style, we think it also affords us the ability to become complementary to our existing portfolio, and less likely to put us into direct competition with our Pillar 2 commingled fund investments.

Our approach with both Pillar number 3 and 4 is to form long-term multi-generational partnerships that will allow us to access the talent that we need to succeed in these two domains.

And with that, I'll turn it over to John with a brief introduction of Professor Monk.

INVESTMENT DIRECTOR COLE: Thank you, Ted. John Cole, CalPERS staff.

I have a bit to complete the presentation, but now seems an appropriate moment to introduce Dr. Monk and I'll -- and have him comment on his perspective.

By way of introduction, Dr. Ashby Monk is the executive and research director of the Stanford Global Projects Center. He's also a Senior Research Associate at the University of Oxford, and a senior advisor to the chief investment officer at the University of California.

In addition to all that, he serves as a senior advisor to the CEO at the OPTrust, that's in Ontario, and an advisor to the Australia Super Fund.

His current research focuses on the design and governance of institutional investors with a particular specialization on pension and sovereign wealth funds.

His doctorate came from Oxford University, his Master's from the University of Paris, and his Bachelor's from Princeton University.

It's a pleasure welcome Dr. Ashby Monk.

DR. MONK: Thank you so much for this kind invitation. I'm Ashby Monk. I'm from Stanford.

I'm here today to give my objective views on these private equity innovations, and do so both in the form of 10 or 12 minutes of prepared remarks, and then weigh in on any questions or answers you may have for me about some of the experiences I've had around the world helping build innovative private equity platforms, or in the research on studying these private equity platforms.

It's an honor to be here. I have to say as a California resident, I feel the weight of this. I feel the weight this has on the pension plan, but also the states and -- the state and the cities. I think this is an Incredibly important decision for the future health of our state.

So I'm thankful and impressed to be here, because the staff asked me to come here and give remarks, and not once did they ask to read them. I don't know how wise that was.

(Laughter.)

DR. MONK: So if you're nervous about what I'm going to say, I promise you, they are too.

(Laughter.)

DR. MONK: They simply asked for some context and views on private equity innovation generally, and on CalPERS direct specifically. And my plan for the next 10 or 11 minutes is to situate private equity in your portfolio, and differentiate private equity from some of the other alternatives to talk about innovation and alignment, and how they're mixed. And alignment is the buzz word of the day that we will talk briefly about. And we might even mention an aligned intermediary.

And then I'll offer some brief remarks on what I know about CalPERS direct. I know probably less than everybody around the table, but I have enough context from other funds to perhaps offer some insight on what works and what doesn't.

Let's jump in. So private equity is a tough business for funds such as this, in large part because you need it. You can't walk away from private equity, even if you don't like the fee structures, and the misalignment. It's going to be core component of any long-term portfolio. And there's a few reasons for that.

Most of the CIOs I know running pension plans view -- view private markets as a critical component of any portfolio to achieve their return objectives. They don't see public markets as delivering on the return objectives in the way they did in the past 30 years. We were in a very favorable environment with interest rates, and that isn't going to be repeated in the next 30 years.

So in order to generate the needed returns to avoid cuts to benefits or increases to contributions, you're going to need higher performance. And I'm not alone in saying this, it's probably going to come from private markets, and specifically private equity.

In addition, the private markets have changed. The number of public companies for you to invest in has shrunk. You can go back and look at a few stats. But in the nineties, it was between 7500 and 8000 depending on the moment. And now we're under 4000.

So there's just fewer opportunities for a public market investor. You have to be engaged in the privates. And the wealth creation of those private companies seems to be extending. So a lot of the private wealth is being accumulated before and IPO.

So that by the time you invest in a company that is public, the private market investors have already captured much of the upside. And there are many other reasons why private equity would fit into a portfolio such as yours due to reasons of portfolio construction, risk return dynamics, and even the ability to generate alpha through information asymmetries that don't exist in public markets.

So you need it. But the challenge here is everybody else has realized they need it too, everybody. Everybody I know in the world is ramping private equity exposures right now. So there's a flood of capital coming to private equity. In the 1990's, it was something like five percent of all of pension AUM in America was in A -- alternatives. And that number today is approaching 30 percent. And that directionality will continue, as I've seen sovereign funds around the world say they're looking to get to 50 percent of alternative assets. I don't think they're alternative anymore more at that point. I think the public markets end up being alternative.

And with this massive increase in supply, what we would call a wall of money coming at private markets, the tables have turned. The asset managers that we have relied on have benefited incredibly. We've all seen the high fees. We've all seen your fees. We're here today, in large part because of the fee and transparency project you engaged on and you deserve credit for engaging on.

What we've learned over the last five years is the dynamics in the private equity market, they turn the traditional forms of capitalist incentives on their head.

Capitalism functions in a principal agent relationship, where the principals, you, discipline the agents, your asset managers. But because of a series of bizarre governance and market dynamics, the agents are disciplining the principals. The GPs are telling you what the terms of trade are in order to participate in a fund. They're using scarcity. They are using NDAs that silo you from your peers and limit information flow. They're using side letters. They're using more tricks than I could probably fit into a 20-minute conversation.

So that's why we're here. This transparency project has led us to this moment where we realize that for 10 percent of what you spent on this asset class last year, we could operate the entirety of this investment organization, 10 percent.

The oversupply of capital to private equity would obviously lead to high prices. But it's an artificial market. We limit ourselves through a lack of innovation. We don't do -- I'm not saying this is you now. But in general, I hear things like we don't do first-time funds.

Why? How are you going to have competition in the market if you're not doing first-time funds. We rely on two funds with great track records. So in other words, you're reinforcing the funds that have had a good fund and helping them build brands for which they can wield their influence over you.

We call this individually rational, but collectively crazy, behavior. And the way you break out from it is through innovation. Because most people in the world today don't grasp the sheer sale -- scale of the compensation we've paid to these external managers. It's often hidden in footnotes. It's often buried in NAVs. And that lack of transparency has limited the amount of innovation that we've had. That transparency project of you all have realized and has start here a few years ago when the true cost came forward, drove this Board to say is there another way?

And that is the best thing we could have had happen. Because the fastest path to becoming a billionaire in America today is not starting a tech company, it's starting as asset management firm, okay, by a factor of two.

In order to get back at this and realign ourselves with our managers to exert our power in the marketplace's true principles as the base of capitalism, which you are, we need to be innovative. We need to step outside our traditional frames and logics, and find ways to re-intermediate and align ourselves more directly with the people that are investing our capital.

This fee and cost transparency project, as you guys have well realized, is not going to end with shutting down private equity. That's what most of your peers around the country are worried about, and especially the endowments. If the true cost came out, they literally say in closed doors, we would be forced to change and give up on private equity, which would charm our beneficiaries.

But that's a strawman. The truth is that transparency will lead to innovation. And that's where we are today. But the problem is, innovation is incredibly challenging inside the context of a public pension plan operating inside a government.

Truth be told, most of our public pension plans view a lack of creativity as a feature, not a bug. The mix of monopoly status of your organization - you're not going out of business here. You're going to be here - combined with prudent person rules and strict interpretations of fiduciary duty have led to an environment where innovation is not cherished. Worse we tend to prioritize and reinforce efficiency in our organization. Lean. Do more with less. The people working at CalPERS are probably doing two jobs, three jobs. You just define them differently than the private sector.

They're one-man bands playing a tune that is recognizable, but wouldn't it be great if they could play their own instrument. Innovation doesn't fit inside an efficient organization. We've come to learn that through academic research and studies. Pensions are lean and efficient. That is not an environment in which innovation thrives. Innovation thrives when it has resources, where failure is endorsed and accepted, where waste is part of the process.

You can't mix failure into a just-in-time process. A just-in-time process arrives just in time. You can't tweak it at the end. It's not a cultural thing, where you tell people to think creatively. It needs its own resources. It needs its own governance and structure.

Thomas Watson, second president of IBM said it, if you want successful innovation, you double your failure rate. Are you ready to double your failure rate in this organization? I don't think so.

The challenge I think facing us and facing organizations like yours, and you're not alone - I'll repeat that later - is how do we bring meaningful innovation within public pension plans to realign these organizations with the private equity managers that are just minting billionaires.

Where you innovate, in my view, is not the same place where you run efficiency. I've got a couple more minutes, so let me just jump in here and say like all economic entities, we can think of what you do as a production function. You take capital, you add people, you add process, you add information, and the output is a combination of those inputs generate more capital. That is the investment production function.

The only way you can improve those inputs, people, process and information, or combine them differently, internal or external, is through three key variables. And they are, governance, culture, and technology.

And so as we move through this process of CalPERS direct, which I will comment on in a second, I encourage you to think about those inputs, people, process and information. Where are we getting them? Are we building them internally, at they do in Canada, or are we acquiring them through external managers as endowments do?

Those inputs combine to create an institutional investment model. And it is your governance, your culture, and your technology that allow you to define that model.

No two organizations are the same. You can't just copy the Canadians. Your governance model is different. Okay. Canadians and endowments are operating in different contexts, different capital bases, different processes, different information flows, and all of that stems from their culture, their tech, and their governance.

I give you that context now as I move into some brief comments on what I know about CalPERS direct, which I have to say is less direct than the name implies. To me, it looks and feels a little bit more like we're removing some mis-aligned links in a chain, and adding some new more aligned links in a chain, which is fine. We call that re-intermediation, not dis-intermediation.

And the part of the reason I think that's fine is it's innovation that's doable and feasible. You are not alone in trying to stand up arm's length entities with unique governance structures. Unique governance structures. Remember the input that allows you to be innovative.

You could drive 100 miles down the road and look at UC regents which built UC Ventures from scratch to take advantage of the UC ecosystem, arm's length entity, innovative governance, compensation models based on market, but it theirs. They built it. They're going to get the benefit of it.

The differential in compensation between the market, and this organization here today is too big. I would love to endorse a plan to help you internalize all of your private equity dollars, but I am afraid that that is not practical in the short-run.

The differential in compensation that has been created over time is just too great. These are people who are making hundreds of millions of dollars. Okay. It's hard to recruit those people, even if you can really tap their heart strings to come and work for CalPERS.

This is a feasible path to create an arm's length entity and a series of entities to go after this base. To break the cycle, you need these intermediate moves. You re-intermediate before you dis-intermediate. And the governance model that it could be an arm's length model will help attract those people that don't want to work for a government agency, and they are out there. They have never operated in this environment, and they're worried about taking the risk of doing so. It's an intermediate step.

The credibility also that comes with an arm's length entity will help you in the marketplace, where market players won't yet know if CalPERS is real, and this time is different.

