MEKETA INVESTMENT GROUP

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July 23, 2018

Mr. Henry Jones
Chair, Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

RE: REVISION OF THE PRIVATE EQUITY INVESTMENT POLICY – SECOND READING

Dear Mr. Jones:

Meketa Investment Group ("Meketa") has been asked in its capacity as Board Consultant for the Private Equity Program (the "Program") to opine on the revisions of the CalPERS' Private Equity Investment Policy (the "PE Policy") submitted to the Investment Committee for a first reading on June 18, 2018. The revisions to the Policy are described in Item 6a. There has been no revisions to the PE Policy since the first reading, however the Total Fund Policy has been revised since the first reading.

As we described in our letter for the first reading, there are a number of changes to the PE Policy, as described below.

<u>Transition to "dollar-oriented" authority on its per-investment limits.</u> Staff has proposed moving to "dollar-oriented" authority limits, from "percent of Total Fund" limits. A benefit of dollar limits is that they are clear and do not fluctuate based on changes to the size of the Total Plan. Staff has proposed limits that are comparable to what would be allowed under the existing PE Policy, as calculated for a Total Plan value of approximately $356 billion. Staff has maintained the concept of separate authorization limits for the MID and the CIO.

- The appropriate delegation limits under a "dollar-oriented" framework may change should the size of the Total Fund change dramatically.

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Elimination of First and Second Quartile fund sub-limits. The current PE Policy includes a limit for a "First Quartile" fund and a separate, lower limit for a "Second Quartile" fund. The proposed PE Policy no longer includes these sub-limits. Staff evaluates potential fund investments across a broad range of quantitative and qualitative factors. We have noted that, while important, quartile ranking of past performance is not fully indicative of the potential future performance of a private equity manager, particularly early in a fund's life.

- The current PE Policy has large differences in delegated authority for funds depending on quartile ranking of the manager. By eliminating the sub-limits, Staff can consider a wider range of variables such as portfolio fit, investment pacing, strategic relationship, and fees in sizing the fund commitment.

- Currently, Staff needs Board approval to commit to a fund from a manager that is not at least second quartile, as defined in the CalPERS Glossary. Unless Staff requests the Board approve specific Private Equity Funds, this requirement significantly constricts the universe of investment opportunities. We note that the recently revised Total Fund Policy includes a requirement that CalPERS obtain a Prudent Person Opinion for any commitments to funds where the manager does not qualify as at least second quartile as defined in the CalPERS Glossary.

- Our understanding is that Staff will continue to include quartile ranking information on managers committed to in the fiscal year.

Elimination of sub-limit for Emerging Manager funds. The current PE Policy includes a limit for "Emerging Manager" funds that is in-line with limits to a second quartile fund manager. The proposed PE Policy will allow Staff to consider "Emerging Manager" funds on an equal basis with all fund opportunities.

- Our understanding is that Staff will continue to include descriptions of characteristics of the Emerging Manager funds that Staff commits to in the fiscal year.

Elimination of CIO's ability to increase committed capital to an existing Customized Investment Account. Currently, the CIO has the ability to increase the commitment to an existing Customized Investment Account by 20%, provided it has top quartile performance.

- The CIO will no longer be able to add additional capital to any existing Customized Investment Account without approval from the Investment Committee. Additionally, delegated authority for Customized Investment Accounts would require a Prudent Person Opinion in the recently revised Total Fund Policy.

Elimination of Direct Investments as a transaction type. Direct Investments are those where CalPERS would invest without the participation of a general partner. Historically, Direct Investments have included CalPERS investments in private asset managers such as Apollo Group.

- We understand that authority for Direct Investments will be considered at a later date.

Modification of certain limitations for Co-investments. The current PE Policy limits the size of CalPERS Co-investment to be less than (a) the amount committed by the private equity fund, and (b) the commitment CalPERS has made to the private equity fund. The proposed PE Policy includes a dollar-based limit for individual Co-investments ($300 million for MID and $600 million for CIO) that generally correspond with the limits under the existing policy. Additionally, under the proposed PE Policy, CalPERS would not be restricted to Co-investments deriving from the private equity fund in which it had made a commitment, but rather CalPERS could make a Co-investment in an opportunity proposed by a manager so long as CalPERS had an active investment to any private equity fund managed by such manager.

- The elimination of these limits provides a wider set of Co-investment opportunities for Staff to consider.

- The delegated authority for Co-investments would require a Prudent Person Opinion in the recently revised Total Fund Policy.

New limit on aggregate annual investments. The proposed PE Policy includes a new limit on the MID's cumulative annual authorization across each of Funds, Co-investments, Separate Accounts, and Secondary Investments.

- The limit on commitments in a fiscal year by the MID helps protect the Fund by building vintage year diversification in the Program. We note that the Real Assets program includes similar fiscal year aggregate commitment limits on its MID.

Strategy ranges are updated. Staff has proposed a modification to the target and ranges of the Buyouts (increase) and Credit Related (decrease) strategies. Staff has stated that certain Credit Related strategies are being invested through CalPERS Opportunistic Program, thereby reducing the investment set available under the Private Equity Program.

The proposed PE Policy includes a number of modifications to Staff delegation. Most of the modifications provide some expansion of the range of investments that Staff may consider, but remain generally in-line with current limitations for overall size of delegated authority. Meketa believes the proposed revisions are in line with CalPERS Investment Beliefs, in particular Investment Beliefs 1, 2, 5, 6, 7, and 10.

Please do not hesitate to contact us if you have questions.

Sincerely,

Stephen McCourt
Managing Principal

Steven Hartt
Principal

Hannah Schriner
Vice President

SPM/SKH/HS/nca