

Calpers Rocked By 'Pay to Play'

By CRAIG KARMIN
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America's largest public-pension fund, Calpers, revealed that a former board member had reaped more than \$50 million in fees for arranging investments that could saddle state taxpayers with hundreds of millions of dollars in losses.

The disclosure deepens concerns that alleged conflicts of interest are undermining state retirement funds.

The California Public Employees' Retirement System said it is launching a "special review" into payments by money managers—including billionaire Leon Black's Apollo Management LP—to firms including Arvco Financial Ventures LLC. Arvco is headed by Al Villalobos, who served on Calpers's board from 1993 to 1995.

Calpers made no accusation of wrongdoing. "We are gathering facts to confirm that the \$50 million in fees paid to Arvco did not come at our expense," said spokeswoman Pat Macht.

Mr. Villalobos said in a statement Wednesday that he would cooperate with Calpers's review, which he said would find that staff, advisers and board members at Calpers "have

acted properly."

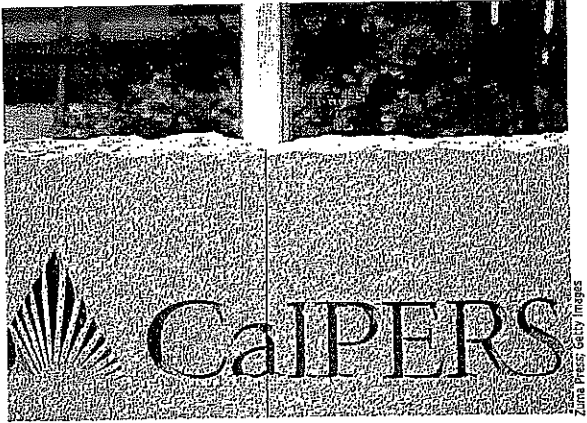
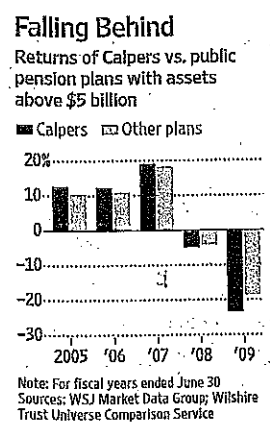
The disclosure stands to embarrass Calpers, a longtime champion of good corporate governance. It also promises to cast the fund even deeper into conflict in California, because the burden of Calpers's soured investments stands to fall flatly on taxpayers who are already reeling from a huge state budget deficit and steep unemployment.

Calpers funds the guaranteed pensions of retired state employees from returns on its investments and contributions from local governments. With its investments tanking, Calpers has requested more money from municipalities. To pay up, many of these governments will have to cut services or raise taxes.

"Whenever any public fund does anything to detract from their investment performance, the victims are local governments and state governments," David Crane, an economics adviser to Gov. Arnold Schwarzenegger, said Wednesday.

Calpers's disclosure also renews questions over the role of the middlemen who collect fees from private-equity firms, hedge funds and other invest-

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Above: Calpers's former chief executive, Fred Buenrostro, in March 2005. The public-pension fund is taking heat for fees a former board member received.

Calpers Under Fire for Investment Fees Paid to Ex-Board Member

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ment firms eager to manage a slice of these vast public assets.

These so-called placement agents came under scrutiny in March, when New York Attorney General Andrew Cuomo announced two arrests. In that case, a connected middleman allegedly received kickbacks for helping investment firms gain access to billions of dollars of New York pension money.

Mr. Cuomo has said his staff is coordinating with law-enforcement agents to examine similar "pay to play" issues at pension

Calpers's disclosure is the latest to raise questions over the role of middlemen who collect fees from firms.

funds in states including New Mexico, Connecticut and Illinois. The Securities and Exchange Commission has proposed a ban on placement agents for state and municipal pension funds.

Now questions about "pay to play" turn to California. This week, Gov. Schwarzenegger signed a bill that requires disclosure of all fees paid by investment firms to placement agents.