People will worry if it's not arm's length, that this will end up being shut down in the future. The delegations of authority will be very valuable.

I see breathing space for innovation in this entity, which it needs. Very hard to innovate where you run your day-to-day organization. Incredibly hard to predict what all the resourcing is going to be and where the failures will come. You need to empower this organization and give it the tools for success. That's governance independence under the watchful eye of a board. But that's the ability to do what's needed to succeed commercially, which is ultimately the objective, and that breathing space is embedded today, which I applaud.

Third, I like seeing the focus on comparative advantages. So too often we in the LP community don't realize that we have huge advantages. We are the base of the capitalist system. We just done exert it.

And when I see strategy to seed managers, which the -- or emerging managers, which the research shows us already outperforms - small managers are outperforming big manages - and I see a focus on evergreen structures, so they can use your time and scale, and focus on technology in California, I'm encouraged that if you can get the governance right, if you can evolve this into a platform that can recruit the right talent, you can succeed over time.

And I wouldn't be doing my job if I didn't give them some grief. So that's what I'm about to do, which is technology. If you remember my inputs on how we create innovation that is meaningful and sustainable, in changing the inputs to our production function, people, process and information. The choice that's been made here is to focus on governance and culture, as a means to create innovation.

Where is the role of technology? It's not too late. But I promise you technology in the form of alternative data, artificial intelligence will completely disrupt our understanding of value in the built environment and in private equity. And so I would encourage the team not just to think of technology as an investable asset, but as technology is an empowering force in this white piece of paper, this white sheet of paper where for the first time you're going to sit down say how should we do it?

Technology should be at the core, because I promise you, how we invest today is not how we will invest 15 years from now.

And with that, thank for your time.

CHAIRPERSON JONES: Okay. Thank you.

INVESTMENT DIRECTOR COLE: Thank you, Ashby.

I'm going to turn back and briefly complete the presentation and to get us to our Q&A period.

And, first, I'll turn to page five --

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INVESTMENT DIRECTOR COLE: -- in your deck, which is a process diagram. Page five describes the steps taken and anticipated as we contin -- as we've been on and continue on this journey. The concept proposal in the far left describes the 18 months of listening, soliciting ideas, testing alternatives, and developing this strategy that we've been on.

Research and planning to the right is an indication of the past six months, as we have put concrete steps into place for each of the pillars we've discussed. Next, the implementation plan. Each pillar is at a different stage with some, such as the partnership model, still rather early stage with -- and requiring further discussion with the Investment Committee, and others being further along, which leads to implementation on the far right.

And the best indication of implementation is in our Pillar 1, our Emerging Managers Program, which is in the midst of that implementation stage, with an active search underway, where we are in the evaluation and the scoring phase.

All of this is illustrated on page six using the same color coordination as introduced onto page five. And I hope you've had a chance to look at it, both in terms of a timetable, meaning -- described mid-2018, towards the end of the year, and into 2019, for each of the four pillars.

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INVESTMENT DIRECTOR COLE: Along this discussion journey, the staff and Committee have agreed to use a checklist, as we've shown on page seven --

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INVESTMENT DIRECTOR COLE: -- in order to inventory consideration still to be pursued and reviewed. This is a living list that will be updated as we progress, including the addition of additional subjects to consider.

At this stage, the checklist is focused on the direct investment vehicles, Pillars 3 and 4, as this is our area of current focus.

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INVESTMENT DIRECTOR COLE: Among the items noted, the last one is about key risks. On page eight, we have highlighted, in fact taken from the McKinsey study, a report that we've -- public document that they prepared for the Norwegian government in their consideration of private equity. And we feel it gives a very good baseline foundation of the key risks associated, both at the partner level, as well as the individual asset level.

We will keep these. We have and will keep these at top of mind as we assess the teams that we'll engage, and we'll work hard to provide the safeguards where possible as we begin the negotiation of partnership agreements.

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INVESTMENT DIRECTOR COLE: Finally, on page nine is an updated version of a chart that we used first back in November 2015, when we held our private equity workshop for a good part of a day for the Investment Committee. It illustrates that the range of realized net returns among categories within private equity are actually quite wide.

This chart, since the 2015, has now been updated for the data through the end of 2015, or in 2015 we used a chart that had data through 2012.

I'm going to pick on the line on the right, the far right of the graph. And that's the buy-out category, which is most of what we do today at CalPERS.

The top dot here is the annualized return for the 25th percentile. And here it's about 19 percent as you can see, while the bottom dot is the point for the 75th percentile. So we're taking into account 50 percent of the universe, the top -- the edge of the top, and the edge of the bottom quartile.

What's notable is that -- and that bottom is about five percent. That's a difference of nearly 14 percent in each year illustrating the point that although fees matter, higher gross returns matter more in order to get us to the best net return, which ultimately is what we need to fulfill our obligations.

That returns us to our strongly held view, and

Ted has reiterated on several counts, and Dr. Monk has also noted, getting the best talent is the -- is the most critical element for success.

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INVESTMENT DIRECTOR COLE: So at this point, I'd like to turnover to our new COIO, Elisabeth Bourqui, who brings with us her -- now her first month a fresh perspective and some very relevant personal experiences in the private equity world.

Elisabeth.

CHIEF OPERATING INVESTMENT OFFICER BOURQUI:

Thank you, John. So from my -- can you hear me?

Yeah. From my perspective as both outsider and a new joiner, I do think that this represents a unique opportunity for CalPERS to be able to take advantage of its size, of its culture, and of its long-term liability profile.

Liabilities of the fund stretch out over 50 to 60 years. Investing in long duration assets that match such a long liability profile is not always easy to achieve in an effective manner on the public market.

With this direct investment model, CalPERS can play a significant role among the handful world leaders large investor. The structure of the Pillar 3 and the Pillar 4 are up to me sound approaches that can resonate with CalPERS culture, as reflected in its Investment Belief.

It can permit CalPERS to be able to work in the same league as the world top-notch investors in private equity. The Pillar 3 and Pillar 4 permits also to take advantage of the new technology, as you just mentioned, Mr. Monk. We can have access to that new technology, and we are able to somehow cross-pollinize this information, and this technology between the direct vehicle, and within our CalPERS investments operations, and investment decision processes.

CalPERS has not taken a place among the world leaders in the area of private equity yet. Given its size, scale, and culture, I think CalPERS can reach this excellency, but need to do it in a thoughtful way, with seasoned world class talent, with a particular and broad skill set, and very strong network.

I think this is our chance. These are my observations, and I can turn over to Mrs. Marcie Frost, our CEO, for the rest of the presentation.

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CHIEF EXECUTIVE OFFICER FROST: So I know we likely have Board members who are anxiously awaiting asking questions, and I do have a bit of a response for Ms. Brown when you're ready.

But I think just in summary, these are the reasons, of course, that we're looking at the way that we invest in private equity. I did talk about this at the beginning. But innovation and creativity is extremely important. And we have to start with yes. We have to fill-in the gaps, the missing information that you all need to be comfortable, but we also have to be careful that we don't extinguish creativity before it has had a chance to really form, and shape, and gel. And that's what we are talking with you about today.

It is different. There will be necessary change management practices, you know, internally as well as externally. We have to talk about risk and what the risk mitigation strategies would be for the fund. Extremely important reputational risk is something that we're very mindful of here. And so we need to work through what the mitigating strategies might look like.

Governance. Governance very important. And I know that we've been looking at governance structures for a bit of time and will continue to do so. Recruitment of a talented people, that's really where the alpha comes from. I think we all know that. And finding, you know, this right recipe of getting a team who wants to work closely with CalPERS on this endeavor for the membership. I think there are teams out there who also have an alignment of interests to this mission, and would be a nice recruiting strategy for us.

And, you know, the -- I like Dr. Monk's observations about being very careful of putting too much fear in making mistakes. Innovation cannot really thrive if a culture of fear, so we have to be really thoughtful and careful about that, as we go through this process of determining a go/no-go.

And then back to alignment of interests, we certainly have a return orientation that we're hearing from our members, we're hearing from our employers, we're certainly hearing from all of you. Fee management and transparency about the fees that we're paying also very important. We've had significant work with ILPA, which is limited partner association group. Our own creation of a system called PEARS, where we get at better transparency and disclosure around private equity fees. And then I think if you look in our CAFR reporting, we're one of the lead public funds in disclosing private equity fees through that -- through that channel.

So I'm going to close it there, and open it up for questions. And I know we're happy to address any that you may have.

CHAIRPERSON JONES: Yes. Thank you. And thank you for a very thorough presentation, very clear. But before we open it up to questions that the Committee members may have regarding the proposal, I would like to have Mrs. Brown's question responded to. So I'll call on our General Counsel, so that we could respond to that.

CHIEF EXECUTIVE OFFICER FROST: All right. Well, I thought I could start, and then Matt could finish up.

CHAIRPERSON JONES: Okay.

CHIEF EXECUTIVE OFFICER FROST: But for what could be talked about in open versus closed, we do have Ashley Dunning with us today to answer some of the questions that have come up during closed session. So she will be here to do that.

And then Matt can correct me if I get any of this wrong. But I think generally you can talk about process, we can talk about time frames, we can talk about questions that have yet to be addressed, any updates to the checklist. I think where we're careful is individual allocation of capital to any one of the pillars. We want to be, you know, careful about that. Any legal advice that has been shared or transacted between us and Ms. Dunning. Any kind of terms or arrangements -- specific terms or arrangements of what this governance structure could look like I think would also fall on protected communication at this point.

And then I think generally ask the question, and if we feel like we can answer it, we will. If not, we'll write it down, and we'll bring it up again in closed session. But I'd ask Matt to comment further if he chooses to.

GENERAL COUNSEL JACOBS: I think Marcie pretty much nailed it. But there's nothing that shouldn't be asked, as long as the question doesn't reveal confidential, or proprietary, or closed session material.

And then there's certain matters that Marcie has pretty much walked us through, that we may not be able to address in open session, but will be addressed in either closed session, or a future open session, or whatever. But the point being ask all the questions. We're going to have answers either in open or closed at some point.

CHAIRPERSON JONES: Okay. Thank you.

Does answer your question, Ms. Brown?

COMMITTEE MEMBER BROWN: It's very helpful.

CHAIRPERSON JONES: Okay. Thank you.

Okay. So now we go to the questions regarding -- the proposal.

Mrs. Brown.

COMMITTEE MEMBER BROWN: Oh, I'm first. Thank you. I had a set of questions for Mr. Eliopoulos, but I think I'll start with our distinguished guest, Dr. Monk. I'm new on the Board since January, so I'm new to some of this. But I've been a Board member in closed session asking a lot about what research and analysis do we have that shows that these direct/indirect models will actually work, and you've talked about failure, so that's really not allowed.

