THE BROOKINGS INSTITUTION

CAN AMERICA GET ITS ENTREPRENEURIAL GROOVE BACK?

A DISCUSSION ABOUT PRIVATE CAPITAL'S ROLE IN THE ECONOMY

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PANEL TWO: CAPITAL'S ROLE IN STIMULATING ECONOMIC GROWTH

Moderator:

JONCARLO MARK
Founder
Upwelling Capital

Panelists:

RICHARD P. JAFFE
Member, Executive Board, Association for Corporate Growth
Partner, Duane Morris LLP

HEATHER SLAVKIN
Senior Legal and Policy Advisor, Office of
Investment
AFL-CIO

HARRY WILSON
Chief Executive Officer
MAEVA Advisors

MARK WISEMAN
Executive Vice President
Canada Pension Plan Investment Board

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MR. MARK: My name is Joncarlo Mark. I recently founded a company called Upwelling Capital Group, after 12 years working with the California Public Employees Retirement System. I'm pretty excited, because I do have relatives from the "schmatta business," (laughter) -- so I'm hopefully going to be successful with my business.

This is a great panel in that represented on this panel are people from the legal world, labor, Wall Street, and institutional investors.

To my immediate right is Richard Jaffe. He's had a long distinguished career as one of the United States' leading attorneys in the business world. He recently joined the law firm of Duane Morris in Philadelphia, where he practices corporate law, with a focus in the areas of private equity, M&A, divestitures, corporate finance and venture capital. He also is on the executive board of the Association for Corporate Growth, and has played a pretty important role in corporate governance overall. And he chairs an advisory board for corporate governance at the Corporate Governance Center at Drexel University's LeBow School of Business.

Next to him is Heather Slavkin, who is the senior legal and policy advisor for the AFL-CIO's Office of Investment. Ms. Slavkin's work focuses on legal, regulatory and corporate governance issues that impact union and other workers -- worker-based pension, health, and saving funds.

Next to her is Harry Wilson, who is chairman and CEO of MAEVA Advisors, a turnaround and restructuring company. Harry has played a wide variety of roles at four highly distinguished firms, including Goldman Sachs, Clayton Dubilier, the Blackstone Group, and Silver Point. In 2009 Harry agreed to serve as the sole Republican member of the President's Auto Task Force, which is the group responsible for overhauling GM and Chrysler. And in 2010 Harry also ran as the Republican candidate for the New York comptroller position.

Next to Harry is Mark Wiseman. Mark Wiseman is the executive vice president of investments at the Canadian Pension Plan Investment Board, which might be the most important institutional investor in the world at this point in time. And he's responsible for all the investment activities of CPP's Investment Board, including public market investments, private investments, real estate and infrastructure. Prior to joining CPP, Mark was head of private equity with Ontario Teachers. And mark was also the former chairman of the Institutional Limited Partners Association, a role that he graciously handed to me -- by vote -- in 2007.

So, what's great about this morning is we've had a really great overview of some of the issues that are going on in the private capital world. One point that I would like to emphasize from an institutional standpoint is the reason why you've seen these numbers -- a trillion dollars of dry powder, globally, $500 billion of U.S.-oriented private capital that's sitting in dry powder -- is because the institutional investor community globally has seen the importance -- first and foremost from a returns standpoint -- of private equity.

And just to give you some evidence of this, when I joined CalPERS in 1999, the allocation of private equity was roughly 4 percent. Today that allocation is 14 percent. The program has grown from $10 billion to $50 billion in total exposure. That's the market value, plus the unfunded.

In 1999 CPP didn't even exist -- right, Mark? And today what's the size of CPP's total program in private group?

MR. WISEMAN: Private capital would be -- not including real estate -- $38 billion invested. Private equity would comprise $22 billion of that 38 invested.

MR. MARK: So, to echo Michael's comments about the flow of capital, CPP didn't exist 12 years ago. Today they have a staff of 140 people just focused on private investing -- correct?

And you can see the ramp from CalPERS and other institutions, because in a world where a lot of public institutions, a lot of public pension plans are underfunded, all roads point to private capital, private equity, where the returns, if done properly, generate a return in excess of what they can get in the public markets.

