MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

INVESTMENT COMMITTEE

OPEN SESSION

ROBERT F. CARLSON AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

MONDAY, DECEMBER 16, 2019

9:00 A.M.

JAMES F. PETERS, CSR
CERTIFIED SHORTHAND REPORTER
LICENSE NUMBER 10063

APPEARANCES

COMMITTEE MEMBERS:

Mr. Rob Feckner, Chairperson

Ms. Theresa Taylor, Vice Chairperson

Ms. Margaret Brown

Mr. Henry Jones

Ms. Fiona Ma, also represented by Mr. Frank Ruffino, Mr. Matthew Saha

Ms. Lisa Middleton

Mr. David Miller

Ms. Stacie Olivares

Ms. Eraina Ortega

Mr. Jason Perez

Mr. Ramon Rubalcava

Ms. Betty Yee

STAFF:

Ms. Marcie Frost, Chief Executive Officer

Mr. Matt Jacobs, General Counsel

Dr. Yu (Ben) Meng, Chief Investment Officer

Mr. Danny Brown, Chief, Legislative Affairs Division

Ms. Kit Crocker, Investment Director

Ms. Carrie Douglas-Fong, Associate Investment Manager

Mr. Matt Flynn, Acting Interim Chief Operating Investment Officer

Ms. Caitlin Jensen, Committee Secretary

A P P E A R A N C E S   C O N T I N U E D

STAFF:

Mr. Paul Mouchakkaa, Managing Investment Director

Ms. Beth Richtman, Managing Investment Director

Mr. Greg Ruiz, Managing Investment Director

Ms. Anne Simpson, Investment Director

ALSO PRESENT:

Ms. Sandy Emerson, Fossil Free California

Mr. Andrew Gaitan, Service Employees International Union, United Service Workers West

Ms. Tina Gallier, Fossil Free California

Dr. Robert Girling, California Emeritus and Retired Faculty and Staff Association

Mr. Alan Hanson, United Food and Commercial Workers, Local 400

Mr. Steve Hartt, Meketa Investment Group

Mr. Von Hughes, PAAMCO Prisma

Mr. Daniel Ingram, Wilshire Associates

Mr. Andrew Junkin, Wilshire Associates

Ms. Michelle Le, United Food and Commercial Workers, Local 400

Mr. Derick Lennox, Association of California School Administrators

Mr. Steve McCourt, Meketa Investment Group

Mr. Michael Ring, Service Employees International Union

A P P E A R A N C E S   C O N T I N U E D

ALSO PRESENT:

Ms. Carolina Rocha, Service Employees International Union, United Service Workers West

Ms. Deborah Silvey, Fossil Free California

Ms. Sara Theiss, Fossil Free California

Ms. Vanessa Warheit, Fossil Free California

I N D E X

INDEX CONTINUED

P R O C E E D I N G S

CHAIRPERSON FECKNER: Good morning. We'd like to call the Investment Committee meeting to order. The first order of business will be to call the roll.

COMMITTEE SECRETARY JENSEN: Rob Feckner?

CHAIRPERSON FECKNER: Good morning.

COMMITTEE SECRETARY JENSEN: Theresa Taylor?

VICE CHAIRPERSON TAYLOR: Here.

COMMITTEE SECRETARY JENSEN: Margaret Brown?

COMMITTEE MEMBER BROWN: Here.

COMMITTEE SECRETARY JENSEN: Henry Jones?

COMMITTEE MEMBER JONES: Here.

COMMITTEE SECRETARY JENSEN: Fiona Ma represented by Frank Ruffino?

CHAIRPERSON FECKNER: Nobody yet.

COMMITTEE SECRETARY JENSEN: Lisa Middleton?

COMMITTEE MEMBER MIDDLETON: Present.

COMMITTEE SECRETARY JENSEN: David Miller?

COMMITTEE MEMBER MILLER: Here.

COMMITTEE SECRETARY JENSEN: Stacie Olivares?

COMMITTEE MEMBER OLIVARES: Here.

COMMITTEE SECRETARY JENSEN: Eraina Ortega?

COMMITTEE MEMBER ORTEGA: Here.

COMMITTEE SECRETARY JENSEN: Jason Perez?

COMMITTEE MEMBER PEREZ: Here.

COMMITTEE SECRETARY JENSEN: Mona Pasquil Rogers?

CHAIRPERSON FECKNER: Excused.

COMMITTEE SECRETARY JENSEN: Ramon Rubalcava?

COMMITTEE MEMBER RUBALCAVA: Here.

COMMITTEE SECRETARY JENSEN: Betty Yee?

COMMITTEE MEMBER YEE: Here.

CHAIRPERSON FECKNER: Thank you.

Item 2 is the approval of the December 16th timed agenda. What's the pleasure of the Committee?

VICE CHAIRPERSON TAYLOR: Move approval.

CHAIRPERSON FECKNER: Moved by Taylor.

COMMITTEE MEMBER MILLER: Second.

CHAIRPERSON FECKNER: Seconded by Miller.

Any discussion on the motion?

Seeing none.

All in favor say aye?

(Ayes.)

CHAIRPERSON FECKNER: Opposed, no?

Motion carries.

Item 3, Pledge of Allegiance. I've asked Board Member Miller to plead lead us in the pledge.

BOARD MEMBER MILLER: Please stand and face the colors. Hand over heart.

(Thereupon the Pledge of Allegiance was recited in unison.)

CHAIRPERSON FECKNER: Thank you.

And please show Mr. Ruffino has now joined us.

Item -- before we go to Item 4, I do want to say Item 6i and 6j, the climate change report and the Responsible Contractor Policy are being pulled off the consent calendar and we will have discussion on those.

That brings us to Item 4, Executive Report, Mr. Meng.

CHIEF INVESTMENT OFFICER MENG: Good morning, Mr. Chair, members of the Investment Committee. So today this morning in open session, we have a relatively light agenda. So Item 6, we have ten information consent items. And as you just pointed out, the last two of the ten, 6i and 6j, are being pulled. And Item 7 is the second reading of the Investment Policy revision for private asset classes. And Item 8 is the consultant's review report of CalPERS divestment.

And Item 9 is the continuation of the Board education workshop. So this will be the last of the four. So if you recall, the first one we had was in May on the return -- risk and return basics of the total fund. So that's first education workshop by CFA Institute. It was in May. And then in June, we had the second workshop on global fixed income. And then in August, the third workshop on global equity. And then today is the last workshop on private markets. So with that, I'm turning back to you, Mr. Chair.

CHAIRPERSON FECKNER: Thank you.

That brings us to Agenda Item 5, the approval of the November 18th meeting minutes. What's the pleasure of the Committee.

VICE CHAIRPERSON TAYLOR: Move it.

CHAIRPERSON FECKNER: Moved by Taylor.

COMMITTEE MEMBER OLIVARES: Second.

CHAIRPERSON FECKNER: Seconded by Olivares.

Any discussion on the motion?

Seeing none.

All in favor say aye?

(Ayes.)

CHAIRPERSON FECKNER: Opposed, no?

Motion carries.

Item 6, the information consent items. We've pulled off Item 6i and 6j. So let's start with 6i, the climate related financial risk.

Mr. Meng.

CHIEF INVESTMENT OFFICER MENG: Yes. I'm just waiting for my colleague to come up to the --

CHAIRPERSON FECKNER: Very good. Thank you.

And this we pulled -- was pulled off as a request of a number Board members who thought it was important we have an open dialogue, so that everybody understands, both the audience and the Board, rather than just being in written form.

Thank you.

CHIEF INVESTMENT OFFICER MENG: Yes, we appreciate that.

LEGISLATIVE AFFAIRS DIVISION CHIEF BROWN: Good morning, Mr. Chair and Committee members. Danny Brown, CalPERS team member. This item is our initial draft of the public report required by SB 964, a bill that was passed by the Legislature and signed by Governor Brown in 2018. The bill requires CalPERS to publicly report on the climate related financial risk of our public market portfolio, including alignment with Paris Agreement on Climate Change and the California Climate Policy.

This first report is due on January 1st, 2020, and then we'll issue a report every three years until January 1st, 2035. The Investment Office has put a lot of time and effort into this very informative report. And then I'm going to turn it over to Anne Simpson now who will kind of briefly summarize the report.

INVESTMENT DIRECTOR SIMPSON: Thank you very much, Danny. I'm joined here by Beth Richtman, who leads our Sustainable Investment Integration team in the Investment Office. But I do want to acknowledge that many people from different sides of the organization have contributed to this first effort under this important piece of legislation from our Legal department, our Public Affairs, our Legislative Affairs, and, of course, the Investment team across the total fund including the asset classes as well.

Let me just highlight for you briefly how we've structured the report. And then Beth will be here to answer any questions that you might have around the way that we've gathered the data.

The first part of the report really focuses on the history of CalPERS understanding of climate change as a risk and as an opportunity. So in the report, we recap the important work that was done back in 2012 to review evidence through the Sustainable Investment Research Initiative. Then the feed -- the way that fed into CalPERS Investment Beliefs, where both in the understanding of value creation, climate change is called out. But also in our understanding of risk being multi-faceted, climate change is specifically highlighted. So we have it called out in two of the Investment Beliefs, if you'd like, on both risk and return.

The second important area of work for CalPERS on climate change was how this understanding of the issue fed into the development of a strategic plan on Sustainable

Investment, which the Board adopted in 2016. And this has climate change as one of six priorities for this five-year plan, which has got time-bound KPIs. And the focus in that work is to ensure that we are using our influence as an owner of companies to bring down emissions.

And you'll recall in our work under the Montreal Pledge, CalPERS found that a hundred or so companies in our 10,000 plus portfolio were responsible for the bulk of the emissions in some extraordinary work done by Divya Mankikar who's here today.

What that meant was that we could form a partnership with other large investors with the goal of bringing those emissions down. That's Climate Action 100+, which now has over $35 trillion in assets under management signed up.

So in the report, we give examples of how that work is having a real impact on our engagement strategy. We've also highlighted what we're doing on advocacy. I would say that Divya has just come back from the COP meetings in Madrid. So CalPERS has had a presence right from the beginning with the Paris signing in 2015. We're also working hard on issues like carbon pricing coming out of a Vatican dialogue, which Betty Yee attended this year, along with other investors alongside CalPERS.

And then vitally important in the strategy is integration. And this is the work that Beth leads, which is where we're using very imperfect data sets to understand where risk resides and where there is opportunity. So this call in the Legislation for us to report on our climate risk is something that we welcome, because CalPERS has a track record of commitment on this issue of understanding how it affects risk and return. But we're also very humble, because the data that we're working with are thin and frail. Just on carbon emissions alone, less than half of the companies we invest in in public markets give us any sort of reporting.

Now, it's not all doom and gloom. Another of our priorities in the strategic plan is around improving data in corporate reporting. And last week, we were just delighted to see that the International Financial Reporting Standards body has issued guidance on how climate risk should be integrated into the financials. So this is just a tremendous development and we're really thrilled.

We've also been working through groups like SASB and through our support for the TCFD, which is an almost correct acronym for the Task Force on Climate-Related Financial Disclosure. Through these voluntary measured, we've also been trying to get better data.

So finally in the report, we look ahead. We talk about things that are coming up, which include a commitment to produce our own first asset-owner TCFD report, which will be a great challenge, but it's something that CalPERS is committed to. We have a roundtable on carbon pricing with Notre Dame University and the Vatican coming up in June. And we highlight a number of other activities ahead as well.

I also just want to say that Brad Pacheco drew to my attention this morning that a Chief Investment Officer magazine has just nominated -- not just nominated but agreed that our Chief Investment Officer has won an award for innovation in this space, which I think is a great credit to Ben's commitment on this issue. And also an op-ed on the issue of climate risk by Marcie Frost, our Chief Executive Officer, is published today in CalMatters.

So CalPERS' presence in this area, I think is very strong. However, I would say two things. We have ambition, but we also have humility. So this first working draft we're presenting to you really to get feedback. We presented it to the stakeholder group on Thursday and they had some interesting ideas for us. But we look forward very much to your thoughts and suggestions on how we can improve this before it's filed with the Legislature.

So thank you.

CHIEF INVESTMENT OFFICER MENG: Mr. Chair, so first of all, I would like to say thank you for the good work. This is truly an example teamwork. It represents the collaboration between the CEO's office, Danny Brown, and Anne Simpson and the Investment Office with Beth, myself, and the asset team.

And for the teamwork, I really want to highlight one, which is Anne Simpson. I really want to thank you for -- thank her for her deep knowledge and her clear thinking and clear writing style, so which has proven to be very useful to this task force.

And the award of winning the ESG award from the CIO magazine, I have to say on the record when they interviewed me, I do not deserve any award. I'm fully committed to it. I'm -- I am receiving the award not because what I have done. It's because what you have done. And it just -- I happened -- I'm the person who in this seat, so I'm receiving this award, but on behalf of this organization, which I'm very proud of. And to the question I'm very committed to climate action and sustainable investing.

So to put on the record, I do not deserve any award. I'm here receiving the ward on behalf of what you have done.

CHAIRPERSON FECKNER: Thank you. Appreciate that. And nice report.

I do have a couple of requests from Board members.

Ms. Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chairman. Thank you for the report and congratulations on the award. And I also want to add my thanks to Anne for her deep knowledge and really the long-standing work that was really spearheaded by her here at CalPERS. And if there's anything I would say about the report, I think it actually understates some of the work that we've done.

And a couple things I wanted to highlight, if I could. The proxy vote section I thought was a bit vague. But there's been so much intense work done in that arena, that I really would like to see that elevated some more. We -- I think we're probably a leading voice in so much of this for so many periods of years that I'd like to see that expressed a little bit more forcefully.

And then also, I thought the engagement section was a little condensed. Obviously, engagement is something that we take very seriously. It's really what has guided us with respect to our actions on the more global initiatives that we're a part of. And so I would hope that we could expand on that a little bit.

What I didn't understand and maybe you can explain a little bit more, but -- in terms of looking forward about CalPERS in 2020, publishing a TCFD-aligned asset owner climate risk report. So does that mean we ourselves are going to report with respect to CalPERS along the four pillars of the TCFD framework?

INVESTMENT DIRECTOR SIMPSON: Exactly.

BOARD MEMBER YEE: Okay.

INVESTMENT DIRECTOR SIMPSON: It's called leading by example.

COMMITTEE MEMBER YEE: Okay.

INVESTMENT DIRECTOR SIMPSON: We're calling on all these companies to do this type of reporting. And as you know, on their website, Marcie Frost, our Chief Executive Officer, is there with a public statement of support for TCFD. So, of course, then the question is, well, what are you going to do?

However, Beth has been doing preparatory work on this. And I think she'll attest to the fact that this is not a simple thing.

BOARD MEMBER YEE: Right.

INVESTMENT DIRECTOR SIMPSON: So we're looking at the first quarter of 2020 for pulling that together. But again, it will be certainly something where we'll be learning as we go.

MANAGING INVESTMENT DIRECTOR RICHTMAN: Beth

Richtman, Sustainable Investments. Just a few things I would add to that are that we are looking across our total fund for that report. Whereas, this focused in response to the SB 964 mandate to focus on the public sector.

COMMITTEE MEMBER YEE: Okay. All right. That makes sense. But that also would be dependent on, I guess, a company's own TCFD reporting as well, right? So can you talk a little bit about whether you're seeing progress with respect to companies on adopting the framework and actually putting forth information that could then guide our own report?

MANAGING INVESTMENT DIRECTOR RICHTMAN: Excuse me, do you mean related to the privates or do you mean just across the board?

COMMITTEE MEMBER YEE: Across the board.

MANAGING INVESTMENT DIRECTOR RICHTMAN: Across the board.

COMMITTEE MEMBER YEE: Yeah.

MANAGING INVESTMENT DIRECTOR RICHTMAN: I think on the public side, a lot of the analysis that we sort of -- you can see the seeds of planted here related to sort of the physical risk, and also, you know, the transition risk, some of that is reported by the company, some of that comes from just analysis we've been able to do internally and through, you know, reviewing a lot of research from industry and academic research as well to get to our own sort of risk analysis over our very large portfolio.

For the privates, we've -- we've actually been going through portfolio holdings, sort of almost one by one to sort of do some assessment of their various climate risks.

COMMITTEE MEMBER YEE: Okay. And then I thought the report, maybe because we are viewed as a leader in this area, might benefit from maybe a concluding section about -- not recommendations, but maybe some direction setting with respect to what are some of the things that can be beneficial that we could be doing going forward that would help with the transition and protecting our investments. And it could be things like advocating for carbon pricing - and certainly, we're going to be very heavily involved with that - additional climate reporting.

But I just think with all of the global kinds of initiatives that we're a part of, that having a section like that might be helpful in terms of just a future direction setting kind of framework.

And then my last question has to do with at what point do you think - this is kind of the $64 million question - are we going to be able to include Scope 3 reporting in the carbon footprint? And maybe explain what

Scope 3 is for those that don't know.

MANAGING INVESTMENT DIRECTOR RICHTMAN: Okay. So -- Beth Richtman, Sustainable Investments.

Scope 3 emissions are what you can think of indirect emissions of a company. So this is upstream emissions through a supply chain for a company or downstream emissions through sort of use of a company's products. So it's -- you know, it's a pretty broad landscape of types of emissions, if you think about it, with a 10,000 company portfolio related to Scope 3. So there is a challenge there.

I guess there are a couple things I want to say about Scope 3 to answer your question. One, Scope 3 matters. It absolutely matters to us. We need to be thinking about it. It's a large source of emissions. And it's something that we actually did analyze as part of this. And it was included in the analysis that our two consultants provided.

But at this stage, there are very few companies that are actually reporting their Scope 3 emissions. And even ones that do, they're not audited. There's quality issues. And so we do have -- I could give you a range of where we are in terms of what the consultants provided, which is a range of between 58 and 68 million tons of CO2 per year based on the 2018 year.

Now, that's a very large number. And if you look at our report, you'll see that for our global equity portfolio for Scope 1 and Scope 2 was only about 23 million. So you might wonder why is that so large?

And there are a couple things I would say about that. One, you know, the -- again, the data quality is something that we're concerned about, because, in fact, both ISS and MSCI, which were the two consultants we used, basically said that they found the numbers to not be reliable. So that's one thing. I mean, they both had that.

And also, when you think about a portfolio as complicated as CalPERS and as many industries, you've also got to think that when you're doing Scope 3 analysis, you're going to have not only double counting, but perhaps triple counting, maybe quadruple counting. And just to give a basic example. So, you know, a company in our portfolio, let's take an auto manufacturer, like a GM or a Ford. Let's take GM.

So GM, when customers buy those cars from GM and they drive those cars, they are creating Scope 3 emissions for G.E.[SIC]. Okay. So they're driving them. But let's say they fill up their GM cars at an Exxon gas station. Well, then they are now driving the GM car creating Scope 3 emissions for GM in our portfolio, but also Scope 3 emissions for Exxon in our portfolio. So that's just two layers. So that's a double counting.

But then imagine that that is a fleet of GM trucks that is then owned by another company in our portfolio, that would be another company's Scope 3 emissions. So quickly we get to triple counting. And so that's the something that it's not easy with a 10,000 company portfolio to ease out to really get to good data.

So we -- we can report Scope 3. But at this point -- and we, again, think it's very important that companies analyze this and report on it, because we want them to manage this. We want GM to think about the Scope 3 emissions and manage the efficiency that vehicle fleet. But for us as an asset owner, it's -- those numbers are, you know, difficult to have a lot of confidence in just because of the multiple double countings that would be going on.

INVESTMENT DIRECTOR SIMPSON: Let me -- let me just add to what Beth says, and she's quite right, it's fiendishly complicated. However, just because something is difficult doesn't mean you shouldn't make an effort. So we take the point very well. And the point here I think is that we are asking companies to report on Scope 1, Scope 2, Scope 3. So Shell is one of the companies in Climate Action 100 that's agreed to take responsibility for all of its emissions. So when oil is being drilled, there's emissions. And when oil is being refined, there's electricity used that's Scope 2. Scope 3 is when you and I go and fill up our car, if we're using petrol or gas and burn that product. So Scope 3 is where most of the emissions lie.

But as Beth says, it's a very, very tricky area to get good numbers. So I think what we'd like to do is take this back in the final drafting, and see what we can introduce, so that we're not underestimating, because I think it's better to be in a range of approximation, rather than very precisely underestimating what the emissions are in the portfolio.

And then we continue to work with the standard setters, because really the only way this will get fixed is when the reporting requirements become mandatory. And that's very clearly CalPERS position. And as I said, we've just had a big opportunity open up with IFRS, which is outside the U.S., the main accounting framework worldwide. So things are moving.

COMMITTEE MEMBER YEE: Okay. Great. And then just lastly, the two areas that I raised with respect to the proxy voting section. I think just an explanation or a flavor of what some of the proxy issues were.

And then with respect to the --

CHIEF INVESTMENT OFFICER MENG: We're looking for our colleague.

COMMITTEE MEMBER YE: And not for mere. I mean, I think for the report itself. Yeah. And then on the --

INVESTMENT DIRECTOR SIMPSON: That's the good work of Simiso Nzima --

COMMITTEE MEMBER YEE: Yes, exactly.

INVESTMENT DIRECTOR SIMPSON: -- who's in the back.

COMMITTEE MEMBER YEE: And then on the engagement section, what we have done CalPERS solely, and then certainly what we've done in terms of being lead engager in Climate Action 100+.

Okay. Thank you.

CHAIRPERSON FECKNER: Thank you.

Ms. Taylor.

VICE CHAIRPERSON TAYLOR: Yes. Thank you, Mr. Chair.

To sort of piggyback on Controller Yee's comments, when I asked Anne and Ben to have this pulled, I also was concerned about Scope 3. So I want to encourage you, even if we're double reporting, it's better to have it overreported, like you said, than to -- to try to get it so analyzed that you're actually underreporting. So I would -- I think it should go in our final copy before we turn it over for Scope 3 emissions.

I also -- the report is great. And I congratulate you on all of the hard work it takes to go into this report. I know it all got dumped on your lap with the legislation. So, you know, Beth, thank you so much for all this work that you've done, and I really appreciate it.

Woops. I lost my little thing I was working on here.

