



Investment Committee

Agenda Item 5b

November 14, 2022

Item Name: Assembly Bill 890: Diversity in the Management of Investments 2021-22 Fiscal Year

Program: Sustainable Investing

Item Type: Action

Executive Summary

The intent of this agenda item is to present to the Investment Committee CalPERS' first Diversity in the Management of Investments Report mandated by Assembly Bill (AB) 890 to be submitted to the California State Legislature (Legislature).

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 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, and corporate boards) is important

Background

In October 2021, AB 890 was signed into law requiring CalPERS and the California State Teachers' Retirement System (CalSTRS) to submit a report to the Legislature commencing on March 1, 2023, and annually thereafter. The bill sunsets on January 1, 2028. According to the bill's author, Cervantes, AB 890 is intended to ensure transparency and promote the inclusion of women and minority owned managers in the asset management industry. Known supporters of the bill include the New America Alliance and Association of Asian American Investment Managers.

In September 2022, staff provided their recommendation to the CalPERS Board to approve the objective of the Emerging Manager Program and define the terms emerging and diverse manager.

Emerging Manager Definition

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

Diverse Manager Definition

Staff identified four core demographics (i.e., gender, ethnicity, sexual orientation, and other) as diversity identifiers. The definitions of diverse manager were approved based on the total percentage of firm ownership or fund economics as follows:

- **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

Emerging Manager Program Objective

The following objective for the Emerging Manager Program was also approved by the Board:

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

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 US Constitution. CalPERS may, however, collect data and other information regarding diverse characteristics for annual reports to the Legislature.

Analysis

The proposed Assembly Bill 890: Diversity in the Management of Investments 2021-22 Fiscal Year Report contains information related to CalPERS investments with emerging and diverse managers and among other things, provides the manager's name and commitment amount of each emerging and diverse manager. This first report contains emerging and diverse manager activity from January 1 through June 30, 2022. The activity is displayed by each asset class and across CalPERS' Total Fund.

The report is based on contracts entered into on and after January 1, 2022 and includes:

- 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 Assets Under Management (AUM) of each asset class

During the reporting period, CalPERS allocated funds to 7 managers that met the emerging manager definition, across 3 different asset classes, for a total allocation of \$480.5 million. And for the same reporting period, CalPERS allocated funds to 12 managers that met the definition of diverse manager, for an allocation of approximately \$3.2 billion. Both categories included investments made directly and via fund of funds.

The significant majority of the investments with diverse managers during this reporting period were made in Private Equity, totaling over \$3 billion with diverse managers, and \$175 million with emerging managers.

The Assembly Bill 890: Diversity in the Management of Investments 2021-22 Fiscal Year Report will be submitted to the Legislative no later than March 1, 2023.

Budget and Fiscal Impacts

None. CalPERS has team members that manage the emerging and diverse manager program and the mandated legislature reporting program.

Benefits and Risks

Benefits:

This item satisfies the California State Legislature reporting requirement.

Risks:

None.

Attachment 1: Assembly Bill 890: Diversity in the Management of Investments 2021-22 Fiscal Year-PPT

Attachment 2: Assembly Bill 890: Diversity in the Management of Investments 2021-22 Fiscal Year Report

James Andrus
Interim Managing Investment Director
Sustainable Investing

Nicole Musicco
Chief Investment Officer

Assembly Bill 890: Diversity in the Management of Investments 2021-22 Fiscal Year Report

James Andrus, Interim Managing Investment Director

Sustainable Investing

November 14, 2022

Contents

- Assembly Bill (AB) 890 Legislation
- AB 890 Report Requirements
- CalPERS' Investment Beliefs
- Emerging Manager Program Objective
- Emerging Manager Definition
- Diverse Manager Definition
- CalPERS Allocations to Emerging and Diverse Managers
- Summary of Allocation by Asset Class
- Next Steps

Assembly Bill (AB) 890 Legislation

- Emerging Manager Program objective along with emerging and diverse manager definitions
- All emerging and diverse manager commitments during the investment period January 1, 2022, through June 30, 2022
- This report is due to the California State Legislature on March 1, 2023

AB 890 Report Requirements

- Name of each emerging or diverse manager
- The year these emerging or diverse managers were first engaged or under contracted 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 Assets Under Management (AUM) of each asset class

CalPERS' Investment Beliefs

Our CalPERS' 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.

