Manager Transition Program Webinar

Date: October 23, 2015
Host: Mike Silva
Q&A Panel: John Greenwood, John Cole, Ron Chavez, Todd Nunes, Eric Schlenker, and Rina Lessing

Mike: Good morning. My name is Mike Silva. I'm an investment officer for the Targeted Investment Programs at CalPERS. Thank you for joining us for the Manager Transition Program webinar. The purpose of this webinar is to provide information on the program and its objectives. Today I'm joined by John Greenwood of our Private Equity team. John Cole, Ron Chavez, and Todd Nunes from the Global Equity team. And Eric Schlenker and Rina Lessing of our Real Estate team, who will answer any questions on the asset classes. We are saving plenty of time at the end of this webinar to answer your questions. However, we urge you to send in your questions via the chat box during the webinar, so we have them in hand as we begin the Q & A session.

Before I begin to outline the Manager Transition Program, I want to share some information about our team and our role here in the Investment Office. Targeted Investment Programs seeks to identify new investment manager talent across all asset classes, increase manager diversity and economic development, and helps to ensure fair labor practices. Our team overseas investment programs designed to have positive impacts on investment returns. These programs include: Emerging in Transition Manager programs, Diversity and Inclusion Initiatives, California Investment initiatives, and Labor Relation policies. The Targeted Investment Programs provide total fund coordination across all asset classes at CalPERS. We also act as a liaison between the Investment Office and interested stakeholders including advocacy groups and labor organizations. Coordinate and report on various legislative and board mandates and initiatives, and develop and implement communication and outreach plans.

CalPERS has a legacy of leadership and innovation in emerging investment strategies. We've been investing directly with emerging managers for more than 20 years. We remain committed to engaging with our stakeholder community. We want to strengthen relationships with emerging managers and improve implementation of in emerging manager investment strategies. In 2012, as part of our emerging manager programs, CalPERS created the emerging manager five-year plan. The plan serves to describe and guide our efforts in emerging manager investing. When we engaged emerging managers and stakeholders on the development of the five-year plan, they expressed concern about firms that grow beyond the definition of an emerging manager but are not large and experienced enough to compete against established firms for direct investment mandates. In response to concern about this in between status, the work stream was included in the five-year plan to set parameters and criteria for transitioning successful emerging managers to direct mandates.

The development of the Manager Transition Program started with a survey of asset class staff. Information was gathered on their observations and experience in transitioning emerging managers to direct relationships. Staff also gathered information from our pension peers, external advisors, and stakeholder groups. The purpose of the survey was to examine current methods and best practices for transitioning emerging managers to direct relationships. Key findings from this information gathering process included a formal program was needed to provide specific program parameters and review criteria so emerging managers can grow to scale appropriately. Definitions needed to be revisited to avoid restrictions on manager participation. Restrictions such as those found in the emerging manager definitions which can restrict follow-on fundraising efforts. And greater communication was needed regarding the opportunity to transitioning emerging managers to direct relationships. The new Manager Transition Program addresses each of these issues identified in the survey and engagement process.

Absent a transition program, there is a sizable gap preventing emerging managers from growing to sufficient size to be able to compete to become an established manager. As illustrated on this slide, emerging manager investment commitments range from $8 million to $150 million and emerging manager programs include external manager or adviser oversight. The pool of established managers is expected to have investment commitment ranging from $350 million to over $1 billion in direct relationships overseen by Investment Office staff. How does a manager grow from the new small emerging phase to become large enough to compete for a spot in the established manager pool? And how can CalPERS continue to have access to successful new investment platforms that have demonstrated early success? The establishment of a new Manager Transition Program answers both of those questions.

As we began our work to establish a program to provide a path of growth an opportunity for successful managers, CalPERS announced it was taking the next step in a multiyear effort to reduce risk, cost, and complexity in our portfolio. Reducing the risk, cost and complexity of our portfolio meant reevaluating our relationships with external managers. Our goal through this ongoing restructure is fewer and larger relationships with those external managers who are most aligned with CalPERS investment strategy.

Key elements of this restructure are the addition of new capital committed to emerging manager programs over the next five years and the development of a new strategy to transition emerging managers to larger direct relationships. Scaling up our commitment to our emerging managers and designing a robust program to include significant capital allocations to transitioning managers over the next five years dovetails with our manager reduction efforts. The architecture behind the emerging and transition manager programs is designed to create a path of growth an opportunity for successful managers to ultimately compete for a larger relationships in our pool of established managers.