So I wanted to also ask -- there's a couple of things. There was -- in the very beginning, it talked about the lack of data, and you have expanded upon that. But my thinking is -- and I know we've got all kinds of different measuring -- we've got TCFD. We've got like you said MSCI, ISSN. I'm wondering -- and I know that we -- that's not standardized yet, but I'm wondering does -- as we're taking into account how it impacts the financial industry, we need to take the science of climate change itself, and the actual facts behind that, because that's all settled science. So I think that needs to be -- I don't know if you want to put a paragraph in there, that we accept the settled science. We know it impacts our portfolio. That it is, you know, a material risk as -- and you kind of said that here, but you didn't direct -- directly link it to that.

So I'm wondering if maybe we could do that, because I kind of go by the science. Since we don't have anyway to measure it otherwise, that's kind of my thing. Let's say that the science is there.

And then finally -- hold on. I've got to get to it. Again congratulations on the CIO award. That's amazing. That is -- I know when we went to PRI how much of a forward thinker we are. We are in California though, so our stakeholders expect so much from us. And I don't expect us to be perfect at this, especially our first round. But I hope to see our next report in 2020 that you guys -- I think -- what was it called, the Carbon Emissions Data Report for 2020? Did I write that down incorrectly?

INVESTMENT DIRECTOR SIMPSON: We're working with some of the wonderful people in the new Research Strategy Group, Nelson Da Conceicao and Lauren Rosborough Watts to really get our arms around this data. And they're going to be sitting working with Divya Mankikar and just give this our absolute full attention and best shot, so that we can do a TCFD report. As Beth says, that will be for the total fund. It will be grappling with 1, 2, and 3.

We'll get -- navigate our way through all the acronyms in the alphabet soup, but it's very ambitious for us to commit to do that, but it's the right thing, because we should not be saying one thing to others and not be willing to do it ourselves.

That's part of our credibility when we talk to companies, I feel, so --

VICE CHAIRPERSON TAYLOR: Right.

INVESTMENT DIRECTOR SIMPSON: -- we expect first quarter 2020, and the work has already begun.

VICE CHAIRPERSON TAYLOR: I'm -- so much appreciate all of that. And I think because we are so good at this and so forward thinking at this, that -- and starting Climate Action 100+ and Net-Zero Alliance, that people sometimes forget that we set the standard for this. The problem is we have to bring the rest of the industries dragging, kicking, and screaming behind us.

And I think the financial industry isn't -- hasn't been real helpful with this either, in terms of agreeing to report. So the advocacy that you guys were talking about behind making sure these -- the reporting gets done, I don't know how well we'll be able to do any kind of federal legislation for a while. But I appreciate that you guys are talking talking about it and moving that needle a little bit.

And again, I just want to congratulate you on the report. If we could make sure we get some of this into the report, like Ms. Yee was talking about, the Scope 3.

Even if we're overestimating for now, at least it will be there. If we're asking our companies in Climate Action 100 to do it, then we probably should do it. So thank you very much.

CHAIRPERSON FECKNER: Thank you.

Ms. Olivares.

COMMITTEE MEMBER OLIVARES: Thank you.

This is a very helpful report. And I appreciate all the work that goes into it, particularly since the accuracy and quality of the information isn't always there. I think going forward, it would be helpful to see how this translates, especially the transition and physical risks to stranded asset risk, and then how the stranded asset risk could then impact our portfolio.

Thank you.

INVESTMENT DIRECTOR SIMPSON: Thank you. That's a very timely and important issue. And it's something the financial analysts are beginning to comment on. There's a group that's feeding into Climate Action 100 called Carbon Tracker, which is analyzing stranded assets sector by sector. So we've got some analysis for oil and gas. They're looking at transport. We have other major sectors coming through. So I think this is one of those issues where we're going to have to take it one piece at a time, being aware that all these pieces hang together and each sector affects the other. They're not, you know, being affected individually.

There's also an initiative that's just been launched at PRI called the Inevitable Policy Response, which I encourage you to take a look at online, because they've actually done some very nice scoping work and scenarios on how different policy measures could lead to assets being stranded. So that's another broader discussion that might be helpful.

COMMITTEE MEMBER OLIVARES: Thank you.

MANAGING INVESTMENT DIRECTOR RICHTMAN: One additional thing I'll just add just to make sure it's clear -- oh, Beth Richtman -- is that around the Investment Office, even when we're not reporting, this is something that our investment analysts are looking at, and trying to understand, and underwriting new investment say for our Infrastructure or Real Estate Program in, you know, working to understand credit, and -- you know, this is something that is not just about reporting. It's something that's real that we're thinking about as investors. So I just want to make sure that you understand that as well and our stakeholders.

CHAIRPERSON FECKNER: Thank you.

Ms. Taylor.

VICE CHAIRPERSON TAYLOR: Sorry I forgot one more thing. And, Beth, I do get that. I do get that.

And I do want to thank you guys. And I know we are leaders. And one thing I really wanted to call out and I forgot to was that I really appreciate that in the report that you're looking at, and I'm going to quote this. "The physical risk to investor's portfolio from climate change policy should be designed to avoid exacerbating economic inequality and its associated geopolitical risks. And policies should be designed to provide incentives for carbon sequestration, including through natural methods, such as ecosystems, protections, and restoration".

And what I'm taking that to mean is that you're looking at just transition here. And I wanted to call that out and thank for putting that forward. In terms of advocacy, where are you going -- where is CalPERS going to advocate that -- for that? And is that within Climate Action 100, Net-Zero Alliance? Is it with the federal government, like I said earlier? So I just wanted to ask that question that I didn't ask before.

INVESTMENT DIRECTOR SIMPSON: No. Thank you very much for the question. The just transition is an integral part -- as a concept, an integral part of the Paris Agreement. If you read the preamble, it doesn't just talk about workers, but communities, vulnerable communities, the impact on migration from climate change, a whole range of issues.

And I think that in order for making progress on the policy front, keeping social cohesion, keeping support for policy measures rests upon making sure that we don't see a backlash -- an economic backlash. And I think the yellow vests in France are understood to be an example of how disadvantaged communities can be hit by measures that look good and green, but actually they're going to cause political protest, if they're not handled carefully.

So where do we go with that idea, because it's so big and it's actually a public policy issue and we're an investor. So we need to be very thoughtful about, well, what's our role in thinking this through.

So the place it sits at the moment is, first of all, in our engagement work with Climate Action 100+. So we're asking companies to put forward their plans as part of their strategy. Now, in Europe, this is a more common area. But I do want to call out big companies like NRG, Big Texas Utility, and ConocoPhillips as examples of companies, which are building in the worker transition and impact on communities into their plan.

In terms of how the just transition is financed, because these projects take money, the framing for the roundtable on carbon pricing by Notre Dame and the Vatican is carbon pricing for a just transition. And there have been some ideas floated on both Republican and Democratic sides bipartisan spirit to be thinking about what would happen with the revenues of a carbon tax?

And again, we're not policymakers. We're investors, but it's encouraging if we can get to the point where companies can be talking to policymakers about what will facilitate the transition, rather than what will cause, to coin a phrase, roadblocks.

So I hope that's -- I hope that's helpful.

VICE CHAIRPERSON TAYLOR: All right. I do appreciate it. I think -- I think it's important that -- you know, in the conversation we include workers, so that we're seeing them being included, whether that's through transitioning them to the greener jobs, whatever that means.

The problem I see, if -- I know we're investors, but if CalPERS isn't in the conversation, we're not -- we're not helping move it. And I think it's important that our voice moves that conversation as well, because we don't have a cohesive government -- except in California, governmental message for a just transition.

It's worldwide. And I've talked to many investors all over the world in Europe, Australia that are working very hard to make sure that the just transition is included in the green economy. So I appreciate it.

Thank you.

CHAIRPERSON FECKNER: Thank you.

No requests from the Board. I do have a number of requests from the audience that wishes to comment. You'll have up to three minutes for your comments. I'll call you down two at a time. Sandy Emerson and Tina Gallier.

MS. EMERSON: Good morning. My name is Sandy Emerson, and I'm the Board President of Fossil Free California. Thank you for the opportunity to comment on this first report for the SB 964 legislation.

One effective and timely way to mitigate risks posed by fossil fuel investments would be to decrease such investments. A recent IPCC report states that $200 billion per year must be disinvested from fossil fuel extraction and production and 100 billion per year must be disinvested from fossil fuel electricity.

Every share that remains invested in the most polluting companies that are identified by your Climate Action 100+ research is an obstacle to the kind of investment we need to limit global warming.

The SB 964 report could have, and looks like will, disclose the risk of PERS fossil fuel investments on a company-by-company basis. It should have included reports of Scope 3 emissions. The carbon disclosure project made well-qualified data available on company's Scope 1, 2, and 3 emissions for your Climate Action 100+ initiative. CalPERS used this data to identify the most polluting companies for its list.

The initial 100 focus companies leverage up to 66 percent of global emissions. As the lead investigator for 22 of these companies, CalPERS is in a good position to disclose the climate risk of these investments clearly and specifically.

Companies with carbon reserves pose the greatest risks. These primary producers, such as BP, Chevron, Exxon, and Shell are even now increasing their reserves, even though we already have more than six times the amount of carbon reserves that we can safely burn. These companies leverage the Scope 3 emissions that this report should disclose.

With more than $8.7 billion invested in primary fossil fuel producers and over $28 billion invested in the energy sector overall, CalPERS is carrying great risk. And CalPERS still has over $3 billion invested in the thermal coal category, defined by the Global Coal Exit Database.

I urge you to start somewhere. Disclose what you already know and continue the important discussion that this report deserves.

Thank you.

CHAIRPERSON FECKNER: Thank you.

MS. GALLIER: Good morning. My name is Tina Gallier. I'm a member of Fossil Free California. And thank you for the opportunity to comment.

Fossil fuels are not going away literally tomorrow, but there are strong indications that the market for them is softening, enough to create reasonable doubt that they necessarily good investments. Late this year, the Wall Street Journal and Reuters reported that Chevron and Schlumberger wrote down 10 billion and 12.7 billion dollars in assets respectively due to a glut of oil and gas on the market, investor concerns about the long-term future of fossil fuels, and a slow down in shale drilling.

And we have seen that coal, once the bedrock of an industrial economy for about 200 years, has been pushed out by natural gas. This year, the $70 billion UC pension system announced it will divest its fossil fuel holdings. So the fact that the Chief Investment Officer for the UC system and the Chairman of the UC Board of Regents Investment Committee considered it safe to do so should be taken into account in CalPERS investment planning.

There is reasonable doubt that fossil fuels are good investments. Therefore, we feel CalPERS should consider the possibility of moving these investments to more sustainable sectors of the economy.

Thank you.

CHAIRPERSON FECKNER: Thank you.

Next two, Sara Theiss and Sheila Thorne.

MS. THEISS: Thank you. My name is Sara Theiss. And I am a CalPERS retiree and on the Board of Fossil Free California. I appreciate the opportunity to comment on the report. I'm going to talk about transition risks.

And specifically, the first row of the chart on Attachment A, the report on page seven, which states, "Policy market and technology changes may result in the loss of value and/or stranding of long-lived and carbon-intense energy assets in our portfolio".

I would say that "are resulting" is a more accurate way to phrase it. As the Wall Street Journal noted this month, oil companies have struggled to reap the profits of old and are falling out of favor with investors amid fears that electric vehicles and renewable energy, along with government regulations, to address a warming planet will constrain their futures.

As my colleague mentioned, Chevron wrote down 11 billion in assets this quarter. According to the Wall Street Journal again, this admission could force others to publicly reassess the value of their holdings in the face of the supply glut and growing investor concerns about the long-term future of fossil fuels.

And in a press release Chevron stated that it's considering alternatives for its gas-related assets, including divestment. It's ironic, isn't it, that in the light of the perfect storm facing the fossil fuel sector, Chevron is considering divestment, while apparently CalPERS is not.

As Tina mentioned, other oil majors are taking similar actions, in addition to Schlumberger, BP, and Repsol also wrote-down billions. And according to figures I have access to, CalPERS has almost one billion invested in these four companies.

It's not surprising that in light of these problems, Moody's just adjusted ExxonMobil's AAA credit rating from stable to negative, raising the prospect of the company being downgraded in 2020. Exxon had a negative cash flow this year, and Moody's expects the same in 2020 and 2021. And Moody's also cited transition risks, in terms of its action, specifically emerging threat to oil and gas companies, profitability, and cash flow, the growing effort by many nations to mitigate the impacts of climate change through tax and regulatory policies.

So I guess my take-home point from this is one made by Ms. Olivares, and I think others, which is that I personally would like to see, and I think it makes sense to see, more of a link between the science and the actual investment decisions that this Board makes, not just in terms of reporting, but actual investment decisions.

Thank you.

CHAIRPERSON FECKNER: Thank you.

MR. THORNE: Good morning. My name is Sheila Thorne. And I'm a member of CalPERS and I'm very, very grateful for the benefits I receive. Very grateful.

But I also am very worried about the risks to those benefits that are posed by your continued investments in fossil fuels. Not only are fossil fuels losing money right now, as has been pointed out, but there are so many -- so many risks, which I think that have been underestimated in the report.

There are stranded asset risks, which you recognize are not adequately analyzed. There are litigation risks, which are already numerous, and will increase with the recent decision by the Philippine Commission on Human Rights that Carbon Majors can be held accountable.

There are regulatory risks, which you don't address, such as the EI/TI rules and amendments to EU directives, and constant new laws and ordinances passed by

U.S. states and cities despite the current administration.

For instance, Colorado passed a law this year bolstering local control of fossil fuel development to prioritize public health and safety. Berkeley has passed an ordinance banning natural gas in all new constructions. And other cities are looking into similar measures.

And inside Climate News Reports that a November federal court ruling has suspended BLM oil and gas leases in hundreds of thousands of acres throughout the west for ignoring climate impact. Energy companies had bought those leases. So those are stranded assets.

These actions will continue and regulation will be pursued. And as more and more countries, states, and cities transition, a tipping point will eventually occur, the Carbon Tracking Initiative predicts between 2020 and 2027, and most likely by 2023, and investors in fossil fuels will lose a whole lot of money.

So I ask you considering all these risks, why do you continue to invest in fossil fuels?

CHAIRPERSON FECKNER: Thank you.

The next two are Deborah Silvey and Vanessa Warheit.

MS. SILVEY: Good morning, Board members. Thank you for allowing me to speak. I'm Deborah Silvey, a CalPERS retiree and co-founder of Fossil Free California.

In September 2013, I came for the first time to speak to the Board in support of the CalPERS Investment Beliefs number 4 and number 9, which reference the investment risk of climate change. We were pleased that you passed those beliefs. But here we are six years later and the urgency to act on climate risk is far greater than any of us imagined back in 2013.

Scientists consistently report that climate threats are coming much earlier than they had thought. Per the United Nations Environmental Program, UNEP, if what countries have planned for fossil fuel production in the coming decades go as planned, the world will blow past two degrees limit -- the two degrees limit outlined in the Paris Accord. They'll blow past that before 2030.

So a sense of urgency should pervade the entire SB 964 report. Unfortunately, so far, it does not. First, it does leave out the analysis that the biggest source of emissions in the portfolio, as you've heard, the Scope 3 data. It's too late to wait for perfect data. Scope 3 includes about 80 to 90 percent of fossil fuel company emissions. And that -- and you have about eight percent of those fossil fuel companies in your portfolio, so you -- it really should not be left out.

Second, there seems no sense of urgency about what's to be done going forward. CalPERS points to their gradual approach of engagement, proven fruitless in dealing with fossil fuel companies. Yet, CalPERS has -- as a lead actor with Climate 100+ can act on that data to protect our members' pension funds from the harm -- from harm in the not so distant future.

And what's coming in the not-so-distant-future, as you're hearing -- well, what's coming is a collapsing demand and that's the biggest threat to the fossil fuel sector. Once concerned with about peak oil supply, now is peak oil demand, which may occur as early as 2025.

In writing the Board last June, Tom Sanzillo, Director of Finance for the Institute of Energy Economics and Financial Analysis said, "This new legal requirement comes during a time of broad financial changes in the fossil fuel sector. SB 964 is not merely a legal exercise in compliance, but a more fundamental call for an increased level of prudence and care". So we call for a deeper examination of climate risk, including Scope 3 data.

Thank you so much.

CHAIRPERSON FECKNER: Thank you.

MS. WARHEIT: Hi. Thank you for hearing us today. My name is Vanessa Warheit. I'm the Executive Director of Fossil Free California. Our organization represents over 1,100 CalPERS members, which include my own mother.

And I'm here to express our profound disappointment with your CalPERS approach to addressing Climate Change Risk Report, as mandated by Senate Bill 964. And we're very happy to hear that you're going to be revising it.

Many of my colleagues have already spoken about the massive write-downs and mounting climate liability lawsuits that are facing the fossil fuel industry today. So it is disheartening, to say the least, that CalPERS has not taken this opportunity to do the kind of robust reporting necessary to protect our members from climate-related financial risk to their portfolio.

Specifically, we are alarmed at the omission of Scope 3 greenhouse gas emissions data in the analysis of the fund's holdings, and their impacts on the climate crisis. And I would like to add some estimates put it anywhere from six to nine times, not double, but many, many times the Scope 1 and 2 emissions.

We are also outraged at PERS' failure to name the companies that put our public funds at risk. As co-sponsors of Senate Bill 964, we believe that these glaring omissions render this report both inadequate and unacceptable.

Why is robust reporting critical this year? The bill's author accepted an amendment making the report triennial, instead of annual. At a time when the window of opportunity to avert global disaster is now measured in years, the 2019 report needs to provide direction for CalPERS' risk-based investment decisions between now and the end of 2022. And it sets the standard for future reports and for reporting by other funds who look to CalPERS for leadership and essential models. This report, as written, fails to provide either of those.

Staff and my colleagues have addressed the report's shocking lack of readily available and crucially important Scope 3 emissions data. I would like to briefly address the report's lack of specificity in attributing risk to industries and companies within the portfolio.

In drafting SB 964, the Legislature intended for CalPERS to report on the climate-related financial risk of its public market portfolio, which the authors of the bill understood to include discussion of specific holdings by name as well as specific industries.

As we stated in our letter to you of June 25th of this year, there is precedent for this discussion in both CalSTRS and CalPERS reports on compliance with SB 185, which requires the funds to divest from thermal coal companies that meet a certain threshold.

CalPERS' SB 964 report, however, contains no such discussion of the fund's holdings, making it impossible to accurately assess where and how climate related risk is distributed.

So I urge you, in your revisions, to include, at a bare minimum, industry specificity, but really you should be including company specificity, so that we know where that risk lies.

Thank you.

CHAIRPERSON FECKNER: Thank you.

Mr. Perez.

COMMITTEE MEMBER PEREZ: Thank you. I have a question for Ben.

Sorry. Thanks.

CHIEF INVESTMENT OFFICER MENG: Yes.

COMMITTEE MEMBER PEREZ: The -- let's -- just for sake of argument, let's pretend that you suspended all of -- al of the advocacy and the way we are investing currently. Knowing that that seven percent discount rate is difficult target for us to reach, if we suspended this program -- not program, this -- one of the Beliefs that we have, would that help our returns in the short term?

CHIEF INVESTMENT OFFICER MENG: That's a very complex question. Let me put it this way, as I said last month in the open session in my opening remarks, about 11 -- Item 11b, the unique challenge we face, we are a long-term investor. Long-term risk matters a lot to us, including sustainability ESG factors, but we also have a short-term challenge. The short-term, for one, the challenge every year, we need to pay out about $24 billion benefit to the policemen, firefighters, and public workers who have dedicated their entire life to public service.

And also, as you said, that in the near -- we also need to be mindful of the survivability of our fund in the short term. Without surviving the fund in the short term, there's no long term to speak to.

So I hope that answer your question. It is a very tough balance. We need to balance basically, the long-term survivability and the short-term survivability.

COMMITTEE MEMBER PEREZ: Thanks, Ben. And I -- I hate to put you on the spot, and you kind of answered it, but not really. So I'm hearing, yes, that if we suspended this stuff, we should do better in the short term?

CHIEF INVESTMENT OFFICER MENG: No, that's not what I said. Sorry.

COMMITTEE MEMBER PEREZ: Oh.

CHIEF INVESTMENT OFFICER MENG: I said it's a complex question. I cannot give you a straight yes and no answer. All I need -- I would like to highlight the additional challenge we face, when we compare to our global peers, who some of them does not, you know, have current liability structure, let alone we need to pay out $24 billion a year. Many of them, they do not have assumed rate of return at seven percent.

But given all this together, we view the pension liability as a shared responsibility among CalPERS employers and employees. So without causing additional stress, financial stress, on the employer and employee, the Investment Office what we can do is really focus on delivering the seven percent return.

COMMITTEE MEMBER PEREZ: Yes, sir. My concern is that we are so focused on engagement and talks of divestment, that we are going -- we're putting too much pressure on the contract agencies, the cities and the counties, that contract us with CalPERS -- for CalPERS for their pensions.

CHIEF INVESTMENT OFFICER MENG: That's true. If we cannot deliver the required rate of return from the investment portfolio, unfortunately we will be putting on more pressure on the employer and the employee

COMMITTEE MEMBER PEREZ: Thank you.

CHAIRPERSON FECKNER: All right. Thank you.

CHIEF INVESTMENT OFFICER MENG: Thank you.

CHAIRPERSON FECKNER: All right. Thank you.

Nothing else on Item 6i.

Move to 6j, the Responsible Contractor Policy.

CHIEF INVESTMENT OFFICER MENG: So, Mr. Chair, I forgot to mention, if I may, there is one correction in eye 6f.

CHAIRPERSON FECKNER: 6f?

CHIEF INVESTMENT OFFICER MENG: The alternative fee reporting. With that, I would like to introduce my colleague Matt Flynn who's the Acting Interim COIO today. Our Interim COIO, Dan Bienvenue, is out of the country, so Matt Flynn has kindly offered to step up as the Acting Interim COIO today and who will cover the correction in Item 6F

ACTING INTERIM CHIEF OPERATING INVESTMENT OFFICER FLYNN: Good morning. Matt Flynn, CalPERS team member.

