Moving Forward to Better Serve Our Members

Private Equity Fees and Expense Transparency
Amy Barrett, Eric Lang, Neil Randall, TRS;
Lorelei Graye, Leodoran Financial; Jennifer Choi, Institutional Limited Partners Association; Paul Yett, Hamilton Lane; Suresh Krishnamurthy, State Street
Private Equity Fees and Expense Transparency

**Agenda**

- **Introduction**
- **Panel Discussion**
  - History and issues around private equity fees and expense transparency
  - Industry involvement and perspective
  - TRS Initiatives
Comprehensive Annual Financial Report

- Revisited disclosures given increased reliability of information
- For FY 16, disclosed the following by asset class:
  - Assets Under Management
  - Fees paid from trust (management and performance)
  - Fees netted with returns (management and performance)
- Disclosures consistent with GFOA and GASB guidance

Audits

- Validating fees at 2 funds as a pilot project
- Report results to Audit Committee in FY17 (June or September)
Private Equity Fees and Expense Transparency

PE Overview

- All TRS returns are reported net of fees and expenses
- Common PE waterfalls require the GP to pay back fees prior to earning their carried interest
- TRS is leading LP in this area; as we gain momentum in transparency - the whole industry benefits
- TRS Private Equity performance has been exceptional:

<table>
<thead>
<tr>
<th></th>
<th>3-Year Return</th>
<th>5-Year Return</th>
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<tbody>
<tr>
<td>Private Equity IRR</td>
<td>13.1%</td>
<td>12.6%</td>
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<tr>
<td>Private Equity TWR</td>
<td>12.6%</td>
<td>12.5%</td>
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<tr>
<td>Private Equity Benchmark</td>
<td>10.1%</td>
<td>8.9%</td>
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<tr>
<td>Excess Return</td>
<td>2.5%</td>
<td>3.6%</td>
</tr>
<tr>
<td>TUCS Peer Comparison</td>
<td>16th</td>
<td>10th</td>
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</tbody>
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Source: IRR (State Street as of 6/30/16); TWR (State Street as of 9/30/16)
Private Equity Fees and Expense Transparency

LP Reporting Challenges

- Lack of Consistent Detail in Financials
- PDF Format

### Quarterly Statement Examples

#### Example A

- % of Capital
- Partner %
- Total Capital Commitment
- Capital Contributed to Date (includes transfers)
- Remaining Commitment

**Opening Capital Balance**
- Contributions during the period
- Contributions receivable
- Distributions during the period
- Transfer of Interest
- Syndication Costs

**Investment Results**
- Interest Income
- Management Fees
- Management Fee Offset
- Other Expenses
- Realized Gain/(Loss)
- Deemed Gain/(Loss)
- Change in Unrealized Gain/Loss;
- Net Investment Results
- Unrealized loss on cash escrow
- Equity interest in net operating income and realized gain from investees
- Equity interest in change in unrealized depreciation from investees
- Incentive Allocation
- Closing Capital Balance

#### Example B

**Statement of Changes in Capital Account**
from October 1, 2015 to December 31, 2015

- Capital Commitment
- Capital account balance at October 1, 2015, at cost
- Net operating income (loss)
- Partnership distributions
- Capital account balance at December 31, 2015, at cost
- Net unrealized appreciation of investments at October 1, 2015
- Change in net unrealized appreciation/depreciation of investments
• CEM Benchmarking white paper
  o Proposed a report that would highlight the struggle to identify fees of PE investments
  o Generated to be a “rousing call to action”; the industry needs standardization

• LP Response
  o Strong positive reaction from LPs around the globe
  o Many pensions, including TRS, wanted to collaborate
  o ILPA reached out as our path forward for industry change
Organizational Attitudes

“The lack of reporting consistency among GPs hinders our ability to adequately monitor our PE plan costs.”

<table>
<thead>
<tr>
<th>Change in Concern Levels (Past 2 Years)</th>
<th>Public Pensions</th>
<th>All Other LPs</th>
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<tbody>
<tr>
<td>Concern increased significantly</td>
<td>62%</td>
<td>60%</td>
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<tr>
<td>...and moderately</td>
<td></td>
<td></td>
</tr>
<tr>
<td>for</td>
<td></td>
<td></td>
</tr>
<tr>
<td>of large plans (&gt;5bn)</td>
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<tr>
<td>of midsized plans</td>
<td></td>
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<td>and</td>
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<tr>
<td>of small plans</td>
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Source: 2016 ILPA Members Survey on Fee & Expense Practices
Drivers of Organizational Interest in Reporting

Source: 2016 ILPA Members Survey on Fee & Expense Practices
### Private Equity Fees and Expense Transparency

