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CalPERS' Clout Tested in Fee Fight
By Dale Kasler
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CalPERS is throwing its weight around on Wall Street in order to slash investment management fees and rid itself of the controversial middlemen known as placement agents.

But despite a breakthrough last week with investment titan Apollo Global Management, it's unclear whether the giant public employee pension fund will get others to play along.

Many of CalPERS' partners are reluctant to give any pension fund a discount on fees, experts say, even one as powerful as the California Public Employees' Retirement System.

And placement agents won't go down without a fight. Although Apollo pledged to stop hiring placement agents to seek business from Cal- PERS, agents scoffed at the suggestion that the industry has been crippled.

"CalPERS is one fund. It's gigantic, but it's one fund," said Frank Minard, a New York placement agent and board member of the Third Party Marketers Association, an industry group. The group is fighting a CalPERS-endorsed bill in the Legislature that could restrict agents' fees.

Still, CalPERS' agreement with Apollo is groundbreaking. The private equity firm – CalPERS' largest investment partner – will cut fees by $125 million over five years.

And its promise to swear off placement agents represents a big turnaround. Apollo has been a frequent client of the most controversial placement agent of all, former CalPERS board member Alfred Villalobos, paying him at least $40 million in contingency fees to obtain investments from the California fund.

Villalobos' success as a placement agent – he's earned at least $60 million from all clients off CalPERS deals – has been an enormous embarrassment to the California pension fund, raising questions of possible influence peddling.

Apollo is the first private equity firm to respond to a year-old CalPERS campaign to reduce management fees. CalPERS says its investment partners have been earning too much, especially when many of the investments have been doing poorly.

The Apollo fee cut could put pressure on others.

"No one wants to cut fees," said Mario Giannini, chief executive of Pennsylvania asset manager Hamilton Lane. "What this does is engage everybody in that conversation. This will make this conversation much more topical." Hamilton Lane manages a $500 million CalPERS fund devoted to California deals.

CalPERS believes a precedent has been set.

"I hope this sets the stage for others," CalPERS President Rob Feckner said last week. "There will be pushback from some, but the majority are going to see that this is a a good thing."

But it remains to be seen if other private equity firms will do as Apollo did.

CalPERS has "made a major effort to get similar concessions across the board," said Allan Emkin of Pension Consulting Alliance, a firm that advises CalPERS. "They've made some headway, but as you may imagine there are some headwinds."

CalPERS' crusade on management fees evolved into a broader conflict over placement agents. The agreement with Apollo was negotiated by Philip Khinda, a Washington lawyer hired by CalPERS to investigate agents.

Another big Wall Street firm, the Blackstone Group, dropped its opposition last week to AB 1743, the legislation backed by CalPERS that would ban contingency payments to agents.

Blackstone, which owns a placement agent business, had argued that small investment firms must pay agents with contingency fees – usually a 1 percent to 2 percent cut of any deal the agent secures – because they can't afford full-time marketing representatives.

The firm changed its mind after talking with the bill's author, Assemblyman Ed Hernandez, D-West Covina, about language that would "preserve the policy objective" while allowing "legitimate placement agents to be fairly compensated," said Blackstone spokesman Peter Rose.

Walter Hughes, Hernandez's chief of staff, said the assemblyman remains adamant that contingency fees must be banned because he believes they invite corruption. But Hernandez agrees "there has to be compensation" for agents, he said.

The bill still faces opposition from others in the financial industry. Because it would amend the Political Reform Act, the legislation needs a two-thirds majority for passage.

Placement agents are now banned in New York, following an investigation into pension fund corruption that generated criminal charges and guilty pleas.

Attorney General Jerry Brown is investigating agents' activities in California but has yet to file any charges. On its own, CalPERS is trying to drive out placement agents by persuading investment firms to stop hiring them, as it did with Apollo.

Yet Giannini and Emkin said they believe most firms will offer resistance.

Many "believe the role of the placement agent may add value," Emkin said.

CalPERS says placement agents are simply unnecessary; anyone with a worthy investment proposal can get an audience with the pension fund.

But Minard, the New York placement agent, said agents help their clients – many of them small, emerging firms – by consulting with them on marketing materials and the oral presentations they make to pension funds.

If CalPERS cuts itself off from placement agents, "it means CalPERS is not going to have access to a lot of good (investment) managers," he said. "That's CalPERS' problem, that's CalPERS' shortsightedness."

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