Item 6f, which is our AB 2833 report contained in attachment number 1, page number one, there was an error in the formation in the formatting of the table that resulted in some inaccurate information. And the most critical piece of it is in the cash profit received column. It is incorrectly stated as printed. However, it will be corrected on the online posting. It is -- it should have read $24 million in cash profits received for our Absolute Return Strategies Program and not a negative 760 million as stated. So again, the correction will be online. And it's just currently an issue in the printed version.

CHAIRPERSON FECKNER: Very good. Thank you.

Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair. We did receive an updated report. Is that correct, the updated report we received subsequently to the printing of the agenda?

ACTING INTERIM CHIEF OPERATING INVESTMENT OFFICER FLYNN: I believe there was an error in -- earlier in the week that is contained in the updated report that you received. The information we're talking about here this morning was discovered late on Friday afternoon --

COMMITTEE MEMBER JONES: So it's not the updated report.

ACTING INTERIM CHIEF OPERATING INVESTMENT OFFICER FLYNN: -- and I do not believe you've received that yet.

COMMITTEE MEMBER JONES: Okay. Thank you.

CHAIRPERSON FECKNER: Very good. Thank you.

Item 6j, Responsible Contractor Policy. Mr. Meng.

CHIEF INVESTMENT OFFICER MENG: Thank you, Mr. Chair. So with that I call on my colleagues.

INVESTMENT DIRECTOR SIMPSON: Thank you. Thank you very much, Chair. Anne Simpson. I'm joined here by Carrie Douglas-Fong and also Paul Mouchakkaa. And it's my pleasure to introduce this item, which is an annual report on the Responsible Contractor Program.

However, it's also painful that I have the task of saying unfortunately there was a mistake in one of the tables that was sent to you, which we will correct online. The mistake is in Attachment 2 under what's called Non-Core. And the mistake is a transposition, if you'd like. Hines-Green in the fourth and fifth column should be zero. And we do apologize for this. What this means is reducing the sums of contracts under the Responsible Contract Policy by $2.5 million. So there's a knock-on effect on the totals shown in the presentation and in the attachment, and we'll be putting that right in the online version.

So thank you for your understanding on that.

CHIEF INVESTMENT OFFICER MENG: So on that note, we would like to say that on behalf of the Investment Office, we realize that there have been a couple errors in the materials presented to the Committee. We're looking into it -- to the route cause of the errors. But regardless, we apologize for the errors and we'll do our best to make sure it doesn't happen again in the future.

CHAIRPERSON FECKNER: Thank you.

INVESTMENT DIRECTOR SIMPSON: Thank you, Ben. Absolutely. Let me now turn to Carrie Douglas-Fong, who has a presentation to explain the history of this policy and the program attached to it. And Paul Mouchakkaa, who's the Managing Investment Director for Real Assets, will be here to help answer any questions that you might have.

Thank you.

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG:

Good morning. Carrie Douglas-Fong, CalPERS team member.

(Thereupon an overhead presentation was Presented as follows.)

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG:

Today, I'm going to provide you with information on thre RCP Policy, including overview, history, summary results, communication and engagement, and compliance and total contracting.

Next slide.

--o0o--

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG: The RCP Policy applies to domestic real estate and infrastructure assets where CalPERS holds greater than 50 percent interest on contracts of a hundred thousand dollars or more.

Next slide, please.

--o0o--

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG: The first mention of the policy was in 1992.

Thank you.

The RCP Policy was carefully drafted by CalPERS external managers, labor, fiduciary counsel, and the Board's consultant, Pension Consulting Alliance, which is now part of Meketa, and staff. We worked together to create the RCP Policy for external real estate managers to hire responsible contractors and subcontractors, based on local market conditions, all the while, maintaining a competitive bidding process that enables an appropriate risk-adjusted return.

In 1996, the CalPERS Investment Committee approved and established the policy. Over the years, it has evolved. There were two periods of extensive review and revision. The first between 2010 and 2013 and the second between 2014 and 2015.

Over this five-year period, the Investment Committee, so you, asked staff to spend significant resources reviewing and revising the policy. At the Investment Committee's request, staff initiated engagement with labor stakeholders and investment managers on the RCP Policy. Each review included multiple discussions and written communication with all sides.

Staff, PCA, and fiduciary counsel worked with managers to make sure that real assets could continue to remain competitive in the marketplace, while being sensitive to the requests of the labor community.

The results were a groundbreaking neutrality trial for core real estate and infrastructure applying to service contractors and subcontractors, which is now a permanent part of the policy; significantly increasing manager responsibilities and establishing roles for unions, external investment managers, contractors and staff; and, the creation of an enhanced, certified responsible -- and enhanced certification of responsible contractor, which increased requirements for all of our subs and contractors, while still retaining enough flexibility for managers to be competitive.

Next slide, please.

--o0o--

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG: Summary results. All managers provided a report, including dollars paid under the policy and a certification that they and their contractors and subcontractors have complied with the policy. Importantly, managers reported that there were no adverse material impacts on returns.

--o0o--

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG: Communication and engagement. Staff communicates regularly and proactively with labor stakeholders and CalPERS real asset managers regarding the policy. And we hold quarterly calls with many of the labor stakeholders, who -- that have concerns regarding the policy to make sure that we can be proactive in addressing any concerns.

When specific things come up often at a local level, we address them as quickly as possible. Often, these issues are outside of the policy, such as when CalPERS does not own the asset.

I also want to note that the policy encourages direct communication between labor, stakeholders, CalPERS external real estate managers, and potential contractors. And this is noted on page ten of the appendix of the PowerPoint.

--o0o--

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG:

Compliance and total contracting. For the last fiscal year, ending June 30th, 2019, managers reported a combined 99.98 percent compliance with the policy, paying over 841 million contractors certifying as responsible contractors under the policy. This compliance percentage is comparable with previous year's reporting.

Over the last few years, more than 5.4 billion - and the number 6.4 is incorrect in line with what Anne reported. That should also be changed - to support and encourage fair wages and benefits based on local market conditions.

The policy requires managers and contracts to consider responsible wages and benefits in the contracting process. And all winning bids are required to sign a certification saying they are a responsible contractor.

In closing, the policy has been replicated by many other public pension funds and investors. And it sets a standard in the marketplace in which we invest, not just for ourselves, but for other investors as well.

The RCP Policy was developed to provide a framework for responsible contracting on CalPERS' investments by the CalPERS Board. The goal being to have flexibility in the framework to contract responsibly while still ensuring a competitive risk-adjusted return.

And with that, I'll go back to Anne.

INVESTMENT DIRECTOR SIMPSON: Thank you.

CHAIRPERSON FECKNER: Ms. Taylor.

VICE CHAIRPERSON TAYLOR: Yes. Thank you, Mr. Chair. Thank you, Carrie.

I really appreciate the report. I'm the one that keeps pulling these things out. I'm sorry, but it's just I think that we need to highlight that we, again, are a leader in this. And I don't think we tell that story well enough. And I want to make sure that the report got brought to the public's attention, rather than sitting back in the information consent items, that was number one. Because we have such great compliance on our RCP program, I think that -- and that we are -- we set standard. I hear that often from other folks in the industry.

I just do want to caution us, the only thing I have is I want to caution us as we respond to like a labor request as they come in. I want to -- I'm trying -- so that we're not letting things drop through the cracks, I'm hoping that -- for example, I'll give a specific.

So, for example, if -- if a labor contractor applies, it's an expensive process to do a State application. It takes a lot of time. It takes a lot of making sure that you have all the right requirements, right, to -- as a contractor for building.

So I'm -- I think I'm a little concerned in that possess, because I'm hearing that a lot of unionized labor contractors that are applying. And it's not necessarily just CalPERS. It's perhaps -- and I haven't heard specifics of it -- is CalPERS. But that sometimes it's not even worth them applying, because they don't -- other -- other contractors that are contractors that aren't compliant, but have like gone out of business, started a new business, so that they are no longer on that list of noncompliant companies. We -- we're -- those companies are getting it, they're underbidding, or how -- because they don't have to pay the benefits that union labor has to pay.

So I'm just concerned that maybe the listing of these companies that are not compliant or have violated regulations in building, et cetera, et cetera. Do -- do we have that listing and is that something that we refer to when we're looking at who we -- or who -- maybe not us, but whoever our company is, like that we use for building?

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG: So each manager keeps a list of both responsible contractors and, you know, non-responsible contractors. If there's a specific instance, it would be helpful for me to understand what specifically the issue was. I know there was one instance with a manager that CalPERS does use, where an accusation was made that they did exactly what you're saying. I did look into that issue and CalPERS is not anyway invested in the property.

We've had other issues like that that have been brought to our attention. And I can assure you that we -- you know, very -- we take them very seriously, and we, as quickly as possible, look into the concerns of labor leaders. So anyone who has concerns like that, I would encourage them to reach out directly to us. I'm unaware of any situation where we were not able to resolve it upon talking to both labor and the manager.

VICE CHAIRPERSON TAYLOR: And I appreciate that. I do know you do listen to that. Thank you very much. I -- it seemed like it's something that we can mitigate it before that, because these -- these companies -- these buildings companies, unfortunately, a lot of times are in violation of a lot of our requirements and sometimes even worse, right? Sometimes, even just labor law in general or safety laws -- health and safety laws.

And like I said, they either stopped doing business under that name, started up under another name, or -- somehow or another, they get their recertification under RCP. And I don't know how that happens. I'm just wondering if we have a way to mitigate that as we -- moving forward.

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG: We have a 24-month look-back, which is part of our certification. And it does specifically speak not just to the company, but also to the officers. In one instance, there was a company that labor leaders let us know there was a violation. There was actually more than one company that they claimed there were violations.

In one of them, we found there to be no -- thoroughly research it, we did not find there to be any violations and the manager moved forward.

On the other one, there was approximately a million dollars in fines and back wages. And the manager found that to not be a responsible contractor. And they lied on their certification and they did not move forward with that --

VICE CHAIRPERSON TAYLOR: With that manager.

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG:

-- particular manager.

So, you know, as I said, any of these particular instances, we're happy to handle them. Sometimes in looking at them thoroughly, we find that there's credibility, and that the evidence that the contractor is not responsible. In other instances, they are.

VICE CHAIRPERSON TAYLOR: It's not. Yeah. Yeah. Okay. Great.

Again, Ms. Fong, Ms. Simpson, Mr. Mouchakkaa, Mr. Meng, thank you for pulling these out for us and letting us highlight these. And again, great report. Thank you so much.

CHAIRPERSON FECKNER: Thank you.

Ms. Olivares.

COMMITTEE MEMBER OLIVARES: Thank you, Carrie. I had a quick question for you. I'm trying to understand how the RCP impacts risk mitigation and value retention within our portfolio?

ASSOCIATE INVESTMENT MANAGER DOUGLAS-FONG: That's a great question. I think that, you know, as early as 1992, the Board made it clear that we didn't want to be using substandard labor. And there are -- there are real estate investors who pull people off street corners. We felt it was important to be using responsible labor, both because that ensures that you've got a good product. And in terms of services, it ensures that the service personnel in your building are providing appropriate services. One specific example I'll give is that when we move to neutrality with services, we found that janitorial service -- the people who -- the janitors were staying longer than they had under the prior system.

So, you know, a very specific example is we make a change in the policy. The wages for janitors go up slightly at our properties, and they discover that in that -- doing that, the janitors are staying. Instead of six months, they're staying a year, 18 months.

And the -- what they found in doing that is that the tennants were actually much happier with the janitorial services they were receiving. So that would be a very specific example of how the policy had benefited. And, Paul, do you have anything to add?

MANAGING INVESTMENT DIRECTOR MOUCHAKKAA: Good morning. Paul Mouchakkaa, CalPERS staff.

Yeah. Our core real estate portfolio is circa $29 billion of equity. And much like you would -- and we look to hold those assets over a long period of time through a business cycle at least. And much like you would protect the value of your own home by hiring, you know, an appropriate contractor to do whatever work, it applies that same type of principle that you want the best possible labor or the best quality of work, but being mindful of your bottom line.

And what the Responsible Contractor Policy does, I don't think only attempts to do, but really has been proven out in its history, is to really find that balance between managing the bottom line, and at the same time protecting the assets for the long term, and ensuring that we're applying appropriate labor practices, hiring high-quality laborers to do the work that's necessary, and really to protect the asset for the long term.

COMMITTEE MEMBER OLIVARES: Thank you.

CHAIRPERSON FECKNER: Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair.

Yeah, Ms. Douglas-Fong, I just wanted to thank you for your work in regard to the RCP Policy, because I know a decade ago, we were getting some complaints. And you were very -- working on it expeditiously, responding to those complaints, and ironing out their concerns, and bringing the -- the eight -- the firms into compliance. And so just looking at the data, 14 out of the 15 companies are 100 percent in compliance and I think that's a good reflection of what has occurred. And also, in terms of the value of our portfolio during that same decade has gone up over $10 billion. So there is a correlation to good practices and growth in value. So I just wanted to appreciate -- let you know that we appreciate the work you've done in this regard.

CHAIRPERSON FECKNER: Thank you.

I do have some requests to speak from the audience. Three of you. I'll call you all down.

Michael Ring, Carolina Rocha, and Andrew Gaitan. You'll have up to three minutes for your comments. And please Identify yourself for the record.

MR. RING: Good morning, Mr. Chairman, members of the Committee. Happy Holidays. Michael Ring with Service Employees International Union. I'm here today with SEIU USWW member Carolina Rocha, SEIU USWW Vice President Andrew Gross Gaitan behind me. And two more USWW members, Julia Velez and Maria Elena Delgado. Julia and Maria Elena have cleaned the CalPERS headquarters for many years. In Maria Elena's case for 17 years she's kept this building running and clean.

We wanted to share some brief comments with you today with regard to the Responsible Contractor Program and also share some details about newly passed legislation this fall, AB 547.

And we believe -- AB 547 is legislation, which calls for important changes in the process of ensuring that all janitors in the State of California receive adequate training to prevent sexual harassment and sexual violence in the janitorial industry in California, which we believe is a critical risk mitigation factor for CalPERS in its portfolio.

Carolina and Andrew will share the details around AB 547. So let me focus my comments on the Responsible Contractor Program. And first of all, let me join Mr. Jones in thanking Ms. Douglas-Fong for her excellent work. She puts up with me and lot of other folks in the labor community in working with us to ensure that your buildings are both built in a responsible manner, and serviced, and cleaned, and securitized in a manner that is to the benefit of all CalPERS Beneficiaries and to the workforce that ensures the building's value over the long haul.

As an organization that represents over 200,000 members in the CalPERS system and tens of thousands of workers across North America who provide first class service, both janitorial and security, and other services in buildings across the continent, SEIU sees this as a model program and has always understood that CalPERS was a leader in the investment industry in understanding that responsible contracting is critical to human capital management risk. Excuse me.

We appreciate CalPERS' leadership in this regard. And we believe that it facilitates a long-term sustainable business model that works for workers and investors. So thank you very much for the opportunity to address the Committee.

And with that, I will turn it over to Carolina. And just a logistical issue for you to note, Mr. Chair, is that Carolina will be speaking in Spanish, so Andrew will be translating for her.

Thank you very much.

MS. ROCHA(through interpreter): Good morning. My name is Carolina Rocha. I've been working in the janitorial industry for 21 years. I'm part of the Executive Board of SEIU United Service Workers West, which represents some 25,000 janitors statewide. I've also been trained in sexual harassment violence prevention at the Ya Basta Center.

A hundred of my co-workers and myself have completed over 80 hours of training to be able to receive our certificate as sexual harassment trainers in order to be able to train our co-workers in the janitorial industry about sexual abuse and sexual harassment. We worked very hard to get AB 547 passed this year. That's a law which will allow us to begin to change the culture in this industry.

Under that law, janitors who are survivors of sexual assault will be able to be trained as teachers to be able to train our co-workers about this issue. And that way we're the center of the solution to this problem in helping our co-workers understand the rights and how to report what happens.

We want to thank CalPERS for being an owner in the industry that is helping to change this issue. Your belief in the power of the janitors has helped us to take measures to combat sexual assault in the buildings. By supporting these programs, like the responsible contracting, CalPERS is sending a message that sexual violence will not be tolerated in its buildings. And together, we can work to make sure that the buildings will be dignified workplaces where sexual violence will not be tolerated.

Thank you.

CHAIRPERSON FECKNER: Thank you very much.

Andrew, did you have anything you wanted to add?

MR. GAITAN: Yes, I did.

CHAIRPERSON FECKNER: Okay.

MR. GAITAN: So as Michael said, I'm the Regional Vice President for SEIU United Service Workers West. We do represent some 25,000 unionized janitors in California. Our mission has never been just to improve the conditions for the workers with the union. There are over 130,000 workers in California whose employers at least report payroll taxes to EDD. There's an untold number who are working in the underground economy, who are paid in cash. And it is also an industry that's rife with human trafficking.

So what we have done as a union, and CalPERS has over the years been very supportive, is try to look at changing the legislative situation for the entire industry, beginning with the issue of wage theft, which is -- the janitorial industry is one of the worst in the State, if not the country, for wage theft.

And what I mean by that is workers who come to work and not paid -- are not paid for all the hours they work, who work through their lunches and breaks, who work overtime and are simply told that overtime is not allowed, or who come to the buildings with their family and perhaps one person might be on payroll, but the children who are coming are not.

What we have done to deal with the very issue that Ms. Taylor referenced is -- it's well known in this industry when employers finally get judgments against them for wage theft, they simply change names and enter into the market as a new employer.

What we have done in SB 588, which was passed in 2015 is to make sure that the liability for wage theft follows not only the janitorial contractor and the individual owners of those companies, but also the owners of the buildings whose -- whose -- whose offices the janitors are cleaning. And when we speak to the issue of financial responsibility and the importance of the responsible contracting standard, it is currently California law that the owners of real estate in California can be held joint and severally liable for wage theft in their buildings.

Sexual harassment and sexual violence is also endemic in this industry. If you haven't seen it, I'd encourage all of you to take a look at the PBS Frontline special called *Rape on the Night Shift*, which features countless women who have been subject to sexual violence in the industry. It's a -- it's a perfect set-up for sexual violence. It's a heavily immigrant industry, primarily male supervisors, primarily women workers, and generally working alone at night where there's no one to see what happens.

We also know it's an industry that has a tremendous number of undocumented workers who are subject to all kinds of intimidation, because of their immigration status.

And what we have found in terms of CalPERS' role and the impact of the Responsible Contracting Policy, as we've organized this industry in California over the last 30 years, we've been able to bring health care as a norm, at least among the 25,000 who are unionized. So there are literally hundreds of thousands of children in California who have health care, because of the rippled effect of CalPERS' policies.

To have an institutional investor of CalPERS size be the role model for all the major real estate entities in whom you invest and state that the quality of life and respect for human rights of the workers who clean their buildings is a substantial investment priority, has had an effect, which as I said, has been able to bring health care to hundreds of thousands of children in California.

And, you know, the impact on longevity --

CHAIRPERSON FECKNER: Your time is up.

MR. GAITAN: -- is very clear. CalPERS in 2003 when the janitors strike --

CHAIRPERSON FECKNER: Can you please come to an end. Your time is up.

MR. GAITAN: Okay. When the janitors in Sacramento struck, CalPERS was an essential ally in telling the real estate owners that it did matter that they used responsible contractors. Carolina was one of those strikers and has been in the industry for 21 years. And she has any number of colleagues here in this city who have stayed in the industry for 15, 20, 25 years, because of the health care.

So I would like to express our appreciation to CalPERS for taking this leadership role. There are many other industries affected by the -- your contracting policies, but the janitorial industry is certainly one of the industries that has benefited the most, not only the workers in the buildings, but also their families.

So thank you.

CHAIRPERSON FECKNER: Thank you very much. Thank you all for being here today.

That brings us to Item 7, Mr. Meng.

CHIEF INVESTMENT OFFICER MENG: Yes. Mr. Chair, Item 7 is action item, which is the second reading of the Investment Policy revision of our private assets.

So with that, I'll turn it over to my colleague Kit.

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

Item 7a is a second reading of staff's proposed updates to the Private Equity and Real Assets Program policies arising out of this year's annual review.

For private equity, we're proposing refinements to the definition of customized investment account to afford staff sufficient latitude in selecting the best partner for these specialized accounts.

For real assets, the two primary changes are expressing the Managing Investment Director's fiscal year limits at the program, that is to say real assets level instead of at the portfolio level, and also relocating the program-specific leverage constraints to the policy related procedures.

And this is consistent with the centralization of leverage management at the total fund level that has been discussed here numerous times before.

Since the first reading in November, the only change you'll see today is a proposed rewording of the new definition of customized investment account in response to Board feedback at the November Investment Committee meeting.

And just as a reminder, regarding two of the proposed strike-outs, the duty to report policy violations to this Committee is now contained in one overarching all-encompassing statement in the Total Fund Investment Policy.

So since this is a second reading, we're seeking action by the Committee. And I'll pause there and ask if there are any questions or comments and also invite Wilshire and Meketa to comment.

Thank you.

CHAIRPERSON FECKNER: Thank you.

Ms. Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chairman. I guess I'm still troubled by this and I'm just trying to understand this a little bit better. And so the customized investment account definition. And the revision is intended to hopefully give us more flexibility and to provide a larger pool of potential private equity investments. I get the goal.

But I guess I'm curious as to how you would weigh a general partner's track record under the proposed revisions. So if there's a disagreement, let's say, between staff and the consultant providing a prudent person opinion on the customized investment account, how would that get resolved? I am still kind of just trying to see this in practice and how this would work.

INVESTMENT DIRECTOR CROCKER: Okay. And I may want to invite someone from private equity up or perhaps from Wilshire. But it's my understanding that we simply don't want to tie staff's hands, since the prior definition was too limited in terms of the factors staff could take into account. And track record is necessarily backwards looking not forward looking. And there could be other factors in -- that would dictate a different -- a different answer than if you're narrowly bound by that former definition.

COMMITTEE MEMBER YEE: Okay. I understand that. And I guess with respect to private equity, I would imagine that we're going to be engaging with probably a number of new managers, since I'm -- I guess I just found that -- the definition to be, I guess, weakened rather than strengthened, even though I understand what the goal is. So that's -- I'm having a hard time reconciling.

INVESTMENT DIRECTOR CROCKER: Yeah. And the goal is certainly not to weaken it. It is to give staff the latitude that they need to make the correct decision, because picking the best partner is perhaps a more subtle decision than was reflected in the prior definition.

