



Agenda Item 6a

August 13, 2012

ITEM NAME: CalPERS Five-Year Plan for Emerging Manager Participation

PROGRAM: Targeted Investment Programs

ITEM TYPE: Total Fund – Action

RECOMMENDATION

Approve the draft CalPERS Five-Year Plan for Emerging Manager Participation and direct staff to forward the approved Plan to the State Legislature as required under statute.

EXECUTIVE SUMMARY

Staff is requesting the Investment Committee's approval of the draft CalPERS Five-Year Plan for Emerging Manager Participation ("Plan"), as required under legislation. Please see Attachment 1 for the draft Plan.

The Plan outlines definitions for emerging managers in each asset class. The Plan also establishes ten work streams across two major areas of focus: Portfolio Management and External Outreach. The Portfolio Management work concentrates on emerging manager investment programs, and the External Outreach work emphasizes communication with the emerging manager stakeholder community.

The Plan commences August 1, 2012. Staff will submit the draft Plan to the Legislature and submit annual reports on progress made under the Plan as required by statute.

BACKGROUND

Effective on January 1, 2012, Chapter 701 of the Statutes of 2011 (SB 294 Price) requires the Board of Administration of the Public Employees' Retirement System and the Teachers' Retirement System to:

- Provide a five-year strategic plan for emerging investment manager participation across all asset classes.
- Submit an annual report to the Legislature, starting in 2014 continuing through 2018, regarding the progress of the plan.
- Define "emerging investment manager" for purposes of these provisions.

CalPERS objective for investing in emerging manager (EM) programs is to generate appropriate risk adjusted investment returns by identifying strong performing, early stage funds; accessing investment opportunities that may otherwise be overlooked; and cultivating the next generation of external portfolio management talent. The ultimate measure of success for our EM programs is investment performance against benchmark. To date, performance against this metric has been mixed. One of the key work streams of the Plan is to evaluate the performance of EM programs to understand the drivers of performance.

California law prohibits State agencies from discriminating against or granting preferential treatment to any individual or group on the basis of race, sex, color, ethnicity, or national origin in the operation of public contracting. CalPERS therefore may not grant preferential treatment to emerging managers based on the above characteristics. Women and minority managers are more likely to be emerging managers; as a result, an ancillary benefit of our EM strategies may be the increased diversification of CalPERS external fund managers.

ANALYSIS

Investment Office Development of Five Year Plan

Staff developed the draft Plan in consultation with RG & Associates and CalPERS Legal and External Affairs offices. Highlights of the Plan development process include:

- The Targeted Investment Programs staff established a cross asset class team, set project milestones and defined “emerging managers” for the purposes of this effort.
- RG & Associates was selected to provide consultant services from a spring fed pool to assist with development of the Plan.
- Staff solicited the “Top 3 Ideas” from industry associations such as New America Alliance, National Association of Investment Companies, National Association of Securities Professionals, Association of Asian American Investment Managers, and Toigo Foundation.

Work Streams in the Five Year Plan

The Plan includes ten work streams. Six work streams are focused on Portfolio Management and four are focused on External Outreach.

Portfolio Management is comprised of EM Programs and EM Research.

- EM Programs work streams are focused on existing, and the potential for new, emerging manager programs. These efforts include: Track and report the performance, cost, and diversity of EM portfolio; Review Global Equity Manager Development and Fund of Funds Programs; Track and report progress of Private Equity and Real Estate EM strategies; Establish criteria for

transitioning EMs to direct mandates; and Establish criteria for new capital to EM programs.

- The EM Research work is focused on understanding and comparing CalPERS emerging manager programs against other large pension systems. The work stream is to benchmark CalPERS EM program design and implementation against peers.

External Outreach is comprised of Pipeline and Networking.

- Pipeline work streams are focused on improved information, process and communication between CalPERS and prospective emerging managers. These work streams include: Improve communication regarding investment proposal submittal and tracking; and Improve EM information on CalPERS website.
- Networking work streams include: Host and participate in workshops, webinars and conferences; and Improve communication and strengthen relationships with stakeholder organizations.

CalPERS will monitor progress under the Plan and may make changes and adjustments to work streams as necessary. Any changes will be discussed in subsequent annual reports.

Current Emerging Manager and Diverse Manager Exposure

CalPERS has approximately \$10 billion currently invested with emerging managers. This investment with over 300 emerging managers, totals approximately 12% of CalPERS externally managed net asset value.

CalPERS has over \$3 billion invested with over 80 diverse (women and minority) investment managers. This diverse investment manager exposure, comprised of both emerging and non-emerging managers, totals approximately 4% of CalPERS externally managed net asset value.

Growth of Emerging Manager Programs

CalPERS has committed \$900 million to EM strategies in the areas of Private Equity, Real Estate, Global Equity, and Hedge Funds Absolute Return Strategies in the last three years. Highlights include:

- \$100 million increase to the Absolute Return Strategies fund of emerging hedge funds program in May 2010.
- \$100 million increase to the Global Equity EM fund of funds program in September 2010.
- \$400 million increase to the Global Equity manager development program (Phase II) in June 2011.

- \$200 million initial allocation for the Real Assets new real estate emerging manager program approved in August 2011.
- \$100 million committed to EM in the Private Equity program in the last year.

Communication with EMs and Stakeholders

Staff has initiated the External Outreach Networking work stream to improve communication with emerging managers and professional associations. The purpose of the outreach effort is to increase communication regarding CalPERS emerging manager programs, how to submit investment proposals, and CalPERS criteria for making investment decisions.

In addition to reaching out to stakeholders for their input on the development of the Plan, in July staff hosted the New America Alliance at CalPERS headquarters bringing together key NAA members and investment staff. Staff is scheduled to participate and speak at upcoming annual meetings including Credit Suisse, National Association of Investment Companies and the Association of Asian American Investment Managers. Finally, staff will hold our first workshop with the Asian Pacific Islander, Latino and Legislative Black Caucuses in the fall.

BENEFITS/RISKS

In addition to meeting the legislative mandate, the benefits of the Plan include increased understanding of EM investment strategies and outcomes; improved transparency and communication with emerging managers; and the establishment of criteria for new capital to EM programs.

Risks associated with the Plan may include potential impact on investment performance if emerging manager performance does not meet expectations. Another risk associated with the Plan is the need for additional staff and consultant resources to accomplish the work laid out in the Plan. Additional resource needs could result in re-prioritization of other Investment Office Roadmap priority initiatives.

ATTACHMENTS

Attachment 1 – Draft CalPERS Five-Year Plan for Emerging Manager Participation
Attachment 2 – Summary Presentation to Investment Committee

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