So maybe I -- you can tell me what research and analysis that you've been provided by CalPERS to support this proposed reorganization.

DR. MONK: Thanks for the question, Ms. Brown. CalPERS has not provided me with their research to support this. I am drawing on my academic career studying this. I wrote a book called *Reframing Finance* that talks about pension plans establishing arm's length vehicles in a re-intermediation way with peers mostly. And in process, you know, studied at length the CEM data around direct investing, the papers from Harvard Business School around direct investing. And there are a variety of different studies that have been put out, which I'm sure the staff can send to you that show the values of building more direct, more efficient, in terms of cost portfolios. But I haven't been privy to the internal -- the internal research.

COMMITTEE MEMBER BROWN: I've actually read some papers on direct investing. And so let me ask another question where I think you have stated in the past that you favor buying rather than renting direct investment capacity. And my question is do you view the track record that CalPERS is on as ending up as buying, because to me it seems more like renting?

DR. MONK: Yeah, I don't recall saying buying versus renting, but I've been noted to say a bunch of things.

(Laughter.)

DR. MONK: So -- but like what I probably meant to say was like let's own the alignment and be able to determine the governance. To me, CalPERS direct if they get the governance right if -- it's big if -- will be, for lack of a better term, a captive GP. And it's a pretty common structure in other parts of the world especially in Canada, but also in Australia, the Netherlands to establish these captive GPs where there's an arm's length structure, that allows you to compensate and reward staff differently than you would in a government context, but for which you main ultimate control -- maintain ultimate control.

And so I would say you are buying an external team. And platform companies, which are incredibly common today, where public pension plans go in and acquire a company that does dams, or solar, or wind, they are buying into a company to use their resources. It's not internal, but it's an extension of the internal team.

COMMITTEE MEMBER BROWN: Thank you for that. I want -- I have a whole bunch more, but I'm going to wait and then ask them later, if that's all right.

CHAIRPERSON JONES: Okay. I'll -- no, yeah, why don't we continue, because remember, we have our time management now.

(Laughter.)

CHAIRPERSON JONES: And so you may not get a second turn.

COMMITTEE MEMBER BROWN: I have a -- well, I have a feeling that a lot of my questions will be asked by other Board members, so I don't want to dominate, if that's --

CHAIRPERSON JONES: Okay. All right. All right.

COMMITTEE MEMBER BROWN: -- if that's fair?

CHAIRPERSON JONES: That's fair. That's fair.

COMMITTEE MEMBER BROWN: Okay. Thank you.

CHAIRPERSON JONES: Okay. Ms. Taylor.

COMMITTEE MEMBER TAYLOR: Wow. I'm second.

Thank you very much for the report. Thank you to our distinguished guest. I am -- agree with a lot of what you were talking about. I had a couple of questions on page eight, when we get to page eight, non-financial risks controlled in private equity. And I guess how do we make sure that we -- because we're going to have these arm length entities, how do we make sure we explicitly manage for the non-financial risks that you guys laid out? So, for example, what if we get somebody like -- that David Bonderman from TPG that basically made some really ill-advised comments, and ended up -- so what if we get somebody like that at one of our arm length's organizations? How do we manage for these risks?

Because ultimately, and I think I brought this up the last time, we're on the hook. This Board, whether or not we're managing it, we -- it's us that gets in the news.

INVESTMENT DIRECTOR COLE: Yeah. Thank you for the question. And it's an important one that we will be talking about continually, because it's real life. Investing is about people. And so if we invest in an organization, in a company, then there are two things that we can do. One is upfront, we can establish what we believe is important.

So when we're negotiating a partnership agreement with a general partner, who will be working for us, we will make perfectly clear, as much as we possibly can, the basis of our beliefs, and our principles, and as a requirement of actually working together.

So up front, we're setting the stage, which is a -- very much addresses two parts of what Dr. Monk referred to, culture and governance. Now, after the fact, something bad is going to happen somewhere along the line.

COMMITTEE MEMBER TAYLOR: Right.

INVESTMENT DIRECTOR COLE: And we had talk -- we've talked about bringing case studies for review with the staff and with the Investment Committee of real-life situations, like Tesla, or like an Uber, or -- we can come up with a number of them in different walks.

And it's important for us to have a mechanism, a process by which we would deal with the inevitable not only tensions, but behaviors that would cause problems. There's no way to prevent in the end.

COMMITTEE MEMBER TAYLOR: Right.

INVESTMENT DIRECTOR COLE: There is a way to identify and then engage. And engagement, being such an important part of what we do, is not unlike how we deal with the general partners now, who we invest in their most recent fund. If we have an issue associated with an underlying investment portfolio company, we engage them, and we come back and try to get to an appropriate resolution.

In the case of the direct vehicles, we have one step more, and that is that starting point. We've spent the time to say let's talk about the types of things that would cause us anxiety, and therefore we wouldn't -- we don't want to be involved in. And let's agree in advance that we'll be diligent around those.

But once it occurs, as it will inevitably, we're going to go through that same confidential face-to-face engagement to get there. So there's no prevention, and there's no saying that we can --

COMMITTEE MEMBER TAYLOR: It will never happen, right?

INVESTMENT DIRECTOR COLE: It will never happen. But I think what we've contemplated gives us the best chance of having -- getting to the right outcome on the basis of our own values and beliefs.

CHAIRPERSON JONES: Yes, Mr. Monk.

DR. MONK: Thank you. That's a great question, Ms. Taylor. I think what I'm excited about in terms of vehicles like this is the opportunity to maintain the culture of a CalPERS in the context of a kind of arm's length entity, whereby the people being attracted to work at that entity are attracted for more than just being a billionaire.

So they're going to be compensated well, but in -- in my view, and I haven't talked comp with these people, but it's not going to be the level of compensation you will see in the traditional GPs. And so the people that will raise their hand to come and work for this are people who are hopefully incredible investors, who do not enjoy the business of fundraising, and who have a mission.

And so there is an opportunity for a vehicle like this to be a breeding ground for a new generation of investor that is thoughtful, and is also incredibly commercially successful.

COMMITTEE MEMBER TAYLOR: So are you --

DR. MONK: So I might flip it around and say you're worried about the bad guy getting in there. And I'm saying, you could create this where it's an environment where great people emerge.

COMMITTEE MEMBER TAYLOR: So in your expert opinion, in the research that you've, have you found that to be the case?

DR. MONK: We find that the people that want to work at pension plans, in places like Canada and Australia, have a mission orientation, and believe in securing the pensions of the members, and that it guides their thinking. And that many of them, if you could just get their compensation close - it doesn't even need to get all the way there - to what they would make in the private sector, would happily walk away and go work with you to help solve these big problems.

COMMITTEE MEMBER TAYLOR: So that's inclusive of our ESG strategy being included in all of this corporate --

DR. MONK: I see ESG as just long term risk management.

COMMITTEE MEMBER TAYLOR: Right.

DR. MONK: And I think that's the way most investors that are going to hold assets for 20 years, or 10 years, if your -- what is it the Horizon Fund. Horizon Fund is going to embed ESG, and it's just going to be called risk management. That's my guess. It's not going to be called ESG, because if you're holding an asset for 50 years, you want to know what's going on the environment.

COMMITTEE MEMBER TAYLOR: Right. Right. Thank you. Thank you very much.

CHAIRPERSON JONES: Okay. Mr. Costigan.

VICE CHAIRPERSON COSTIGAN: Thank you, Mr. Jones.

Dr. Monk, thank you for being here. I would encourage folks, if they haven't read some of his writings to read them as part of the due diligence. In addition to being pithy on Twitter, he's got some excellent materials out there.

(Laughter.)

VICE CHAIRPERSON COSTIGAN: So I would -- you do. So I'd encourage you. So one is really appreciate you being here, the insights and on private equity, and also, just to the staff. I mean, just some observations and some questions. Again, we're doing this to try to be as transparent as possible and have these open discussion. And I know we're going to hear from a number of folks shortly from the public, which I think is going to be very important.

But I just want to kind of reiterate one of the reasons that we're doing this, or at least as I see how we're doing it. You know, we start with that the -- you know, the Board is -- primary risk is the payment of the promised benefit. So that's what we start with every day.

The second issue is we try to create certainty for the employer and the employees as to what their costs are going to be. You know, I know every year -- or when you go out and talk to the stakeholder groups, they want to know are we cutting the discount rate, are we -- what are the returns going to be, what are our long-term projections?

And I see a lot from local governments and others. And I know Mr. Gillihan works very -- is going through this with the MOU negotiations recently that that's what the labor groups are looking for as well.

We have significant pressure on returns, which addresses the unfunded liability. We're under enormous pressure to control costs, and at the same time we have to balance the behavior of our private equity, our external managers internally.

I think Dr. Monk hit on a key element. I, last week, was at a conference in Canada and had the opportunity to meet with a couple of Canadian funds. And I thought was most interesting was the pay of those Investment staff considerably higher than ours. And it's this hybrid between being in the private sector and the public sector.

The first driving one is they didn't feel the pressure to raise capital. They get focused on returns. That they were mission oriented. That these were people that were giving up the opportunity to go make considerably more in the private sector. And I've said that over a number of years. There's a noble calling in coming into the public sector, but you have to be able to live on what that pay is.

And while you're willing to give up some salaries, right now there's just a huge disparity between what we pay our investment staff, and when we look OMERS or the Canadian funds, or the Australian -- excuse me, the Australian funds or the UK funds. And I'm not sure where we're going to be able to get there.

So you start sort of with that premise if we can't change our governance model because we were a State agency, how is it we create a model that's in between and OMERS and public sector agency in order to go back to sort of the points I was making which is got to pay the benefits, got to focus on returns and control costs.

And so I think, Dr. Monk, in what you were saying, and one of the things I've heard is, if we're not doing this today, we're going to be passed by. Is that a fair assessment that other funds, other entities -- I know 10 years ago no one would have thought of robo-trading or -- I use the Schwab robo account. I've talked about it before.

I never would have thought of using algorithms ten years ago. Now you sit there and look at it as entirely plausible, but -- it is a model you see going forward. If we do nothing, we're going to be left behind to what you see in the future, five or ten years, as to what other industry standards would be?

DR. MONK: Well, I think the misalignment of interests continues to deteriorate, not improve.

And we all hoped that the financial crisis would be a reset between the LPs and the GPs. But in that time period with the hit to funding levels, actually what happened was pension plans said, gosh, we better move into alternatives faster, which shifted the supply and demand dynamic for these alternative managers that had track records.

