CalPERS Emerging and Diverse Manager Forum
General Session PART 2 of 2

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Segment: General Session

Ginger Lew:
Thank you so much Laurie. Well many of you have greeted you with a good morning so I will not add my greetings as well. But as Laurie mentioned, my name is Ginger Lew and I'll be serving as the moderator for this morning's panel discussion on building stronger relationships and practices between CalPERS and the emerging manager community. I'd like to take a moment to thank CalPERS, the leadership, Anne Stausboll, Joe Dear, Laurie Weir, the Board, Rob Feckner, Henry Jones, and the Board members who are here today especially, for convening this forum. I first, the last one I remember attending was in 2006 in San Jose where we had about 300 participants. Today, we have more than 400 people in attendance, which demonstrates the continued growth of and interest in emerging manager programs. The purpose of this session is to engage in a discussion about the value and the opportunities of emerging manager programs. To explore where we are today. Identify some over arching concerns and hopefully find ways to strengthen the roles of emerging manager programs at CalPERS. We'll spend about 30 minutes discussing some key issues and then we'll move into a question and answer period. When you checked in this morning, you were given 3x5 cards. Please, over the course of the next 30 minutes, take some time to write out your questions. And they will collected by assistants who are in the room. If you need additional cards, please just raise your hand and you will be given additional material.

Let me take a few brief moments to introduce our panel. The complete bios of our panelists and a description of their respective organizations can be found in your program materials. To my far left, your far right, we have Orim Graves. Orem is the Executive Director of the National Association of Securities Professionals. NASP is an organization that helps people of color and women achieve full inclusion in the financial services industry. Next to Orim is Jan Le Chang. Jan is the President of the Association of Asian American Investment Managers. It is the only national organization for Asian American investment managers which seeks to expand their professional opportunities for managing institutional capital. Next to Jan is Ed Dandridge. Ed is the CEO and President of the National Association of Investment Companies. NAIC is an industry association representing diverse private equity firms and emerging fund managers. And next to Ed is Pilar Avila who is the CEO of the New America Alliance. NAA is a national American Latino organization dedicated to advancing the economic development of the American Latino community. And of course, we have Joe Dear, CIO of CalPERS. We'd like to thank Orim, Jan, Ed and Pilar for participating in this session. Your input has been sought because your industry associations represent significant segments of the emerging manager community and you have firsthand knowledge of both the successes as well as some of the concerns of how we move this program forward. In prior presentations, we learned that CalPERS has been involved in emerging

manager programs for more than 20 years. CalPERS has been truly a pioneer in establishing diversity and emerging manager programs since 1991. It was an industry leader and a catalyst for other institutional funds to establish similar programs. Over the years, the programs have changed and evolved. The demand for these programs has come at a time when we have seen the financial services and the work force become more diverse as new talented associates enter the work place. We've also seen increased numbers of experienced managers moving into leadership roles, seeking to establish their own funds. We also know that over the past 20 years, the financial markets have changed dramatically with the introduction of new, sometimes complex, financial products, and new technologies that have turned regional international economies into one global trading market. And we have all experienced both personally and professionally, the volatility of the financial markets and how challenging the last four years have been. Therefore, I think it is very timely that we take some time here today, this moment, to step back and assess where the emerging manager programs are today, what are some of the concerns that we jointly face, and how we can strengthen the programs to align our collective interests to meet the goals of both CalPERS and the emerging manager community.

So with that, I'd like to begin the discussion with a general question or topic. And perhaps kick it off with Joe making some comments and then inviting all our other panelists to participate as well. Joe, you, prior to coming to CalPERS you were involved with another pension fund north of here in the state of Washington. And so you've had I think a timeline of looking at emerging manager programs and being involved with them. And from where you sit today, how did we get to where we are today with the emerging manager program?

Joe Dear:
Well Ginger, nothing happens in terms of change without a demand. For CalPERS, there was a demand from the Board and from the emerging manager community that the organization look to see what could be done about breaking through the barriers and looking for talent that otherwise has not neglected the investment thesis I talked about. Now what I think has changed is the response of organizations like CalPERS to what occurred as a result of the global financial crisis. I spent a fair amount of time a few moments ago talking about performance and how I feel that CalPERS long-term performance is simply not as good as it should be. And that it has to get better. That necessarily implies making decisions about who's managing money, both our internal programs and how they do, as well as our external manager partners. And we have been, this is a nice way of saying it, restructuring the portfolios. What does that mean? That means some managers we decided to discontinue a business relationship with them. Now, depending on which asset class, that can be relatively quick and global equity determination clauses in a contract are 30 days and the assets are relatively easy to transfer and managers can be gone. In private equity, it's necessary to run out the terms of the limited partnership agreement. It can take quite a while but a decision not to re-up is fairly immediate. So we have over the

time I've been at CalPERS, 3-1/2 years now, made a number of very tough decisions about whether to continue or discontinue a relationship. I think one of the things that changes is we got more notoriety, if you will, or more noticed after some of the decisions we made with respect to emerging firms than we did for the decisions we made with regular firms. Now, we don't make a habit of going out and saying today CalPERS terminated the relationship with you know, this or that firm. I don't think it serves the firm, it's not something we've done. So it may be that the total sum of the decisions we've made isn't apparent to all. But certainly with respect to the emerging manager community, I think we generated a high degree of concern. I think my panelists would at least agree with me on that this morning. A high degree of concern. But what's going on with the programs. But I take this back to the trauma of the global financial crisis. The added issues that CalPERS had with respect to the scandal around some placement agents and the changes that we made in governance as a result of that, and this total focus we have on improving performance of the portfolio, therefore taking the steps that are necessary to make sure that with respect to the assets we managed, whether they're internal or external, we have the highest quality, highest integrity managers available to help us get to our objective.

