



## Investment Committee

# Agenda Item 5e

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**December 17, 2018**

**Item Name:** Report on Alternative Investment (AB 2833) Fee Disclosure (Government Code Section 7514.7)

**Program:** Investment Compliance & Operational Risk

**Item Type:** Information Consent

### **Executive Summary**

State legislation enacted in 2016 (Assembly Bill 2833, or AB 2833) requires California public retirement systems, including CalPERS, to report on certain fees, expenses, and carried interest paid in connection with alternative investment vehicles (AIVs) in which the systems invest. The report must be presented at least once annually at a meeting open to the public. Attachment 1 contains the report produced by CalPERS pursuant to AB 2833.

### **Strategic Plan**

This item is required by statute and not a specific product of the CalPERS Strategic Plan.

### **Investment Beliefs**

This agenda item touches on several CalPERS Investment Beliefs, and in particular:

- Investment Belief 8, that costs matter and need to be effectively managed, and its associated sub-beliefs:
  - CalPERS will balance risk, return, and cost when choosing and evaluating investment managers and investment strategies.
  - Transparency of the total costs to manage the CalPERS portfolio is required of CalPERS business partners and CalPERS itself.
  - Performance fee arrangements and incentive compensation plans should align the interests of the fund, staff, and external managers.
  - CalPERS will seek to capture a larger share of economic returns by using its size to maximize its negotiating leverage. CalPERS will also seek to reduce cost, risk, and complexity related to manager selection and oversight.
  - When deciding how to implement an investment strategy, CalPERS will implement in the most cost effective manner.

## **Background**

AB 2833 (Cooley) was introduced during the 2016-17 Legislative session for the stated purpose of increasing the transparency of fees paid by California public investment funds to alternative investment vehicles. The enacted legislation was sponsored by State Treasurer John Chiang, signed by Governor Brown on September 14, 2016 and chaptered under California Government Code (G.C.) § 7514.7.

## **Analysis**

The AIVs in which CalPERS invests are typically limited partnerships, limited liability companies, or similar limited liability vehicles in which the investment would take the form of an ownership interest in the AIV. Monies remitted by CalPERS *to the AIV* can therefore be expected to take the form of capital contributions, and not fee or expense payments *per se*. The obligation to pay management fees and expenses typically runs from the AIV to the fund manager, and not from the individual LPs, whose obligation, as spelled out in the AIV agreement, is to provide a specified amount of capital to the AIV to fund its investments and operations. In those relatively rare instances where the LPs remitted fees directly to the fund manager or its related parties, these payments are accounted for as capital. Accordingly, the vast majority of fees and expenses paid to the fund managers are funded indirectly by the LPs, out of capital contributions to the AIV.

The legal relationships that dictate the characterization of the various money flows involved in these investments have provided the context for our analysis of AB 2833. We have, moreover, aimed for consistency with our historically rather expansive read of G.C. §6254.26 regarding disclosure of AIV-level fees and expenses.

The information provided has been derived from CalPERS' books and records, or directly from the General Partner, or both.

## **Budget and Fiscal Impacts**

Not applicable.

## **Benefits and Risks**

Not applicable.

## **Attachments**

Attachment 1 – CalPERS Alternative Investment Vehicle Fee & Expense Disclosure Report

Attachment 2 – Explanatory Notes

Attachment 3 – Assembly Bill 2833

Attachment 4 – California Government Code §6254.26

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