

# Emerging Manager Five-Year Plan

Pathway to the Future

January 1, 2018

Year Five Annual Report | Fiscal Year 2016-17

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For more than eight decades, CalPERS has built retirement and health security for state, school, and public agency members who invest their lifework in public service. Our pension fund serves more than 1.8 million members in the CalPERS retirement system and administers benefits for nearly 1.4 million members and their families in our health program, making us the largest defined-benefit public pension in the U.S. CalPERS' total fund market value currently stands at approximately \$343 billion.

For more information about CalPERS, visit [www.calpers.ca.gov](http://www.calpers.ca.gov).

## Message From Our CIO

On behalf of CalPERS, I am pleased to present the fifth and final annual progress report on our *Emerging Manager Five-Year Plan – Pathway to the Future*.

CalPERS has invested with emerging managers for more than 25 years, directly or through fund of funds partnerships. Over the last five years we have diligently engaged the emerging manager community to improve communication, strengthen our relationships, and enhance the implementation of our emerging manager investment strategies.

In June 2016, CalPERS announced the investment of new capital to our Emerging and Transition Manager programs through fiscal year 2020. The report outlined how managers will be identified, evaluated, and selected.

CalPERS continues to engage and communicate with the emerging and transition manager community as we implement the next step and evolution of the Five-Year Plan. The Emerging and Transition Manager 2020 Plan will continue the strategic framework established under the Five-Year Plan.

The new Plan includes identifying appropriate objectives and initiatives to be undertaken over the course of the plan including the administration of two solicitations seeking qualified candidates for the Transition Manager Program across Global Equity, Private Equity and Real Assets.

Our staff look forward to building on the success of the Five-Year Plan as it concludes, and applying what we have learned to the next step, the Emerging and Transition Manager 2020 Plan.

We value your feedback as we continue our leadership role in emerging and transition manager strategies.

Sincerely,

Ted Eliopoulos

*Chief Investment Officer*

## Section 1

### Executive Summary

In 2012, CalPERS' Board of Administration adopted the *Emerging Manager Five-Year Plan – Pathway to the Future* (Five-Year Plan or the Plan), which provided a strategic framework to guide CalPERS' investments and engagement with emerging investment managers. Under this plan, CalPERS has delivered annual updates to the California State Legislature, reporting on progress and accomplishments toward achieving plan goals.

CalPERS has completed all 10 work streams of the Five-Year Plan. Notable accomplishments over the past five years include:

- CalPERS has expanded and restructured its emerging manager programs to strategically integrate into the CalPERS portfolio. These new structures include 45 emerging managers, 22 of which are diverse, for a total of \$3.6 billion of net asset value.
  - Global Equity completed a restructuring of its Emerging Manager Program. The restructure resulted in 21 new emerging manager relationships, totaling over \$3 billion.
  - CalPERS committed an additional \$200 million to Private Equity's Emerging Manager Program, the Domestic Emerging Manager II (DEM II) fund to 11 emerging managers.
  - CalPERS increased its commitment to its Real Estate Emerging Manager Canyon Catalyst Fund from \$200 million to \$550 million, with a total of five emerging managers.
- Developed the Transition Manager Program, to provide a path of growth and opportunity for successful early stage managers who no longer fit parameters of emerging.
- Publication of the Emerging and Diverse Manager Data Report, and the Emerging Manager Exposure and Cost Report, to better understand CalPERS cost and exposure to emerging manager programs.

The Five-Year Plan includes 10 work streams, organized under two areas: (1) Portfolio Management and (2) External Outreach. Notable accomplishments covering July 1, 2016 through June 30, 2017 include:

#### **Portfolio Management Work Streams**

- Established a process for the investment of capital to Emerging and Transition Manager Programs for each participating asset class through fiscal year 2020.

#### **External Outreach**

- Hosted the third annual CalPERS Emerging, Transition, and Diverse Manager Day in September 2016. Approximately 70 emerging manager firms and over 160 representatives participated.

## Introduction

For more than 25 years, CalPERS has developed and implemented emerging manager strategies, as well as invested with emerging managers. For purposes of its programs, emerging managers are generally defined as newly formed or relatively small firms. Each CalPERS asset class has emerging manager definitions based on assets under management and/or length of track record. *The CalPERS Emerging Manager Programs and Definitions* (Reference 1) details the current Emerging Manager Programs and definitions across asset classes.