Ginger Lew:
Would any of our panelists like to jump in, comment. Perhaps I can call on Ed to kick off this discussion.

Ed Dandridge:
Well thank you Ginger. And on behalf of NAIC, we're delighted to be here. I'm not gonna start by asking everyone if it's a good morning because I think from our view it's already been a good morning. It's actually on its way to being a great day. So we certainly want to say thank you to the Board of Administration, in particular Henry Jones who's just demonstrated real leadership. Anne Stausboll of course. And Laurie Weir who in some ways is now part of our extended family. She has been working rather closely with us, and we're delighted to have her as part of this. It might be helpful if I just took a minute and gave people just a little bit of context about who NAIC is and then we can talk about where we are today and how we got here. The NAIC is a 43 year old trade association and we started representing principally minority small business financial services companies some 43 years ago. Today we represent diverse and women private equity funds. Collectively, that constitutes 0.24 percent of all private equity assets in the market. So it's a rather small group. We are comprised of three sets of members, fund-to-funds, leading funds-to-funds who advise CalPERS and other large LPs, general partners and funds formation. It's important because for all of the diversity of operation and structure among our membership, what they share in common is a manifest commitment to excellence, to learning how to exceed, excel in this business, how to generate excess returns, as Joe talked about, how to scale, and really define excellence. And so while Joe is very correct that 2008 created a fair amount of trauma, it doesn't exist in a vacuum. At the same time that CalPERS has been going

through some significant restructuring, which we clearly understand, we also represent a very small composition, private equity in general, but within the CalPERS private equity portfolio, as Laurie said, just two percent. We understand that we are not the priority. Again, this doesn't take place in a vacuum. At the same time we are very proud of what I would describe as a new wave of managers, diverse managers who are members of the NAIC, many of whom enjoyed very early relationships with CalPERS and their first funds, who really produced quite well in the marketplace and just as CalPERS is going through the restructuring, these firms are going back into the market to raise again and really gaining a significant amount of traction with other LPs, fair amount of coverage in leading journals. But the relationship with CalPERS has changed. And there are several reasons for that. Instead of being a placement agent, the competition for capital is significantly tougher now. And these are folks who were emerging managers before it was cool to be an emerging manager. And I say that tongue-in-cheek but certainly the category has expanded over the years, and for some reasons in California as the statutory component and others, it's just fundamentally competitive. But we draw a very clear distinction. We are not emerging managers, we are diverse and minority managers, and again within that two percent of the CalPERS portfolio, some of our biggest and best firms were not having success re-engaging with CalPERS. And that sent a very chilling message to our association. If the biggest and the best couldn't re-up with CalPERS, what did it mean for our industry. And more broadly, we started to see for other first time funds who may not have historically been diverse, but were emerging managers from a CalPERS perspective, what did that say in general for the category of smaller managers who were considered emerging managers. And, so the NAIC reached out to CalPERS to really begin to engage in what all of this means. And at the same time, we stepped back and we conducted, we commissioned an independent performance survey for us to take a look at our own performance. Because we recognize for all the benefits of diversity, that is ancillary. What matters most is performance. And we never have viewed those as being mutually exclusive. We view them actually as we truly include, as our country becomes more diverse and opportunities present themselves in more diverse context. So, we're very pleased with the progress that CalPERS has made over the course of the year. It certainly has not been without its bumps. We owe a debt of gratitude to Senator Curren Price who helped bring all the stakeholders together as well as the recently elected to Congress. Congresswoman Gloria Negrete McLeod and we look forward to working with her in Washington. But where we have been is we have always had a great relationship with CalPERS. But like all relationships, from time to time, it's important to step back and reinvest. And that's what this year has been about, and we're very pleased to look forward to 2013 with a very clear sense of collaboration and we really do owe Joe Dear a significant amount of respect, appreciation and I really want to start our conversation with first acknowledging what Joe has done for us this year, and it means a lot to all of us that he's sitting up here. So thank you Joe.

Ginger Lew:
Ed, you saw Laurie presentation in terms of the five year plan, and we were sitting next to each other so we could chat a little bit during the presentation. And so I just wanted to ask, you know, when I look at the five year plan, and it looks, there's a heavy emphasis on things like metrics and performance and things like that, how, how do you see that as, what are some of the concerns that are commonly shared amongst all the groups that you want to be engaged in this dialogue about those issues?