So I do believe that you'll continue to see this flow. A lot of the capital's been committed. It's sitting there. So we have -- there is a tremendous amount of capital available.

But I think what I'd like to do with this panel is really talk more granular, from "we know the money's out there," to getting to some evidence of how that capital is being put to work. And one point that Michael made earlier today is when people hear about private equity, a lot of times they think of the big, bulge bracket firms that have gotten a lot of attention on their highly levered deals. But the reality is that -- a recent article came out in PitchBook, which is an aggregator of private equity industry information -- that of that $450, $500 billion of dry powder, 90 percent of that is committed to firms that operate in the middle market. So these are firms that most of the people in this audience probably haven't heard of. Richard, in his role with the ACG represents many of these firms.

So I'm going to turn it over to you, Richard. If you'll just give a brief background of ACG, and what their role is, and what they're seeing in the market.

MR. JAFFE: Great. So, although I'm a full-time lawyer, my partners sometimes think I'm a full-time ACG member.

ACG is an organization of about 14,000 members, with 54 chapters. It's a global organization that focuses on the middle market. And we had a mission that about a year ago was three paragraphs. And we had a strategic planning process we undertook. And our mission now is driving middle market growth. And that's the focus of ACG.

Its members are professionals in private equity funds, banks, corporations, and their supported by advisors like lawyers -- you always need lawyers -- (laughter) -- accountants, and investment bankers. And we accomplish our goals by providing content education for our members. And we also provide opportunities for our members to get together to develop relationships. Because if you're in this business, it's a relationship business.

And our focus is -- as Joncarlo said -- on the middle market, where we think there's an enormous amount of activity.

Just to give you an example, about two years ago I was talking to Andrew Ross Sorkin. He was on his book tour for *Too Big to Fail*. And he writes an online daily column and deal book. And it focuses on KKR and Blackstone, and the larger funds. And I said to him, "Andrew -- why aren't you writing about the middle market? That's really where a vast amount of activity is occurring." And he looked at me and he said, "Richard -- it's not sexy." (Laughter) And that's right -- it's not.

But it is Middle-America. And we're finding the funds that I work with are very, very active in growing the middle market, the small or medium-sized companies.

There's also an issue of, ASo what's the middle market?@ And you can talk to anyone on this panel and we'll give you different definitions. But it's principally companies with operating profits or (inaudible) $20 million or less. It's companies with revenues of $10 million to a billion. It's total enterprise value of $25 to $200 million.

So it's a huge number of companies across the country. And that's what private equity is focused on, in middle market.

MR. MARK: And what do the private equity sponsors bring to the table that is different than what a KKO or a Blackstone is bringing to the table with the companies they invest in?

MR. JAFFE: Well, the companies are different. I think that's really the differentiation. It's companies that need more guidance. And I think Michael Klein really articulated -- he kind of eviscerated what I was going to say, but I'll reiterate it -- it's, they bring capital, which is really important. But it's more, it's guidance, and it's more disciplined, and it's opening up the networks that they have so that they can help to build and take companies that really need this kind of discipline and molding, and control that growth, and help them grow.

And there are numerous examples. And I think that's one of the things we're trying to accomplish at ACG, is getting those companies, examples, out there to really educate the public.

MR. MARK: So there are two forms of private capital we were talking about earlier today. One was that held with the private equity firms, but also the corporations and the trillion dollars -- this elusive capital sitting on these balance sheets.

And I'll turn it over to Harry. Harry, what are the hurdles that are out there that are creating barriers for that capital to flow freely into the market?

MR. WILSON: Sure. Well, I think there -- you know, there's a lot of discussion in the political debate currently about tax policy and the like, and regulatory policy. And I think that's part of it. But I think it's much broader than that, much less partisan than that -- which is, you know, I think the fundamental problem for private capital today is the absence of aggregate demand. And when you talk to portfolio companies or investors or consumers, that's a fundamental challenge -- driven by, I think, an abundance of excess leverage in the consumer space, whether it's at the household level in the housing sector, or at the consumer level.

And as a result, demand -- consumer demand -- is not strong enough to drive, you know, a greater supply of product, and therefore a greater basis for investment. And so I think you've got this kind of fundamental problem.