CalPERS has a fiduciary duty that requires the Board of Administration and staff to always work in the best interest of its 1.8 million members. As such, our 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.

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. Therefore, CalPERS does not grant preferential treatment to managers based on the above characteristics. Data shows, however, that women and minority managers make up a higher proportion of emerging managers than established managers; therefore, emerging manager strategies can result in greater ethnic and gender diversity among CalPERS' external investment managers.

As the nation's largest public pension fund, within the nation's most ethnically and culturally diverse state, CalPERS recognizes diversity is a competitive advantage. CalPERS broadly interprets diversity to mean differences such as age, ethnicity, culture, or gender that result in diversity of thinking. CalPERS seeks diversity of internal staff, corporate boards, and external investment managers to secure high functioning teams that incorporate different ways of seeing and solving problems.

CalPERS is also committed to equal access and opportunity for all investment managers. To facilitate equality of access and opportunity for external managers we have established an internet-based investment proposal submittal process and apply consistent review and decision-making criteria in evaluating all investment proposals. 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.

As of June 30, 2016, CalPERS had \$8 billion invested in emerging manager programs, \$3.6 billion of which are part of our recently restructured, and strategically invested, emerging manager programs. As of the same date, CalPERS had \$4.5 billion invested with women and minority owned managers.

CalPERS' dedication to investing with emerging managers is also demonstrated by the integration of its Five-Year Plan into the *CalPERS Fiscal Year 2014-16 Business Plan* and the *Investment Office Fiscal Year 2014-16 Roadmap*, which are the strategic plans that detail the key priorities and initiatives of both the CalPERS enterprise broadly and the Investment Office. The new Emerging and Transition Manager

2020 Plan (2020 Plan) (Reference 2), beginning July 1, 2017 and ending June 30, 2020, will focus on six key initiatives that are intended to maintain CalPERS leadership in emerging and transition manager investment programs, and build on the success of the original Five-Year Plan.

CalPERS adopted 10 *Investment Beliefs* (Reference 3) in September 2013, which are intended to provide a basis for strategic management of the investment portfolio, inform organizational priorities, and ensure alignment between the Board and CalPERS staff. In particular, the following Investment Beliefs underpin the work in the Five-Year and the 2020 Plan:

- ***Investment Belief 3:*** *CalPERS' investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries.*
  - As a public agency, CalPERS has many stakeholders who express opinions on investment strategy or ask CalPERS to engage on an issue. CalPERS' preferred means of responding to issues raised by stakeholders is engagement.
  
- ***Investment Belief 10:*** *Strong processes and teamwork, and deep resources are needed to achieve CalPERS' goals and objectives.*
  - Diversity of talent (including a broad range of education, experience, perspectives, and skills) at all levels (board, staff, external managers, corporate boards) is important.

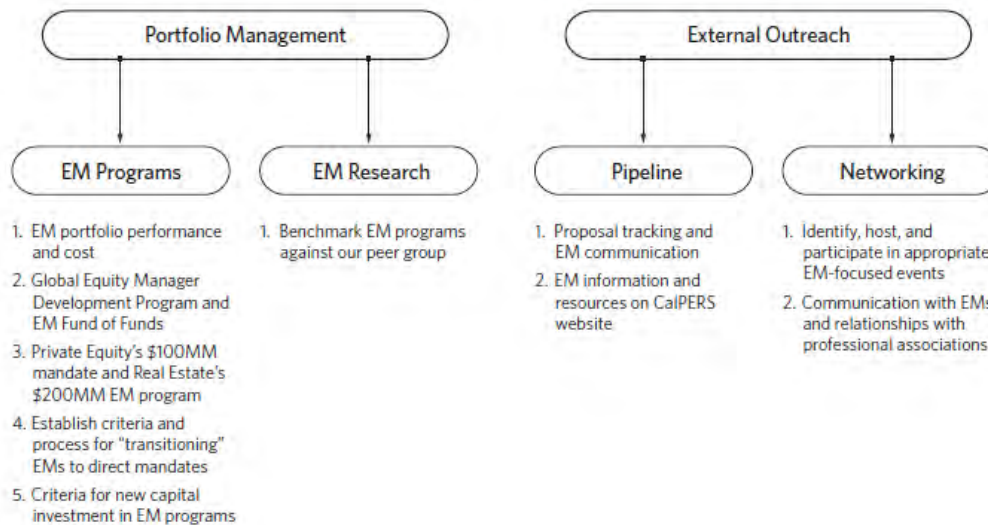
## About the Five-Year Plan and CalPERS Year Five Annual Report

