RECOMMENDED PRACTICES IN PUBLIC PENSION FUND EMERGING MANAGER PROGRAMS

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Report by For The Long Term

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I. EXECUTIVE SUMMARY

This report examines the most common practices by public sector pension funds that have emerging manager programs, highlighting their governance structures, policies, and processes, in an effort to identify what best positions such programs, participants, and pension funds for success.

While there is variation in how each program defines emerging managers, whether diversity is an explicit criterion, the degree to which consultants are relied upon versus staff, and which asset classes are included in the program, among other factors, all of the programs seek to use their programs to tap into the next generation of asset managers and to benefit from their strong performance. Well-established emerging manager programs have a combination of talented and dedicated staff leading the program, buy-in from across the funds' leadership, strong programs and practices that support asset managers' growth, effective program partners, and a genuine commitment to strengthening an inclusive ecosystem in the investment management industry that fosters greater diversity.

Key recommendations that emerged from our interviews with eight state pension funds that have emerging manager programs, half a dozen asset managers who have participated in emerging manager programs, and other industry stakeholders, follow below.

TOP RECOMMENDATIONS
for New And Existing Emerging Manager Programs

- **Clearly define the goals of the program.** This provides everyone within the pension fund, the emerging managers, consultants, and other stakeholders with clarity on what they are working toward.
- **Consider the balance between dedicated staff and outsourcing.** While consultants can play a significant role that enhances the impact of emerging manager programs, overreliance on them can weaken the fund's connectedness to the managers that are tasked with serving its beneficiaries.
- **Integrate the emerging manager program into asset classes of the core fund.** In the integrated model, the investment officers responsible for each asset class

play a role in the selection of emerging managers for their asset class and become invested in their success.

- **Adapt the application and selection process to small firms.** Without taking undue risks, adapt the application, due diligence, and selection criteria to take firm size and maturity into consideration, and provide opportunities for feedback and dialogue throughout the process.

- **Structure manager of managers relationships to ensure maximum alignment with the goals of the emerging manager program.** This alignment should include practices that are transparent and support emerging managers' success, including fairer fee structures, greater transparency, and meaningful development support.

- **Develop structured and clear graduation processes.** Structure and transparency in this process will help ambitious and high-performing emerging asset managers grow their business and strengthen their relationship with the pension fund.

- **Prioritize network-building, learning opportunities, and mentorship.** Ensure the emerging manager program director's role includes taking ownership of cultivating a network of emerging managers, providing opportunities to meet with the pension fund's staff, mentoring emerging managers, and providing training on various business practices that support the development of emerging managers' firms.

- **Be intentional about diversity and inclusion.** Through aspirational goals, outreach plans, encouraging a diverse pool of candidates, and tracking diversity data, being intentional about promoting greater diversity usually yields positive results.

- **Strengthen the ecosystem.** Engage with the wider industry and cultivate a strong network to leverage for the pension fund, its emerging manager program, and participating emerging managers.

- **Provide feedback and encourage dialogue.** Ensure emerging managers have opportunities to receive continuous feedback and advice, as well as opportunities to provide their recommendations for improving emerging manager programs.

II. INTRODUCTION

Emerging asset managers are a traditionally underutilized segment of the asset management industry, especially among institutional investors, including public pension funds. Such funds have large amounts of capital to steward for their beneficiaries and it is often considered more efficient to divide the management of that capital among fewer players. However, that approach often results in only selecting large established asset managers. This deprives pension funds from benefiting from the innovative strategies used by newer, smaller entrants to the asset management industry – many of which outperform established firms. It also means that pension funds, which typically serve a diverse population of beneficiaries, are entrusting most of their capital with firms that lack racial, ethnic, and gender diversity among their leadership. In contrast, among emerging managers, there is far greater diversity, more closely reflecting the demographics of the nation and the pension funds' beneficiaries.