COMMITTEE MEMBER YEE: Okay. So I guess maybe back to the question of how -- if there is a conflict or disagreement between staff and the consultant providing the prudent person opinion on a customized investment account, how would that get resolved.

INVESTMENT DIRECTOR CROCKER: I would say typically we don't proceed, but, Ben.

CHIEF INVESTMENT OFFICER MENG: If I may.

COMMITTEE MEMBER YEE: Yeah.

INVESTMENT DIRECTOR CROCKER: So I see two questions in your question. For one, in terms of the historical performance track record, it is known that in private markets that depending on which database you use and which time period, you can get quite different results. So when you're looking at the -- and also when you look at the past performance, the reason the past performance may be relevant is only in the sense that it may help us to predict the future performance.

So instead of just looking at the numbers, which is imperfect, because we don't have all the -- no one -- no index provider has all the data, like in the public market. When the team underwrite managers, we'll look for what are the driving factors behind the past performance, is that the people, or investment philosophy, or their investment processes, or the better alignment of interest, so we can go beyond the past performance because of the limitation of past performance.

And the more important you ask is whether these people, the same people, same skills still preside with the firm. And then you ask the question are they still the right skills for the future? It could be the right people, right skill for the past to be successful. So it's much more than just looking at the past performance. So that's the first question.

The second one you're asking if there's a difference between the staff and consultants? For one, we try to resolve all the difference between the staff and the consultants. And for that, I'm very happy to report that the staff has very constructive working relationship with the private equity -- private asset consultants, as well as the general pension consultants.

And it -- in my recollection, it did happen in the past. There were rare occasions the staff and the prudent person opinion disagreed. And I believe in that case, we brought all the case to the Board, to this body, and we have a full discussion and then make a decision together.

So it's not -- how do you say? It's not required for the consultant staff to be on the same page all the time.

COMMITTEE MEMBER YEE: Right.

CHIEF INVESTMENT OFFICER MENG: We challenge each other all the time. We learn from each other all the time. But when there's a disagreement, definitely brings to this Investment Committee.

COMMITTEE MEMBER YEE: Okay. All right. So that process wouldn't change. So potentially, we could see some of those disagreements come before us, should it arise in the future?

CHIEF INVESTMENT OFFICER MENG: Correct. That's my understanding.

INVESTMENT DIRECTOR CROCKER: Correct, that process would not change.

COMMITTEE MEMBER YEE: Okay. And that's helpful with respect to looking at track record, because I think in my own head, I was thinking about -- if we're talking about existing managers, the fact that we have a lot of dry powder out there, you know, just like what are the considerations? And so obviously, I mean, I don't want to hamper staff's flexibility. But at the same time, I want to be sure that what we're looking at relative to track record is something that will be helpful.

CHIEF INVESTMENT OFFICER MENG: Correct. Exactly. We are trying to look beyond the track record, because of the limitation of the track record.

COMMITTEE MEMBER YEE: Okay. Thank you.

CHAIRPERSON FECKNER: Mr. Ruiz, anything you want to add?

MANAGING INVESTMENT DIRECTOR RUIZ: No.

CHAIRPERSON FECKNER: Okay. Ms. Brown.

COMMITTEE MEMBER BROWN: Thank you, Mr. Chair.

I can't -- I have a question for you again on the removal of the language in the specific sections and going to the overall -- the overarching policy. I want to make sure that, one, the wording has not changed at all. And two, before when there was a violation, it would come to the next meeting. But now those meetings are quarterly. And so I'm wondering if the Board is going to be notified in advance of that quarterly meeting or what if that violation or issue was collected, will we hear about it at all?

INVESTMENT DIRECTOR CROCKER: Well, to answer that last question first, definitely. I mean, frequently, these violations have been corrected, I would hope more typically, by the time they get here.

COMMITTEE MEMBER BROWN: Right.

INVESTMENT DIRECTOR CROCKER: And we -- I had at least assumed that they would be collected and presented quarterly. That's certainly open to -- you know, we don't have to do it that way. It's open to what the Board would like -- would like to see done. Certainly, in open meeting, we would have to do them quarterly, but there might be another way to share them in the interim.

And then in terms of is it identical language? I think so, except that we -- we -- the existing program level language refers to problems, concerns, and policy violations. And we collapsed -- we didn't see the difference between problems and concerns. So we did collapse that for the sake of some economy. And just in the overarching statement in the total fund, it refers, I believe, to just problems, instead of problems and concerns.

COMMITTEE MEMBER BROWN: But they're the same to us.

INVESTMENT DIRECTOR CROCKER: It is supposed to be substantively identical.

COMMITTEE MEMBER BROWN: Great. Thank you.

INVESTMENT DIRECTOR CROCKER: You're welcome.

COMMITTEE MEMBER BROWN: And then I had a question for -- I guess, maybe it's for Meketa. I was reading the opinion that -- that's attached to this. And what I read was -- I'm on 7A, attachment 7. I don't know if I'm on the right page -- right spot. But one of the Stevens wrote, "If adopted, the proposed changes to the policy would provide staff with an expanded set of potential CIA sponsors to choose from and thereby increase staff's ability to select attractive appropriately experienced managers to partner with".

So have we been -- are there specific examples of when we haven't been able to partner with someone, because they didn't meet the policy? Do you know of specific examples? I mean, I know we might -- I don't want to go into anything closed session, but just generally. Because we're expanding this policy, so I want to make sure that we were -- we're expanding it for a specific reason.

CHIEF INVESTMENT OFFICER MENG: I believe so. But again, I do point out let me find out the names, and then hopefully we can bring it back in closed session this afternoon.

COMMITTEE MEMBER BROWN: Yeah, I just want to make sure as we -- that there's a specific reason for expanding and broadening this policy, especially when we talk about the experience of the managers, because before it said they had to have like specific experience. I can't get -- can you help me with that terminology? Now, we're saying appropriately experienced. I'm trying to understand the difference between the two.

MR. HARTT: So what is specifically your question, whether there's ever been --

COMMITTEE MEMBER BROWN: It's two parts.

MR. HARTT: And investment approved that was not appropriate? I'm trying to understand exactly.

COMMITTEE MEMBER BROWN: No. Like, we had a deal, but we couldn't -- we had a -- we had a potential, but we couldn't do it because it didn't meet this definition.

MR. HARTT: Well, recall -- so the answer is no. And what was the situation previously, it had to be -- meet the top quartile definition. And that was a very limited set of opportunities. And there's been relatively few customized investment accounts over the last couple of years.

COMMITTEE MEMBER BROWN: And then the second part about the appropriately experienced. Are we changing the definition of experience for those CIAs?

MR. HARTT: So that -- if I recall the definition, at the November meeting, there was a suggestion that the language that was provided in that -- in that draft was a little too loose.

COMMITTEE MEMBER BROWN: Liberal.

MR. HARTT: And that as a -- as a suggestion, staff has proposed the word "appropriate", and trying to capture some of the nuances there and having the staff -- having the manager have some connection to the strategy, right? Trying to give some comfort there that the -- the track record, the staff capabilities of the manager are reflected of what this customized investment account would be going forward to use the word "appropriate" was selected to try to be the adjective to put on there.

COMMITTEE MEMBER BROWN: And as our consultant, you agree that that's appropriate?

(Laughter.)

MR. HARTT: Yes, I think it's appropriate.

COMMITTEE MEMBER BROWN: Okay. Thank you.

CHAIRPERSON FECKNER: Than you.

Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair. Yeah, a couple questions. On the prudent person opinion, when there's a disagreement, you indicated that it would be presented back to the Board. But I also would like to not only have it presented to the Board, but also the firm that's providing the prudent person opinion be also before the Board to talk about their disagreements. So if we could add that to the process, I think it would be helpful.

The other comment is this -- just a second here. Oh, the -- and maybe -- the way I'm reading it perhaps is incorrect, but I would like for you to explain it, where -- while I recognize that backwards looking does not always predict success going forward. But here, you're saying that the top quartile is almost like eliminated from going forward. But you have to also always look and see what happened in the past. So I'd just like you to expand on your letter there, Meketa, about the backwards looking at the top quartile.

MR. HARTT: Because the prior definition before these amendments had the criteria that the manager had to have a top quartile track record in order to be considered, my point was that -- and I think the staff's point is too is to have a more expanded set of opportunities to look from. And that while track record is a very important component to assessing the GP or the manager's potential ability to deliver strong returns, it shouldn't be the only one, because it -- it does elim -- it does restrict that set of opportunities.

And that by choosing a criteria that is backward looking, that doesn't incorporate a number of the considerations that Ben was talking about just a moment ago, that -- with the idea of having a broader investment set to choose from to not include that -- not to limit the universe, because of backwards-looking criteria.

COMMITTEE MEMBER JONES: Okay. Thank you.

Mr. Chair, with that, I'll move approval of the private equity class program policy revisions.

CHAIRPERSON FECKNER: ALl right. It's been moved by Jones.

Is there a second?

VICE CHAIRPERSON TAYLOR: Second.

CHAIRPERSON FECKNER: Seconded by Taylor.

Ms. Olivares.

COMMITTEE MEMBER OLIVARES: Thank you, Mr. Chair.

I had a question too of getting back to the definition of customized investment account. It seems like there's questions about the term "appropriate" really, and what that means. And this is to Meketa. Are there other adjectives we could consider there, such as "leading" or something else that would speak to the potential performance, so that -- because appropriate is very vague.

MR. HARTT: As this item was being reviewed, and we were discussing it with staff, we had some discussion about what's the right adjective to use here. And we thought that having an adjective that does tie the -- the kind of experience that a manager has with what the forward strategy of the custom investment -- customized investment account makes sense. But again, with the idea of trying to give staff as much latitude as possible to look at things, and recognizing that staff will look to try to get, you know, strong managers. That's what they are looking to try to do as they're executing on the program, as well as the PPO opinion being included as the entire package. So having that additional set of eyes and that that provider of the opinion would also be making that fiduciary statement to go along with it.

I think as a package overall, it was -- it was --

it works for us. Could we spend a lot of time figuring out other words and then not really understanding what in practice it probably means, we could maybe spend some more time on it. But I think that at the end of the day, it's getting to the point where I think overall it's a package that will hopefully provide a strong set of investment opportunities for the CalPERS staff to choose from.

COMMITTEE MEMBER OLIVARES: Has the term "appropriate" been defined anywhere in this language, such as commensurate with the size and the obligations of the fund and the performance targets, anything like that?

INVESTMENT DIRECTOR CROCKER: Actually, if I -- if I may. You know, the drafting choice we were faced with was to either expand the list of characteristics of experience -- types of experience that we see here and then risk maybe omitting something that should have been in the list, or to say basically appropriate to the particular investment, because we cannot foresee exactly what sort of investment opportunities we're going to be looking at --

COMMITTEE MEMBER OLIVARES: Right, I understand that.

INVESTMENT DIRECTOR CROCKER: -- with one of these vehicles. So the choice of the word "appropriate", I would urge that we just allow it to have its ordinary

English meaning, which means -- you know, and recognizing that we're always looking to optimize returns. And especially in this asset class, we have high expectations. So it's really -- "appropriate" is not intended to replace -- I think maybe we're focusing that as replacing the top quartile return track record. And it's really the whole basket of, you know, should we be looking to -- for more expertise in terms of geographic -- geography of a particular investment, or type of industry, or what other bucket of experience might apply.

So that's why we settled on "appropriate" as basically -- it was really meant to address the perceived deficiencies, the comments we got in November, where we had eliminated the specific attributes and not basically said something that tied, however, the types of experience to the particular investment opportunity. So "appropriate" to me actually seems like the best -- the best designed word to basically say this is something that in light of this investment opportunity is what we want in a manager.

COMMITTEE MEMBER OLIVARES: To my knowledge, "appropriate" isn't a common financial term, so I'm just not used to seeing it in this context. I'm used to seeing something like "prudent". Although I don't know that prudent and private equity always go hand-in-hand. And so

I'm just trying to understand how this term could be interpreted, and if there was some type of definition around that, or some -- about the meaning of this and then intent of that word, I think that would be helpful, because "appropriate" is pretty vague.

MR. HARTT: We could spend some time with staff to try to come up with some additional definition. But I think that, as Ben described, it's hard to foresee all of the conditions that one might need to think about in the future, and also as Ms. Crocker had mentioned, in some cases, might look for someone's industry expertise, in other cases it might be geographic --

COMMITTEE MEMBER OLIVARES: Sure.

MR. HARTT: -- and there's different sorts of criteria that might be, at the end of the day, appropriate for the particular customized investment account. So it's a bit of a, you know, challenge. We're trying to make sure that there is appropriate consideration done by staff in coming up with the investment opportunity, but also, that the PPO is there that eventually has a third party that's saying that it is a prudent investment.

COMMITTEE MEMBER OLIVARES: There are terms like "suitable". I mean, there are other things that have been used. I'm just -- I'm just surprised that we're using financial term -- this isn't typical financial terminology, and it has a pretty big impact.

But I also had another question. And this was about -- is this Attachment 1? And this was on the reporting frequency. So it's 7a, Attachment 1, page four. And it's on the monthly reporting on the investment proposals received.

CHIEF INVESTMENT OFFICER MENG: Sorry. What was the question?

COMMITTEE MEMBER OLIVARES: So it says staff shall report regarding investment proposals it has received on a monthly basis. Is -- that seems very frequent. Is there a reason why we're not going to do that quarterly to align with the Investment Committee meetings?

CHIEF INVESTMENT OFFICER MENG: I would think that's a typo. It should be quarterly, given that we're moving to quarterly Investment Committee meeting next year.

INVESTMENT DIRECTOR CROCKER: And now might actually be a good time to point out that we are, in fact, completing the integration of our investment policies. We've sort of come full circle or rather completed the journey almost to a total fund view. So the program policies are actually a relic of a past sort of legacy, when the -- you know, before we had the total one fund view.

And now, going forward, we're going to be looking to be integrate into one Total Fund Policy. So that, in light of the new quarterly meetings, appreciate pointing that out, because I think that should probably go to quarterly.

COMMITTEE MEMBER OLIVARES: And on the item below it on the consultant reporting, right now that's on -- no less than annually in this document. Is that -- is it possible for that to be made quarterly?

INVESTMENT DIRECTOR CROCKER: That certainly could be quarterly.

COMMITTEE MEMBER OLIVARES: Thank you.

CHAIRPERSON FECKNER: Anything else, Ms. Olivares?

COMMITTEE MEMBER OLIVARES: No, thank you.

CHAIRPERSON FECKNER: Ms. Taylor.

VICE CHAIRPERSON TAYLOR: Yeah. I'm wondering if maybe we should make it a Chair request to review the terminology that Ms. Olivares and Ms. Brown were talking about. If it's not typical financial terminology, I don't see a reason we can't change that. So I'm wondering if the Chair would like to make a stance on that.

CHAIRPERSON FECKNER: That's fine with me. I'd be happy to look at it with staff. I also don't want us to get too deep into the weeds on just wording. I mean, we certainly employ our staff to do a job. And I think that we can rely on you to do so. But again, if we find some words that are more compatible, I think it's appropriate.

Come on. Come on. It was good.

(Laughter.)

INVESTMENT DIRECTOR CROCKER: Thank yo.

CHIEF INVESTMENT OFFICER MENG: So Kit and I was talking. Actually, the word "suitable" is appropriate for this purpose.

(Laughter.)

CHAIRPERSON FECKNER: All right. Any other discussion on the motion?

Motion being before you.

All in favor say aye?

(Ayes.)

CHAIRPERSON FECKNER: Opposed, no?

Motion carries. Thank you.

Bring us to Agenda Item 8, the information item, consultant review of the investments.

(Thereupon an overhead presentation was presented as follows.)

CHIEF INVESTMENT OFFICER MENG: Yes. So, yeah, this is consultant review on CalPERS divestments. And it will be by our consultant Wilshire.

MR. INGRAM: I'm sorry. I'm pressing the wrong one there. Good morning. Daniel --

CHAIRPERSON FECKNER: Before you begin. I just noticed that we're almost to the court reporter's break. So let's take ten minutes and then we'll be begin at 11:05.

(Off record: 10:56 a.m.)

(Thereupon a recess was taken.)

(On record: 11:06 a.m.)

CHAIRPERSON FECKNER: If we'd all please take our seats. We'd like to get back to our agenda.

All right. We're back on Item 8a. Wilshire, please.

MR. INGRAM: Good morning. Daniel Ingram from Wilshire Consulting, here to present Wilshire's annual analysis of the CalPERS active divestment activities through to June 30, 2019. For the benefit of some of the newer members of the Committee, we thought it might be helpful just to provide a bit of context to our divestment analysis. There was a bit of discussion in March about what the scope of this analysis is. And we just thought it would be important to reiterate this is really just about understanding the financial impact, the gains and losses from CalPERS' divestment programs. It doesn't represent a judgment of whether to remain divested or not. That happens now on a five-year cycle, when each divestment program is reaffirmed. That's a much deeper dive into each of the different divestment programs.

This is really an annual exercise, sort of a forensic measurement, as it were of the different programs. So by way of reminder the six divestment programs, tobacco, firearms, coal, Iran/Sudan, and emerging market principles.

We include the two inactive programs, South Africa and emerging market countries, just to illustrate what the present value of the impact of those programs is. They're not impacting the PERF today.

So really we just wanted to step you through as we did in March.

--o0o--

MR. INGRAM: We thought it would be helpful to look at the next slide, which is an illustrative example of the methodology we use. I won't go into this in too much detail, because I think most of you were there when Steve Foresti updated you on this.

But really the idea is just to show you -- you know, to be able to track the divested dollars. And so you can see from this illustrative example how divested assets are reinvested elsewhere in the portfolio. So you see a very simple portfolio here for securities, security A, B, C, and then the restricted security. That could be in any one of the divested programs.

The four securities here A, $45, $27 in security B, $18 in C, and 10 in D. And as we work across, the idea is to show you when we look at the unconstrained benchmark, that's the benchmark with the restricted or divested securities in the benchmark, we then divest from the restricted security. So if you track that on the bottom line, you track the restricted security, there is a cost from divesting from that security in the form of a trading cost.

And then the key point here is you follow further along to the constrained benchmark. This is the divested portfolio. The key point here to note is that the divested security is redistributed equal to the weighting of securities A, B, and C in the portfolio. I think we spent some time on that last time. But I think it is important to note that that's where the divested security goes into the sort of relative weights of the other securities in the portfolio.

I don't want spend too much time on this top chart hopefully. But I can take you through it, if you would find it helpful. With the specific numbers, I think it's interesting probably more to look at the bottom table, which shows the impact on -- in terms of dollars on the portfolio.

So this is the returns of the constrained portfolio. Over the period, you can see we've used a hypothetical example 10.08 percent compared to the unconstrained portfolio 10.02 percent. So in this particular case, the divested portfolio outperforms by six basis points. And then we take that across. There's a little bit of rounding here. So rather than $6, it comes out as $5.75 in terms of the dollar impact. So I think the other key point that we wanted to make for the example, which is very relevant to the -- how the divestment programs have performed in this financial year, is that as you bring forward the cumulative impact of the divestment gains and losses, even if that divested portfolio, or the constrained portfolio, is positive -- it yields a positive return, the cumulative impact, like in this example, can actually still be negative.

And that's actually the case when you look at some of the inactive programs, which aren't impacting the PERF today. As you bring them forward, they will accumulate in line with the performance of the PERF. So you can see that on the next slide.

So actually let me just pause there on the example. I sort of rushed through it a little bit, but I know some of you have heard this before. I don't know whether it's more useful just to go into the specific numbers of the divestment programs or whether it's helpful to continue to talk about the hypothetical example.

CHAIRPERSON FECKNER: We have a couple of questions. Let's see what we have.

Mr. Perez.

COMMITTEE MEMBER PEREZ: I had turned it off, but I just wanted to make sure that these are -- A, B, and C are just examples. They're not specific to stuff that we actually have.

MR. INGRAM: That's right. Just any -- any security A, B, C.

COMMITTEE MEMBER PEREZ: Okay.

CHAIRPERSON FECKNER: Thank you.

Ms. Taylor.

VICE CHAIRPERSON TAYLOR: And he can finish.

CHAIRPERSON FECKNER: She said go ahead and finish.

--o0o--

MR. INGRAM: Okay. Good. So we present two main slides. And then the appendix we include for information, which is the longer back history of the different -- each of the individual divestment programs. So there are two slides here. The first is since the last affirmation, how have each of the different divestment programs performed. You can see here that just over $2 billion of gain or 0.6 percent of the total PERF from the six divestment programs since affirmation. Last year, this was about 1.5 billion, or 0.4 percent, of the PERF for these six different divestment programs.

--o0o--

MR. INGRAM: And this is the chart of the divestment programs since inception, so it's a longer history, particularly for tobacco, where the divestment was initiated in 2001. So here for the active total, we see a loss of $2.269 billion, or 0.6 percent of the PERF. So two different ways of presenting the financial impact, gains and losses, of the different divestment programs.

And then as I said, the appendix contains just each of the different divestment programs that -- their back history and their cumulative impact.

CHAIRPERSON FECKNER: Thank you.

Ms. Taylor.

VICE CHAIRPERSON TAYLOR: Yes. Thank you, Mr. Chair. Daniel, I don't usually see you for this part. Aren't you our ESG guy?

MR. INGRAM: I'd like to think so. That's a good way to be known.

(Laughter.)

VICE CHAIRPERSON TAYLOR: So I just wanted to go back to the -- your little example, which I appreciate, because it does help it explain it. I think we all get a little confused. So when we take money out of whatever it is, firearms, coal, tobacco, we invest it in the public equities portfolio-wide, right? We just -- do we pick like the top tier investments to put that money? How do we -- how do we do that?

MR. INGRAM: There's no active security selection choice made. There's a rebalancing or --

VICE CHAIRPERSON TAYLOR: So there's no money weighted to go into, I don't know, Google or something like that.

MR. INGRAM: Depending on the weighting of that particular security in the benchmark. It would be weighted. So if Google has a higher weighting in the benchmark, then the higher proportion of that divested security will be invested in that security --

VICE CHAIRPERSON TAYLOR: And we have --

MR. INGRAM: -- will be reinvested in that security.