Chapter 701 of the Statutes of 2011 (SB 294 Price) requires CalPERS to develop and implement a strategic plan for emerging investment manager participation across all asset classes. In August 2012, CalPERS adopted the *Emerging Manager Five-Year Plan – Pathway to the Future* as its emerging manager strategic plan (Reference 4). The Five-Year Plan was delivered to the State Legislature in August 2012, as directed by statute. The statute requires CalPERS to submit a progress report to the State Legislature by March 1 each year, from 2014 through 2017, with the last report due on January 1, 2018.

The Five-Year Plan details CalPERS' strategic efforts related to emerging manager investment strategies in two areas: (1) Portfolio Management and (2) External Outreach. These two strategic areas are further organized into 10 distinct work streams, which are detailed below in Exhibit 1.

### Exhibit 1

#### Emerging Manager Five-Year Plan Work Streams



The development of the Five-Year Plan, implementation and monitoring of the work streams, and progress reporting are the responsibility of the CalPERS Investment Office, specifically through the Targeted Investment Programs (effective August 1, 2016, the Targeted Investment Programs has been renamed to the Investment Manager Engagement Programs).

The Year Five Report details progress made on the Five-Year Plan from July 1, 2016 through June 30, 2017.

## Section 2

## Five-Year Plan: Year Five Annual Report

The following details CalPERS' progress on the Five-Year Plan. The report includes a brief description of the work stream and its desired outcomes, as well as how the objective was met.

### Portfolio Management Initiatives

#### Emerging Manager Programs

##### Emerging Manager Programs Work Stream 1

Establish performance, cost, and diversity of existing emerging manager portfolio

Investment performance of CalPERS' emerging manager programs has been mixed. To better understand specific issues related to performance, this work stream requires CalPERS to identify performance, cost, and diversity of the existing emerging manager investment portfolio.

#### Summary of Accomplishments:

In 2013, CalPERS released the *Emerging and Diverse Manager Data Report* (Reference 5). The Report provides the exposure, performance and diversity of CalPERS Emerging Manager investments.

In 2014, CalPERS released the *Emerging Manager Exposure and Cost Report* (Reference 6). This Report provides information on the exposure to, and cost of, emerging manager investment initiatives in the CalPERS' investment portfolio.

This work stream was completed, however, staff undertook additional work to establish regular performance reporting for emerging manager exposures across the investment portfolio. In 2015, regular semi-annual emerging manager performance reporting appears in the CIO Trust Level Review report, a comprehensive report detailing the investments across the CalPERS total fund.



### Emerging Manager Programs Work Stream 2

Review Global Equity Manager Development Program and Emerging Manager Fund of Funds Program

In 2010, the Global Equity Unit initiated portfolio restructuring to transition the traditional capital allocation model to a risk-adjusted return model. CalPERS also reviewed the Manager Development Program and Emerging Manager Fund of Funds programs with three key goals: to achieve superior risk-adjusted investment returns; to continue providing opportunities for new and emerging investment managers; and to incorporate emerging managers into the broader Global Equity Unit capital allocation model.

CalPERS engaged its fund-of-fund partners to better identify highly qualified managers, provide capability development guidance, and establish the process and criteria for determining whether to transition an emerging manager to a larger, direct investment mandate.

#### Summary of Accomplishments:

In 2015, the Global Equity asset class completed a restructuring of its Emerging Manager Program, evolving from a Fund of Funds and manager development approach to a focus on more meaningful mandates and better integration into the total Global Equity portfolio. Five external advisors were retained and as of June 30, 2017 the program consisted of twenty-one emerging manager relationships totaling \$3.2 billion.