**ILPA Template: Seeking Standardization of GP Fee Disclosures**

<table>
<thead>
<tr>
<th>Analyzes and Aggregates:</th>
<th>Establishes Standards for Disclosing:</th>
<th>Developed in Consultation With:</th>
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<tbody>
<tr>
<td>- LP investment costs</td>
<td>- Management fees, including itemized offsets</td>
<td>- 50+ LP organizations</td>
</tr>
<tr>
<td>- Economics paid to the management company (including non-arms-length transactions)</td>
<td>- Fund expenses, itemized</td>
<td>- 25+ GP organizations</td>
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<td></td>
<td>- Carried interest, paid and accrued</td>
<td>- 10+ trade associations</td>
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<td></td>
<td>- Fees charged to portfolio companies</td>
<td>- 20+ sample templates</td>
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<td></td>
<td>...on a quarterly basis, to align with LPs’ own fiscal YE and reporting cycles</td>
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Considerations for Implementation

- LP Demand – telegraphing intent, need for additional information, go-forward/new funds
- LPA Negotiation Processes – side letters
- GP modifications – template does not displace Partner’s Capital Account Statement, or supersede the Limited Partnership Agreement
- GP and LP Systems integration – technical debt, legacy system constraints
- Accuracy and verification of provided data
- Other compliance demands on GPs and LPs
### What are the trends, struggles and strategic direction AIS Clients are moving in as the pressure for transparency increases?

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<th><strong>Limited Partners (LP)</strong></th>
<th><strong>General Partners (GP)</strong></th>
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<tr>
<td>• Increased pressure from constituents, board members, stakeholders and legislative regulators to understand and report on private equity management fee, expenses and incentive compensation/carried interest</td>
<td>• Increased pressure from Limited Partners (LP) to provide private equity management fee, expenses and incentive compensation/carried interest data in customized LP templates</td>
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<tr>
<td>• GP Communication and adoption of a single transparency template (ILPA or LP specific) to standardize and streamline the consumption and aggregation of data from many different GPs</td>
<td>• Developing a plan to address various LP requests and requirements and adopting a single scalable means of providing transparency data that may not resolve the needs of all LPs and could impact LP decisions to make future commitments</td>
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<tr>
<td>• Time consuming review of GP supplied fee transparency templates or reviewing financial statements for non-compliant GPs in order to gather required data</td>
<td>• LPs view all of their GPs as one in the same and do not always understand the complexities of operating in multiple legal jurisdictions, fund structures and accounting methodologies</td>
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<tr>
<td>• Need for comprehensive aggregation, analysis and reporting for internal and external use such as Gross and Net IRR, manager level reporting and periodic Limited Partners Agreement (LPA) reviews</td>
<td>• Need for additional resources to not only provide LP required templates and transparency reporting but also to have a strong understanding of the data provided for the inevitable additional inquiries and questions that come with the availability of more data</td>
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### AIS’ role in assisting TRS of Texas with an effective means to capture, report and analyze the true costs of investing in Private Equity

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<tr>
<th><strong>TRS of Texas</strong></th>
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<td>• For the past 5 years, AIS has provided TRS with private equity and real assets management fee reporting on a quarterly basis to assist with CAFR reporting</td>
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<td>• In October 2016, TRS Staff requested that AIS enhance transparency reporting to track ILPA Fee Transparency Templates (Private Equity) and Enhanced QDIF (Real Assets) and capture management fee, expenses, offsets and incentive compensation/carried interest data in a database to facilitate a more controlled environment, real time online access, analysis, reporting and eFront data feeds</td>
</tr>
<tr>
<td>• AIS has committed to providing TRS with enhanced reporting and eFront data feeds by the completion of the Q4 2016 reporting period (March/April 2017) and providing an online solution by the end of 2017</td>
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<td>• AIS is expanding usage of 3rd party Optical Character Recognition (OCR) software to efficiently transfer standard template data into enhanced data review technology to ensure the integrity of the data supplied by GPs meets certain conditional expectations and reasonability validations to change TRS staffs current role of tracking down and collating data to focused analysis</td>
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TRS/ILPA Fee Reporting Template Timeline:

2015

• ILPA Engages TRS GPs to Collaborate on Development of Fee Template
• TRS actively involved with ILPA Committee

2016

• ILPA releases Fee/Expense Template; TRS publicly endorses
• TRS requests its GP begin utilizing the template as part of quarterly reporting

2017

• TRS current compliance rate for active funds is 32%
• TRS expects 80%+ of GPs to provide ILPA template for active funds by June 2017
• TRS develops new analytics to compare fee/expense loads as part of due diligence

Private Equity Fees and Expense Transparency
TRS Leadership

• TRS has been a supporter of ILPA since 2002
• TRS has been ILPA board member since 2011
• TRS was a leading LP in development of ILPA Principles in 2009 which has been endorsed by over 300 GPs and LPs
Speakers Bios
Jennifer Choi, Managing Director, Industry Affairs, Institutional Limited Partners Association (ILPA)

As Managing Director of Industry Affairs for the Institutional Limited Partners Association (ILPA), Jennifer Choi directs the association’s engagement with external industry stakeholders to inform and enhance ILPA’s education, research, membership and advocacy platforms. Ms. Choi also leads the implementation of ILPA’s responses to emerging issues impacting the asset class, including efforts to establish and promote industry best practices.