VICE CHAIRPERSON TAYLOR: We have 10,000 investments. And so we take however much money this was. And I don't know how much money we're talking about. Say, it's the -- I think you had -- is it 100 million here?

Yeah, $100 million.

MR. INGRAM: This particular example I've -- Yeah, I think we said $10,000 here.

VICE CHAIRPERSON TAYLOR: Is it?

MR. INGRAM: Much smaller than the AUM of --

VICE CHAIRPERSON TAYLOR: Oh, 10,000.

MR. INGRAM: -- of the PERF. We just used it as an example.

VICE CHAIRPERSON TAYLOR: Right, which would be really difficult to spread out all over the fund. So that's what I was trying to figure out. So we're just taking it out of one particular investment, spreading it all over the fund. So we're not replacing it with anything.

And then my other, I think, statement on this is that for example tobacco, we are now losing money in. It's been a 20-year divestment. It's awfully hard for us to look at -- to me, it just seems silly to look at this as a loss. I mean, I get what we're doing here. We're saying, okay, these are the things we pulled out of. This is how much money they've made every year that we could have made, but we're already out of it. So I think it's just -- it seems ridiculous to me to keep doing this.

But -- now the one that I -- or the one, two, three, four EM principles, Sudan/Iran, firearms pending.

What is -- so you guys are still looking at the program for affirmation. Is that what that means?

MR. INGRAM: Yeah. So I don't know whether Ben, or Kit, or others want to comment on the cycle of reaffirming. But you can see on that slide three that the last affirmation was before my time was -- for tobacco was -- I think that was December 2016. And then that discussion -- and then it got sort of officially reaffirmed Q1, 2017. So there's a --

VICE CHAIRPERSON TAYLOR: Okay. So we haven't done these since the dates over here on the fourth column --

MR. INGRAM: Right.

VICE CHAIRPERSON TAYLOR: -- is that correct?

MR. INGRAM: I think there's a discussion about what the timetable for that is going forward.

CHIEF INVESTMENT OFFICER MENG: All right. So Daniel's recollection was right. The last time it was reaffirmed by this body was in 2016. At that time, we -- this Committee decided in five years, which is 2021, we'll come back, do another deep dive of this topic.

But also, at the same time, in 2016, this Committee decided that every year we come back with you a high-level review, such as what Wilshire is doing now today. But then every five years -- but in five years, which is 2021, we do another deep dive of this topic.

VICE CHAIRPERSON TAYLOR: Okay. So it's -- so what is EM principles? I don't even know what that is.

COMMITTEE MEMBER MILLER: Emerging markets.

VICE CHAIRPERSON TAYLOR: Oh, the emerging markets. It says first quart -- estimates begin in calendar quarter and it said first quarter 2008. So we haven't looked at that since then?

CHAIRPERSON FECKNER: We haven't affirmed it since then

VICE CHAIRPERSON TAYLOR: I mean -- that's what I mean, affirmed it since then.

CHIEF INVESTMENT OFFICER MENG: You were referring to EM principle?

VICE CHAIRPERSON TAYLOR: Yeah. It seems like a long time ago.

CHIEF INVESTMENT OFFICER MENG: Yeah. So I would leave it --

INVESTMENT DIRECTOR CROCKER: Yeah. I believe that's the commencement of the program. And it was initially E -- emerging markets countries. And then it was -- it became emerging markets principles. And that is correct, none of these -- we had originally debated -- you may recall doing the deep dive five-year review on a staggered basis. But then it was decided it was really more efficient to tackle all of them in the same year. And really the earliest -- it does take a big time commitment from staff. So the earliest we figured we could do that would be 2021.

VICE CHAIRPERSON TAYLOR: Okay. Okay. I just was confused. It seemed so long ago. So that explains the rest. We're trying to get on the same cycle.

INVESTMENT DIRECTOR CROCKER: Exactly.

VICE CHAIRPERSON TAYLOR: Okay. And then finally, does -- do other pension plans do the same thing with any divestments, they review this annually and/or longer?

MR. INGRAM: So, again, I think before my time. But certainly when I arrived, Steve and the team had done a quick-fire survey of, I don't know, Steve 20 -- 20 or so other asset owners to see to what extent they are monitoring the financial gains/losses of their divestment programs. I think -- we were a bit surprised that the -- sort of the governance around that was probably a bit weaker than we would have expected. Not that many conduct this kind of an exercise. I think we picked out one or two examples here and in Europe.

I think -- as Wilshire, we do conduct this analysis for some of the mandated divestments, like divest -- like Iran and Sudan for some of our clients.

So, you know, this kind of divestment analysis does go on, but perhaps not on an annual basis.

VICE CHAIRPERSON TAYLOR: It's not on an annual basis. Okay. I guess I was -- I was wondering if we were -- so we're not or we are outside of what pension funds are normally doing. I guess that's what I was trying to figure out.

MR. INGRAM: Yeah, I mean, you know, the idea behind this is really sort of to help inform, review, kind of get a better handle on an annual basis. You know, you look at tobacco in this particular year, you've had a gain from not being invested in tobacco. But in previous years, you've had losses from not being investment -- invested in tobacco. So I think this will help to inform the deeper dive discussion you have scheduled for 2021.

So I haven't got a grasp on -- maybe we'll have another look at kind of across the U.S. sort of, you know, how divestment is analyzed by different pension funds. It could be worth having another look at. But I would say, you know, we've got a fair few examples of other asset owners doing this type of exercise.

VICE CHAIRPERSON TAYLOR: So -- and if we have a customized benchmark, then it's not necessarily -- is it something that has to be reviewed on an annual -- annual or five-year basis or whatever. I mean, we have a customized benchmark anyway, so we have things that we have in our portfolio and things that we don't for various reasons. I know these are direct divestments, either by order of the Legislature or by the Board. So is that -- is that -- is it the verbiage that makes the difference?

MR. INGRAM: I don't know whether staff wants to make a comment on that?

INVESTMENT DIRECTOR CROCKER: Yeah. I could say that I believe when the Board voted to include this in the Divestment Policy, it was really out of a desire to just be supportive of the fiduciary duties the Board is under to monitor, since it is an active decision on the part of the Board and/or the Legislature.

VICE CHAIRPERSON TAYLOR: Okay. Thank you.

CHAIRPERSON FECKNER: Thank you.

Mr. Perez.

COMMITTEE MEMBER PEREZ: Keeping in the thought process that we're a long-term investor, we can't really just look at last year, saying that we would have not lost as much money, and over the long term, we would have been a lot more healthy.

I don't know if this is -- because I know this is an information item -- action -- no, information item. I don't know if it's appropriate to ask the Board to vote to lift divestments or if we can put it on for another meeting.

CHAIRPERSON FECKNER: My recommendation would be if we wanted to do that, we should put it on a future agenda item.

COMMITTEE MEMBER PEREZ: Can we do that soon-ish?

CHAIRPERSON FECKNER: We can do that.

COMMITTEE MEMBER PEREZ: And I know I'm a broken record about that. But as part of -- as part of the fiduciary duty that every time this comes up, I have to say it.

VICE CHAIRPERSON TAYLOR: Do we need to vote on that?

CHAIRPERSON FECKNER: You need to vote on what?

What he was -- a different agenda item at a different time.

VICE CHAIRPERSON TAYLOR: Oh, he wants a -- I'm sorry.

CHAIRPERSON FECKNER: Not today. Right. Correct.

Anything else, Mr. Perez?

COMMITTEE MEMBER PEREZ: No, thank you.

CHAIRPERSON FECKNER: Thank you.

Ms. Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chairman.

I'm going to sound like a broken record, because

I keep asking for this. And I don't know if there's a proxy for this, but whether it's now just looking at kind of the review and our duty to monitor this or the deeper dive that we're going to be doing probably surrounding Mr. Perez's question, I'm still trying to get a handle on how we look at any potential benefit that CalPERS derived from the reinvestment of the divested funds.

And I know Ms. Taylor's question really spoke to like what did we do with that money? And, you know, how do we allocate it -- reallocate it, how do we reinvest it?

An so is there a way to get a handle on that? I know it's really -- because I feel like it's a little bit of an incomplete analysis otherwise?

CHIEF INVESTMENT OFFICER MENG: If I may. So for every dollar we divest, we use that dollar to reinvest back into the global equity portfolio on a pro rata basis. So whatever in the 10,000 -- as Ms. Taylor pointed out, we have around 10,000 securities in our global equity portfolio. So for every $1 we divest it, for example, from tobacco, we, pro rata, put it back in the rest of the portfolio.

So this $1 is the opportunity of invest of that $1 -- or that divested $1 is not lost. We but pack in the global equity portfolio.

CHAIRPERSON FECKNER: Hold on your microphone is off.

Go ahead.

COMMITTEE MEMBER YEE: So in terms of any benefit we derive, is it appropriate -- and I don't know the answer to this. Is it appropriate then to track the -- I mean, it's impossible, because you -- I mean, that's the entire global equities portfolio, right?

CHIEF INVESTMENT OFFICER MENG: Right. So in a way -- sorry. So these numbers are based on this methodology, so every $1 divested we put back into the portfolio pro rata.

MR. JUNKIN: Ms. Yee, maybe I can try that. This is Andrew Junking with Wilshire.

COMMITTEE MEMBER YEE: Okay.

MR. JUNKIN: And I came up, because I've presented this report for 15 years now.

Think of this as really the opportunity cost. So you have taken money out of something. You have reinvested it in this case. And we're comparing those two portfolios, one that happens to be your actual portfolio without tobacco and one that is the hypothetical portfolio where it was reinvested in tobacco. But the dollars that come out of tobacco are spread right across the rest of the global equity portfolio. We take into consideration rebalancing at the total fund level. We take into consideration the size of the internally managed portfolio, which is where the restriction actually exists --

COMMITTEE MEMBER YEE: Right.

MR. JUNKIN: -- and not on the external manager. So this is as close as we can make it apples to apples to the kind of comparison that I think that you're looking for without -- without, you know, sort of review mirror kind of driving, well, maybe we should have put it into more, I don't know, technology or whatever. It's just -- we just literally eliminated tobacco and everything else gets prorated up by its existing weight.

COMMITTEE MEMBER YEE: Okay. All right. And maybe before we do the deep dive around Mr. Perez's question, I may want to revisit kind of what should go into the analysis of our decision around that, because I just want to be clear that -- I mean, obviously, there are costs and there are benefits, and so just how to appropriately weigh all of that --

MR. JUNKIN: Yes.

COMMITTEE MEMBER YEE: -- into the economic analysis and financial analysis.

Thank you.

CHAIRPERSON FECKNER: Ms. Middleton.

COMMITTEE MEMBER MIDDLETON: Okay. Thank you, Mr. Chair. And I am somewhat new to this conversation, but it's one that gets an incredible amount of attention. And I think it behooves us to have metrics that are easily explainable to the general public, because there is, in my time on this Board already, a considerable amount of, I think, misinformation and even greater misunderstanding as to what we have here.

So I'm going to follow up on Ms. Taylor and Ms. Yee. If we divest X dollars from a industry, then there is a restrain on what you are able to invest. But you are taking that money, whatever it was, less the cost of the transactions to get out of that industry, and putting it in the general portfolio.

MR. JUNKIN: (Nods head.)

COMMITTEE MEMBER MIDDLETON: It seems to me the fundamental question is the general portfolio outperforming or underperforming against what this industry was that we divested from. And that should be a fairly straightforward delta question. We took $10 million out of tobacco, as an example, and I'm using rough numbers, and over the course of one year, five years, 20 years, tobacco returned an investment of a number, and the general portfolio produced another number. What's the difference in those?

That still leaves all of the political, social questions that drive divestment decisions and drive interest on those. But we should be at least be able to get down to what's that fundamental number. And as I'm going through these reports here, I'm -- I can't get to that simple number that I could take and go to my constituents and say this is what divestment has produced in terms of a result.

MR. JUNKIN: That's -- that is effectively, with slightly more complicated math to represent the fact that the portfolio is fully diversified, exactly what we've done, if you'll go one forward -- one page forward.

And if you wanted to present to constituents the benefit or the decrement to the dollar value of the return of the plan, of the divestments, it's on this page. So tobacco, since inception, has cost three and a half billion dollars to the plan. The plan would have three and a half billion more dollars today had you not divested.

COMMITTEE MEMBER MIDDLETON: Right. Three and a half billion more, accounting for what the general portfolio has produced?

MR. JUNKIN: Yes.

COMMITTEE MEMBER MIDDLETON: All right.

MR. JUNKIN: Yeah. The one point I do want to make, because I think there's one number on this page that is -- it's bothersome to me, and that is the magnitude of the South African divestment. At this point, that divestment has not been active for 25 years.

COMMITTEE MEMBER MIDDLETON: Right.

MR. JUNKIN: And so long as the plan has positive returns, the value of that divestment, the decrement to the dollars that are available to pay benefits will continue to increase to infinity. It could end up in some really, really bizarre -- you know, a hundred years from now, CalPERS is down to its last ten beneficiaries. I don't know. I'm just making up a scenario.

COMMITTEE MEMBER MIDDLETON: Um-hmm.

MR. JUNKIN: And you might say, well, South Africa cost us $78 billion, but we've only got $14 left. I mean, there is a scenario -- so that number is accurate. I would argue it is -- at this point after 25 years, it's meaningless.

COMMITTEE MEMBER MIDDLETON: And that begs the question at what point do we say that the impact of divestment is no longer something that's relevant for us to count?

MR. JUNKIN: Yeah, if it were me, I would put a -- sort of a terminal period.

COMMITTEE MEMBER MIDDLETON: Um-hmm.

MR. JUNKIN: Once a divestment is closed out, so you divest and you reinvest, and that reinvestment closes it out. I would say we're going to measure it for another ten years and then it's just done, because otherwise you will end up with some numbers that, while accurate, are completely meaningless.

COMMITTEE MEMBER MIDDLETON: All right.

CHAIRPERSON FECKNER: Thank you.

Ms. Olivares.

COMMITTEE MEMBER OLIVARES: Thank you.

So I think these are great questions about the comparative performance of those securities from which we've divested versus the overall performance of the portfolio. I think it would be very helpful to see this laid out a little bit differently, so that we could see the actual back-tested value of those securities from which we divested, right, over the same like five-, ten-year time period, or from whenever that divestment became active versus the historical performance of the portfolio, and then at the same time going forward. It's just the way this is laid out is very -- it's difficult to understand. So that's one comment I want to make.

When we get to what other pension plans are doing, I would like to see that -- there are some peer groups that are doing this and that would be the insurance industry has done this. And because they are highly regulated, they've had to report on an annual basis. I am not making that recommendation. In fact, I would say that once there's a decision to divest and there are no new divestments -- or, sorry, no new investments into that particular category, then I would think reporting doesn't need to be as frequent.

These investments are typically of long duration, sometimes ten years or more. And so I'm just trying to make sure that as we look at what CalPERS is doing, that we're also looking at what other peers are doing in this space, in terms of reporting and then monitoring our investment performance related to those divestments.

MR. JUNKIN: I agree that -- I'm now answering a question that was maybe five minutes ago from Ms. Taylor, which is, you know, should we be doing this, should we doing this as often as we are?

I'm certainly not your fiduciary counsel, but I believe it's your duty as fiduciaries to the plan to monitor this on a regular basis, because it is, whether it's forced upon you or whether it's your choice, it's an active decision. And you can change, in some cases, your mind. You can't on Iran and Sudan, but you could reinvest in tobacco. The Board chose not to do that two years ago.

Weighing all of the evidence at hand -- and so I'm not rendering a judgment on that. I'm just saying I think that's the kind of process -- as painful and as long as that process was on a single divestment, that quite frankly is the process that you need to go through on all of these on a regular basis to reaffirm, yes, we want to stay out of that.

In terms of presenting things more simply, I'm all for that feedback. This used to be about a 23-page Word report that we tried to simplify about three years ago and think we got better. But happy to take feedback on how it can be more useful to you or to the general public. There is absolutely no pride of authorship here. We just need to present accurate numbers to you.

COMMITTEE MEMBER OLIVARES: Thank you.

And then on South Africa, so the active dates for that divestment was up until, what Q4 '94. I'm trying to understand how we are calculating the loss here or the comparative performance relative to the PERF. I don't even know the durations on these investments, so it's possible that some of these could have had a ten-year duration or less. And so I don't know how we would project out that comparative performance.

MR. JUNKIN: So pretty simple. You divest -- you divested of South Africa --

COMMITTEE MEMBER OLIVARES: Um-hmm.

MR. JUNKIN: -- during apartheid. Apartheid fell. You reinvested. You lost money while you were out. That opportunity cost compounds at the rate of growth of the total plan.

COMMITTEE MEMBER OLIVARES: So you're just carrying it forward.

MR. JUNKIN: Just carrying it forward.

COMMITTEE MEMBER OLIVARES: You're not looking at how the actual investment is doing now or if it's -- okay.

MR. JUNKIN: Right. Right. Which is why that -- to me, it's -- I understand the magnitude of the number, but it -- that's a decision that was originally made - I'm going to have to do math and this is not my strong suit - 31 years ago --

COMMITTEE MEMBER OLIVARES: Yeah.

MR. JUNKIN: -- and finished 25 years ago.

And --

CHIEF INVESTMENT OFFICER MENG: That was pretty good on the fly.

MR. JUNKIN: Thank you.

(Laughter.)

MR. JUNKIN: Let the record reflect.

(Laughter.)

MR. JUNKIN: So, yeah, it -- but that is exactly -- and if you look at some of these tables, these are the -- these are the open investments. You can kind of dig in and see, all right, here's global equity X tobacco. I'm on page six. Global equity actual. And so the net difference -- and then we just sort of multiply on a monthly or quarterly basis what was the value of the portfolio, what was the value -- the difference in the value of those returns? What does that turn into in dollars? And then we cume -- cumulatively calculate that over time.

But then it's also scaled -- the closed ones are skill for the total fund return. We also -- in the old analysis. And this is one of the reasons it was 25 years pages, we did it by CPI, but that wasn't a real number --

COMMITTEE MEMBER OLIVARES: Um-hmm.

MR. JUNKIN: -- because the opportunity cost actually lost at the total fund level. We also did it at the global equity level and then the numbers were wrong, but too big, because global equity obviously had been the best performing asset class in the portfolio over that time period. So it was growing at too fast a rate.

COMMITTEE MEMBER OLIVARES: Yeah. I think it would helpful to get - I mean, again, if we have another conversation on this - more clarity around this process. As -- you know, there's not perfect information here at all. So I see that a lot of assumptions have been made. But I could also see how this could create a very high divestment cost, particularly when it comes to South Africa. That's not bases on what the actual numbers would have been.

MR. JUNKIN: Did you look up the actual numbers before we came back up?

MR. INGRAM: I did -- I'll have to pull that you.

MR. JUNKIN: Yeah. We've the actual closed cost of South Africa --

COMMITTEE MEMBER OLIVARES: Okay.

MR. JUNKIN: -- that doesn't continue to grow for 25 more years.

COMMITTEE MEMBER OLIVARES: Okay.

MR. JUNKIN: So we could bring that back.

COMMITTEE MEMBER OLIVARES: Thank you.

CHAIRPERSON FECKNER: Mr. Jones.

COMMITTEE MEMBER JONES: Yeah, thank you, Mr. Chair. Yeah, I think you kind of answered my question in responding to Ms. Olivares question. But looking at tobacco, for example, the 3.5 billion -- $3.6 billion. When we divested, that was say a number, a hundred million dollars. And just like the Africa, the South Africa has tended to grow. As the PERF fund grows, the tobacco is going to grow. That hundred million is growing based on the growth of our total portfolio, is that correct?

MR. JUNKIN: Well, tobacco is still open. And so the gap narrowed. If you look at this page, in fact, in the cumulative present value impact, the next to the last column on the right and you follow across 2017, it was 3.9 billion just two years ago. And because the portfolio -- because essentially tobacco underperformed the rest of the portfolio and you didn't own it, you benefited by not owning it over the past two years or year and a half. And so that gap narrowed from 3.9 billion to 3.6 billion.

So that's -- you know, that's one of the issues, and you see it more with some of the shorter term divestments. Let me -- where is coal?

MR. INGRAM: Coal is in the back.

MR. JUNKIN: You know, coal. It could go either way. You're either right or you're wrong by divesting of an industry. And it could actually add to the returns or it could, as has been the case, detract, at least in tobacco. You know, this also goes to CalPERS Investment Beliefs about engagement over divestment. You can't engage with a company that you don't own. You've lost your vote, right? You've lost your seat at the table.

CHIEF INVESTMENT OFFICER MENG: Mr. Chair, if I may say something. So this is related to -- this is a deeper question, a little bit philosophical. So we focus on the outcome. We made an investment decision. Let it be divestment in tobacco, or this morning, you know, to

Controller Yee's question, you know, the Private Market Investment Policy, what is the top quartile? Top quartile is based on the past performance again.

In the course of our professional life, we make a number of investment decisions, some of them turn out to be good, some turn out to be quote unquote bad, if you only just charge on the outcome. But if you recall in my January off-site presentation, I -- you know, I took -- you know, discuss about the skill and luck component.

So in hindsight, to chart investment decision purely on better investment outcome, it's not really a fair game for the investment professionals. What we really should be looking at is when we made this active investment decision, what was our belief? We believed in A, B, and C. And because we believed in A, B, and C, we thought tobacco would underperform financially. And now fast forward after 20 years or ten years -- you know, for the past two years period, it seems like divestment in tobacco paid off. But look at the entire period, it didn't payoff. But again, we are still focusing on outcome only.

So if we went back to the reason we believe in tobacco would underperform because, again, I just threw something hypothetical out there, because we believe the generation -- the generational trend or the younger generation would not subject themself to the -- addiction to tobacco, if that was a belief. And back then, we also believe that the valuation back then has -- had not fully reflected that belief we divested.

Now, ten or 20 years ago, we should analyze the underlying thesis, why we believed that tobacco would underperform. Were the reasons right or wrong or would they still continue to be there? Otherwise, we keep on going back to chasing the tail -- tail of looking to outperform -- either the outperformance or underperformance and try to use that outcome to judge the investment decision previously. It's not constructive. It's not fair to the investment professionals.

