CalPERS

Investment Committee

California Public Employees' Retirement System

Agenda Item 5c

November 18, 2013

ITEM NAME: Revision of the Private Equity Delegation Resolution for Professional Staff

PROGRAM: Private Equity

ITEM TYPE: Policy & Delegation – Action

RECOMMENDATION

Approve the changes to the Delegation Resolution for the Private Equity Program, Delegation No: 07-02-INV (Attachment 1). The consultant opinion letter from Pension Consulting Alliance Inc. (PCA) is provided as Attachment 2.

EXECUTIVE SUMMARY

The Private Equity Program is seeking to make a few clarifying changes to the Delegation Resolution. The proposed changes are to make explicit that the Senior Investment Officer (SIO) has the ability to purchase fund investments in the secondary market and to add some clarifying language to the co-investment delegation.

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan goal to cultivate a high performing, risk intelligent and innovative organization. The Private Equity Delegation provides the SIO the ability to make innovative investment decisions within a defined risk framework.

INVESTMENT BELIEFS

This agenda item supports CalPERS Investment Belief 2: A long time investment horizon is a responsibility and an advantage. The long time horizon enables CalPERS to invest in illiquid assets, such as private equity.

BACKGROUND

Recently two questions regarding the Delegation Resolution for Private Equity were raised.

The first question was the delegated authority of the SIO over Private Equity to purchase fund investments in the secondary market. After discussion with the CalPERS Legal Office, the Board Investment Consultant (PCA) and staff it was determined that the authority was implied, but that language should be added to make it clear the authority had been delegated.

The second issue questioned the co-investment delegation. As the Delegation Resolution is currently drafted CalPERS co-investment is limited by the amount of the investment by the fund in which CalPERS is invested. After discussions with staff, the Legal Office and the Board Investment Consultant, it was agreed that the intent was to base a co-investment limitation on the total invested by the manager, regardless of how the manager may allocate the investment between different funds.

The proposed changes to the Delegation Resolution add language to clarify what is believed to be the original intent of the existing Delegation. Additionally there are administrative changes to some definitions.

BUDGET AND FISCAL IMPACTS
Not Applicable

BENEFITS/RISKS
Adopting the proposed changes will provide additional clarity around the investment decisions that have been delegated to the Senior Investment Officer Private Equity and the Chief Investment Officer. Failure to adopt would result in continued ambiguity and potential disagreement over the intent in the future.

ATTACHMENTS
Attachment 1 – Delegation Resolution
Attachment 2 – PCA Opinion Letter

RÉAL DESROCHERS
Senior Investment Officer
Private Equity

JOSEPH A. DEAR
Chief Investment Officer

STATE OF CALIFORNIA
PUBLIC EMPLOYEES' RETIREMENT SYSTEM
BOARD OF ADMINISTRATION
INVESTMENT COMMITTEE

DELEGATION RESOLUTION

Subject: Professional Staff Private Equity (PE) — Delegation No: 07-02-INV

WHEREAS,

1. In accordance with Government Code section 20120, the Board of Administration of the California Public Employees' Retirement System (the Board) is charged with the administration and management of the California Public Employees' Retirement System (CalPERS), and

2. In accordance with Government Code section 20171, the Board is also charged with the exclusive control of the administration and investment of the Public Employees' Retirement Fund (the Fund), and

3. In accordance with Article XVI, section 17 of the California Constitution, the Board has plenary authority and fiduciary responsibility for the investment of CalPERS assets, and

4. In accordance with Government Code section 20099, the Board is authorized to appoint a committee of one or more of its members to perform any act within the power of the Board itself to perform, and may through express delegation authorize any such committee to act finally, and

5. In accordance with Government Code section 20099, the Board may authorize its Chief Executive Officer (CEO) to perform any act within the power of the Board itself to perform, and may through express delegation authorize the CEO to act finally, and