Ed Dandridge:
Yeah. Again, significant amount of gratitude to Senator Price for initiating legislation that lead to that. If you can't measure something, you fundamentally can't manage it. I think that is implicit in what Joe was talking about and the necessity to restructure the portfolio. What I would say and speaking principally from the private equity standpoint, and would encourage my colleagues to weigh in, is that we have always viewed ourselves as being part of the solution. This is a new business. People in this room are told no significantly more than they're told yes. But not all no's are equal. No's that come in a context where you understand what it takes to get better can actually be rather profitable long term. And so the importance of defining a five year plan that builds on what's happened in the past, and is incremental, is essential. And we recognize the primacy of performance and meeting metrics Joe has laid out. We represent, we think a part of the solution. We respect CalPERS and Joe's investment team's view of the market. We look forward to having more mutual discussion about metrics so that we can understand and encourage managers to meet not only their own view of what success is, but what CalPERS' view is. And ultimately this is just part of the process. I think the five year plan is great, but I would love to see a little bit more looking backwards over the last five years. I think that was a little bit of the fissure that lead to some very, very prominent managers who quite frankly typically get cited at conferences like this as a success metrics of why diverse managers matter, and they've gone to do very well in the marketplace. We need to codify what worked well with them, so that other LPs can understand, and if they are now technically emerged, we'd love to hear a little bit more clarity from CalPERS about what that means and whether or not these emerging manager programs are in fact an onramp into the core portfolio, because in the absence of very clearly stipulated guidance, some people can feel that those programs and those onramps are actually dead ends. And I know that that's not the case, but I think part of it we dealt with this year was when people don't know, it leads to confusion.

Ginger Lew:
And you brought up a very good point about, you know, what are some of the lessons learned and how can we apply them going forward. You know, we've heard from CalPERS about some of the challenges they faced over the last four years. Perhaps we could hear from some of the industry groups, or panelists, what have been some of the challenges that emerging managers have faced

over the last four years. What are some of the lessons learned in terms of going forward. Maybe Pilar you can kick that off?

Pilar Avila:
I'll be very glad to weigh in. And again thank you so much to Joe and the CalPERS organization for this opportunity on behalf of the North America Alliance. The challenges I would say that emerging and diverse managers have been facing are similar to the business challenges that many businesses and institutions have been facing, but certainly in the context of the conversation, what I believe we need to know and remember is that the CalPERS organization you've heard it, has been active in this space for over 20 years. We have a group of diverse managers. We've seen the emerging managers program and knowing them that we know them, because we represent their interests, the CalPERS organization has been oftentimes one of the largest investors or clients for many of these young diverse firms. So when, you know, we're all faced with economic challenges that started in 2008 and these managers begin to see you know, reduction in the amount of allocations or no allocations, there is the trigger of business challenges that begins to happen that obviously are more challenging for the small firms to manage. So I think that the challenges really begin with the availability of capital in the market, and again the importance of having this conversation and the role that CalPERS has had in this space is extremely crucial, given you know, the amount of weight and participation that they have had with many of the diverse and emerging managers.

Ginger Lew:
Any of our other panelists comments?

Jan Le Chang:
Yeah, I would just echo what Pilar was saying. I mean, the availability of capital is certainly a huge issue. And also access to capital. So there are very limited places where emerging managers can come and talk to potential LPs to start, to start the conversation to help them with their business. Some that could be huge performers and really could help solve the problems of LPs. So access as well as availability.

Orim Graves:
I would just jump in and say that you know, I agree fundamentally with what has been said from a macro perspective. The market has kind of adjusted as related to the economic crisis. And there have been many cases where, you know, managers have had allocations reduced because of asset allocation decisions, that have moved away from their core competency and have moved into more I'll say of the exotic asset classes, be it private equity or hedge funds, or whatever. And the emerging manager, some of them don't necessarily have those capabilities. And that's, that's been part and parcel. The other piece is obviously there was a major contraction of wealth, fundamentally all over, and so shrinking piece of the pie obviously doesn't bode well for anyone, and especially emerging

managers. So, you know, the old adage if the, you know, if the pie is shrinking, the larger firms will you know, maybe have the sniffles and the emerging managers will have you know, bronchitis and the flu and everything else, and pneumonia on top of it so. It's just a confluence of events that has happened against emerging managers.

Ginger Lew:
So against that backdrop, and Pilar you touched in this as well, you know, if you are in fact new, you may have experience, you know, from prior positions, but you're new in running your own fund, and Orim you mentioned you know, when somebody, perhaps the newer managers may get pneumonia and the larger fund managers you know, get the sniffles. Is there a way, do you have any suggestions and thoughts about how, how there could be something like an advance warning system or anticipation of, or some sort of outreach that CalPERS might consider, you know, going forward in terms of working more closely with some of the fund, newer fund managers?

Orim Graves,
Well I think the start of this process with the portal is a good idea. It allows everyone to kind of submit their products and capabilities, sort of on an equal basis. So, I think that, that will help. And CalPERS has committed, and again I would add my thanks to Joe Dear and Laurie Weir and the staff and the Board for their recognizing that this is an issue and that they need to get out and be more visible in the community, such that, you know, through forums such as this, such as our individual conferences which they have attended. They can have that point of interaction and to develop those relationships or attempt to develop those relationships with emerging managers as they are starting or those that have been around, and they you know may not be as known to Joe, Lori and staff. So, I, you know, part of the reason that, you know, we're kind of here and you know, as Ed alluded to, you know, Joe's in a difficult spot. He has to get, he has to get returns. He has to manage it in a public forum and there are a ton of managers that he inherited. And you know, like any CIO, I know when I was back in, sort of with issues being on a smaller level, you have to generate the returns. You have to pay attention to your fiduciary responsibilities. But being CalPERS you've got to communicate which is where, you know, the plan, I kind of think fell down. And so part of this whole effort now is to you know, communicate what they're doing, why they're doing it and so that everyone will be at least knowledgeable and working through the groups here, I think that communication to the emerging managers, the smaller ones, can take place effectively as well. So.