So I really encourage -- it's similar to the discussion this morning top quartile selecting private equity managers. The performance is the symptom not the cause. We would like to understand the cause, the underlying driving factors and are these factors still here going forward or not. So that's my two cents of caution, a little bit philosophical. I know the performance -- the outcome -- you know, hindsight is 20/20. And the outcome performance black, white, and read there. Either you outperform or underperform.

It's very convenient for us to grab onto that number, right? But we really need to ask another question later below the performance, what caused it, and more importantly, what was our belief? Why did we make that investment decision. This reason is still valid today and going forward.

CHAIRPERSON FECKNER: Anything else, Mr. Jones?

COMMITTEE MEMBER JONES: No, I agree with Mr. Meng.

CHAIRPERSON FECKNER: Thank you.

Ms. Ortega

COMMITTEE MEMBER ORTEGA: Thank you, Mr. Chair.

Mr. Meng made largely the point that I wanted to make which, thankfully, because I'm sure he did it much better than I would. I think this conversation is very interesting and helpful in the context of the continued discussion we have before the Board and the public comment we get about fossil fuel divestment. And what I think about is the sort of what I see as an overly simplistic way of looking at divestment when we just look at this outcome and not what was considered at the time.

And certainly what I feel like we're missing when we talk about tobacco is at the time that the decision was made, there was an analysis of risk of that investment too. And so we don't -- we don't see the balance in the discussion here. We just say, well, we divested and this is the outcome. But at the moment, there was a belief that there was a risk to continue to be in that -- in those investments. And that's the way I think about the fossil fuel issue.

And all of the risk we have in the portfolio around climate is we might -- we may come to a point where we're making investment decisions, but how do we get to the appropriate analysis of the risk that we would be considering. And the conversation that's come up -- the words that have been used numerous time on opportunity cost.

And so, again, we have this report where we talk about these, you know, six categories of opportunity cost, but every investment decision that's made is an opportunity cost. And we don't -- we don't have a report that lists every real estate investment choice and the trade-offs. And, oh, if we had purchased this other property instead, what would we have had? We're not talking that same kind of look at every aspect of the portfolio. And my sense of that is because we have policy that guides those decisions.

We have direction to the staff about the appropriate level of risk to take. The -- that -- the mix of the portfolio that we have an expectation to have. So we don't call that before us to do that level of review.

So again, going back to opportunity costs and having policy that directs that, it goes back to what our fiduciary duty is, which is to have appropriate process. To be able to say that we used a process that considered all of the risks and all of the information that we new at the time, and connecting that back to the questions about climate risk and some of the fossil fuel investments.

What I think we -- what I don't have a good sense of right now is how this Board is going to have a process going forward to analyze those risks, to take those consideration into place. Notwithstanding, what we heard from the earlier presentation related to the report to the Legislature, it still feels to me that we're missing that. How would we go about making decisions about addressing that risk going forward?

Thank you.

CHAIRPERSON FECKNER: Mr. Miller.

COMMITTEE MEMBER MILLER: Yeah. I'm -- I think Ms. Ortega really hit on a lot of what I wanted to talk about. What I fear is that we kind of -- kind of devolve into, as a Board, trying to micromanage individual investment decisions and investments on a more frequent scale than even we would have envisioned with our five-year review of these divestment decisions seems to me to be a good time frame. We're in the middle of that with some of them, others are coming up.

That seems like a reasonable time frame to be doing a look-back and see, not so much for purposes of saying, oh, should we be jumping in and managing these individual investments out of 10,000 of them? Because on almost any one of them, oh, I might think, oh, we should invest. We shouldn't have done this and we should have done this. And instead of doing this with the money, we should have done something else, but it's a diversified portfolio.

We really -- even the Investment staff, that's not what they're doing. And so it seems like this idea, oh, let's jump in before the five-years up and start revisiting these things on a different schedule, and assigning staff to bring a bunch more stuff back, and have a discussion about tobacco, rather than wait till we get to the point where we had scheduled to review that, and thinking about why are we reviewing it?

We're reviewing it so we understand the impact. We're reviewing it so maybe where there's some lessons learned for our decision-making process, our assumptions, things we can learn going forward. But I wouldn't look at it as we're reviewing it so that we can take this specific investment and start micromanaging it at the Board level now. And that's kind of the sense I'm kind of getting that we could end up heading that direction the way we're thinking about things sometimes.

And when it comes to this cumulative impact, I do think we really should be thinking about how do we look at that and what do we do, because, as you said, if there's nothing but the cost of getting rid of something, and then the next year we jump right back into it, that cumulative loss is just going to keep on compounding. You know, it's a limit at infinity over time, as was mentioned, and it's not useful information. It's not anything you can use in a practical way for decision making. It can only be used if there's a misunderstanding about what it means and people are thinking, oh, my God. Look how much we're losing, because we've divested. We have to jump back into that, when the reality of current performance and a divested -- diverse portfolio doesn't indicate that at all.

So I just caution us, as a Board, that if we want more understanding and clarification of the impacts of these things, that's great, but I don't want us to be prematurely or more frequently second guessing our own decisions.

CHAIRPERSON FECKNER: Thank you.

Mr. Perez.

COMMITTEE MEMBER PEREZ: I have to respectfully disagree with Mr. Miller. We're not micromanaging. We put this constraint on you. The last time this was discussed in March, I had asked if the staff -- if the Investment team wanted to be in it and they said, yes. I don't know if that rings true today. And I'm not saying that we just jump in and put one percent of the fund back into it. I want the staff is to be able to develop a strategy, and whether they think it's valuable to be in it, then they should, and if not, then they don't.

All I want is to life the divestment. On the other -- on the other divestments, when there's -- when we get direction from the government -- from the Governor's office, that's not -- I think I understand it correctly. It doesn't say you shall at all costs divest. What does it say? What is the spirit behind it?

CHIEF EXECUTIVE OFFICER FROST: Are you asking about the Governor's Executive Order that he issued recently to -- that would apply to CalPERS and CalSTRS?

COMMITTEE MEMBER PEREZ: (Nods head.)

CHIEF EXECUTIVE OFFICER FROST: No, he is not -- it's not an Executive Order to divest. He doesn't carry the fiduciary duty that you all carry as the 13 members of this Board, but it is a request to look into greener investments than what we would have with fossil fuels. So we will work with Department of Finance. We've already had one meeting with them. We'll continue to, you know, work with them on identifying a framework where we think the Governor could have an impact for the State of California, realizing that we need to continue to work with this Board on our ESG five-year plan that's already in place.

COMMITTEE MEMBER PEREZ: So if the State would say, you know, go green, if the State would give us the money that we projected to return, then I would say, okay, because then that's a solid return. We're always going to have that. But to say -- to say anything more is kind of irresponsible. We do have a fiduciary duty.

And lastly, Mr. Chair, I would like, when we do bring this back up, if we can have a prudent person opinion on that the matter, please.

CHAIRPERSON FECKNER: All right. We'll add it to notes.

COMMITTEE MEMBER PEREZ: Thank you.

CHIEF EXECUTIVE OFFICER FROST: And, Ms. Crocker, could you -- I think you mentioned the 2021 date for the full review of current divestments from the team.

INVESTMENT DIRECTOR CROCKER: Yeah, that's correct.

CHIEF EXECUTIVE OFFICER FROST: Okay. And then just one -- one other response to Ms. Ortega's question. So at the time that a divestment decision is made, there's a full analysis of long-term risk that is communicated with the Board. We did that in December of 2016, and I can get that analysis to you so you could see -- anticipate really what the team would be bringing back as a part of this review.

CHAIRPERSON FECKNER: Ms. Olivares.

COMMITTEE MEMBER OLIVARES: Thank you.

I think it would be helpful to see the stranded asset risk context around some of these divestments, because I think that's behind the decision that would need to divest or at least that would have -- that's my hope, that that was considered. So the business model risk, political risk, and legal risk. That way we understand what the financial risks were at that time. So if we could just even have a little bit of context in the report, I think that would help us understand.

CHAIRPERSON FECKNER: Thank you.

Ms. Middleton.

COMMITTEE MEMBER MIDDLETON: Okay. Thank you, Mr. Chair.

As we get into a deeper dive into this subject, one of the things that I particularly want to get more information on is when organizations, such as ourselves, divest from an industry, or divest from a certain organization, or country, what is the impact on the behavior of those organizations. If we get out of coal, as an example, does that make any difference in terms of how coal companies are operating their businesses? Are we actually producing a positive impact by our investment -- divestment decisions or is -- are we not?

CHAIRPERSON FECKNER: Okay. Very good. Thank you. Seeing no other requests to speak, I do have one request from the audience.

Derick Lennox. You'll have up to three minutes for your comments. Please identify yourself for the record.

MR. LENNOX: Thank you, Chair and Members. Derick Lennox on behalf of the Association of California School Administrators. For those of you who don't know ACSA. ACSA represents retired and active educators, mostly active, from across the state, 18,000 members. I say retired, of course, because I would say that's our group that has the most to say about some of these social, environmental, and governance issues that are addressed in a lot of our divestment conversation, ESG conversation.

But on the other side, we represent folks who are active members as well that expect to have their retirement there when they get to that point, and that are also our business partners here at CalPERS to make sure that the contributions can be paid, and that the contributions are manageable on that side. So I do appreciate the report. And actually, the comments that were made about some of what goes into it are really interesting comments.

A lot of it looking retrospectively at the divestments that have occurred already. The perspective that I want to bring about why this report is so important to us is that actually prospective. And the reason is because, you know, with us being 68 percent funded on the school side, when we have these conversations in the Legislature and with policymakers about divestment, having this information about the impacts to date is really helpful.

And again, there's a nuance to it. But just to show the overall impact really makes a big difference when we're trying to explain that we have a larger priority here, which is to protect the defined benefit system. And so that any sort of micromanaging -- I mean, you know, you guys are the Board. But to have people micromanaging from outside of this building is not something that we want to see as school employers and public agencies.

So I would just reiterate many of the comments that you have all made, which is to focus on the risk-adjusted returns, and to maximize those, and to take into account the risks that you all are talking about here today, including climate change, including fossil fuel use, including governance issues, but to have that be a staff and Board decision, not something that happens from across the street.

So in that sense, it's a prospective concern that this report raises. And it's very helpful as we have these conversations during the legislative year.

Thank you.

CHAIRPERSON FECKNER: Thank you.

Another request from Dr. Robert Girling.

Again, you'll have up to three minutes for your comments and identify yourself for the record, please.

DR. GIRLING: Good morning. My name is Robert Girling. I'm a professor emeritus from the School of Business at Sonoma State University. I'm also a member -- retired member of CalPERS. I'm the legislative representative for the CSU Emeritus and Retired Faculty and Staff Association.

So I wanted, first of all, to thank the Board for their very thoughtful questions on this -- on the last item. I thought that it really clarified things to me in terms of your thinking. And, frankly, you know, the report that was presented raised more questions in my mind than it answered. And so the line of questioning that you had was to ask for much more, a clearer report that something that I can take back to my members. And that would be very helpful.

In relation to that, one thought that I had was this item draws in part on data from Item 6g, the 2019 California Public Divestment from Iran Act and Sudan Act legislative report, which contained company-by-company data on the risks associated with a wide range of investments. So that's just a report right here.

And as you look through that, you'll see that it discusses a number of specific companies. Now, what I -- my thought is that it would be quite helpful in the revisions that the PERS staff does to the report on SB 964, that they might follow this kind of methodology in examining and looking at the risks, especially the Scope 3 risks, associated with 80 major companies responsible for 50 percent of the greenhouse gas emissions.

So I think that that sort of granular data would prove very helpful to the Committee -- the Board, excuse me, in terms of making decisions that minimize risk. So that's my thought on that.

Again, thank you for all that you do on behalf of our members, and, you know, your work in terms of balancing the short-term risks and the long-term risks. And with regard to long-term risks, I just want to say one thing, which is that climate risk is something that has affected my campus severely. It was closed for a week. The president of my university, her house burned down. And when I went in to talk to her a couple months ago, she spent an entire hour just talking to me about the effect that that had on her family and her inability to perform her duties to the best of her ability.

So I think that this issue of climate risk is something that affects us all. You know, we lost power, many people in my neighborhood did. And I appreciate the fact that you're looking very carefully at these issues and thoughtfully. And my association stands ready to help in any way that we can, in terms of analysis or whatever. So thank you again for all that you do.

CHAIRPERSON FECKNER: Thank you.

That brings us to Agenda Item 9, the Investment Education Workshop.

Mr. Meng.

(Thereupon an overhead presentation was presented as follows.)

CHIEF INVESTMENT OFFICER MENG: Yes, Mr. Chair. As I said in the opening remarks, this is the last of the four Board education series. So today, we have the honor to have -- yes, my colleague Anne Simpson and then -- yes, please. And we have -- as you know that in the past three workshops, we have been working with the CFA Institute.

And for the last topic, unfortunately, CFA does not have a readily available speaker. So instead, you know, we have -- well, I will turn it over to Anne Simpson, who will do a proper introduction of the speaker.

(Laughter.)

INVESTMENT DIRECTOR SIMPSON: Thank you very much, Ben. Well a warm welcome to Von Hughes who's joining us to round off this year's first program on education for the Investment Committee.

I think the Board can feel very proud that some wonderful work came out of the self-evaluation that you completed with NACD and the workstream led by Theresa Taylor and Mona Pasquil Rogers was focused on education needs.

So as we were racing to get the complete curriculum finished, as Ben said, CFA and CII, who've been our partners, weren't able to pull people out of their holiday celebrations, and boiling of Christmas puddings, and things that keep people busy at this time of the year, so they did recommend that we speak to Von, who we knew already, because he's just published what I think is the first handbook for U.S. public pension fund trustees.

So Von comes to us highly recommended, both through his recent publication and also through our friends at CFA and CII. He's also, I think, well qualified to share his understanding of private markets, because of a wide range of experience that he's had over many years. And you can see it in his biography. But in addition to his stellar experience and academic achievement, he's also a trustee of Greenwich Roundtable, which is a nonprofit organization that focuses on private markets or what sometimes get called alternative investments. But that suggests everything is an alternative to the public markets and for CalPERS we're a little more balanced. The public and the private markets are both extremely important.

So we have time today for Von to go through the slides. I'm also glad to say Ben will be here to give us wise advice on how the issues for the private markets rollout for CalPERS. And also we have the leaders from CalPERS private asset classes here available to answer questions as well. That's Greg Ruiz and Sarah Corr, from private equity, Jean Hsu on private credit, and Paul Mouchakkaa from our real assets private markets class.

So we encourage you as before to ask questions or make comments as we go through. Hopefully, you've had a chance to browse through the presentation, so you know what's coming from one stage to the next.

But let me with that, give Von a very warm thanks from everyone here for being willing to give up his time, not just to be with us here today, to travel out from the east coast, which is in itself time and effort, but also for all the work that goes into preparing something like this.

As the Board knows, all of this material will be loaded up onto the new Insight Tool, which Tim Taylor and friends are building as we speak, another workstream from the Board Governance self-evaluation. So whatever Von is able to share with us this morning will be something that you can return to in the future, when you want to refresh your thinking about the importance of private markets for CalPERS ability to achieve its investment target returns.

So with that, Von, a warm welcome. And we're looking forward very much to hearing what you're here to share with us.

MR. HUGHES: Thank you. Well, again, my name is Von Hughes. I'm a partner at PAAMCO Prisma. I've been at the firm for about 16 years. I'm actually here in my own capacity obviously. Some of the research from the book driving the conversation here.

I head our firm's strategic advisory effort. And I personally focus on public pension plan policy and governance. My full bio, for those who are interested, is on page two of the presentation. But before I begin, I really wanted to thank the Board and the Investment staff for inviting me to participate in this discussion on private markets.

Now, to be fair, private markets is a very big topic. Any one of the concepts that pop up today could probably warrant their own educational session. So with that in mind, I really just tried to provide a presentation that provided a general overview of private markets. And turning your attention specifically to page three of the presentation.

--o0o--

MR. HUGHES: Yeah. I just wanted to go through an overview of what I'll talk about. I'll talk about the differences between public and private markets, really highlighting the defining characteristics of the latter. I'll talk about the benefits of investing in private markets, why public pensions do it, what are the risks. I'll also provide a snapshot of the global private marketplace in aggregate. And then I'll finally delve into some of the major private market segments, obviously private equity, real assets, and private debt.

It's kind of funny -- a funny thing happens when you write a 500 book about public pensions, people think you know everything about public pensions and their portfolios. However, I not. And I very much look forward to leaning on the expertise of the staff that's in the room today that live in these markets to answer any questions that might specifically touch upon the CalPERS portfolio.

Now, where my research might be helpful, is that I've tried to really infuse this presentation with the perspective of how public pensions in particular participate in private markets, where the data was indeed available. Any questions you have that I can't answer, I'll work with Anne to make sure I can follow up and add as an appendix for later reviewing.

So with that --

--o0o--

MR. HUGHES: -- turning to page five, to better understand private markets, it's obviously good to touch upon public markets. Public markets typically refer to a market where the general public can buy, sell, or trade on a public exchange. And there are about 60 major public exchanges in the world managing about 69 trillion in publicly-traded securities, New York Stock Exchange and NASDAQ are great examples, the two largest exchange globally.

Companies that choose to go public do so really by registering with the financial authority, the SEC in U.S. And by virtue of this, they're allowed to raise capital from the general public. But in exchange, they also have to comply with disclosure requirements and exchange specific -- exchange specific rules.

For most of the 20th century retail investors were the main capital provided on these exchanges. As you move towards the end and through the end of the 20th century, institutional investors, like public pensions, became larger and became larger players in the public markets. And, in fact, it's really around these institutional investors, the sophisticated investor, that private markets developed.

--o0o--

MR. HUGHES: Turning to page six. So what is a private market?

Well, first and foremost, it's not a public market. It's not open to all investors. The general idea is that the SEC decided that investing in certain securities required a skill, an investment skill, that would put the average retail investor at a disadvantage.

So it decided to limit the access to private markets to accredited investors. And this is defined by Regulation D. Credit investors are typically institutional or high net worth individuals, with institutions being banks, insurance companies, large firms, benefit plans, trusts, and other financial institutions.

And it's really only these investors that generally participate in private markets. A lot of regulation. No need to get in here that are really opening up the doors a little bit more. But suffice it to say that that's probably the best way to look at it.

--o0o--

MR. HUGHES: Turning to page 7. Compared to public markets, private markets have some defining characteristics. The first is that private markets are less heavily regulated than public markets. They are regulated and they are regulated by financial institutions, but they're just not subject to the same degree of disclosure requirements and exchange specific rules.

Second, private market reporting requirements are limited. And this really has led to people to talk about private markets as being more opaque or less transparent. But we'll talk about that a little bit later, because that's not always the case.

Third, private market valuation of securities are established at a point in time, not continually -- continuously as in public markets, what's the plan and -- supply and demand.

And finally, public markets are illiquid. Hard to sell, because there's not a market for ready buyers, and any number of reasons, and -- sorry, private market, securities are hard to sell or illiquid.

And the key concept here is that without a lack of ready buyers, if you want to sell a private market security, the price might be adversely affected. And really because of this, investors in the private markets, investors in illiquid securities have sought any additional level of return. And this additional level of return to compensate for the illiquidity risk is called And illiquidity premium, which we'll come back to.

--o0o--

MR. HUGHES: Turning to page nine. So why invest in private markets? The fundamental reason is to gain return greater than can be found in public markets. And for public pensions specifically, this must be read within the context of the defined benefit liability gap. The average public pension is about 70 percent funded and has returned about 5.6 percent since 2000.

And, however, most assumed rate of returns average somewhere between seven and a half to eight percent. So long-term public pension liabilities are increasing and public pensions are turning to private markets to help close that gap.

A private market return can come from many things, the illiquidity premium, which we talked about, active management, investment focus, investment selection, operational efficiencies generated primarily in private equity, and just skill in structuring and negotiation. There's also the GP/LP alignment with fee structures that really do incentivize for GPs that generate performance for their LPs.

But beyond performance, there are also a number of reasons why to invest in private markets. There's a risk reduction feature. Without the mark to market requirements of public securities, private market, including private market securities in a public pension can lower volatility. I also think that in some cases, private securities can offer more transparency and more oversight into an investment, because an institutional investor is usually one -- or only one of a few investors in the security, and that's a unique position to be in.

In general, the characteristics of the private market, the long-term horizon of investments is consistent with the public plan's long-term goals. And something that we'll talk about shortly. And that is with the rapid increase in private markets in order for public pensions to gain exposure to broadly diversified global growth, accessing these private markets beyond the public markets is actually important.

--o0o--

MR. HUGHES: Now, there's some things to consider, when investing in private markets, and -- high fees. It's and expensive -- it's an expensive place to play. Management fee and performance fee can dilute from performance. In fact, a 2018 study found that specifically dealing with public pension expense ratios for PE found it the highest at 136 bps, followed by real estate at 89. And you actually can compare that to domestic public equities at 21. So it is expensive. I would argue that the most important thing is to focus on net performance. And in that regards, many of these assets still outperform.

Second, the market is illiquid. The flipside of the illiquidity premium is the simple fact that if you want to sell, you might not have a market of ready buyers, and that could adversely affect selling or definitely might require steep discounts in some of the assets. And the GP alignment, although it's pretty much there for performance, there are certain circumstances where GP and LP interests can diverge, usually around the end of an investment period. So that's something to be aware of too.

And finally, private markets are highly, highly talent dependent. The dispersion of returns from managers within the private market compared to the public market is just far wider. There is one Morningstar report that looked at PE performance from 2013 to 2018 and saw manager performance from down negative 30 to up -- to up 40 percent. And that study actually compared the return dispersion of U.S. domestic equities and it was only between 5 and 12 percent. So manager selection is paramount in private markets.

--o0o--

MR. HUGHES: Turning to the next page. This is a simple slide that just lists out the major private market segments, PE, real estate, private debt. We're going to talk a little bit more about the overall market, but then we'll touch upon these segments by diving deeper.

--o0o--

MR. HUGHES: But turning to page 12, the total size of global private markets is 5.8 trillion. The chart on the left, it shows private market assets broken down by market segment and geography. The chart on the right shows the relative size of each major market segment to the global market. And what strikes you immediately and what you can take away from this is PE accounts for over half of total private markets, 59 percent, representing approximately 3.3 trillion; real assets accounts for 28 percent, or 1.6 trillion; and private debt accounts for 13 percent, or about 800 billion.

