

Assembly Bill 890: Diversity in the Management of Investments

March 1, 2023



Year One Report | Fiscal Year 2021-22

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Section 1: Introduction

The California Public Employees' Retirement System (CalPERS), headquartered in Sacramento, provides retirement and health benefits to more than two million public employees, retirees, and their families. CalPERS is led by a 13-member board of administration consisting of member-elected, appointed, and ex-officio members.

For more than 30 years, CalPERS has developed and implemented emerging manager programs and invested with emerging and diverse managers. We are committed to equality of access and opportunity for our business partners and staff. As the nation's largest public pension fund, within the nation's most ethnically and culturally diverse state, we believe diversity and inclusion in our workforce, workplace, and marketplace improve business performance.

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 (AUM), length of track record, and/or the specific fund's size when applicable. An overview of current CalPERS Emerging Manager Program definitions across asset classes can be found in Section 2 of this report.

CalPERS has a fiduciary duty, which requires the Board and staff to work in the best interest of our 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.

It is important to note that California state law (enacted through the passage of Proposition 209 in 1996) prohibits state agencies from discriminating against or granting preferential treatment to any individual or group based on race, sex, color, ethnicity, or national origin in public contracting. As such, CalPERS cannot establish any participation goals for, or provide preferential treatment to, external managers based on race, sex, color, ethnicity, or national origin. Similar restrictions exist under federal law and the U.S. Constitution. CalPERS may, however, collect data and other information regarding diverse characteristics for annual reports to the California State Legislature (Legislature).

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.

CalPERS investments with emerging and diverse managers are not limited to dedicated emerging manager programs. CalPERS is committed to equal access and opportunity for all investment managers, who may submit an investment proposal to CalPERS at any time. CalPERS has made significant efforts to communicate our investment strategies and criteria for making investment decisions to the manager community, including emerging managers, to help ensure that investment proposals are aligned with CalPERS objectives.

Chapter 472, Statutes 2021, Assembly Bill 890 (AB 890) requires CalPERS to submit a report to the Legislature on the status of achieving appropriate objectives and initiatives, as defined by the CalPERS Board, regarding participation of emerging and diverse managers responsible for asset management within the CalPERS investment portfolio.

In addition to the emerging and diverse manager definitions, the report must also include the following information:

- Name of each emerging or diverse manager
- The year these emerging or diverse managers were first engaged, or under contract to provide services
- Amount managed by each emerging or diverse manager by asset class at the end of the prior fiscal year
- Total amount allocated by CalPERS in the applicable asset class during the fiscal year
- Total AUM of each asset class

The information regarding emerging managers encompasses CalPERS investments made through direct relationships, including with fund of fund advisors, as well as with underlying funds in fund of funds.

Information regarding diverse managers encompasses CalPERS investments with both emerging and non-emerging managers.

To prepare this report, CalPERS utilized information provided directly from managers on a voluntary basis to indicate if they met the definition established for a diverse manager by identifying the gender, ethnicity, race, and sexual orientation classification of the ownership or fund economics of the entity. In addition, CalPERS utilized information provided to staff in due diligence and monitoring, and via fund of funds vehicles and partnerships. The data collected are incorporated into this report.



Section 2: Emerging Manager Program Objectives and Definitions

During the September 2022 CalPERS Board meeting, staff received approval of their recommendations to define emerging and diverse managers, as well as the objective of the Emerging Manager Program.

Emerging Manager Program Objective

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 portfolio management talent.**

Emerging Manager Definitions

The term emerging manager is based on the firm's overall AUM, length of track record, and/or the specific fund's size, when applicable. The qualification thresholds vary across asset classes for reasons related to the nature of respective asset classes (e.g., private vs. public).

Private assets include Private Debt, Private Equity, and Real Assets. The emerging manager definition for these assets is **based on length of track record that includes 1st, 2nd, and 3rd Institutional Fund, or Separate Account when applicable, as well as the fund size being less than, or equal to, \$2 billion dollars.** (see *Figure 1*)

Public assets include Global Equity and Global Fixed Income. The emerging manager definition for these assets is based on **AUM totaling less than, or equal to, \$5 billion dollars.** (see *Figure 2*)

FIGURE 1: **PRIVATE ASSETS DEFINITIONS**

	Fund Size	Length of Track Record
Private Debt	≤\$2B	1 st , 2 nd , or 3 rd Institutional Fund
Private Equity	≤\$2B	1 st , 2 nd , or 3 rd Institutional Fund
Real Assets	≤\$2B	1 st , 2 nd , or 3 rd Institutional Fund or Separate Account

FIGURE 2: **PUBLIC ASSETS DEFINITIONS**

	Firm AUM
Global Equity	≤\$5B
Global Fixed Income	≤\$5B



Section 3: Diverse Manager Definition

In 2013, CalPERS definitions for women and minority owned firms were established for the basis of an External Manager Diversity Survey. The definitions were developed with the input of several stakeholder groups including the Association of Asian American Investment Managers, National Association of Securities Professionals, National Association of Investment Companies, New America Alliance, and the Toigo Foundation. Staff also reached out to diversity consultants and conducted research into diversity definitions used by peer investors and public agencies.

Applying CalPERS initial definition of diversity as a compass, as well as conducting additional outreach and research, staff identified **four core demographics (i.e., gender, ethnicity, sexual orientation and other) as diversity identifiers**. CalPERS Board approved the following diverse manager definitions based on the total percentage of firm ownership or fund economics:

Substantially Diverse

A firm that is **25% to 50%** owned by women and/or ethnic minority group members, and/or a person of the LGBTQ+ community, or where diverse teams receive 25% to 50% of the fund's carried interest.