Ginger Lew:
But wouldn't you also want the communicational, communication to be bidirectional, two ways? In the sense that soliciting, you know, in anticipation as well. So encouraging CalPERS to do, do that two-way dialogue as well.

Orim Graves:
Oh, no question. Ed do you want…

Ed Dandridge:
I just want to sort of weigh in here once again and I know Joe's heard me on this and Laurie certainly has. This isn't a communications issue. The communications issue is are you hearing me. Which is important. But you have to communicate something around which there's some sort of mutuality or common understanding about what it is. And post-2008, to say it's a communications issue is just not, I think, particularly constructive to managers. We have fundamental questions that CalPERS by virtue of its historic leadership, by virtue of its size, by virtue of the demonstrated leadership that the Board has used to great effect ton corporate governance, as well as in our space, comes with it a great opportunity to help advance the common interest. What am I talking about practically? I'm talking precisely about what Laurie referred to which is helping to define what diverse means, as a subset of emerging managers. And coming up with standards and practices that other LPs who always want to be first to be second behind CalPERS in this space, can follow. That's relevant for managers because it enables them to scale. It's also relevant to LPs because it gives Joe the latitude not just to say no, but to say no within the context of here are some best practices that help managers who are trying to emerge scale. They may not be consistent with what my goals at CalPERS are in restructuring, but objectively speaking, this is an indication of what a firm ought to be ascribing to do. In the absence of that mutuality with our organizations, then what ends up happening is communications well intended or made, and either managers or associations are not hearing them, or they're disagreeing with them. And the underlying intent very, very well intent on CalPERS' part, gets lost somewhere.

Ginger Lew:
And this leads me to my, sort of a third topic area, but before we go there I'd like to just remind the members of the audience that if you have questions, please start writing them down and I will encourage the roamers, the assistants in the room, to start collecting them because given the size of the number of people here today, I just want to make sure we have a chance to collect all of them. So going on to the third topic. This might be a little bifurcated, but what are the desired outcomes or objectives of the emerging manager industry associations as it relates to CalPERS? Then, what are the desired outcomes or objectives that CalPERS h as with respect to their emerging manager program, and whether Joe, you want to go first, or maybe one of our panelists want to go first? Orem?

Orim Graves:
Maybe I'll jump in. I think first and foremost, one of the objectives for our organizations are to move that needle that we saw earlier on the screen of two percent, or four percent if you will, exposure to diverse managers. We want to

get that number up, that number, and there are ways that that can be done, which do not sacrifice performance. And/or efficiency. It's a matter of taking the time and understanding where you can get that performance and sort of doing the leg work to find those managers that do perform and do perform well. I think also that there, we've made some recommendations to CalPERS as it relates to the five year plan on how they look at diverse managers. Some of the categories and the, quantifications that are dictated on that chart, and I think that there needs to be some level of flexibility on those metrics, such that more of our better performing managers, diverse managers, can get direct allocations. Then go to direct allocations, I think that's a way to get, get the ultimate goal of why everybody's here. Get an increased level of exposure for the diverse managers with CalPERS. So those are some of the outcomes I think that we would all share and begin. I understand there's a protocol to all of this as it relates to how it's managed internally at CalPERS. And I think from CalPERS' perspective, they would like to see some of the same things in that a fairly efficient and functioning diversity program with some meaningful level of assets across the spectrum, and across all of the asset classes in the private equity side on the global side, the domestic et al. So I think you know, those are some of the things that if I had to, to get at, to focus on, you know, I think those…

Ginger Lew:
Pilar, you had some.

Pilar Avila:
Yeah, very simple, it's a very simple and clear outcome of what we're doing here and it can be described in three words. Just show me the money. It's all about the allocation isn't it. But obviously there is a process to that allocation and I would, as I was preparing for this show, I actually thought about (inaudible). And I realized it all starts with performance. We're all here to perform and provide that edge and that, you know, desired performance so that we can fulfill our responsibility with the retirees that this institution serves. Your plumbing P I would expand into three segments. Let's start with the right policies and when you think policies, what you're assuming is and what you need is leadership that is committed to really having that opportunity for diverse and emerging managers. And we know we have that, you know, at CalPERS, but we also know that it has been a time of change. And we need to understand more what those new policies and evolving changes are. The other P under plumbing would be programs. There's phasing out programs, there's new programs that are coming in and you know, for a while a number of us were wondering about the new programs and we've got them some moiré information about that, but I suspect that in the continued evolution of policies and programs, there's more to be heard and we're looking forward to learn more about the vehicles and the level of funding available for emerging and diverse managers. The other P under plumbing would be profit. You know, there's usually the devil's in the details and you know, we're looking for processes that are you know, facilitated you know, simplified and at the end of the day these emerging and diverse managers which

have very limited resources, you know, can be expedited through a process of due diligence and not be held back, you know, waiting for an answer, waiting for direction, or advise on how to get there. And last but not least, I had the P for people. And I think all of that considered, I would say that the people are, to me the most important. As you mentioned Joe, you know, you need to have the right people inside the institution. People who understand, who are committed to this space, to this market, who understand what a due diligence process for these particular managers should look like, which is not your ordinary due diligence process. You know. You need to have the people within your consulting team who again understand, know this market and are committed to the process.