Public pension funds have the opportunity to use their considerable assets toward both achieving the highest possible returns for their beneficiaries and promoting a more inclusive economy by supporting the entry and growth of new players in the asset management industry. To take advantage of that opportunity, several public pension funds have established emerging manager programs.

This report is an examination of the most common practices by public sector pension funds that have emerging manager programs. The information contained in this report was gathered from in-depth interviews with eight state pension funds that have emerging manager programs and were recommended by industry stakeholders, eight asset managers who have participated in emerging manager programs, and other industry stakeholders. This report highlights governance structures, policies, and processes that best position these programs, participants, and pension funds for success.

While there is broad variation in many aspects of how the emerging manager programs were established, whether and how they define diversity, and how they are run, these programs also share several common characteristics. This includes:

- **Leadership** – From the top of the pension fund to the staff responsible for the emerging manager program on a day-to-day basis, buy-in and commitment to the emerging managers program over a sustained period of time yields positive results, for the pension funds and the emerging managers alike.

- **Focus on performance** – Not a single pension fund in our study compromises performance, which is what matters for the funds' beneficiaries, and also has the effect of bolstering support for the continuation and expansion of emerging manager programs.

- **Support for emerging managers' growth** – Support by the pension fund staff for the emerging managers, providing them with mentoring and opportunities for networking and learning that will help them grow their business and graduate from the emerging manager program to the core fund.

- **Strengthening an inclusive ecosystem that fosters greater diversity** – Staff for established emerging manager programs share a commitment to strengthening the entire community of their peers, industry groups, consultants, and managers, with an intentional focus on diverse associations and managers. They organize and attend conferences, create learning opportunities, speak on panels, provide thought leadership, and make themselves available as a resource. They take the long view – that strengthening the ecosystem also redounds to them: it results in identifying new managers to invest in and adapting lessons learned by others to their own funds, resulting in greater returns for their beneficiaries.

Origin: Pension funds' emerging manager programs did not require legislation to be established. All were started by the leadership of the fund, such as then-State Comptroller Carl McCall and current Comptroller Thomas P. DiNapoli in New York and then-Board Chair Jarvis Hollingsworth in Texas. Even in Illinois and New York, where statute now defines certain parameters of their programs, the emerging manager programs had their origins in the initiatives of pension fund leaders.

Many of the pension funds we interviewed began their emerging manager programs in order to have exposure to talented, smaller management firms that are typically bypassed by pension funds because of their size. The funds have been able to maintain these programs because the selected managers perform strongly, and in some cases outperform the portfolio at large.

Criteria for Definition: For the purposes of the pension funds' emerging manager programs, the exact definition of an emerging manager varies. There are often different criteria for those firms that are managing assets in private markets and those in public markets. For private markets, the criteria are usually based on the limited partnership sizes of under $1 billion to $3 billion and/or whether they are fundraising limited partnerships I through IV. For those in public markets, the limits can be higher. In Illinois, the state statute includes a clear diversity requirement and definition: 51% or more owned by minorities, women, or persons with a disability. There are other states that bar diversity requirements but emerging manager programs in those states can encourage, or at least track, diversity.

Diversity. Over time, emerging manager programs have become a natural place to embrace and foster racial, ethnic, gender, and other dimensions of diversity. As a legacy of racial, gender, and other wealth gaps, investment management firms owned and operated by people of color, women, and other socially disadvantaged groups tend to be small as they have less capital starting out. Therefore, there's a natural correlation between diversity and a fund's size or stage in its lifecycle. Any emerging manager program is therefore likely to have a more diverse roster of managers than the core fund.

Through meaningful steps such as outreach and engagement with minority and women focused trade groups, being accessible to diverse asset managers, and hiring fund of funds managers that prioritize finding strong performing diverse managers, the level of diversity within the emerging manager program is able to grow further. Several of the funds we interviewed cited as an impetus for the focus on enhancing diversity being the desire to have investment managers that better reflect the diversity of the beneficiaries they ultimately serve.

