

Report to
California Public Employees' Retirement System (CalPERS)
Regarding
Private Equity Compliance Review

June 10, 2015

*This report is to be considered confidential and use thereof is restricted to CalPERS.
We have no obligation to update this report for events and circumstances occurring after the date of this report.*

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INTRODUCTION

FTI Consulting, Inc. (“FTI”) was retained by California Public Employees’ Retirement System (“CalPERS”) to perform onsite compliance review relating to certain specified areas of the following private equity firms (collectively as “PE Firms”): Apollo Global Management (“Apollo”), The Blackstone Group (“Blackstone”), Carlyle Group (“Carlyle”), Cerberus Capital Management, L.P. (“Cerberus”) and CVC Capital Partners (“CVC”).

The results of our work performed to date and the relevant observations are memorialized in this report (“Report”). In the individual sections of this Report, we set forth the documents reviewed and the procedures performed for each area of inquiry.

SCOPE OF SERVICE

Our procedures performed were set forth in the CalPERS Letter of Engagement #10 for Contract Number 2011-6094 CalPERS Investment Office Project: Private Equity Program (“PE”) – Special Project – Contract & Regulatory Compliance Review, and as discussed below in this report, our detailed regulatory and compliance review addresses the following areas:

1. Assessment of the severity of SEC examination findings if applicable, and controls and enhancements implemented in response.
2. Assessment of the severity of most recent mock exam or compliance review findings if applicable, and controls and enhancements implemented in response.
3. Management fee calculation; including the offsets and determining whether it is in accordance with the LPA; acceleration or continuation of fees after exit.
4. Transaction Fees or other types of fees and any payments, including those made to affiliates, (other than those applied as management fee offsets) and determination of whether they should not be subject to management fee offset, and are in accordance with relevant policies and agreements (including LPA), and review any related disclosures.
5. Contribution and proceed distributions and determination of whether they follow the waterfall in the LPA.
6. Cross-fund investments and policies, procedures and related disclosures.

7. Allocation of fund fees and expenses in accordance with the LPA or other policies and related disclosures.
8. Valuation processes at year end and at interim periods, including any valuations that are performed at non-reporting periods.
9. Compliance with CalPERS side letter and Placement Agent Disclosure form and the process for ensuring compliance with side letter agreements.
10. Key financial reporting processes and relevant policies and procedures.
11. Recent material changes to firm-level policies and procedures related to compliance, valuation, management fees, distributions, expense and investment allocation, and fee reimbursements any.

DISCLAIMER

The information contained herein has been prepared based upon financial and other data obtained by FTI Consulting, Inc. (“FTI”) from the PE Firms. FTI further relied on the assurance of management and staff of the PE Firms that they were unaware of any facts that would make the information provided to FTI by them incomplete or misleading.

The work performed has been limited to the specific activities that you requested. Other analyses may be necessary for you to adequately formulate a basis to support your conclusions, regarding any actions, which may or may not be taken by CalPERS. Any decisions resulting from the findings in this Report rest entirely with CalPERS – we make no representation as to the adequacy of the work performed for you.

With respect to any financial information, historic or prospective, our work did not constitute an examination, review or compilation in accordance with standards established by the American Institute of Certified Public Accountants (“AICPA”). Further, the work involved cannot be expected to identify errors, irregularities or illegal acts, including fraud or defalcations that may exist. Accordingly, FTI cannot and does not express an opinion or any other form of assurance on the financial information and does not assume any responsibility for the accuracy or correctness of the historical and projected financial data, information and assessments upon which the Report is presented. Additionally, we make no representations regarding questions of

legal interpretation. The analyses we have performed should not be taken to supplant any additional analyses that you should undertake in your consideration of these findings.

PROCEDURES PERFORMED

FTI prepared and CalPERS approved Work Plan (Appendix H) and Management Questionnaire (Appendix G) as a guideline for our onsite compliance review. The Work Plan details the documents requested and specific review and testing procedures to address each of the areas described in our scope of services.

FTI reviewed documents received from CalPERS including the LPA, fund audited financial statements, advisory board reports and capital account statements and then we provided the Management Questionnaire to point person(s) at each of the PE Firms as identified by CalPERS. FTI also chose a sample fund and portfolio company to test calculations of, but not limited to, the allocation of fees, investment allocations, management fees and distributions. In some cases and after consultation with us, the PE Firm chose a different portfolio company that was more relevant to our testing.

FTI met with personnel at each PE Firm (See Appendix F for comprehensive list of personnel), which included the PE Firm's private equity compliance and finance personnel, such as their private equity chief compliance officer and private equity chief financial officer, and other PE Firm personnel as deemed necessary.

For each area of our scope, FTI requested and reviewed relevant documents, which included, but were not limited to: Limited Partnership Agreement ("LPA"), financial statements, sample calculations and policy and procedures related to: compliance, valuation, management fees, distributions, expense and investment allocation, and fee reimbursements. In certain instances, we had follow-up communications with the PE Firms after our site visit, either because not all information was readily available during our visit (e.g. Apollo) or we had additional questions after analyzing the data we received (e.g. Blackstone.) Additional detail of documents reviewed specific to each PE Firm is included in the Appendices A-E.

FINDINGS

Our findings and observations are summarized in the matrix below, followed by more in depth discussion in the following section. Check marks (✓) indicate that the PE Firm satisfactorily met our test without exception.