6. The Board has adopted a Board of Administration Governance Policy relevant to the granting of delegations, and

7. Through Board Delegation Resolution No. IC-11-01 and pursuant to Government Code section 20191, the Board delegated to its Investment Committee the authority to make, through final action and by the affirmative vote of at least seven members, any investment authorized by law, and to re-delegate its authority to others, and

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~~Revised May 14, 2012 to include delegation re Customized Investment Account~~
~~Definitions updated September 10, 2012~~

8. Through Board Delegation No. EXEC-11-01, the Board has delegated to the CEO principal authority and responsibility to direct and manage staff to execute the policies adopted by the Board and administer the various programs consistent with the policies, and to re-delegate to others, and

9. The Board and its committees retain the implied authority, pursuant to Government Code section 20099, to re-delegate their authority directly to the Chief Investment Officer (CIO) and Senior Investment Officers and such re-delegations are deemed to have been made through the CEO and the CIO.

RESOLVED,

(A) Recognizing the respective roles of the CEO as the internal leader of the organization and the CIO as the principal investment expert, and yet also wishing to gain the full benefit of the unique private equity expertise of the Senior Investment Officer-Private Equity (SIO-PE), the Investment Committee hereby delegates to the CIO and the SIO-PE, the authority described in the attached Private Equity Delegations (the "Delegations").

(B) Where such Delegations do not prohibit sub-delegation, the CIO and the SIO-PE are authorized to re-delegate to his or her responsible subordinates any portion or all of the responsibility delegated to the CIO and the SIO-PE.

(C) Where such Delegations do not specifically require the Investment Committee's review or ratification prior to action, the CIO or the SIO-PE has the authority to act finally, and to re-delegate, and will be responsible and accountable for his or her actions.

(D) The exercise of authority under the Delegations shall be reported to the Investment Committee in sufficient detail to keep the Investment Committee appropriately informed and in order for the Investment Committee to monitor the performance of the CIO and the SIO-PE.

(E) Upon adoption by the Investment Committee all Delegations will expressly supercede all prior delegations regarding AIM to the CIO and the SIO-PE, including without limitation, the AIM authority delegated in the interim PE Delegation No. 07-02-INV, revised May 17, 2010.

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(F) It is understood that the PE Delegation and the grant of authority are created with the intent to fully comply, in letter and in spirit, with all federal and state laws and regulations, as well as CalPERS Policies and procedures as approved by the Investment Committee or the full Board of Administration.

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HENRY JONES
CHAIR, INVESTMENT COMMITTEE
BOARD OF ADMINISTRATION
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

I accept this delegation.

Dated: ______________ ________________________________
JOSEPH A. DEAR
CHIEF INVESTMENT OFFICER
INVESTMENT OFFICE
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

I accept this delegation.

Dated: ______________ ________________________________
RÉAL DESROCHERS
SENIOR INVESTMENT OFFICER – PE
INVESTMENT OFFICE
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

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Private Equity (PE) Delegations

Within each of the following subject areas (as shown in italics), the Investment Committee delegates (as shown in bold) the following authority to the CIO or SIO-PE:

I. Authority to Allocate Assets

A. Authority to Establish Asset Classes and Asset Allocation (Targets and Ranges) for the Total Fund

(*No Delegation)*

B. Authority to Establish Programs/Sectors Within an Existing Asset Class

1. **Consistent with policy and the investment limits set forth herein, to establish Programs/Sectors within the PE Asset Class.**

PE Investment Policy, Section V

C. Authority to Make Allocation Decisions Within the Asset Class and Among Programs/Sectors

1. **Consistent with policy and the investment limits set forth herein, to manage allocation decisions within the PE Asset Class and among its Programs/Sectors.**

PE Investment Policy, Section V

II. Authority to Make Investment Decisions

A. Authority to Directly Invest In and Dispose of Public Securities

1. **To manage the disposition of any public securities received as a distribution from a limited partnership to which PE is committed.**

PE Investment Policy, Section V

B. Authority to Select, Commit Funds to, and Dispose of/Exit Investments in Private Investment Vehicles either directly or on the secondary market.