Remember, it's the big funds that benefit from our governance rules around, you know, we need two funds with track records, you need to be a team that's established working together. I don't know your specific governance protocols for picking private equity managers. But oftentime, it's a -- it's a huge benefit to the existing players.

And so everybody just chased these same funds. And so the take-it-or-leave-it mentally has probably gotten worse, and will continue to get worse unless you break out. So I'd say you can continue to do what you're doing, but that 700 million number will go up. And you need to be ready to communicate that. It will go up dramatically.

VICE CHAIRPERSON COSTIGAN: And just one other question, last one. Can you maybe shed a little light on the way UC does it? And sort of just so that the Board understands that this is sort of not being done in a vacuum, that at least the University of California Board of Regents and the Office of President have something similar.

DR. MONK: Well, that is a regental model, and so everything needs to go to a subcommittee of the Regents, the Committee on investments. But in terms of private equity, there's been a push to shrink the number of relationships, increase the size of those relationships dramatically, in order to win fee breaks, and get better co-investment rides and all those things. So the number of relationships in that portfolio since I took over as a senior advisor to Jagdeep has gone from the 300s probably down under 100 at this point.

So concentrating benefit -- sorry concentrating mandates to get more alignment of interest with the underlying manager. And in the case of the UC Ventures, if that's what you're talking about?

VICE CHAIRPERSON COSTIGAN: Yes.

DR. MONK: Okay. That was looking at the ecosystem that is the UC, understanding all of the IP being generated in that environment, five patents a day, and designing through an incredibly complex governance world a series of small funds on campuses, leading into a big fund that is an arm's length fund called Bow, which is part of a broader UC Ventures program. So there's a whole series of funds, of which Bow is the pinnacle.

VICE CHAIRPERSON COSTIGAN: Thank you.

Thank you, Mr. Jones.

CHAIRPERSON JONES: Yeah, you're welcome. Yeah. Yeah, Dr. Monk, I was just thinking about, you know, we have a roadmap, a laid out plan in terms of strategy, timelines, et cetera. But could you comment on your experience that there's such a thing as going too slow? And the risks that are involved is you start pushing this thing out further and further, and you lose the steam, or you lose the confidence in the marketplace, et cetera.

So could you comment on that aspect of a proposal like this, in the event that we slow down, and what the risks are?

DR. MONK: Yeah. So I start all these comments with a real positive comment, and then I'll give you the negative comment and then I'll end with a positive comment.

(Laughter.)

DR. MONK: The positive comment is at least you're doing it alone.

So most of the projects I work on like this include peers coming together to try to do something innovative. And that can be like herding cats. You, in this room right here, can define your future. And so already that is an incredible advantage that a lot of pension funds aren't willing to own up to. It creates a little bit of career risk here, maybe some political risk there, but it's the right path to try to get something truly innovative done.

Speed matters, right? I think you don't want to shortchange your governance conversation, laying the foundation to have the best governance framework is worth every moment you spend on it. But at that point, you know, don't let great be the enemy of good.

Move fast. Get things built. Make a recognition here that things are going to be a little bit messy, and see how fast you can move once you have the governance in place to be confident that it's set up for success.

Does that answer your question, Chair?

CHAIRPERSON JONES: Yes, it does. Okay. Thank you. Mr. Miller.

COMMITTEE MEMBER MILLER: Yeah. Thank you. Kind of take this a little bit of a different direction. Just -- Dr. Monk, in your experience, as we look toward creating these partnerships, particularly in the direct pillars as we're calling them, how much of a role do you see for those partners, and in kind of either participating or informing our medium is to longer horizon planning when it comes to workforce, knowledge management, and technology. And is there a real role to build in or will that happen organically? How do we make sure that we continue to develop our organization for that dynamic environment to be agile enough to, you know, see things coming and work with those partners to be effective, not just with this, but with all of our business.

DR. MONK: So my advice is to build a culture inside this new organization whereby all the members of this new organization feel a part of this team. They may be an arm's length entity with different arrangements and delegations, and constraints and challenges. The people working there may be fired if they underperform. They may be paid considerable sums of money if they perform well. But they should be a part of this overarching umbrella that is CalPERS with a focus on providing pensions and securing the finances of the State.

I think that is a critical thing, because what you're creating is the ultimate networking team in the world. Okay. So we often undervalue social capital. Like if I -- if you go to ask the investment staff how are you writing social capital and networks into your investment memoranda in order to understand where this deal came from, and how doing this deal will affect our future relationships and deal flow? I can't guarantee this, but I'm guessing they don't have that.

Whereas, it's critical. A heuristic that most pension plans use in order to decide to make the next step is who else is invested, where did we get the deal, even before they look at the cash flows, and the multiples, and all that.

And so in building a CalPERS direct, you are building the ultimate networking engine. Everybody will want to talk to them. Every manager, every company, you'll have this incredible asset. And, of course, that should feedback into this organization, whether it is adding value to the fund managers you have today. Hey, you guys should be talking to our CalPERS direct guys. They're doing something right here. Maybe work together on it.

Or it's literally funneling technology. I loved Elisabeth's comment, funneling technology in the investment portfolio back into your own organization to help improve risk management, factor identification, you know, the provision of bespoke portfolios for people nearing retirement. I don't know what it is. The technology is going to change. And so you'll have these, you know, networks that no one else will have.

Did I answer your question?

COMMITTEE MEMBER MILLER: Thank you.

CHAIRPERSON JONES: Ms. Mathur.

COMMITTEE MEMBER MATHUR: Thank you.

I think this is a really important discussion. You know, as I speak to -- excuse me -- members and employers across the state, I hear members saying, okay, we want CalPERS to make meaningful progress towards full funding of the system, and we can't afford -- we cannot bear additional burdens of -- in terms of contributions.

And we've done a number of things recently to increase the contributions for employers, and members also. And that has been necessary. It's been important. And yet, we are, I think, sort of at the -- at the capacity of what members and employers can bear.

And so this -- this idea, where we could in a very risk-conscious thoughtful way, and actually in a way that perhaps reduces risk in certain key areas, in an asset class which could actually -- which is the only one that we expect to actually -- to really outperform our target rate of return over the next decade or more, I think is just essential.

And, you know, the areas where I see this adding so much value is, number one, we are -- we're not just an investor. We're actually an owner, because we truly expect to own companies for their lifecycle. And on the private side, we don't -- that's actually where we're not doing it. We're doing it on the public side. We're owning companies in the public markets for generations.

But on the private side, because of the way the fund structures are, we're selling companies every five, seven, 10 years. And we should be owning companies that we think are going to deliver value over the long term for a very long term. And that's what I think this is -- that's one of the major advantages, in my opinion, of looking at this particular approach.

It allows us to truly be owners, to look at some of the long-term risks that can manifest over a long period of time, either emerge slowly over time or erupt in a particularly aggressive fashion at some point in the future. And that could really damage our returns and performance.

And so, to me, this is -- this is all about -- you mentioned a lot about alignment of interests. It is very much about alignment of interests. It's also about aligning our own investment approach to our true nature, which is a long-term owner of companies, property, et cetera for -- in a way that's going to generate value for our members.

So, of course, the devil is going to be in the details. We're all going to work really hard to make sure that we understand the terms and the terms advantage us as much as possible, and create that alignment that we want, including the governance structure and all of that, which I know we -- you know, we -- we're not there yet at the end of that journey yet.

But, to me, this is -- this is an important step forward, and something that is really to the benefit of our members. So I'm glad we're having this conversation.

CHAIRPERSON JONES: Ms. Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chairman. And I will echo Ms. Mathur's comments. This is a very critical discussion to be having and very happy that we're doing this in open session.

I wanted to just make a couple of observations. And, first, thank you, Dr. Monk, for really highlighting the importance of governance. That's really, I think, the foundation upon which all of this is going to either stand or fall apart. And I hope that we do actually put the adequate amount of commitment and time into establishing our governance framework.

I wanted to -- and I would agree that timing is of the essence as well. So I wanted to just make a couple comments with respect to the checklist perhaps. I was a little kind of taken aback and put off by the third box about fiduciary counsel input. Actually, I would like to include fiduciary counsel as part of the evaluation up on top with respect to the Board's.

I think it will probably help with getting questions asked and answered in a more relevant fashion. And obviously the input is important, but just kind of being at that level of involvement, so that we can include that at the ground stage, if you will.

Another comment, Dr. Monk, that you made, and I'm kind of sitting here scratching my head, because I'm trying to reconcile it. And that is that, you know, high gross returns matters the most.

And I guess at the end of the day, how do we reconcile that with hopefully being able to attain a lower fee structure. And it may be an issue of timing in terms of when we kind of realize and actualize all of that. But, you know, I think about also what's missing in all this that could help with some of the non-financial risk, and that is just kind of an overall communications plan about what we're doing, which I think can be helpful. And I think having this conversation in open session is part of that.

But can you just talk a little bit more about how we should think about -- obviously, the high gross returns completely get that. But in terms of how we should look at that in relationship to hopefully getting to a point of lower free structure, and should that be something that we're, you know, kind of just at the outset looking to strive for?

DR. MONK: I'm happy to comment to on this. I will say that I think the high-gross returns comment was John.

COMMITTEE MEMBER YEE: Oh, I'm sorry.

DR. MONK: But my view, since I'm on the mic now --

(Laughter.)

DR. MONK: -- is -- it is not the most important. I actually think squeezing the most return, per unit of risk, per unit of cost is the priority. And if you build something like CalPERS direct, you actually don't need the same gross return to generate a higher net return.

So you can lower your risk in terms of the investments and generate similar or better outcomes, especially if you're holding these assets over decades, and not having one of your private equity GPs sell them to another one of your GPs within your same portfolio.

So risk is something we should all be talking about. It is the engine and the oxygen of financial markets, and there's no return without it. In order to generate the net returns you are receiving, those private equity people have to take a lot of risk, and you wouldn't have to.

COMMITTEE MEMBER YEE: I'm sorry I attributed the comment to you. But I do think it's something we kind of have to reconcile in terms of how we talk about this. And perhaps it is really putting more of the focus on risk. John, I'm sorry.

INVESTMENT DIRECTOR COLE: Agreed and -- totally with the comments that Dr. Monk just mentioned.

On the subject of fees, we believe that our true opportunity in acting alone and innovatively comes in the area of economies of scale. Our ability to sit across the table from a very successful general partner and insist that we should have fees that are lower just -- we have no leverage. We have no basis in which to do that in the primary commingled fund area.