Majority Diverse

A firm that is **over 50%** owned by women and/or ethnic minority group members, and/or a person of the LGBTQ+ community, or where diverse teams receive more than 50% of the fund's carried interest.

Minority group members include United States citizens and permanent residents who are African American, Asian American, Hispanic American, Native American, Pacific Islander, or Other, based EEO-1 US Census classifications. Person of the LGBTQ+ community includes people who identify as Lesbian, Gay, Bi-sexual, Transgender, Queer, and more.

California law prohibits State agencies from discriminating against or granting preferential treatment to any individual or group based on race, sex, color, ethnicity, or national origin in the operation of public contracting. CalPERS therefore may not grant preferential treatment to emerging or diverse 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 Emerging Manager strategies may be the increased diversification of CalPERS external fund managers.

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Section 4: CalPERS Year One Annual Commitments

This first report, and the following table show CalPERS allocations made to emerging and diverse managers during the period of January 1, 2022, through June 30, 2022.

\$480.5 million was allocated to emerging managers and \$3.2 billion to diverse managers.

CalPERS investments with emerging managers were not limited to dedicated emerging manager programs. Private Equity made two direct investments with emerging managers totaling \$175 million. Global Equity and Real Assets investments with emerging managers were made through dedicated programs totaling \$140.7 million and \$164.8 million dollars respectively. The total allocated to the seven emerging managers for this reporting period was \$480.5 million dollars.

FIGURE 3: EMERGING MANAGER ALLOCATIONS (JANUARY- JUNE 2022)

Emerging Manager	Asset Class	Year First Engaged	Allocation Date	Allocation Amount (in millions)
Base 10 Partners	Private Equity	2022	January 2022	\$50.0
Butterfly Equity	Private Equity	2022	February 2022	\$125.0
Rincon	Real Assets	2021	May 2022	\$49.8
Lisanti Capital Growth	Global Equity	2022	April 2022	\$69.9
Paragon	Real Assets	2013	April 2022	\$29.9
Rondure Global Advisors	Global Equity	2022	April 2022	\$70.8
Sack Properties	Real Assets	2013	May 2022	\$85.1
Total Allocated to Emerging Managers				\$480.5

The following table lists allocations made to diverse managers for the period January 1, 2022, through June 30, 2022. CalPERS invested with 12 diverse managers, across three different asset classes for an approximate total of \$3.2 billion dollars. CalPERS investments with diverse managers were not limited to dedicated emerging manager programs. All Private Equity investments with diverse managers in this reporting period were made directly and outside of a dedicated emerging manager program.



FIGURE 4: DIVERSE MANAGER ALLOCATIONS (JANUARY- JUNE 2022)

Diverse Manager	Asset Class	Demographic/ Characteristic	Year First Engaged	Allocation Date	Allocation Amount (in millions)
Base 10 Partners	Private Equity	Majority Diverse/ African American	2022	January 2022	\$50.0
CapVest Partners, LLC	Private Equity	Substantially Diverse/Women and Other	2022	February 2022	\$341.0
Rincon	Real Assets	Substantially Diverse/Hispanic	2021	May 2022	\$49.8
Clearlake Capital Group	Private Equity	Substantially Diverse/Hispanic	2009	January 2022	\$350.0
Francisco Partners	Private Equity	Substantially Diverse /Hispanic	2000	February 2022	\$550.0
Lightspeed Ventures	Private Equity	Substantially Diverse/Asian American	2006	March 2022	\$400.0
Lisanti Capital Growth	Global Equity	Majority Diverse/ Woman-owned	2022	April 2022	\$69.9
Paragon	Real Assets	Substantially Diverse/Middle Eastern and Hispanic	2013	April 2022	\$29.9
Rondure Global Advisors	Global Equity	Majority Diverse/ Woman-owned	2022	April 2022	\$70.8
Sack Properties	Real Assets	Majority Diverse/ Woman-owned	2013	May 2022	\$85.1
Thoma Bravo, LLC	Private Equity	Substantially Diverse/Hispanic	2021	May 2022	\$600.0
Veritas Capital	Private Equity	Majority Diverse/ Middle Eastern	2022	March 2022	\$625.0
Total Allocated to Diverse Managers					\$3,221.5



The following table summarizes allocations made to all external managers, emerging managers, and diverse managers for the period January 1, 2022, through June 30, 2022. The table also reflects each asset classes AUM as of June 30, 2022.

FIGURE 5: **SUMMARY OF ALLOCATIONS BY ASSET CLASS** (in millions)

	Total AUM as of June 30, 2022 ¹	Allocation to External Managers, ² January-June 2022	Allocation to Emerging Managers, ² January-June 2022	Allocation to Diverse Managers, ² January-June 2022
Private Equity	\$52,800.0	\$8,100.0	\$175.0	\$2,916.0
Global Equity	\$195,150.0	\$140.7	\$140.7	\$140.7
Global Fixed Income	\$117,562.0	\$133.0	\$0.0	\$0.0
Real Assets	\$65,300.0	\$5,900.0	\$164.8	\$164.8

¹ AUM figures for each asset class are represented as Net Asset Value (NAV)

² Allocations to external managers, emerging managers, and diverse managers are listed as NAV in Global Equity and Global Fixed Income, and by dollars committed in Private Equity and Real Assets

Section 5: Conclusion

CalPERS believes that emerging managers are important to investment strategies and the overall performance of the Total Fund. 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.

It is CalPERS' belief that organizational cultures promoting diversity are vital to improving the long-term performance of our organization, as well as the businesses and markets in which we invest. Our Investment Beliefs state that strong processes, teamwork, and deep resources are needed to achieve CalPERS goals and objectives and highlight the importance of diversity of talent in this process.

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

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