In July of 2015, CalPERS Investment Office announced a new industry leading Manager Transition Program. 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 establishment of a Manager Transition Program is particularly timely in light of the portfolio wide restructuring effort that will result in fewer relationships with larger investment managers. The new Manager

Transition Program will help fill the gap between emerging managers and large established managers. Investment Office staff will review potential transition candidates from CalPERS emerging manager programs as well as outside managers who qualify under the guidelines of the Manager Transition Program. This program will allow CalPERS to continue to invest in successful up and coming firms including women and minority-owned firms that are transitioning through small entrepreneurial platforms to established asset management firms. After a successful transition, the firm may qualify to compete for larger investment mandates from CalPERS.

The objectives of the Manager Transition Program are to generate appropriate risk-adjusted investment returns by investing with managers who demonstrate early success, continued success to investment opportunities for successful firms and increased representation of women and minority-owned firms in CalPERS portfolio as well as 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 asset classes that have emerging manager programs, private equity, real estate, and global equity will have the opportunity for continued investment in successful emerging manager firms through the Manager Transition Program. While the emerging manager program in each asset class is different, the Manager Transition Program will provide the opportunity to invest incrementally larger amounts and follow-on funds for growing firms. This will allow a significant amount of additional time to test and prove the skills and capacity of the investment management firms. The goal is to establish a pipeline of talent so we can invest with managers as they grow large enough to compete for significant investment mandates. CalPERS asset classes will be able to review potential transition candidates from our emerging manager programs as well as outside managers who qualify under the definitions of Manager Transition Program.

The evaluation criteria to determine transition candidates are the same as those in all manager selection decisions. The criteria are also largely the same across all asset classes and include the following key categories: historical performance, strategy and value creation, management team and talent, asset allocation and portfolio fit, and alignment of interest.

The parameters of the Manager Transition Program are purposely broad to allow asset classes thoughtful and flexible administration of this program going forward. Managers must constantly compete to meet or exceed expectations to remain in the Manager Transition Program. Asset class staff will make all decisions to invest or to remove a manager from the Manager Transition Program should their performance not meet expectations. Transition program commitments will be direct relationships with CalPERS and managed by asset class staff.

Over the course of the next five years, the Manager Transition Program will commit up to $7 billion to approximately 15 transitioning managers across the three asset classes. As you can see on this chart, with continued commitment to emerging manager programs of up to $4 billion, the combined capital commitments of the emerging and transition manager program is up to $11 billion. To assure asset class flexibility, it is important to note that these are not hard investment targets, but instead estimated program amounts. Based on the investment opportunities that are pursued, actual commitment amounts maybe less than the maximum stated here. Staff will track and report activity in both emerging and transitioning manager programs and report to the Investment Committee on commitment amounts as well as any issues and successes as the programs mature in the coming years.

Emerging manager program parameters will remain unchanged. For Private Equity, its first or second institutional funds with $8 million to $20 million allocations in fund to fund structure and CalPERS staff oversight. The product or deal size is less than $1 billion. For real estate, its first, second, or third institutional fund and/or separate account with $50-$150 million programmatic capital allocations, joint venture structure with dedicated external adviser oversight and maximum $1 billion firm AUM. For global equity, it's a maximum $2 billion assets under management with CalPERS representing no more than 25 percent of firm assets under management. With $75-$150 million allocations in direct relationship and CalPERS staff oversight.

The Manager Transition Program definitions and parameters vary by asset class and should be viewed as general guidelines in order to provide each asset class with flexibility in administering the Manager Transition Program. The definitions and approximate commitment amounts are as follows: For Private Equity it's third, fourth, fifth, and six institutional funds with $50 to $300 million allocations and a direct relationship in CalPERS staff oversight. We expect to deploy up to $2 billion in total capital allocations over the next five years. For Real Estate, it's fourth, fifth, and sixth separate accounts. With $200 to $500 million in allocations and a direct relationship and CalPERS staff oversight. We expect to deploy up to $2 billion in total capital allocations over the next five years. For Global Equity, it's a minimum of $2 billion assets under management and CalPERS representing no more than 25 percent of firm assets under management. $500 million to $1 billion allocations in a direct relationship and CalPERS staff oversight. We expect to deploy up to $3 billion in total capital allocations over the next five years.