Investment Committee approval will be required for commitments beyond those authorized for the SIO-PE or the CIO. If there is a vacancy in the CIO position, Investment Committee approval will be required for commitment authority otherwise delegated to the CIO.

1. **To limit the aggregate Net Committed Capital to any General Partner to no more than 10% of PE's Net Committed Capital.**

2. **For Top-Quartile funds, to limit PE's C~~c~~ommitment to no more than 25% of the fund, with SIO-PE approval required for amounts up to 4% of the PE Policy Target and CIO approval for amounts up to 8.0% of the PE Policy Target.**

3. **For Second-Quartile funds, to limit PE's C~~c~~ommitment to no more than 25% of the fund, with SIO-PE approval required for amounts up to .75% of the PE Policy Target and CIO approval for amounts up to 1.5% of the PE Policy Target.**

4. **For Emerging Management Teams, to limit PE's C~~c~~ommitment to no more than 25% of the fund, with SIO-PE approval required for amounts up to .75% of the PE Policy Target and CIO approval for amounts up to 1.5% of the PE Policy Target.**

5. **For Customized Investment Accounts, SIO-PE may approve commitment up to 3% of PE Policy Target and CIO may approve commitment up to 4.5% of the PE Policy Target. Furthermore, CIO may approve an increase in committed capital to an existing Customized Investment Account with top-quartile performance by up to 20%.**

~~5.~~6. **For Secondary Market Purchases, with SIO-PE approval required for amounts up to 2% of the PE Policy Target and CIO approval for amounts up to 4% of the PE Policy Target.**

~~6.~~7. **To manage all ongoing portfolio maintenance, including without limitation amendments, consents, waivers, and sales/dispositions.**

PE Investment Policy, Section V

C. *Authority to Directly Invest In and Dispose Of Private Securities*

Investment Committee approval will be required for commitments beyond those authorized for the SIO-PE or the CIO. If there is a vacancy in the CIO position, Investment Committee approval will be required for commitment authority otherwise delegated to the CIO.

1. **For Co-Investments, provided the investment by the funds managed by the General Partner is ~~is making an~~ equal to or larger than the CalPERS PE investment ~~commitment~~ and the investment is smaller than CalPERS PE commitment to the**

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fund, the SIO-PE may approve a commitment of up to .75% of the PE Policy Target and the CIO may approve up to 1.5% of the PE Policy Target.

2. **For Direct Investments, to limit PE~~AIM~~'s commitment to no more than .5% of PE Policy Target.**

3. **To manage all ongoing portfolio maintenance, including without limitation amendments, consents, waivers, and sales/dispositions.**

   PE Investment Policy, Section V

D. Authority to Fund Investment Managers Retained through a Contractual Arrangement (pursuant to public contracting process) ~~(No Delegation)~~

1. **Consistent with the investment limits set forth herein, to select and terminate investment managers obtained through public contracting process.**

E. Authority Relating to Shareowner Resolutions and Proxy Execution

1. **To manage all ongoing portfolio maintenance, including without limitation amendments, consents, waivers, and sales/dispositions.**

   PE Investment Policy, Section V

III. Authority to Make Contracting Decisions

A. Authority to Select and Terminate Investment Managers (obtained through public contracting process)

1. **Consistent with the investment limits set forth herein, to select and terminate investment managers obtained through public contracting process.**

   PE Investment Policy, Section V

B. Authority to Select and Terminate Investment Consultants Other than the Board's Investment Consultants

1. **Staff may establish a "spring-fed pool" of External Resources to meet the Program needs.**

   PE Investment Policy, Section V

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2. **The CIO shall have authority to use the "best business practice" exemption from competitive bidding to hire External Resources, but only on a highly selective basis, when necessitated by the urgent nature of the work and where the pool of existing External Resources is inadequate. Use of this exemption must be reported monthly to the Investment Committee.**
PE Investment Policy, Section V