And then you've got the second issue which, when paired with the weakness of aggregate demand, is, I think, you know, very near fatal -- which is the uncertainty, both on the fiscal side and the regulatory side, that comes out of Washington.

And I see the combination of those two things really creates a very uncertain environment. And when you think about long-term investments particularly, which I think we need more of in the economy, it's particularly, you know, negative.

MR. MARK: Go ahead, Mark.

MR. WISEMAN: Yeah -- can I jump in on that a little bit? Because I want to -- it picks up on a point more broadly, as a global institutional investor, and Michael's answer to the question earlier, in his talk.

I think the world -- and not just the United States -- is facing an increasing problem of what I can see -- if you want to take it up to a global level -- of what I refer to as "capital protectionism." And, you know, we worry a lot, in terms of the impact on the global economy of trade protectionism. And you have a body you can go to, the WTO, and a bunch of treaties and other things, to complain about trade protectionism.

But capital protectionism and limitations on the free flow of capital to its most efficient use are growing -- whether it's CFIUS in the United States, Foreign Investment Review in Australia, various tax rules -- and, in fact, other regulations. And Wall Street can look at the U.S. -- the problem is global. In fact, China, as many of you know, is one of the most difficult countries to invest in, with foreign exchange rules. Even if you invest in the public market in China you require something called a "qualified foreign institutional investor license," which I have no idea how to get one, but we've been trying for two-and-a-half years. (Laughter)

And this limitation on the free flow of capital, I believe, is having all kinds -- causing all kinds of dislocations in global markets. And for us, we're an exporter of capital. So we're interested in moving our capital. We have to move our capital outside of our domestic market, because we're $160 billion. Canada represents 2 to 2-1/2 percent of global capital markets. We don't want to own Canada. (Laughter)

So, for us, there's a real opportunity to attract global capital, but exactly the opposite is taking place. And just to use the CFIUS example, we were actually the first -- as far as I know, the first application through CFIUS when we bought Puget Energy in early 2009. And, you know, the U.S. regulators kept telling us, "Well, you guys aren't the target of this. We're not really worried about long-term Canadian capital buying a U.S. utility." But, in fact, it put us at a strong disadvantage against domestic buyers who, quite frankly, didn't exist. Because if you were the seller of that company, you either had to wait for us, even for a 30-day regulatory process, or have certainty of closing with a domestic buyer.

By the way, we went through the process. We got very quick approval. And we have invested a billion dollars into Washington State to build the wind-power project at lower Snake River. A billion dollars, and I don't know how many jobs that's created.

But quite frankly, but for the fact that we were willing to subject ourselves to this process -- which we weren't the target of -- you know, that money would have gone elsewhere. So it's a massive problem.

And it's not just a U.S. problem, quite frankly. It's a problem -- you know, the potash deal in Canada -- for those of you who followed that -- that was turned down by the Canadian government? So I'm not blaming the U.S. here. In fact, the U.S. is one of the better places to put capital. But if we don't globally start looking at protectionism against the free flow of capital the way that we look at trade protectionism as being a huge impediment to economic growth, we're going to be in big trouble.

MR. MARK: Heather, what's the AFL-CIO's perspective on private capital? And how are you trying to balance the needs of your members with this flow of capital into the market?

MS. SLAVKIN: Sure. It's a good question.

And, you know, coming into this panel I tried to come up with the best and most succinct way to answer it, given the fact that we represent more than 55 different labor unions, in almost as many different industries. And we're looking out for their interests, not just as employees of companies that may be purchased by private equity funds, but also as beneficiaries of pension funds who are oftentimes investors in the private equity funds.

And so I've spoken with our affiliates in various industries to try to get a sense of how they feel about this. And, you know, I talked about one prominent person who makes investment decisions and said, you know, "What do you think of the future role of private equity?" And his immediate response was, "There's no role for private equity in helping to rebuild the economy unless they adjust their fee structure."

But I spoke with other unions who have had more positive experiences with private equity. For example, I spoke with the hotel workers union, who see that the Blackstone purchase of Hilton has provided some opportunities for them. And at the same time, the hotel workers have had problems with casinos that were bought by private equity funds, and trying to deal with over-leverage.