That concludes the presentation portion of this webinar. We will now begin answering your questions. The first question, can you confirm that a manager does not have to be part of CalPERS emerging manager program to be eligible for the transition program? Again, yes, I can confirm. The emerging manager and transition manager program is set is designed to include both managers that were in our Emerging Manager Program and those outside of our Emerging Manager Program.

The next question, for Global Equity was will you be utilizing the advisers in the selection process. John Cole.

John Cole: The answer to that question is yes, we will have external advisors that are involved in our Emerging Manager Program that and both for the selection and the analysis.

Mike: Thank you, John. We had a question for real estate. When do you expect to deploy capital to the emerging and transition manager program? Eric Schlenker.

Eric: Real Estate uses an annual investment planning process for external managers for commitment starting July 1of this year. Applications are submitted by the managers early in the year for allocations for discretionary commitments during that year and the Emerging Manager Program [inaudiable] is included in that process along with the establishment.

Mike: Thank you Eric. For Private Equity, will you be utilizing any advisers in the selection process for transitioning emerging managers?

John Greenwood: [Off mic]

Mike: Thank you, John. We have another question for you, are there any particular strategies you're seeking for the Manager Transition Program that might vary from the emerging or established manager?

John Greenwood: [Off Mic]

Mike: Thank you. For Global Equity, has there been any consideration to include long short managers in your global equity mandate?

John Cole: John Cole here. Yes, there is consideration for the inclusion of long short managers. It's important to note in Global Equity portfolio that we are strongly emphasizing [inaudible], but that does not preclude the possibility or consideration. [inaudible].

Mike: Thank you so much. We have a question for Real Assets. Do you plan to focus outside urban California for the Real Estate Emerging Manager Program?

Rina: This is Rina Lessing. As the program is continually evaluated there's potential for it to grow outside of [inaudible]. Our strategy is typically geographic focused based on the portfolio fit. And the geographic [inaudible] of our existing assets.

Mike: Thank you so much, Rina. This question will go out to all of the asset classes. When do you expect to start the selection process of transition managers? We will start first with John Greenwood from Private Equity.

John Greenwood: [Off Mic]

Mike: Thank you, John. Up next, John Cole from global equity.

John Cole: This program is a wonderful opportunity for us to institutionalize what we have already begun to think a lot about. So in global equity, we have in fact been paying close attention to this area and our position whereby where we can already have designated managers that have room for future growth.

Mike: Thank you. For real estate, when do you expect to start the selection process for transition?

Eric: I'm pleased to say that existing emerging managers are already being considered as transition candidates through their mentoring managers. Additional opportunities for transition managers to enter the CalPERS stable of managers is ongoing and will likely begin even more of a focus following the adoption of our strategic plan establishing the roles for our established manager throughout the program.

Mike: Thank you Eric. The next question is also for Eric. How do you view emerging markets like China and India for the Emerging Manager Program?

Eric: This is something that I alluded to that will be addressed in the strategic plan and our role of emerging markets within the real estate strategic plan for all of the countries. And whether or not we would want to overlay the emerging manager into some of those programs so it will be considered, but at the present time, we are not considering opportunities for emerging managers at this point.

Mike: Thank you. I think we have another question here, one for Global Equity. John Cole, how do you expect or anticipate the process for selection to be run for global equity?

John Cole: The process for selection will be in the same spirit as the process for selection of all of our programs. So we have a scoring mechanism. We have a contracting process that we follow for all of our mandates and the transition program will be very much aligned with that discipline.

Mike: Thank you very much. We have another question for Real Estate. Investment strategy included in separate accounts in co-mingled funds. Does this mean CalPERS would consider investing capital in emerging manager co-mingled funds?

Rina: Thank you. This is Rina Lessing. So our preference and our current model is using a mentoring manager in a separate account structure, but if in fact, we could not access the talent through the separate account structure, only then would we consider co-mingled fund as it's not our preferred structure at this time.

Mike: Understood. Thank you. And Global Equity, is there a lower AUM minimum requirement for women-owned advisory firms for global equity?

John Cole: There is not. It's important in our minds to be very fair handed in both our quest for the best managers that are available and also the selection.

Mike: Thank you, John. While that just about wraps it up. We wanted to thank you for taking the time to watch and listen to this webinar. We hope you've gained a more thorough understanding of the Manager Transition Program. Should you have any additional questions for any of your questions were not answered for any reason, please reach out to us at INVOTIP@calpers.ca.gov. This concludes our webinar. Thank you and have a great day.