1 NEW YORK CITY TEACHERS' RETIREMENT SYSTEM
INVESTMENT MEETING
2 held on Thursday, December 6, 2012
at
3 335 Adams Street
Brooklyn, New York
4
5
ATTENDEES:
6
7 MELVYN AARONSON, Chairperson, Trustee, TRS
SANDRA MARCH, Trustee, TRS
8 MONA ROMAIN, Trustee, TRS
PATRICIA REILLY, TRS
9 LARRY SCHLOSS, Comptroller's Office, Trustee
JUSTIN HOLT, Trustee, Finance
10 JANICE EMERY, Trustee, Finance
JAIME SMARR, Trustee, Finance
11 JOEL GILLER, TRS
MARC KATZ, TRS
12 SUSAN STANG, TRS
CATHERINE BANAT, Comptroller's Office
13 JOHN BRIGHT, Comptroller's Office
LIZ CALDAS, Comptroller's Office
14 ADI DIEGI, Comptroller's Office
MARTIN GANTZ, Comptroller's Office
15 SEEMA HINGORANI, Comptroller's Office
THADDEUS McTIGUE, Comptroller's Office
16 KATHY MARTINO, Comptroller's Office
BARRY MILLER, Comptroller's Office
17 EVAN NAHNSEN, Comptroller's Office
YVONNE NELSON, Comptroller's Office
18 ROBERT C. NORTH, JR., Actuary
ROBIN PELLISH, Rocaton
19 CHRIS LYON, Rocaton
MIKE FULVIO, Rocaton
20 MARINA MEKHLIS, Rocaton
RENEE PEARCE, TRS
21 ROBERTA UFFORD, Corporation Counsel
MICHAEL KOENIG, Hamilton Lane
22 STEVE BURNS, Townsend
ISHIKA BANSAL, Townsend
23 STEVE NOVICK, Courtland
BILL FOSTER, Courtland
24
25

1 P R O C E E D I N G S

(9:50 a.m.)

2 MS. REILLY: I will start the December 6,
3 2012 Teachers' Retirement System Investment meeting by
4 calling the roll.
5 Melvyn Aaronson?
6 CHAIRPERSON AARONSON: Here.
7 MS. REILLY: Justin Holt?
8 MR. HOLT: Here.
9 MS. REILLY: Sandra March?
10 MS. MARCH: Present.
11 MS. REILLY: Freida Foster?
12 (No response.)
13 MS. REILLY: Mona Romain?
14 MS. ROMAIN: Present.
15 MS. REILLY: Larry Schloss?
16 MR. SCHLOSS: Here.
17 MS. REILLY: We have a quorum.
18 I will start by giving a short update on the
19 operations of TRS. As everybody knows, we're out of our
20 building due to Hurricane Sandy.
21 MS. MARCH: Spelled with a "Y," not an "I."
22 (Laughter.)
23 MS. REILLY: Our building is making
24 progress. We have electricity back on two of our
25 floors. We have the 16th and 17th floors and the 2nd

1 floor. So the electricity is back on the 16th and 17th
2 floors, and we've been told that we can do what they
3 call a soft opening to go in and assess the situation,
4 assess the computer systems.
5 As of today the elevators still are not
6 working, so when we have people going in to do that
7 assessment, they use the freight elevator up and down.
8 But we're being told that any day we'll have actual
9 elevator service up to the 16th and 17th floor.
10 We still don't have an estimated time of
11 return for the second floor, where we have our call
12 center and walk-in center. And we have no telephone
13 service.
14 So we're really not in a position yet to
15 move back into the building, because we wouldn't have
16 access to any computer systems or any telephones to make
17 calls to members or have members call us.
18 So we continue to reside in Long Island
19 City. So we want to thank NYCERS again for their
20 generosity and hospitality. It's really been a life
21 saver for us. We also have staff out in Manhasset, Long
22 Island, continuing to work in a double wide trailer
23 doing processing.
24 MR. SCHLOSS: Do they sleep there?
25 MS. REILLY: We do operate 24/7.

1 MR. KATZ: They have great bathroom
2 facilities.
3 MS. REILLY: For a trailer.
4 (Brief discussion off the record.)
5 MS. REILLY: I want to thank the Actuary for
6 calculating retirement benefits in the office space at
7 the Actuary's office; and the Board of Education
8 retirement system is hosting our walk-in center.
9 Again, at this point we have no date because
10 we don't have phone service. It's going to be restored.
11 We're working with Verizon and they're trying to assess
12 where the problem is. Unfortunately, if the problem is
13 in the basement of 55 Water Street, we may not have
14 service for a month. If they find the service is coming
15 in from a different area, that could be soon.
16 So we're waiting for the day we have
17 telephone service back, and then we'll start an orderly
18 transition. We did send in an environmental hygienist
19 firm who did an air quality test for us, and we should
20 be getting results of that test on Friday, to make sure
21 it's safe to go back when we can go back.
22 CHAIRPERSON AARONSON: Thank you very much
23 for that report.
24 I also want to thank you very much for your
25 leadership in these times. It really is great knowing

1 that you and your staff are doing such a wonderful job,
2 keeping almost every single one of the important
3 benefits and communications with members going during
4 this time. So, thank you so very much.
5 MS. REILLY: Thank you, Mel.
6 I have to say, without Joel and the other
7 directors, it would be a much harder job. They've been
8 great support to me. I thank them.
9 I will turn it over to Mark.
10 MR. KATZ: The plan today is somewhat
11 different than in previous months, only because we have
12 certain individuals who have time constraints that need
13 to present and then leave. So what we're going to end
14 up doing, and it may be a bit confusing, is to go in and
15 out of public session, public and executive.
16 But to kick it off we will start with the
17 public session for the variable fund. Depending if our
18 outside presenter shows up during the course of our
19 session, then we can go to executive session. So we
20 need to be flexible.
21 CHAIRPERSON AARONSON: I don't want to be
22 remiss in not thanking the Comptroller's Office and the
23 Bureau of Asset Management, the people who are
24 responsible for all the funds in the system, and they
25 have done an excellent job. Our pension checks were

1 able to go out, and money is still being invested. So I
2 want to thank the Comptroller's Office and Larry in
3 charge of BAM for their hard work in this.
4 MR. SCHLOSS: Thanks, Mel.
5 MS. MARCH: This is our last investment
6 meeting in 2012. For those of you who will not be at
7 the board meeting and who we will not see again in this
8 month, on behalf of the board, have a very happy
9 holiday, whatever holiday you practice, whether it's
10 Chanukah, Christmas, Kwanzaa, et cetera. And a happy
11 and healthy new year.
12 CHAIRPERSON AARONSON: Robin?
13 MS. PELLISH: Chris will start off with the
14 variable public agenda.
15 MR. LYON: Good morning, everybody. Today
16 we have a quarterly report for the Passport funds. And
17 because we present these results monthly I will hit a
18 couple of highlights in the quarterly report and then
19 over on to the October information.
20 As a reminder, if you turn to Tab 1, page 1,
21 you can see the green bars, equity markets performance
22 was very strong through September 30. That's changed a
23 bit subsequent to September 30. However, for the time
24 period we're reviewing, 2009 is a backdrop, where U.S.
25 returns were in the 6-ish percent range, depending on

1 the benchmark, and non-U.S. returns were a percent or
2 two higher than that.
3 Fixed income markets performance was also
4 positive for most of the major broad benchmarks shown
5 here.
6 And so, with that as backdrop, the first
7 investment option that will reflect on the Passport
8 funds is the diversified equity option, also known as
9 Variable A. And that fund was up about 6 percent,
10 roughly in line with the benchmark of 6.2, the broad
11 Russell 3000, and 6 percent for the hybrid benchmark,
12 during the fiscal third quarter.
13 And for the trailing one year, the
14 investment option was up 26 percent. It did lag the
15 hybrid benchmark and more meaningfully lagged the
16 Russell 3000. Some of that was due to the international
17 equity composite, which, not so much due to specific
18 managers, but due to the difference in performance
19 between the U.S. and non-U.S. markets in the one year
20 period. That only generated about half of the returns
21 of the U.S. Equity market, the broad U.S. Equity market,
22 up 30. The international was up about half as much.
23 So that was the major explanation for the
24 fund results being different than the broad U.S. Equity
25 market.

1 The defensive composite was also perhaps
2 more in line with expectations. It had strong positive
3 returns for the quarter, about 4 percent, for the year
4 over 17 percent. But again, in a time period where
5 equities were really on a run, we didn't expect to and
6 typically don't expect the defensive composite to fully
7 keep up, because it's not as equity sensitive.
8 But when the opposite happens, we're hoping
9 that most of that time it will provide a significant
10 element of downside protection, and it generally has.
11 If you look ahead a little bit, you can also
12 see that, on page 4, for instance, if you look at it,
13 regularly, the realized volatility, the risk of this
14 investment option has been less than the broad U.S.
15 Equity market given its diversified nature, as well as
16 some of the specific strategies employed, and also in
17 large part because of the allocations to the defensive
18 composite.
19 If you skip ahead a little bit further to
20 page 7, we started showing this in this format somewhat
21 recently. We'll review again what's on page 7. We
22 picked apart the defensive composite in more detail,
23 looking at things like equity sensitivity of the
24 underlying strategies. There are six different managers
25 within this composite, three converts to low volatility

1 equities and one tactical asset allocator.
2 And what you can see in general if you look
3 at the beta column, for instance, is that they tend to
4 have a beta between .4 and the low .6 range. And so,
5 being that is a beta of 1, a higher beta would have
6 similar equity exposure as the broad U.S. Equity market,
7 and so some equity sensitivity, but not as much as the
8 broad market. That's what we are looking for.
9 That also means if you look at the middle
10 graphic, that we have something called up market capture
11 and down market capture, that this composite is designed
12 to not fully participate on the upside in exchange for
13 hopefully not participating in the downside. So there
14 are percentages where 100 percent would be "full
15 participation."
16 Then if we skip ahead to Tab 3, some
17 information about the bond fund, formerly known as
18 Variable B. And there are some comments on performance.
19 This fairly closely tracks the benchmark. You can see
20 also that we have continued the migration over the
21 course of the past year away from similar value type
22 structure and away from stable value instruments, to the
23 point now where almost everything in the portfolio is
24 market value, except for 4.3 percent in legacy
25 positions, guaranteed insurance contracts.

1 Then, if you flip ahead to Tab 4, we have
2 the remaining Passport fund options. International
3 equity, inflation protection, socially responsive, in
4 that order. You can see some comments about their
5 performance, as well.
6 I commented already on the international
7 composite within Variable A, and this international
8 equity fund of course is a unified clone of that
9 composite, so the same comments generally hold true.
10 The inflation protection fund, which is
11 predominantly invested in an underlying strategy managed
12 by PIMCO, their all-asset strategy, which itself is a
13 fund-to-funds tactically allocated across PIMCO
14 strategies, is trying to outpace inflation over the long
15 haul, not necessarily with low tracking, however. That
16 inflation measure over shorter time periods, the
17 strategy has done very well over recent periods in
18 absolute terms and relative to inflation, and realized
19 since you added it.
20 The socially responsible equity fund, which
21 also allocated to one underlying manager, but in this
22 case a much more concentrated portfolio, in part because
23 of that concentration and more limited, it's still a
24 diversified portfolio of securities, has underperformed
25 in recent periods. And so for the one year period this

1 fund is significantly behind the broad S&P 500
2 benchmark, and something that we're monitoring closely
3 and will be reviewing in the first quarter in more
4 detail with the manager.
5 Any questions on the quarterly report?
6 Of course, there are many more pages of
7 analysis in here. If you do have questions, I'm happy
8 to take them off line or at the next meeting, as well.
9 With that I'll turn to the October
10 performance report for the quarter for the variable
11 funds. This is information distributed in advance and
12 also handed out today, through October 31, starting with
13 Variable A, the diversified equity fund.
14 You can see that there were $9.6 billion of
15 assets in this fund. All the major composites were
16 fairly close to target in the rebalancing process. And
17 the performance, if you skip ahead to page 3, was
18 negative; however, better than benchmark, down 1.2
19 percent for the month while the benchmarks, depending on
20 which one you looked at, were down a little bit or
21 meaningfully further.
22 Year to date results for the calendar year
23 to date were 13 and a half percent return, a little
24 ahead of the hybrid benchmark, behind the Russell 3000.
25 So no particular concerns to highlight

1 because of the quick version of the results. Again, I'm
2 happy to take any questions.
3 Then, the next handout has the other
4 Passport options, also through October 31, starting with
5 the bond fund, $379 million, roughly. This is the very
6 conservative end fixed income spectrum, not a lot of
7 movement there during the month. You can see the total
8 bond fund was essentially flat, had a negative 1 basis
9 point return.
10 The benchmark was up 2 basis points, on a
11 year to date would have been 6 basis points of the
12 benchmark, of 1.99 percent year to date return. All of
13 this information is net of fees, and that compares to
14 205 for the benchmark.
15 If you flip to the next page you can see the
16 asset levels for the other three Passport options,
17 around 76, 72 and $38 million respectively, and how
18 those performed for similar time periods.
19 For the month, the international option was
20 a little behind but in positive territory, so can you
21 see diversification did help during this time period,
22 and EAFE bounced back a bit. Every one has had a modest
23 positive return, and the year to date results were about
24 12.3 percent.
25 The inflation protection option was

1 essentially flat at 0.14 percent return. For year to
2 date it's 12 percent return, a little more than 7
3 percent ahead of the inflation benchmark, the U.S. TIPS
4 benchmark. And depending on which inflation measure you
5 use, it's meaningfully ahead, regardless which one you
6 use.
7 And the socially responsive equities fund
8 was in negative territory, not as negative as the
9 benchmark, but they have a more significant gap to fill,
10 as mentioned earlier, if you look at the year to date
11 results.
12 (Mr. Smarr entered the meeting room.)
13 CHAIRPERSON AARONSON: Before you go on, let
14 the record show Jaime Smarr has joined the meeting.
15 MR. LYON: Lastly, for the Passport public
16 agenda, this will be a preview of the November results.
17 And in November, things were pretty volatile, but the
18 way we ended up, we ended up with moderate positive
19 returns for most of the benchmarks.
20 And December so far has been off to a mixed
21 start. So we will see how that goes. A lot of it is
22 dependent on macroeconomic policy decisions that may or
23 may not be made soon. Of course, we're all awaiting
24 that.
25 (Laughter.)

1 And we'll have to see what happens.
2 So that's everything we have for the
3 Passport public session.
4 Any other questions or comments?
5 CHAIRPERSON AARONSON: Are any of the guests
6 ready?
7 MR. KATZ: The QPP side presenters are here
8 for private equity. So I think we need a motion to go
9 into executive session and proceed from there.
10 CHAIRPERSON AARONSON: Do I hear motion?
11 MS. MARCH: I make a motion that we go into
12 executive session under Public Officer Law 105, for
13 purposes of discussing sales and securities.
14 CHAIRPERSON AARONSON: Is there a second?
15 MR. HOLT: Second.
16 CHAIRPERSON AARONSON: All in favor?
17 (A chorus of "Ayes.")
18 Any opposed?
19 We're now in executive session.
20 (Brief discussion off the record.)
21 MR. SCHLOSS: We'll start with the manager
22 updates and then go through two new investments, so I'll
23 hand it over to Barry.
24 MR. MILLER: I wanted to give everybody an
25 update on one of the funds you all committed to, which

1 was the Yucaipa corporate initiative fund. This was a
2 fund that was between -- there were two members, general
3 partners, Yucaipa and Magic Johnson.
4 And there's been a lot of things going on.
5 We have good news to report to you all, which is, there
6 have been discussions with a group of LPs that's been
7 led by some very large West Coast LPs that are very
8 large pension funds.
9 And there's been disappointment with the
10 performance in the initial fund. It is the second worst
11 performing fund in the overall retirement system. It
12 got challenges, had a mandate when it started. Some
13 investments got a little bit off kilter.
14 So the LPs have gotten together. They
15 talked to the GP, and the proposal on the table, the GP
16 accepted. And we think -- and it's important to note
17 that, when the LPs got together, it was greater than 90
18 percent of the LPs, which is really unheard of. Usually
19 you do things you get half or two-thirds. This is
20 greater than 90 percent.
21 So what we were able to negotiate with the
22 GP is as follows: One, to end the commitment period, so
23 no new investments. So what that does is, releases 16
24 percent of your commitment. I think the best way to
25 think about that is, people just lost faith, I think

1 that's the best way to think about it.

2 Second thing was, reduce the amount of
3 dollars available for follow along. So while the GP was
4 looking for -- again, this is roughly a $400 million
5 fund, to put it in perspective -- the GP was looking for
6 50 to $60 million of followup capital. The LPs got
7 together and moved it closer to 6. That was a positive.

8 And two other things which everybody will
9 like and Mel will like, is a better fee situation. So,
10 what we were able to do is get them to effectively defer
11 management fees up until a point where you all get your
12 money back. So right now, even though the fund has lost
13 roughly half your money, they're still earning full
14 management fees. And the simplest way to think about
15 is, it's just not fair.

16 (Laughter.)

17 So, we went back to them and said to them,
18 that you need to do something for us, and we don't think
19 that this money they invested -- just by way of
20 reference, they had a company called AGFA that we talked
21 to once before, a company that made hamburger patties,
22 and it was called pink slime. Twenty-five percent of
23 the fund, or greater than 25 percent of the fund was in
24 this company. For background, they put $120 million
25 into it, it went to zero.

1 So what we were able to do was get them to
2 defer the management fees up until the point you get
3 your money back. That's the good news.
4 The not as good news is, we don't actually
5 believe you'll get all your money back, but this at
6 least reduces the drag of the expenses.
7 Finally, what we were able to get, we were
8 able to get the commitment of the general partner
9 subordinate to yours. So the best way to think about it
10 is this: If a dollar was coming back of distributions,
11 you would have gotten your piece based on your
12 commitment, and the GP would have gotten their piece,
13 based on the dollars they put into it.
14 Now what we've done is made your commitment
15 senior, so every dollar that comes back goes to you all
16 until you get your money back. Again, we think this is
17 important because, unfortunately, we don't believe
18 you're going to get all your money back, so you might as
19 get as many back as possible.
20 This was, we believe, a very positive
21 outcome. A challenging investment; they're not going to
22 raise another fund, no surprise. But in the aggregate,
23 Teachers had a commitment of $35 million, the City had a
24 commitment in the aggregate of $100 million, or 25
25 percent of the fund.

1 So while it is painful, we think we were
2 able to negotiate something that is palatable and in the
3 end will get you more dollars back. So I wanted to let
4 you all know that.
5 If there are any questions I'm happy to
6 answer; if not, we have two managers here.
7 CHAIRPERSON AARONSON: Of the $35 million,
8 how much did they draw down?
9 MR. MILLER: They called down roughly 80
10 percent of the money. So the additional 16 percent of
11 that 20 percent that's left to be called down, that
12 additional 4 percent is really for follow-on investment
13 in a couple of things. Unfortunately, out of the 80
14 percent of the money called down, you lost half of it.
15 CHAIRPERSON AARONSON: They only called $30
16 million?
17 MR. SCHLOSS: Yes.
18 CHAIRPERSON AARONSON: So we last half of
19 that, $15 million, so far.
20 Is there a possibility that we could make
21 back some of the $15 million?
22 MR. SCHLOSS: That's what they think, not
23 what we think.
24 MR. MILLER: They think that, not only will
25 you get the money back you lost, but you will get a

1 reasonably attractive return on your overall investment,
2 and that there is a possibility that you will end up
3 getting something along the lines of 1 and a half to 1.6
4 times your money, and you'll end up with an IRR
5 somewhere in the 8 to 10 percent. That's what they
6 think.
7 I'd say, what our position would be, is that
8 the likelihood of you getting all your money back is
9 incredibly remote. And if you end up somewhere in the
10 75 or 80 cents, you live to go another day and you take
11 a loss. It's an unfortunate situation, but it's better
12 than losing all your money. The glass is half full, the
13 glass is half empty.
14 The challenge is they've made investments in
15 areas that we just don't think are where you should put
16 money. It's hard to find a way to get your money back.
17 I should also mention the one last piece
18 here, which you did bring up. That's a little bit
19 strange. Generally speaking, when you have private
20 equity guys doing deals, if they get fees back, either
21 they share them with you or some sort of ratio.
22 And one of the companies they did was Magic
23 Johnson -- Magic Johnson the man, not Magic Johnson the
24 institution -- actually getting paid a salary. And this
25 is called the gospel network. So Magic is getting a

1 salary and Magic is getting equity in the deal; again,
2 not Magic Johnson the firm, but Magic Johnson the man.
3 And that's one open item right now. So the
4 LPs went back, and we said we thought that was
5 unconscionable; that if the fund is making money, you're
6 happy to talk more about it. But when you lost half
7 your dough, it kind of puts salt in the wound.
8 So we're waiting for a proposal back from
9 them, which is how Magic is going to repay the fund this
10 money. And that's what we're working on now. They even
11 said it's not a lot of money to Magic. So we said fine,
12 if it's not a lot of money, give it back.
13 MS. ROMAIN: Do you recall how much they
14 committed, the GPs?
15 MR. MILLER: About $30 million in the deal,
16 in the fund.
17 MS. MARCH: What was the total amount?
18 MR. MILLER: Four twenty-five. They put a
19 lot of money in on a relative basis, 1 to 3 percent. So
20 they've got real dollars to lose. Again, they also
21 clipped on fees from you all.
22 MR. SCHLOSS: The good news is, that all the
23 investors got together because they were outraged. And
24 to get 90 percent of investors to do anything is damned
25 near impossible. So the good news is we got together,

1 and with good negotiation it probably took six months of
2 back and forth, to the crisis level, got something done.
3 It is just bad news, this is not a good investment, but
4 at least it was dealt with.
5 CHAIRPERSON AARONSON: Based on the fact we
6 were able to get 90 percent of the investors in this
7 case, if there were other egregious cases, maybe we
8 could work on, since you were so successful working on
9 this, getting 90 percent of the investors in some of the
10 other worst case scenarios to try to get something?
11 MS. MARCH: Before we suggest that you push
12 the envelope, we'd like to congratulate you for pushing
13 the envelope.
14 MR. MILLER: We're happy with the outcome.
15 MS. MARCH: We want you to continue pushing
16 it, but we're happy this one was so successful.
17 MR. MILLER: Thank you.
18 MR. SCHLOSS: Mike, any comments?
19 MR. KOENIG: It's one of those things we've
20 talked about when we originally started talking about
21 the portfolio. There's going to be things you can do
22 sometimes. It takes a lot of effort, but they are worth
23 it, both because of solutions reached, an okay one, and
24 because they set a little bit of a standard that
25 displays you to the market in a way that you think is

1 consistent with how you want to be seen.
2 MR. MILLER: With that, we will turn to page
3 173 in the book. We'll talk about Platinum Equity Fund
4 III, a new relationship we'd like to recommend to
5 Teachers.
6 The recommendation we have is to recommend
7 $115 million to Platinum Equity Fund III. As the name
8 shows, it's their third fund, targeting $3.7 billion.
9 This is a fund that has really stellar returns. We'll
10 talk a little bit more as we move forward, but the
11 recommendation to the overall retirement system is $305
12 million.
13 Proven track record. These are hands on
14 operators. They roll up their sleeves, they work with
15 the companies. It's a very differentiated strategy. If
16 you were to look at the overall portfolio of the
17 Teachers, there aren't a lot of special situations funds
18 similar to this.
19 Strong alignment of interest. They put a
20 lot of money in there. They will end up being as much
21 as 10 percent of the fund. They continue to put
22 additional capital in on an annual basis.
23 Of all the funds we talk about here, there's
24 an unrealized portfolio that we are comfortable with,
25 working with Hamilton Lane, that there's real value

1 going forward.

2 I'll touch on some of the high level things

3 and then talk about fees. So the fees on a high level,

4 they came out looking for 1.75 percent. We went back to

5 them and negotiated -- not only the Teachers did, but

6 the New York City retirement system, and were able to

7 negotiate fees from 1.75 down to 1 and quarter; so we

8 think that's attractive.

9 When you look at the firm, the firm was

10 founded by Tom Gores, who's here today. Tom founded the

11 firm in 1995. Tom is self-made. It's quite an amazing

12 story. If you look at the first group of dollars he

13 invested, he generated an IRR -- again, the number is

14 not a typo -- of 237 percent. He generated a multiple

15 of almost 3 and a half times, so quite successful.

16 As you can imagine, when doing that with

17 your own money and other people's money, it's not too

18 difficult to raise an institutional fund.

19 They came to market, the institutional fund

20 back in 2004, raised a subsequent fund in 2007.

21 One of the things we talked about before and

22 I'll talk about later when we talk about the next fund,

23 with private equity everyone invests money, it's always

24 difficult to see the larger buyout, how you've gotten

25 all your money back. In this particular fund, invested

1 in the aggregate under the Platinum umbrella, $3.3
2 billion, returned 3.4, so everyone got their money back.
3 If you look at Fund I, to put it in
4 perspective from a returns standpoint, it generated 2.6
5 net and a net IRR of 63 percent. If a fund like this
6 had been in the portfolio it would have been probably
7 the best performing fund. The other funds were all
8 performing well.
9 Again, they're all top quartile funds.
10 Nineteen percent net for 2007 vintage fund; one and a
11 half times net multiple.
12 If you look on page 174 towards the bottom,
13 this is again based on the policy statements previously
14 approved.
15 What this looks like in the overall
16 portfolio for Teachers. This was called the special
17 situations bucket, so again, right in the target area.
18 As I mentioned before, this was founded back
19 in 1995, Tom focused on software. He's an operator, not
20 a financial guy. He ran his own business, had his own
21 business, put together a team of 150 employees, 10
22 investment professionals in Beverly Hills. If you look
23 at the team, the group has been together for a long
24 time, averaging 13 years.
25 You will meet the number 1 and number 2

1 guys. So we've got Tom Gores and you've got Jacob
2 Kotzubei, the two of them are the number 1 and 2 guys.
3 They've broken up the industry verticals, so
4 they have different areas of focus, although they do
5 consider themselves a generalist fund. They have teams
6 that are dedicated on sourcing transactions, so we think
7 that's important. As you look at it, there's a lot of
8 rolling up their sleeves. And they are operators. They
9 are operators that are going into companies and making
10 them better.
11 If we go to page 176 towards the bottom,
12 which is the investment strategy. As I touched on
13 before, it started with software companies, that was
14 really the genesis of the business. Now they've taken
15 everything they've learned from software, they went out
16 and raised institutional funds, they've basically gone
17 much farther than software.
18 They are looking to take what they have
19 learned on the operating side, on the turnaround side,
20 and go into larger companies. They've been very, very
21 successful.
22 One of the things they focus on are
23 long-term relationships. They want sticky or recurring
24 revenue. They are looking for brand recognition. So
25 they want to get that big gorilla, the largest --

1 They have a sizable market share, so they
2 don't want to be a small business in a small industry,
3 they want to be a larger business in a larger industry.
4 Finally, what it says here, I'll give a
5 little more detail, the value locked in the balance
6 sheet. Effectively, they look at companies that are
7 within. So, if they are there, they are just not core.
8 So if somebody is in the shoe business, then
9 you have another company in there in the tractor
10 business, they probably don't make a lot of sense
11 together. They can unlock value by separating the
12 company and selling it to someone else.
13 Finally, if you go to page 178, this is the
14 value creation driver. This is that step chart that's
15 in almost every memo. It's a little different than
16 other memos, because it's a different strategy.
17 And so they make money through growth of
18 capital, which we think is very important. Multiple
19 expansion, so they're buying smaller companies and
20 selling to larger companies. This idea of paying down
21 leverage, we've all talked about that. Divestitures,
22 that's a kind of a hard to set term -- historically,
23 it's not been in. And the reason that is, again, it
24 goes back to the other piece, it unlocks value in the
25 balance sheet. They sell off non-core companies.