And so I think a lot of the time it depends on the perspective of the particular private equity fund going into a business. And what we are really looking for is private equity firms that see the workers as an asset, and see them as partners. Because these are people that oftentimes have been working for a company, that know the business better than the private equity fund coming in to purchase the company, and hope to stay there for a long time into the future. And if the private equity firm looks at their employees as partners in this project, then the workers can help as an asset, and to provide some additional expertise.

On the other hand, if the workers are seen as the enemy, it can cause some major headaches. It can become a big expense for the private equity fund.

MR. MARK: Harry, you've had some experience, through the Task Force and some other investments. Can you talk a little bit about that partnership between labor and private capital.

MR. WILSON: Absolutely. I was going to pick up on Heather's point, which I think is excellent -- and I think totally misunderstood by most people in the business sector, including myself until a few years ago.

And I say that because, yes, I come at it from a career of private capital, but the last few years working intensively with a number of labor unions starting with the UAW, and more recently the Teamsters. And I think there's such an understanding gap between a lot of folks in the private capital space and the folks on the labor side. And they come at it from a perspective expectations of, you know, acrimony, hostility, et cetera, as opposed to really a partnership approach.

And what we try to do -- both in our work with Ron Bloom on the Task Force, with the UAW and General Motors and Chrysler, and what I've tried to do on a couple of transactions since then, is really create a partnership between the union -- the employees -- and management, through equity ownership, board representation, and, you know, shared governance.

And there are a couple things associated with that. One, it's very German model. Those of you familiar with the German corporate structure, it's much more common over there. And I think, frankly, it's worked quite well in a number of instances. But what it does is allows for a, you know, greater sharing of ideas, greater, you know, collaboration, a realization of kind of where the kind of shared incentives are. Sure, at some level, there's a zero-sum game between costs and margins. But at another level there's a lot more to be gained by growth. And if you saw Michael Klein's chart from the last presentation, half the returns for private capital deals that were cited on that one slide were driven by sales growth, and a relatively small percentage was driven by margin enhancement.

So this concept of kind of working together as more of a partnership is very valuable.

If you talk to Bob King at the UAW he would say -- and Al Mulally of Ford would agree -- that a lot of the improvements in the new Taurus were driven by improvements that were identified on the factory floor, pointed out by factory workers on the factory floor, and bubbled up to top management, and resulted in design improvements that both improved the cost of the Taurus, improved fuel efficiency, and improved the margins. So that's like a real-world example of how this can be a very fruitful partnership -- if people can get past the kind of preconceived notions that are often false.

MR. MARK: Richard, you and I talked about regulation, and your role in advocating for your members -- private equity firms and the corporations you represent.

What are the two or three things that you are educating people on constantly to help improve the environment for the ACG members?

MR. JAFFE: So, one of the principal things that ACG is doing, we've actually partnered with Private Capital Research, and Josh Lerner, to create a data base of growth stories, principally to help the legislators and shapers of policy to understand how private capital works. And, again, I have to refer to Michael's slide. It's not just investing, growing and selling, recapping. It's what private capital and what private equity managers do once they have an interest in a company.

And that's really the important thing. It's that kind of growth. And it's not trying to create a barrier or eliminate -- or crush the expenses and improve margins. It's to grow the company, to grow the top line. So that's one of the things that we do.

The other thing is, Dodd-Frank was enacted, and it was designed to identify and deal with systemic abuses. And there are those abuses.

But it also casts a very wide net, and it included private equity funds for registration as investment advisors. And what's interesting is it excluded venture capital funds. And I'm still trying to determine the difference between the structure of a private equity fund and a venture fund. I mean, they're structured the same way. It's not that private equity funds invest in securities. They don't manage capital, they call capital. And when it's called, they then invest it. So, the registration as investment advisors didn't seem to me to really add anything, and didn't seem to be meaningful.

As part of this, there was a Form PF, which would have required, in its proposed form, the reporting on a quarterly basis of a variety of information which would have been costly and burdensome, and taken away from the focus of the private equity fund's managers in helping to build the companies.

There was a coalition of groups -- including ACG -- that was able to work the regulators to the final form of Form PF as much less onerous. And it requires now, instead of a quarterly, an annual report.

So the bottom line is, we seek to influence that by educating the policy-makers and shapers.