But as we become more of a presence in the direct vehicles, there's a tremendous amount of potential for economies of scale as we work away from a management fee and towards a budget-based compensation system for example. And there's lots of opportunities as we work with general partners on more specialized and mandates like custom accounts, and especially, of course, in co-investments, where we can -- where fees should be zero or approaching zero.

So we -- I don't want to understate the importance of the fees side of the equation. I definitely want to acknowledge the risk side of the equation. But at the end of the day, if the range of returns is a thousand basis points, then the most important thing of all is being as high up on that chain as we can be. But that's really the point.

COMMITTEE MEMBER YEE: Agreed. Okay. Thank you, Mr. Chair.

CHAIRPERSON JONES: Okay. Good. Okay. Ms. Hollinger.

COMMITTEE MEMBER HOLLINGER: Thank you. I want to thank staff and Dr. Monk just a really great presentation. And I as a fiduciary and trustee, I think my -- our main driver fiduciary duty is to increase the funding status of the plan. And returns are the driver.

And this CalPERS direct accomplishes both. And we want to do it in a risk-adjusted way. And, you know, we've had a nine year run in the public markets. And I think if, in the next downturn, this also -- you're better off in the private markets.

So I think this also does this in a risk-adjusted way. It also, as far as our ESG, when you have the optionality of holding companies for the long term, that truly creates long-term sustainability. A lot of times you can create -- if you know you're going to sell a company in five or seven years, you may do things that increase the price in the public -- in the markets, but don't necessarily contribute to the long-term sustainability.

And, Ms. Yee, on fees, I think eliminating the buying and selling of companies in our own portfolio by the current business model of holding something five or seven years, that is an extraordinary savings to us, because we're really trading on our own portfolio. So I am very encouraged and look forward to getting the governance structure that enables us to move forward. Thank you.

CHAIRPERSON JONES: Okay. Thank you.

Ms. Brown.

COMMITTEE MEMBER BROWN: Thank you.

Dr. Monk, I want to follow up on Ms. Mathur's point about alignment of interests in this new CalPERS I like captive GP model. I kind of like that. I'm sure we won't want to say that more than today.

But I'm wondering how we get that alignment of interest when no CalPERS Board member would be on this Board - I don't know if you're aware of that - or we would select the Board that's going to govern the new direct system.

I'm just wondering how we get that alignment of interests. You can't write everything in that agreement, that LPA. So I'm just wondering how we get there, and if you know that the current governance structure, which is so important, doesn't have any CalPERS appointees or any CalPERS members on the governing boards of this new entity we're forming.

DR. MONK: Sure. So it's not -- it's not a new problem. We can point you to sovereign funds and pension funds that use double arm's length nomination procedures for boards of directors. Mr. Costigan mentioned OMERS. They run a similar nomination procedure for the investment committee overseeing the investment organization.

New Zealand Super Fund uses a double arm's length process, whereby a board of guardians I believe choose the board members from a list of qualified candidates. And so it would be the job of this board, as I understand it, to define that nomination procedure. And determine the qualities that you would like to see on a Board of a private equity entity.

And then set the terms, and then ideally as part of that initial governance process, understand what are the delegations of authority in painful detail, for what this organization can do, and do without having to get input from their board, and from this board.

I'll tell you that I used to believe that the signal of a great pension plan was the nomination procedures, of the board of directors. And over time, I've changed my mind, because I've seen a bunch of wonderful boards with weird nomination procedures. But it's the delegations of authority. That delegation framework, if you show me 50 pension plans, and their associated delegation frameworks, I can probably point to you the plans that are having the most success, by just based on looking at that delegation framework. So that will really be a critical component of this organizational design.

COMMITTEE MEMBER BROWN: Thank you.

CHAIRPERSON JONES: Okay. Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

And I want to thank staff for developing this presentation and inviting Dr. Monk. And thank you very much for being here, because this has been quite a great experience for us to be able to have your knowledge shared with us. And I appreciate your dedication as a Californian, and your interest in helping us succeed and -- in the future.

I want to come back to a couple of things. This -- I'm intrigued by -- and this is the first time I've really heard it framed the way you framed it, which is by reducing -- restructuring how fees are paid under this new model, we, in effect, can get the same return with lower risk. I'd like you to expand a moment on that issue.

And then the other one is you talked earlier in your presentation about the amount of private equity that funds are doing today. And we have a target of 8 to 10 percent is kind of where we seem to be going. Is that the right number or is that too low?

DR. MONK: Is that a return target just for private equity 8 to 10 percent?

COMMITTEE MEMBER SLATON: No, amount of assets. No, no. Amount of assets invested.

DR. MONK: On the first part, you can think of a return as being a function of a number of things. People talk about information ratios, and Sharpe ratios, and all these things. But let's just say that the risk that you're taking in the portfolio minus the cost of accessing those risks will generate the return.

If you can remove the cost, you can reduce the risk, just like it's a simple analytical framework. And you can think of it like buying a piece of infrastructure. When a private equity GP was buying a piece of infrastructure through a private equity structure with a two and 20 fee arrangement, that piece of infrastructure is a cash flowing asset. It's a pretty simple asset.

But in order to make that asset perform in such a way that the private equity GP could capture their carry, they would have to do wacky things with it, like lever it up, create a bunch of different interesting structures. So that's increasing the risk of a pretty basic asset in order to meet the return requirements to cover their cost and your net return needs.

If you can remove some -- or change -- you're not going to remove it. But if you can change the way those fees structures are defined, you can get that alignment of interest. And that's why we talk so much about aligned intermediaries. It's like how do we take CalPERS and build an intermediary that aligns them to the underlying asset, and not allow that underlying asset or the fee structure between them change the nature of the risk?

It happens more than you'd expect, where the productization of the asset actually changes the risk profile. And that's what you'd like to avoid as a long-term investor.

Your second question about the asset allocation target in private equity I'm going to punt on that one. I would -- to answer that really well, I would probably want to spend a week understanding your portfolio, your comparative advantages, your future liability structure, and try to think about how private equity fits into that.

My guess is as the plan matures, you're going to move more quickly towards cash-yielding assets, like infrastructure, agriculture, things like that, and away from things that are all about capital preservation. I don't remember what the maturity level of the plan is right now, so...

COMMITTEE MEMBER SLATON: Thank you very much.

And I -- I just think that I'm also persuaded by your issue that you discussed of timing, and the fact that it's not going to get better, where we are today.

And that, to me, is an extremely important takeaway, that I'm not sure we really have -- we have a lot of choices in how we design this, and how we construct it, but I don't think we have a lot of choice about doing it. I think we're going to be compelled by the marketplace to do it.

DR. MONK: I would agree. I mean, I think that moment that we're in right now, that's exciting from my perspective, because I get to sit here and help you think about designing new vehicles. You're not alone. I mean, you guys are on a journey that I can think of probably 20 or 25 plans like you right now are saying, how are we going to do this?

So, you know, if any of you want introductions to your peers to talk about what they're doing, this is a -- this is a common problem.

COMMITTEE MEMBER SLATON: Thank you very much.

CHAIRPERSON JONES: And, Dr. Monk, one comment on that. Those 20 plans that are on this road -- on this path also, I wonder how many of those jumped out after they heard of what we were going to do?

(Laughter.)

DR. MONK: Your fee disclosure catalyzed a lot of plans. So, you -- I mean, you guys fell on your sword a little bit. I promise you, you are not alone in overpaying private equity managers. But you were the first people to publish a report saying it, and being clear about it. And so we owe you guys actually gratitude for taking that first step.

CHAIRPERSON JONES: Thank you.

Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you, Mr. Chairman. First, I do want to thank the staff. I mean, you did a tremendous job trying to educate this -- educate me and the Board on this new venture, and that I -- I'm convinced is needed. And I also want to thank you for being experts, Dr. Monk and others that have presented.

And I think one thing coming into the Board is there has been a history of guiding principles over governance and sustainability that I think this Board will carry forward. And so I do look forward to the continued deliberation and discussion as we develop this business model, because I'm convinced there will be governing principles and governing rules that will frame the -- the final product that will bring the right culture and those aspects that Dr. Monk brought to the table. So I appreciate the ability to sit in on this discussion and thank you.

CHAIRPERSON JONES: Okay. Thank you. That concludes the questions from the Committee. And I think you've heard that this is a very important project. And it's refreshing to see that we're kind of all on the same page as we move forward in this regard.

So we want to thank you again for the report, and thank you Dr. Monk for being here to provide your insights and information with us. So with that, we will -- oh, we've got some speakers on this.

And I -- Mr. Baker, you shared with me that some of the people on this list may not want to speak. So what I'm going to do is I'm just going to ask all of the Toys"R"Us that are going to speak to come up. And if you, Ted and group, could -- and you could introduce yourself and your name, so that I won't be calling names that are not going to speak. So I'll let you do that.

And also, Mr. Darby, you are on this list, and Mr. Lennox, you are on this list in addition to the groups of you. You'll be up next.

Just come on up and sit. Just -- just.

And the process is that for those that are going to speak, please indicate your name and the organization which you've already listed. But you will have three minutes to speak. And this light right below my name I think here will advise you as to how much time you have left during your comments.

MR. BAKER: Perfect.

CHAIRPERSON JONES: Okay. And the light will come on once you start to speak.

MR. BAKER: Good afternoon, Mr. Chair, members of the Board. My name is Jim Baker from the Private Equity Stakeholder Project. Hearing the discussion about interest alignment and about partnerships, I have an issue that I think is relevant to the current discussion. Also here with -- on behalf of the Center for Popular Democracy and the organization United For Respect, which work with retail workers.

As you know, CalPERS is among private equity firm KKR's largest investors, having invested over $1.2 billion since 2012. CalPERS also invested $150 million in the KKR Millennium Fund, which owned retailer Toys"R"Us until KKR, Bain Capital, and Vornado took the first into bankruptcy last year.

CalPERS is also among Bain's largest investors, having committed at least $500 million to Bain Capital since 2012, although is not in the Bain Capital fund that owned Toys"R"Us.

In March of this year, Toys"R"Us announced that it was liquidating closing nearly 800 stores throughout the United States, and terminating 33,000 employees, including 113 stores and thousands of employees here in California.

Toys"R"Us collapsed under more than $5 billion in debt piled on by private equity firms KKR, Bain, and Vornado following the 2005 leverage buyout. When the company filed for bankruptcy in September, it disclosed it was spending around $400 million a year just to service that debt.

While 33,000 employees are out of work, and limited partners such as CalPERS got wiped out, KKR, Bain, and Vornado appear to have profited from $464 million in fees and interest that they collected from Toys"R"Us during the period that they owned the company.

Toys"R"Us employees have asked KKR, Bain Capital, and Vornado to pay severance to laid-off employees out of the fees and interest they collected from Toys"R"Us. A copy of the letter employees sent is the packet.