1 Finally, page 179, take a look at the
2 returns. So net IRRs 170 percent, 65 percent, 35
3 percent; so, pretty significant returns. And they've
4 been able to do this through all different business
5 cycles.
6 Their fundraising, they expect to have their
7 final close at the end of this year. If you look at the
8 benchmarks slide, page 180, you'll see they've been a
9 top quartile fund.
10 With that, if there any questions, I'm happy
11 to answer them. If not, we have the members from
12 Platinum.
13 CHAIRPERSON AARONSON: If instead of giving
14 them the 1.25 committed amount, we let them charge 1.75
15 only the invested amount. Have we ever looked --
16 MR. MILLER: We have. There's a couple of
17 things that go with that. It's this idea of incentives.
18 Again, not that this would happen with them; it's more
19 of a macro-discussion; which is, if your fee is on
20 invested capital only, you could make an argument that
21 there is a very high incentive to invest as fast as
22 possible. The management fees don't kick in until they
23 put the dollars in.
24 The flip side is, I believe it was
25 Trilantic, one of the earlier funds recommended that you

1 all committed to, we tried to do some analysis in our
2 head when we were focusing on the management fee
3 discussion with the GP, which is a better way to do it?
4 It's interesting. If you believe in a
5 measured pace of investing, you're actually better off
6 with one and a quarter of committed, which you'll see is
7 kind of a two year investment period. And the one kind
8 of delta unknown there is how fast they'll make the
9 first one or two years.
10 If they make quicker deals, then, which way,
11 one or the other direction, but if you assume it's a
12 measured pace, then this is actually a better way to do
13 it. And the reality is it's also important to think
14 about. While we negotiated hard on the fees, the fees
15 are in advance.
16 So really it's actually expensive money
17 we're giving them, because you are paying a manager fee.
18 And then if you look at the waterfall at the end when
19 they have returns, they are paying the money back plus 8
20 percent. It's actually expensive money for them, plus
21 the fee.
22 MR. SCHLOSS: Before they get their carry.
23 So they give you back all your money plus the fees you
24 paid, plus 8 percent. Then they get 20 percent of the
25 profits. So if you have someone like this that you

1 believe will make more than 8 percent, it's a very
2 expensive loan to him to run his business.
3 CHAIRPERSON AARONSON: So why --
4 MR. SCHLOSS: I have no idea why anyone in
5 their right mind does this anymore. You're supposed to
6 get past it and say, wait a minute, let's talk about the
7 whole fee structure.
8 On the other hand, if you have something
9 like Yucaipa Johnson, you're never going to see those
10 fees again. So, a little bit of -- it works better for
11 them than it does for us on the downside; it works
12 better for us on the upside. Barry's right, we pushed
13 the math a lot.
14 The problem is, the fee that's most relevant
15 is on invested capital, because that goes on for 5, 6,
16 7, 8, 9, 10 years; whereas the commitment period, if you
17 invested fast, is only for three years on the ramping
18 up.
19 So mathematically you're better off the way
20 we have it structured. We pay less fees, aggregate
21 dollar fees.
22 One thing you'll find out about Tom, you
23 won't have seen a guy like this before. He takes
24 something that's broken, fixes it very fast, and gets
25 your money back. You look and go, How the hell did you

1 find that transaction?
2 CHAIRPERSON AARONSON: Is his Platinum Fund
3 I all invested?
4 MR. SCHLOSS: All invested, all back.
5 CHAIRPERSON AARONSON: And Platinum Fund II?
6 MR. MILLER: They're actually doing deals in
7 the new fund. This fund we're recommending to you all,
8 they are doing deals already.
9 CHAIRPERSON AARONSON: So there's no
10 overhang?
11 MR. MILLER: None.
12 MR. SCHLOSS: But they're really -- if you
13 look at the portfolio, we always didn't have turnaround
14 guys that really were good and not job crushers. This
15 is what these guys are. They have a great track record,
16 they're still hungry, young.
17 CHAIRPERSON AARONSON: Can they tell us how
18 many jobs they created and all that?
19 MR. SCHLOSS: Yes.
20 MR. MILLER: I will bring Tom and Jacob in.
21 (The Platinum people entered the room.)
22 MR. MILLER: I will turn it over to Tom.
23 MR. GORES: Thank you, everybody. Good to
24 be here. I'm honored to be here and have you consider
25 us, investing with us. We appreciate it very much. I

1 don't take it lightly at all.

2 I started the business in 1995, and the

3 grass roots of executing and being detailed are very

4 important to me. And so I appreciate being here. I

5 know we're open to questions, and Mark and Jacob have a

6 presentation. We've been told to do that rather

7 quickly, keep it tight, which we will do. They didn't

8 give me the presentation, because I rarely follow them

9 myself.

10 (Laughter.)

11 So they'll keep it tight, and thank you for

12 having us.

13 MR. BARNHILL: I'm Mark Barnhill, partner

14 with the firm, Jacob Kotzubei, my colleague, will be

15 introduced in just a moment. Really quickly, what I

16 think we'll probably do is, I'll make a few minutes'

17 overview, let Jacob talk about a couple of key

18 differentiating slides, and then I'll wrap it up again

19 with investor relations, if that's okay.

20 And just speaking for only a couple of

21 slides here, starting on 3, which is really an overview

22 page. As a general preamble, we are a very heavy

23 operationally focused buyout firm that has developed

24 what we think is a highly differentiated strategy around

25 comprehensive operations diligence, identifying

1 turnaround opportunities and then going in and going
2 deep inside the companies and fixing what's broken.
3 We'll talk in a second, Jake will talk about
4 the details of that. We think it's very different from
5 other firms in the asset classes, who tend to be more
6 financial engineering driven, don't have that kind of
7 detail and ability to bring resources to bear in the way
8 we do in these investments.
9 A couple of critical differentiators that
10 I'll highlight here, and then hand it off to Jacob.
11 One is the team, the breath and depth of our
12 team. A hundred plus investment and operations
13 professionals on our team. That gives us a tremendous
14 amount of depth and the ability, as I said earlier, to
15 go deep inside these businesses.
16 Our operations expertise is not just high
17 level kind of former CEOs who can tell you from the 45th
18 floor what they think ought to be going on down on the
19 factory floor. These are people who work inside
20 businesses, run business units, manage customer
21 relationships, and run all aspects of the enterprise.
22 And that gives us a real edge in terms of our ability of
23 going into businesses and understanding them.
24 Also important is the tenure of that team.
25 Tom mentioned he founded the firm in 1995. The

1 senior-most group of the firm, the partners group, is
2 about 14 strong; averages about 13 years of tenure
3 together. Jacob and I who are at eleven years bring
4 that average down slightly.
5 When you go down a level deeper there's 40
6 in the firm of partners and principals that average
7 about 11 and a half. The tenure and cohesiveness of
8 that team, the way we work together across this model is
9 very important in terms of our ability to deliver.
10 The strategy, again, we think extremely
11 differentiated; value oriented investors. Our
12 emphasis -- and Jake will tell you in a moment -- is
13 focused highly on downside protection and making sure
14 we're preserving your investment capital.
15 And then, after we've done that and secured
16 that invested capital, looking for the upside in terms
17 of creating value.
18 And the discipline of our approach in terms
19 of the way we identify opportunities, underwrite those
20 transactions, is very different from others in the asset
21 class. We tend to resemble, frankly, another business
22 that maybe looks to acquire a competitor, deep
23 capabilities across all operating units in the business
24 to understand what is going on.
25 Performance, we think is a differentiator.

1 You are what your record says you are. The Bill
2 Parcells quote, he's still coaching, we think that's
3 true in our business as well. You can say you're a
4 great football team, but --
5 We're very proud of our track record and
6 have consistently delivered best in class results. And
7 we are well equipped to do that to for the foreseeable
8 future.
9 The last piece before I turn it over to
10 Jacob is, we have a principal investor mind set, that
11 rebounds not just to the rhetoric but how we invest, the
12 actual dollars in the business.
13 We started out, Tom started the firm with
14 his own capital. The first eight years we were in
15 business was entirely founders and principals' capital.
16 More than three dozen transactions drove those returns.
17 When we got into the fund business, it was
18 looking for co-investors to stand alongside us.
19 Frankly, we're not in the business of managing other
20 people's money for a fee.
21 As a consequence of that, we have a much
22 higher than normal GP commitment inside our funds; 22
23 percent of all investments we made since we opened the
24 fund business in 2003 have been Platinum capital's own.
25 We're the equivalent of the largest investor in our own

1 funds, and that allows us to tell you we'll treat your
2 money like our own money, because it is our own money
3 alongside.
4 We think it's very important, as well, to
5 get our skin in the game and having an alignment of
6 interest is critical.
7 I'll turn it over to Jacob to talk through a
8 couple of critical slides, and then wrap up with
9 questions.
10 MR. KOTZUBEI: By way of introduction, I'm
11 Jake Kotzubei, also a partner in the firm and one of the
12 five members who sit on our investment committee,
13 together with Tom and three others.
14 I'm on Slide 4 here. This slide is intended
15 to convey several aspects of our investment model.
16 Number 1, we are sector agnostic. So you'll see us
17 investing across a whole host of sectors from
18 manufacturing to services, logistics, metals, even a
19 newspaper; because we are somewhat contrarian. And that
20 transaction, by the way, the San Diego Union Tribune, we
21 did 15X on that investment. So this model produces
22 results.
23 We also write equity checks that vary
24 dramatically in size from very small to several hundred
25 million dollars. We were playing up and down in what's

1 called the middle market for private equity.
2 And our model is a model that produces
3 results. You'll see time and time again the track
4 record of investments like in the middle on the left
5 here, Compucom $62 million in, $415 out inside of two
6 years. Kendeth (phonetic) $60 million in, $300 plus
7 million out inside of two years.
8 On the bottom left, PA Group, $19 million
9 in, $500 million out inside two and a half years. San
10 Diego Tribune, a small investment, 7 and a half million,
11 inside of two years, $110 million out.
12 We also do some very unique transactions
13 that you won't hear a lot about in private equity
14 generally, which is transactions where we never issue a
15 capital call from our partners. We take on a very
16 significant problem of businesses that are losing money
17 dramatically, and we have sellers hand us that problem,
18 and then we turn the business around and produce
19 results.
20 So, for example, we acquired a business from
21 Alcoa, a division called AVS that produces wire
22 harnesses. Those are the cables that route power
23 communications through vehicles. It was a business
24 losing over $100 million dollars in EBITDA annually
25 under Alcoa's ownership. The didn't have the capability

1 to turn it around, and they did not have the ability to
2 shut it down because they had customers in other
3 divisions who were also serviced by this division. So
4 politically, it was a very difficult thing.
5 We negotiated with them, they provided some
6 cash into the business, handed us the business. We
7 turned it around inside of two years, distributed $250
8 million and stabilized that business, grew it and sold
9 it to a strategic investor. So that is a very unusual
10 dynamic, one of the benefits of investing in Platinum.
11 CHAIRPERSON AARONSON: Jacob, in all these
12 funds you talk about value. The value's been realized
13 and you exited all these companies?
14 MR. KOTZUBEI: The vast majority, not every
15 single one. But the vast majority, yes. The ones I
16 mentioned, the answer is yes.
17 On page 5, this is a few comments about what
18 it means to have operating capability. I don't think
19 there is a general partner today who can come talk to
20 you and not mention their operating capability. But
21 operations is a very big word, means a lot of different
22 things.
23 I think it's important to understand about
24 the type of people at Platinum who are our operations
25 executives. These are not ex-CEOs who are sitting on

1 the 40th floor of a building reflecting on what should
2 happen on the factory floor.
3 We're also not an army of 28 year olds who
4 are very bright and produce fantastic 60 PowerPoint
5 presentations, telling what management should do and
6 hand it to them.
7 These are operators who actually have spent
8 their careers in business making changes, and they are
9 sleeves rolled up, working alongside management,
10 effecting change quickly in businesses to improve.
11 So that's what we mean by operations. We
12 actually coined a term we call M&A&O, which stands for
13 Mergers and Acquisitions and Operations; and that's
14 intended to convey to you all that this is a single
15 integrated discipline. From the first day we're meeting
16 with management at a management presentation, learning
17 about a business, our M&A execution executives are
18 sitting alongside operations, working together as a team
19 to evaluate a business, understand how we can add value
20 to it.
21 So that's an important concept for us. We
22 interlock with operations from the first day.
23 On page 6, just a few words about what makes
24 a deal a Platinum deal. And you saw on page 4 we were
25 sector agnostic when investing all over in terms of the

1 types of businesses. So what is the consistent theme.
2 It starts with who we buy from. We're
3 looking for sellers who are committed to selling a
4 business. They're not selling opportunistically where
5 price is the single most important factor in their
6 transactions. We are there to solve a problem for them.
7 And so that posture is a much better
8 posture. Imagine walking by a store window, seeing a
9 nice bright shiny object, walking in to the shopkeeper
10 and saying, "How much is that?" You might get a
11 different price than if you're walking by that object
12 and there's a for sale sign, "50 percent off." And we
13 like that for sale sign, "50 percent off." That's the
14 starting point for where we participate.
15 We're also focused on businesses that are
16 undermanaged or underperforming. And we use those words
17 deliberately and differently than using the word
18 "distressed," because while we can handle classically
19 distressed investments where businesses are losing money
20 and they need significant turnaround, we also invest in
21 businesses which are good businesses, that are
22 profitable businesses, but they're not meeting their
23 peak performance capability, and our operations
24 capability alongside management will dramatically
25 improve the cash flow and the profitability.

1 So undermanaged, underperforming is the
2 universe. It's a broader universe than distressed. And
3 you heard Mark mention downside protection. This is a
4 very critical theme for us. We want to know that under
5 a whole host of scenarios, including adverse scenarios,
6 that the capital we put into the investment is protected
7 and salvageable even if things don't go well.
8 And we get at that a number of different
9 ways. It does start by being a disciplined buyer and
10 knowing how to walk away from deals. We do that all the
11 time. You have to buy right as a first instance in this
12 business. We also look --
13 MR. GORES: I think there's downside
14 protection, just as an investor, from your point of
15 view, is one of the single biggest things that I look at
16 personally. We have never had an IC call where we're
17 afraid to talk about what is the downside? What happens
18 if something goes wrong?
19 We're very honest with ourselves. Not that
20 we don't believe in the investment, but we need to know,
21 the world's a very tricky place, the economy is tricky,
22 especially these days. What happens if things don't go
23 well? My big thing is, we want to protect our money.
24 We want to go for the upside and get the kind of return
25 Jacob mentioned earlier.

1 But at the end of the day our evaluation on
2 the business is, if it doesn't go well, where do we
3 stand? And I think if business goes wrong on our side
4 of the world, you end up getting zero on a big check.
5 You really don't want to be in this position, because
6 then you have to be very, very smart to make it up.
7 So the downside protection for us, probably
8 the single biggest thing you would be investing in that
9 I invest in, knowing if you wake up in the morning and
10 the world changes, you can recover from that. The
11 operating team will react to that.
12 But a very, very important point I want to
13 make sure -- the reason we've been in business for a
14 long time is, this is a fundamental part of the way we
15 look at investments. And on your side of the table, my
16 biggest concern would be taking a business loss. That's
17 always my concern.
18 MR. KOTZUBEI: We spend a tremendous amount
19 of time on reinvestment. As Tom mentioned, we're not
20 afraid to talk about it. What happens if things don't
21 go your way? And it takes the form of a lot of
22 different ways of evaluating, including looking back
23 very carefully at historical records, understanding why
24 the customers buy from this business, why do they come
25 back and buy again, what other options do they have, how

1 can we get comfortable with that revenue being stable;
2 looking at balance sheets very deeply, getting
3 comfortable with the assets, the tangible assets that
4 we're getting are very high with the percentage of
5 purchase price we pay for businesses; and knowing the
6 business is a business that we can adjust to bearing
7 macroeconomics or circumstances or events like a lost
8 customer.
9 So in addition to the downside protection,
10 you heard Mark mention that we want to know in every
11 investment we are more than just capital. If we're only
12 capital in the investment, then we're competing with
13 other providers of capital who are willing to accept the
14 lowest return. What we want to know in every investment
15 is that we have a meaningful operational component where
16 we can improve the business.
17 And if we can combine a very high degree of
18 confidence on the downside protection with a great
19 opportunity operationally to improve a business in every
20 investment we make, on any single investment there's no
21 guarantee of great results, but on a portfolio-wide
22 basis we will produce leading returns and we've done
23 that now for 17 years.
24 We have not had in 17 years of investing a
25 single Chapter 7 or Chapter 11 proceeding with an

1 investment we made. We're very proud of that. There
2 may be a day where we can't say that, but we have not
3 had that, and that speaks to the operational acumen. It
4 doesn't mean we're infallible investors, things do go
5 wrong, but we react to that and make change and come out
6 of it okay.
7 MS. ROMAIN: Generally, how long does it
8 take you for an average turnaround?
9 MR. KOTZUBEI: A typical change timeline
10 would be between 18 to 36 months, depending on the
11 complexity and size.
12 MR. SMARR: Some of these companies you
13 don't actually have a controlling interest. How do you
14 get a meaningful operational role in a company like
15 that?
16 MR. KOTZUBEI: Our investment model is very
17 much to have a controlling interest. And there's been a
18 circumstance where we made an investment that was just
19 below the controlling, but we did it in the form of a
20 loan with a very, very tight operational covenance that
21 if the business failed to continue to improve on its own
22 management team's execution, we would get control. We
23 have a built-in mechanism for that.
24 So we very much are controlled investors and
25 we're not making investors as a passive --

1 MR. GORES: We're 99 percent. You're
2 probably referring to Kenneth --
3 MR. SMARR: Yes.
4 MR. GORES: We put up debt. We had downside
5 protection in the case and it didn't go well. We
6 controlled the company. Things went very well. We had
7 49 percent warrants. But that is a very unique deal,
8 we made a lot of money on the deal, it was really
9 Jacob's deal, he did very creative stuff with it. But
10 we are controlled investors. That is a unique deal, so
11 you are clear on that.
12 MR. KOTZUBEI: One last thing on the bottom.
13 Multiple ways of realizing return. A really important
14 part of this downside protection aspect, part of our
15 value creation is, we don't hold that value to some
16 future exit point in the entire business. So we bring
17 that capital home early. That helps us to derisk the
18 business from a financial standpoint.
19 And one of the hallmarks of our fund is very
20 high distributed pay ratio, because we are bringing
21 that value home. Jake and I were talking about one
22 service business we own called (unclear) we're about to
23 make a distribution in that business. After that
24 distribution is made we'll be at four times realized on
25 that investment and still own the company and still

1 continue to manage it on a go forward basis.
2 We're a little unusual in that regard and
3 we're bringing money home quickly and we have a very
4 deep value that helps us minimize that downside risk.
5 The last thing, and we'll close on this
6 quickly and can answer any questions you all have is,
7 the next slide 7 talks to a little bit the sense that we
8 view this as a really important relationship for us. We
9 have spent a lot of time making sure that we have a
10 really strong two-way relationship with our investors.
11 We're not just simply identifying you as a
12 capital resource in a blind pool that we want to invest,
13 but there's a two way conversation. We're doing all the
14 things we need to do to meet your needs; not just in
15 terms of great returns, which are of course of primary
16 importance, but also from a reporting, transparency and
17 the context of the way we manage relationship with labor
18 and in general the way we manage our businesses.
19 And I think we've done that. Again, a
20 little of bit best in class kind of aspiration here
21 relative to developing these relationships in ways that
22 give you those kinds of things. We're happy to talk
23 about what that means in terms of either reporting or
24 things like (unclear) or ESG issues, I know is important
25 to some investment groups.

1 With that, I think we're open to your
2 questions.
3 CHAIRPERSON AARONSON: I have a couple of
4 questions.
5 In Portfolio 1 you had a certain number of
6 companies. And at the beginning of your investment,
7 these companies had a certain number of employees. And
8 at the end of your investment period, what happened to
9 the head count of these companies as far as employees
10 go?
11 MR. KOTZUBEI: Let me take it. We buy
12 businesses that are in difficult straits. And so often
13 when we come into those businesses we'll see initially
14 head count reductions as we stabilize the business.
15 We're protecting those jobs and preventing them from
16 going into bankruptcy.
17 But on a net basis as we move through those
18 businesses and grow them, both organically with
19 acquisitions, we're job creators. We've created tens of
20 thousands of jobs across our portfolio over a long
21 period of time. While in the early stages there may be
22 a process where we're making some head count reductions
23 or plant rotations, those kind of things, on a net basis
24 we've created substantial amounts of jobs across the
25 portfolio.

1 CHAIRPERSON AARONSON: In this American
2 commercial lines company, I see here you have one of
3 your important points you pointed out, is that you
4 reduced the head count and compensation expenses.
5 In the newspaper in San Diego, I see one of
6 the points you make is that you reduced the head count
7 at the company.
8 MR. KOTZUBEI: That's a great point. I
9 think it's important to understand that there are
10 investments we make where the alternative of not
11 reducing head count is that the business fails and
12 nobody has a job. So in those examples, even though
13 there is a head count reduction, our belief is net/net
14 we have saved jobs in investments like that.
15 MR. GORES: Every situation is different.
16 Of the three you just mentioned, ACL is a business we
17 bought that at the time was doing $110 million business
18 of EBITDA. We get the company more efficient. Today it
19 will do close to 250, but that's a growing employee base
20 now.
21 What we did, we had to clean up the
22 employees going in, get the company efficient. Just
23 because you have a lot of people doesn't mean you're
24 efficient, but now it's growing an employee base.
25 In the case of the Alcoa, deal, Alcoa was

1 going to shut that business down. And the reason they
2 paid us $175 million to do the deal is, they thought it
3 would cost them $400 million and nobody would have a
4 job.
5 In that case, we saved the company, got the
6 company close to break even or a little better, found it
7 a nice home. They were too small to be a big player, we
8 found a bigger strategic -- in that case we saved jobs.
9 And in San Diego, assuming you're referring
10 to the paper, the paper was going to go under. There
11 was the bottom line, and everybody thought the whole
12 newspaper business, that's it, it's going to be gone.
13 We looked at it and said, this community is
14 not going away. They bought newspapers for the last 30
15 years here. How can we save this company? Every
16 situation is a little different. In that case we didn't
17 grow jobs, we saved jobs, San Diego.
18 And ACL, initially we reduced jobs to make
19 the company efficient, but now it has a growing employee
20 base.
21 MR. BARNHILL: We're net positive there now.
22 One of the things ACL has is a shipyard, manufacturing
23 ships. And it was really poorly run. We added a lot of
24 jobs there, frankly. We're growing at ACL, for sure net
25 positive.

1 MR. GORES: One of the things that makes us
2 unique is, we're able to understand every situation is
3 different. We're not a cookie-cutter. We have our
4 model, we have the things we believe in, but every
5 situation is different. We have five fundamental
6 principles, but every situation is different.
7 We're very engaged in the details so we
8 don't have to make calls way up here. Personally, as
9 the CEO, I can grab any one of our portfolio companies
10 and sit with them, talk about their P&L, talk about
11 their balance sheet, why is this happening. I have an
12 operating background.
13 So we're very much into details, it allows
14 us to make the decisions on each company separately and
15 differently.
16 CHAIRPERSON AARONSON: In the various
17 companies you've had in your portfolios, have there been
18 any cases of labor relations which has resulted in
19 strikes or any other activities inside any of those
20 companies you've been involved in?
21 MR. BARNHILL: No. In fact, one of the
22 things we've established as a differentiator is, very
23 positive relationships with labor. We've looked at and
24 acquired a number of businesses in the auto sector, for
25 example, and our relationships with the United Auto

1 Workers at all levels, from national on down, have been,
2 not just extremely positive, but critical
3 differentiators in those transactions in the face of an
4 industry where there were other financial buyers out
5 there that were telling those union folks to
6 essentially -- take their leave, "this is what we're
7 going to do."
8 So we've kind of gone the opposite
9 direction. We have set out and sought out positive
10 relationships and transparency. We go in to these
11 businesses and we'll tell the employees, "Here's where
12 we are, here's what we just inherited. We have to fix
13 this together."
14 And consistently we get cooperation from
15 those employee bases as we do that because, as both Jake
16 and Tom noted, we're saving those businesses. We made
17 36 some-odd Platinum investments since October 2007 into
18 the teeth of the recession, and zero, none of those
19 companies have gone bankrupt; no Chapter 7, no Chapter
20 11.
21 Look across the rest of the asset class.
22 There are firms out there, one in particular, that said
23 more than two dozen during the same period of time,
24 where they've broken the company, thrown the keys at the
25 bank and said, "We're walking away."

1 MR. MILLER: You're not an investor in that
2 fund.
3 (Laughter.)
4 MR. BARNHILL: The point is, I think, we
5 have extremely -- we've gone out of our way to say this
6 is a differentiator for us in this space. Rather than
7 going in with a club and trying to bludgeon labor into
8 accepting something, we've gone in and embraced them and
9 said, "We need a partner to fix what is a broken
10 business together."
11 And that buy in has helped us, not just in
12 terms of running these businesses, but often to win
13 transactions where the recalcitrant organized labor was
14 a problem for the potential buyer.
15 MR. GORES: You can't be lazy in your
16 communications with labor unions or whoever. And I
17 think up front, if you're really transparent with them,
18 so look, "You can't survive this way in the business,
19 how can we work together and make it work?"
20 I think once you do that you're able to sit
21 at a table and speak honestly with each other, it makes
22 a huge difference. I think when you go in there with a
23 club, you've got a strategy, you're sticking to that
24 strategy, you're not listening to anybody, is why these
25 companies fail in those relations.