MR. MARK: Besides Cash for Clunkers II, Harry, anything else the government can do? (Laughter) To free up some more of this capital? Or your perspective on just the environment, in general, in Washington. Is it a leadership hole, or something, that's perhaps being an impediment here to the flow of capital?

MR. WILSON: Sure. So -- for the record, I was opposed to Cash for Clunkers I, and I would be opposed to Cash for Clunkers II.

But I think in terms of, you know, the leadership vacuum and deficit that we see in Washington on both sides of the aisle -- with all due respect to those who are part of that -- you know, I think the frustration a lot of us have in the private sector is when you look at the -- I think the biggest challenge facing our country is our fiscal gap, particularly over the long term.

There are some really commonsense solutions. You know, Simpson-Bowles, Domenici-Rivlin, that are bipartisan, that address our long-term problems, and create both financial stability to avoid the fate of Europe, and real clarity and certainty. And with a handful of exceptions on both sides of the aisle, very few people in Congress have seen the ability to embrace that -- or in the White House, for that matter.

And so I think, to me -- and I think to many people in the business sector -- is having clarity and certainty and a solution on our fiscal deficit is the primary problem. And I think most people have given up hope that they'll see anything of consequence before the election.

MR. MARK: Mark, one of the things that CPP is involved with, as well as CalPERS, and a lot of the other large institutional investors, is the U.N. Principles of Responsible Investing.

Can you talk a little bit about that? And why that's important for CPP? And then I'll turn it over to Heather to talk about labor's role in the UNPRI, as well.

MR. WISEMAN: Sure. The UNPRI, we're a signatory to the UNPRI. And we do look extensively across, not just private investments -- actually, a lot of this activity takes place in our public market side of our business, as well.

And we take a particular view towards that ESG factors -- meaning "environmental, social, and government" factors -- when we invest.

We look at it from not a policy point of view. We look at it from an investment point of view. We are a long-term investor. We're investing our assets for the next 75 years and beyond.

And we believe that as a long-run investor -- not an organization that's going to be trading out of investments on a daily basis, or can trade out of investments on a daily basis -- we believe that in the long run companies and enterprises that pay attention to ESG factors will become more valuable in the long run.

And that's one of the things about being a long-term investor that is -- we can make a difference in terms of the way that we invest. And for us it is all about maximizing long-term return.

And so to take a simple example -- and this, by the way, is one of the reasons that we think disclosure -- so we're a signatory to the Carbon Disclosure Project -- it's one of the reasons we think disclosure is so important, because it can help us make better investment decisions.

So let's take a view of carbon. If one believes that in the long run carbon will be taxed, or the emission of carbon will be taxed or regulated in some way shape or form, it then follows that companies that do a better job controlling carbon emissions will be more valuable. And particularly if they can do that efficiently. And so we have our ESG folks actually sitting inside our fundamental research teams. And they're looking, so that we can put those types of factors into our investment decision-making, so that we can pick those firms that we believe will be more valuable in the long run.

We don't screen stocks. We don't choose to make investments for any public policy reason. That we can leave to the politicians to make public policy. We're all about maximizing long-term return. And we think companies that manage environmental risks well, that manage their workforces well, and that have good governance practices will be more valuable in the long run.

And that's why long-term capital that's provided by institutions like ours can take a very, very different view of investing. And we're not the guys -- back to Michael Klein's comment -- we're not the guys flipping stocks nine times a day. We're investors. And there aren't enough of us left.

MR. MARK: Heather, a big part of ESG has to do with how you treat your workforce. What specifically are the key things that you'd like to see private equity firms consider as they put their capital to work as it relates to your members, and labor in general?

MS. SLAVKIN: Wow, that's a big question.

You know, I think I touched on earlier the importance of looking at your employees as partners, and seeing them as a resource when you go into a firm. In addition, there are the interests of pension beneficiaries, and the interest of the trustees of the pension funds in ensuring that they have the information, the transparency, necessary to make informed investment decisions. So, you know, labor is looking at investing and at private capital from both perspectives.

And I wanted to actually build on the UNPRI conversation, and talk for a second about something that the AFL-CIO's been involved in, trying to be a bit more proactive, actually, in terms of investing in a responsible way.