On Wednesday, Scott Gerber, a spokesman for California Attorney General Jerry Brown, said

access Calpers cash.

Mr. Villalobos's connections in the state of California go back decades. He worked as a consultant to California Gov. Ronald Reagan and later helped raise money for California Gov. Pete Wilson, who named Mr. Villalobos to the State Personnel Board. That board, which administers the state's civil-service system, picked him as its representative on the Calpers board in 1993.

Mr. Villalobos left Calpers in 1995. About two years later, he started Arvco in Stateline, Nev.

Interviews and a review of public documents show Mr. Villalobos maintained close ties to people at Calpers, including a former head of its investment committee and its former chief executive.

Mr. Villalobos's daughter, who has worked on several Calpers deals with him, and Arvco employees contributed to the election

his office "has an ongoing, independent investigation" into the use of placement agents. He said the office will cooperate with the SEC and other government agencies in ongoing probes, but declined to give details on the investigation.

Calpers's losses amid the financial crisis topped \$50 billion and shrank the fund by more than 23% through June 30, leading to its worst fiscal year ever. For the year ended in June, the median return of public-pension funds with \$5 billion or more in assets was a 19% decline, according to Wilshire Consulting.

Public criticism of Calpers has been building for months, over poor returns, the deep burdens it places on municipalities and pensions that in some cases exceed \$100,000 a year. In August, the fund's chief actuary, Ron Seeling, publicly said California's pension costs were "unsustainable."

Calpers says its internal probe was sparked by an internal review showing the tens of millions in fees Mr. Villalobos's placement agent firm had secured from money managers over five years.

Mr. Villalobos's firm pitched the services of Apollo, Mr. Black's New York private-equity firm, according to documents The Wall Street Journal requested from Calpers in a Sept. 23 Public Records Act request. According to these documents, Apollo paid Arvco at least \$40.9 million in fees.

Since 2006, Calpers has committed more than \$3.5 billion to Apollo funds, the largest commitment to any firm in Calpers's \$20 billion private-equity investment

campaign of Calpers board member Charles Valdes, who served as head of the pension fund's investment committee for 13 years.

Mr. Valdes is being investigated by California's Fair Political Practice Commission for accepting campaign donations that exceeded the legal limit for his 2005 re-election to the board.

A representative for Mr. Valdes has said the campaign misunderstood the limit rules, according to commission documents. Mr. Valdes did not return a call for comment Wednesday. Mr. Villalobos's daughter did not respond to a request for comment placed with Arvco.

Former Calpers Chief Executive Officer Fred Buenrostro, who stepped down last summer, was hired in August by Arvco and does research and prepares marketing materials for the firm's clients, he said in an interview

portfolio.

These investments have been among Calpers's worst performers, according to fund documents. Calpers committed \$1 billion in 2008 to Apollo Credit Opportunities Fund I, which invests in debt markets and was down 49% as of March, according to Calpers documents.

Investments in two other Apollo funds—\$1 billion in its flagship private-equity fund, and \$200 million in an Amsterdam-listed vehicle that invests in Apollo's funds and deals—were both down around 60%.

Apollo's funds have recovered substantially since the market lows in March.

Calpers also acquired a roughly 9% direct ownership stake in Apollo for about \$600 million in 2007. After that direct link was solidified, Apollo continued to pay Arvco substantial fees to

Wednesday. He served for several years on the Calpers board before he became CEO, and from 1993 to 1995, he was trustee on alongside Mr. Villalobos. "That's where our friendship began," Mr. Buenrostro said.

Calpers staffers sometimes felt that Mr. Buenrostro pressured them to look favorably on deals where Arvco was a placement agent, according to several people familiar with the matter.

Mr. Buenrostro says all he did was "make introductions to staff and if there were questions about the investment process, I would answer them."

Calpers's review will be conducted by the law firm Steptoe & Johnson LLP, the fund said. It also recently hired the consulting firm Houlihan Lokey to advise it about its poorly performing investments, according to people familiar with the matter.