Emerging Manager Program Objective

CalPERS' mission is to deliver retirement and health care benefits to our members and their beneficiaries.

The 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 Definition

CalPERS Emerging Manager definition is based on the firm's overall Assets Under Management (AUM), length of track record, and/or the specific fund's size when applicable.

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

Private Assets			
	Private Debt	Private Equity	Real Assets
Length of Track Record	First, Second, or Third Institutional Fund	First, Second, or Third Institutional Fund	First, Second, or Third Institutional Fund or Separate Account
Fund Size	≤\$2B	≤\$2B	≤\$2B

Diverse Manager Definition

CalPERS diverse manager definition is based on the total percentage of firm ownership or fund economics, and meet one of following tiered thresholds:

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

CalPERS Allocations to Emerging and Diverse Managers

- During the reporting period, CalPERS allocated to seven managers that met the emerging manager definition, across three different asset classes, for a total allocation of \$480.5 million
- For that same period, CalPERS allocated to 12 managers that met the definition of diverse, for an allocation of approximately \$3.2 billion

Summary of Allocation by Asset Class

SUMMARY OF ALLOCATIONS BY ASSET CLASS \$Millions				
	Private Equity	Global Equity	Global Fixed Income	Real Assets
Total Assets Under Management as of June 30, 2022¹	\$52,800	\$195,150	\$117,562	\$65,300
Allocation to External Managers: January 2022 – June 2022²	\$8,100	\$140.6	\$133	\$5,900
Allocation to Emerging Managers: January 2022 – June 2022²	\$175.0	\$140.6	\$0	\$164.8
Allocation to Diverse Managers: January 2022 – June 2022²	\$2,916	\$140.6	\$0	\$164.8

Next Steps

- Work with the Office of Public Affairs to develop the formal AB 890 Report format
- Work with the Legislative Affairs Division to submit the AB 890 Report to the California State Legislature
- Next year, we will report out on Fiscal Year 2022/23

Questions

Appendix

Minority group members

- 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

**Assembly Bill 890: Diversity in the Management of Investments
2021-22 Fiscal Year Report**

March 1, 2023

Table of Contents

Section 1	Introduction	3
Section 2	Emerging Manager Program Objectives and Definitions	5
Section 3	Diverse Manager Definition	7
Section 4	CalPERS Year One Annual Commitments	8
Section 5	Conclusion	10

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 (Board) 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, 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).

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 Assets Under Management (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. The emerging manager objective and definitions are as follows:

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 Assets Under Management (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.

Private Assets			
	Private Debt	Private Equity	Real Assets
Length of Track Record	First, Second, or Third Institutional Fund	First, Second, or Third Institutional Fund	First, Second, or Third Institutional Fund or Separate Account
Fund Size	≤ \$2B	≤ \$2B	≤ \$2B

Public assets include Global Equity and Global Fixed Income. The Emerging Manager definition for these assets is based on Assets Under Management (AUM) totaling less than, or equal to, \$5 billion dollars.

Public Assets		
	Global Equity	Global Fixed Income
Firm AUM	≤ \$5B	≤ \$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. The 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.

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.

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 \$140.6 million and \$164.7 million dollars respectively. The total allocated to the seven emerging managers for this reporting period was \$480.5 million dollars.



EMERGING MANAGER ALLOCATIONS JANUARY 2022 – JUNE 2022				
Emerging Manager	Asset Class	Year First Engaged	Allocation Date	Allocation Amount (\$ 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.

DIVERSE MANAGER ALLOCATIONS JANUARY 2022 – JUNE 2022					
Diverse Manager	Asset Class	Demographic/ Characteristic	Year First Engaged	Allocation Date	Allocation Amount (\$ 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 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 Assets Under Management (AUM) as of June 30, 2022.

SUMMARY OF ALLOCATIONS BY ASSET CLASS \$Millions				
	Private Equity	Global Equity	Global Fixed Income	Real Assets
Total Assets Under Management as of June 30, 2022 ¹	\$52,800	\$195,150	\$117,562	\$65,300
Allocation to External Managers ² : January 2022 – June 2022	\$8,100	\$140.6	\$133	\$5,900
Allocation to Emerging Managers ² : January 2022 – June 2022	\$175.0	\$140.6	\$0	\$164.8
Allocation to Diverse Managers ² : January 2022 – June 2022	\$2,916	\$140.6	\$0	\$164.8

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.

¹ The Assets Under Management (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