### Emerging Manager Programs Work Stream 3

Manage, track, and report progress of Private Equity's \$100 million and Real Estate's \$200 million Emerging Manager Programs

In August 2011, CalPERS committed an additional \$100 million to its Private Equity Emerging Manager Program and \$200 million to its Real Estate Emerging Manager Program. This work stream focuses on ensuring appropriate management and tracking of these investments so investment performance, cost, and other relevant factors can be evaluated and used for investment decision making.

#### Summary of Accomplishments:

In October 2014, CalPERS committed an additional \$200 million to Private Equity's Emerging Manager Program.

Since the start of the Year Five Report, six new investments have been made to the following emerging managers: Gemspring Capital Fund I, LP; Aldrich Capital Partners Fund, LP; Central Valley Fund III, LP; Peak Rock Capital Fund II, LP; and Crayhill Principal Strategies Fund LP; Argand Partners Fund LP. These investments bring the Domestic Emerging Manager II program to 11 emerging managers and over

\$135 million committed as of June 30, 2017. Strategies include Middle-Market Buyout, Distressed Debt and Special Situations.

Since inception in 2012, CalPERS increased its commitment to Canyon Catalyst Fund (CCF) from the initial commitment amount of \$200 million to \$550 million in June 2017. In this same fiscal year, a new investment to BKM Capital was made through CCF giving CalPERS exposure to five emerging managers in real estate covering industrial, multi-family, office and retail product types.

In addition, in July 2015, CalPERS increased its initial \$100 million commitment to AGI Resmark to \$150 million. AGI Capital is a San Francisco-based, emerging manager-led real estate investment company.

#### Emerging Manager Programs Work Stream 4

Establish criteria for “transitioning” emerging managers to receive direct mandates from CalPERS

The goal of this work stream is to establish criteria to evaluate emerging managers’ potential for direct investment mandates. This will be done by building on demonstrated performance and capabilities, actively managing risks, and providing a clear understanding of what is required of emerging managers to compete for additional capital.

#### Summary of Accomplishments:

In June 2015, CalPERS announced its Transition Manager Program with the following objectives:

- to generate appropriate risk adjusted investment returns by investing with managers with demonstrated early stage success;
- to have continued access to investment opportunities with successful firms with an ancillary benefit of increased representation of women and minority owned firms in the CalPERS portfolio; and
- to provide a path of growth and opportunity for emerging managers to build their firms to a size large enough to compete for entry into our pool of larger established managers.

The development of the Transition Manager Program started with a survey of staff, pension peers, external advisors, and stakeholder groups to gather information on their observations and experience with transition emerging managers in the past. The objective of the program is to provide a path of growth and opportunity for successful early stage managers who no longer fit the parameters of an emerging manager.

The parameters of the Transition Manager Program vary by asset class and should be viewed as general guidelines in order to provide each asset class with flexibility in administering the Program. Prospective transition managers will be evaluated in the same manner as established managers and should meet a strategic need within the respective asset classes. The parameters and approximate commitment amounts are as follows:

- Private Equity – 3rd, 4th, 5th, and 6th institutional funds; \$0 - \$400M million allocations in a direct relationship with CalPERS' staff oversight. The Private Equity Transition Manager Program may commit up to \$2 billion in total capital allocations over the next five years.
- Real Estate – 4th, 5th and 6th institutional funds; \$50 - \$300 million allocations in a direct relationship with CalPERS' staff oversight. The Real Estate Transition Manager Program may commit up to \$2 billion in total capital allocations over the next five years.
- Global Equity – The investment manager should have a minimum of \$2 billion in assets under management with CalPERS allocations representing no more than 25% of firm assets under management at the time of funding; \$500 - \$1 billion allocations in a direct relationship with CalPERS' staff oversight. The Global Equity Transition Manager Program may commit up to \$3B in total capital allocations over the next five years.

Staff will continue to track activity in both emerging and transitioning manager programs and report to the CalPERS Investment Committee on commitment amounts, as well as issues and successes as the programs mature in the coming years as part of the reporting in the 2020 Plan.