1 I have a very good friend at the UAW, and we
2 always joke. I can be at the pool hall shooting pool
3 with him, wearing jeans in Flint, Michigan, or come to
4 New York with a tie. I can do both.
5 (Laughter.)
6 MR. SCHLOSS: We appreciate the tie.
7 MR. GORES: It's a matter of understanding
8 the other side and being able to deal with them. For us
9 it's very easy. We certainly can do business in New
10 York. But there's also the human level, connecting with
11 people.
12 Somehow in our business, you know, Larry, at
13 the private equity level -- I don't know if they're
14 humans anymore, just operating and look at another -- we
15 respect those people working in the plant. We respect
16 -- everybody's got kids, everybody is human, right? And
17 we may be good at certain things. So I think we have
18 that respect and honesty, you end up having good
19 relations.
20 CHAIRPERSON AARONSON: One last question.
21 There is discussion that's going on nationally about
22 raising revenue. One of the things that is being
23 discussed is the taxation of carried interest, and
24 whether it should be as it is today or it should be
25 counted as earned income.

1 President Obama had a meeting with a number
2 of people yesterday; and if he called you and said "Tom,
3 what is your position on carried interest and the
4 taxation of carried interest," what would you tell him?
5 MR. GORES: I think it's a good question.
6 When I heard it I struggled with the question myself.
7 You can look at it like it's ordinary income. On the
8 other hand, it could also go at the heart of capitalism,
9 sweat equity. You start a business out of your
10 basement, you put your sweat equity in, you own the
11 business, you sell the business, it gets treated as a
12 capital gain.
13 So there's an argument that says that sweat
14 equity -- you don't necessarily want to take that away
15 from the folks. I'm a little torn on the argument. I'm
16 an entrepreneur by heart. So I believe in sweat equity
17 and I don't want to take that away from people who are
18 willing to take a chance.
19 In carry sometimes you pay somebody less and
20 you give them more carry, because they want to be
21 invested in the company. So they are giving you
22 guaranteed income as an employee and they pay carry.
23 It's sweat equity.
24 So I'm very torn on the issue. I might try
25 to convince the President that maybe there should be

1 something in between. I'm not sure that it's really
2 ordinary income. You can argue that it shouldn't be
3 capital gains. Maybe there's something in between.
4 CHAIRPERSON AARONSON: Thank you.
5 MS. MARCH: Talking about sweat equity, do
6 not believe that a policeman who goes out on the street
7 is not performing sweat equity every day. Do not
8 believe that a firefighter or a teacher who goes into a
9 classroom is really not operating under sweat equity
10 every day. They are.
11 MR. GORES: My brother-in-law is a fire
12 chief, and I see what he does for his town every single
13 day.
14 MR. MILLER: Any other questions?
15 CHAIRPERSON AARONSON: Other questions?
16 MR. MILLER: Great.
17 CHAIRPERSON AARONSON: Thank you very much.
18 MR. GORES: Thank you for having us.
19 (The Platinum people left the room.)
20 (Discussion off the record.)
21 MR. MILLER: Our recommendation to the
22 Teachers' Retirement System is a $115 million commitment
23 to Platinum. And as we touched on before, we've
24 negotiated fees, so we feel very good about that, as
25 well. We'll see if there is consensus.

1 MS. MARCH: We have consensus.
2 MR. MILLER: Thank you.
3 MR. SCHLOSS: Thank you very much.
4 MR. MILLER: We'll now move to Landmark,
5 which is a re-up, on page 242 of the book.
6 This is a re-up commitment that we're
7 recommending to the Teachers' Retirement System. This
8 is Landmark Fund XV. They've been doing it a little
9 while, so I won't bore you with the details you've heard
10 a couple of times before.
11 We are recommending a commitment, round
12 number, $113 million to Landmark Fund XV, and $37
13 million to a co-investment vehicle, and that's what I
14 want to spend the time on.
15 So we had a discussion with Landmark about a
16 creative structure on effectively how to reduce your
17 fees, and how to potentially reduce the carried interest
18 you might pay.
19 So we came up with the idea of a dedicated
20 co-investment vehicle. By a doing a dedicated
21 co-investment vehicle with them, we effectively reduce
22 your fees from 1 percent down to 75 basis points.
23 It's a dedicated co-investment vehicle, has
24 no manager fee and has no incentive fee on it. When you
25 blend that with a 1 percent fee on the overall fund, you

1 get a blended fee of 75 basis points.
2 This is a secondary fund. A lot of the
3 questions we talked about, a lot of the things we talked
4 about don't really fall into the category of this. So
5 they are buying seasoned assets, three to five years
6 old, 70 percent funded.
7 They have a proven track record. You can go
8 back a long time, 14 funds to take a look at.
9 Experienced general partners. These guys
10 have done the deal, been around together for a very long
11 time. It's a well-known brand. Landmark is one of the
12 brightest brands that's out there.
13 We also believe when building a portfolio
14 for Teachers on the secondary side, there's really two
15 secondary firms we believe will be your core positions.
16 So you have AXA private equity, which is your core
17 European manager, and Landmark will be your core North
18 American manager.
19 Secondary market opportunities, we talked
20 about this before. You are able to alleviate the
21 J-curve. So you're buying assets in general at a
22 discount. You're reducing the management fee drag, so
23 we think that's important.
24 This idea of a co-investment vehicle is a
25 nuance. It is something that's relatively new. We

1 think it's not an opportunity that's available to
2 everyone. You're getting it based on your brand and
3 your size, so that's important.
4 And finally, we look at performance. We
5 will talk about it a little later in the presentation.
6 Pretty consistent top quartile returns, so that's
7 important.
8 Overall, a commitment we're recommending to
9 the retirement system, $300 million to the fund, $100
10 million to a co-investment vehicle, which is how we get
11 to a blended 75 basis points.
12 If you take a look at page 243, again, as
13 mentioned before in the Platinum discussion, this is the
14 granularity with regard to your overall private equity
15 portfolio. You will notice secondaries, 10 to 15
16 percent target, 8.7 percent, so in that range.
17 Looking at the senior team, probably some of
18 the names ring a bell, some will not ring a bell. So
19 Frank Borges is the CEO. Tim Haviland is the president,
20 and they're outside. And then on the balance of the
21 team we have Rob Shanfield, who's one of the senior
22 members as well.
23 They're focused in the U.S. though they do
24 have an office in Europe, specifically in London. Jim
25 McConnell is one of the local partners, and when I say

1 "local," so local is not New York. And he has now moved
2 over to the U.K. and working on growing the platform
3 there.
4 If you go to page 346, this is something
5 we've talked about before. These are the returns. So
6 they've generated net returns over a very, very long
7 period of time of 19 percent. We think those are good
8 private equity returns. They've generated a net
9 multiple of 1.4.
10 So again, if you look at secondaries, you
11 get usually a little higher IRR, a little lower
12 multiple, because it's shorter duration, the dollars in
13 the ground for a small period of time.
14 They're returned all the money that's been
15 invested, and we think that's important. Again, it's
16 the nature of secondaries, because it's shorter
17 duration.
18 If you look on page 247 on the benchmarking,
19 very consistent top quartile returns. That's important.
20 And finally, when you look at it, you get
21 into the overall secondary market, we think it's a great
22 space for you all to be in. It helps diversify the
23 portfolio by sector, by stage, by type and by vintage.
24 We think Landmark is one of the premier
25 funds out there.

1 And with that, I would turn it over to Mike.
2 MR. KOENIG: I'll spend two seconds on the
3 strategy. I think when we look at secondaries, the
4 thing that we think is important is there is some
5 definitive differentiator of the firms that you would
6 support in their ability to go out and find the best
7 deals and drive the pricing of those deals.
8 The two firms that Barry mentioned before
9 being core, one of them we think has that
10 characteristic. And here it's a very structured
11 sourcing approach that allows them to be in most every
12 case the only party on the other side of the
13 transaction.
14 So it allows them a lot of flexibility and a
15 lot of tools, so that you're not just ending up with
16 exposure to the secondary market, you're ending up with
17 exposure to a specifically more attractive part of the
18 secondary market. You're not just following the trend,
19 you're impacting managers who can actually go out and
20 drive value.
21 And so that's something that is consistent
22 with what you would want in a primary portfolio, and I
23 think you would want in a secondary portfolio as well.
24 I think because of that sourcing and because of their
25 size it's differentiated.

1 We do also agree that on a strategic basis,
2 and you have seen it in our proposals around strategy,
3 this makes sense. They have a really good history of
4 breaking the J-curve that's good for your portfolio as
5 you increase you allocation, as you make any new
6 commitments. And it's also good in the entire context
7 of some of the overall goals for trying to reposition
8 the portfolio.
9 So we agree with this recommendation.
10 MR. MILLER: Also, I would expect a logical
11 question from Mel, kind of where they are on the current
12 fund with investing versus the new fund with manager
13 fees and so forth.
14 Today they're roughly 85 percent committed
15 to the current fund. They have deals in the pipeline
16 that they will begin sharing between the two funds. So
17 once there is a close in the first quarter of the year,
18 that management fee will kick in again. You will end up
19 by the time you're done, with 75 basis points, which we
20 would say is the lowest management fee of any of the
21 funds in the portfolio.
22 CHAIRPERSON AARONSON: I'm looking at page
23 246, Barry. And I'm seeing a $626 million fund, they
24 still have $36 million to invest in that fund? Then the
25 next one they still have $23 million to invest in that

1 fund? So what is happening with those investments?
2 MR. MILLER: Again, because they're buying
3 secondaries, so they committed capital. So what
4 happens, this is the unfunded of the underlying funds.
5 When you all make a commitment to a fund, you commit X
6 and they draw down money over time. So the money is
7 committed, it's just not funded.
8 With that, any other questions? Or I can
9 have Tim and Bob come in.
10 (The Landmark people entered the room.)
11 MR. HAVILAND: Good morning. My name is Tim
12 Haviland, one of the partners at Landmark. To my right
13 is Bob Shanfield, also a partner with the firm. We
14 appreciate you having us in today to spend a little time
15 talking about our firm.
16 Going right to the presentation material, on
17 page 4, we won't read it to you, but basically on page 4
18 the highlights are that Landmark was formed in 1989.
19 Since 1989 we've been a registered investment advisor
20 focusing on the private equity and real estate space and
21 in the secondary market in particular.
22 We have been considered by most to be the
23 pioneer and originator of the secondary market. That
24 goes back to 1989 when we bought a $100 million
25 portfolio from an insurance company. Since that time

1 we've expanded from venture to buyout to mezzanine and
2 real estate. So today, 95 percent of the business that
3 we do is real estate and private equity secondaries.
4 We have raised 19 secondary funds totalling
5 8 and a half, $8.7 billion since that time. And over
6 the past 23 years we've done over 400 transactions which
7 have exposed us to approximately 1400 different
8 partnerships.
9 The firm is located in Simsbury,
10 Connecticut, with offices in Boston and an office in
11 London, England, as well.
12 On page 5 we like to highlight the fact that
13 we're often in the market, we're in the market on a
14 regular basis. And that's important for us in terms of
15 our strategy, because if we're across the table from a
16 potential investor in our fund that we learned is not
17 really an investor, they then become a potential seller
18 to our fund, and so it's very important to be in the
19 flow.
20 We also highlight that the senior team, the
21 eight individuals listed here, have been together for an
22 average of 17 years. So we have cycled through multiple
23 funds and we have cycled through multiple markets, so we
24 understand the pluses and minuses of all those things.
25 On page 6 is a summary of our investors. It

1 is more difficult to list all of our investors, given
2 all the different confidentiality requirements and all,
3 but we have over 150 investors, very diverse, high
4 quality group.
5 Approximately 60 percent, as the pie chart
6 shows here, is pension funds. So we're very comfortable
7 and have been since the get-go in 1989 in terms of all
8 the regulatory requirements and reporting requirements
9 that go along with that.
10 Our performance since inception has been
11 strong. On page 7 we've highlighted our last four
12 secondary funds. But if you were in all of the Landmark
13 secondary funds since 1989, the net return that one
14 would have received is 20 percent, 20.4 percent to be
15 exact.
16 So why secondary investing? We presented in
17 front of you all before and have gone through that in
18 pretty good detail. But basically what we're bringing
19 to the table is the opportunity for higher returns with
20 lower level risk. And where does that come from?
21 It comes from the ability to buy into the
22 underlying funds at the right time in their life cycle.
23 And as the picture on the bottom of the page shows,
24 we're typically buying in years 4 through 7 of a fund's
25 life. And so by that point in time, that fund has made

1 most of its investments. We have an expression that the
2 lemons have ripened, the lemons have fallen off the
3 tree.
4 And so hopefully we're buying into funds
5 that have established companies, and those companies are
6 at that a point where they're ready to grow and be
7 harvested.
8 And so the higher rates of return we
9 generate are a function of buying at the right time in
10 the life cycle, buying at the right price; we often buy
11 at attractive discounts. And then as importantly,
12 buying at a closer point to when we have liquidity.
13 And so, investors in our fund have capital
14 deployed on a much quicker basis, and they get a return
15 of their capital almost immediately. We have made
16 distributions within one quarter of calling capital down
17 for a fund.
18 Bob will speak a little bit more in detail
19 when we get to the market dynamics and our strategy.
20 But the question is, what is driving the secondary
21 market, what's driving our deal flow?
22 It originally started out with limited
23 partners who had organizational changes. Two chief
24 investment officers changed position, and there was a
25 need to key up liquidity. It then moved into some

1 balance sheet management overexposed assets, a need to
2 sell something.
3 And then more recently, in the last few
4 yeses, it's become an acceptable portfolio management
5 tool. So it's okay to go ahead and sell an interest
6 that you bought a few years ago. It's okay to have your
7 consultant recommend you sell an interest that they
8 recommended you buy a few years ago. So there's all
9 these different motivations that are driving that.
10 Then on top of that base of deal flow you
11 have regulatory changes which seem to continually come
12 up. And as a result of that we are seeing and expect to
13 see over the next three or four years in particular an
14 increase in deal flow because of the different Volcker
15 rules, et cetera.
16 So deal flow has not been a problem. Back
17 in 1989 when we first started this business, people
18 didn't know what the secondary market was, and creating
19 deal flow was more difficult. But today it's acceptable
20 practice to do portfolio management, and as a result
21 there's more deal flow.
22 MR. SHANFIELD: Again, I'm Bob Shanfield,
23 also a partner at the firm. I'm going to spend a couple
24 of minutes on market dynamics as they exist today, so
25 looking at page 11.

1 Essentially we're pretty close to the end of
2 2012 and it's going to extend the market consecutive
3 streak of over $20 billion in secondary transactions.
4 There's a number of drivers behind the
5 activity level in the secondary market. The biggest is
6 the level of activity in the primary market. The
7 secondary market activity lags the primary market, and
8 we're still in the secondary market seeing a lot of
9 activity driven by the volume commitments that were made
10 a number of years ago.
11 On top of that, there's other factors that
12 are causing the activity levels to spike. There's a lot
13 of regulatory pressures, a lot of changes in investor
14 preferences that will continue to drive activity,
15 certainly through the next few years.
16 There's been a fundamental change in what
17 looks like the duration of the underlying assets in
18 private equity funds, which tend to have longer horizons
19 to liquidity. That has implications on how owners in
20 the asset class think about their portfolios, and the
21 needs that they have for the liquidity and the need to
22 find alternative means. That's where the secondary
23 market is serving those needs.
24 And there's also a lot of interesting and
25 unusual dynamics unfolding at individual partnerships,

1 which has to do with -- some of it has to do with the
2 extended liquidity of the underlying assets, some of it
3 has to do with just individual performance and the LP
4 issues at those funds. We're seeing more activity
5 coming from individual partnership opportunities and
6 restructurings.
7 Overall, seller goals and objectives are
8 becoming more diverse and complex. We think there's a
9 lot of opportunities for structured transactions, as
10 well as traditional transactions to address those.
11 That's where we're seeing a lot of growing activity.
12 On page 12 you have a pictorial of that. It
13 takes you through the first half of 2012. It's
14 essentially on pace with 2001, but what we've seen
15 unfold in the second half of 2012 is pretty much
16 following that same trend. So it's going to be at or
17 around the level in 2011, certainly in excess of $20
18 billion that we talked about.
19 I'd also make the point that we re-measure
20 the capital in the secondary space; that is, looking for
21 a home, that is investors looking to invest secondary
22 capital. By our measures, it does not outweigh this
23 range of opportunity.
24 There are certainly segments of the market
25 we think are more competitive than others, and we'll

1 talk about that in our strategy, how we focus on what we
2 think are the most opportune areas of the market.
3 What that, I'll turn your attention to the
4 next section, which really is about Landmark's strategy.
5 And I'll start on page 14. I think probably the most
6 important thing to know about us is that we do have a
7 highly differentiated strategy in the secondary space.
8 And the central elements of that strategy are outlined
9 on page 14.
10 We spend an awful lot time identifying
11 limited partners early in their portfolio management
12 decision process. I'll take you through that in the
13 upcoming pages.
14 We try to position ourselves and do position
15 ourselves as a partner. We offer access to education
16 and information, and even resources and analytical tools
17 that investors use and can use to think about their
18 portfolio, and we try to identify specific issues for
19 those individual investors and ideally apply a
20 transaction or solution that involves Landmark
21 transactions as part of their solution.
22 The creativity in those transactions is a
23 big part of what we do. And I think, again, what you
24 will see in the coming pages is, our approach really
25 affords an opportunity for a differentiated relationship

1 with investors that really allows us to stay away from
2 the most competitive situations and in most cases end up
3 in negotiated situations --
4 On page 15, what we outline here is pretty
5 simple, four pillars of our investment strategy. It's
6 about sourcing, finding the right deals, it's about
7 diligence and a very important focus for us is making
8 sure we have the time to diligence the assets we're
9 evaluating.
10 It's pricing that access to information, as
11 well as some of the structures that we apply in the
12 transactions that we do afford some pricing advantages
13 relative to competitive processes. And it allows us
14 some unique management in our own portfolio and
15 portfolio development, with a focus in certain cases on
16 some specific and opportune assets that we see in the
17 marketplace.
18 Page 16 is our attempt through a picture to
19 really describe what is different about how and where we
20 source deals relative to the rest of the market. And
21 this pictorial across the top with Chevron, starting
22 with the circle "Status Quo" on the left side and
23 "Execute on Final Transactions" on the right side,
24 really captures the entire universe of institutional
25 private equity investors.

1 And the point that I'd make is that most
2 secondary investors are really aimed at the far right of
3 this pictorial. They are trying to find situations
4 where an institutional owner of private equity has made
5 a decision that they want to sell and how they're going
6 to sell.
7 And the whole focus of their sourcing
8 approach is basically networking as many places as
9 possible to run into those decisions once they've been
10 made.
11 The very different thing about Landmark's
12 approach is that we're starting down at the other end of
13 this spectrum.
14 And while there may be a high probability of
15 execution on the right end, we think there is rich
16 opportunity for being exactly what I described before:
17 A thought partner, a solutions provider, providing
18 information and tools and analytics to help investors
19 think about their portfolios and be at their side as
20 that thinking develops, and really be in a position to
21 offer a customized solution; and at the same time living
22 with that portfolio long enough that we really have an
23 opportunity get deep into the underlying assets,
24 evaluate them correctly with respect to price, and so
25 give us both a pricing advantage and an execution

1 value-added advantage for them.
2 MR. HAVILAND: If you were to take this
3 picture, you would put auctions on the far right and
4 private negotiated deals on the far left, and that's
5 where we're trying to focus.
6 MR. SHANFIELD: Page 18 is a snapshot of
7 where our Fund 14 actually was at the end of June 2012.
8 We continued to deploy capital since then. At this
9 point we're 84 percent deployed in Fund 14. The
10 pipeline is 2 and a half billion plus. So clearly it
11 brings us into Fund 15.
12 The characteristics, even at June end
13 though, are typical; and there's a few points I will
14 make about the page here. The first is, on the top
15 right hand side of the page, we're investing in 226
16 partnerships over 24 underlying companies. The average
17 age of the underlying companies is almost seven years
18 old.
19 To Tim's point before, we're buying mature
20 assets, ripening on the vine, close to their time of
21 realization. That drives cash back to our investors
22 faster, and we have a lot of visibility on these assets
23 in terms of really being able to identify their value.
24 On the left-hand side you see we're running
25 over 20 percent net IRR. Importantly, we've also

1 distributed back to investors almost 28 percent of the
2 distributed capital. That's a feature of secondaries,
3 something we've been very rigorous about adhering to,
4 the quick return of capital, shorter duration and lower
5 risk of our exposure to private equity relative to other
6 private equity exposures.
7 We also see vast diversification, which is a
8 key criteria for us.
9 MR. SHANFIELD: We have an appendix for
10 after the meeting, if you'd like some case studies,
11 examples of what we have done. But at that point we
12 would leave it to you all for any questions we'd be
13 happy to answer.
14 CHAIRPERSON AARONSON: Any questions?
15 MR. HOLT: Minor question. You mentioned
16 that you source a lot of your deals through kind of
17 exclusive unilateral non-competitive bids.
18 How many of your clients are the other guy
19 on the transaction? How many of those are repeat
20 transactions? Is the other side generally pretty happy
21 with the deal that you offer, and do they come back or
22 always try to replenish the wealth?
23 MR. HAVILAND: Good question. We have had
24 maybe ten groups that we've had repeat buys from. It's
25 not a big number, but we do get a fair amount of deal

1 flow from the limited partners, other sellers, sharing
2 with them how well we were to work with. And I don't
3 mean that we're just good people, it's just that we're
4 well prepared. Our diligence process, we take it over
5 and make it easy for the seller.
6 That's often the biggest challenge, the
7 seller has a shrinking staff or doesn't have the time to
8 really take care of the sale. So our process allows
9 them to make it easier.
10 As part of the negotiated transactions, that
11 is 85 percent of the deals we do, are what we call
12 negotiated, one or two people competing, or more than
13 likely just ourselves. That's because we're in earlier,
14 as mentioned.
15 MR. HOLT: I just bring it up because,
16 obviously, it's incumbent on you to strike favorable
17 buying terms. But if the seller walks away and
18 subsequently has seller remorse, then I guess you can
19 achieve good returns on a few funds, but with the
20 prospects going forward.
21 MR. SHANFIELD: That's a very good point.
22 In fact, one of the things we tell sellers, we're not
23 going to steal something from you. We're not going to
24 outsmart you. But if we're in early enough, have enough
25 time to understand your real needs, that's part of it.

1 And so maybe you need to get out from
2 underneath the carrying cost of the asset, but you want
3 to continue to have the exposure. So maybe you'll sell
4 a slice to us. We'll represent you in the back office
5 part of it, and you still represent the front office.
6 There's a variety of things. So we're not
7 getting a better price, necessarily, but better terms.
8 And most important to us is, we're getting more time to
9 do better underwriting, make sure what we're buying is
10 appropriate. That's probably our difference.
11 MR. HOLT: Thanks.
12 MR. MILLER: Any other questions?
13 CHAIRPERSON AARONSON: Thank you.
14 MR. HAVILAND: Thank you very much.
15 (The Landmark people left the room.)
16 MR. MILLER: With that, the recommendation
17 we have to Landmark Partners 15 is $113 million to Fund
18 15, and a $37 million commitment to the fund (unclear).
19 So 150 in the aggregate.
20 CHAIRPERSON AARONSON: How large is the fund
21 going to be?
22 MR. MILLER: Three and a half to four
23 billion.
24 Thank you very much.
25 MR. SCHLOSS: Consensus?

1 MS. ROMAIN: Yes.

2 MS. MARCH: Yes.

3 (Discussion off the record.)

4 MS. PELLISH: We're going to go straight
5 into the continuation of the defensive strategy
6 composite. This is a discussion we've had over several
7 investment meetings. And because we weren't able to
8 accomplish this at the last meeting, we're now bringing
9 forward the recommendation to hire First Pacific
10 Advisors, FPA, for a mandate within the defensive
11 composite of the Variable A fund.

12 There are materials that were just passed
13 out that were also e-mailed to everyone in advance. And
14 I believe most of the information in here has been
15 presented in prior meetings. And there is a lot more
16 detail that I'm happy to go through if you would like,
17 but in the interest of time, I would suggest that maybe
18 we could start with page 4, and I will refer to some
19 facts on page 4.

20 Let me ask you to turn to page 9, and just
21 remind you about the components of the defensive
22 composite within the variable funds. This is a
23 composite whose role is to provide downside protection
24 within the Variable A fund of the diversified equity
25 fund. And therefore, it includes a number of strategies

1 that diversify the long only equity portfolios within
2 the rest of the diversified equity fund.
3 So you can see we have a TAA manager,
4 convertibles manager, and low volatility equity
5 managers.
6 What we have talked about in prior meetings
7 is our concern about the Lord Abbett convertibles
8 mandate, both from a performance and from an
9 organizational perspective. And so we had discussed
10 replacing that mandate with a long/short equity mandate.
11 In prior meetings we have talked about three
12 different managers that TRS staff and Rocaton have spent
13 time with. And today we're bringing forward FPA's
14 Crescent fund as the recommended manager for this
15 mandate.
16 So I will ask my colleague Marina Mekhlis to
17 go to page 4 with you and provide some characteristics
18 of FPA, and then they will come in and talk in more
19 detail.
20 CHAIRPERSON AARONSON: Can we go back to the
21 long/short strategy?
22 MS. PELLISH: Yes.
23 CHAIRPERSON AARONSON: As an investor, I buy
24 stocks in companies that I think are going to grow and
25 grow and provide growth and income and grow in value.