Ginger Lew:
Very good. Joe?

Joe Dear:
Well. You know, I'm simple, three is all the Ps I get to handle, Pilar can do five. I'm really impressed. You know, when we think about communication, I think about that movie Cool Hand Luke. Remember that? What we have here is a failure to communicate. I think Luke spent the time in solitary confinement after that, but communication really is important. About intent, about what we're looking for. A lot of firms have great product but we're not buying it because it doesn't fit in the portfolio. Which is another P. But communications is really important. There's outcome satisfaction. That's Pilar's show me the money. You get a commitment, we're great, right, from CalPERS. And then there's the no, and the no can vary from no with no explanation to a no with a detail. And Orem I think said helpful, or Ed said helpful explanations. So I think we have a lot of opportunity there. Now we created the web portal, the investment proposal tracking system because prior to that, CalPERS as an organization had no way of knowing what proposals were in front of the organization. Now, some managers were clever about this. So they would go knock on different doors and present fundamentally the same investment product. But they would have it in the guise of real estate, if they were selling to real estate, or fixed income, private equity. And they have fees accordingly for each of those. And we, we, you know, we had different parts of the organization looking at the same proposal and we had no accountability for providing an answer. We got your proposal, we looked at it, we're sorry, we're unable to advance it through all the way to yes. So, it was designed to level the playing field and not allow some to seek an advantage through hiring experts like placement agents, to somehow get them to the head of the line. Now, having said that, thinking about communication, I think one of the roles of the industry associations, a really valid role, is stepping in for the job that some placement agents did, which was well how do you approach a pension fund like CalPERS? What do you need to say, how do you make your presentation? How do you, you know, communicate, how do you get in front of em? Jan talked about that. It's not just availability of capital, it's getting access to that capital. Now again, every investment management firm in the world isn't gonna be able to get to CalPERS just because they knock on the door, but as

I've tried to say several times, it's to our advantage to find the undiscovered firms, the newer firms. So it's worth effort to try to get there. We do that through our own staff and importantly we do that through fund-to-funds arrangements. Fund-to-funds extend our reach, expand our staff capacity and are capable of making smaller commitments that we would be able to as CalPERS. As you all know, the due diligence to add a $10 million proposal is about the same as for a $100 million proposal. At some point your staff capacity runs out in terms of what you can look at. So, all those are ways of improving communication, getting outreach and expanding the opportunity to get to CalPERS. But I don't want anybody here to miss the earlier point that the panel is talking about which is availability of capital. There's no more dramatic example at CalPERS than private equity. In the years leading up to the global financial crisis, 2005-06-07, part of 2008, CalPERS committed over $35 billion to private equity funds. In the years since the global financial crisis, we've committed just over $5 billion to private equity funds. Now that number will go up going forward, but we kept it about our 14 percent allocation to private equity, even with that vastly diminished commitment of capital. Now interestingly, in the pre-crisis allocation, a big one of over 35 billion, about 18 percent of the money went to emerging manager firms. Now that wasn't the target and we can have them, but that's just what the number was. After the financial crisis, in that $5 billion plus allocation, about 18 percent went to emerging managers. Again, it wasn't a target but even though the pie has shrunk dramatically, the actual allocations emerging managers didn't change. And I can't think of a better observation about why we think our commitment to emerging managers is still there. Now having said that, as the plan indicates and the panel's talked about, you know, we are where we are. Is this good enough? No, what could be, you know, can we make it better. And that's what we're looking for. And you're right, part of the way of looking better is look at the past and see. So that's part of the plan and I talked about analysis and I talk about being prepared, that's partly what I'm talking about. One more example and then I'll stop. Laurie mentioned the emerging manager program in real estate. Now she said it was the first ever but we did have programs in real estate that looked at geographies that were challenged, urban environments and we did have a program that sought out emerging managers. California Urban Initiative. And you know, these didn't really succeed to put it gently. The program looked at what we had done, said well what did we learn from that? And what could we do? And the resolve is the new program, and Lori mentioned the key term here, which is it's not just a commitment of new capital, it's an arrangement that allows for mentoring by the emerging manager firm with the parent firm, in this case Canyon, and what we call the catalyst fund. That's a demonstration in my view of our ability to look back and go well what worked, what didn't. So in our global equity program, we're in a conversation with our funds-to-fund partners at FIS leading edge in progress, about how to take what we learned from the manager development program and the fund-to-fund and global equity, and build a new program. Similar dialogue will be occurring in the absolute return strategies program. You have a ne leader there, Ed Robatello, we're looking at performance there. We'll be talking with our hedge fund partners

and those who are interested in that program. Private equity will be a detailed discussion of their criteria, because Pilar is right, there is more than one P than performance. It is people, it is process, hitting the portfolio or other elements. You'll be able to learn from the private equity group how they're looking at that. And so I think we have a big chance here after the experience of 2012, to grow and move beyond.

Ginger Lew:
Ed, did you want to comment?