And in comparison, total public equities amounts to about 70 trillion to give you a relative size of the market that we're dealing with here. And total public corporate debt is around 12 trillion.

--o0o--

MR. HUGHES: On page 13, private markets have grown dramatically in recent years. Cumulative fundraising has more than tripled since 2006. Fundraising has grown steadily at 7.8 percent annually since 2013. And this has really been driven by mega funds, your funds five billion to ten billion. And they've accounted for almost a third of all fundraising in 2008, which is actually double what they accounted for three years ago.

Private equity drives private market growth at seven percent annually. One thing I will mention is that private equity is the only market segment that in the last year has actually had a lower growth rate. Real estate, with this four percent growth, that's a tiny bit misleading, because it excludes direct investments, separate accounts, and other open-ended funds that have done well.

And I did want to mention one thing that stands out. It's the recent growth of infrastructure at ten percent annually since 2013 and 17.2 percent since 2017 and 2018.

McKinsey wrote a report recently that estimated that nearly four trillion in annual infrastructure investment will have to be made globally to keep up -- and this is through 2035 to keep up with global growth. I just want to highlight that what this represent is going to be a persistent funding gap. And I do believe that will provide some opportunities, particularly in investment -- excuse me, in infrastructure investing going forward.

--o0o--

MR. HUGHES: Turning to page 14, dry powder. That's the capital available for GPs to deploy. In other words, it's committed LP capital that remains uninvested. And it's often looked at as a proxy for the health of the market. The chart here shows the growth of dry powder in private markets since 2000. And it's grown to a record high of over two trillion in 2018.

It's grown at a strong 13.6 fundraising rate since 2012. But you really have to step back and kind of interpret what this really means. While on one hand, it means a strong demand for exposure to private markets and the likely continued growth of this marketplace. On the other hand, it might represent that there's pressure in the system. In fact, some people talk about a dry powder problem, where GPs can raise a lot of money, but have insufficient deal flow to really put that money to work. And that can lead them to invest in lower quality ideas or overpay. With increased competition in the marketplace, multiple valuations are getting high. Some even talk about a private market bubble pointing to some market conditions today that look like 2007.

It's just my opinion, but I believe today is very different today than 2007. The people who do point to 2007 see similar high-deal volumes, see similar high valuations and covenant-light lending.

But today, the market in private securities is just far more mature. It's twice as large. It's more liquid. Sellers have more options. There's lower leverage in general in the marketplace, and honestly investors are just more savvy in the space. They're committed to the space and willing to play through market downturns, even finding value in that space.

--o0o--

MR. HUGHES: One thing I do know is that private markets will continue to grow. On this page is a BlackRock institutional investor survey. And it shows that even with high levels of dry powder, institutional investors are going to remain bullish on private markets. The greatest expected increases are in private equity and real assets. And with this primarily coming from a decrease in traditional equities, and for that matter, fixed income, but mostly equities.

--o0o--

MR. HUGHES: And finally looking at public pensions specifically, public pension demand for private securities is likely to remain. As this chart points out, on average, public pension allocations are under their target weight across all private market segments. Public pensions are closest to their target allocations in private equity and real estate, but furthest from their private allocations -- their target allocations in private debt. So you really see this being behind the demand -- the continued demand for private markets by public pensions.

So turning to page 19 --

--o0o--

MR. HUGHES: You know, maybe I'll pause here and ask any questions about public markets in general, before I delve into specifically the markets segment for a bit?

CHAIRPERSON FECKNER: Ms. Brown.

COMMITTEE MEMBER BROWN: Thank you. Let me go back to my notes. Hold on. It was with your slide 9.

MR. HUGHES: Sure.

COMMITTEE MEMBER BROWN: So before I start out by saying, admittedly I can't match your Ivy League

Education.

MR. HUGHES: Just a lot of school debt.

(Laughter.)

COMMITTEE MEMBER BROWN: And I have a UC education and I have advanced degrees from the school of hard knocks. And -- but it did draw my attention on a slide when you said that private markets have risk reduction. And you talked a little bit about more transparency in the GP/LP framework. And we don't see that. I don't think we see that. And more oversight. We want more oversight. I don't know that we're getting more oversight or more peeks into it.

So I'm just wondering since you're the Ph.D. here, tell me what data you have that supports this risk reduction in private markets.

MR. HUGHES: Well, it's -- well, I'll say it in two ways. One, there's the mathematics behind the simple fact that without having --

COMMITTEE MEMBER BROWN: I can do math.

MR. HUGHES: Right. Okay. Without having to mark private securities as often as public securities, you don't have a change in valuation, so that reduces volatility, if those securities are in the portfolio.

But I think -- and this is something that gets overlooked, is that because you're an only investor in the security very often in the private market, you have an insight on a direct access to a lot of information directly from a company that you just would not get by simply being a shareholder in a public entity.

And I think it's precisely with large public plans that begin to build out their resources and have staff to really engage with the companies that they're investing, as will come up later, either with managers and through commingled funds or directly, really have an opportunity to take advantage of the information that is actually out there that is well ahead of what could be offered by simply buying shares in a company, for example.

COMMITTEE MEMBER BROWN: Yeah. Mr. Meng, how many times are we the only investor?

CHIEF INVESTMENT OFFICER MENG: I don't know the exact number. We are the only investor we -- in some of the separate managed accounts --

COMMITTEE MEMBER BROWN: Real estate.

CHIEF INVESTMENT OFFICER MENG: -- so we are the only investor in the account, but that account invests in other companies in partnership with other investors.

What I would like to say something about the risk reduction, as Mr. Hughes has said, that if you look at private markets, the risk reduction comes -- in my mind comes as two-fold -- two source of it. Exactly, as Mr.

Hughes just mentioned, that, you, know the manage selection in private market is of paramount importance. You have to have access to the top managers.

And why we have such a strong belief in the top manager, because we believe in their active management skills to generate with something we call alpha. Alpha means on top of the market beta can give you.

So the alpha normally comes to us, what we call, educe in credit risk. But if you build a portfolio of different private equity deals, for example, the educe in credit -- educe in credit risk comes with the additional alpha. They're diversifiable. It means that the more larger portfolio you build, the alpha component by construction is orthogonal or not correlated with the beta components, and not correlated with each other. So it means that the fact of the portfolio diversification helps you to reduce the educe in credit risk that the skilful manager brings to the portfolio without sacrificing the additional return. So that's one aspect of the risk reduction from a private market.

And the other aspect, as Mr. Hughes point out very elegantly that in private markets since it's that private not traded on exchange, so they are marked -- they are reporting less frequently. The valuation is really based on a model valuation, not really a market transaction. And many times the valuation is delayed. So not timely valuation. So when there's not a timely valuation it provides a time diversification as well.

So the risk reduction from private markets really coming from two folds, one is the alpha components. It's diversifiable, educe in credit risk. And the other one is on bet part. It's the valuation, the marking is less frequent and is marked based on the model appraisal based, not so much about in the market transaction based.

So that's the benefit of private market, you see the higher return result the commensurable higher risk, because the higher risk comes. It can be diversified away, if you build large enough portfolio.

COMMITTEE MEMBER BROWN: Thank you for that explanation. I would want to eventually have a conversation with you about valuation in the private markets. And since they get -- since the managers get paid on that asset under management, it behooves them to have greater valuation.

CHIEF INVESTMENT OFFICER MENG: Yeah. So for that discussion --

COMMITTEE MEMBER BROWN: So I know we have ways of checking on that, but we can have that conversation later.

CHIEF INVESTMENT OFFICER MENG: For the

conversation, I may have to go back to school get another Ph.D.

(Laughter.)

COMMITTEE MEMBER BROWN: Thank you.

CHAIRPERSON FECKNER: Mr. Rubalcava.

COMMITTEE MEMBER RUBALCAVA: Thank you.

I appreciate the discussion. My question was also about the risk reduction, so appreciate the little insights.

Thank you. I'm good. Thank you.

CHAIRPERSON FECKNER: Thank you.

Okay. Please continue on.

MR. HUGHES: Sure. So turning to the individual market segments and these are major market segments, let's first start talking about private equity. And I've obviously touched upon many of these potential benefits and risks when I talked about the broader private markets, so I'll tread lightly. We discussed enhanced return through a liquidity premium, through active management, through GP/LP alignment. And we're going to talk specifically about the performance of private equity shortly.

We touched upon risk reduction I think for PE, in particular provides equity correlation -- high equity correlation, in fact, without the short-term volatility, which we were discussing. There's diversification alignment with public pension goals.

I did want to touch upon some of the risks. Liquidity risk, again the flipside of the illiquidity premium. I put funding risk here. It's a really GP concern. But I think LPs still must be sensitive to the impact of capital calls. Market risk, general and specific, and capital risk.

--o0o--

MR. HUGHES: Turning to private equity returns. It's clear private equity has been the best performing asset class for public pensions. The chart on the left shows that PE has generated an annual return of 10.2 percent over the last ten years, outperforming public equities at 8.5, and fixed income at 4.8.

In fact, looking at the chart on the right, private equity ha outperformed all public pension asset classes from, I think, it's '98 to 2017, except for listed REITs on a net basis. I did want to -- it's not in here, but it's hard to talk about performance at PE or for that matter, the private markets in general without at least touching upon benchmarking.

Benchmarking for traditional asset classes is done by comparing performance to some investable public index that arguably accurately reflects the market segment or the asset class. Given that public markets -- excuse me, private markets strive to outperform public markets, usually picking a public index for private markets, you know, is insufficient. And, in fact, benchmarking for private markets is very difficult.

Many investors will come up with custom approaches to benchmarking as a way to deal with this. In fact, some of the research on, in particular, public pension PE benchmarks found that 60 percent of public pensions use some general public equities benchmark, with the majority of those then adding some premium to that.

And the research that I found saw that those premiums range from one to five percent on top of a public index, with the average being about, you know, three percent. So I think with that regard, CalPERS' existing custom benchmark is well within what's normally done by public pensions.

--o0o--

MR. HUGHES: Turning to page 21, this page is really meant to be a leave-behind, like many of the other pages that look like this. It's obviously a little too detailed. It highlights the major types of PE investment styles. And I'll touch upon each briefly.

Buyout funds are the largest segment within PE. And this is only likely to continue. A recent study of public pensions by Preqin found that 70 percent of public pensions plan on increasing their allocation. They're actually investing in buyout funds in the next 12 months.

A buyout fund focuses on the acquisition of controlling interest in companies. When a management makes the acquisition, it's a management buyout. When excessive amounts or extensive amounts of debt are used, it's an LBO. And buyout funds typically target mature companies -- or very mature companies.

Compared to growth or expansion funds, these target mature companies as well. Usually, the companies that are looking to build out operations in some way, restructuring, acquisitions, entering a new market. Buyout -- excuse me, growth and expansion funds do not take majority stakes. They typically take minority stakes, and they're targeting companies less capable of raising money or debt, because of either existing debt level or low earnings.

Credit related we'll talk about under private debt.

Opportunistic are investing in assets where the owners are motivated sellers and there are few willing buyers. It's usually based on some kind of price dislocation that has nothing to do with fundamental value. And assets here can be bought at substantial discounts and are often sometimes contrarian in their approach.

Venture capital invest in small emerging companies, plain and simple, with no track record. And the tradeoff for that is you're picking companies that you think have a high growth potential. The goal is outsized returns and ability to exit successfully.

--o0o--

MR. HUGHES: I did want to spend a little time on the next two pages, because this is not only a proxy for how you invest in private equity, but really how you access private markets in generally from a structural point of view. Again, this page was meant to be a leave-behind, but I'll walk through it as well.

Commingled funds are the most common approach to investing in private equity and private markets in general. Commingled funds are funds that consist of assets from various investors. LPs are limit partners and are professionally managed by a GP, or general partner.

They're often called pooled investment vehicles, because it's pooling all LP capital together. And each LP's exposure is limited to the money they put into the fund.

Separately managed accounts are typically for much larger investments and it's an account owned by a single investor overseen by a professional money manager or subadvisor. Greater ability to customize. Greater control, liquidity, and governance with these. Also, higher fees, higher set of costs, and, in some sense, more due diligence and active oversight are necessary.

CHIEF INVESTMENT OFFICER MENG: Generally speaking, yes. So on separate management accounts, the fee tends to be higher. The set-up fee definitely is higher, because we are setting up a separate managed account just for us. So we have to eat -- quote/unquote eat all the set-up fee. In a commingled fund, the set-up fee can be spread out by all the investors.

But in our experience, again because of our size and brand, we haven't been able to set up some separate managed accounts as the fee can be lower. So that's not necessarily mean the fee has always be higher in separate managed account.

MR. HUGHES: That's actually a very good point, because the larger the investment gets, most managers are willing to discount their fees. So you are dealing with fees that could very often be substantially lower than commingled fund investments.

CHIEF INVESTMENT OFFICER MENG: So it shows our size advantage.

MR. HUGHES: Yeah. Turing to co-investments. And co-investments, direct investments are actually pretty interesting. A co-investment is an investment made into an opportunity, an asset or a company, that's made alongside a financial sponsor. The investor investing alongside the financial sponsor is typically an LP in a fund that the financial sponsor is already a GP. So it's really this preexisting GP/LP relationship that distinguishes co-investments from direct investments. The rebenefit of co-investments is that the co-investor rarely pays a management or performance fee for this individual investment.

And co-investments can offer enhanced returns that could also provide a cost effective way to scaling PE allocations, added control over capital deployment, and can also just create a stronger relationship with your GP.

What's interesting is because of the benefits of co-investing, the demand for co-investing vastly outstrips supply at this point. And that demand is so high, that you now have fund of funds, secondary funds and even dedicated co-investment funds beginning to play more in this space.

Unfortunately, demand is so high that many people are beginning to point to a time when fee-free co-investments are going to become increasingly difficult to find. And, in fact, it's definitely today that people are beginning to -- managers are beginning to charge smaller fees for co-investment opportunities.

--o0o--

MR. HUGHES: Turning to direct investments, these are investments made directly into a company asset or a firm, not through a fund, not side by side, a financial sponsor. The institutional investor owns the deal, owns all the benefit, and assumes all of the risk. It requires the greatest amount of resource commitment, but that's in exchange for potentially the highest amount of return.

I will also say that direct investments like co-investments is a recent trend. With a lot of institutional investors, and particularly public pension plans, building internal staff to actually execute on direct and co-investment strategies. The biggest challenge facing public pensions are governance constraints and resource constraints.

In order to do this well, and it happens more often in real estate than private equity, you really have to commit a substantial amount to talent, to governance, and even the compensation, because you're now competing for the private market and also competing with some of your GPs for the talent. So that's something to consider.

Secondary funds, specialize in acquiring assets and securities in the secondary markets. So many of these funds are just assets purchased from other investors.

They offer some benefits. They can allow benefits to acquire assets at a discount. They can also -- you can also gain exposure to funds that have been closed, and also you can get out of your -- you can get out of our investments whenever you want prematurely. In the end, I think it's a point emission that secondary funds really have made accessing the private equity markets easier for investors, and also have added a lot of liquidity, again, something distinguishing the markets today from the markets in 2007.

And very simply a fund of fund, which you're all aware of, is a pooled vehicle, usually a multi-manager vehicles. It offers broad diversification but comes with higher levels of fees and other expenses.

--o0o--

MR. HUGHES: You've -- the Board's seen this slide before. I just wanted to touch upon a few comments about PE. It's a slow moving asset class. The results you're seeing today are results based on decisions made years ago. And the decisions you make today, they're not going to be felt for years, until years to come. But what's important for a successful program is a commitment to the asset class, a clear investment strategy, steady capital deployment through all years, and vintage year diversification, which I know the Board been discussing with staff.

And I just wanted to highlight that, given the fact that 40 percent of the capital committed is in the years 2006 to 2008. But again, that' a topic for a different discussion.

--o0o--

MR. HUGHES: Turning to page 25, this page lists the largest public pension PE investors. CalPERS is obviously the largest by size in terms of dollar, but not the largest allocation. The average public pension has an 8.7 percent allocation to private equity. The average large public pension has a 9.3 percent allocation to private equity.

CHIEF INVESTMENT OFFICER MENG: Yeah. I want to make a comment here. If we look at this slide, this slide shows that our size is our disadvantage. Previously slide, when we set our SMAs, we sometimes we could get lower fees because our size. But here, again, when we compete with our public pension peers, our dollars have absolutely the largest private equity, even though we only try to allocate eight percent. Currently, our target as of this month, the latest number, was only 6.7 percent. So we're still 1.3 percent short of our target.

But in the dollar for a smaller fund, for example, the number ten fund, Ohio fund, right, is nine percent, but the dollar amount is only $9 billion. And what that we're -- we're trying to make a point last month as well, for a smaller program, because manager selection in private equity is of paramount importance, so -- and also you want to build a diversified portfolio, the manager want to have a diversified base of investors.

So if you run only $9 billion fund, for example, Ohio Public Pension Fund, they could concentrate on the -- if you think of the GP or the general manager as a pyramid. So the top performance manager very small on the top. So they could invest -- focus more on the top end of it. But because we are larger, we're three times in dollars size, three times of the number ten fund. We're forced kind of down to the pyramid. So that's why here our size is too our disadvantage.

MR. HUGHES: Good point. Turning to page 27 --

--o0o--

MR. HUGHES: -- to real assets. I'll only hit this briefly, because we've already talked about this. Enhanced returns, low correlation to public markets, stable predictable cash yield, portfolio diversification, typically away from equity risk in particular, and inflation protection, in that many of these assets are structured that enable inflationary costs to be passed on to consumers.

You saw the same risks, idiosyncratic deal risk. You're dealing with credit now, so structure, credit, leverage, and some of the operational risks. There's liquidity risk. There's regulatory and political risk, even reputational risk, because you're dealing with regulatory bodies.

Climate environmental risks, which is just the impact of climate change. And technology risk, which is really just, you know, new ways -- or new ways that are coming onto market that are making old ways obsolete and still have manager risk. And I did want to make one comment. Most investors in a recent Preqin study cited market risk, general market risk is the biggest Risk to the sector affecting real asset investing and price appreciation.

--o0o--

MR. HUGHES: Turning to page 28, looking at real estate and infrastructure specifically. Real estate involves the purchase, ownership, management, rental, or sale of real estate for profits. The key here is building up tax deferred profit through price appreciation, capital intensive, and highly cash-flow dependent.

There are really three strategies, core, value-added, and opportunistic. Core, low to moderate risk with predictable cash flow. Value-added, medium to high risk, targeting properties in need of some kind of operational improvement or have some management issues. And opportunistic, high risk return with properties that require massive enhancement.

On the other hand, infrastructure involves investing in basic physical structures, like transportation facilities, telecommunication networks, sewage, et cetera. The largest scale in infrastructure investments, or infrastructure projects, usually are produced by the public sector or some publicly-regulated monopoly. These investments can Either be soft, hard, or critical. Soft based on human capital. Hard, physical systems, like roads and highways, are critical essentially facilities like for public health.

--o0o--

MR. HUGHES: Page 29, the Board has seen as well. It's a slide that highlights how CalPERS specifically defines core, value-added, and opportunistic in terms of return expectations and leverage. Core, investing in real assets has historically been the predominant strategy for investors including public pensions.

However, it's interesting to note that 2018 is the first year that value-added has actually surpassed core as the most attractive strategy. And again, I think institutional investors, including public pensions, are simply looking for return.

--o0o--

MR. HUGHES: Looking at public pension real estate returns by style on page 30. Internally managed real estate has consistently outperformed externally managed assets. Opportunistic has been the best performing externally managed real estate strategy. And listed REITs have actually outperformed private markets. In fact, as we saw on page 20, listed REITs have been the best performing public pension investment on a net returns basis since 1998.

However, they offer less diversification benefits and much higher correlation to public markets. Return is typically enhanced by leverage and a greater degree of leverage than is used in private markets, so that's what you see.

--o0o--

MR. HUGHES: Turning to page 31, this page lists the top public pension investors in real estate. Again, CalPERS is the largest by dollar volume. I think the 33.4 is real estate assets, whereas I think 42 billion is probably a closer figure for the total real assets bucket.

Again, for comparison, the average public pension real estate allocation is 8.2 percent. However, the average large public pension allocation, again, I'm talking about public pensions greater than ten billion, is 9.8. So CalPERS is still under that average.

--o0o--

MR. HUGHES: Moving to private debt, this is page 33. To oversimplify private debt, what we're really talking about are loans made directly to companies outside of the public market structured in any of a number of ways. The credit exposure that you see in private debts can either be corporate, when the repayment of the loan is made from the cash flow of operations from operating companies or it could be asset-backed, when the repayment of a loan is made from cash generated for some physical asset, like inventories or property.

When you look at the strategies on page 33, you can really bucket these strategies into two categories. Direct lending and mezzanine debt, typically referred to as capital preservation strategies in general. Distressed debt, special situations, and venture debt are return maximizing strategies.

And I will -- sorry. Go ahead.

CHIEF INVESTMENT OFFICER MENG: Yeah. So this afternoon in closed session in the investment strategy discussion, we'll talk about private debt as well. As you notice, the private debt currently, it's not an asset class in our portfolio. And I think that's something we overlooked in the past, particularly given the changes in regulation after the Global Financial Crisis. Private debt had grow -- has grown very rapidly.

So that's -- again, this afternoon, in the closed session investment strategy discussion, we'll mention -- we'll have another discussion on private debt. So currently, it's not in our portfolio. We think it should be.

MR. HUGHES: Yeah. I would also just add to that, that given the variety of public debt strategies, you know, private debt can reside in any number of places within a public pension portfolio. Capital preservation strategies can typically be found in fixed income. And the return maximizing strategies can most commonly be found in private equity. So there's -- and I'm sure you'll talk about that a little bit later as well.

Just touching very quickly upon this -- again, this is meant to a leave-behind. But direct lending is corporate debt, in which a lender, other than a bank, makes a loan to a company straightforward. Borrowers are often small mid-sized companies and tend to be senior debt.

I wanted to make one comment here, and that is since 2008, private credit funds have really filled the financing void left by banks to small to mid-size companies in particular post crisis, when new regulation required that banks reduce illiquid securities on their balance sheets.