1 As a short seller, I'm selling companies -- like, it
2 just feels strange that this is an investment -- it
3 doesn't seem to be an investment. It seems to be some
4 kind of a bet against a company succeeding and -- could
5 you -- short as an investment.
6 MS. PELLISH: To give some background, any
7 investment manager, any stock manager, when they are
8 reviewing the universe of stock opportunities, spends a
9 lot of time winnowing through lots of stocks to identify
10 a relatively small number that they think are likely to
11 outperform.
12 In the process of identifying those that
13 they think are likely to outperform, they come across
14 quite a few stocks that they think likely to
15 underperform, and a few stocks they think likely to
16 underperform significantly.
17 So when you say to a manager, we're only
18 going to let you buy those you think will go up a lot in
19 price, and we're going to force you to ignore all the
20 information and analysis you've done on stocks that you
21 think will go down a lot in price, you are leaving
22 potentially something on the table.
23 They have done a lot of analysis to garner a
24 lot of information on a much wider universe of
25 opportunities than you are letting them take advantage

1 of. So you buy stocks whose price you don't think
2 always reflects their opportunities, and you sell stocks
3 whose price you think overestimates the opportunities
4 for that.
5 CHAIRPERSON AARONSON: You have to buy them
6 before you sell them. You're buying these stocks that,
7 for lack of a better word, stink.
8 (Laughter.)
9 And then you're selling them at a certain
10 time in the future.
11 MS. PELLISH: You are never buying them,
12 you're borrowing them. We lend securities we own long
13 to folks who borrow and sell them short. So what
14 selling short is, I don't own it, and I'm borrowing it
15 from you to sell to someone else.
16 And so the happy outcome is, I borrow from
17 you when the stock is priced at 100, I sell the stock to
18 someone else at 100, I buy it back when it's 80, right?
19 And so I've made a profit of $20. I returned the stock
20 to you. I got $100 for the stock that only cost me $80.
21 So, there are risks associated with selling
22 short. Because when you buy a stock long, the worst
23 outcome is, you lose all your money. When you sell a
24 stock short, the worst outcome is an infinite loss.
25 Because if it goes up exponentially and you do nothing

1 to manage that risk, you are going to have to buy it in
2 the market to return it someday. You have to return
3 that stock. If the stock goes up infinitely, your loss
4 is infinite.
5 So not every manager -- in fact, very few
6 managers who buy long also have the risk management
7 tools and the experience and expertise necessary to sell
8 short, because it is a riskier strategy.
9 The manager we're bringing forward to you
10 today on average only sells short 5 percent of their
11 portfolio. They do some short sales. They also try to
12 add value by, in their analysis of companies, not only
13 buying equity of those companies, but also sometimes or
14 instead buying debt of those companies.
15 So what they're trying to do in their
16 analysis of companies is identify the best way to invest
17 in the companies that they think are the most
18 undervalued. And that might be stock, that might be
19 debt.
20 And on occasion, when their analysis
21 identifies companies that really are obviously
22 over-valued in their analysis, to sell those short. I
23 think the largest short position they've ever had in the
24 portfolio is something like 10 percent. Sometimes it
25 goes down to zero, and on average it's been 5 percent.

1 So it's a much more modest step into the world of
2 shorting.
3 MARINA MEKHLIS: On that note -- and I would
4 echo all of Robin's comments here. We did consider
5 three managers for this mandate, which is FPA, what
6 we're bringing today, Highline and First Pacific
7 Advisors. And all of those firms have long track
8 records actually managing portfolios.
9 And what we are most worried about is
10 actually shorting and having the risk management
11 experience not to have that infinite loss that Robin
12 referenced.
13 Why we like FPA more for this specific
14 mandate is for three main reasons. One, it's the
15 easiest one to implement. So, if you think about short
16 selling, you actually need to go and work through a
17 primary broker. And as we had decided to go down that
18 route, we have to have more legal costs necessary and it
19 spans a significant amount of time to set up what's call
20 a "fund of one," a lot of you are very familiar with.
21 We don't need to do this in this case
22 because the FPA returning value fund is actually set up
23 in a 40X mutual fund that does allow limited shorting,
24 so sort of 5 or 10 percent, whatever they were doing.
25 So we don't need to reinvent the wheel to implement this

1 strategy.

2 In terms of the equity beta, most fund
3 managers that employ significant shorting have a
4 corresponding lower net exposure or lower beta to the
5 equity market.

6 Given the benchmark for the Variable A is
7 the Russell 3000, we do want some beta participation.
8 We don't want a complete lack of correlation there. So
9 the historical correlation of the FPA has been .7 to the
10 equity markets, which sort of corresponds to the net
11 exposure of 50 to 70 percent net.

12 The other part is lower fees, which is a
13 very important part. So as we all know, a typical LP or
14 long/short fund structure charges 2 and 20, which is 2
15 percent management, 20 percent incentive. In this case,
16 FPA does not charge a performance fee, and they only
17 charge a 1.25 percent management fee per year.

18 Unless there are questions, should I turn to
19 FPA?

20 CHAIRPERSON AARONSON: In this fund, will it
21 be the long portion is actively managed and the short is
22 actively managed?

23 MS. MEKHLIS: Yes.

24 CHAIRPERSON AARONSON: So we're getting
25 double actively managed as opposed to a passively

1 managed?

2 MS. PELLISH: Correct; there's no indexing

3 here.

4 CHAIRPERSON AARONSON: Is there any kind of

5 long/short fund that uses passive, in that they use an

6 index and out of the index they buy stocks that they

7 think will be coming up and sell 5 percent?

8 MS. PELLISH: There are some firms that will

9 buy select stocks to purchase long, to purchase

10 outright, and when they're concerned about the market,

11 will short the market through an ETF, which is

12 essentially passive. They're not selecting a particular

13 stock, or they may short a selective industry ETF.

14 So that exists. We're not particularly

15 excited about that strategy because we're paying a

16 manager lower than 2 and 20, it's not an insignificant

17 fee.

18 CHAIRPERSON AARONSON: We're paying 2.5

19 compared to 3/10 of one basis point.

20 MS. PELLISH: Gargantuan. It's low relative

21 to some managers, but it's high relative to the default.

22 And so we could simply index this money and

23 invest most of the money --

24 MS. MARCH: I think about that often.

25 MS. PELLISH: We all think about that often.

1 (Laughter.)
2 MR. SCHLOSS: We think about it often.
3 MS. PELLISH: For the defensive composite,
4 what we're trying to do is put together a group of
5 strategies that will, in the worst markets, keep us a
6 little bit out of trouble. And so that's why we have
7 TAA, that's why we have converts. And this is just
8 another way to attack the problem.
9 MS. MARCH: One thing I will say, during the
10 course of our history, the downside investments that we
11 made have absolutely done what they were supposed to do
12 as the market plummeted. This would be a new strategy
13 within --
14 MS. PELLISH: With the same objective.
15 MS. MARCH: Okay.
16 MS. PELLISH: So at one point this whole
17 composite was U.S. tactical asset allocation strategies.
18 Over time we added a global strategy, we added converts,
19 we had low volume equity. And everything we added had
20 an extensive track record. So this is just another way
21 to attack the same problem.
22 Should we bring FPA in?
23 MS. MEKHLIS: I'll say two words about FPA
24 before we bring them in. It's a Los Angeles based firm,
25 they flew in from Los Angeles today. And Steve Romick

1 is a portfolio manager for the firm. He's a graduate of
2 Northwestern University. And he has worked for a very
3 successful investment firm in Los Angeles before
4 actually starting this strategy and bringing it over to
5 FPA Crescent.
6 The firm is 100 percent owned and its track
7 record, as a preface, actually began in 1996, so he's
8 been doing this for a while. He's been nominated for
9 the manager of the decade by Morningstar for the period
10 of 2002 to 2010. And the firm --
11 CHAIRPERSON AARONSON: That's a decade?
12 MS. MEKHLIS: 2000 to 2010.
13 So, with that, we are going to bring him in.
14 Of course, if you have questions afterward he'll be here
15 to answer them.
16 (The FPA people entered the room.)
17 MR. HANCOCK: Good morning, everybody. My
18 name is Mark Hancock, of First Pacific Advisors.
19 MR. ROMICK: My name is Steve Romick, and
20 I'd like to thank you for hosting us here today. We
21 appreciate the opportunity. This is a special day for
22 FPA, we don't often get to do this. So, let's hope we
23 don't muck it up.
24 (Laughter.)
25 Thank you for having us. We have a

1 presentation book in front of you that we'll go through
2 in an abbreviated fashion. I know there's a limited
3 amount of amount of time. Please interject throughout,
4 because it will make for a more interesting
5 presentation.
6 So, if you think first about who we are and
7 what we do, if you turn to -- you already have the
8 firm's background and introductions, as well.
9 The philosophy of our trade value strategy
10 is a little different from most public funds. It's
11 different to the extent that we strive for an
12 equity-like rate of return. We don't strive to beat the
13 market, we strive for an equity-like rate of return, and
14 to do that while avoiding impairments of capital.
15 And the only way really to do that is by
16 doing a couple of things. One is to have a very pure
17 value investment philosophy. Thinking about a margin of
18 safety, protecting against downside, being willing to
19 wait on the sidelines until opportunities present
20 themselves; as well as investing across a company's
21 capital structure.
22 So we're fairly agnostic, is where we find
23 value, common stocks, preferred stocks, senior debt,
24 bank debt, et cetera, as well as other asset classes.
25 I'll go through some of those type of investments we

1 made.

2 If you turn to page 3 and look at what we

3 believe to be our competitive advantages; or, if not

4 competitive advantages, at least points of

5 differentiation. Other firms could do this, certainly

6 if they should focus on it. It happens to be something

7 we focused on for many years, a couple of decades, where

8 we have built in expertise across these different asset

9 classes.

10 So we are absolute return focused, which

11 means we don't invest, as I said before, just to invest.

12 If the market is up 20 and you are up, saying our

13 benchmark is up 20 or 21 or 22; or if the market's down

14 20 you're also saying the same thing, we're up, we don't

15 want to be 19 or 20, we can't be down more.

16 We don't think in those terms. We think

17 about how we're going to do over time.

18 In being sector agnostic, particularly over

19 the short term, it leaves us free of the concern of

20 trying to keep up at any one point in time -- bad

21 decisions get made as a result of that.

22 If you're feeling the need to keep up, so

23 you were keeping up in 1999 and you're buying every

24 Internet stock out there; we were not. As a result, in

25 1999, we were doing pretty poorly. In fact, I think the

1 only reason we had clients left with us at that point in
2 time was because they forgot they had money with us.
3 And so there's something to be said for bad memories.
4 (Laughter.)
5 We are perfectly willing to withhold cash
6 for extended periods of time, waiting for that next
7 opportunity. And then when the opportunities present
8 themselves, we're going to look across all different
9 types of places.
10 Think about New York City, for example, and
11 things we've done in the past. We used to own
12 Rockefeller Center in REITs. We don't go back to the
13 days when Columbia University actually sold it to the
14 Rockefellers. And the Rockefellers didn't make any
15 money for 40 years, but we bought it when it became a
16 public -- and then we disinvested at a point in time,
17 the property got sold to the Japanese and it went into
18 bankruptcy.
19 There was a back involved in the transaction
20 investment through the debt that offered very high rates
21 of return, and we were able to recycle -- we already had
22 into something that we understood well but offered a
23 different risk structure.
24 Because now we have to be worried about the
25 equity and how it might fare at different points in

1 time. Here we have a contractual obligation, and all we
2 have to be concerned about is that at the end of the day
3 when the principal comes due they have the money to pay
4 us back, and what is the collateral?
5 We always understood it. So that's how we
6 go about our research process and different kinds of
7 ways we think. When you think about equity rates of
8 return, if you can inundate the market -- and make up a
9 number, don't have a strong view -- but being in the
10 market is going to be compound for the next decade at 8
11 percent.
12 MS. MARCH: We will take it.
13 (Laughter.)
14 MR. ROMICK: Mark will offer you his
15 personal guarantee, and a very cute baby he'll put up as
16 collateral.
17 We can talk about larger views of the world,
18 because my views are not terribly sanguine.
19 MS. MARCH: We don't want to hear it.
20 MR. ROMICK: Tequila or Prozac.
21 (Laughter.)
22 As we think about 8 percent, if we can find
23 a bond that yields 9 percent that we're confident on its
24 ability to return that principal at a point in time at
25 maturity, then we will be perfectly fine owning that.

1 In a year when the market is up 30 we may only get 9
2 percent yield, but that's okay, that fits our targets.
3 And we also, in this flexible approach, as
4 we invest in different asset classes, we'll buy things
5 like subprime -- some very scary things, but not when
6 you're buying in 2010. The loans originated in 2005 to
7 2007 and you're paying 45 cents on the dollar.
8 So -- third party service (unclear) from the
9 likes of Redcap and Citigroup and others. We're also
10 (unclear) some other illiquid investments. We don't do
11 a lot of them as we are a public fund, but we do on
12 farmland. There's a long, large thesis we have about
13 that.
14 After this meeting, today, from having the
15 gentleman, key people at this company, the last two
16 hours with them. We are effectively part of a group
17 that now farms 7,000 acres in this country; and one of
18 the biggest farmers in this country.
19 And we have a big rationale for that. We
20 worry about all this quantitative easing, what it might
21 mean. People talk about gold, and we would rather have
22 an asset that actually can appreciate with inflation,
23 benefit from erosion of currencies, and as well have the
24 ability, should the emerging markets continue to grow,
25 spend more money on improving larger values, longer

1 share of (unclear) In emerging markets, just to improve
2 diet for people coming out of poverty.
3 So to get to this place and make each of
4 these types of investments, whether it be Rockefeller
5 Center or whether it be farmland, whether it be the
6 subprime home loans, we dig deep, we try to understand
7 the kind of work that we do, the kind of companies we
8 own, understand the businesses, understand the
9 businesses in a holistic sense and very deep sense, so
10 that we don't just make a trade.
11 We want to (unclear) things, go in depth, in
12 down markets, so you don't have that fear. And if you
13 have that fear of the marketplace, if you get scared of
14 your own shadow, and you don't end up buying into the
15 weakness (phonetic), go into 2008, we had a lot of cash
16 sitting on the sidelines. We were closed, we weren't
17 taking capital. We didn't take capital for three and a
18 half years.
19 Our goal is not to be large. Our goal is to
20 do a very good job. We weren't seeing opportunities.
21 And we also felt that we didn't have the team. So as we
22 built the team and saw opportunities in the winter of
23 2008 and 2009, we reopened and started taking capital
24 corporate debt hand over fist. And that was a terrific
25 opportunity at that point in time.

1 What we do is, we try to dig deep along the
2 way. We're great believers in understanding and
3 learning. We feel that we're students constantly. And
4 that's the exciting thing about what we do, learn about
5 different industries, and we look to hire people to
6 teach us.
7 As students, we don't presume that we can
8 figure it out all on our own. So we look for
9 consultants, experts, and we look for people who can not
10 just -- we can go through a dearth of financial
11 statements with the next guy. That's not what I think
12 differentiates us.
13 I think what differentiates us is to
14 understand the business, what the numbers mean, and what
15 the sustainability of that cash flow might be over time
16 or how it might grow.
17 So to that end, we actually have a Pulitzer
18 Prize nominated journalist on our team, who digs through
19 to gather for us qualitative data on the company, by
20 interviewing ex-employees, amazing resources out there
21 that you can take, and just through the Internet track
22 down people.
23 Anybody who's on LinkedIn, it shows where
24 they used to work. It's like tracking down people where
25 they used to work. You can say okay, well, when you

1 worked there, what was it like working with this man or
2 woman? And that's what we try to do.
3 What we do also is incorporate this against
4 the macro backdrop. We have a point of view of where
5 the world is and where the world is going to be. That
6 point of view is not considered in order to derive a
7 trade. It's not considered in order to figure out, oh,
8 we have to go put money here over the short term. It is
9 really considered so that we can try to avoid large
10 (unclear) of capital.
11 MS. ROMAIN: What can go wrong with your
12 strategy?
13 MR. ROMICK: The biggest thing that can go
14 wrong is, if you believe we're in for a big bull market
15 from here, you shouldn't invest with us. You shouldn't
16 invest with a product that has a bias to protecting
17 capital, rather than getting return on the capital.
18 So the biggest thing that can go wrong --
19 there's two questions that you asked. Specifically, you
20 asked a question about what can go wrong with our
21 strategy? I answered the question, What can go wrong
22 with your investment or product? Which could be two
23 parts, it could be the strategy or it could be you made
24 a bad choice on investing with the fund that seeks to
25 protect capital when one shouldn't protect capital.

1 (Unclear) stock trade are from the 20s, bankrupt a
2 number of times and ultimately committed suicide, so
3 probably not somebody to quote -- (laughter).
4 Nevertheless, in a bear market, once you
5 give a kid the money to manage who's never seen a bull
6 market; once you give a kid who's never seen a bear
7 market money to manage. So that's thing.
8 The second thing is, about strategy, one of
9 the reasons if you looked at our returns, we've
10 accomplished those returns averaging 20 percent cash for
11 over two decades. Our batting average is very, very
12 high on the investments we make.
13 And so, we will make mistakes with
14 individual companies. It happens. We'll talk mea
15 culpas and learn from them and move forward. So we make
16 mistakes in individual companies. I don't think, I'd be
17 hard pressed to understand anything that can really go
18 wrong over time.
19 Over the short term, we could be zigging
20 with the market and zagging. In the short term, we
21 could make a number of mistakes that collect all in one
22 year; that possibility exists. It hasn't really
23 happened in the past, but that possibility certainly
24 exists.
25 But by digging deep, I think, and digging

1 into these companies, and looking at the turnover, the
2 turnover in our portfolio is relatively low, which
3 supports the argument at least that we get to know our
4 companies better. It doesn't mean we know them well,
5 that isn't proof that we know them well, just because we
6 hold something for five years.
7 But I think if any of you were to come into
8 our office, and we welcome that, we will share that
9 research with you, you will see the depth we go to,
10 which is unusual. So I don't think that over time
11 there's much that can go wrong. I think the biggest
12 factor is the first one, protecting capital when you
13 shouldn't.
14 If you look at page 4, looking at the
15 investment committee, it's run by an investment
16 committee of myself, Mark Landecker and Brian Selmo.
17 We're all value investors. Mark is more of a value
18 investor than the rest of us.
19 To give you -- to understand who we are as
20 investors (unclear) to understand us as people. It's
21 hard to get this across in a very short meeting. But we
22 are people who aren't looking to live large, people
23 looking to gather the most dollars. We're just looking
24 to do a good job for our clients. The commitments we've
25 made, I've made to my team -- if we're looking (unclear)

1 I wouldn't have been closed for three and a half years.
2 Our other products in our firm have been closed, as
3 well.
4 It's also how we live. I would only buy
5 used cars for myself. I hated the idea of driving off a
6 lot and having to give up $10,000, because immediately
7 the depreciation; it's anthema to me.
8 MR. SCHLOSS: You just have to hold it
9 longer.
10 (Laughter.)
11 MR. ROMICK: My first new car I ever bought,
12 when (unclear) passed away (unclear) I bought my first
13 convertible. I had a stomach ache for month.
14 MS. MARCH: I bought a fur coat.
15 (Laughter.)
16 MR. ROMICK: Mark is an unusual guy. Mark
17 is in touch with value. He can't stand the idea of
18 wasting money, and he can't stand the idea of wasting
19 time.
20 So, as an example of that, money and time,
21 his home in Santa Monica, astroturf in his front yard
22 and his backyard. Your vision of Southern California is
23 not astroturf, but it's cheaper and it doesn't have to
24 be maintained. You don't deal with gophers, gardeners,
25 or anything. So that's the way we think. And that

1 thought process is pervasive throughout the team.
2 Page 5 are returns relative to performance,
3 which I believe we don't need to talk about today or
4 discuss ad nauseam.
5 If you at page 6, this dissects the returns
6 a little bit. The absolute return focus, as you think
7 about downside protection. When we think about downside
8 protection, willingness to underperform. (Unclear)
9 breaks the market into rolling three year periods, it
10 puts in the deciles for the last 20 year.
11 And we've underperformed, you can see on the
12 far right, in the top two deciles. On average, 7.7
13 percent, compounded over the rolling three year period.
14 Then, if you look at the bottom two deciles
15 where we outperformed, we outperformed by a larger
16 margin than we've underperformed. And that's where some
17 of the excess performance comes from. Again, we aren't
18 proposing excess performance, our goal is to do as well
19 with less risk. The excess performance has been a bonus
20 thus far.
21 The absolute return, also if you look at
22 what's happened on page 7, you see a rolling calendar
23 performance -- outperformed the market in all of the
24 rolling ten year periods that we have been in business.
25 You can see as you look at the average allocation fund,

1 which is the nearest comp that you can find, that as you
2 look at these periods, the one year, three, five, seven,
3 they go down, because they outperform over time, as ours
4 is going up.
5 To give you an idea of how we think about
6 flexibility, if you look at page 8, this is to put
7 pictures to paper on this. If you look, this chart on
8 page 8 shows small cap stock versus large cap stocks,
9 shows the relative PEs of each; so the PEs of small caps
10 divided by the PEs of large caps.
11 What it means is, the chart is going down,
12 it means that small caps are cheaper, and if it's going
13 up that large cap stocks are cheaper.
14 And it you look at this, you'll see that, at
15 point A, that the (unclear) goes up to 1990, small cap
16 stocks were 30 percent cheaper than large cap stocks.
17 So the point in time where you get down to 1997 where it
18 was 10 percent cheaper, we look for things that are
19 cheaper, we're buying small cap stocks and we're buying
20 more of them.
21 In '97 to '98, down 20, 30 percent, to '99,
22 down 40 percent discount. This means also as the
23 discounts are getting wider, we're getting more and more
24 excited, but it also means we're not making money for
25 our clients. People are buying, throwing big money at

1 technology, throwing money at growth stocks, and that's
2 where the opportunity was.
3 So we underperform wildly over two years.
4 You can see the market cap at the bottom, $900 million.
5 But our underperformance in those two years, which were
6 56 points behind the market, over two years (unclear)
7 three more years to it, for 2001 to 2002, they were 42
8 percent ahead of the market over the five year time
9 frame.
10 So the first two years weren't so good by
11 comparison in this period. The next three years were so
12 much better than the first two years were bad, that the
13 market was down for each of the years 2001 and 2002 and
14 we were making money.
15 And that's not because we got smarter, not
16 because we were stupid in the early years, but because
17 what we were buying finally was being recognized. And
18 if you buy good businesses at great prices, you will be
19 recognized over time, invariably. That's been the case
20 since the beginning of time.
21 And now, today you can see that large cap is
22 more expensive, explains a little bit the current
23 portfolio's positioning where we have larger cap
24 exposure, (unclear) market caps, and this is a dated
25 chart here, but it's $64 billion, I think we're $62

1 billion or something like that today.
2 Turning the page, what we do buy bonds,
3 we'll show you investment bonds in a minute, we start
4 with the right-hand side of the chart this time and move
5 to the left to explain the thought process.
6 So the red line is the spread. The spread
7 is what you can get in a bond, on a corporate bond, in
8 high yield versus Treasuries. The bigger the spread, or
9 greater the red line, the wider the spread, the more
10 attractive corporate bonds are.
11 So one should expect at a point in time on
12 the right, when spreads are about average, our exposure
13 should be less. Well, our exposures are well below
14 average. Not only are spreads relatively normal, the
15 starting yield is so low with Treasuries, ten year
16 Treasuries at 1.7 percent, it's just not interesting;
17 1.7 plus 5 percent on a spread, or 6 percent (unclear) 7
18 or 8 percent return for high yield bonds, which doesn't
19 justify the risk you're assuming to make those
20 investments.
21 So our exposure, which peaked when the
22 market was so attractive, you can see back in 2008 or
23 2009 when the red line goes through the roof, and our
24 exposure peaked, we hit 34 percent exposure at that
25 point in time, and it's been coming down since along

1 with spreads coming down.
2 And you can see back in the middle part of
3 the last decade, our exposure was low then, and we
4 necked up when the spreads were attractive, as it was in
5 2002. But we still got good exposure actually in the
6 late 90s.
7 So why such great exposure when the spreads
8 weren't that wide? The reason is, yields were higher.
9 We were very comfortable where yields were, and getting
10 what we thought was the equity rate of return for less
11 risk in the market.
12 So what we do is, we don't look to have
13 every industry. We'll invest in whatever industries are
14 out of favor. We look for bad news, bad news in
15 whatever industry or whatever asset class. So this is
16 an example of bad news. Bad news means the lines go up,
17 and you would expect the blue bars, which is our
18 exposure, to also increase.
19 If you have questions?
20 Mark told me to pause.
21 (Laughter.)
22 When you think about cash and how we think
23 about cash, we take a flexible approach to cash, which
24 is page 10. The cash in our portfolio goes up and down,
25 not because we're targeting cash. It goes up and down

1 predicated on what the opportunity set is. If there's a
2 lot of opportunity, cash goes down. If there's not much
3 opportunity, cash goes up.
4 So this will show you that in periods when
5 cash is high, our returns in the next two years have not
6 been particularly stellar. They've averaged 5.8 percent
7 in those next two years.
8 However, when cash goes down and hits these
9 troughs, you can see the returns for the next couple of
10 years are much, much higher. It shows we understand
11 what value is. I think, graphically, it's what I'm
12 trying to explain orally.
13 That leaves us with page 11, it's very
14 small. It shows our allocations historically, and I can
15 tell you where they are today, we're about 66 percent
16 long equities, we're about 3 percent and change in short
17 stocks, and we have got less than 3 percent in corporate
18 bonds, and we've got a couple percent still left in
19 these 1.5 subprime (unclear), with a smattering of
20 smaller things in the portfolio in other asset classes,
21 including farm land. So we're actually pushing our cash
22 above historic average.
23 I thought I would go through a few
24 investment examples to show you the kind of things we
25 have owned in the portfolio, that will help exemplify

1 what it is --
2 MS. MARCH: Page 13 is pain.
3 MR. ROMICK: I won't go through all of them.
4 MS. MARCH: We don't like Wal-Mart.
5 MS. PELLISH: Maybe we don't need to go
6 through the examples unless the board wants to.
7 Are there any questions?
8 MS. MARCH: We're good.
9 MR. ROMICK: Thank you all very much for
10 your time.
11 (The FPA people left the room.)
12 MS. PELLISH: The proposal on the table is
13 to replace Lord Abbett, the verbal mandate, with the FPA
14 Crescent fund, and that will be about $30 million of
15 target.
16 MS. MEKHLIS: Their fund is $9 billion.
17 MS. MARCH: We have consensus.
18 MR. HOLT: Question. Since there's a lot of
19 curiosity about the risk that would be borne from going
20 short stocks, and also what impact it would have on
21 return, would it be possible to add some reporting to
22 just keep track of this new investment prospect that you
23 brought to us?
24 MS. PELLISH: Sure.
25 MS. MARCH: We keep track of it all the

1 time.

2 MR. HOLT: Of short sales?

3 MS. MARCH: We do, they keep track for us.

4 That's why they're there. They keep track of whatever

5 we invest our money in, whatever manager we invest our

6 money in.

7 MS. MEKHLIS: As part of the long/short

8 strategy, we do keep track of long/short attribution of

9 all of our client exposures to insure that the short

10 side is indeed adding value over time, rather than to

11 track value.

12 MR. HOLT: Excellent.

13 MS. PELLISH: This decision incorporates two

14 actual actions. One is the determination of Lord

15 Abbett, and the second is the investment if FPA.

16 Is there consensus on both?

17 MS. MARCH: Yes.

18 MS. ROMAIN: Yes.

19 CHAIRPERSON AARONSON: Mark will notify Lord

20 Abbett that we're firing them, and I will notify the

21 company that we're hiring them.

22 (Laughter.)

23 MR. KATZ: Notification will come subsequent

24 to board resolution.