More than a month and a half later, KKR, Bain and Vornado still have not responded to employee's requests. So investors wiped out 33,000 people out of work, no response from KKR or Bain Capital. KKR and Bain Capital's refusal to even talk to Toys"R"Us employees demonstrates a profound lack of integrity.

The fee structure that KKR, Bain Capital, and

Vornado put in place further incentivized them to use debt, which ultimately proved to be Toys"R"Us's undoing. So every time Toys"R"Us added debt, they got a fee.

So I guess by saying nothing, allowing KKR and Bain Capital to keep the fees and interest they drew from Toys"R"Us continuing to give more money to KKR and Bain, CalPERS will encourage KKR to act in its own interest rather than the interests of investors and stakeholders, such as employees.

Last week, the $93 billion Minnesota State Board of Investment halted new investments in KKR, pending a review of the transaction. We ask CalPERS to do the same.

CHAIRPERSON JONES: Thank you.

MS. LOPEZ: Hello. My name is Sandra, and I'm a manager at Toys"R"Us at the Ontario location here in California. I started out as a season part-time associate 22 years ago. I worked my way up while raising two kids as a single mother. I have Missed football games, cheerleading competitions, family barbecues, Thanksgiving, Christmas, 4th of July, and even the healing of my daughter after her ruptured appendix.

Our work in retail has value for the families we help at the stores, and our families at home. We can't let Wall Street and we can't let Bain and KKR take it all away. We are fighting for the future, so our kids can work and feel valued.

Please, I'm asking you to do your homework and make sure you're not investing in companies that are all about corporate greed instead of workers' needs.

Thank you.

CHAIRPERSON JONES: Thank you.

MS. KLEVEN: Hello. My name is Colleen Kleven, and I live in Martinez. I've been working for Toys"R"Us for almost two years now. In fact, I -- it would be two years in October, if the company wasn't going out of business.

I am a floor associate and toy specialist for the company. And I've also been taking care of my 68 year old father while working for this company. And my father's health is not doing too well.

When I had found out that Toys"R"Us was going to start liquidating its operations, I freaked out. I didn't really know what to do. My family depends on me and this job to take care of everything. We have eight animals that we live with, and I'm living in a two-bedroom, one bathroom house with five other people, because I can't afford to get a house or an apartment on $11.75 an hour.

When I started -- when I joined this movement, I had originally joined for my co-worker who had been with the company for 38 years, and I wanted to ensure that he was able to get all of the money that he had earned from this company. And now I'm joining this fight to make sure that my future kids, if I ever have kids, will be able to have a good amount of money to live off of.

I'm asking that Bain Capital and KKR seriously do some research and actually look into more, oh -- sorry. I'm really nervous.

Uh-oh. Sorry. I'm going to throw-up.

CHAIRPERSON JONES: Sorry.

Okay.

MS. ROMO: Hello. My name is Nadia Romo. I was a store manager for an outlet store in Ventura, California. My fiance, my stepson, and myself have worked for Toys"R"Us and have put 21 years together. We have a two-month old daughter right now and three other children at home to support.

Financially, this has been a huge burden in my home. My two-month old baby girl needs medical insurance right now, for a medical need she has. So not having insurance would be devastating. We tried to downsize our home to save some money when we heard that our stores are closing. But we were denied. A lot of people they were like, hey, you both work for Toys"R"Us. We can't take that chance, you know, renting you a place.

So now we got forced to sign a 13-monthly lease with paying an additional $100 a month, which is more stress on us.

I'm upset how Bain Capital, KKR, and Vornado can walk away with millions of dollars, while over 33,000 dedicated Toys"R"Us employees don't know if they're going to support their families or pay their mortgages next month.

I'm angry in how we were all lied to about getting severance pay. I also felt like a liar telling my employers -- my employees that our store was safe and it was not going to close, when the first wave of stores closed. When I went to New York to join the RISE Up in retail, it broke my heart listening to so many employees it hurts and burdens, hearing the stories about losing their jobs. Many were with Toys"R"Us over 20 to 25 years. Some lost their parents during the liquidation, lost their homes, one newlywed had a miscarriage, some had spouses with cancer that they rely on this job for financial medical needs. The list goes on and on.

I would like you to review and investigate these greedy bad people who didn't care about putting 33,000 employees out of jobs. Please do not invest with people who just want your money to fill up their budgets and pockets with your money, and that do not care about people's needs, employee cultures.

KKR, Bain Capital, and Vornado never put their hearts into a 70-year old company to grow with a great good investments in return. They just took advantage of investors like you and took advantage of hard workers like us.

Please, please think about it really good. If you decide to risk and engage any of your future investments partnerships with any of these three greedy lying companies as KKR, Bain Capital, and Vornado.

Thank you.

CHAIRPERSON JONES: Thank you.

Is that it for your group, Mr. Baker.

MR. BAKER: We're good.

CHAIRPERSON NICHOLS: Okay, you're good. Okay. So the rest are just -- okay. Mr. Darby. And then you come forward Mr. Lennox, and Mr. Gammelgard.

MR. DARBY: Good afternoon, Mr. Chairman and members of the Board. Al Darby, Vice President, Retired Public Employees Association.

RPEA applauds this new PE initiative. We've long recommended more PE investment, and we agree with continuing and expending its -- our PE position. We question the forming of another Bain Capital or new administration entity that this kind of flies in the face of transparency and efficiency.

The fund has been attempting over the past few years to eliminate cost. And this certainly is not moving in that direction forming a new entity to oversee this new initiative in private equity.

In addition, Ted Eliopoulos had just told us that outside managers largely underperform, so why not use our own PE staff except to maybe beef up Pillar 3, which is the venture capital portion. We may need some more expertise there. Pillar 4 may also be -- need some additional staff. However, a consultant or consultants might be the answer to beefing up that area.

So we really question, you know, whether deviating from the Canada model is really necessary. It just doesn't increase transparency or efficiency.

The goal is to lower fees, then we need to invest in fewer outside managers, and use the internal staff to a greater degree. If the goal is -- to get into the recent trends, it looks as if we're trying to time the market. And according to recent reports, this is probably the wrong time to go into this -- to the market. However, that depends on, you know, the efficiency of the staff in selecting the right opportunities.

The other thing that happens here is if we form this new entity, we actually increase the importance of the outside managers, and increase the cost of the outside managers, because it's already a seller's market. And finding these people to do the job is even more difficult and costly.

Thank you.

CHAIRPERSON JONES: Thank you.

MR. LENNOX: Good afternoon. Thank you. Good afternoon, Chair and members. Derick Lennox on behalf of the School Employers Association of California, and the Small School Districts Association. You have many, you know, kind of granular and intricate decisions ahead of you on how to move forward with this. But our message today is more on the big picture side, which is we support your efforts to be creative, to be aggressive about capturing risk-adjusted returns in today's market.

We feel like on the employer side, we like to be good partners with you, and -- in some respects, we don't have a choice. We pay the rates that we're given. But at the same time, we try to do things like support the lowering of the discount rate down to seven percent. And, you know, work with you on the amortization policy, because they're the right things to do.

This, in our view, is you and your great staff upholding your end of that kind of partnership as well by looking for ways to make those investment returns, and ensure that schools can remain fiscally solvent as well.

So we really appreciate that. And we know that it's going to be a long discussion ahead, but wanted to let you know in person that you do have support from school employers, who are thinking about the same big picture issue of fund status that you are. But we're happy you're taking on this project as well.

Thank you.

CHAIRPERSON JONES: Thank you.

MR. GAMMELGARD: Good afternoon, Chairman and Board. Alex Gammelgard on behalf of the California Police Chiefs Association. And I would echo a lot of the things the previous gentleman just mentioned, in that our interests are very similar.

For starters, thank you for the work you do. You're an integral part to a sustainable workforce in California, particularly from our interest as it relates to public safety, ensuring that we have a viable, and robust, and long term CalPERS system is important to the work we're doing.

In our industry, the most uncertain future looking issue that we're dealing with is the cost of CalPERS as it relates to our employ -- our police officers long term.

As it relates to the private equity model and California direct, Cal Chiefs has an interest in ensuring that the CalPERS investments are as successful as possible, and we believe that your efforts and taking note of your -- the importance of the thoughtful efforts to creating a good CalPERS direct model is very important to us.

Investments with a lower performance have a direct impact on our resources. And with the roll-up rates that we're seeing as a result of some of the -- what we anticipate seeing as a result of some of the recent decisions, which we also believe are very important, such as the lowering discount rate and amortization, we'll have significant impacts on our budgets. And so it's important that we're looking at ways to fill that other portion of the CalPERS Buck as we've seen graphically represented.

So as such, Cal Chiefs encourages -- encourages you to take actions in a thoughtful way to move forward on this initiative, and to bolster the earning potential of CalPERS to ensure its sustainability in the future and ensure public safety in California.

So thank you.

CHAIRPERSON JONES: Okay. Thank you for your comments.

Okay. So that completes the discussion of private equity business model alternatives.

So now we will got to Item 9c, Corporate Board

Diversity Update.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Mr. Chair, members of the Committee, we're just waiting for your team to come in place.

And I'll give them a moment to get their slides ready.

All right, Beth. Are you kicking us off?

MANAGING INVESTMENT DIRECTOR RICHTMAN: I am.

CHIEF INVESTMENT OFFICER ELIOPOULOS: All right.

MANAGING INVESTMENT DIRECTOR RICHTMAN: That's me.

Beth Richtman, CalPERS Investment staff.

Thank you for the opportunity to share with you some updates on our Board diversity efforts. The ESG strategic plan has an objective to enhance total fund performance by increasing corporate board diversity. And we understand and appreciate the Board's interest in this topic. Over the past several years, staff has shared research --

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MANAGING INVESTMENT DIRECTOR RICHTMAN: There we go.

Over the past several years, staff has shared research indicating that companies with diverse boards can have better performance. For instance, the research conducted by Credit Suisse indicates that companies with at least one woman on the board had significant outperformance over companies with no women on the board.

But when we talk about board diversity, it's important to note we are not just talking about gender diversity. In fact, how we broadly -- we talk about diversity broadly defined. Indeed, our principles state that board diversity should be thought of in terms of skill sets, gender, age, nationality, race, sexual orientation, gender identity, and historically underrepresented groups.

And further, they say that consideration should go beyond the traditional notion of diversity to include a more broad range of experience, thoughts, perspective and competencies to help enable effective board leadership.

In light of this broader definition, we wanted to highlight some research that was published recently in the Journal of Financial Economics in 2018 that looks at diversity more broadly.