#### Emerging Manager Programs Work Stream 5

Evaluate and establish criteria for new capital to emerging manager programs

The information and lessons learned from CalPERS' research, analysis, outreach, and strategic reviews will assist CalPERS in determining prudent targets for emerging manager participation. In developing the emerging manager program strategies, factors to be considered include availability of new capital for investment, capital allocation among asset classes, percent of assets managed externally, emerging manager performance and costs, and the size of the viable universe of emerging managers, while also ensuring alignment with CalPERS' investment strategy.

#### Summary of Accomplishments:

In June 2016, CalPERS announced the commitment of up to \$4 billion of new capital to our emerging manager programs through the fiscal year 2020. The report outlined how managers will be identified, evaluated, and selected.

Allocation of new capital in our Emerging Manager programs:

- Up to \$500 million in Private Equity
- Up to \$500 million in Real Estate
- Up to \$3 billion in Global Equity

Staff will track activity in the emerging manager programs and report to the CalPERS Investment Committee on commitment amounts, as well as issues and successes as the programs mature in the coming years as part of the 2020 Plan.

### Emerging Manager Research

#### Emerging Manager Research Work Stream 1

Benchmark Emerging Manager Program against our peer group

CalPERS is committed to maintaining leadership in emerging manager programs. This work stream directed staff to compare CalPERS' Emerging Manager Programs against its peers in the institutional investor community.

### Summary of Accomplishments:

In 2014, CalPERS released the results of the *CalPERS Emerging Manager Programs Benchmark Survey* (Reference 7). This peer survey was conducted to understand investment exposures with emerging managers, and the goals, governance, and operations of each emerging manager program in order to learn how other programs are implemented.

As a result of this survey, staff conducted a follow-on survey to examine peer exposure to women and minority owned investment managers, the *CalPERS Peer Benchmark Survey: Women and Minority Owned Managers* (Reference 8).

### External Outreach Initiatives

#### Pipeline Work Stream 1

Improve emerging manager proposal tracking and communication

CalPERS is committed to providing equal access and opportunity for submittal and consistent review of emerging manager investment proposals. This work stream aims to improve and enhance the centralized Internet-based portal system through which all investment proposals are received and routed to the appropriate asset classes for evaluation.

The goal of this work stream is also to educate and improve communication with potential emerging manager partners about the investment proposal submittal process, the decision criteria and process for evaluating investment proposals, and range of potential outcomes.

### Summary of Accomplishments:

**Proposal Tracking:** By June 2015, significant improvements to the investment proposal submittal and review process have been made including: increased ease of use for managers, improved capture of emerging and diverse manager data, updated response guidelines for more constructive feedback, and ability to enter and save data, providing up to 90 days to complete proposal submittal process.

**Communications Initiative:** CalPERS goal is to strengthen communications with emerging and diverse managers and stakeholder groups, as well as to facilitate a better understanding of the investment proposal submittal and review process. Accomplishments under this initiative included:

- Updated procedures and communication strategies
- Improved reports and documentation from the online proposal submittal process
- Improved feedback to emerging and diverse managers regarding evaluation and decision processes
- Improved written and verbal communications to facilitate stronger working relationships with emerging and diverse managers

#### Pipeline Work Stream 2

Improve emerging manager information and resources on CalPERS' website

The goal of this work stream is to review and identify enhancements to CalPERS' website to provide improved access to information about the CalPERS Investment Office, its strategies and processes, and other information important to its external stakeholders.

### Summary of Accomplishments:

In June 2015, the Investment Office launched a web page that provides information about initiatives and activities of interest to emerging and diverse managers. In support of the Five-Year Plan, the web page provides:

- A calendar of events (meetings, forums, and events)
- Emerging Manager Five-Year Plan reports and deliverables
- Emerging Manager and Transition Manager focused updates to the Investment Committee
- Emerging Manager and Transition Manager focused publications
- Links to asset class information and strategies
- Link to the web-based investment proposal submittal portal

As processes and programs change, staff will continue to evaluate, enhance, and improve the web page to meet the information and program needs of CalPERS and the emerging manager investment community.

### Networking

#### Networking Work Stream 1

Identify, host, and/or participate in emerging manager-focused events

CalPERS has a long history of hosting and participating in industry association events focused on emerging and diverse managers. This work stream focuses on staff's outreach efforts via conferences, webinars, workshops, and meetings to strengthen CalPERS' relationships and improve communications with its stakeholders.

