CALIFORNIA STATE TREASURER JOHN CHIANG

AB 2833 (Cooley) – Public pensions: disclosures

UMMARY

B 2833 will require public pension funds to publicly disclose ross management fees, management fee offsets, fund expenses, arried interest, and any related party transactions paid to their rivate equity general partners, hedge fund partners, and other ternative investment partners on an annual basis. The disclosure equirements will apply to CalPERS, CalSTRS, 1937 Act retirement ystems, the University of California Retirement System, and all idependent retirement systems. Transparency requirements ould be applied on a prospective basis.

ACKGROUND

rivate equity is a source of investment by institutions or wealthy idividuals aimed at gaining significant, or even complete, control f a company, and then earning a high return from the sale or ublic offering of that company at a later date. Typically, a group of ivestors buy out a company and use that company's earnings to ecover the cost of the initial acquisition. U.S. public pension funds re currently the largest investors in private equity with more than 350 billion committed worldwide. Pension plans are limited artners in private equity transactions, and pay fees to general artners (otherwise known as a fund managers) in private equity rms. Private equity firms use money from pension funds and ther investors to make investments within a portfolio.

edge funds are also private, alternative investment vehicles that eek to increase gains and offset losses by "hedging" investments sing a variety of sophisticated investment strategies not available more traditional asset classes. Hedge fund investments are ypically managed more aggressively than other investment ehicles, and employ significant leverage to take on more peculative positions. Hedge fund strategies include, but are not mited to, speculation on securities that are expected to either ain or decline in value. Hedge funds have grown into a $2.87 illion market, with 66 percent of global assets coming from istitutional investors, such as pension funds.

o manage these funds, private equity and hedge fund general artners typically charge investors a 1-2% annual management fee n committed capital, which is taxed as income. Managers also ypically keep 20 percent of investment profits, over a specified ireshold, as carried interest (otherwise known as performance ees), which is taxed as capital gains.

alPERS disclosed in November 2015 that it paid $3.4 billion in erformance fees to private equity managers since 1990. From 990 to June 30, 2015, CalPERS' private equity program generated 34.1 billion in profits. Private equity investments produced rofits of $4.1 billion in fiscal year 2015, with management fees otaling $414 million and performance fees totaling $700 million iat year.

As of January 31, 2016 CalPERS had $27.2 billion of its $295 billion portfolio invested in private equity, about 9.22% of the portfolio. Private equity is CalPERS' top performing asset with returns of 12% over the last decade. In September 2014, CalPERS announced that it would pull $4 billion from its investment in 24 hedge funds and 6 hedge fund-of-funds.

CalSTRS had total assets of about $179.4 billion as of January 31, 2016 and $17.152 billion, or 9.6% of its portfolio, was invested in private equity. CalSTRS' private equity portfolio had a 13.52% return as of March 31, 2015. At the February 2016 CalSTRS' Investment Committe meeting, the Committee voted to allocate 9% of total fund assets to Risk Mitigation Strategies, of that 9%: 35% will be allocated to U.S. Treasuries, 40% to Trend Following strategies, 15% to Global Macro strategies, and 10% to Systematic Risk Premia. This creates a target o allocation to hedge funds of about 5.85%. As of December 31, 2015, CalSTRS had $879 million in Trend Following strategies, and $973 million in Global Macro strategies.

UC manages investments totaling $95.7 billion as of December 31, 2015, of which $53.6 billion were pension plan assets. UC's total private equity portfolio consisted of $10.2 billion in commitments wit 138 active partnerships from 1979 through March 31, 2015. Its net asset value as of March 31, 2015 was $4.2 billion. It has produced $5.3 billion in profits and generated a total return of 10.3% for the 10-year period ended March 31, 2015. As of June 30, 2015, UC had more than $6.2 billion in hedge funds – including 24% through its general endowment fund, 6% through its employee pension plan, and 10% through its Total Return Investment Pool (TRIP). While UC does not disclose the fees it pays private equity or hedge fund managers, AFSCME conducted an analysis of UC's hedge fund investments over the past 12 years just through its general endowment and pension funds, and estimated UC paid out approx. $1 billion in hedge fund fees to partners.

WHY THIS IS NEEDED

All public pension plans are funded by employee contributions and taxpayer dollars. These funds pay significant fees to its alternative investment general partners but lack sufficient insight into the amoun and nature of those fees. The investment portfolios of California's public pension plans require certain levels of returns to fund constitutionally guaranteed benefits for government workers. Both management and carried interest payments to general partners decrease the net returns on the portfolio. If net returns of the portfolic are reported to pension plans without specific disclosure of the amount of fees paid to general partners, public pension plans have no means of assessing whether the amount of compensation paid to private equity managers or hedge fund managers is appropriate.

SUPPORT

American Federation of State, County and Municipal Employees (AFSCME) Local 2399 – Co-Sponsor