So really a lot of people point to private credit funds, particularly this direct lending, as really being much of the genesis of the rapid growth in private markets in general.

Mezzanine debt is subordinated debt, not senior debt. And it includes embedded equity instruments. So it's sort of a hybrid of both equity and debt characteristics. It's often used in LBLs. Distressed debt is the debt of companies or governments for that matter that are undergoing some kind of financial distress. You can pick these assets up at significant discounts. And it's usually -- these purchases are made in the secondary market as opposed to direct origination.

Special situations, it's just investments made based upon some special situation. Now, that has nothing to do with underlying fundamentals. It could be mergers and acquisitions, spin-off, tenders offers, litigation, or anything like that.

Special situation investments can be made in secondary markets or as well as in direct markets. Venture debt is just debt lent to venture capital-backed companies, companies that don't have any other option to raise capital. And it often, like mezzanine debt, includes some kind of equity option, so you can capture the upside additional return for the risk that you assume.

--o0o--

MR. HUGHES: And again, here are all the potential benefits and risks. The only real thing here that's different than before is just the regular income flow I think is significant for private debt, you know, obviously through loan interest and repayment. Credit default and restructuring risks, and liquidity we're now dealing with loans.

Manager selection we know about and the quality of collateral risk, which is obviously particularly relevant for asset-backed exposures.

--o0o--

MR. HUGHES: This chart shows on page 35 the historical performance of private debt. And you can take a look at the returns here and the volatility as well. But what clearly stands out is obviously return-maximizing strategies to distressed debt, special sits, and venture outperformed the capital preservation strategies, direct lending and mezzanine, with distressed and special sits being the highest returning private debt segments.

It's funny, I try to figure out what these pies meant. And they -- and it's a little misleading. I actually found someone to talk to at Preqin, because this chart is a little misleading. These bubbles are not the size of the private debt market segment. It's what I thought they were. But rather, it's just the total AUM of the managers in their database. So I don't want you to use those as a proxy for the size of the markets, but at least it gives you an indication of the data that they're collecting and the returns.

CHIEF INVESTMENT OFFICER MENG: Just one thing I would like to draw to your attention, the X axis starting point is nine percent. So even the lowest risk, the lowest return strategy within private debt asset class is higher than nine percent historically speaking, according to this study. I think this study a little bit more on the generous side.

MR. HUGHES: I think so too.

CHIEF INVESTMENT OFFICER MENG: Yeah. So maybe a little bit lower than nine percent. But my point is that, as we'll discuss later, just, yeah, keeping in mind the X axis starting on the nine percent.

MR. HUGHES: Just to that point, I also noticed the bubble is small. So that means there are not a lot of managers in that sample size. And this has no indication of what kind of level -- levels of leverage that they might be using as well, so...

--o0o--

MR. HUGHES: Now, and just -- and just finally, page 36, this is a chart from Cambridge Associates that really shows the attractiveness of various credit strategies through the market cycles. You can see that senior debt direct lending is really an all-weather strategy. You can also see that distressed debt requires some sort of distress. So it typically occurs in late stage economic expansion or contraction. And that mezzanine is most attractive in economic expansion when companies are looking to finance their growth.

I think I sped through that, but if you have any questions.

CHIEF INVESTMENT OFFICER MENG: Yeah. So this chart basically breaks out the economic cycles into four components -- of four phases. Then depending it's a income-driven strategy or capital-appreciation strategy. So different part of the cycle. For example, the later part of the cycle probably you prefer more income-driven strategy than capital-appreciation strategy.

But you can apply the same philosophy, the chart, this is only for private debt. You can talk about private equity, public equity, fixed income, real estate as well. For example, our real estate is a core U.S. real estate. Bulk of the expected return coming from income --

income-driven strategy.

So for any income-driven strategy, you can apply for this kind of chart. Almost all-weather environment, you need income. But for capital-appreciation driven strategy, such as private equity and in debt -- distressed debt strategy, you probably want to be early part of the cycle, not later part of the cycle.

MR. HUGHES: Um-hmm.

CHIEF INVESTMENT OFFICER MENG: So the same philosophy can apply to much broader sense of portfolio construction.

MR. HUGHES: The only last page is a list of sources. And so if anyone wants to do anything, any additional information, I'm here to answer any questions

CHAIRPERSON FECKNER: Thank you.

Thank you for the presentation. We do have a few requests.

Ms. Brown.

COMMITTEE MEMBER BROWN: I'll go ahead and pass. Thank you.

CHAIRPERSON FECKNER: All right. Mr. Jones.

COMMITTEE MEMBER JONES: Thank you, Mr. Chair. Thank you for a very comprehensive report on capital markets. I really appreciated the information.

I do -- my question is probably driven from that last chart that we looked at, because it talked about economic expansion. But when you listen to a variety of economists today, they're talking about a slow-growth economy that's coming, if we're not already in it --

MR. HUGHES: Yep.

COMMITTEE MEMBER JONES: -- in the next year or so. So what impact does it have on private debt in a slow-growth economy, which most economists are predicting.

MR. HUGHES: Sure I'll take a stab at it then. Well, it's a great question first of all. And I think the big question you have to ask is how well are the private markets positioned for a market downturn? And I tried to highlight that they're better positioned today than they were in, you know, 2007, primarily because the market is just much more mature.

So I think you're not going to see some of the behavior in managers fleeing the market as you saw back then really depressing asset values. In fact, you might even see a large number of investors looking forward to an opportunity to pick up access at a discount.

So I think with this greater market maturity, it's more liquid with approaches, including secondary markets. And the conditions in the marketplace are just better than they were then. So I think there's less concern than in the past. And I think people believe that the private markets are not only pretty well positioned for a market downturn, but in some sense waiting for it.

CHIEF INVESTMENT OFFICER MENG: Yeah. So I see two questions in your statement, Mr. Jones. For one is say if we can form an opinion on where we are on economic cycle, say, we're very late in the cycle, if we believe in that. If we are able to identify we're late cycle, you would like to move your portfolio higher up in capital structure. It means more in debt instead in equity. And you -- also, you would like to be more in private assets than public assets, right. Provided that you have the liquidity, you can sustain the illiquidity of private assets.

The reason is that, as I mentioned earlier on, the private markets, if you have access and you can find the very skillful managers, they do generate alpha by actively manage the portfolio. And alpha components is uncorrelated with the market beta. So when market goes down, the ability to generate additional alpha should not be affected by the beta in theory.

So in private market, you can find that source of alpha. And if we believe in later market, you want to be higher up in capital structure, it means more in debt, less in equity, you would like to be more in private -- more in private than in public, provided that you have the liquidity and access to the top private manager.

So if I were running only a $10 billion fund, probably I -- if I were running a $10 billion fund, and if I were able to get to the point saying that, yes, we're in late cycle now, I would move into private debt, right? I want to be in debt. I want to be in private. So that give me private debt.

So -- but the first part is can we really formulate our -- formulate a view on the economic cycle. That is -- I won't say $380 billion question.

Just today, there's article in Wall Street Journal talk about how the economists got it wrong for the past ten years. In the past how many years we have been saying that we're late cycle, late cycle, late cycle. The economic cycle does not die of old age. So there are two examples in front of us. We are in the longest cycle of our own history already. In the U.S. history, we're in the longest recovery cycle already.

We're ten careers into it now. That's only to our history. But if we look globally, there are two examples, one is 30 years expansion and still counting. That's Australia, right. And the other extreme example is Japan. It's 30 years, the growth has been low growth -- no growth to low growth for 30 years. It has not fully recovered.

So that's a bi -- a binary scenario. One side is Australia 30 years, the recovery still going, the other side of 30 years has not fully really recovered from the recession.

So calling where you are on economic cycle is very difficult. But if we believed that we are late cycle, and if we're running smaller fund, I would be probably in private debt.

CHAIRPERSON FECKNER: Ms. Middleton.

COMMITTEE MEMBER MIDDLETON: Okay. Thank you, Mr. Chair and thank you for a very interesting, very helpful presentation.

There were a couple of slides that I wanted to ask questions about. The first is on slide 20. And what it -- it's showing median return --

MR. HUGHES: Yes.

COMMITTEE MEMBER MIDDLETON: -- private equity, performing at 10.2, and public equity at 8.5. Would it be fair to say that the range from poor performance to high performance in private equity is much larger than it is in public equity?

MR. HUGHES: Yes. And I'll just repeat the one data point that I had on that that I probably said way too quickly. Looking at returns over a five-year period from 2013 to 2018, there was a recent -- relatively recent

Morningstar report that showed the performance dispersion between private equity funds really -- very large performance dispersion from negative 30 to positive 40.

Over the same time period, public equities, as measured by U.S. domestic mutual funds showed a return dispersion of only between five and 12 percent, over the same five year period. So the answer to your question is, yes and it's very dramatic.

COMMITTEE MEMBER MIDDLETON: So the magnitude is even greater than I suspected it might be.

MR. HUGHES: Yes.

COMMITTEE MEMBER MIDDLETON: So can you talk to us about what are some of the attributes that those that are the highest performing funds have in terms of how they have managed their private equity?

CHIEF INVESTMENT OFFICER MENG: You mean, private equity or private debt?

COMMITTEE MEMBER MIDDLETON: Yeah. Well, I'm looking at a chart of private equity, but I'm thinking broadly in terms of private markets.

CHIEF INVESTMENT OFFICER MENG: Right. So the attribute I look at that we can have our private equity expert come up as well. Basically, can you find capable and aligned manager? If I reduce it really, first capable and aligned.

I think that's -- nothing more than that. Capable, and aligned, and also available. That's -- they are willing to take our money. Not all the GPs are willing. We don't have access to all the GPs.

MR. HUGHES: I would also argue that performance persistency is key. And I think nowadays, given the competition in the marketplace, it's a really focus not only on individual managers, but individual managers within the GPs. And you have money following those individuals. It does speak to a little trend in the private equity world, where, you know, you've got to hold on to talent. But to your point, you know, it's really focusing on the right managers, but it's really getting down to focusing on the right individuals within the right managers, so...

MANAGING INVESTMENT DIRECTOR RUIZ: Yeah. I think it's a really good question and it's really what we spend all our time trying to figure out. And what I would say is fundamentally we look for managers who I would say durably add value across all cycles. And that can come in many different forms. It can come from specialized sourcing expertise. It can come from finding situations that have less competition and bind assets very well. It can come from operating assets very well, both through growing their revenues, also growing -- and also growing earnings.

And in each of these things is very particularly to a situation and each of them evolves over time. So the question we're repeatedly asking ourselves is what is the competitive differentiation of a manager and how durable is that?

And you can see different market segments rise and fall, and a manager can benefit or not benefit in those situations. But what we're looking for is across all cycles, someone who's going to continuously add that value for us.

COMMITTEE MEMBER MIDDLETON: And the next slide I wanted to speak to is slide 25, which looks at how we compare to other organizations. And while our allocation at eight percent is somewhat less, just in terms of actual numbers at $27.2 billion invested, we're significantly larger than anyone else. And this is an industry, from what I'm hearing now, talent makes all the difference in the world. And with the size that we have, do we have the capacity to attract, manage, monitor the talent that it's going to take to be successful in this area?

MANAGING INVESTMENT DIRECTOR RUIZ: Yeah, I believe we do and I would call out on this slide, this is all U.S. public pension funds.

COMMITTEE MEMBER MIDDLETON: Right.

MANAGING INVESTMENT DIRECTOR RUIZ: It does not include a number of other active asset allocators, who would have both larger allocations and larger total dollars invested in private equity. So I think there is continued headroom for us.

Your question is a very relevant one. And I would say, I think we will be able to grow our total dollars invested and allocation with the team we have in place today. There are certain strategies though that will require additional expertise. And one that we've spoken about previously is co-investing. That is one where I would expect over time, for us to build kind of a durable program and a scaled program, we may need to bring in additional expertise.

COMMITTEE MEMBER MIDDLETON: Okay. My last question is for Mr. Hughes. Looking back for the responsibility that we have here as a Board, what are the areas of oversight that you would recommend concentration on?

MR. HUGHES: For investments in private markets in general?

COMMITTEE MEMBER MIDDLETON: Um-hmm, or no specifically to the private markets.

MR. HUGHES: It's a good question. I think, as I mentioned before, the biggest challenges facing public pensions really is on the resource side, giving staff the needed resources to effectively invest and monitor these assets. So that's the first thing and involves a commitment from the Board level.

The second thing is governance. And I think governance can extend very broadly, but it's how quickly and effectively decisions can be made. I've talked to a few public pensions and helped them think through the governance behind co-investments. You need a much shorter process and ways to do that effectively.

I also think to the degree, as Greg mentioned, you want to now delve into some of these strategies that have less fees, because you're not dealing with external managers in the same way, be it co-investment or direct, you need the talent and you've got to invest in the talent. And you've got to invest in the talent in a way where you can compete with the private market for that talent.

And I think one of the issues facing public pensions in general is as public pensions have become more sophisticated in their investment approach and investment goals, that many plans have this mismatch between great goals, not enough a commitment to resources in the governance structure. And I think the bigger public pensions get and the more complex and sophisticated the investment goals get, there's going to have to be a realization that we need to match that with a resource commitment, a staff commitment, and a governance commitment.

CHIEF INVESTMENT OFFICER MENG: If I may. I just second on what Greg and Von just said. It's absolutely right that if we look globally, there are larger fund have run private equity program much larger than ours, and probably with higher return as well.

Currently, my assessment of our team, we don't -- there are still a lot of work for us to do in order to get to what could be done. As you said, resources in terms of, you know, budget, headcounts, governance is all the issue. So we'll continue, you know, with -- Greg will continue to work out -- work on each one of the challenge and keep on coming back to this body when we need headcount, budgeting, governance, and we can compare ourself to the successful larger players. How do they do it? How do they run the program larger than us and with higher return?

COMMITTEE MEMBER MIDDLETON: Okay. Thank you.

CHAIRPERSON FECKNER: Thank you.

Ms. Olivares.

COMMITTEE MEMBER OLIVARES: Thank you, Mr. Hughes. It's been a really interesting presentation. I was wondering if you've looked at Senator Warren's SB 2155 and how that would affect public pension plans?

MR. HUGHES: I have not. My apologies.

COMMITTEE MEMBER OLIVARES: Okay. It's the private equity bill.

MR. HUGHES: Oh, to consider how private equity should be restructured in terms of investing.

It's an interesting idea. I think it would more adequately put managers in a position of being responsible for what actually happens with the underlying portfolio management companies. But I think it does have potential ripple effects that have not been thoroughly thought out, nor have I thought them out myself. But it's an interesting concept to make -- or add a little bit more of accountability into the private equity investing. But what would actually happen longer term, I couldn't say.

COMMITTEE MEMBER OLIVARES: Thank you.

CHAIRPERSON FECKNER: Okay. Seeing no other requests. Thank you very much for your presentation.

Great information.

That brings us to Agenda Item 9 -- or Item 10, Summary of Committee Direction. Mr. Meng.

CHIEF INVESTMENT OFFICER MENG: Yes, Mr. Chair. I misspoke this morning. I though it was going to be a lighter session this morning.

(Laughter.)

CHIEF INVESTMENT OFFICER MENG: It's well into the afternoon now. So I noted two follow-ups. Item 6j on the climate risk report, there are requests from Controller Yee's office and from other Board members to expand on the -- on our achievement, proxy voting session, as well as adding a conclusion section. And I noticed our team, SI team, and Anne Simpson took detailed notes. So that is one follow up.

The other one -- the -- on Item 7, the private asset class program policy revision, second reading, we'll work with you, the Chair of the Investment Committee, to come -- to finalize the exact wording of that sentence. These are the two follow-up that I noticed.

CHAIRPERSON FECKNER: Okay. Thank you.

The divestment, that's going to be a future agenda item, yes. We have to figure out when, because we're not meeting every month now.

CHIEF EXECUTIVE OFFICER FROST: It will be in 2021, unless the Board asks to have it sooner.

CHIEF INVESTMENT OFFICER MENG: The reason I didn't put it, that wasn't part of staff follow-up, so that's why I didn't put it.

CHAIRPERSON FECKNER: That's right. It was my follow-up.

We have two requests from the audience under public comment. We have Michelle Le and Alan hanson.

Please come down. You'll have up to three minutes for your comments and identify yourself for the record.

MR. HANSON: Can you switch --

CHAIRPERSON FECKNER: It's on.

MR. HANSON: Oh, it's on. Great.

Good afternoon. My name is Alan Hanson. I am the Field Director of UFCW Local 400. We represent 35,000 grocery, retail, meat packing workers in the mid-Atlantic from the Washington suburbs of Maryland all the way out to Ohio, Kentucky, and Tennessee. I'm joined here by Michelle Le, a Safeway member and a shop steward. I'm also joined by Eileen O'Grady from the Private Equity Stakeholder Project.

My remarks are going to be very brief, because I definitely want you to hear from Michelle's experiences working at Safeway, particularly since being acquired by Cerberus.

But I'll just say that our immediate concern of being here today is that, you know, frankly, we're deadlocked in contract negotiations. And one of the thorniest issues that we're dealing with is a significantly underfunded pension, and, you know, making sure that the companies that, you know, have made a promise to provide retirement security to folks honor that commitment.

But we have a larger concern here, and that is that since being acquired by Cerberus, we have serious concerns about the long-term financial health of this company. That since 2015, private equity grocery -- seven private equity owned grocery stores have declared bankruptcy. And that -- those bankruptcies have impacted 125,000 workers.

And we see a very similar model in all of these bankruptcies, that, you know, a private equity firm purchases the company, grows the company significantly through a series of high leveraged transactions, sells assets, namely grocery stores, and leases those assets back to pay down the debt, and then balances the book -- the books on the back of workers.

Those are serious concerns. Safeway alone has 275,000 employees, including a significant number of UFCW employees, of Teamster employees, all of whom enjoy the retirement security that unionized employees have long enjoyed in this country.

And so we want to make sure that Safeway doesn't go the same way that these other private equity owned companies go. That Safeway makes sure that not only do they honor their commitment to workers in the mid-Atlantic and all across the country, but that they also make sure that when they exit their investment in -- when Cerberus exits their investment in Safeway, that they leave the company healthy enough to sustain good jobs and provide access to groceries in communities across the country.

And so with that -- I'm sorry. One more thing. We shared a report with you that I see some folks reading. I would encourage you all to take a look at that. It elaborates on the comments that I made here.

And with that, I'll turn it over to Michelle Le to talk to you about what it's like to work at Safeway.

CHAIRPERSON FECKNER: Thank you.

MS. LE: Good afternoon. It's a pleasure to be here. My name is Michelle Le. I am a 32-year employee of Safeway and a member of UFCW Local 400. Our union represents over 6,000 Safeway, Albertsons workers in the Washington D.C. metropolitan area.

In 2013, an investment group led by the private equity firm Cerberus acquired Safeway. And since then, working conditions and our customer's shopping experience have gone down.

CalPERS is one of the investors in the fund that acquired Safeway. Under Cerberus, Safeway has dramatically cut hours leading to long waits at the deli counter and at the cash register. Sometimes the lines are 10 to 15 people deep. Shelves are empty due to understaffing and stores are not as clean, safe, or maintained.

For example, the refrigerators in my store are always breaking down. The coolers are not deep-cleaned causing excessive dirt and mold buildup. We lose sales every day, because we don't have enough staff in the stores to keep the shelves stocked nor enough registers open.

But that hasn't stopped Cerberus from making money. Since 2013, Cerberus-led investment group has taken over $350 million in management fees and dividends from the company. Now, Safeway tells us that we must take concessions. They refuse to commit to adequately fund future pension benefits placing my pension and the pension of more than 50,000 current and retired Safeway employees in the mid-Atlantic at risk.

They also want us to pay more for health care, keep new hires in Washington D.C. Montgomery County, Maryland at the minimum wage. And they want to maintain a cap on hours, so that present part-time workers from -- will not qualify for health care.

Many of our members already rely on public assistance to provide for themselves and their family.

Safeway Cerberus contract will likely force more of my co-workers to defend -- to depend on taxpayers to make ends meet. We have been negotiating with Safeway for more than 14 weeks. During that time, we have shared our story with other public pension funds with Cerberus investments, including the Pennsylvania School Employees' Retirement System.

We also joined with other retail workers to lobby for federal legislation that would stop private equity abusive and anti-workers practices.

Your Fourth Investment Belief states that long-term value creation requires effective management of three forms of capital, financial, physical, and human. We are the human capital that makes Safeway successful. We know our customer's names. We know their birthdays, their favorite cut of meat, and how ripe they like their avocados.

As an investor in this fund that owns Safeway, we urge you to please meet with Cerberus and encourage them to work with us to achieve a successful contract and ensure that we share in that success. And if you don't, we -- and if they don't, we ask that you please halt all new investments with Cerberus until they do.

I thank CalPERS staff and trustees for your attention in this very important matter.

CHAIRPERSON FECKNER: Thank you. And we thank you for your comments and for your being here today and sharing with us. This board takes very seriously the responsibility of employers to do the right thing. I do know that Mr. Baker from your organization has met with our staff a number of times. I urge you have him continue meeting with our staff, so we can keep an open dialogue.

Ms. Taylor.

VICE CHAIRPERSON TAYLOR: Yes. Thank you, Mr. Chair. Thank you very much for talking to us today about this. I will say this is something that Ms. Olivares mentioned earlier, which is the reason we need the Warren bill that's currently up at the Senate and the House, because these companies -- one of the problems -- and I didn't comment earlier. But one of the problems with having private equity is that this is their common practice.

I know we all have a need for private equity and I understand that, but there has to be a way to stop the debt loading that they do. $350 million in management fees. They bought the company. What do you mean management fees?

I'm just appalled the fact that they would undermine the defined benefit pension and try to -- grocery jobs used to be middle class jobs. This is ridiculous. So thank you very much for bringing it to our attention.

MS. LE: Thank you.

CHAIRPERSON FECKNER: Okay. Seeing nothing else on our agenda, the open session of this Committee is adjourned.

(Thereupon California Public Employees' Retirement System, Investment Committee meeting open session adjourned at 1:20 p.m.)

C E R T I F I C A T E OF R E P O R T E R

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 18th day of December, 2019.

JAMES F. PETERS, CSR
Certified Shorthand Reporter
License No. 10063