#### Summary of Accomplishments:

CalPERS hosted several emerging manager-focused events including:

**Transition Manager Solicitation Webinar** - On June 22, 2016, CalPERS hosted a webinar to announce and communicate the Transition Manager Solicitation to stakeholders, external managers, and interested parties.

**CalPERS Emerging, Transition, and Diverse Manager Day** - On September 8, 2016, CalPERS hosted its third Emerging, Transition, and Diverse Manager Day. The event provided participating managers with an opportunity to meet with CalPERS' senior staff and external advisors in the Private Equity, Global Equity, and Real Estate asset classes. The event was well-attended as 70 emerging manager firms, with over 160 representatives attended.

**CalPERS hosted Emerging Manager-Focused Events** - CalPERS hosted a National Association of Investment Companies (NAIC) 2017 Luncheon on December 7, 2016 at CalPERS headquarters in Sacramento.

This work stream is ongoing and staff will continue to reach out to external stakeholders to strengthen CalPERS' presence in emerging manager networks through industry associations.

#### Networking Work Stream 2

Improve communication with emerging managers and professional associations

CalPERS believes that constructive engagement with the emerging manager community is a critical element to continuing its commitment to emerging managers. As such, CalPERS is focused on strengthening efforts in (1) outreach, (2) education and messaging, (3) technology networking tools, and (4) ongoing communications.

### Summary of Accomplishments:

**Engagement with Emerging and Diverse Manager Industry Organizations** – Throughout the reporting period, CalPERS engaged with the following emerging manager investment stakeholders:

- Association of Asian American Investment Managers (AAAIM)
- National Association of Investment Companies (NAIC)
- National Association of Securities Professionals (NASP)
- New America Alliance (NAA)

**Emerging and Diverse Manager Events** - During the reporting period, staff attended and participated as featured speakers in the following emerging and diverse manager events:

- 100 Women Summit
- 9th Annual PartnerConnect West
- AAAIM National Conference
- Achieving Diversity in Boardroom/C-Suite
- Central Valley Venture Forum
- ConsortiumEAST
- ConsortiumWEST
- FIS Group 20th Anniversary Conference
- Grosvenor SEM Conference
- JOIM Conference
- Markets Group PE US Forum
- NAA Wall Street Summit
- NAIC PE and Hedge Fund Conference
- NASP Annual Conference
- NASP Emerging and Diverse Manager Forum
- SEO Alternative Investments Conference
- Toigo Board Meeting
- Toigo Gala
- TRS ERS Emerging Manager Conference
- Women's Alt Investments Conference
- Women's PE Summit

CalPERS will continue to engage with stakeholder groups and participate in their organizations' meetings, conferences, and events related to emerging and diverse managers in the investment area.

## Conclusion

This Year Five Report concludes the Emerging Manager Five Year Plan. CalPERS has executed and completed all ten work streams.

The new Emerging and Transition Manager 2020 Plan (2020 Plan), beginning July 1, 2017 and ending June 30, 2020, will focus on six key initiatives intended to maintain CalPERS leadership in emerging and transition manager investment programs. The new plan will continue industry-leading efforts and initiatives focused in emerging, transition, and diverse managers in CalPERS investment portfolios.

CalPERS will continue its efforts to examine and improve its emerging and transition managers programs and to communicate with emerging, transition, and diverse managers and other interested stakeholders about the goals of our investment programs.



## References

**1. CalPERS Emerging Manager Programs, Definitions, and Fact Sheets**

<https://www.calpers.ca.gov/page/investments/investment-manager-engagement-programs/emerging-transition-manager>

**2. CalPERS Emerging and Transition Manager 2020 Plan**

<https://www.calpers.ca.gov/docs/forms-publications/emerging-transition-2020-plan.pdf>

**3. CalPERS Investment Beliefs**

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**6. Emerging Manager Exposure and Cost Report**

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**7. CalPERS Emerging Manager Programs Benchmark Survey**

<https://www.calpers.ca.gov/docs/forms-publications/emerging-manager-benchmark-survey.pdf>

**8. CalPERS Peer Benchmark Survey: Women and Minority Owned Managers**

<https://www.calpers.ca.gov/docs/forms-publications/peer-benchmark-survey.pdf>