25 MS. PELLISH: Can I also call the board's

1 attention to a few pages that are in the rear of this,
2 that deal with a benchmark issue? And so, I will point
3 your attention. So page 13 has a lot of information.
4 Let me summarize it for you.
5 As I mentioned before, the defensive
6 composite used to be comprised almost entirely of the
7 tactical asset allocation strategy. Those tactical
8 asset allocation strategies could have an exposure to
9 long Treasuries.
10 Over time composite has changed
11 significantly in the types of strategies that are
12 represented, and they no longer use long Treasuries as a
13 significant allocation. And so the benchmark needs to
14 change to keep pace with the change in the composition
15 of the strategies used.
16 So we need the board's approval to do that.
17 MS. MARCH: You have consensus.
18 CHAIRPERSON AARONSON: Okay.
19 MR. SCHLOSS: Done?
20 MS. PELLISH: Done.
21 MR. SCHLOSS: Mark?
22 (The Rocaton people left the room.)
23 MR. KATZ: I want to bring your attention to
24 the renewal of Rocaton's contract as a consultant for
25 the QPP and the Variable.

1 Back in 2009 we did an RFP for an investment
2 consultant, and the results of that was that Rocaton was
3 selected effective January 1, 2010 for a period of three
4 years. And the resolution read that they could be
5 renewed as a consultant for two 3-year periods
6 subsequent to the expiration on December 31, 2012.
7 We are recommending that they be renewed for
8 the second three year period. And consistent with that,
9 they would like to increase our fees, albeit moderately.
10 The way we had structured the initial
11 contract was that the fee would be increased $20,000
12 every year for the first three year period and
13 conceivably would remain $20,000 for every year in the
14 next three year period.
15 We have had chats or discussions with
16 Rocaton, and we were successful in bringing down the
17 increase to $10,000 per year for the Variable and the
18 pension fund similarly, instead of $20,000, also $10,000
19 per year.
20 So I think we need just consensus to renew
21 their agreement.
22 MS. MARCH: After we give the consensus, is
23 there a resolution?
24 MR. KATZ: A resolution indicating that we
25 are renewing.

1 CHAIRPERSON AARONSON: And we're discussing
2 both contracts now?
3 MR. KATZ: Correct; the Variable and the
4 pension fund.
5 MS. ROMAIN: We agree.
6 MR. SCHLOSS: I think they are great. They
7 are very easy to deal with, user-friendly, accessible,
8 straightforward, practical. I like them a lot.
9 MS. MARCH: And on the Variable side?
10 MR. KATZ: Same story. They are there when
11 we need them, and more often than not they initiate.
12 MS. MARCH: Can the motion be at the
13 December board meeting?
14 MR. KATZ: Yes, ma'am.
15 MS. MARCH: We're ready.
16 (Recess taken.)
17 CHAIRPERSON AARONSON: Back on.
18 MR. SCHLOSS: I'd like to go back into the
19 public session to talk about real assets, and then
20 bounce back into the executive session to talk about AXA
21 Europe, and then we can muddle through the rest of the
22 order.
23 MS. MARCH: I move that we go back into
24 public session.
25 CHAIRPERSON AARONSON: Is there a second?

1 MS. ROMAIN: Second.
2 CHAIRPERSON AARONSON: Any objection?
3 We're back in public session.
4 (Discussion off the record.)
5 (The Rocaton, Townsend and Courtland people
6 entered the meeting.)
7 MR. SCHLOSS: We're here to talk about real
8 assets. Let me see if I can lay a little background as
9 to what we're talking about.
10 About 18 months ago in connection with the
11 asset allocation, we talked about real estate, we talked
12 about infrastructure, we made reference to timber, we
13 made reference to other hard assets like energy. And I
14 think it might have been in last year's annual plan, I
15 talked about additional staffing, and inside that we had
16 infrastructure people.
17 So we now have two infrastructure people.
18 And once you have the people -- it's a little bit of
19 chicken and the egg, do you get the IPS before the
20 people, or do you get the before the IPS? The answer
21 was, first you get the people, because people have to
22 write the IPS.
23 And as we went through the process of
24 talking about real assets originally, we kind of talked
25 a lot with all the consultants, Robin and Steve, and we

1 sort of came up with real assets, we sort of came up
2 with a plan to basically expand the real estate
3 definition into real assets.
4 So we had allocated 6 percent to real
5 estate, and then we said, let's expand real estate to
6 real assets, we'll have an IPS for real assets, embedded
7 in the asset IPS will be real estate and the
8 infrastructure allocation in the future timber and
9 energy assets.
10 And we were also in the process of redoing
11 all the IPSs anyway, so rather that just read you the
12 real estate IPS, put the real estate IPS into real
13 assets.
14 So what we're here today to talk about is A)
15 the asset category of real assets, B) the real asset
16 IPS, and anything in the middle.
17 So let me first ask Robin to talk about real
18 assets and how it fits into the asset allocation, to get
19 to the IPS.
20 MS. PELLISH: Sure. Real assets provides a
21 source of diversification for the pension fund, which
22 has a significant allocation to equities, and then a
23 significant allocation to market bonds. Those are the
24 big allocations within the plan.
25 Real assets provide a different set of risks

1 and return for the program. And in addition, provides a
2 significant sensitivity, which is also available within
3 the TIPS program in the plan. But elsewhere, given that
4 you have a significant allocation in nominal bonds,
5 having an allocation to asset classes such as
6 infrastructure and real estate, which tend to appreciate
7 when inflation rises, is a big plus.
8 So for those reasons, having an allocation
9 to a diverse set of real assets makes sense.
10 Historically, the real assets was dominated by real
11 estate, and that will continue to be the case for many
12 years. But I think it makes sense within that type of
13 exposure, it makes sense to seek out additional sources
14 of risk and return.
15 And infrastructure is related to real estate
16 but has significantly different characteristics, and it
17 makes sense to start the process of allocating assets to
18 those kinds of strategies.
19 Undoubtedly, over time, additional types of
20 real assets, strategies like energy investments, timber
21 investment, perhaps agricultural, farmland investments
22 makes sense. We're starting the process of diversifying
23 the real assets investment with infrastructure as a
24 first step.
25 MR. SCHLOSS: Any questions on real assets?

1 So perhaps the easiest way to go through
2 this is perhaps talk about the IPS.
3 Who down at the west end of the table wants
4 to start?
5 MR. BURNS: I was very encouraged a few
6 years ago when you looked at infrastructure. And that
7 was part and parcel, in my view you're looking at real
8 assets, and I know that effort didn't come to fruition.
9 But about that time many of our other clients were
10 looking at timber and "supplements" on a creation basis,
11 in an effort to create assets for the portfolio.
12 I think about ten of our pension fund
13 clients, about 70 have moved in that direction. Most
14 recently I was in Europe with the United Nations
15 investment committee, and they had moved their real
16 estate portfolio from 6 percent they crafted a real
17 asset portfolio, through the portfolio by 4 percent,
18 they intended from (unclear) and timber.
19 So I think you're really at the cutting
20 edge. Wide real assets, there's not a lot I can add to
21 what Robin said. As I was preparing my comments I found
22 an article from JPMorgan. I thought it very succinctly
23 made the case. It says as follows:
24 "History shows that secular changes in an
25 investment environment fosters dramatic changes in asset

1 allocation. Low bond yields along with outside equity
2 market volatility and (unclear) have brought us to an
3 asset allocation tipping point. In the next decade real
4 assets will move from alternative to a mainstream asset
5 class. Portfolio allocations could rise from roughly 5
6 to 10 percent today to as much as 25 percent in the next
7 decade."
8 I believe that's true.
9 Robin, anyone in your base, I think you're
10 probably seeing it. I talked to Steve and Bill. I know
11 people are definitely moving in this direction, it's a
12 good idea.
13 The IPS itself --
14 MS. MARCH: Is it possible for you to get us
15 that article?
16 MR. BURNS: I have it here.
17 MS. MARCH: Do you have the link? It would
18 be better if you gave the link to Patricia or to Mark or
19 Larry, they could pass it on to us. Larry will send it
20 to us.
21 MR. SCHLOSS: Perfect.
22 MR. BURNS: On page 2, in your book it's
23 page 115 the IPS begins. Page 2 of the document, I have
24 probably 116 for you. The strategic objective -- also,
25 if I might draw your attention, we dropped the

1 PowerPoint off, it's page 1 of my PowerPoint.
2 The strategic objective for all of the
3 assets basically the same, and they're listed in my
4 PowerPoint on the bottom of page 1, in your overall
5 documents the first real text.
6 What we're trying to do here is similar to
7 discussions we've had historically concerning real
8 estate. Preserve investment capital, very important.
9 We provide a hedge against inflation. Diversify the
10 product portfolio by damping volatility and providing
11 attractive risk adjusted returns.
12 Straightforward, simple, it's what we've
13 been doing in real estate for years. We're now going to
14 attach that definition of strategic across numerous
15 asset classes.
16 On page 2 of my PowerPoint, I've laid out a
17 diversification model (unclear) low or negative
18 correlations of these asset classes to the other asset
19 classes, not highly correlated to one another. And as a
20 result, a really nice supplement to your existing
21 portfolio, in my view.
22 Page 3, another big one. We moved with
23 inflation, it's a partial hedge for inflation, I might
24 use the real estate space as an example. If you
25 consider leases, goods and services when inflation goes

1 up, those go up. And it is basically true in our other
2 asset classes, as well. I wouldn't bore you with you
3 details of that. A lot of signs, as we talked about
4 that, how do you move with inflation, hedge, et cetera,
5 et cetera. That's for another day.
6 Page 4, obviously we're always looking for
7 profit, to create dollars for your beneficiaries. And
8 just as an example, we put together a schematic which
9 gives you an idea of the ten year risk return on a
10 variety of different real assets.
11 TTP out fund index, that's your higher risk
12 opportunity fund. The Odyssey is your core space.
13 And then we have a listed infrastructure,
14 category farmland, timber. That's a long time period, a
15 pretty long time period. That gives you an idea of what
16 this is going to do. That's a ten year study, I
17 believe.
18 There is private market data regarding
19 infrastructure. But it is not as deep or as long, so
20 our challenge is to put in a composite for you.
21 MR. NORTH: Steve, you put this out and we
22 used the terminology, which I think is inconsistent with
23 what I would normally hear from you, which is this is
24 what you can expect.
25 And between the time period, and the past is

1 not a guarantee of the future, you might want to for the
2 record make, this is history, and the challenge is
3 whether and what you can do for the future.
4 MR. BURNS: Past performance is not
5 necessarily --
6 (Laughter).
7 -- thank you, sir. Pas performance is not
8 necessarily indicative of future performance. But it's
9 a nice backward look. As an indicator -- that's the
10 real asset portion of this.
11 Basically, as we design this, we went
12 through many different iterations with BAM. The roles
13 and responsibilities of the parties are in here. Things
14 you have seen from year to year to year in your IPSs, so
15 I won't read that to you.
16 What I'd like to do now if I may is turn to
17 real estate. We drafted a new IPS, BAM and Townsend and
18 Courtland. Much of what we've done is the same. When
19 you look at it, your program -- no less than 40 Core, no
20 less than 40 Non-Core, and the balance tactically --
21 nothing at all that is changed that way. Nothing that
22 changed in the IPS relative to the roles of the parties.
23 This is largely a nondiscretionary program
24 with two caveats. On the Core side, BAM and consultants
25 can do things, in terms of re-ups we can do things. By

1 and large you see (unclear) quarterly, at least, if not
2 (unclear).
3 We've made some modifications. In my
4 PowerPoint I take you through these. The benchmark, if
5 you recall, initially when your program started, we had
6 the NCREIF property index benchmark. Within the past 18
7 months, there are challenges within NCREIF. It's not a
8 representative benchmark. It's very different.
9 We moved to investable investors. We've
10 netted out expenses. We want to do longer, larger
11 cycles, get a (unclear) premium. The ten year rolling
12 returns, what we did and why is that fair, why is that
13 true?
14 Your more current returns, you're about 100
15 bips over on the one -- look at the numbers. It seems
16 to be -- intuitively, it seems to makes sense. But if
17 you take a look at the ten year rolling returns I put
18 forward there, you basically, we took blended portfolio,
19 which is 50 Core, 50 Non-Core, and we ran it against
20 Odyssey.
21 And what you basically have is sort of
22 (unclear), that's about what your risk is going to look
23 like, Core to Non-Core. And that's a rolling backward.
24 I think it's fair, transparent. I think the Odyssey is
25 better than the NPI, it's investable, it's real life,

1 we're in the Odyssey funds already.
2 So that's the change to the benchmark.
3 MR. SCHLOSS: That's the old change.
4 MR. BURNS: We changed the Odyssey a year
5 and a half ago.
6 MR. SCHLOSS: So it's not a new change.
7 MR. BURNS: We actually tightened up the
8 IPS. If you recall in prior times (unclear) this
9 morning, there was like a plus or minus 30 on the NPI
10 property type, the geographics. I can drive a truck
11 through that. That means you can be 70 or 80 percent
12 off at any given moment in time, or any other property
13 type for that matter.
14 So now what we have done is, we've put some
15 constraints in. And they are logical, but based on the
16 Odyssey, I will say this to you, though. I'd always ask
17 for a lot of flexibility. You will see opportunities in
18 certain property types. It wouldn't surprise me at all
19 if (unclear) comes to you with a deal or two towards
20 apartments or industrial, what we sense are good market
21 conditions, et cetera.
22 But by and large, we're trying to track toe
23 Odyssey more or less, in terms of our property holdings.
24 And we ask for some flexibility along those lines.
25 MR. NORTH: Steve, it would seem that if the

1 policy is to include flexibility, then defer to the
2 consultants and managers to provide that level of choice
3 of things moving around, to be asked their activity,
4 they put themselves -- you and they put themselves at
5 more risk of missing the benchmark because the benchmark
6 is often largely fixed allocation over time. They don't
7 change a lot within the property types.
8 But now, with this level of flexibility, do
9 you see any issues for that, if it turns out that you
10 move well within one of the ranges and it turns out that
11 range decision was wrong, and for that reason
12 underperforms the benchmark? That's an acceptable and
13 appropriate risk at the policy level, in your opinion?
14 I understand that at the manager level it's
15 a tactic and a strategy for managers. You're proposing
16 to put this level of flexibility at a higher level than
17 it usually is in investment policies. And if that's
18 appropriate, fine, but I think it does create a greater
19 variance around the expected benchmark and puts a lot
20 more burden on the consultants and the decision-making
21 process.
22 And that may be perfectly fine, but think it
23 is very different than the kinds of tight restraints on
24 our other asset classes.
25 MR. SCHLOSS: I don't think I'm following

1 everything you said.
2 MR. HOLT: I think there's some confusion
3 about what the real assets benchmark would be, and it
4 seems there is a fair amount of room for interpretation
5 with the current policy.
6 MR. SCHLOSS: Real asset, or real estate?
7 MR. HOLT: This is part of the real assets
8 components.
9 MR. SCHLOSS: We're just talking real
10 estate. I think you were talking about what kind of
11 properties the manager is buying.
12 MR. NORTH: I'm suggesting we take something
13 like Core+5, specific as to the benchmark. With this
14 particular policy level item, you are talking about
15 flexibility up to 45 percent, which I presume means zero
16 to 45 percent.
17 Now, the NCREIF plus 100 is based off the
18 NCREIF averages I presume, and it will be fairly stable
19 over time. As a strategy of moving away from the
20 NCREIF, that's usually an active manager decision. Here
21 you've got a policy level.
22 MR. BURNS: The overriding objective or
23 theme is not to allow me the flexibility to go buy a
24 certain property type or region. Do I want that
25 flexibility? I do. The overarching theme, the reason

1 for the restraints is -- I will correct you on one thing
2 -- the Odyssey weights will move. They will move.
3 And it is not our desire to start creating
4 benchmark risk by massively shifting one way or the
5 other. But I need some room. I know you will change
6 and I don't want to walk into the board and say, "Oh, by
7 the way, office is at 27 percent, we're way below that."
8 That's more the team of this, Bob.
9 I want the ability to do it, I do.
10 MR. NORTH: I'm not suggesting you shouldn't
11 have it, it's not appropriate. But I'm noting that,
12 unlike a lot of other areas, at the policy levels this
13 would appear to allow for more variance around the
14 benchmark because of the wider ranges of potential
15 investment; not that you wouldn't presume to do it, but
16 -- let me just be blunt.
17 Five years from now after somebody makes a
18 decision to do the following investments that happens to
19 move something away from the average investment in the
20 benchmark, and then the portfolio has underperformed, I
21 don't think it is appropriate then for you to come in
22 and say, "Oh, we underperformed because it's not where
23 the average is."
24 I didn't say that very well.
25 MS. MARCH: Not at all.

1 MR. SCHLOSS: Try again.
2 (Laughter.)
3 MR. NOVICK: The current policy statement
4 prior to this presentation -- the current has a plus or
5 minus 30 percent for each property type. That's a wider
6 range than was being proposed today.
7 MR. NORTH: I don't disagree.
8 MR. NOVICK: It's more restrictive compared
9 to what it was.
10 MS. PELLISH: The question is whether there
11 should be any flexibility. The question you are raising
12 is, should there be any flexibility? Or if there's 25
13 percent office properties in the Odyssey, why don't we
14 have 25 percent office properties?
15 MR. NORTH: What should the level of
16 flexibility be? That's really the question. Because
17 five years from now you come in and say, after you make
18 the decisions as to where to put things, they
19 underperformed because it didn't meet the benchmark
20 because it wasn't on the benchmark indices.
21 Then I don't think that would be a good
22 excuse. That's part of the active management of the
23 portfolio, as well as individual managers. That's all
24 I'm saying.
25 MR. NOVICK: I would agree with that.

1 MR. SCHLOSS: Everyone agrees I have to
2 implement. So if I look on page 7, this nice little bar
3 chart under "Hotels," the index says we should have two
4 and a half percent hotels. And if I believe these
5 numbers, we currently have 13 percent hotels; right?
6 His question I think, is, wait a minute,
7 you've got too many hotels. So if the performance
8 deviates, you wheel around the report after I'm gone and
9 say, is it because of the hotels or lack thereof? He
10 will say, that's kind of, you varied from the benchmark.
11 I guess that's reality. That's just the way it's going
12 to be.
13 Intentions aside, particularly since you
14 have a blind pool of managers who don't care about the
15 benchmark. This is not like stocks and bonds where you
16 hug benchmark and have a little alpha. You give it to a
17 Core manager -- there may be a Core hotel manager, but I
18 doubt it -- but if you give it to a Core manager for
19 hotels, where it is, he's going to buy hotels, buy
20 office, buy whatever the hell he feels like.
21 And if you give it to two billion dollars
22 worth of those people, you get it right, Core, Core plus
23 and opportunistic, but you're never going to get the
24 buildings right.
25 MS. PELLISH: You are okay with that.

1 MR. NORTH: I have no problem assuming
2 responsibility in terms of the performance measurement
3 at the end. But who decides to vary from the benchmark
4 and by how much and who should be held accountable, is
5 really the question here.
6 And I'm just advising that at the policy
7 level the board chooses to make for this level of
8 deviation, the board is assigning authority wherever it
9 assigns it, that becomes an element in that variation.
10 And that's fine, I have no problem with it.
11 I'm just saying, I think in this particular
12 asset class, the way this is set up, it does bring a
13 bigger burden to the consultants and the constructors
14 who are managers.
15 MS. ROMAIN: Are you saying it's too tight?
16 MR. SCHLOSS: You'd rather have less
17 granularity?
18 MR. NORTH: I think it is fine.
19 MR. SCHLOSS: Move on.
20 (Laughter.)
21 MS. MARCH: Move on, please.
22 MR. HOLT: If I understand correctly, would
23 it help to set in place ranges around the secondaries?
24 MR. NORTH: No. They've got something that
25 I think is fine. It's just a question of better

1 understanding that this is a little different, and
2 that's okay.
3 CHAIRPERSON AARONSON: Thank you, Bob.
4 MS. MARCH: Thank you very much, Bob.
5 Can we move on?
6 MR. SCHLOSS: Steve, you were saying?
7 MR. BURNS: Back in time, if you recall the
8 inception of this portfolio, we instituted a 50 percent
9 -- pretty conservative. And if you also recall at that
10 moment in time, the board had several higher risk
11 Tishman deals, opportunity funds, et cetera. And at
12 that moment in time we were moving in a more
13 conservative direction. That's why 50 percent LTD
14 showed up in your documents. By and large, I think
15 we've held to it.
16 Here's what is happening now. Our portfolio
17 is not like it was eight years ago. We indicated to you
18 we're probably going to go into a fifty-fifty mode.
19 Probably in the near term 60/40 favoring Non-Core
20 because of some overcommitted activity, et cetera.
21 The leverage thresholds in those types of
22 deals are higher, about 75 percent. The leverage
23 threshold on the Core side is about 35 percent. But
24 remember, we have a Core/Core plus portfolio.
25 So we will, if we think it's strategically a

1 good idea, we can overweight into Core plus in that part
2 of the portfolio, and those deals typically carried
3 about 65 percent.
4 We're asking to go to 65. We're not asking
5 to go to because we intend to do it, we're asking again
6 for flexibility. If I have a market correction in the
7 fifty-fifty portfolio, assuming 65 percent leverage on
8 the non-Core side about 35, if I have a 20 percent
9 correction I'm bringing to you it's pretty severe, but
10 not as severe as we went through a couple years ago. In
11 the mid 60s.
12 We don't intend to push it. The
13 understanding is a risk factor. At the same time, we
14 think fifty-fifty, I'm going to come to you a lot saying
15 "I'm not making it 50, I can't." That's all I'm saying.
16 And we report to you quarterly on this.
17 Those are the changes in investment
18 diversification. Not unlike our property type and
19 geographic diversification, where we really typed it up,
20 in terms of investment diversification (unclear) we used
21 to have 25 percent (unclear) manager, we dropped that
22 down to 15. The fund raises, too. We don't want to be
23 in more than about 15 percent overall. That fund raise,
24 incidentally, from time to time we'll have to talk to
25 you, because we're going to (unclear) enough space --

1 MS. NELSON: If it's favorable to us.
2 MR. BURNS: Infrastructure, I know this is
3 on your minds quite a bit.
4 MR. SCHLOSS: Page 10.
5 MR. BURNS: It's page 10, my PowerPoint. We
6 came to you in the last few months for really two
7 different things, largely an educational 101 and
8 discussion. I don't intend to go through the asset
9 class, brownfield, greenfield, et cetera.
10 But I wanted to tell you what we did in
11 terms of this idea. This is designed to be a very
12 conservative, first step into infrastructure. We have
13 put a limitation 60 to 100 percent, in Core
14 infrastructure. So in other words, we're not going off
15 into La-La Land on here on the risk side. Again, these
16 are measured steps. And I think these are conservative.
17 We are of course, this is listed throughout
18 your IPS in any number of different sections;
19 permissible countries list, obviously, and responsible
20 contractor policy is another one.
21 I wanted to talk to you a little bit -- if I
22 can ask you to flip through to page 12, my PowerPoint.
23 A meaningful policy statement as to asset types,
24 geographic, et cetera, are all laid out for you
25 succinctly here. I think one or two I'd like to take a

1 look at for you, leverage, we're putting that at 65
2 percent here.
3 Understanding infrastructure is a lot
4 different than other asset classes. If you have a pure
5 Core deal, low risk, managers can put 90 percent
6 leverage. It is all over the place, it can be. That's
7 why we're asking (unclear).
8 And then we talked about benchmarking -- why
9 are we where we are? (Unclear.)
10 MS. BANSAL: We're approaching a benchmark
11 on CPI plus 4 percent over a 5 year period. We think
12 this is appropriate, given that one of the objectives
13 for investing in real assets is to achieve some kind of
14 inflation hedging or inflation protection.
15 We also think that the benchmarking proposed
16 is consistent with the overall strategy of the
17 infrastructure program, and is going to be Core based.
18 And we are looking to invest in assets that are
19 operational, that have long term cash flows, and that
20 can provide stable cash yields. And typically, these
21 assets return investments.
22 The benchmark being proposed is consistent
23 with your practices. There are some very large
24 institutional investors that are actively investing in
25 the infrastructure asset class and have adopted a

1 similar approach. So, a CPI based approach to
2 benchmarking, their construction program plus a premium
3 on what we are proposing.
4 Also, within Townsend's client base we have
5 observed several of our clients who have adopted a
6 similar approach in the recent time for their
7 infrastructure portfolios.
8 The history also supports a full percent
9 premium. The gross returns across public and private
10 infrastructure in the very long term have generated a
11 gross nominal return with adjustment for fees and
12 inflation equal to approximately a 4 per premium, which
13 we are proposing today.
14 So those are some of the highlights for the
15 benchmark.
16 MR. BURNS: I don't have any more formal
17 remarks.
18 MR. SCHLOSS: I have one thing to add to
19 what she just said.
20 I asked Steve and Townsend the other day to
21 try to interpret for me the Odyssey plus 100, which is
22 our real estate benchmark, into CPI equivalent. We've
23 got an apple, one is CPI and one is -- they're both
24 inside real assets.
25 So, it turns out that the Odyssey plus 100,

1 the way our benchmark is, the ten year rate of return is
2 6.7 percent, and CPI plus 400 is 6.6 percent. So it's
3 spot on. And the 15 year rate of return is 8.3 percent
4 for the Odyssey, and CPI plus 4 is 6.6, and the 20 year
5 rate of return is 8.3 percent for the Odyssey and CPI
6 plus 4 is 8 percent. So they actually get you to the
7 same place.
8 So we can, regardless of how the mix
9 percolates up, if you want to stick a benchmark on the
10 entire asset class of real assets and call it CPI plus
11 4, you have a direct check on the infrastructure and
12 your Odyssey plus 100 tracks it very, very well.
13 So it was sort of a check that did
14 numerically, coming back historically, that says if you
15 want to benchmark all of the real assets and make it the
16 same as for infrastructure, it ultimately is going to be
17 the same as the Odyssey plus 100. The numbers happened
18 to work out the same, which I thought was great.
19 So they both basically are CPI plus 4.
20 MR. NORTH: Given the nature of the cash
21 flows, the measurement will be done on a dollar weighted
22 return basis, as opposed to a time weighted basis?
23 MR. SCHLOSS: Yes.
24 MR. NORTH: That's good.
25 CHAIRPERSON AARONSON: Page 2, the general

1 partner -- I don't know how many general partners there
2 are in this asset space.
3 MR. SCHLOSS: You'll have a lot of new
4 friends.
5 (Laughter.)
6 CHAIRPERSON AARONSON: I wonder if we do
7 co-investing?
8 MR. SCHLOSS: Yes.
9 CHAIRPERSON AARONSON: So 10 percent would
10 include our investment plus our co-invest?
11 MR. SCHLOSS: In theory it should. So if
12 you had, for instance, 6 percent to real assets, forget
13 where it is -- so 15 percent of 6 percent is .9. So .9
14 on your fund, it should say that you shouldn't have more
15 than -- you don't have 360 with anybody. Because 360
16 grosses up to a billion dollars, a billion 2 across the
17 systems with a manager.
18 Before you get to that, we should talk about
19 manager concentration. In fact, in the big IPS, there's
20 a manager concentration test also. We shouldn't have it
21 within a subclass without talking about it.
22 But to your question on co-investing, for
23 instance, if you had a -- we just made a $400 million
24 Teacher commitment to a secondary fund. That's as big a
25 commitment you'll make to a fund; right?

