



Board of Administration

Agenda Item 9e

June 16, 2021

Item Name: Assembly Bill 890 (Cervantes) – Emerging and Diverse Investment Managers

Program: Legislation

Item Type: Action

Recommendation

Adopt a **SUPPORT** position on Assembly Bill (AB) 890, as amended May 24, 2021, because the bill supports the ongoing emerging manager program.

Executive Summary

AB 890 requires the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS) to each define the term "emerging and diverse manager". It also requires each retirement system to annually submit a report to the Legislature beginning on or before March 1, 2023, on the status of achieving appropriate objectives and initiatives regarding participation of emerging and diverse managers responsible for asset management within its portfolio of investments. The bill includes a sunset provision of January 1, 2028.

Strategic Plan

This agenda item supports the Strategic Plan goal to strengthen the long-term sustainability of the pension fund.

Investment Beliefs

This agenda item supports Investment Belief 3 and the Sub-Belief of Investment Belief 10: that CalPERS investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries; and diversity of talent at all levels is important.

Background

CalPERS Investment Manager Engagement Program

For more than 25 years, CalPERS has played a leadership role in developing and implementing emerging and transition manager strategies, investing with emerging managers, directly or through fund of funds arrangements, and more recently with transition managers. For purposes of these investment strategies, emerging investment managers are generally described within the industry as newly formed or relatively small firms. Each CalPERS asset class participating in this program has separate emerging manager and transition manager definitions based on assets under management and/or length of track record.

Consistent with its fiduciary duty to work in the best interests of its 2 million members, CalPERS' objective for investing in emerging manager programs is to generate appropriate risk-adjusted investment returns by: identifying early stage funds with strong potential for success; accessing unique investment opportunities that may otherwise be overlooked; and cultivating the next generation of external investment management talent. CalPERS has made significant efforts to communicate our investment strategies and criteria for making investment decisions to the external manager community, including emerging managers, to help ensure that investment proposals are aligned with CalPERS' objectives.

CalPERS Reporting of Ongoing Emerging and Transition Manager Program Activities

Chapter 701, Statutes of 2011 (SB 294, Price), required that CalPERS and CalSTRS each define the term "emerging investment manager" and produce a five-year strategic plan for emerging investment managers' participation across all asset classes. That bill also required each retirement system to submit an annual report to the Legislature, until January 1, 2018. More than ten years prior, CalPERS launched its Management Development Program to allocate capital and invest directly in small and emerging public equity investment management firms in exchange for an equity stake. In 2007, CalPERS also established a series of emerging manager initiatives focused on hedge fund and private equity strategies.

Following the enactment of SB 294, the Investment Office created an Emerging Manager Program to integrate its emerging manager strategies across all asset classes, improve communication and engagement with the emerging manager community, and address the specific reporting requirements of the bill. The first report, the 2012 Emerging Manager Five-Year Plan established a strategic framework of 10 work streams to address these portfolio management and external outreach activities. In 2015, the Investment Office created a Transition Manager Program to address the continuous maturity and development of its original Emerging Manager Program by providing a pathway for an emerging manager to be seriously considered as a traditional, established manager engaged by an Investment Office asset class.

In 2017, as part of its final report mandated under SB 294, CalPERS adopted a new Emerging and Transition Manager 2020 Plan to continue the strategic framework established under the 2012 Emerging Manager Five-Year Plan. The 2020 Plan identifies appropriate objectives and initiatives to be undertaken over a three-year period ending June 30, 2020, including how transition managers will be identified, evaluated, and selected, as well as the administration of two global solicitation processes seeking qualified candidates for the Transition Manager Program. The Investment Office team members report annually to the Board on activities

undertaken to meet the six plan objectives and continue to engage and communicate with the merging and transition manager community.

Analysis

Bill Summary

Specifically, as the bill relates to CalPERS, AB 890:

- Requires the CalPERS Board of Administration (Board) to submit a report to the Legislature commencing on March 1, 2023, and annually thereafter, on the status of achieving appropriate objectives and initiatives regarding participation of emerging and diverse managers responsible for asset management within its portfolio of investments.
- Requires that the report shall be based on contracts that the System enters into on and after January 1, 2022.
- Specifies the report must also identify and include all of the following:
 - The name of each emerging manager and diverse manager providing investment portfolio or asset management services at the end of the prior fiscal year, including, but not limited to, fund of funds contracts for all asset classes as applicable.
 - The year the emerging or diverse manager was first engaged or contracted to provide investment portfolio or asset management services.
 - The amount managed by each emerging or diverse manager by asset class at the end of the prior fiscal year, as well as the total amount allocated by the System in the applicable asset class during the year and the total amount of the asset class in the System's investment portfolio.
- Requires the Board to define the term "emerging and diverse manager" for reporting purposes.
- Specifies that nothing in this section shall require the Board to take action that is not consistent with the fiduciary responsibilities of the Board as described in Section 17 of Article XVI of the California Constitution.

Purpose of the Bill

According to the author:

"CalPERS and CalSTRS have combined assets of over \$700 billion but a relatively low rate of participation of emerging and diverse managers when compared to other state pensions systems.

"California cannot have shared success without shared opportunity.

"In order to address systemic inequality, the California State Legislature will need accurate information on how CalPERS and CalSTRS disperse capital to women and minority managers."

Budget and Fiscal Impacts

Program Costs/Savings:

Unknown.

Administrative Costs/Savings:

Unknown, but likely nominal. CalPERS has team members that manage the emerging and diverse manager program and the mandated legislative reporting program, respectively. However, existing resources would be diverted from current workload to fulfill the bill's reporting requirement.

Benefits and Risks

Benefits:

- Provides reassurance that the Legislature and CalPERS are committed to an investment strategy that includes emerging and diverse managers.

Risks:

- None.

Danny Brown, Chief
Legislative Affairs Division

Brad W. Pacheco
Deputy Executive Officer
Communication and Stakeholder Relations

Marcie Frost
Chief Executive Officer