

Opinion: Time to shed light on CalPERS' private equity investments

By Peter Scheer

The public has grown accustomed to “pay to play” scandals and other misconduct at CalPERS, the nation’s largest public employee pension plan with over \$300 million in investments. Still, the former CEO’s guilty plea entered in federal court last week was shocking even by CalPERS’ standards. Frederico Buenrostro, CalPERS’ top official from 2002 to 2008, acknowledged in his plea agreement with the government that he had taken \$200,000 in cash bribes, delivered in paper bags and shoe boxes, to influence CalPERS’ investment decisions in private equity funds.

The paper bags and shoe boxes are a nice touch.

CalPERS and other public employee pensions, struggling to meet soaring obligations to retirees, have turned increasingly to alternative investments, and in particular to private equity deals, in order to boost their overall rates of return. Financial experts disagree about whether this strategy (also popular among college and university endowments) is sound or poses too much risk for “defined benefit” pensions promising specific benefit payments upon retirement. (Think Social Security.)

Regardless of the outcome of that debate, there is no debating that private equity investments lack the transparency of investments in stocks, bonds and other publicly traded securities. There is very little that the public doesn’t know, or can’t easily find out, about CalPERS’ investments in publicly traded securities: their value, performance, amount of leverage (and other measures of risk), fees paid, officers’

compensation—to name just a few. But little, if any, of this information is available for private equity deals.

The “private” in private equity means secret. And secrecy in government decisionmaking, rarely a good thing, is especially dangerous when it hides an agency’s decisions about literally billions of dollars of investments. The secrecy surrounding CalPERS’ private equity investments, combined with the temptations facing CalPERS’ investment staff and directors, and the incentives of private equity managers and their agents, creates a climate in which (to put it mildly) the public interest is almost certain to be subordinated to private interests.

Excessive secrecy made it possible for Buenrostro to take bribes from his friend and former CalPERS’ director, Alfred J.R. Villalobos, and for Villalobos, who is also under indictment, to solicit multi-million-dollar finder’s fees from private equity firms for facilitating CalPERS’ investments in their funds. More recently, the Securities and Exchange Commission has raised questions about whether some private equity firms have ripped off their investors, including public pension funds, by accounting improperly for fees paid to related firms. This emerging scandal is also made possible by excessive secrecy—in particular, the secrecy surrounding CalPERS’ partnership agreements with private equity funds.

Secrecy serves the interests of private equity firms far more than the interests of their investor-clients. Nonetheless, public pensions in California—not only CalPERS, but also CalSTRS, the pension fund for public school teachers, and the University of California’s endowment (which funds faculty pensions, among other things)—prevailed on the Legislature in 2007 to enact, for their private equity deals, secrecy protection that is excessive, unnecessary—and, consequently, dangerous. (The law, an amendment to the Public Records Act, is Government Code section 6254.26).

Although some degree of legal protection may be justified for genuine trade secrets and competitively sensitive business strategies (sections 6254.26(a)(1)&(4)), there is no basis for sealing up specifics on the legal and financial arrangements between CalPERS and its private equity funds. (Section 6254.26(a)(6)). The funds, of course, want to keep these records secret so investor A won't be able to find out if investor B got a better deal. That certainly doesn't benefit CalPERS (unless you believe, against all odds, that CalPERS always negotiates the best deal).

More important, secrecy for legal and financial deal terms puts CalPERS at a huge disadvantage in monitoring its private equity investments. The fund managers know everything about the fund investments, while CalPERS knows almost nothing. This all but assures that if an investment is experiencing severe but undisclosed financial difficulties, CalPERS won't learn of it (until too late). And this all but assures that if CalPERS is getting ripped off—whether due to fraud or mistake, whether on the part of the private equity firm or third-parties—CalPERS will never detect it.

There is no substitute for transparency to uncover and deter abuse in financial investments. It's time to shed some light on CalPERS' private equity deals.

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