And one of the things that we've done recently is we've partnered with the Clinton Global Initiative, and with the Center for American Progress, and American Federation of Teachers, and committed to working to get workers' capital up to $10 billion in workers' capital deployed in energy-efficient investment strategies to put people back to work in America, and to help improve and clean up the environment. And we've actually already gotten a billion dollars in commitments from CalPERS and CalSTERS. And my colleagues are working hard to try to get up to that $10 billion mark as quickly as possible.

So we're really looking for more proactive ways to try to push to create jobs, and create a cleaner environment.

MR. WISEMAN: I think it's an important contrast. Because there is a difference in what you're saying and what we're saying. And I think it's important to understand it's a distinction.

You know, personally, I like the idea of there being a cleaner environment. But for my beneficiaries, 17 million of them, if we can get to that end through making better investment decisions, that's great. But we're not -- and we can't be -- in the role of making those policy decisions.

So we're looking for undervalued companies. And if that movement exists that says companies that are good in terms of managing their environmental exposures will be more valuable, that we'll take into consideration.

But that's the real locus of the debate, I think, between public policy and investing. And it's one of the things, interestingly, in the U.S. that I think there's much more of a struggle with than there is north of the border, where our mandate is clearly an investment mandate. We see that as having a good end, but to me, it makes it less confusing in terms of how we think about deploying our capital.

MR. WILSON: If I can jump in -- isn't a key distinction there one of fiduciary responsibility? Your fiduciary responsibility is to maximize --

MR. WISEMAN: Absolutely.

MR. WILSON: -- returns for your beneficiaries.

Your fiduciary responsibility is broader.

MS. SLAVKIN: (Inaudible)

MR. WILSON: You want to do that, but you also have a broader mission to your members, to your 55 member unions.

And that's, I think -- to tie it back to private capital -- that's one of the great things about private capital, because the fiduciary responsibility is so much clearer than you have in, say, a public company. And I think that's something that I think is really kind of a bedrock issue for everybody on this panel, but also everybody in this room, is how do you make sure that that fiduciary responsibility is both aligned with the organization's goals, as well as kind of, ultimately, you know, kind of more beneficial on a broader basis.

MR. MARK: And when it comes to reputation issues of private equity, Harry, what do you think needs to occur for there to be an enhanced image? I mean, clearly, it sounds like capital is flowing, jobs are being created. How come it just seems that the image is so down in the industry? And what needs to happen to change that?

MR. WILSON: Sure. I think it's a couple things. And this is -- again, I'm having the benefit of having spent most of my career there, but having now a different perspective, is that most people in business, in general, and particularly in private capital, shy away from the media. Do not want to be in the press, do not want to be covered. If they're covered, it's for a, you know, ostentatious birthday party or something that they'd rather people not know about, other than the guests.

And so it is a real mentality -- I remember in the first 15 years of my career, the only appropriate answer to the press was always "No comment." And for good reasons. But as a result, that kind of mentality means that you don't trumpet the good things about the industry.

And there are a lot of great stories. Lex Smart, from CDNR, is a fantastic story that a lot of people don't fully appreciate. Steve Klinsky, New Mountain, talks about the 8,000 net jobs his firm has created, and they're tenured -- net jobs, net of all reductions and restructurings. And those are great stories that don't get out there very much.

And so the sexy narrative is the $15 billion deal, and all the things that go along with that. The really interesting part of the industry is the part that leads to, you know, job creation and real enhancements at the company level. And sometimes those are efficiencies, because companies that are not efficient die over time. But a lot of times they're growth and improvements.

So I think one is a PR strategy, I think is important. I think secondly there are -- you know, I think the industry does have some marginal players. And I think the press for higher returns among institutional investors has led towards an over-allocation to private equity.

In my opinion, there are a handful -- you know, Michael Klein's point about the top performers generate all the returns in the industry is basically true. And so there are a handful of firms that have demonstrated for many, many years that they're outstanding. And those firms should manage large amounts of capital. And there are a lot of firms that have, frankly, not done very well, and don't justify the fee stream.

It's hard to outperform the market, a relatively efficient market, on a 2&20 structure. Some people can. Not many. And the rest shouldn't be in the industry, in my opinion.

And so, kind of a rationalization of the industry -- which I think is happening now because of the over commitments of institutional investors to private equity -- will be an important part of, you know, the industry improving and growing again.