Ed Dandridge:
So I suspect there's some folks who are in the audience who are starting to see how this year has played out in terms of where we started, and where we're headed. Just a couple of observations. And Pilar clearly did hit on it which is why we're delighted that there would be breakout sessions really soon because we have some members who've come who clearly don't want to hear us talking, they want to talk to you guys directly. But, the desired outcome is clearly more performance based commitments, and at least speaking for the private equity side, we believe we've got a very strong case to make for that. And I'll let the managers speak to that. In terms of Joe's point about communication and roles of trade association, it is true that with the ban on placement agents, our roles have evolved. But I again don't really think we see it as communication. Our managers are very capable of communicating as I think you know. We only get brought in when they're perhaps not being heard or perhaps not speaking to the right people. I think what we're being asked to do is to engage you and in particular CalPERS, and I really hope the board hears me on this because you have been a leader. But what worked 20 years ago, worked 10 years, what worked even eight years ago, may not work today and at least in the case of private equity, we're working very closely with other leading LPs to really redefine what might work moving forward. We encourage you to participate in that broader piece. That's what I mean about not all no's meaning no. No's that lead to more profitable insight, scalable opportunities within a broader class of LPs who identify commonality is really leadership. At least from our perspective, where we think CalPERS has a distinct role to play. The last piece I would just say on that point is that this is a unique moment in time. We saw that with the presidential election. Any question about 47 percent or 53 percent is really I think a red herring. I think everyone in this room is 100 percent focused on performance. And to the greatest degree possible, what our members are asking us to do is really sit down with LPs, particularly CalPERS in a free and open dynamic environment where we have an ongoing discussion about what performance looks like, so that that stands separate and apart from the other things that you discuss and will hear about in the breakouts that have to do with strategy fit. Because it's one thing to be told no because you don't fit our strategy. It's something else just to be told no and then the rest of the marketplace automatically assumes it's because you did not have performance. I think we've have vericated conversations where some no's are not just getting a

cold one. They can be rather damaging because of the implication and I know that's never been the intent. I think that's not a communication issue, it's really much more structured than that and I think we can all look together. That's a desired outcome our managers want us to work with because it's systemic improvement, and that enables them to achieve on their own merit.

Ginger Lew:
Orim?

Orim Graves:
I just wanted to add to kind of a general observation. Joe you mentioned earlier in your prepared remarks that in evaluating emerging managers, diverse managers, you take a chance in looking at them, or a chance on the investment. And I would posit that, the evaluation of an emerging manager's generally no different from than an evaluation of a larger manager. And the number of studies that prove that emerging managers do outperform would tend to give you more comfort that in looking at an emerging diverse manager, the possibility or probability that they will do better may be a little bit higher, as opposed to a larger manager. So I think from the mindset of how you kind of approach the emerging manager, diverse manager sector, is one that should look at it not as, not as much of a chance as it is a, probably a good bet to make that investment. The other thing I would just add is that I think your, the evidence that your emerging manager fund-to-funds programs have performed well. I think there's some evidence of that if I'm not mistaken. Is that correct?

Joe Dear:
It's mixed. It's mixed Orim. It's not a slam across the board success.

Orim Graves:
Okay, so there's some, there are those within those programs that could be considered for an increase allocation.

Joe Dear:
Yes.

Orem Graves:
I think that's an easy way to kind of get rolling on your, on the advancement of the, the allocation. So I would just posit those two ideas.

Joe Dear:
Could I just, one of the things that you touched on is what we call transitioning a manager who's in one of the fund-to-funds into a direct relationship. And I think this is one area where we have a real chance to improve. Because we really haven't set about systematically harvesting those managers who have been in the fund-to-funds. For the audience to know all the detail, for private equity or global equity, public equity, the fund-to-funds commitments tend to be on the

small side, 10-15-20 million dollars, where a direct relationship in private equity is 100 million or more and the global equity can be of similar size. So, when we say transition, that's really a big, that's really a big moment. And for us to be more systematic about that is a chance for us to really identify the high performers in those fund-to-funds and move them along. So I think Orim your observation there is well taken. So even if in general the programs themselves haven't necessarily been additive to performance, certainly within each of these programs there's definitely managers who have performed extremely well and it's in our interest, our strong interest to figure out how to see them early and transition them to larger commitments.

Ginger Lew:
Before if I can, this is the final call for any additional questions before we move into the question and answer period. So again our assistants, if they could roam around and pick up any additional cards I would appreciate it. Pilar, excuse me.

Pilar Avila:
Yeah. You know, the reality for, for small managers, diverse managers is that a yes from CalPERS is a big yes. It's a big seal of approval. Likewise, a no from CalPERS it really could mean, or be interpreted as many other things by the market. So, basically, considering the leadership and the respect and the regard that the industry, particularly in the public pension fund system, has for the CalPERS policies and the way that CalPERS structures its investment strategies, I think that there's also an opportunity and particularly Joe you are certainly a leader within the industry, and you have been for a while. I believe that there is an opportunity as well for CalPERS to serve as a conduit for increased awareness, education and connectivity between the emerging and diverse managers community and the, you know, potential. Because let's face it, it's not all about CalPERS. Certainly there's a big weight on a relationship with CalPERS. But I think that to move our industry forward, one of the critical challenges that we have is diversification. And have more players who are understanding the opportunity and willing to go through the process of funding more emerging and diverse managers.

