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# CalPERS weighs direct investments in private equity

The $323bn fund is exploring a wide range of options for its long-term private equity strategy

Dietrich Knauth | 18 Jul 2017

The $323bn California Public Employees' Retirement System (**CalPERS**) is exploring making direct investments in private equity, and is considering a wide range of options as it reviews its long-term strategy for the asset class.

At an offsite meeting in Monterey, California, CalPERS staff discussed options on a continuum from low-risk, high-cost, and relatively simple investments, such as investing in funds of funds, to higher-risk, more complex investments, including direct investment through CalPERS staff. CalPERS noted that direct investments would require very high reliance on expensive internal talent.

CalPERS spokeswoman **Megan White** said that the discussion was meant to be informational for the CalPERS board.

"The board directed staff to look into different approaches to private equity including expanding co-investing and possibility even doing a small amount of direct investing," White said. "Of course, implementing any of

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these strategies would be years away, but staff will come back to board in approximately six months with more information for the board to review."

Board member **J.J. Jelincic** previously told *MMR* that he supported an exploration of direct private equity investment, an approach that has gained some traction among Canadian and European funds, if not in the United States. CalPERS would have to pay high salaries to staff in order for that to happen, which would be a political and public relations challenge, Jelincic said.

"Yes, it would be unusual, but it's not unheard of, and it's not unprecedented," Jelincic said in an interview before the meeting. "The truth is, we pay those salaries anyhow, it's just that we pay them in management fees."

CalPERS CIO **Ted Eliopoulos** plans to recommend setting up a separate vehicle for direct investments and expand the current co-investment program, and will also recommend focusing on opportunities that do not compete with its current private equity investments, such as owning companies for longer than 10 years, and investing in technology and life science companies.

CalPERS staff noted that the fund's influence in mitigating economic and governance issues has declined over time, mainly as a result of limited partners' willingness to allocate increasing amounts to private equity. As the private equity asset class matures, limited partners are targeting concentrated portfolios, and limited partners are basing their decisions on performance and, increasingly, criteria such as transparency and environmental, social and governance (ESG) factors, according to a CalPERS presentation.

CalPERS also noted the increasing concentration of private equity allocations. Typically, limited partners are investing with large and proven private equity firms; the 10 largest private equity funds accounted for 26% of overall fundraising in 2016, up from 19% in 2014, according to a **Prequin** study cited by CalPERS staff. The concentration of assets and talent is the most commonly-cited concern for potential private equity investors, with 64% of respondents in a 2017 **Probitas Partners** survey agreeing that "too much money is pursuing too few attractive opportunities across all areas of private equity."

CalPERS has come under fire for the fees it pays to its private equity managers, and the scrutiny and second-guessing led Eliopoulous to mount a public defense of his investment staff at CalPERS previous board meeting in June (***MMR, 7/14/17***). Whatever strategy it pursues, CalPERS is simultaneously planning to reduce the number of external managers it works with, and those cuts will likely fall heaviest on private equity managers. CalPERS is trying to get from 160 external managers to 100 by 2020, and most of its external managers work in private equity, White said.

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