Topic	Procedures	Apollo	Blackstone	Carlyle	Cerberus	CVC
SEC Exam	SEC exam	✓	✓	<i>No Exam during relevant period</i>	<i>No Exam</i>	<i>N/A (Not SEC Registered)</i>
	Addressed deficiencies (if any)	✓	✓	<i>No Exam during relevant period</i>	<i>No Exam</i>	<i>N/A (Not SEC Registered)</i>
Mock Exam/ Compliance Review	Mock exam or compliance review	✓	✓	✓	✓	<i>None</i>
	Addressed recommendations (if any)	✓	<i>One exception. See below for details</i>	✓	✓	<i>None</i>
Management fee calculation, including offsets	Year end management fee with offsets provided	✓	✓	✓	✓	✓
	Agreed calculation to LPA	✓	✓	✓	✓	✓
	Tested Calculations (no exceptions noted)	✓	✓	✓	✓	✓
	Manager cannot continue to earn fees on exited investments	✓	✓	✓	✓	✓
	Offsets that exceed management fees do not benefit GP/Affiliates	✓	✓	✓	✓	✓
	No fees that give rise to conflict of interest	✓	✓	✓	✓	✓
	Manager cannot accelerate fees upon exit	<i>Fees partially offset. See detail below</i>	<i>Fees offset. See detail below</i>	<i>Monitoring Fees upon IPO. See detail below</i>	✓	✓

Topic	Procedures	Apollo	Blackstone	Carlyle	Cerberus	CVC
Portfolio company transaction fees and payments, other than those applied as (flowing to) management fee offsets	Provided detail for fees (including salary and travel) other than those that offset	√	√	√	√	√
	No related/affiliated party that receive payment from portfolio companies, if yes details of affiliated companies payments provided	<i>Apollo Consulting. See detail below</i>	<i>Blackstone Affiliates. See detail below</i>	√	<i>Cerberus Affiliates. See detail below</i>	√
	Agreed to terms of LPA/ Other Policies or Agreements	√	√	√	√	√
	Basis for fee is at cost or market rates	√	<i>Historical Overhead Cost. See detail below</i>	√	√	√
	Basis for fee precludes double charge across any co-invest vehicles	√	√	√	√	√
	Disclosures	<i>No Disclosure of amounts paid and Price Terms</i>	<i>No Disclosure regarding Price Terms</i>	√	√	<i>No Disclosure regarding Price Terms</i>
	No significant change to relevant policy or procedure	√	√	√	√	√
	Distributions of capital contributions and investment proceeds; waterfall distributions	Agreed to terms of the LPA	√	√	√	√
Tested Calculations (no exceptions noted)		√	√	√	√	√
No significant change to relevant policy or procedure		√	√	√	√	√
Cross-fund investments	Received example of cross fund investment	√	√	√	√	√

Topic	Procedures	Apollo	Blackstone	Carlyle	Cerberus	CVC
	Agreed cross fund allocation to terms of LPA	✓	✓	✓	✓	✓
	Tested Allocations (no exceptions noted)	✓	✓	✓	✓	✓
	Disclosures of Allocation Methodology	<i>Not disclosed. See detail below</i>	<i>Not disclosed. See detail below</i>	<i>Not disclosed. See detail below</i>	<i>Not disclosed. See detail below</i>	<i>Not disclosed. See detail below</i>
	New fund cannot invest in portfolio company in existing fund	<i>Allowed. See detail below</i>	<i>Allowed. See detail below</i>	<i>Allowed. See detail below</i>	<i>Allowed. See detail below</i>	<i>Allowed. See detail below</i>
	No significant change to relevant policy or procedure	✓	✓	✓	✓	✓
Allocation of fund fees and expenses	Received allocation of fund income/ expenses	✓	✓	✓	✓	<i>N/A</i>
	Agreed to terms of the LPA/Policies	✓	✓	✓	✓	✓
	Tested Calculations (no exceptions noted)	✓	✓	✓	✓	<i>N/A</i>
	Disclosures of Allocation Methodology	<i>No disclosure</i>	<i>No disclosure</i>	<i>No disclosure</i>	<i>No disclosure</i>	<i>N/A</i>
	No significant change to relevant policy or procedure	✓	✓	✓	✓	✓
Valuation	Received sample valuations at quarter and year end	✓	✓	✓	✓	✓
	Agreed valuation methodology to terms of valuation policy	✓	✓	✓	✓	✓
	Tested valuation at different period ends for Consistency	✓	✓	✓	✓	✓
	IRR calculated only quarter end	✓	✓	✓	✓	✓

Topic	Procedures	Apollo	Blackstone	Carlyle	Cerberus	CVC
	Third Party Review	✓	✓	✓	✓	<i>No Third Party Review</i>
	No significant change to relevant policy or procedure	✓	✓	✓	✓	✓
Key financial reporting processes	Review Policies/Procedures	✓	✓	✓	✓	✓
	No significant change to relevant policy or procedure	✓	✓	✓	✓	✓
	SOC1/SSEA16/SOX	✓	✓	✓	✓	✓
Compliance with CalPERS Side Letter and Placement Agent Disclosure	Confirmed compliance with Side Letter and PAD	✓	✓	✓	✓	✓
	Confirmed PAD was completed if placement agent was used	✓	✓	✓	✓	✓
	Formal Process for Side Letter Compliance Review	<i>No formal process</i>	✓	<i>No formal process</i>	✓	✓
	No significant change to relevant policy or procedure related to Side Letters	✓	✓	✓	✓	✓
Additional Inquiries	No undisclosed changes to LPA	✓	✓	✓	✓	✓
	Notice was given for all events that require notice	✓	✓	✓	✓	✓