Prior to joining the ILPA, Ms. Choi served as Vice President of Industry and External Affairs for the Emerging Markets Private Equity Association (EMPEA), where she led the association’s member and industry engagement activities, including efforts to encourage policy frameworks that support the growth of the asset class. As EMPEA’s Research Director, she built the industry’s first global database of private equity activity in the emerging markets. Previously, Ms. Choi was a consultant with Boston-based Stax Inc., leading due diligence engagements and providing advisory services for the U.S. private equity and venture capital industry. Jennifer’s other consulting experience includes organizational development and strategy consulting for clients in the healthcare, financial services and pharmaceutical sectors.

Jennifer holds a Masters in Law and Diplomacy from the Fletcher School at Tufts University and a B.A. summa cum laude in Economics and Political Science from Augustana College.
Lorelei Graye, founder, Leodoran Financial

Lorelei Graye is founder of Leodoran Financial, the plan sponsor consultant for SS&C Conifer Financial Services, and subject matter expert in the private market reporting trends, including investment cost reporting, for institutional investors as well as key issues surrounding public pension policy. Formerly, a reporting officer for the South Carolina Retirement System Investment Commission (RSIC), Lorelei spearheaded the development and implementation of their annual fee collection, validation, and reporting process which was featured in the April 2015 CEM Benchmarking study, “The Time Has Come for Standardized Total Cost Disclosure for Private Equity” [1].

Over the past two years as an industry advocate and strong proponent for standardization, Ms. Graye has travelled extensively to promote best practices with audiences of institutional investor staff, their trustees, and local policymakers. Presentations and media coverage have included the WSJ, FundFire, Governing, Pensions & Investments, The Hedge Fund Law Report, Staying Ahead of the Curve - Cammack Retirement, NCTR, ILPA, APPFA, IMDDA, and the Lowell Milken Institute at UCLA School of Law.

Lorelei holds dual business administration degrees: a bachelor of science majoring in finance and a bachelor of arts with a major in accounting summa cum laude.


Suresh Krishnamurthy, Senior Managing Director of Global Services, State Street

Suresh Krishnamurthy is a Senior Managing Director within Global Services for State Street Corporation. He has over 22 years of product and technology experience in the Financial Services arena across various investment products.

Suresh currently leads our PE/RE IT and Strategy efforts from a business unit perspective with particular focus on advancing product strategy across our LP and GP businesses and driving adoption of future state IT models with our most strategic customers.

Prior to his current role, Suresh managed State Street’s Private Equity Administration for Private Equity/Real Estate Fund of Funds and Limited Partner Services globally as COO.

Previously, Suresh managed Global IT development for Performance Measurement/ Attribution Solutions, data-warehousing and Information delivery in support of the Performance/Analytics group and the Investment Operations Outsourcing businesses.

Prior to joining State Street as part of the acquisition of the investment services business at Deutsche Bank, Suresh headed Technology and Product Management for the Securities Lending and Short Term Investments business at Deustche Bank.

Suresh holds an M.BA. with Distinction from the Leonard N. Stern School of Business at New York University and a B.S. in Electrical Engineering from the University of California at Los Angeles.
Michael Miaskiewicz, Assistant Vice President, State Street

Mike joined State Street in 2007 and is currently responsible for managing a team in the Limited Partner Services group of AIS, providing investment performance and exposure analysis for the alternative investment portfolios of several of State Street’s large institutional clients. In addition to his oversight responsibilities, Mike also provides support to client services and assists senior management with strategic initiatives. Prior to his current role, Mike was a Portfolio Accountant in Institutional Investor Services division until he joined the Private Edge group in 2008 and then the AIS LP Services Team (formerly Private Edge) in 2013. Mike received his Master in Business Administration from Suffolk University and his B.A. from Boston University.
Paul Yett, Managing Director, Hamilton Lane

Paul is a Managing Director at Hamilton Lane, based in the firm’s San Francisco office, where he is involved in both the firm’s investment activities and client relationships. Paul began his career with Hamilton Lane in 1998 in the Due Diligence Department, where he managed the firm’s global venture capital practice and real estate. Paul is an Investment Committee member and manages a number of the firm’s client relationships.

Prior to joining Hamilton Lane, Paul spent four years with Stone Pine Asset Management, LLC, a Denver-based private equity firm, where he was part of a team that managed a direct private equity mezzanine fund under the parent company, FCM Fiduciary Capital Management Company. Paul began his career in Denver as a Lease Accountant with Bramalea U.S. Properties where he covered several of the firm’s U.S. commercial retail properties. Paul received a B.S. in Finance from San Diego State University.

Paul currently serves on the governing board of the Robert Toigo Foundation.