1 MS. MARCH: Right.
2 MR. SCHLOSS: If you co-investment in that
3 fund, it might be 10 percent of the fund, 5 percent of
4 the fund. It won't move the needle, the co-investment.
5 It's never bigger than the fund commitment.
6 And since they are limited to put a certain
7 amount in each deal, like 15 percent in a deal, a $400
8 million commitment to a fund should yield you a
9 co-investment no bigger than 50 or 60 million bucks.
10 The co-invest won't drive it, is what I'm
11 trying to say. It's a small percentage of your
12 aggregate commitment to a fund, and your aggregate
13 commitment to a fund, according to this, we shouldn't
14 have more than 15 percent with any fund, which makes
15 sense also. And you shouldn't be more than 15 percent
16 of a fund.
17 It's all about diversifying, and I don't
18 think your co-investment will at all drive any decisions
19 on this.
20 MS. ROMAIN: Larry, to clarify. Ten percent
21 of the fully invested real assets allocation, it is not
22 just on the infrastructure?
23 MR. SCHLOSS: It's across it all. You need
24 to have a manager that does real estate, infrastructure
25 and maybe timber. If you check all those boxes, they

1 won't be more than $450 million. I just doubt it.
2 You'll see it when it comes.
3 MS. PELLISH: Until you have lot more
4 infrastructure and non-real estate assets, that's going
5 to be more restrictive than the 15 percent in the real
6 estate program. I think that's what they are referring
7 to.
8 MR. SCHLOSS: Say again?
9 MS. PELLISH: You have a fifteen percent
10 limit to a real estate program. For many years -- the
11 real estate program is going to dominate by far this
12 program, so this 10 percent will then become more
13 restrictive than the real estate limit.
14 Is that the intention?
15 MR. SCHLOSS: I don't think that's right.
16 Let's say it's half real estate and half
17 infrastructure.
18 MS. PELLISH: But it's not going to be that
19 for a decade. So up until that point, up until you have
20 a lot of invested -- and it takes time to invest in
21 infrastructure assets. So for many years from today the
22 10 percent limit is going to be operative, rather than
23 the 15 percent that's in the real estate -- you have a
24 limit of 15 percent real estate and loans.
25 MR. SCHLOSS: Isn't 15 percent operative?

1 Most of your assets are real estate.
2 MS. PELLISH: The 10 lowest limit is going
3 to be operative?
4 MR. SCHLOSS: It is not.
5 MS. PELLISH: It will be.
6 MR. SCHLOSS: What would you like it to be?
7 MS. PELLISH: It's up to you guys. There's
8 going to be a conflict. The 10 percent is going to
9 drive decision-making. It's going to be the maximum
10 limit for the real estate program for years to come.
11 And that's a question of whether you want that to be the
12 case.
13 MR. NAHNSEN: This ten percent is only --
14 (Laughter.)
15 (Discussion off the record.)
16 MR. SCHLOSS: Would it be useful to go
17 through the IPS by page to see if there's any comments
18 so we can get to the end of it? Because Steve did a
19 good job talking about what is in it. It's in the big
20 book, page 115. So who wants to wander through this?
21 (Laughter.)
22 MR. BURNS: Do you want me to do a fast
23 review of this?
24 MR. SCHLOSS: Do a fast review of this.
25 Start with real assets, page 115 in our prayer books.

1 MR. BURNS: The objective is not going to
2 change the asset class. If you move to the next page,
3 we'll talk about asset allocation, 6 percent, plus or
4 minus 2. That's where we are from an allocation
5 standpoint.
6 The responsibilities and delegation of the
7 trustees, of the Comptroller and the other parties are
8 in the next few pages of this document --
9 Those are not changed since I've been IPS's,
10 so if you would like -- the exception to the IPS is on
11 page 5 of the actual IPS, something you may want to take
12 note of.
13 MR. NORTH: Just to come up before, an
14 encouragement. When we're going to the exception
15 approach of time sensitive things, things can be
16 electronic, whatever, but then the matter needs an
17 exception and then it calls for a documented phone vote,
18 as opposed to the more flexibility phone, e-mail,
19 whatever -- I agree with the documented vote, but I know
20 we've discussed this elsewhere, you may want more
21 flexibility than just a phone vote.
22 CHAIRPERSON AARONSON: We could vote by
23 e-mail or --
24 MR. NORTH: Just not to take an e-mail vote
25 in violation of the policy.

1 MS. MARCH: Take out the word "phone." It
2 would say "documented vote."
3 CHAIRPERSON AARONSON: The Actuary had one
4 good idea.
5 (Laughter.)
6 MR. BURNS: The next part of the IPS moves
7 into real estate. We lay out -- as I indicated earlier,
8 this is the no less than 40, no less than 40 program,
9 split between Core and non-Core. I think there are some
10 useful definitions for you that talk about Core, Core
11 plus, non-Core allocations.
12 Also, I had noted, it is important, there is
13 a limited level of discretion that staff and consultants
14 have, particularly in the Core space and also with
15 respect to re-ups in existing investments.
16 The classification of this system is -- I
17 wanted to touch on page 8, if you will, Investment
18 Types. Remember that we're pretty broad based here.
19 This is real estate private equity, but also allows you
20 to move into things such as little number 2 there,
21 private debt investments, secured (unclear) on real
22 property and other debt investments, private interest
23 and real estate (unclear).
24 In other words, we have some flexibility.
25 The reason we did that years ago, put it in, if you're

1 going into an opportunity fund, that opportunity fund
2 basically, those are very broad strategies -- they might
3 get involved in buying re-ups. But it also allows you
4 to assume, take stands on yields and other things like
5 that, things that we would obviously bring to you.
6 It is also constructed to allow for that
7 over time.
8 At the bottom of page 9 is the highly
9 controversial property type ranges, which I will not get
10 into any further.
11 I think what's interesting on page 10 of the
12 real estate IPS diversification, this is still a U.S.
13 based program. We're allowing ourselves about 25 in
14 international. We're not close to that, we're about 4
15 to 5 percent international.
16 As time goes on I anticipate the hard asset
17 class to become more and more global. So that's
18 allowing for some additional exposure and investments
19 (unclear) 15 percent investment position is 15 percent,
20 managers is 15 percent in the system. We discussed the
21 leverage and the IPS (unclear). Currency is referenced
22 here.
23 And then we get into the evaluation
24 criteria, and basically that hasn't changed since I've
25 been here. It's always listed the same way, it's how we

1 diligence things, how parties work together, et cetera.
2 That gets you to page 12, page 13. I think
3 it's laid out very logically. Again, a conservative
4 approach to the space. And the general approach,
5 several paragraphs are very good, indicating exactly
6 what we intend to do on a go forward basis. The ranges
7 are 60 to 100 percent, indicated on size, a conservative
8 approach.
9 We talk about the annual plan. If you get
10 into infrastructure you get into real estate, and
11 probably, perhaps (unclear).
12 Pacing and how that's done and the
13 investment guidelines, the permissible markets and
14 responsible contractors policy, always noted in your
15 IPSs.
16 Again, starting on 17 -- to evaluate
17 diligence opportunities as we go forward.
18 And the performance objectives, listed on
19 page 18, as is your CPI plus 4.
20 MR. NORTH: Steve, is there any kind of,
21 similar to real estate, where there's NCREIF that takes
22 into account the correlation between public markets and
23 the real, anything that would be appropriate or
24 comparable here with the CPI plus 4 concept, for the
25 infrastructure only?

1 I realize that the infrastructure will
2 depend tremendously on what types of infrastructure
3 invested, but as a hypothetical you invest in something
4 that has a market traded component, and the remaining
5 correlation with the markets. Kind of like the NCREIF
6 goes up and down, and on a short term basis is very
7 useful to watch versus the managers. Even though the
8 long term objective remains the CPI plus something. Is
9 there anything comparable for infrastructure that should
10 be considered or not?
11 MR. BURNS: There's a composite that we have
12 that consists of about 20 different funds, I think
13 tilted more toward the Non-Core side of the equation.
14 It could be used as a measure.
15 Again, Bob, we talked about this with
16 respect to infrastructure. The data set and performance
17 information is simply more limited. In addition,
18 there's public listed infrastructure. I'd recommend you
19 put this in your performance reports. We could tell you
20 what those are doing.
21 CPI plus is a way -- it's very interesting
22 to me, the best way if you have 25 years real estate --
23 because the NCREIF was immature, people did CPI all the
24 time. That's where it started, then it looked NCRIEF,
25 now Odyssey. As we get more data in on performance,

1 there will come a time when you'll have a pretty good
2 benchmark different than this.
3 MR. HOLT: Can I make a couple of
4 observations on the benchmark? I guess I'm just
5 curious. I see the rationale for the CPI plus 400 basis
6 points. That seems like a pretty good proxy based on
7 what Larry said and historical studies.
8 But the total return target of 6.5 percent,
9 seems like we're judging the manager on things that are
10 out of their control. They don't really have any
11 control over what the CPI is. So what if CPI is
12 negative 400 for a decade and a manager breaks even?
13 (Laughter.)
14 It seems they would have done their job.
15 MR. BURNS: What you're pointing out, that's
16 useful. Could you have a swing like that? I supposed
17 you could. I'd love to tell you that I have a locked
18 down, bullet proof benchmark, but I find in real assets,
19 but I don't seem to have that. I like the Odyssey net
20 plus 100. I agree that is a something that needs to be
21 considered. It has a massive fluctuation.
22 MR. HOLT: Any way we can remove ambiguity
23 or reward -- I don't want to say punish, but discipline
24 managers for things that are out of their control, and
25 just make it really unambiguous. That probably serves

1 all parties best.
2 MS. PELLISH: To clarify, is that a manager
3 specific benchmark? Are you saying a reasonable
4 expectation for this program? Six and a half percent,
5 managers would have much more benchmarks related to
6 their period of time, their strategy.
7 MR. BURNS: What I tend to do, and I think
8 everybody does, when you look at manager and you look at
9 what they're charging and what the return was, and also
10 what period of time, I focus on that when i make manager
11 decisions, on the assumption that you have managers that
12 you think (unclear) the best way to evaluate (unclear).
13 MR. HOLT: I guess the other thing, the
14 rolling five year period, you an almost call this an
15 ultra long-term investment proposition, five years may a
16 little short. You want it to be within the board's
17 lifetime, but five years could actually be a bit short,
18 the kind of investment we're talking about -- projects.
19 MS. BANSAL: We would expect to achieve the
20 benchmark (unclear) these are very long term
21 investments, but we would expect to see (unclear).
22 MR. BURNS: In other words, we think with a
23 rolling five you will see -- I don't disagree with you.
24 Down the road, maybe we can consider it, and we move to
25 a full market cycle. But right now I'm satisfied it's a

1 good fair measure.
2 MR. SCHLOSS: Any other questions on this?
3 Otherwise, we'd like to submit this to get the IPS
4 approved.
5 CHAIRPERSON AARONSON: Based on the
6 arithmetic, it's conceivable we could invest up to about
7 a billion dollars in infrastructure?
8 MR. SCHLOSS: Yes, over some number of
9 years.
10 CHAIRPERSON AARONSON: Any other questions?
11 MR. HOLT: As far as what we're approving
12 here, this is a work in motion, so to speak. It's a
13 living document; right? We've only had a week to review
14 it. This is for you and staff time to continue progress
15 on a tactical plan, vet managers, but we can work with
16 consultants and your staff to update any ambiguity about
17 benchmarks.
18 MR. SCHLOSS: Sure. We change IPSs all the
19 time.
20 MS. MARCH: This is the investment policy
21 we're adopting. We're always able, either through your
22 recommendations or through our recommendations to ask
23 you to review it.
24 MR. SCHLOSS: We review it all the time.
25 The reason we changed the benchmark, Odyssey, was we

1 thought it was time to change it.

2 MS. MARCH: It's not a temporary document.

3 It is our investment policy statement, and as we choose

4 to move along, we may choose to change it.

5 MR. SCHLOSS: Yes.

6 CHAIRPERSON AARONSON: We need consensus.

7 MR. SCHLOSS: Do we have consensus on these

8 documents?

9 MS. MARCH: Since you're submitting it and

10 we agree with it, you have consensus.

11 MR. SCHLOSS: Thank you. Welcome to

12 infrastructure. I'd like to sell you that bridge over

13 there.

14 (Indicating window.)

15 MS. ROMAIN: What will the toll be?

16 (Laughter.)

17 MR. SCHLOSS: I'd like to go out of public

18 session and into executive session.

19 MS. MARCH: I move that we go into executive

20 session.

21 MS. ROMAIN: Second.

22 CHAIRPERSON AARONSON: We're now in

23 executive session.

24 MR. SCHLOSS: We would like to talk about

25 investing in a real estate fund in Europe; actually, a

1 debt fund in Europe that's real estate based. And I
2 will hand it over to Carol.
3 MS. BANAT: We're on 332 in the book, but
4 Yvonne and Janet have handed out new copies of the memo,
5 just because the graphs are in color and read better in
6 color, so I thought they'd be more helpful in color.
7 You don't have your own technology, so I thought it
8 would be helpful.
9 The AXA real estate joint venture, we're
10 asking for a $150 million commitment from Teachers, $300
11 million across the systems. This is a pretty unique
12 market opportunity to invest in a pool of senior
13 mortgage loans, so really Core debt, secured by prime
14 real estate assets in major markets in Western Europe.
15 We have targeted primarily three areas in
16 Europe: London, Paris and major cities in Germany.
17 Regulatory issues in Europe have caused the
18 banks in Europe to withdraw from the real estate
19 markets. A lot of the English banks have been taken
20 over and the banks are no longer lending in the real
21 estate sector; the result of which, there is a dearth of
22 capital available to make senior mortgage loans.
23 The opportunity fund has stepped in to do a
24 lot of the mezz kind of lending, but senior Core
25 mortgage loans, there's nobody there, a void in the

1 market. The insurance companies are stepping up to make
2 those loans, and AXA is leading the way.
3 The biggest effect is that spreads are
4 widening significantly, and they continue to do so. So
5 where in the old days on a senior primary office
6 building in London, the spreads might have been for 70
7 percent LTV loans, 150 to 175 over that same loan today
8 is being made at 50 to 55 percent LTV at 350 over, the
9 result of which is outsize size returns for much less
10 risk.
11 If you may recall, we had Townsend in, Nick
12 Cooper from Townsend came in over the summer and came to
13 talk to you and he told you this story.
14 We like the Core mortgage opportunity. It
15 is a much better story than the Core equity
16 opportunities that are available today. We've chosen to
17 go with the Core debt route as opposed to Core equity,
18 to fulfill the Core space in our portfolio.
19 Cap rates are at all time lows, the Core
20 equity funds are buying real estate at sub-Core caps,
21 and people are standing in billion dollar queues for the
22 privilege. We, and I think our consultants, will
23 concur, don't get it, but people are doing it. It is
24 not a position we think is appropriate for the portfolio
25 at this time.

1 We looked to do the same thing domestically,
2 we found it hard to find a partner to do it in the size
3 and scale that we can do it with AXA. And the Core
4 funds -- and I think Bill will elaborate on it -- that
5 are doing it here in the States right now are having a
6 hard time achieving the same yields that they had set
7 out to do.
8 The void in Europe is something on the scale
9 of 400 to 700 billion euros, and expected to continue on
10 that pace over the next 5 to 7 years.
11 Why AXA? AXA is the leader in the business
12 at this time. They started in the real estate business
13 from the equity perspective since 1999, and started
14 their real estate lending activity in 2005.
15 Through today they have built a team of 20
16 professionals and have lent over 4 and a half billion
17 dollars under the guidance of Isabel Scemama, who you
18 will meet shortly.
19 They have a strong track record. They have
20 to date not lost a penny in their real estate lending
21 activity.
22 There are charts in the book which show the
23 breakdown of their portfolio on a geographic basis, on a
24 property type basis, and basically what they have done
25 in the past is in the sweet spot of what we want them to

1 do.

2 We have created a program with them which
3 has strong alignment of interest. It's a true
4 partnership. They are co-investing with us on a dollar
5 for dollar basis. So they are going to put another $300
6 million to co-invest with us off the AXA balance seat.

7 We have put in a lot of governance
8 provisions in this program, in addition to standard
9 provisions like key man. If Isabel leaves, we stop the
10 program. Significant euro fluctuation, we stop the
11 program. But probably the most important thing is, we
12 have negotiated this unfettered right to suspend.

13 If there's a world event that makes us feel
14 we don't want to be in Europe, we pick up the phone and
15 call them and say "We want to stop." This program is
16 totally run at our discretion. They do the loans, but
17 we decide when we want to put the brakes on.

18 And once we got that right from them, we
19 knew we had a real partnership here. The program will
20 add a lot of geographic diversification to your
21 portfolio. Today your portfolio is just under 5
22 percent. This will give you really good international
23 exposure in Western Europe markets that the Teachers
24 program likes.

25 We believe that will act as an inflation

1 protector. It's all floating rate loans, and as rates
2 start to rise, which we all believe they will at some
3 point, this will act as a protector, as they say, it's a
4 floating rate program.
5 And some diversification from a currency
6 perspective, because it will be a program that invests
7 in euro and sterling, and should round out a little bit,
8 give you something you don't have.
9 Bill, would you like to talk a little from
10 the due diligence you've done?
11 MR. FOSTER: Sure, I'm happy to.
12 Good afternoon. I wanted to avoid just
13 repeating what Carol said, but she really hit the
14 highlights of this particular transaction. Roughly a
15 year or so ago is when the genesis of this really began
16 to take place.
17 And what I'd say, we have done an
18 independent valuation. We at Courtland and Townsend has
19 done an independent evaluation of this particular
20 investment.
21 And about probably six months ago when the
22 first iteration of the documents came our way and we
23 looked at issues that Carol just addressed, control
24 structure, lack of control under New York's, BAM's and
25 Teachers' perspective, et cetera, we were a little bit

1 nervous about the transaction, to be very honest with
2 you.
3 Again, I'm not trying to butter up the staff
4 here, but we went back and Townsend I believe went back
5 with their concerns to Larry and Carol, Yvonne, Janet,
6 the team at BAM, and I believe that the Bureau of Asset
7 Management has done really an exceptionally good job in
8 terms of renegotiating the documents.
9 The biggest issue we had a hard time getting
10 our hands around was, what level of control does BAM
11 have to nip it in the bud and call it quits, should
12 countries start exiting the euro. There is some risk
13 and some concern of countries exiting the euro, as well
14 as the euro falling through the floor. We did see a
15 large sell-off earlier in the year, which really seems
16 to have evened out at this point in time.
17 So we're very comfortable with the control
18 structures. I want to highlight a couple of other
19 issues, and other folks from AXA are here to present.
20 We do like the return potential. Would we
21 like to see more return? Ideally, of course we would.
22 In our due diligence report, I believe Carol's memo, it
23 states 5 to 6 percent is what we're looking at right off
24 the bat right now.
25 We're also looking at a very low Libor or

1 euro Libor benchmark that we're earning a spread
2 against. So interest rates we do believe at some point
3 in time will begin to move north. And as interest rates
4 move north and inflation eventually sets in, whenever
5 that may be, this will be a perfect offset to that,
6 because these are all floating rate loans.
7 MR. NORTH: Which Libor is this based on?
8 MR. FOSTER: London.
9 MR. NORTH: The duration?
10 MS. BANAT: Three months.
11 MR. NORTH: And the terms of these loans
12 that are going out?
13 MS. BANAT: They're mostly three to five
14 years.
15 MR. NORTH: So there isn't the problem like
16 the S&L in the United States, where you lend long and
17 then the rates go against you and you don't get your
18 money back?
19 MS. BANAT: No. I used to be a lender, I
20 know what to watch for.
21 MR. FOSTER: Final comments here. Obviously
22 we spend a lot of time working with staff, meeting with
23 AXA here in the States. We had one of our colleagues
24 meet with them in Europe.
25 We like the fact that historically they have

1 had very conservative underwriting standards. This is
2 not a shoot the lights out, high octane opportunistic
3 strategy. This is basic blocking and tackling in terms
4 of Core lending, and very high quality collateral
5 assets, with a very modest use of leverage when
6 applicable to enhance the returns a very modest amount.
7 To dovetail off something Carol had said, a
8 year ago, two years ago, we were looking, people said,
9 why do this in Europe, why not do this in the United
10 States?
11 It's interesting when you follow what
12 happened in the Core markets, whether it's Core equity
13 markets in terms of the money rushing towards the door
14 desperately in search of yield. Because of the low
15 yields that domestic U.S. investors are getting in their
16 current fixed income portfolios, real estate's become a
17 very attractive alternative.
18 We've seen Core lending funds, one of which
19 Cornerstone, which we work quite a bit with our firm,
20 that we reference in our report.
21 Just come back to the advisory board in the
22 past month and asked us as the advisory board -- it's
23 really a club deal fund -- and asking the investors to
24 not only make the guidelines -- we just talked about the
25 investment policy to get more leeway and flexibility in

1 the guidelines, but also to expect a lower return than
2 what was originally projected 12 to 24 months ago, due
3 to the fact that there is again capital desperate for
4 yield that investors are not getting in the bond
5 portfolio.
6 So even here in the States where we thought
7 we were getting 7 or 8 percent returns 12 to 24 months
8 ago, it's a pipe dream unfortunately at this point in
9 time. This gives us the opportunity to avoid that.
10 I do want to point out a couple of cons,
11 because I wouldn't be a true consultant if I didn't talk
12 out of both sides of my mouth.
13 (Laughter.)
14 There are some fundamental economic issues
15 that Europe has we don't necessarily have in the States
16 right now; or perhaps they are a little bit more evolved
17 in terms of level of issues, but overall we as firm
18 endorse it, and we think it's a very good investment for
19 Teachers.
20 MR. SCHLOSS: Can I throw a couple of big
21 picture, what this is? Europe has issues. All the
22 banks have to fix their balance sheets, and
23 consequentially in a really big picture, they're not
24 lending money to anybody.
25 So that creates opportunity, because in the

1 normal course of business, people need to refinance
2 loans. Forget buying stuff, your mortgage comes due.
3 So AXA is the biggest real estate firm in Europe, and
4 AXA the insurance company is I think the second biggest
5 insurance company in Europe behind Allianz, which owns
6 PIMCO. And they love lending, and in Europe they are
7 like the Met and Pru in the United States.
8 So the question was -- so they were the
9 biggest business doing this, but the banks were no
10 longer making what I call the simple loans, which is
11 what these are.
12 So we sat down with them and said, "We don't
13 want risk. We want real simple, simple stuff, and we
14 don't you to juice this with returns," because they kept
15 trying to get the returns up, because they felt we were
16 worried about returns.
17 So we said, "We don't want risk." So that
18 means A) we don't want to invest in Southern Europe; no
19 Spain, no Italy, no Portugal no Greece. What we want is
20 first mortgage loans on the Champs Elysees, next to the
21 Eiffel Tower. And they said, "Great, that's what we'd
22 like to lend to you also."
23 So these are just first mortgage loans
24 ideally in Germany, the U.K. and France, that's really
25 it; in the best locations, fifty percent loan to value,

1 and we have the biggest real estate person in Europe,
2 AXA, putting in every dollar -- it's a joint venture,
3 you put up half the money, we put up half the money.
4 So if anything goes wrong with your first
5 mortgage loan portfolio in your backyard, you've got a
6 problem. So the answer is, these are good guys for us
7 to partner with.
8 And so they started to say, "You need some
9 more return, take some mezzanine, take some preferred,
10 take some participating." We said, "No, we can go for
11 the return later, we want real simple stuff."
12 This is it sort of a starter set. We can
13 dress it up in two years if you want more return, but
14 because the banks aren't lending, the simple stuff like
15 the hotels and the Champs Elysees, the spreads have
16 widened.
17 So getting 350 basis points over the
18 comparable Treasury, it kind of gets you a junk bond
19 yield for the best loan you can get in Europe. It's
20 just the way Europe is.
21 So we're supposed to be smart, long term
22 money, partner with a big smart European institution
23 that's not a bank. And as spreads go down, we're
24 supposed to say "stop." But for now, there's none of
25 this money around.

