

J.J. Jelincic  
Member, Board of Administration  
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Hayward, California 94544

August 23, 2015

Via Email and USPS

Anne Stausboll  
Chief Executive Officer  
California Public Employees' Retirement System  
400 "Q" Street, Room 3340  
Sacramento, California 95811

Dear Anne:

I am writing to express my dismay regarding what can only be regarded as a failure of your investment staff to perform adequately during the August Investment Committee meeting. In particular, Real Desrochers and Christine Gogan offered inaccurate responses to questions I posed, or refused to answer them at all. Moreover, their overall tone toward me was one of condescension, which is unacceptable.

During agenda item 9(a), I asked Real and Christine multiple times and in multiple ways to confirm a basic feature of virtually all PE fund management fee offset provisions. I was attempting to verify that, if a private equity manager receives a fee from a portfolio company (a "portfolio company fee"), and if that fee is 100 percent offset against the management fee, then the manager receives the same total fee compensation (management fee + portfolio company fee) that the manager would have received absent the portfolio company fee.

Since the meeting, I have verified my understanding that the cash flows do, in fact work as I was trying to confirm from your staff. This leaves me all the more disturbed that your staff denied this fact repeatedly. Here is an excerpt of our exchange that reflects their denial:

**JELINCIC:** And, to the extent the GP collected money from the portfolio company and shared it with the LP as an offset, then the total that the GP would have collected would have been the same. Because he could have collected 100 from the LPs. Instead he collected 50 from the LPs. The portfolio companies gave the GP the LPs' credit for that 50 and he still wound up with his 100.

GOGAN: If you could, Mr. Jelincic, just boil down the essence of the question again and Real and I will do our best to answer if from the theoretical prospective.

JELINCIC: If the GP collects from the portfolio company and uses that money to offset the LPs' management fee, so it takes it from one pocket and credits it to the other pocket, the total fees that the GP collects will be the same, assuming it's a 100 percent offset. When you go back...you don't agree? I mean if the assumption's wrong...

DESROCHERS: No. I don't agree.

JELINCIC: Let me give a specific...Management fee is 100. Fees to the portfolio company is 50. There is 100 percent offset to the LPs. So what then happens is that the GP has collected 50 from the portfolio companies, and he will collect the other 50 from the LPs, because that part has not been offset. So he will have collected the 100. Correct?

Desrochers: No. He will collect 50.

JELINCIC: So if the management fee is 100, he collects 50 from the portfolio companies...

DESROCHERS: No, he offsets the management fee of 100 by the 50 million dollars that he collected from the portfolio companies

JELINCIC: OK, so he offsets 50 of the management fee. What happens to the other 50 of the management fee?

GOGAN: It is paid by the limited partners.

JELINCIC: OK, so the GP ultimately gets 100. He gets 50 from the portfolio companies, 50 from the LPs. Right?

DESROCHERS: No

The failure of staff to correctly answer my question about management fee offsets raises fundamental questions of their competency. They are negotiating these fund contract provisions on a daily basis but do not seem to understand the most basic aspects of their economics. Moreover, our exchange was so lengthy, and I repeated my question so many times in different ways that the opportunity for misunderstanding was non-existent. I am also troubled for reasons that go beyond the issue of basic competency. By telling the Board that we are receiving a better deal than we actually are, staff is perpetuating the talking points and mythology of PE fund managers, who are continuously—and largely successfully—trying to convince the limited partners that they receive a more favorable deal than they actually do. The role of the CalPERS staff, it seems to me, is not to propagate GP propaganda to the board but to guard against it

Subsequent to the exchange about management fee offsets, I asked Christine Gogan to explain the mechanics of a management fee waiver, which is a very



common feature of private equity funds. In response, she lectured me about the funds having audited financial statements. I'm glad the statements are audited. That was also true of Enron. The response was disturbingly condescending and evasive. She continued to duck the question, never even acknowledging it, when I asked it a second time, and persisted in her condescension.

Her behavior constitutes a breach of decorum toward the board that I believe that neither the board nor you should tolerate. Moreover, her evasion of my question is doubly disturbing because, just in the last month, the IRS issued regulations indicating that a large portion of waiver structures that PE managers have employed historically constitute an abusive and illegal tax shelter. This raises fundamental ESG issues for the Board. It appears our managers are not meeting their most basic social and governance responsibilities to pay their taxes and CalPERS is potentially abetting them.

I cannot emphasize enough the importance of expeditiously correcting the inaccurate information that was provided to me and the entire committee. I therefore am asking that the same Item 9(a) be put back on the September Investment Committee meeting and that staff use that item to acknowledge the mistakes they made at the August meeting and correct the record with respect to both management fee offsets and management fee waivers. I also believe it is critical that the staff acknowledge their breach of decorum, which goes beyond just their condescending tone about matters that they, themselves were wrong about, but also included a general posture of implying that my questions about these topics were irrelevant, ill-informed, or silly.

If this matter is not brought forward to the Investment Committee for the September meeting, I will take steps to correct the record in the same public manner in which it was blackened.

Thank you.

A handwritten signature in blue ink, appearing to read "J. J. Jelencic". The signature is fluid and cursive, with the first and last names being more prominent.

CC: Board of Administration