



California Public Employees' Retirement System

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The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

July 27, 2020

Subject: Capital Markets and Worker Protection Hearing Follow-Up

Dear Chairwoman Waters,

Thank you for providing CalPERS the opportunity to testify at the House Financial Services subcommittee hearing on July 14, "Promoting Economic Recovery: Examining Capital Markets and Worker Protections in the COVID-19 Era." We appreciated being able to set out CalPERS' work on diversity and inclusion which supports our goal to earn the investment returns which contribute the majority of benefit payments to our nearly 2 million public employee members across the state of California.

CalPERS' commitment to diversity and inclusion is reflected in our Board's Investment Beliefs and our strategic plan on sustainable investment which sets out our corporate engagement on board diversity, our advocacy with regulators and integration into our investment process. CalPERS has appointed a Chief Diversity Officer to the C suite, whose role will be to review current work and report to our Board on proposals for the next stage. In coming months as this work is undertaken, we will welcome the opportunity to seek input from peers, stakeholders and experts to ensure we reflect best practices on diversity and inclusion in support of our fiduciary duty to our members.

CalPERS has a challenging target rate of return at 7% which reflects our 70% funded status. In addition to providing retirement security to future generations, we also need to pay over \$25 billion each year in current benefits to our members. For every dollar that we pay to beneficiaries, nearly 60 cents comes from investments. This matters to our members, but also to our employers across California who rely on these returns when calculating the contribution from their budget which taxpayers provide.

In order to improve CalPERS' chances of meeting its investment returns we have undertaken an extensive review of the portfolio with a focus on costs, scale and performance. As a result, CalPERS has increased the base of assets which are managed internally in our Global Equity Portfolio from 80% to 95% reducing the number of external active managers from 31 to 4. This will generate annual cost savings of more than \$100 million and provide further alignment with our performance goals at the scale we need. Overall about 78% of our entire fund is managed in-house by our investment professionals.

We have drawn on our most recent diversity survey of external managers conducted by Lenox Park to assess the impact on our overall ranking against Equal Employment Opportunity Commission financial sector diversity. The overall workforce diversity reflects industry norms.

Bringing assets in house at CalPERS brings investment within the direct oversight of our Board and CEO. As you know, our Board currently reflects diversity being majority female, with representation from appointed and elected members that include the African American, Asian, Latinx and transgender communities. Also, CalPERS has a female CEO and Asian American CIO who has recently appointed three females to his 8-member management team. The recent appointment of a Chief Diversity Officer to the CalPERS C suite will further strengthen our progress.

This background is provided to highlight the significant diversity at the highest levels influencing the management of our entire portfolio.

Turning to your question regarding emerging managers and who is helping manage CalPERS' assets, we recognize that you highlighted the distinction between emerging managers and diverse managers. The terms are often used interchangeably, so we will provide information on both because we think that this better aligns with what you requested. We highlight those changes below.

Emerging manager programs have been established within the Global Equity, Private Equity and Real Estate asset classes in the CalPERS investment portfolio. The activity originated with Global Equity more than 25 years ago. These investment strategies have evolved through a number of iterations to identify and develop investment management talent that contributes to our fund's investment goals on behalf of our members.

The emerging manager programs in each of the three asset classes are centered on a "fund of funds" (FoF) structure. This approach is utilized to access domain specific knowledge and expertise that does not reside within the CalPERS staff. Furthermore, the FoF structure allows for the investments at a smaller scale than we have capacity to handle internally due to our size. In response to your question during the hearing regarding the current status of CalPERS' emerging manager program, please find details below for each asset class.

Global Equity – Global Equity has recently reviewed and streamlined its deployment of external managers with active strategies. External active management represented approximately \$33 billion of capital deployment, with emerging manager strategies representing approximately \$3 billion, or 10% of that amount. The strategic investment review identified that the majority of active investment strategies within Global Equity had not met risk/return expectations

particularly in light of costs. Consequently, we decided to reduce the degree of external active management in order to reduce operating expense and improve overall performance. The redeployment of capital (both internally and externally managed) into more passive, benchmark-oriented strategies resulted in a reduction in the number of all external active managers, including emerging managers. External managers in this asset class were reduced from 17 to 3, managing roughly \$4.5 billion down from \$30 billion. In addition, the number of emerging managers FoF partners declined from five to one, managing about \$380 million. This has overall resulted in a shift from the emerging manager program investing 10% of externally managed global equity to 8.4% of externally managed capital. As noted above, one of the 3 retained managers is a graduate of our emerging manager program.

Global Equity FoF Partner – Legato Capital Management

Underlying # Managers – 4

Diverse - 1 (25%)

Manager	Legato Capital
Assets	\$379.7 mm
Inception	3/07

Private Equity – The emerging manager program in Private Equity seeks domestic emerging managers (DEM) in the Buyout, Growth and Distressed for Control categories. Grosvenor Capital Management (GCM) has been the FoF manager since 2012 and is in the process of allocating the \$500 million awarded to it in 2018 for the third vintage (CGM DEM III) of its effort. CGM DEM III includes a target of 30% co-investment opportunities. The underlying managers in the CGM DEM III funds are raising their first, second, or third fund and raising up to \$2 billion. Current invested capital in the DEM series of funds is about \$282 million.

Private Equity FoF Partner – Grosvenor Capital Management

Underlying # Managers – 32

Diverse – 19 (59%)

Manager	Grosvenor Capital
Assets	\$281.6 mm
Inception	8/12

Real Estate – The emerging manager program in Real Estate seeks emerging managers in market niches outside of the core exposures in the overall Real Estate program. Typically, these managers are value-add opportunities which may eventually demonstrate characteristics warranting inclusion in the core of the program. Since 2012, Canyon Partners has been the FoF manager and is currently deploying capital from the \$375 million most recently allocated to it in 2019. The current invested capital is about \$623 million.

Real Estate FoF Partner – Canyon Partners

Underlying #Managers – 5

Diverse – 3 (60%)

Manager	Canyon Partners
Assets	\$623.3 mm
Inception	9/12

We hope that this letter directly addresses your questions. We are committed to best practice on diversity and inclusion across CalPERS' portfolio and operations. Please do not hesitate to contact me directly at (916) 795-3818, or your staff can contact Danny Brown, Chief of our Legislative Affairs Division, at (916) 795-2565, if you would like additional information.

We thank you for your leadership and look forward to continued communication with your office on this and other important issues.

Sincerely,

Marcie Frost
Chief Executive Officer
Division or Branch

cc: Danny Brown