1 So I will bet you that in 18 months or 12
2 months some very smart bunch of fund managers are going
3 to come trying to sell this to us. So they are going to
4 make products that say, "You need to go buy first
5 mortgages in Europe," and they're going to charge fees
6 and carries, stuff like that.
7 So we told these guys, "We want to be your
8 partner, we don't pay participating fees," it's 45 basis
9 points.
10 MS. BANAT: We're paying them 40 basis
11 points. The first time they came and asked us for an
12 incentive fee and we said, "This is Core, this is your
13 bread and butter, we're not paying you an incentive on
14 it." They looked at us and we said "Really."
15 And they really wanted to make a market in
16 the U.S. for this. We are their first U.S. pension fund
17 client. So I smiled at them and they said, "Okay."
18 So for 40 basis points we're good. And I
19 think it really showed the alignment of the interest.
20 This is really a true partnership. And they are
21 watching out for us.
22 MR. SCHLOSS: There's lots of bells and
23 whistles we can add in the future. But for now, the
24 simplest lending, the most senior and the best
25 properties, in theory, in Europe, with the biggest guy

1 in Europe.
2 MS. BANAT: And I think they do view it as
3 the first step to a bigger relationship, and I think we
4 do too. As they perform and they continue to show us
5 good product, the next step will be moving in.
6 This is primarily leverage up to 55 percent
7 with a sliver of levering our portfolio to a maximum of
8 35 percent, and we can over time, as the markets
9 improve, if we get comfortable, move to 60 to 65 percent
10 and start to take advantage of some incremental yield to
11 raise the returns.
12 MR. SCHLOSS: I just wanted to give you a
13 30,000 foot as to what this is supposed to be.
14 CHAIRPERSON AARONSON: Question. On page 6,
15 in "Others," you mentioned Denmark, Italy the
16 Netherlands. What is "Pan"?
17 MS. BANAT: It's pan-European. It got cut
18 off. They do have in their portfolio things that they
19 have done in some countries that we told them not to.
20 And the reality is, we would love to lend in the
21 Nordics, the Nordics have very strong real estate
22 activity. But their banks are solid and the risk return
23 profile opportunities don't present as are presenting in
24 the southwestern parts of Europe.
25 We told them if you can find these kind of

1 returns up there, we will certainly look at them. But
2 anything right out outside of the U.K., France and
3 Germany would require them to pick up the phone.
4 MR. SCHLOSS: So we should bring them in.
5 MS. BANAT: You'll meet Isabel Scemama, who
6 runs the commercial real estate program, and Dennis
7 Lopez, who is the head of the investment committee. So
8 he signs off on everything.
9 I will forewarn you, Israel is very French,
10 so you have to listen --
11 MR. SCHLOSS: One more thing while Robin is
12 still here. We had a discussion about the most obvious
13 question, hedging, currency hedges. So we spent a lot
14 of time -- talking to John Bright about hedging this
15 specific issue. Should we hedge each loan? Because we
16 get five year loans, it's euros, maybe we should talk to
17 Goldman Sachs or Morgan Stanley and buy a hedge for five
18 years.
19 The problem is, maybe the loan gets called,
20 so now you've got a hedge that's not quite right for
21 currencies. And the more we kicked it around, the more
22 we said, wait a minute, we also have a bunch of euro
23 denominated private equity funds, we don't hedge that.
24 So we backed ourselves up to the fact that
25 we don't hedge our currency exposure. So we shouldn't

1 drive ourselves crazy trying to hedge this. If as a
2 board we decide to get a hedge for some reason, it
3 wouldn't really be specific to this particular venture,
4 it would be specific to hedging all of our currencies.
5 And if you look at the plan for the year, we
6 talk about having a discussion about hedging, should we
7 do it, because we're doing some more European things.
8 But our conclusion was, it's euro
9 denominated, we're not going to hedge this specifically,
10 we should have a conversation about hedging in general,
11 but it's sort of diversification of our currency.
12 CHAIRPERSON AARONSON: You said euro
13 denominated. It's my understanding the U.K. is not --
14 MR. SCHLOSS: Sterling denominated.
15 MS. BANAT: Either euro or sterling
16 denominated.
17 MR. SCHLOSS: For diversification.
18 MS. MARCH: If I recall correctly, when we
19 first went into the developed markets, we did have
20 conversations about hedging. And we made a decision not
21 to do it at that time. But it would be a good idea to
22 revisit it and see how we feel if we want to do it now.
23 Then we decided not to do it.
24 Correct, Robin?
25 MS. PELLISH: I agree that currency is both

1 a source of risk and source of diversification. And as
2 the non-U.S. program has gotten bigger we should
3 re-evaluate that.
4 MS. MARCH: Re-evaluate and decide what we
5 want to do. We made a decision then to not do it.
6 MR. SCHLOSS: Right.
7 MR. NORTH: I think, Larry, for the
8 documentation purposes, I believe many of the documents
9 here do talk about they intend to currency hedge. So I
10 presume that will get adjusted.
11 MS. BANAT: No. I say we can, at our
12 option.
13 MR. NORTH: "AXA plans to use hedging
14 tactics," on page 401 of the big book. I'm just saying,
15 you probably should make sure whatever is decided is
16 just clear and consistent. And I was going to make a
17 whole case against not doing hedging --
18 MR. SCHLOSS: We're not going to hedge;
19 let's be clear.
20 CHAIRPERSON AARONSON: Our policy is that we
21 don't hedge.
22 MR. SCHLOSS: We're not going to hedge it.
23 MS. BANAT: On 400 it says everything is at
24 NYCERS' option.
25 MR. SCHLOSS: This talks about floating rate

1 debt. It doesn't talk about currencies. The bottom of
2 401, the word "currency" should probably be taken out.
3 I think they're talking about rate.
4 MR. NORTH: Later there's the thing about
5 there would be no hedging of interest rate exposure.
6 MS. BANAT: It was changed on page 400 in
7 the Townsend memo.
8 MR. SCHLOSS: Let's be clear, we're not
9 hedging this.
10 MR. NORTH: That's good; that's all I'm
11 saying.
12 CHAIRPERSON AARONSON: I thought she
13 answered the question that we don't hedge, at this
14 moment. We'll review it some time in the future.
15 MR. HOLT: A couple of questions, Larry.
16 For when Robin brings her study on hedging, will you put
17 some thought into when we take currency risk and what
18 assets we think it would be best in?
19 For my understanding of this is, it's a
20 unique opportunity and kind of a dislocation and a
21 limited life investment. So it is just a question mark,
22 how long we'll be in there.
23 And it seems like maybe a coin toss at best,
24 what the euro is going to do in that time. So maybe it
25 makes most sense for equities where we know we're going

1 be invested in that asset class for 10, 20, 30 years, to
2 incur the currency risk.
3 But in areas like this where you identify a
4 unique dislocation in the market, has done a good job
5 hedging away interest rate risks, and for the most part
6 address credit risk, why would we add currency risk,
7 which is kind of a big wild card on top of this
8 particular investment?
9 MR. SCHLOSS: It goes back to the philosophy
10 of hedges.
11 MS. PELLISH: I think your question is,
12 when we evaluate hedging, let's take into account
13 whether we would hedge shorter duration assets
14 differently than longer duration assets. That's fine.
15 MR. HOLT: I see this as two investment
16 propositions. One is what Carol and Yvonne were able to
17 negotiate with the manager to find high grade, low
18 collateralized loans that we could provide liquidity and
19 exploit the situation to our advantage.
20 And then, that's what we're ultimately
21 buying into the currency risks, I don't get a sense we
22 have a view on the euro. Don't know how long a term
23 risk investment is. And a currency risk is pretty big,
24 it's 10 to 15 percent. And we've taken all these steps
25 to avoid Southern Europe investments.

1 But unfortunately, Germany and France, they
2 don't have their own currencies, so you know, if Spain
3 and Italy go to pot, we're going to get stuck by that by
4 association. We're in the euro. The euro can be
5 contaminated by that. So I think this is something that
6 we should address sooner rather than later.
7 MR. SCHLOSS: Any other questions before I
8 bring them in?
9 (The AXA people entered the room.)
10 MR. LOPEZ: I'm Dennis Lopez, the CIO of AXA
11 real estate. This is Isabel Scemama.
12 We will go through quickly. If you have
13 questions stop us. You take a look at page 5, which is
14 our executive summary. The opportunity today in Europe
15 is huge. We've got a 1.2 trillion euro real estate debt
16 market that's completely dysfunctional.
17 Up until 2007, 95 percent of that credit was
18 provided by banks. Most of those banks today are wards
19 of the state. There's no CMBS business, there's nothing
20 coming to the rescue.
21 So what we have is, we have a situation
22 where in the next two years we have 300 billion of loans
23 coming due. There's nobody to provide the financing.
24 AXA real estate has been extremely active.
25 We are the largest real estate, non-real estate,

1 non-banking real estate lenders. We've raised 6.6
2 billion euros, and we're in a position where everybody
3 in the market comes to us because of our size.
4 To date our performance has been good.
5 We've had no payment defaults. And we have a very
6 unique combination of -- we run over 40 billion euros of
7 equities, so a combination of real estate knowledge and
8 fixed income is very strong.
9 The program we're talking about with you
10 guys is for your initial commitment of 300 million.
11 We'll co-invest with you. So in the investments you
12 make, over 50 percent of the capital that goes into
13 those investments will be our capital too; we're
14 completely aligned as partners.
15 What you'll be investing in is floating rate
16 loans. It will be targets of the highest quality. The
17 returns will be 5 to 6 percent, net of fees. And once
18 again, the floating rate provides you protection in a
19 rising interest rate environment.
20 So that's the background. We'll walk
21 through the presentation, and once again we'll go fairly
22 quickly. Stop me or Isabel if you have questions.
23 On page 7, we've got a couple of charts
24 there. As you can see on the one on the left, high
25 volume, pricing in 2006 and 2007, close to 500 billion

1 euros of loans were made. That's almost 40 percent of
2 the market at the peak of the market.
3 As a result, now, in 2013 and 2014 on the
4 chart on the right, with 300 billion coming due, these
5 are loans that will have to be restructured.
6 Turning to the next page, on page 8, you can
7 see that the spread in the chart, back in 2005, 2006,
8 2007, the peak of the market, the difference between
9 what you can get on real estate loans and let's say
10 Single A corporate bonds, was 50 to 125 basis points;
11 today it's 250.
12 So spreads are two to three times the norm.
13 The reason is simply, supply and demand. There's no
14 lenders in the market, and as a result the lenders get
15 the best quality loans at the highest prices.
16 We'd like to talk about our capabilities on
17 page 10. AXA is the second largest insurance company in
18 the world. We've got $1.4 trillion in assets under
19 management.
20 In asset management, the asset management
21 group, our overall group manages over $700 billion of
22 investments, and we and AXA real estate, who are the
23 sole providers of real estate services in the AXA
24 investment management group, we manage about 556 billion
25 euros of properties.

1 We're Europe's largest real estate asset
2 manager, and in the top five in of the world.
3 I'd like to turn it over to Isabel now to
4 talk a little about our background, which is on page 11.
5 MS. SCEMAMA: (Unclear) real estate lending
6 market. And we have now, as Dennis said, a platform of
7 6.7 billion. And the pipeline is very important. We
8 have a pipeline of 1.8 billion. It is because we have
9 access to the loans. We have access to the loans both
10 through banks and through the -- but thanks to the
11 (unclear) coverage, we have extensive access to the
12 loans.
13 And what is also important to the Teachers
14 is that we have built up a platform for the outside
15 group, first, of course, to benefit our clients and
16 hopefully to you.
17 And another thing I'd like to say about our
18 platform is that we have a very strict conflict of
19 interest policy, because we never invest at (unclear)
20 capital structure. So no loan will finance an asset, a
21 real estate asset managed by AXA real estate. It's a
22 way to align our clients, and all of them, including the
23 AXA group, could have the same loans. So each time you
24 would invest in a loan, AXA would co-invest in the same
25 loans.

1 And as you can see on the charts, we have
2 managed very cautiously the cycle. We have been very
3 prudent in 2005, 2006 and 2007, despite the fact that we
4 get from AXA one billion at this stage. And it's only
5 2010 when the market stopped to become (unclear) that
6 started to invest significantly.
7 And the consequence of that is that now we
8 are managing a portfolio which has experienced no
9 payment default, and we have only experienced one loan
10 to value breach with (unclear) the loan, and now it is
11 going on well. So we have no problem with our
12 portfolio.
13 As can you see, the metric of the portfolio
14 is very strong. We never had loan to value at 51
15 percent. That is apparent valuation.
16 So just after this, a couple of examples of
17 what we have in the portfolio. The first one is
18 (unclear) which is close to the Seine River bank. It's
19 a very good visibility on Paris, and it is a quarter --
20 a Triple B tenant, the telecom in France.
21 So this building has very top quality
22 specifications. And as you can see, the credit metrics
23 are very good, because the loan to value is at 44
24 percent; so low level of leverage. And the spread for
25 this one is at 3.25 percent.

1 The following example on next page is
2 (unclear) portfolio. It used to be CMBS, and the
3 building has been repurchased by Carlyle. We have
4 financed four of those buildings. They are all very --
5 one has been sold, so we are backed by three buildings.
6 They are all very well located in London, close to the
7 Thames River, and with very good tenants like IBM, UBS,
8 so very strong tenant base.
9 And the loan to value for this one is at 38
10 percent, so ver low again. And for this one we have a
11 margin of 3 percent.
12 MR. LOPEZ: So the real estate organization
13 we've put together has a debt side of 18 people. These
14 are specialists in debt we've taken from our
15 organization throughout the European community. It has
16 very strong support. We have 189 people in property
17 services. These are people who live all around Europe,
18 in our offices, and they are underwriters of these
19 properties.
20 Many times these are properties we've owned
21 before or we've bid on before, we've seen in the market
22 many times. This is also supported by a research group
23 of 13 people, a macro and micro market analysis.
24 In terms of structuring loans to make sure
25 that you have proper documentation, we've got 20 people

1 in corporate finance, and 18 people in legal.
2 We'd like to turn now to talk a little about
3 the investment strategy, and give you some examples of
4 transactions in our pipeline.
5 MS. SCEMAMA: In the pipeline currently we
6 are working on a hotel portfolio. It is a portfolio of
7 33 hotels. One is a five star hotel, it used to be the
8 former London City -- it's in front of Big Ben, so very
9 good location, the primest location for hotel, and the
10 hotels are four star hotels.
11 What is interesting for you, the price of
12 the portfolio is now 600 million pounds. But at the
13 peak of the market the value of the portfolio was close
14 to 1 billion. So now the value has corrected, and we
15 are only financing 50 percent of the this 600 million.
16 And we expect a spread of 4 percent for this very good
17 portfolio of hotels. It is operated by Marriott.
18 The second example that is part of our
19 pipeline is the factory (unclear) it is located between
20 Germany and Benelux, so very good catchment area.
21 CHAIRPERSON AARONSON: Is it possible for
22 Mona and Sandy to do due diligence on that?
23 (Laughter.)
24 MS. SCEMAMA: You have also very strong
25 tenants, good tenants like Prada, Burberry (laughter) at

1 very discount price. It is so attractive, but the
2 (unclear) factory increase by 6 percent a year, done
3 very, very well.
4 And the final thing we would grant to this
5 asset -- with a loan to value of 50 percent again. And
6 the margin we are discussing is 330 basis points.
7 So there are plenty of examples you can see
8 in the appendix. Of course if we have time or if you
9 have questions I can do full examples. But maybe we can
10 conclude.
11 MR. LOPEZ: I think this gives you a pretty
12 good pretty sense. In today's European market you can
13 make extremely conservative loans with very good returns
14 on some of the best properties in Europe.
15 Turning to the next page, 17, I know you've
16 spent a lot of time with Carol and Townsend and
17 Courtland on the investment strategy, so I'll just go
18 through it quickly.
19 The maximum loan to value is 60 percent.
20 The targeted average spread is 340 basis points,
21 releveraging the portfolio of 35 percent. The countries
22 that we'll invest in will be primarily France, Germany,
23 the U.K. Eighty percent of the investments we make in
24 those countries, but we also will make the Scandinavian
25 countries and the Benelux countries as well.

1 And the property types we're lending on will
2 be all the basic Core property types.
3 The next page, page 18, I'll quickly outline
4 the program. Once again, 300 million. This will be a
5 ten year program with two one-year extensions. It's a
6 buy and hold strategy with a target return to net of 5
7 to 6 percent.
8 So we'd like to conclude on emphasizing the
9 fact that we'd view you as our partners in this. We're
10 putting up a significant amount of capital. The loans
11 that we make will be invested in the same loans you make
12 with us.
13 And in addition to that, there are 16 other
14 investors that will be working in these programs through
15 some of the top pension funds and insurance companies in
16 Europe, premier financial institutions of Europe.
17 The loans will be sourced by us, will be due
18 diligenced by us, and we will be responsible for the
19 management.
20 So I'd like to conclude by saying we think
21 that the opportunity today is extremely unusual. To
22 have a market of this size in this distress with no
23 obvious solutions provides an opportunity that, frankly,
24 I've only seen in the 25 years I've been doing this one
25 other time.

1 AXA has worked extremely hard to position
2 ourselves as the market leader. We are proposing a
3 program where we fully align with you, putting our money
4 where our mouth is with you. And I'd like to say we are
5 extremely excited by the opportunity to work with you
6 and to work together on this opportunity.
7 CHAIRPERSON AARONSON: Thank you.
8 Questions?
9 MR. HOLT: Are there any caps on the
10 adjustable portion of the rate terms? Say if the rates
11 go up 400 percent, is the debtor, do they get an opt-out
12 on some certain movement?
13 MS. SCEMAMA: The rate for each loan is a
14 floating rate loan, but it's forced to turn to an
15 instrument, a swap or a cap. So then as the lender we
16 are protected against any increase -- we benefit of the
17 increase of interest rates, but it does not impact the
18 (unclear) because you are getting these protections
19 through capital swaps.
20 So we get the benefit of it, but the
21 (unclear) is protected (unclear) instrument.
22 MR. HOLT: The overlay component -- the rate
23 adjustment component is an overlay that you have put in
24 place?
25 MS. SCEMAMA: It's provided by a bank. We

1 are not part of the edging, but we benefit from the fact
2 that the cost is edged for the (unclear) and we benefit
3 from the increase of rates.
4 MR. SCHLOSS: We have no cap; our rate can
5 go up.
6 Perfect; thanks.
7 CHAIRPERSON AARONSON: Thank you very much.
8 Merci beaucoup.
9 (Laughter.)
10 (The AXA people left the room.)
11 MS. BANAT: It's a $300 million program.
12 We're asking Teachers for 150.
13 MR. SCHLOSS: Consensus?
14 MS. MARCH: Consensus.
15 MR. SCHLOSS: Thank you.
16 We're still in executive session.
17 (Discussion off the record.)
18 MR. SCHLOSS: Ready?
19 MR. DIEGI: Can the board please turn to
20 page 122, the large copy, where BAM's memo on capital
21 begins.
22 Chairman Aaronson, Teachers Trustees, BAM
23 welcomes the opportunity to present Contrarian Capital,
24 its latest manager in options for fixed income to the
25 Teachers board today.

1 BAM recommends an allocation of $90 million
2 to the Contrarian mandate. This is part of an aggregate
3 NYCERS allocation of $250 million. Rocaton, the advisor
4 the Teachers concurs with this recommendation.
5 And to make most effective use of Teachers
6 time, BAM will go consecutively and only touch on the
7 most relevant areas of the memo.
8 The second paragraph, page 1, Contrarian's
9 flagship commingled fund, CCI 1, has an unleveraged
10 since inception net annualized return of 12.3 percent,
11 as of October 31, which is in line with OFI's
12 performance benchmarking.
13 What BAM wants to focus on with this memo is
14 what differentiates Contrarian from the handful of
15 existing OFI managers that Teachers portfolio currently
16 has.
17 There are three primary differentiators for
18 Contrarian. Number 1, Contrarian will be the second OFI
19 manager that has the capability to invest in emerging
20 markets, Marathon being the first.
21 Number 2, Contrarian since 1986 has invested
22 in trade claims and bankruptcy claims, an asset class
23 currently that the existing five portfolios of Teachers
24 does not have direct exposure to.
25 And Number 3, Contrarian is by far the

1 smallest manager presented to the board in OFI. For
2 example, they're roughly a quarter the size of Marathon,
3 with a little over $3 billion under management as of the
4 end of October.
5 As a result, what they focus on is debt that
6 is middle market debt, and debt that comes in far
7 smaller sizes than typical broadly -- loans, for which
8 each of the existing OFI managers could potentially
9 focus on.
10 Flipping to page 2 of the memo, 423 of the
11 larger packet, BAM provides several bullet points
12 providing its rational in support of the mandate.
13 To focus on the second bullet point, as
14 discussed, two of the new asset classes that Teachers
15 will have exposure to are trade claims and emerging
16 markets.
17 Trade claims as an example represents over a
18 quarter of Contrarian's commingled fund allocation, and
19 as a result Contrarian is heavily invested in the asset
20 class.
21 Number 2, emerging markets. As of October
22 31, net annual returns of 14 percent since its 2006
23 inception for commingled funds.
24 Number 3, Contrarian has over 25 year track
25 record, which is line, if not longer, than many of the

1 existing options for fixed income managers.
2 CHAIRPERSON AARONSON: To go back to
3 emerging markets for a second.
4 They will honor our portfolio constraints on
5 emerging markets?
6 MR. DIEGI: Absolutely. There are five
7 limited countries, China, Russia, Indonesia, Morocco,
8 Pakistan, that Contrarian will not be allowed to invest
9 in.
10 As indicated on page 1, BAM requests that
11 Teachers allocate $90 million of the remaining, a little
12 over a billion of capacity to the Contrarian mandate.
13 If you flip to page 23, 424 of the larger
14 packet, BAM, for Teachers convenience, has provided a
15 mosaic of the existing OFI portfolio pro forma for the
16 Contrarian mandate.
17 As you can see, $2.3 billion is the policy
18 target; $1.05 billion is what's remaining, a little over
19 2 and a quarter percent of the overall Teachers
20 portfolio.
21 If you flip to page 4, on top there is a
22 table of the five asset classes for which Contrarian
23 will focus on for this portfolio, as well as the target
24 gross returns and expected allocations.
25 As noted before, row 3 and row 5 are the

1 portfolio diversifiers for Teachers, because no manager
2 other than Marathon does any of those asset classes
3 currently, specifically trade claims and EM debts.
4 In the third paragraph of page 4, we wanted
5 to a give time frame on when on the ramp-up process for
6 Contrarian. The majority of the capital Contrarian
7 believes it can source within a six month period.
8 But certain investments on the more illiquid
9 side, specifically trade claims and other odd lot types
10 of assets, takes time to build Core positions. The firm
11 believes that these investments might take up to a year
12 to create a full weighting in the mandate.
13 If you flip to page 5, BAM touches on the
14 investment strategy and process, as well as the
15 platform. Contrarian, given its global focus, has
16 offices across the world, with the majority of
17 investment professionals based in Greenwich,
18 Connecticut, but also a handful in Paris, Sao Paolo and
19 Hong Kong.
20 If you flip to the next page, it provides
21 you an organizational chart of the Contrarian team.
22 Overall, including two of the co-founders, John Bauer
23 and Janet Stanton that are presenting here for Teachers
24 today.
25 After that, the investor composition. Of

1 note, BAM would request that Teachers note that over 30
2 percent of the commingled fund's LPs are fellow
3 pensions; and over a quarter of the firm's assets are
4 with fellow pensions. In aggregate, including
5 endowments and foundations, over 60 percent is with
6 those institutions as LPs, and over half in the overall
7 firm.
8 If you go to the next page, 7 of the memo,
9 and 428 of the larger book, on the top is a table of the
10 analyzed IRRs for all of Contrarian's commingled funds
11 as of October 31. What we wanted to reiterate at the
12 bottom for highlights, a couple of the key touch points.
13 What we would like to note now that we
14 haven't noted before is the sizable GP investment listed
15 on the third bullet point. Contrarian has confirmed
16 that it will contribute 5 percent as an equity
17 contribution to the mandate, further aligning Teachers
18 and Contrarian's interests.
19 If you flip to the next page, 8, on the
20 second bullet point in highlights, we want to show the
21 significant employee ownership in the firm. Over a
22 quarter billion of equity is owned by the three founding
23 partners, Bauer, Stanton and Tenzer, across the firm's
24 partnerships.
25 BAM would like Teachers to note in the first

1 bullet point of concerns, that Contrarian is looking to
2 raise a commingled $1 billion target lockup found called
3 the Opportunity Fund, whose primary focus in many ways
4 will be similar to the Contrarian mandate.
5 However, BAM believes the mitigating factor
6 for this is that is that the two founders, as well as
7 the firm's other senior professionals, have the direct
8 attention of this mandate and have indicated that they
9 will be focused on this mandate alongside their other
10 commingled funds.
11 The next page provides a brief biography of
12 each of the key principals at Contrarian.
13 The last page is the track record and firm
14 overview provided by Rocaton.
15 BAM is happy to take any questions.
16 MR. LYON: We also included a few pages
17 later in the board packet the analysis we provided to
18 BAM and the board. It is fairly detailed, but I think
19 Adi did a great job covering the relevant points. We
20 concur with the recommendation and think it's an
21 interesting complement to the existing program thus far.
22 MR. DIEGI: Page 433 of the larger packet,
23 where Rocaton's information begins.
24 Any questions?
25 MR. NORTH: What is the risk/return

1 expectation for this fund? Rocaton referenced something
2 by subsets, but is there an overall expectation?
3 MR. DIEGI: We believe the risk/return
4 expectations are in line with other existing mandates,
5 as well as the performance benchmark. Basically, low or
6 double digit net, 10 to 14 percent on average; again,
7 based on market conditions.
8 What BAM has provided Teachers is a
9 breakdown of the expected returns in each of the five
10 asset classes that Contrarian will focus on. On page 4
11 at the top, on the table Target Gross Return, is the
12 expected return per asset class. When you take a
13 weighted average based on the expected allocation, it
14 becomes on a weighted average basis roughly 10 to 14
15 percent.
16 MR. GANTZ: As far as volatility, likely
17 less than equities but more than high yield.
18 MR. SCHLOSS: Questions?
19 MR. DIEGI: Questions?
20 (The Contrarian people entered the room.)
21 MR. GANTZ: Please identify yourselves for
22 the court reporter.
23 MR. PERCARPIO: Thank you for inviting us
24 today. My name is Tim Percarpio, and I lead Contrarian
25 Capital's marketing efforts. I'll be your day to day

1 relationship manager with Contrarian.
2 My contact information is in the back of the
3 presentation. If you have any questions that arise
4 after we leave today, feel free to give me a call.
5 With me today are Janice Stanton and Jon
6 Bauer. Janice and Jon are two of Contrarian's founding
7 partners, as well as the portfolio managers for the
8 opportunistic fixed income strategy that we're
9 proposing.
10 I know you have a full agenda, so I'll turn
11 things over to Janice.
12 MS. STANTON: Good afternoon. Thank you for
13 having us. I'm here to tell you something about
14 Contrarian. As we go through our presentation I'm
15 going to flip through the pages and start on page 2,
16 basically, raise some highlights that you think about
17 when you think about Contrarian.
18 The first important point is that we have a
19 26 year track record. Jon and I have managed distressed
20 capital since 1986. We think it's one of the reasons we
21 have a track record that we're very proud of, which is
22 12.3 percent net returns to our investors. That's net
23 of all fees and expenses using no leverage over that
24 period of time.
25 We are distressed investing specialists, and

1 in the distressed investing space we focus on buying
2 debt securities at a discount, and that's potentially
3 how we get our returns.
4 We have a very deep fundamental research
5 process, and when I start to talk about the team you'll
6 see how deep our bench is and our shop.
7 We focus on under the radar situations.
8 We're looking to find opportunities that we think we can
9 take advantage of because of our middle size. We're not
10 the largest fund out there, we don't have to have the
11 largest opportunities, and we're looking for outsized
12 returns.
13 If you flip to the next page, page 3, it
14 goes over more of the history of the firm. I was one of
15 the founding partners along with Jon, and our third
16 partner Gil Tenzer, who founded Contrarian in 1995, but
17 we worked together since 1986 back at the old
18 Oppenheimer and Company.
19 We have a continuous track record. Again,
20 Jon and I worked together over this period. We actually
21 sit across from each other and always have since we
22 started working together, regardless of where we moved.
23 We have a very broad platform of credit
24 capability in the space, a deep bench, and we try take
25 advantage of whatever there is in terms of opportunity

1 in the distressed space.
2 I mentioned our flagship strategy is the
3 strategy of the fund that has the 26 year track record,
4 that's the broadest base of our capital. Our focus is
5 on private securities, again, under the radar --
6 CHAIRPERSON AARONSON: I notice in the
7 biographies here, Jon graduated from Stuyvesant High
8 School.
9 (Laughter.)
10 MR. BAUER: Thank you. I'm proud to be here
11 today. I didn't just go to Stuyvesant. I started at PS
12 40, then I went to Middle School 104, which was called
13 Junior High School 104 when I was there, Stuyvesant. I
14 grew up in Stuyvesant Town, Peter Cooper Village, and
15 it's a pleasure to present today.
16 (Laughter.)
17 MR. SCHLOSS: Do you always put that in
18 there, or just for us?
19 (Laughter.)
20 MS. MARCH: That's more important to us than
21 "My mother was a teacher." "My mother was a teacher"
22 doesn't impress us.
23 (Discussion off the record.)
24 MS. STANTON: We have offices in Greenwich,
25 in Sao Paulo, in Paris and in Hong Kong, although the

1 base of our operations is in Greenwich where all trading
2 investment decisions are made.
3 We have a team of 29 investment
4 professionals that would all be involved in some
5 capacity in managing the account. We have predominantly
6 an institutional client base. We have $3.1 billion of
7 assets under management, which makes us mid-size or
8 large enough to be important in the distressed investing
9 space, but not so big that we have to do only very large
10 deals.
11 We've been managing separate accounts since
12 1996. Our first client in a separately managed account
13 was General Motors Pension, and we continue to manage
14 that account today, and actually manage some money for
15 UAW when part of that pension money was spun off.
16 We have a very strong alignment of interest
17 with our investors. The partners and employees of
18 Contrarian have been together -- our largest account.
19 And that goes to the office managers, it's not everybody
20 (unclear) in the firm matching program 401(k).
21 The next pages give details on each of our
22 individual backgrounds that you can look in more deeply.
23 If you have more questions.
24 The following page, page 5, gives an
25 overview of our team of investment professionals. At

1 the top we've highlighted the partners. Jon and I run
2 the corporate side of the portfolio. Gil focuses on
3 real estate investments. And it's very much a team
4 approach. If you saw our office, it's a very open
5 floor. We value everybody's input, it's a very flat
6 organization.
7 We have seven senior investment
8 professionals. We do our own work, we don't rely on
9 street research. And a very deep bench. These people,
10 we've highlighted the areas that they are involved in
11 specifically.
12 The next page, going to page 6, basically
13 shows what our portfolio looks like in terms of ranges
14 of different buckets that we invest in. Our U.S.
15 performing debt, European performing, debt, bankruptcy
16 claims and obligations, emerging markets performing debt
17 and then equity securities that we receive --
18 MR. BAUER: Thanks, Janice. And thanks
19 again for the opportunity to present.
20 So the second part of the last three or four
21 minutes of our presentation is really on where do we see
22 the opportunities going forward, and why should you
23 consider Contrarian as a great firm to partner with?
24 The three main areas of opportunity that we
25 see in the next five years are U.S. performing bank

1 debt, and specifically companies that have a billion of
2 bank debt or below. Trade claims and liquidations; and
3 by liquidations we mean financial liquidations, or there
4 are a number of insurance companies that are in
5 receivership. It's a very esoteric area of the
6 distressed market, but it's one that we have particular
7 expertise.
8 And then the last big area is European and
9 emerging markets performing debt and restructurings.
10 And we also have the ability to customize any account
11 and to leave out certain countries.
12 If you go to page 8, this shows the U.S.
13 levered loan market. And the biggest deals where a lot
14 of our competitors normally play is in the $5 billion
15 and above category.
16 And as you see, that opportunity set has
17 gone down a little bit over the last three years, but
18 there's still six issuers and $57 billion in debt, and
19 in our flagship we actually own three of those issuers
20 right now, and they're very attractive.
21 As you get to smaller companies in the 1 to
22 $5 billion space, there's a lot to do, and there are 178
23 issuers, $339 billion outstanding, and we're seeing good
24 opportunities to buy distressed bank debt, in that
25 category.

