



Emerging Manager Policy

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I. Introduction

LACERA's mission is to "Produce, Protect, and Provide the Promised Benefit" for all its members. In order to achieve this mission, LACERA has developed various policies to guide its investments. These policies are governed by the California constitution and by various statutes, and embedded within the regulations are fundamental concepts of loyalty and prudence. The duty of loyalty means that Board members and staff must act in the sole interest of LACERA's members and beneficiaries; the duty of prudence requires that we discharge our responsibilities with skill, care, and diligence—and that we diversify the portfolio in order to minimize the risk of loss and maximize the expected rate of return.

The Emerging Manager Policy ("Policy") furthers the investment beliefs, philosophy, and strategies outlined in LACERA's Investment Policy Statement ("IPS"), adheres in all respects to the Code of Ethical Conduct and the Conflict of Interest Code, and complies with all applicable governing regulations.

LACERA values diversity and inclusion. These values permeate the entire LACERA portfolio and extend beyond the emerging manager program. As stated in the IPS, LACERA believes that effectively accessing and managing diverse talent—inclusive of varied backgrounds, age, experience, race, sexual orientation, gender, ethnicity, and culture—leads to improved outcomes. LACERA expects all its external asset managers and third party providers to respect LACERA's values of diversity and inclusion and to reflect them in their own organizations.

II. Purpose and Objective

The objective of LACERA's Emerging Manager Policy is to enhance the total Fund's risk-adjusted return. The Policy seeks a proper balance between the potential for higher returns available to select emerging managers, and the higher risks—both investment-related and operational—associated with less established firms.

The Policy provides LACERA an opportunity to invest in promising investment management organizations early in their development. Investing with managers that have fewer clients, smaller assets, or a short track record may provide LACERA access to investment strategies that larger, more established managers might overlook. Smaller investment management firms may generate attractive performance, net-of-fees, because of increased market flexibility associated with smaller asset bases. In addition, first- or second-time funds may outperform later funds in private markets. Furthermore, investing early in the lifecycle of select emerging managers may carry benefits that include lower fees (founder's terms), future capacity rights, and preferred economics such as a share of future revenues.

Counterbalancing the attractive returns from investing with emerging managers is a greater return dispersion and the possibility of greater investment and operational risk—particularly in areas such as compliance, portfolio administration, cybersecurity, business continuity, and succession planning.

Emerging managers are highly motivated to perform well for early investors because doing so can be crucial to their firm's growth. As a result, institutional investors such as LACERA may have a greater alignment of interests with emerging managers than with more established ones.

III. Emerging Manager Definition

Emerging investment managers are independent firms that have less substantial assets under management or may lack a long-term investment performance record. LACERA is interested in emerging managers that have strong alignment of interest with their investors and expects principals of the firm to hold a substantial majority of the ownership interest of the company. Specific requirements for assets under management (“AUM”) and length of track record are tailored for each asset class and updated for each mandate to take into account the composition of the manager universe prevailing at the time a search is conducted.

Emerging managers are held to the same high performance standards that apply to all of LACERA’s external managers. In addition, LACERA conducts an ongoing assessment of all external managers’ commitment to, adherence with, and track record of accessing and retaining diverse and inclusive workforces. Emerging managers may include, but are not limited to, investment managers that are owned by individuals of diverse backgrounds that have traditionally been underrepresented in the financial services industry. More broadly, all else equal, LACERA prefers firms that are committed to and have established a demonstrated track record of diversity and inclusion throughout the firm’s workforce, inclusive of investment professionals.

IV. Structure

LACERA may hire emerging managers either directly or by employing a fund-of-funds manager skilled at sourcing emerging managers. Either type of mandate must adhere to LACERA’s defined procurement procedures and requires approval by the Board of Investments. Investment strategies managed by emerging managers must be suitable for LACERA’s portfolio and fit within the approved strategic asset allocation and asset class structure, as well as the portfolio’s risk and liquidity constraints.

For each asset class, LACERA conducts periodic structure reviews that incorporate specific criteria and recommended allocation ranges for emerging managers (see “Attachment” for current BOI-approved ranges). The structure reviews take into consideration the opportunities and risks of the asset class and are conducted in consultation with LACERA’s applicable investment consultants. The implementation of any emerging manager program must advance the principles, objectives, and initiatives established within the asset class structure review.

V. Graduation

Selected emerging managers will be reviewed in accordance with their respective asset class policies to determine if they continue to meet the requirements of the emerging manager program or if they qualify for graduation from emerging status. Graduation recommendations will be included in the biennial asset class structure reviews.

VI. Monitoring and Reporting

LACERA staff will monitor the emerging managers on an ongoing basis and report annually to the Board on potential issues, performance, and significant developments.

Attachment

Emerging Manager Allocation Ranges¹

	Minimum	Maximum
Global Equities	0%	5%
Fixed Income	0%	4%
Real Estate	0%	20%
Private Equity	0%	7%
Hedge Funds ²	0%	10%
Total Fund	0%	6%

Document History

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¹The allocation ranges shown are the most recent numbers approved by the BOI.

²The BOI approved a \$200 million allocation in September of 2019, and \$200 million is approximately 10% of the target Hedge Fund allocation.