That study concluded that diverse boards perform on several fronts -- performed better on several fronts, including more efficient risk taking and more efficient innovation, in terms of innovation per dollar invested. They found diverse boards were better at creating and maintaining less risky financial policies and maintaining greater dividend payouts. So research continues to support the concept that board diversity can improve performance and is beneficial to us as long-term shareowners.

That said, I think many of us on the Board and staff are concerned about how log it's taking to improve board diversity, particularly in the U.S. when we see that this could benefit our performance. I wanted to let you know that there will be a new session at the upcoming Board off-site. It's going to be called *Innovations in the Quest for Board Diversity*. And during this session, we plan to explore with you some new tools and new practices that are seen as effective in terms of addressing this issue.

And this will all be in support of coming black -- coming back with a plan in the fall to enhance our strategy on this topic.

And this said, I do want to point out that when we talk about board quality, we're not just talking about board diversity. We have three pillars of board quality. One is diversity, but also independence and competence. And, you know, as long-term investors, we want to ensure that when we come back with a plan -- and enhanced plan on this on board diversity, that we make sure that these three pillars are in concert, and, you know, that our desire to have independence and competence on our boards is represented in our strategy as well. So rest assured, we won't neglect those.

Now, Simiso will walk us through the Corporate Governance team's efforts and thoughts and potential next steps, and we can plan to talk further even more about this at the off-site.

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INVESTMENT DIRECTOR NZIMA: Thank you, Beth. Good afternoon. Simiso Nzima, Investment Director, Global Equities.

Since July 2017, we've engaged over 500 companies in the Russell 3000 regarding the lack of diversity on their boards. Our engagement really is focused around four main pillars, when we talk about diversity, is the diversity policies and disclosures. We think about diversity practices, then benchmarking progress, as well as board accountability for having diversity practices.

As of the end of May 2018, which is 11 months since we started this engagement of the Russell 3000 companies, 18 percent of the companies have added a diversity director to their board, 31 percent have enhanced their diversity disclosures to explicitly state that they're going to include diversity when they do board refreshments, about one percent their responses were not -- were not adequate.

But really, the point on our -- you know, I emphasize size here is that we've had 50 percent of response rate in terms of the engagement of these companies. And, you know, it's really encouraging that 11 months later, we've -- you know, even 18 percent have added an element of diversity to their board.

In order to hold directors accountable, you know, for increasing diversity on the boards, what we did which we brought to the Board in March here, is that we adopted diversity and inclusion voting enhancement, which we applied for the first time in 2018. And this really enhancement really was about withholding votes from a combination of board chairs, nominating and governance committees members, and long-tenured directors where we felt that these companies are not making progress in terms of our Board diversity.

And we've actually voted -- withheld vote against 271 directors in 85 companies as of the end of May this year.

We also ran proxy solicitations where diversity proposals were filed by other investors on the two companies listed there. When you look at the level of support, it seems relatively low. But really when you think about it, the first company is 38 percent controlling shareholder, and the other one is 62 percent controlling shareowner.

So if you actually adjust for the non-controlling shareowners, those proposals got about 65 percent non-controlling shareowners votes cast, which is really encouraging, and -- you know, which is something we'll continue to do in terms of running proxy solicitations even where the proposal is not filed by us but are filed by other investors.

The ast point on this slide really is the 3D, which is the Diverse Director Datasource, which was transferred to the Equilar Diversity Network. And over 200 public companies have signed on to search for candidates over there. And we have 14 candidates within 3D that have been appointed to company boards.

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INVESTMENT DIRECTOR NZIMA: What are the potential additional steps that are going to take.

So the first thing in order for us to actually scale up globally, we need enhanced data analytics platforms from vendors. This is really important, because it will allow us to benchmark not only, you know, within the U.S., but, you know, originally and so forth.

And as Beth mentioned earlier we're coming back at the off-site in July. We'll explore some of the tools that are out there that are going to enable us to perform some of that benchmarking exercise.

The second point is around manager disclosure, you know, on the issue of diversity and -- and really three main points I want to make here in regard to the current SEC disclosure regime.

The first point is that the current disclosure is in -- really does not provide firms with a definition of diversity. So what you get right now, there's no standardization around what diversity means. So some companies will choose to include social demographic information, such as age, you know, race, gender, ethnicity, while some companies will only focus in terms of, you know, experience, skill set, and education. So you really don't have that standardization that enables you to sort of benchmark, you know, in terms of different companies.

The second thing is that the current disclosure really does not require firms to consider diversity in their director nomination processes. What it actually does is that it asks them to describe whether, and if so, how they actually, you know, implement and consider diversity?

And the last point in terms of the current sort of disclosures is that there's no requirement for firms to actually -- you know, to actually adopt a diversity policy. Rather, the requirement is that if they do have a diversity policy, then they should, you know, describe how that works.

The fourth -- the third point I want to make is on the KPIs. So what we've done, we've gone back and looked at the KPIs on our diversity and inclusion initiative under the ESG strategic plan. And currently as it is written, it says that, you know, all public companies which CalPERS invest have an element -- you know a dimension of board diversity.

What we're going to change is we need to have this new, you know, enhancement and have sort of broader definition in terms of diversity where we look at the level of board diversity that reflects the company's business, workforce, customer base, and society in general, taking into account the fact that, you know, society changes with time.

So that enhancement, what it will do really for us is to enable us to file majority vote proposals at some of the companies that lack diversity. And why is this important? This is important really in terms of when we have those withhold votes, we want to have sort of tiered behind those withhold votes. Because if a company does not have majority voting in their principles, then really there's no way -- you know, those votes are just there, and they're not really effective. So we'll be planning to file majority vote proposals at companies next year.

And then the last point really is around collaboration with other investors, and thinking about how we advance this in terms of a market-wide approach and trying to get, you know, good results and better diversity amongst the companies that we invest in.

At this point, I'll stop and take any questions.

CHAIRPERSON JONES: Thank you for the report.

Mr. Juarez.

ACTING COMMITTEE MEMBER JUAREZ: Yeah. Thank you very much. And thank you for the very exhaustive report. I know it's welcome from our perspective -- from the Treasurer's perspective, because this is an issue of great importance to him.

I had mentioned at the May meeting that we were contemplating coming forward with a proposal. Subsequent to that -- or after that, I should say, I got a call from Marcie and from Anne Simpson to talk about whether or not we could work together on this in terms of where you were already headed and where the Treasurer would like to see you get to.

And I said that after talking with the Treasurer, I think -- I thought that was a good idea. And so we've been discussing various ways to create a multi-step process that you've already, I think, sort of spoke about in terms of starting with the July meeting, where we'll get some presentations on maybe some databases that will help us better identify the actions of companies, and what they've been able to do as a measurement of progress.

And certainly, we -- we're going to support that. And then hopefully in the fall, certainly before the Treasurer leaves office, we're hoping to have brought this further along to maybe there's some policy changes that we might adopt in that regard.

But I did want to share with the Board in particular, but also with staff, and as I've also already shared with Marcie and Anne, some of the objectives that we believe are important to this discussion, and we hope that the Board and the staff will take to heart, and hopefully keep them in front of the Board and our staff as we go forward.

The first of these is more direct board involvement as we do this discussion. And I think what we're thinking about there is that the Treasurer would like to see at least one meeting -- on Investment meeting annually, if not totally dedicated to this issue, that it's a good part of the discussion, so that in fact the Board is wholly invested in what the activities of the staff are relative to corporate diversity and making sure that, in fact, that occurs routinely on an annual basis. And so we would hope that that would be something that we could entertain.

Clearly, I think the staff has identified this, but we do need more accountability from the boards in which we invest. And we're certainly open to starting with the top quartile or whatever means that it seems appropriate to get -- go after those that should be taking proactive actions in this regard.

The results of your survey I think show that, in fact, a lot of companies are basically ignoring us. They're getting a free pass for what we have to assume is very poor behavior in terms of the value of adding to their own corporate boards in terms of diversity.

And so we need to be, I think, a little bit more up front as to what -- how we will consider actions by those boards, both in terms of responding, and then also measuring the progress of those boards. We should have a place at which we can start and say, what has this company done over the course of a couple of years to show us that they're dedicated to this issue?

We don't think everybody necessarily is going to come up to the standard right away. And so on that we just feel that we should -- we should make sure that, in fact, we're holding them accountable both for responding, but also for then taking the appropriate actions.

I think the last thing that -- the last objective that we would like to see the staff and the Board tackle has to do with the establishment of bottom-line conditions and criteria when we use our proxy vote, so that, in fact, if a board has no diversity of any sort on it, and we're investing in it, I think that raises a very serious red flag.

And while we certainly recognize that we may need other factors to go into the determination as to whether we pull money out of that particular company, or that we exercise our proxy action, we believe that no progress or zero diversity on a board is a very significant factor that this -- that we should take into account as to whether or not we're going to continue to do business with that firm.

And so we will spell these out in much more detail as we go forward, but we welcome, I think, the offer and the outreach that has been done by staff. We want to continue to work collaboratively with you in this regard. And we'll certainly be very seriously engaged with you along the way, and see what we can come up with in terms of perspective changes.

I want to thank you, and I want to thank Marcie and Anne for their willingness to reach out to the Treasurer's office.

And with that, I'll turn it back to the Chair. But again, thank you for your presentation.

CHAIRPERSON JONES: Mrs. Mathur.

COMMITTEE MEMBER MATHUR: Thank you.

You know, as you've noted, Ms. Richtman, clearly there is a connection between performance and the diversity of a board. And that's why we care about it. We care about it, because even companies that are performing fine, we want them to perform better. And certainly companies that are underperforming, we want them to perform well for the long term.

And so I think this is a really essential topic And I'm glad it's one that we've incorporated into our five-year strategic plan as one of our top six priorities, and one I'm glad we're spending so much time and resources working on.

A couple of things. One is I support the enhanced KPI language that you have articulated on page four of the presentation. I think it does add -- it does -- it is -- it does add quite a lot of context to the KPI and I think is a -- and so I appreciate that.

You know, obviously, one of the -- there are -- one of the things we've learned over time, we -- I mean, I think -- I know when we developed the DDD, the Diverse Director DataSource, we thought that it was really a supply problem. That somehow these boards did not know how to gain access to diverse candidates. They weren't in their social circle, or in their business circle, or I don't know what, but they weren't -- they didn't know how to access them.

But clearly what we've learned is that's not -- that's not the only issue, and that part of it is other structural impediments, including turnover within corporate boards, and how frequently new seats become available. Majority voting is a key issue that has been highlighted, particularly in connection with those companies who have been nonresponsive to our requests for enhanced diversity and focus on that within corporate boards.