Ginger Lew:
And actually this leads to sort of our final topic. And we've been covering this somewhat already, is you know how does CalPERS and the emerging manager community and the trade associations that are represented here today, how can we work toward more collective, common outcomes? I'm asking really for sort of concrete suggestions. We've heard some about increasing the allocations. But I would ask our panelists to see if there's additional comments or suggestions that you have. Perhaps Jan you can kick off?

Jan Le Chang:
Sure. And you know I really think that an event like this is really a great start, so I really think Joe and CalPERS staff Laurie and the CalPERS Board for putting this

together for our communities because I think it's very important. And I think it's something that will really help us, not just look backward, but also move forward because it's been five years since the global financial crisis and we need to, you know, move on. In terms of recommendations for collaboration, I think we've heard bits and pieces of it throughout this conversation. You know, first of all I would still say communication. I think it's really important. But from the CalPERS perspective, communicating to the outside communities, the diverse communities, the emerging manager communities. When I was an LP, for about six years I was in the emerging managers space, we always appreciated it when our fund managers communicated with us, and so you know, good news or bad news, you know, if you're upfront about it and you come to the table and just kind of give us a heads up right away, we really appreciate it, really appreciated it. So I would recommend that CalPERS could do the same in terms of communication and outreach to the various communities. My second recommendation would be from, I guess from the communities looking in, we would love, and it would be great to see increased transparency into investment processes. You know, how you're thinking about the market, how you're thinking about making investment decisions, what your challenges are in terms of thinking about your portfolio construction. And then also in terms of performance measurement. You know, we would like to have clarity in terms of, you know, how you measure performance, how you look at the world, what you benchmark to. Because you can play around with numbers a lot and different numbers mean different things to different people. And so just to have that insight into CalPERS would be definitely helpful I think for, particularly for our group. And then of course that's why we're all here is I guess increased allocation. So, to the extent that CalPERS can be open and willing to come to the table in terms of discussion, to increasing allocations to the emerging manager community, that would be fantastic obviously. So.

Ginger Lew:
Pilar?

Pilar Avila:
I would say that on behalf of the New America Alliance we've had a very productive relationship with CalPERS over the last 10 years. Our approach to all relationships is to be open in our communication, to be constructive. And to also find, participating in forums like this so we're delighted to do these again and again whenever the opportunity arises. We also have our own forums, like our Wall Street Summit, and we thank you Joe and Laurie for joining us there and Henry as well. That will continue to be a vehicle for continued communication and engagement in getting to know the managers out there. We also have private forums like the private meetings that we do during our national tour and again as expected in 2013, we'll be back for a private conversation with NA members. But certainly a, I think that the collaboration that is increasing among the organizations I think it's another thing for all of us and for CalPERS and the industry to embrace. As Ed mentioned, we consider ourselves part of the

solution. We want to continue to be a partner and you know, the NA and our board and our members, we will remain available to collaborated with CalPERS in any shape and form to move the needle and open the doors, continue to have the doors of opportunity open.

Ginger Lew:
Thank you. Now we're going to move into the question and answer period. We've collected a number of questions and given the time constraints, we're not gonna be able to address every single one of them. However, we, CalPERS has made a commitment to make sure that the questions are directed to the appropriate staff member and in fact the questions and the responses will be posted on CalPERS' website. So for the first few questions that I've received, let me see if I can read the first. I think we also need a lesson in penmanship too, but. How do you, this is I think a question addressed to Joe, so how do you balance CalPERS commitment to reduce the number of managers and increase commitment sizes, and amounts with the fact that emerging managers tend to raise relatively small first time funds, especially as it relates to private equity?

Joe Dear:
As I mentioned, we have several approaches. One is direct programs or investments from the CalPERS to funds, and the other is a fund-to-funds investment. And we've used the fund-to-funds approach primarily to reach smaller funds and to be able to make smaller commitments. So, the fund-to-funds stand is an augmentation of CalPERS staff and extend our reach as a result. I know there's some fund-to-funds partners out there, I don't want to give you a heart attack to talk about it, but that layer of fees that fund-to-funds applies is actually performance of these commitments. So we have to look at that and make sure we're getting value received. In some instances we definitely are and others we really have to understand what's going on with the portfolios. But the fund-to-funds come at a cost. So an alternative to that is to increase the size of CalPERS staff and reduce the commitment size that we need when we have a targeted program like emerging managers. And that's a conversation we're having, and it's particularly relevant in the private equity sphere because we do need to think about additional capital into emerging managers and private equity. But I want to solve for that problem of do we want to do it internally with additional staff, or do we want to continue the fund-to-funds approach that we've taken. And that's an open question so to Jan, like we'll just allocate more capital, we've got a predicate issue we have to solve. But clearly in private equity there's a, we're going to need to make a decision about additional capital in the relative near term. Now, on the overall balancing of the portfolio. Again, if we can manage assets internally because of our own cost structure, it's vastly in our interest to do that. But the "if" has to be solved by the capability of delivering investment returns that are as good as or better than what we could get from contracting for outside service. But about 70 percent of CalPERS assets in total are internally managed and the direction over the past couple of years has ringed them in. So we've increased the amount of assets internally managed in fixed

income and global equity. I don't know how much more we can extend in that direction but again, if we can do it successfully, it's worth it. Now that of course raises the question about diversity inside CalPERS which is not a topic for today. But it's a highly relevant topic for the organization and one that the Board is interested in. So it doesn't take the diversity issue off the table by any means. But from a portfolio standpoint, the last part of that question was if you're trying to reduce the number of relationships and this would be particularly true in private equity, and thereby increase the size of the commitments that result, does not affect the small emerging manager firms. And the answer to that solution is you've got to be mindful of what emerging managers take and allocate capital accordingly in the plans that we develop. And so that's how we'll take it down to that. And then we would hope over time that a number of those firms in the emerging manager program would transition into direct and larger relationships.