Delegation No. 07-02-INV History

Date	Approval / Revision Details
02-20-2007	Approved by the Investment Committee
05-17-2010	Revised to delegate authority to the CIO and rescind SIO-AIM authority
06-13-2011	Revised to delegate authority to the CIO and the SIO-AIM
05-14-2012	Revised to include delegation re Customized Investment Account
09-10-2012	Updated definitions
11-18-2013	Revised to include clarifying language regarding secondary markets and co-investments

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Definitions

Commitment

The total amount CalPERS has committed to a fund, including management fees and partnership expenses.

Co-Investment

A Direct Investment made by CalPERS where CalPERS has an existing commitment to a fund which is also investing in the company.

Customized Investment Account

An investment structure in which CalPERS partners with a firm that has distinct investment expertise in an industry, geographic region or investment style and has demonstrated the ability to provide top-quartile returns. Other than the General Partner, CalPERS would be the sole investor. This structure may have an individual mandate or may invest alongside other similarly structured funds in the same investments with different terms.

Direct Investment

An investment that is made directly or indirectly by CalPERS in a company.

Emerging Management Team

A firm raising a first or second time Institutional Fund.

External Resource

Consultants and advisors qualified through a public contracting process to perform consulting and advisory work for the PE Program. May include but is not limited to management consultants, accountants, attorneys, industry specialists, traditional pension fund consultants, investment bankers, or industry experts.

General Partner

The managing member of a limited liability company (LLC), or the management company or managing organization of a limited partnership. As used in this delegation resolution, the term General Partner can also generically refer to the principals that manage a family of funds.

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Institutional Fund

A Fund which is being raised by a proven team with a demonstrable track record to which at least three institutional investors have made a commitment.

Net Committed Capital

Remaining cost plus unfunded commitments. ~~Total active commitments less permanent return of capital.~~

Second-Quartile Firm

A General Partner with whom CalPERS may or may not have an existing relationship and where the capital-weighted average net IRR or multiple of invested capital of ~~all~~ the four most recent funds pursuing the same strategy managed by the General Partner is in the second-quartile of a private equity industry benchmark.

Top-Quartile Firm

A General Partner with whom CalPERS may or may not have an existing relationship and where the capital-weighted average net IRR or multiple of invested capital of ~~all~~ the four most recent funds pursuing the same strategy managed by the General Partner is in the top-quartile of a private equity industry benchmark.

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MEMORANDUM

To: The Investment Committee
California Public Employees' Retirement System (CalPERS)

Date: November 18, 2013

From: Pension Consulting Alliance, Inc.

RE: Private Equity Delegated Authority

PCA previously assisted Staff in formulating its Delegated Authority set forth in Delegation No. 07-02-INV (the "Delegation"), which recognized market dynamics and gave Staff sufficient authority to be competitive in the existing environment.

Proposed revisions to the Delegation set forth:

1. The extent of the authority of the Chief Investment Officer and Senior Investment Officer-Private Equity to utilize the secondary markets to purchase and dispose of interests in private equity funds;
2. The modified conditions surrounding Co-Investments.
3. Private Equity's authority to select and terminate investment managers obtained through the public contracting process; and
4. A new definition for the term "Commitment" and modifications to the definitions of "Net Committed Capital," "Second-Quartile Firm," and "Top-Quartile Firm."

In light of the continued growth and evolution of the private equity secondary market, PCA believes it is prudent to empower Staff with the authority to enter into secondary market transactions to the extent consistent with policy. Furthermore, allowing Staff to select and terminate investment managers obtained through the public contracting process will give Staff the ability to cast a wide net in searching for investment opportunities and to manage the portfolio in a manner consistent with other asset classes. As such, PCA believes the aforementioned proposed revisions to be prudent and therefore recommends that the Investment Committee approve the Private Equity Delegation No. 07-02-INV, revised November 18, 2013.