So cleary, these need -- these components need to be part of any strategy that we proceed with. And turnover is a tricky one. I'm not sure term limits is the right answer, but some sort of average tenure, or -- I don't know, because clear -- you know, there's some value to long-term institutional knowledge. And yet, we don't want every member of the board to be serving for 20 years. Any member of a Board is no longer independent after 20 years on the board probably.

So anyway, so I'll -- one last question -- maybe that was really more of a statement. But one last question is really about SASB, the Sustainable Accounting Standards Board, which we have really supported their work. How are they looking at diversity, and are they looking at it across all industries that they're developing disclosure around. And so that's a question. I don't know if you have the answer today. And if not, we can -- we can talk about it another time.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Maybe we'll bring that back --

COMMITTEE MEMBER MATHUR: Sure.

CHIEF INVESTMENT OFFICER ELIOPOULOS: -- at a future time when we have more time.

COMMITTEE MEMBER MATHUR: Sounds good.

Thank you.

CHAIRPERSON JONES: Ms. Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chairman. Really appreciate the report as well. I, too, also support the enhanced KPI. And I guess I wanted to just understand a little bit more about how it would work, because you're asking for a couple tiers of information. So looking at the information as compared to the company's workforce, and business, and then to its customer base, and then to society in general.

So, I mean, obviously society in general is kind of what we hope they can kind of take a look at with respect to the broadest diversity to be achieved, but is that -- just kind of give me a flavor about how that information will be used in an engagement.

INVESTMENT DIRECTOR NZIMA: Thank you for the question. Really, the idea here is to move away from being too prescriptive when you're talking about diversity, because again when you think about business or you think about society, you know, this always changes. And we want to give companies the flexibility to reflect that, the change in society.

And the only thing about it, again, you think about the way we think about diversity in the U.S., diversity in the U.S. is not the same sort of lens that you view with it in Japan, for example, or other markets. You want to, you know, have that flexibility in terms of the definition.

But again, we will be looking at all elements of diversity, as opposed to have a dimension of diversity as the KPI. Really, this is more broad and really aligns with our definition of diversity, which is in the principles.

COMMITTEE MEMBER YEE: Okay. Okay. Good. Thank you. Beth, I'm sorry.

MANAGING INVESTMENT DIRECTOR RICHTMAN: What I will say I think some key elements that are added to this KPI that I think are important are that the board diversity will also reflect the customer base --

COMMITTEE MEMBER YEE: Right.

MANAGING INVESTMENT DIRECTOR RICHTMAN: -- the workforce and society in general. Those are -- I mean, the workforce and the customers, we do want to make sure that the diversity on our boards, you know, is additive in terms of perspective that helps make the companies better businesses.

And so that is something that we'll be looking at exploring a little more in the off-site, in terms of the types of databases and tools. But also to Ms. Mathur's point as well, I think one of the speakers at the off-site will be talking, not necessarily about a database, but just practices that have been effective in getting first elements added to boards, because I think we need to open it up to look at more about what is effective, how do we achieve this goal.

COMMITTEE MEMBER YEE: Okay. And then on page three of seven, you highlighted two companies, Pilgrim's Pride and First Hawaiian where they are the overwhelming control -- they have overwhelming control of the shares. So what's the expectation of the proxy vote in those instances?

INVESTMENT DIRECTOR NZIMA: What we're going to try and do is really to talk to the controlling shareowner and figure out how to proceed this. We've already -- you know, we -- we tried to reach out to the right people, you know at Pilgrim's Pride, and we did not get a response. But we're trying to see in terms of our networks whether there are people that we can reach out through them to be able to talk through the controlling shareowners and be able to influence that situation.

So it's something which we're not just going to leave there just because there's a controlling shareowner. Something which we'll try and use our networks.

I think, we've talked about the value of networks, I think when we're talking about the private equity business model and so forth. And those are some of the things that we can use in instances like this, where we can use those networks to reach out and be able to change sort of behaviors.

COMMITTEE MEMBER YEE: Okay. Great. And have we started to talk with other institutional investors about mandatory diversity data disclosure? I mean, is that a conversation that's underway?

INVESTMENT DIRECTOR NZIMA: We have talked to other institutional investors, sort of on a one off basis as opposed to sort of a -- in the view of the coalition. For example, I think the two components here -- when you think about coalition, a coalition takes a long time to build. And we don't want to wait, you know, until we've put a coalition together. If you -- if you think about the Climate Action 100 coalition, I think Anne is right here, she would tell you that it took quite a time to bring, you know, people together and agree on the, you know, terms and so forth.

So that takes longer. But in the interim before we actually get to that coalition, we've been talking to a number of institutional investors, as well as other, you know, asset managers in other funds just to see what we can do. And, for example, I mean, you look at -- you know, in 2015, we did, you know, file and write a petition with the SEC in terms of getting, you know, better disclosure around this issue.

And we've been supportive of, you know, New York City Funds in terms of some of the work that they're doing around -- around this. So our approach really is multi-pronged. And we don't want to wait until -- to build the coalition. We want to be able to, even -- for those institutions that are already there, we want to be able to start moving in that direction.

COMMITTEE MEMBER YEE: Thank you.

CHAIRPERSON JONES: Okay. We're going to have to take a break, because we've got another request to speak, and also we have a request for a public comments. So let's take a 10 minute break, and we will reconvene.

(Off record: 1:16 p.m.)

(Thereupon a recess was taken.)

(On record: 1:26 p.m.)

CHAIRPERSON JONES: Okay. We'd like to reconvene the Investment Committee meeting.

Okay. Mrs. Taylor.

COMMITTEE MEMBER TAYLOR: Thank you, Mr. Chair. Thank you, Beth, for this. And I'm really excited to see this. One of the things as people were talking that dawned on me is we were talking about coordinating with other institutional investors. And I just came back from Harvard, and I think there's a whole bunch of institutional investors that would be happy to coordinate. I don't think that's going to be a big reach, because one of the subjects we talked about was diversity.

So if you're talking other pension funds, we had a ton of pension funds attending. And I think that that is the goal of all of us. So, in my view, we should have been working with them long before now, but I hope that moving forward not only do we move along our own track, but we also use institutional investors.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yes. And I just want to emphasize, we have been working with our peers for quite some time, as an institution, and on this plan as well.

And, yes, there are lots of institutional investors ready, willing, and able to collaborate with each other. The hard part is developing this market consensus on an approach.

COMMITTEE MEMBER TAYLOR: On an approach?

CHIEF INVESTMENT OFFICER ELIOPOULOS: Because we -- you know that's where there's a dispersion of approaches by different managers. And what we've seen in the Climate Change 100, when the market -- when all of these peers get together on a common approach, there's huge power behind that. And that's -- that's what we're trying to explore to find where is that common approach that we all can align around to make progress.

COMMITTEE MEMBER TAYLOR: Okay. Great. And I appreciate it. Thank you very much.

CHAIRPERSON JONES: Okay. We have one request to speak on this item. Mr. Michael Ring, if you can come forward.

MR. RING: Chairman Jones, members of the Investment Committee, Michael Ring with Service Employees International Union. I just wanted to make a few comments in reference to this point, which as many of you who have been on this Board for some time now is that SEIU under the leadership of our international President, Mary Kay Henry, has been dedicated actively, along with CalPERS and many other actors to working in this area.

In particular, our focus has been on racial diversity, given the extraordinary low numbers of non-white board members on corporate boards in the U.S., and the data indicating that that is a real loss in long-term value, and opportunities for better performance.

So we continue that work. We are obviously very committed to supporting CalPERS and collaborating with CalPERS in this area, and really appreciate CalPERS leadership, the Treasurer's leadership many years ago in introducing this idea when he was sitting in Ms. Yee's seat.

So this is a fundamental systemic risk issue, and systemic opportunity issue. And SEIU, as an institution, is committed to working with CalPERS and other investors in this area. Just to flag a few specific things, I think we obviously fully support the idea that's mentioned here in the bullet point, and as Ted mentioned, and some of the Board members mentioned working for further collaboration. I do think there are challenges in finding that precise collaboration point. I also think there are enormous opportunities that have already been worked on and will continue to work on.

It's also exciting to hear that this will be discussed further at the off-site. It's rare that we can all see so clearly an opportunity to make money and do good. And the data is very clear here, that if we do the right thing, we are going to improve returns for ourselves. So I think that's really exciting.

In the case of SEIU, I wanted to highlight a couple of things we did specifically this year just so you're aware of them and they can be taken into account. Obviously, we've already shared this with your staff, but we filed per shareholder resolutions at Amazon and Facebook. And in both cases, the resolutions were calling for them to implement something called the Rooney Rule, that calls for them to have a diverse candidate pool as they consider new boards of directors.

And in both cases, one company being a little more amenable at first than the other, you can see in the press that they have both agreed to implement these resolutions, meeting that market leading companies are going to change their behavior in this area, and improve their board diversity, which we think will lead to better performance for both companies, and the industries that they lead.

You know, finally, I think we -- we want to point out that CalPERS leadership is not only critical in this area in the public markets, though I know this agenda point is focused on that, given the money and the discussion we just had about private markets and the flow of cash into private markets, it's critical we apply this same principle as we do this work in the private markets in real estate and private equity, et cetera.

So thank you very much for your work and for your staff's work.

CHAIRPERSON JONES: Okay. Thank you, Mr. Ring for your comments.

Next item is Summary of Committee Direction.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yes, Mr. Chair. I have three items. First in the area of our Total Fund Policy and delegation item, a follow-up item to explore fully -- further policy revisions on the disclosure of material sexual harassment settlements to the topic of aggregation of settlements. And we'll bring that back at a further date.

Second also to bring back at a further date in our sustainability program is a follow-up on the ideas of Mr. Buffett and Mr. Dimon around quarterly reporting, and the perspective of a long-term investor.

And then third, to bring back at a future date a report back on the approach of SASB to diversity in their standard setting.

CHAIRPERSON JONES: Okay.

CHIEF INVESTMENT OFFICER ELIOPOULOS: I think those are the three I got.

CHAIRPERSON JONES: Yeah. Okay. Thank you.

Okay. So that concludes the open session. We're going to adjourn this meeting and go to lunch, and we'll come back at 2:15 for closed session Investment Committee.

Okay. Thank you.

(Thereupon California Public Employees' Retirement System, Investment Committee meeting open session adjourned at 1:33 p.m.)

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I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Investment Committee open session meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California, and was thereafter transcribed, under my direction, by computer-assisted transcription;

I further certify that I am not of counsel or attorney for any of the parties to said meeting nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 22nd day of June, 2018.

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