Ginger Lew:
Ed?

Ed Dandridge:
And I think Joe hit on a number of very key points and I'll just speak specific to private equity. This is to your earlier question about desired outcomes and this is clearly where, from a board's standpoint, our board is keen to engage with Joe and the leadership of CalPERS around two issues. One is an input and the other's an output. So just looking out in the room here, there are a significant number of people who fall within the emerging manager category as it's defined in California, certainly now how we would define it, and they're probably not really sure why we're having this panel because a lot of the issues related to diversity are not particularly applicable to them. Understood. But I do think that there is a definitional issue that we need to always be mindful of. The focus typically is how it gets communicated, but I think we need to take a step back and that's where we, you know, collectively play a unique role. We know who these diverse managers are because they're in our association. Everybody else here has a day job where they do other things. Not the four of us. This is our day job and so we think we can be additive at a very strategic level on that point. The output goes back to the question that Joe just answered, which is it's great that we had a program that now has 20 years of a track record called emerging manager. It's great that it has a five year program moving forward. I think it will really mean something when we have a point where everyone understands what it means to emerge. And go into a core portfolio and implicit in the question that Joe was asked, which is fewer managers, larger allocation, fee pressure. You start looking at that, that doesn't really suggest that there's a clear path for diverse managers without performance. You're not talking about em, but for some who have very notable performance, even then just given the dynamics that Joe laid out, it presents a very, very challenging environment. We need to get to a point of policy clarity around that, and that, you know, we can talk about how to communicate that later, but that's a fundamental policy issue.

Pilar Avila:
I'll stress again this is not a CalPERS exclusive challenge. This is a challenge for the industry. And in fact, this whole notion of you know fund-to-funds which we are fans of, but how do you grow the fund-to-funds, increase those direct allocations and then prepare that managers to gravitating to the larger allocations. Institution after institution there is a gap that needs to be figured out and perhaps again, this is something that, you know, CalPERS can lead some of the current and future industry players into figuring out so we can grow this space and grow the managers.

Ginger Lew:
I think that suggesting is really good. The dialogue here has been very, very helpful and I think very constructive. Here's a very specific question for Joe. We are a new/emerging manager and a minority owned manager and we are not getting responses from the fund-to-funds and consults we have been referred to by CalPERS. What is the process to get feedback, even if it's a no, from the external manager firms that CalPERS has engaged to screen emerging managers?

Joe Dear:
Hm. Well, I'd hope you'd get an answer. I take it we've gotten a proposal, we said too new, too small, go to one of the fund-to-funds and not have heard something. That's disappointing because the idea is to get some kind of feedback. I don't know, I'd have to get more specific information. But part of the idea is to get information back about what's happening and why that's not getting any information.

Ginger Lew:
I think the challenge Joe is that the good news is CalPERS is a thought leader and is an industry leader and it's viewed as being really, you know, the example setter for so many. And so you would, CalPERS attracts a huge number of people at its front doors and sometimes it is hard to respond to all the inquiries. But you know, I know that CalPERS has tried to set up various systems for responding to those and I think the purpose of my asking this question was just to bring it to your attention that maybe some things are falling through the cracks, that's all.

Joe Dear:
Some more work to do.

Ginger Lew:
So this next question and unfortunately our last question, how does venture capital fit into the broader private equity picture of CalPERS? How much of the private equity allocation devoted to venture capital now and looking forward?

Joe Dear:

Venture's very, very tough. It, it may be one of the most difficult fields in which to deploy capital and to achieve success. Currently, about seven percent of our private equity portfolio is invested in venture capital firms, but we're only planning going forward to make investments in venture capital on a strictly opportunistic basis. Therefore we expect the allocation to venture over the next 5-10 years to fall to about one percent. Why? General, in general, venture capital returns over the past 10 years have been very disappointing, not helping CalPERS achieve its goal in private equity of exceeding public markets by 300 basis points. There are a fairly limited number of venture capital firms who have very successful track records and are able to generate good returns. We would love to invest in them. Most of us don't want large public pension funds as partners. Partly because we're large public pension funds, also because of public records act, disclosure policies in California that require the release of information which the partners are concerned about. And because of their track records, they simply don't need public pension fund capital. I met a venture capital partner at a dinner last winter and he said we haven't had a new LP since 1984. So we can't get at many of the funds we want to get at, and even if we could, we can't get at them in a size which is meaningful to effective performance of the fund. So venture will be opportunistic. If one of those funds becomes available to us, we'll jump on it. For a new venture capital firm coming to CalPERS, I mean this is one of the areas where we're just not in the market, we're just not really buying. That may not be true for our fund-to-funds partners and that's where the logical place to go is. But we've kind of thrown up our hands on venture for the reasons I just provided.

Ginger Lew:
We have many more questions and not enough time. And we all want to get over to the asset allocation sections. I would like to thank all of our panelists for engaging in a very robust discussion. Please join me.