MR. MARK: We have a few minutes left. Can we take a few questions from the audience?

Anybody have any questions?

MR. LITAN: Hi. This is Bob Litan. I'll be on the next panel.

But actually, let me pick up on your point that you were just making about relatively few PE firms are successful, and most of them aren't. That's certainly our foundation's experience. We've put a lot of money into private equity, and also venture capital.

But your numbers imply a dramatic reallocation of money. I mean, if institutional money is going to go away from the losers, where's it going to go? Into direct investing? Into other kinds of vehicles?

But let's just be clear -- you're talking about a huge movement, potentially, of funds out of this industry.

MR. WILSON: Yes -- great question. And I'll answer it very specifically.

As Joncarlo said in the beginning, I ran for New York State Comptroller last year, narrowly unsuccessfully. But I mention that because the State Comptroller is the sole trustee of $130 billion pension fund -- at the time. And one thing I pointed out was that the fund pays -- the fund, for long periods of time, has underperformed its indices. Not even risk-adjusting, it's underperformed its indices, largely because of fees. It pays about -- and I'm going to get these numbers a little bit wrong since it's been a year ago -- but I think it's about $300 million in fees overall.

Now, my recommended strategy was to allocate the vast majority of its capital into passively-managed products, and allocate to a handful of, relatively smaller number, of outstanding performers, who do have higher fee structures but can beat the market on an after-fee basis which, of course, is the only way to look at it. And allocate to those.

Now, that does mean, you know, a lot less capital in private capital, more successful firms doing better. But it also implies a much lower fee structure. And when we did the numbers, that $300 million goes down to like $25 or $30 million. And so it becomes a lot easier to outperform the index when you're not being dragged down by $275 million in fees.

MR. WISEMAN: Or there's another path. And the other path is the one that we've taken -- and for some of the same reasons.

And the other path is saying, "We will hire top managers. But where we can build internal excellence, we will bring it in-house." So -- and we will hire our own teams, and pay them commensurate to what they could make, and incent them the way that they would be incented in the private market. And we'll capture, essentially, the spread, to the benefit of our pensioners.

So let's take infrastructure as an example. Our infrastructure program. Let's use round numbers, just to make the math easy.

Our infrastructure program is just about in excess of $10 billion invested capital. Let's say we could go out an really negotiate well with some infrastructure funds. Instead of paying 2&20, because we're so large, we could pay 1&10. Well, 1 percent management fee is $100 million on $10 billion. And let's assume it returns 10 percent a year, and you pay 10 percent of that profit to the manager, that's another hundred million.

So outsourcing our infrastructure program would cost us $200 million a year. And that would be good negotiation to get there -- in fee and carried interest.

Now, we determined we could actually do just as well hiring a team ourselves. And so we have an internal direct infrastructure investment team. We have about 35 investment professionals located in Toronto and the

U.K. Our total cost, including compensation, incentive, keeping the lights on, travel, et cetera, for that team -- it's a lot, it's a lot. It's about $30 million to run that internal team. And we're paying our top investors, you know, commensurate wages with what they would make working in a fund.

But that $170-ish million per annum is captured to the benefit of our beneficiaries.

That takes a very different governance model, though -- a very different governance model than exists for most institutional investors. Because we have to be nimble, and we have to be able to go in and compete with those funds for talent and for investments. But that's the path that we've taken.

So I think you're right, but there's two ways to get to that end.

MR. WILSON: If I could just -- really quickly on that, too, which I think is a huge point. I totally agree with you -- it's a -- I was approaching it very much from a U.S. mentality, which is you cannot pay people a lot of money, because people will kick and scream. And that is a huge problem. And so you either hire people internally and pay them for performance, or you pay big fees, or you pay in a passively-managed strategy.

But, you know, New York State, for example, doesn't have the capacity to pay people significant amounts of money to attract that kind of talent in the way that your fund can.

MR. WISEMAN: Yes, and I mean, I find it ironic that, you know, that socialist place up north of the 49th parallel (laughter) is kind of, you know, more capitalistic in terms of the way we manage our money than Wall Street.

So, I think you're right. It's just there's another way to get there. Whether the U.S. plans can get there from the right governance perspective to achieve that is another question.