1 But the biggest thing that we are looking
2 forward to and something that we're good at is investing
3 in companies with a billion of bank debt or below. And
4 our normal way we go about it is to buy 15 to 30 percent
5 of the outstanding bank debt. And we really work with
6 the company to help them if they need to restructure, to
7 cut debt and convert it to equity.
8 We have the ability to go on the board,
9 which we have done on many occasions, and we have nine
10 investment professionals who have chaired committees or
11 been on boards, and really been active in rolling up our
12 sleeves and creating value, a big part of what we do.
13 On page 9 we talk about the trade claims
14 opportunity. Really quickly, the classic trade claim
15 is, if you are a dress manufacturer and you sold to
16 K-Mart, and K-Mart filed for bankruptcy and owed you
17 money, we would offer to buy that claim for cash, and
18 then we would help the company to reorganize and
19 restructure.
20 What is interesting is, we're one of the few
21 firms that have the ability to source claims directly.
22 We have a former managing director of Bear who's worked
23 with us for ten years, who left Bear to go on maternity
24 leave, and we convinced her to come back and work with
25 us.

1 The ability to buy claims directly is a very
2 big competitive advantage.
3 Finally, there is a great opportunity in
4 Europe and in emerging markets. Basically, a lot of
5 banks in Europe will be forced to liquidate distressed
6 loans in the next couple of years. That's the first
7 graph on the top of page 10.
8 And then a lot people don't realize that EM
9 corporate debt, when you look at it globally, is the
10 size of the U.S. high yield market. And what means to
11 us is, there's always going to be an interesting
12 opportunity somewhere in the world to put money to work.
13 And that's what we do.
14 Lastly, on page 11, shows our 26 year track
15 record on a year by year basis. As Janice mentioned,
16 we're very proud of the fact that we never used leverage
17 ever, and our track record is net of all fees and
18 expenses.
19 And when you think about us, I think what
20 you really should focus on is, we're mid-sized, so we
21 can focus on smaller private deals that complement the
22 bigger funds that you might have.
23 We have a total alignment of interest, and
24 we love and are looking forward to the opportunity to
25 partner with the City of New York and Teachers to have

1 multiple years, hopefully, of excellent returns.
2 We'll open it up for questions if there are
3 any. Once again, thank you so much for allowing us to
4 present.
5 CHAIRPERSON AARONSON: Thank you.
6 Any questions?
7 MR. BAUER: Thanks. It's a real pleasure to
8 meet all of you.
9 (The Contrarian people left the room.)
10 MR. DIEGI: BAM requests that Teachers
11 allocate $90 million to Contrarian.
12 MS. MARCH: Consensus.
13 MS. ROMAIN: Consensus.
14 MR. SCHLOSS: Thank you.
15 Seema, you have some watch list items?
16 MS. HINGORANI: Really quick. Let me go
17 through the monthly packet, page 46. On page 46 you'll
18 notice a couple of lines down from the top your non-U.S.
19 activist manager, Governance for Owners. I want to give
20 you an update on that.
21 We had a call with this firm last Friday.
22 Actually, we met with them four times in the last one
23 and a half years. We put them on the watch list
24 originally a year and a half ago for process. They're
25 an activist manager. We weren't quite sure, based on

1 the businesses and positions in the portfolio if they
2 were really being activist in their process.
3 In the meantime, because of that, we
4 renegotiated fees down. So that was a good thing for
5 the system.
6 As you can see here as we scroll across the
7 page, you will notice they're up a little bit shorter
8 term, then down over 300 basis points. Again, this is
9 gross of fees. And management fee plus an incentive
10 fee, you can see they're down 300 basis points fiscal
11 year to date, and calendar year to date they're down 7
12 and a half, roughly. Fiscal year last year down 6 and a
13 half. Calendar year.
14 They're up and down and very volatile, and
15 in our view way too volatile for what we're trying to
16 accomplish in the public equity portfolio for Teachers.
17 They're having a difficult time in the last
18 couple of years, a very difficult time.
19 So we would add to the official watch list
20 that we have them on the watch list for performance. We
21 talked to Rocaton briefly about this and we plan to come
22 back to you for a more formal recommendation early next
23 year.
24 MR. SCHLOSS: Anything else, Seema?
25 MS. HINGORANI: No, that's it for that.

1 MR. SCHLOSS: Thank you.
2 Since we have this in hand, let's do this.
3 (Indicating.)
4 We need a motion to exit executive?
5 MS. MARCH: I move that we go back to public
6 session.
7 MS. ROMAIN: Second.
8 CHAIRPERSON AARONSON: All in favor?
9 (A chorus of "Ayes.")
10 Any opposed?
11 We're now out of executive session and back
12 in public session.
13 MR. SCHLOSS: In public session we have
14 quarterly reports, if Martin can quickly get us through.
15 MR. GANTZ: I will try my best. Chris
16 already went through the variable funds and the returns.
17 Once again, I'll repeat that September was a very good
18 quarter.
19 If you take a look at page 9, you will see
20 the numbers. The reality was that it was a good quarter
21 because during the quarter the ECB in Europe and the Fed
22 in the U.S. continued with their market interventions
23 and the markets liked that. So the equity markets
24 rallied and the U.S., 6 percent or the Russell 3000, the
25 EAFE and emerging markets did better in the U.S. value

1 (unclear).
2 Fixed income did well, as well. Investment
3 grade did well because the Fed were buying, and high
4 yield did well because high yield keeps doing well.
5 It's very hard to find negative numbers on those. REITs
6 was slightly down, but other than that, very hard to
7 find.
8 On page 9 you'll see that Teachers was up to
9 $46.1 billion, which I believe was a new high. The
10 return for the quarter was a very strong 4.46 percent,
11 40 basis points behind the benchmark, but for the one
12 year period over 17 and a half percent behind the
13 benchmark. And you will also notice over ten years the
14 return is over 8 percent. So that's really good news.
15 MR. SCHLOSS: Mr. North, did you notice
16 that?
17 CHAIRPERSON AARONSON: Mr. Actuary?
18 MR. NORTH: But it is nice to see a positive
19 number.
20 MR. GANTZ: And that includes 2008.
21 On page 11, this is the asset allocation
22 adjusted for the parking places. I'm pleased to note
23 that we are effectively in balance with all of the new
24 asset allocations. We're underweight in Core+5 and over
25 in U.S. Equity.

1 The newest thing we have on the page is bank
2 loans, it's the army colored green towards the top,
3 about 11:00 o'clock.
4 The next few pages show attributions. For
5 the quarter, on page 12, the allocations were roughly in
6 policy. So there was not much of a difference. The
7 management effect is mostly from the private equity time
8 differences.
9 And similar for the one year on page 13, the
10 private equity differences account for most of the
11 management -- the allocation effect we talked of
12 previous quarters, about a year ago we had some cash and
13 that accounts for some of the underperformance along
14 with the underweight in Core+5.
15 The summary of the attributions or the
16 allocations is on page 15 and page 16 for the management
17 effect. You see private equity jumps off the page, and
18 that's mostly a timing difference and some
19 underperformance.
20 And for the allocation effect for the
21 quarter, nothing really jumps off the page. And for the
22 12 months it's the cash that hurt, of course, where we
23 were being overly defensive in an uncertain market.
24 I want to show you some returns versus other
25 large public plans, and that's on page 17. This is

1 plans greater than $10 billion. On the very left, it
2 you take a look, this is the last quarter for the year,
3 and you'll see that the range of returns is very, very
4 narrow.
5 So Teachers' return of 446 was right smack
6 in the middle, so you're at the median return. But for
7 the one year period, which is just to the right of the
8 line, the 17.63 puts you in the top quartile.
9 MR. SCHLOSS: Yay.
10 (Laughter.)
11 MR. GANTZ: The next page shows the
12 annualized returns, and the one year you see the one
13 year 17.63, but also the three year, four year and five
14 year numbers are all top quartile except for the four
15 year, which is just outside of it by a few basis points.
16 Unless there are any questions, or if Seema
17 has comments on equity?
18 MS. HINGORANI: Thanks, Martin.
19 If you turn to page 21. I'll just point you
20 to a couple columns. You can see from the pie chart,
21 you guys are mostly passive in U.S. Equities.
22 So a couple columns I'll point you to are
23 the index return, the actual return and the difference
24 column. And you can see in the index return column the
25 Russell 3 up a little over 6 percent, so it was a good

1 quarter for the market.
2 And I will point out the difference column,
3 you'll see that the emerging markets row outperformed by
4 over 100 basis points. I wanted to highlight that. You
5 might remember we switched the emerging manager of
6 manager program from a Russell 3000 mandate to a Russell
7 2000 mandate, which is a small cap mandate, and that
8 looks good so far.
9 If you turn to page 29, I'll go through
10 international real quick. You can see from the pie
11 charts above that we're 60 percent active versus
12 passive, so much more active in the U.S. And again,
13 I'll point you to the three columns, indexed return,
14 actual return and the difference.
15 And you can see the passive EAFE, that's the
16 index, close to 7 percent return, so a little better
17 than the U.S. and then emerging markets even better,
18 close to 9 percent for the quarter, so a good number for
19 emerging markets.
20 And we are almost fully funded for Teachers
21 in emerging markets in the active piece, based on the
22 search we had done earlier this year.
23 And then again, the difference column is one
24 thing to highlight. Non-U.S. activist is minus 400
25 basis points, that's Governance for Owners, we already

1 talked about that. So just one more data point.
2 MR. SCHLOSS: In the public session, no
3 names.
4 MR. GANTZ: The names are in the appendix.
5 MR. SCHLOSS: Okay.
6 MS. HINGORANI: If you go to page 30, this
7 is emerging markets. And we just look at most periods
8 going back to the trailing five years. Teachers is
9 doing inline versus the benchmark; so the purple is
10 Teachers and the yellow is the index. And so EAFE, you
11 can you see that the system has actually done quite well
12 when you look at longer term periods versus the
13 benchmark.
14 We completed the EAFE search, and we're
15 starting to fund some of the managers.
16 Then if you turn to page 6, that's emerging
17 markets. Again, this is early on, early days for
18 Teachers in active in emerging markets. So not in here
19 yet, but you can see that in the trailing three months a
20 bit behind the benchmark, basically fiscal year to date.
21 And trailing 12 months, we are actually just showing you
22 here that the total EM in passive is actually what you
23 had for most of the year.
24 We'll have more data to show you over the
25 next couple of quarters about how well the activist is

1 doing.

2 Now I'll turn it back to Martin.

3 MR. GANTZ: To continue the positive news,

4 the returns on page 39. You see that half of the fixed

5 income assets are in blue; that represents Core+5, over

6 $15 billion in fixed income.

7 Breaking down Core+5 on the next page, we

8 now see that the corporate sector has been growing and

9 growing as the mortgage sector starts shrinking, so

10 they're almost equal. We've been underweight, as you

11 know, in the government sector, in the over/underweight

12 column and overweight spread sectors, and in this

13 particular quarter Treasuries underperformed the other

14 sectors.

15 And in addition to that, in the difference

16 columns, all the sectors outperformed. In fact, of 15

17 managers, 13 outperformed. The two that didn't were

18 only by a couple basis points. So this was for the

19 quarter all the way down.

20 On the next page you will see the returns

21 overall for the Core+5, which was 2 and a half percent

22 ahead of the 2 percent benchmark. And for the one year

23 period it was 7 and a half percent ahead of the 6 and a

24 half percent benchmark; and for three years was actually

25 8 percent.

1 MR. SCHLOSS: Bob, 8 percent.
2 MR. NORTH: Performance is no guarantee of
3 future results; but it's good.
4 MR. GANTZ: And I will leave you with,
5 taking a look at the very bottom, volatility. The 8
6 percent over three years was achieved with less than 3
7 percent -- 8 percent returns was achieved with less than
8 3 percent volatility.
9 For TIPS, next page, also a good quarter.
10 Two and a quarter percent ahead of the benchmark of 212
11 for the quarter. Two of the three managers outperformed
12 for the year; just under 9 and a half percent, also
13 ahead of the benchmark, and three years also just under
14 9 and a half percent. And five years over 8 percent.
15 So TIPS has done very well, not that there's
16 been inflation, the other component of TIPS is duration,
17 and interest rates have gone down; in fact, real rates
18 are negative, and so TIPS had benefitted from that.
19 High yield is on page 43. As you know, we
20 now have a new roster of high yield managers. The
21 returns were very close to the benchmark, slightly
22 under, returning 396 versus 412 for the benchmark, so
23 another strong quarter. And 16 and a half percent for
24 the year behind the benchmark. And if you take a look,
25 ten year returns are 973 for high yield.

1 So, again, this is another strong area in
2 fixed income.
3 MR. SCHLOSS: Martin, when will we get a
4 leveraged loan page?
5 MR. GANTZ: When we get a leveraged loan
6 return?
7 So the board knows, the money was put out
8 but we funded them --
9 (Laughter.)
10 MR. SCHLOSS: Wait until we get back to the
11 office.
12 (Laughter.)
13 MR. GANTZ: So bank loans were funded in
14 August and September. The managers are on performance,
15 depending on the managers in October, November and
16 December. One manager is not on performance yet, and so
17 you will see a staggering of the managers in this book
18 with the returns with the green and the red.
19 And overall, when we have a full quarter of
20 returns, so probably with the first quarter of 2013
21 you'll see full returns.
22 For convertible bonds on page 44, the
23 returns for the program were roughly in line with the
24 benchmark; and for the one year period was behind --
25 equity sensitive was strong on an absolute basis, and

1 we'll talk more about that next month.
2 The three and four year, we now have a four
3 year number. While the returns compared to the yellow
4 have a benchmark of convertibles, it's behind. The
5 managers are generally ahead of their individual
6 benchmarks, as you see, the three and four year periods,
7 as well as for the one year period.
8 And lastly, for opportunistic fixed income,
9 this is a program that is going to be growing over time.
10 For the quarter was a little over 3 percent. And the
11 yellow is the percentage of the quarter that represents
12 10 percent return. Purple is the high yield benchmark.
13 The one year period was behind that, the three year is
14 very strong returns.
15 And we have now added, as you know, we
16 talked about in executive session, a new set of managers
17 that will be starting to be represented in these returns
18 going forward.
19 I'll turn it over to Kathy.
20 MS. MARTINO: The EAFE portfolio did well
21 for the quarter, outperforming its benchmark and also
22 (unclear) a good performer (unclear) your collateral
23 benefits are in the large book.
24 And start on page 6, I'll bring your
25 attention to the AFL-CIO HIT page, which is page 8.

1 They had committed their HIT home product, which
2 provided low cost mortgages to New York City employees.
3 They committed for ten years. That program is ending.
4 And we have the final numbers of what it did here; 2,155
5 of the loans went to TRS members (unclear).
6 We are currently in conversations about a
7 HIT 2 program, and I will keep you posted.
8 MS. MARCH: Sounds very good.
9 MS. NELSON: In the large book on page 16
10 we'll go through the highlights of the portfolio for the
11 quarter ending June 30. I will jump on the highlights.
12 Se we have a 6 percent allocation to real
13 estate. Right now we're about 2 percent invested and 3
14 percent committed. As of the end of that quarter,
15 second quarter 2012, the market value of what we had in
16 the ground was about $875 million.
17 We have unfunded commitments to the tune of
18 $425 million. Together our exposure to the real estate
19 asset class is $1.3 billion. And looking at the
20 portfolio, that is an allocation to 44 percent in Core
21 strategies and 56 percent if non-Core strategies.
22 You will recall that Non-Core also includes
23 our emerging commitments. The portfolio that we talked
24 about earlier today is well diversified in terms of
25 property type and geography. So prior to AXA, we were

1 close to 5 percent international, and if you assume that
2 it's fully invested with the AXA commitment, it will
3 probably be a lot closer to 17 percent international.
4 We have 37 investments, 28 managers,
5 actually at 28 managers with AXA. To talk a little
6 about performance, for the quarter we were about 50 bips
7 under the benchmark, at one point 8 percent on a net
8 basis. The Odyssey came in at 2.3 percent.
9 I would attribute that underperformance to
10 internal valuations that Core managers took, two in
11 particular. One had a land asset that was not
12 performing according to plan. The other one has some
13 condo projects and they're not selling them as quickly
14 as possible, and so they've adjusted that forecast.
15 Toward the bottom, to give you a sense of
16 how the portfolio is performing over extended periods,
17 we are the blue, TRS is the blue, and the benchmark is
18 in yellow, and as indicated it was slightly under for
19 the quarter. But for the 12 month period we're ahead
20 140 basis points. The Teachers portfolio had a returned
21 of 1.7 percent.
22 Also, for the three years, also a nice
23 overperformance of 300 basis points, 10.4 percent versus
24 7.4. The next period we were under, so this is really
25 capturing the global financial crisis. So we have like

1 20 tough quarters right here, and we underperformed
2 there by about 310 basis points.
3 Overall, since inception, performance of the
4 program has bested the benchmark by close to 300 basis
5 points at 290 basis points. I would tell you that
6 Odyssey is a time-weighted return benchmark, but we also
7 track the performance on a dollar rated basis. So our
8 IRR as of 6/30 for the Teachers portfolio is 6.7
9 percent, an equity multiple of -- 2 times.
10 That's our summary.
11 MR. SCHLOSS: Thanks.
12 MS. CALDAS: I can go through the private
13 equity second quarter report starting on page 33 of your
14 books. If you recall earlier in the year we increased
15 your private equity allocation to 46 percent, and
16 currently as of this second quarter is at 5.4 percent.
17 In terms of your partnerships and
18 relationships, you have 121 funds in your portfolio
19 across 82 relationships. And in terms of capital
20 commitments, you've increased from $3.6 billion in the
21 first quarter of 2012 to $3.9 billion.
22 And also in terms of contributions, you've
23 gone up to $3 billion from the previous quarter.
24 And there's also the total distributions,
25 which is important, because it's capital coming back to

1 you, a very positive number there, going from $1.5
2 billion in the first quarter to $1.6 billion in the
3 second quarter, an increase $122.2 million, so a very
4 positive movement.
5 Then you look at the market value of your
6 overall portfolio going from 2.15 to 2.17, so a gradual
7 upward performance there as well.
8 Your total value multiple pretty much stayed
9 as is from the previous quarter to 1.2 times.
10 And your since inception IRR went down by
11 one bip, but it's pretty much stable, same as 1.86
12 percent.
13 If you look at it against the benchmark on
14 page 35, Teachers is the darker bar at the top. You
15 will see that since inception against the benchmark you
16 underperformed slightly by 47 bips against the venture
17 economic pool, and then only by 37 bips underperformed
18 the Russell 3000 plus 300 basis points.
19 But that is such a small number of
20 difference that it's almost an equivalent. You are
21 doing very well.
22 And then if you look at page 38, you will
23 see your IRR since inception, since September 30, 2011,
24 you'll see an upward trend, and that's mostly due to,
25 pretty much have that trend characterized by the

1 performance of the larger buyout, doing very well with
2 16 percent IRR, which is really offsetting the poor
3 performance (unclear).
4 So that's pretty much a snapshot of the
5 portfolio, performance of your portfolio.
6 CHAIRPERSON AARONSON: Thank you.
7 MS. CALDAS: You're welcome.
8 MR. SCHLOSS: All good for the quarter.
9 So last month and then we're done.
10 Everybody get their monthly?
11 (Indicating.)
12 How about if we start on page 32?
13 So the markets in October were down, so we
14 went down a little bit but bounced back in November. So
15 we're probably back up to about 46-ish, plus or minus.
16 If you look at page 33, again, you're
17 hanging out probably in the highest neighborhood we had
18 before.
19 If you jump to page 35, Martin kind of went
20 through the asset allocation already, but here it is
21 again. I guess if I had to sum it up I'd say we're
22 positioned for the fiscal cliff to be resolved, which I
23 think it will be. I don't know if it becomes a cliff or
24 a hill or a molehill, but these guys have to figure
25 something out, whatever it is.

1 MS. MARCH: The best comedy I've ever
2 watched.
3 MR. SCHLOSS: Too bad it's a tragedy. But
4 they're going to figure something out. I can't tell you
5 if it's before New Year's or after New Year's, but it
6 sure as hell is sometime in January-ish, whatever. But
7 it will take the uncertainty off the markets.
8 I think the economy is turning. I can't
9 tell you the slope of it, but everybody i talk to says
10 things are getting better. I think if you take this
11 fiscal cliff out of the way the stock market will go up.
12 MS. MARCH: And there'll be a lot of work in
13 the Northeast because we hand Sandy and they need to
14 give people jobs to rebuild.
15 MR. SCHLOSS: So we're set up for that stuff
16 to happen, in general. Hence we're up in range of the
17 U.S. stock market, and you will see that some people are
18 declaring dividends and things like that to get money
19 out before rates go up. But again, you'll see the same
20 thing in private equity, we'll get some more money.
21 But ultimately I think that's the quickest
22 way to say how we're positioned.
23 MS. MARCH: Do you think the Department of
24 Education can pay all the teachers this year for next
25 year, before the rates go up?

1 MR. SCHLOSS: I think that's a Janice
2 question.
3 MS. MARCH: Do you think they could do that?
4 MR. SCHLOSS: Moving right along, we're
5 going to our get bonuses paid earlier.
6 (Laughter.)
7 I think that's what happens in the real
8 world. On page 40, just to be done, you can see the
9 month was down half a basis point. It was down because
10 the equity markets were down. It sort of reversed
11 itself in November. So I think when you see the
12 November results you'll find it's up 4 plus, 4 and a
13 half percent, let's say, through five months.
14 I presume December is bouncy because
15 everyone is too focused on the fiscal cliff. But again,
16 it will all work itself out, I'd say.
17 I guess that's it, unless there are any
18 questions. That ends the agenda, actually.
19 CHAIRPERSON AARONSON: We have to have a
20 report from Susan of what we did in executive.
21 MS. STANG: In the executive session of the
22 variable fund there was a presentation by an investment
23 manager and a discussion of the structure of the
24 defensive composite in Variable A. A consensus was
25 reached, it will be announced at the appropriate time.

1 There was a discussion of a contract
2 extension for a service provider to the variable and
3 pension funds. Consensus was reached, which will be
4 announced at the appropriate time.
5 In the executive session of the pension
6 fund, we received a presentation by two private equity
7 investments. Consensus was reached, which will be
8 announced at the appropriate time.
9 There was an update on one private equity
10 investment.
11 There was a presentation on real estate
12 investment. Consensus was developed, which will be
13 announced at the appropriate time.
14 And there was a presentation on an
15 opportunistic fixed income investment. Consensus was
16 reached, which will be announced at the appropriate
17 time.
18 CHAIRPERSON AARONSON: Does that complete
19 your report?
20 MS. STANG: That's all she wrote.
21 CHAIRPERSON AARONSON: Is there any other
22 business before the board?
23 Do I hear a motion to adjourn?
24 MS. MARCH: Motion.
25 MR. SCHLOSS: Second.

1 CHAIRPERSON AARONSON: All in favor?
2 (A chorus of "Ayes.")
3 Any opposed?
4 We're adjourned.
5 (Matter concluded.)
6 (Time noted: 3:35 p.m.)
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2 C E R T I F I C A T I O N

3

4 I, Jeffrey Shapiro, a Shorthand Reporter and

5 Notary Public, within and for the State of New York, do

6 hereby certify that I reported the proceedings in the

7 within-entitled matter, on Thursday, December 6, 2012,

8 at the offices of the NEW YORK CITY RETIREMENT SYSTEM,

9 335 Adams Street, Brooklyn, New York, and that this is

10 an accurate transcription of these proceedings.

11 IN WITNESS WHEREOF, I have hereunto set my

12 hand this _____ day of _____________, 2012.

13

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15 ___________________________

16 JEFFREY SHAPIRO

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