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OCERS announces Pantheon as winner of collaborative procurement for private equity fund of funds mandate; provisionally commits \$50-\$100 million annually for next three years

Upon the recommendation of its chief investment officer, working in collaboration with investment professionals from other public pension plans, the Orange County Employees Retirement System (OCERS) Investment Committee approved the selection of Pantheon as the winning manager in an intense, highly competitive selection process for a private equity fund of funds platform, at its March 26, 2014 meeting.

“We are delighted to see such positive results from this innovative ‘bundled’ procurement process, and will look forward to reviewing final documentation in the next month or so,” said Chuck Packard, the chair of the OCERS board investment committee. “As one of the reviewers attending the semi-finals and finals selection sessions, I can attest to the judges’ unanimous selection of Pantheon in a rigorous selection procedure. Their offer is a game-changer for the industry.”

The Pantheon investment platform will offer public pension plans a flexible private equity portfolio architecture including model portfolios for smaller systems and newcomers to private equity, while enabling consultants and CIOs of larger and more sophisticated public plans to construct individually customized portfolios that complement their other portfolio holdings – and modify them over time. “Pantheon’s investment platform was rated Best in Class by all judges, right along with their solid track record, strong global market presence -- and the size, tenure and experience of the investment team -- giving them superior access to scarce private equity partnerships. It shows up in their performance statistics, all the way down to the underlying GP level. We were impressed that they hold 270 advisory board seats globally,” said Girard Miller, the OCERS chief investment officer.

Best in Class Criteria

To assure a rigorous and comprehensive screening process, the OCERS selection team employed a Best in Class evaluation tool, which included the following criteria:

- Portfolio performance, superior access to successful general partners, portfolio structure, strategy and design
- Product flexibility and fund/platform architecture suitable for use by a diverse community of public pension plans
- Fees, fee structure, alignment of interests and underlying GP fee management
- Best value

One of the objectives of the Best in Class analysis was to assure that the selection process included a comprehensive consideration of all factors likely to result in superior long-term portfolio performance for public plans, and not simply become a low-bid contest focused predominantly on price at the expense of total expected risk-adjusted returns from the overall strategy at the portfolio level, net of fees -- which is a basic criterion reviewers used consistently in their evaluations.

OCERS’ general consultant NEPC assisted the selection team in reviewing the 14 respondents’ historical performance data, and reviewed the 3 finalists in detail all the way through to the

underlying general partnership level. Consultant Allan Martin of NEPC commented that “several of our public pension clients participated in the collaborative selection process and were enthusiastic about the outcome. We expect that Pantheon’s program will be viewed favorably by a number of public plans, ranging from first time investors in private equity looking for a cost-effective broad platform, to larger plans seeking to augment an existing program with targeted geographic or sector mandates”

Pantheon’s proposed fees will result in a substantial (roughly 50%) reduction of fund of funds investment management costs from the levels currently paid our incumbent managers. The total level of savings will depend on OCERS’ later decisions of how much to fund with Pantheon each year, and the level of aggregate investment by other public pension plans. “While striving first to select managers who can achieve superior long-term returns for our portfolios, the California-collaborative procurement was designed to attract lower fees at higher investment levels, and Pantheon’s fee structure was fully responsive to our RFP request,” said Miller.

OCERS required all finalists to quote their fees on *invested* capital, to overcome the frequent industry practice of using committed (and often uninvested) capital to calculate fees. “We have really cut out the J-curve drag from up-front fees on idle capital here. That is just one of the cost-saving benefits available to public plans that follow OCERS’ lead in this bundled procurement,” according to Miller.

“The outcome was actually much better than what the original CIO working group envisioned,” remarked Don Pierce, chief investment officer of the San Bernardino County Employees Retirement System, who was a member of the California CIO team that developed the collaborative RFP strategy and the review panel that evaluated proposals.

The “public pension portfolio procurement (P4)” network and selection process has lived up to its potential to become a game-changer nationally, as several of the unsuccessful bidders have already informed OCERS that they will hereafter restructure their pricing along the lines of their fee quotes. “This will likely result in a permanent downward shift in fund of fund management expenses for public pension funds nationwide, even for public plans that do not take advantage of the attractive terms offered by Pantheon. The OCERS RFP process has ‘moved the market’ through a pro-competitive strategy that will benefit taxpayers, workers and retirees nationwide, in the public interest,” according to investment consultant Jim Link of PFM Advisors, who participated on the finals panel. Link said that “longer term, the national potential for fee reductions industry-wide is even greater if this procurement model and related public pension asset-aggregation strategies become more pervasive. The combination of an attractive fee structure and strong performance versus public market equivalents creates a winning combination for public pension plans.”

Before OCERS and other public pension plans make investments under this program, an independent legal opinion will be obtained to address anti-trust considerations. The OCERS RFP document states that it intends for this opinion to become a public record, to put to rest any concerns other fiduciaries might have regarding that issue.

OCERS’ provisional commitment of \$50 million to \$100 million annually to Pantheon will be subject to subsequent review of the legal opinion and other documents. Staff will also review its overall private equity pacing plan, the optimal timing and structure of Pantheon commitments, and impact on overall fee levels including pricing implications with its incumbent managers, before making its definitive recommendation on the total size of the Pantheon mandate. Subject to future due diligence and OCERS board approval, CIO Miller has declared his willingness to fund Pantheon with a full commitment of \$100 million annually for three consecutive years, if this can be accommodated efficiently and prudently in the overall portfolio.

Miller emphasized that fees and anti-trust issues are really a secondary story here. “As much as we worried at first about how the pricing would come out, and whether we could finally drive a stake in the heart of the anti-trust boogeyman, that’s not the only story here. Pantheon has made a compelling offer to provide small and mid-sized public pension plans a flexible platform enabling those who wish to separately build their own unique private equity portfolios -- and to also get superior access to the industry’s leading private equity partnerships. The pension consulting community should love this platform. By deftly bundling our assets through this unprecedented procurement process and its standout winner, we have opened new doors to achieve superior portfolio returns in what heretofore has been an inefficient and costly asset class for many. And OCERS’ cost savings should exceed our investment division’s entire personnel budget.”

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Located in Santa Ana, California, OCERS is an \$11 billion cost-sharing multiple-employer defined benefit pension plan covering employees of Orange County and 14 other participating public employers. OCERS was established in 1945 and provides retirement, death, disability, and cost of living benefits to more than 40,000 local public employees and their families. For more information about OCERS, visit www.ocers.org.