MR. WILSON: I've said for awhile, stop worrying about the Chinese and start worrying about the Canadians. (Laughter)

MR. MARK: Do we have any other questions?

MR. KENNEDY: Hi. Joe Kennedy. I've got a question for Ms. Slavkin.

Did I understand you right -- did I understand you to say that in some cases the trustees of union pensions should accept a lower rate of return in order for job creation -- in return for greater job creation?

MS. SLAVKIN: That wouldn't be in compliance with their fiduciary duty to their trustees. So that's not at all what I mean.

I'm looking at it from the perspective of someone who works for the AFL-CIO and is not a trustee of a pension fund. And so I'm looking out for the interests of my members -- both as workers and employees of companies that are potentially going to be purchased by private equity funds, and as beneficiaries of pension funds who are looking to maximize their returns to provide for their retirement.

MR. MARK: So one of the things that was alluded to in a couple of the earlier talks was the sort of deleterious effects of the sort of boom-bust cycles that's frequently characterized private capital markets. And certainly, the empirical evidence suggests, for instance, productivity gains on private equity-backed firms are considerably less during deals which are done during booms.

Similarly, if you look at the job creation and destruction, the job destruction is much greater in public-private deals which, as Michael showed, are concentrated at the tops of these booms, as well.

Yet, in some sense, you say, who's to blame on this? Is it the private equity guys for trying to go and raise big funds? Or is it the limited partners for getting so excited and exuberant, and sort of jumping in at the tops of the markets, and sort of throwing all sorts of money during these periods?

Do you see any sort of signs and progress that, you know, due to hard experience, or just generally more sophistication, that that sort of boom-bust cycle can be sort of tamed in private capital markets?

MR. WISEMAN: Who gets to answer that one? (Laughter)

MR. JAFFE: The next panel.

MR. WILSON: I'll speak a little bit to it. And I'm sure my fellow panelists will jump in.

But, you know, the fundamental problem -- it's a little bit of a tragedy of the (inaudible) issue, and I actually will put the blame primarily on the limited partners. Because if you can raise the money and get paid a lot for it, why not? Why are we blaming people from taking advantage of market conditions?

And the fundamental problem is -- and it is as institutional investors increasingly have to search for return, and search for lead -- particularly when there's a deficit in their asset-liability mix, and they need a higher return -- you know, they end up chasing the same types of things, whether it's an individual investment, or an investment in a fund, in essentially bidding up the price, or bidding down the return.

And there is a great difficulty, first of all, in getting some degree of coordination between those folks in order to exercise the market power, essentially. And there's another issue called collusion, that is illegal. (Laughter)

And so, you know, it's a market like any other market, where there is supply and demand. And the supply -- to your point earlier, and to Michael's point -- the supply of really good managers is narrow. And it's not that hard to figure out who the good managers are in private markets, because there's a great degree of persistency. So you just have to look at the track record.

And if you picked the top quartile funds last time around and just did that, and said "That's the sole basis of my investment decision," you'd probably be okay. So it's not that complicated a process to get to. So those top funds attract investment, and then can command -- and they'll pick up, the fund managers will pick up, you know, as much of that arbitrage as they can -- or capture as much of that gain as they can.

So, you know, it's the nature of the way that that market works. And, you know, bad on, you know, limited partners for continuing to overpay. And, in my view, how can you blame the GPs for capturing value when they're trying to capture as much value as they can when they create it.

So that's my view.

MR. WISEMAN: There's another real technical issue that came up in >06 and >07, when you saw the flow of capital so much, and that was the equity market was on a tear, so there was a desire for LPs to actually get to their allocation targets. And when their denominator of the overall assets grew so much, there was push to continue to commit more and more and more -- which is actually the absolute worst time to be committing extra amounts of capital when the equity market is very rich.

But it's a very difficult thing for a staffer at a public pension plan to say, "Guess what -- so-and-so's coming back to market. They've generated 20 percent gross return, and they're 15 percent net returns for us over 10, 15 years. I don't think we should commit capital to them because, you know, it's a rich market." It's a very tough decision.

But I think there's a lot of lessons learned from last year, is that there's much more collaboration internally, so that the CIO now is saying, okay, where across the realm of opportunity should I be putting in a new dollar of capital?

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