III. EMERGING MANAGERS' PERSPECTIVES

As part of this study, we also interviewed half a dozen asset managers that have participated in emerging manager programs with one or more pension funds. These firms range in size from four to 15 staff, with around $300 million to $950 million under management. There was one outlier – a graduated manager – with around $4.3 billion under management, who was able to share the experience of going from a start-up two decades ago that participated in several emerging manager programs, to becoming a more established manager.

A consistent theme across these interviews was the challenge of being a start-up. They tend to start with relatively little of their own money, in a market in which there is increased competition for a shrinking number of opportunities. They face difficult choices as they grow such as how much of their income to reinvest in the firm versus providing for their family. Even managers with great performance are ignored by many institutional investors because of their smaller size. These challenges are further exacerbated by conscious or unconscious racial bias against managers of color, such as prejudiced assumptions about their ability to perform, or a lack of recognition of the struggle and sacrifices made to get their firms off the ground.

These realities make emerging manager programs especially meaningful. They provide benefits to emerging managers – easier access to opportunity, shorten the timeline to raising the capital needed to make their strategy a reality and a success, and open doors to new business opportunities – plus add value to pension funds.

> "Emerging manager programs are really important and make a difference. They open the door for us. And the people opening those doors really care about diversifying the industry. This makes our economy and our country better."
> *- emerging manager program participant*

However, not all emerging manager programs are alike. From the perspective of emerging managers, some of the pension funds are doing a better job than others in how they structure their programs, run the application process, and provide feedback and support.

IV. PROGRAM STRUCTURE AND OBJECTIVES

Each pension fund we interviewed has a distinct structure for its emerging manager program, and in the case of the New York State Common Retirement Fund (NYSCRF), has two parallel (and overlapping) programs – one focused on emerging and the other on diversity. Some pension funds combine both emerging and diverse in the same program, such as the Connecticut Inclusive Investment Initiative (Ci3) – an emerging and diverse manager program run by the Connecticut Retirement Plans and Trust Funds that includes emerging and/or diverse participants. The Ci3 program defines an emerging manager as an asset management firm that is newly formed or relatively small that has the minimum amount of assets under management and/or length of track record.

OBJECTIVES

The objectives of pension funds' emerging manager programs are all similar, and typically include a combination of performance; graduation; access to strategies that might get overlooked in the larger portfolio; access to the next generation of investment management talent; and growing the share of total AUM managed by emerging managers.

The objectives are typically included in the emerging manager program policy that sits within a pension fund's overall investment policy. It will have gone through all of the regular processes within the pension fund to be reviewed and approved by appropriate staff and leadership, such as principal investment officers for the relevant asset classes, the chief investment officer, and trustees. Including all of these players in the process to develop, adjust, and adopt the policy and objectives also helps strengthen buy-in for the program.

DEFINITION OF EMERGING MANAGER AND ELIGIBILITY CRITERIA

The threshold determination of whether an investment management firm qualifies as an emerging manager typically includes size limits on its AUM or the stage of the investment manager's lifecycle. The exact thresholds vary by state and within asset classes. For the

Illinois funds, state law bases the definition of emerging managers on the diversity of their ownership, not the size of the firm.

Table 1: Emerging Manager Eligibility Thresholds

Pension Fund	Size Limits	
	Private Asset Classes	Public Asset Classes
CalPERS	Fund size under $2 billion and institutional fund 1, 2, or 3.	AUM totaling less than or equal to $5 billion
Connecticut Retirement Plans and Trust Funds (CRPTF)	Third generation or earlier institutional funds.	Generally under $2 billion (can vary by asset class)
Illinois Municipal Retirement Fund (IMRF)	Illinois state law bases the definition of emerging managers on the diversity of their ownership, not the size of the firm.	
Teachers Retirement System of Illinois (TRSIL)		
Maryland State Retirement and Pension System (MSRPS)	Funds 1, 2 or 3 with AUM under $2 billion for all private asset classes except infrastructure, which has a threshold of under $5 billion.	Broad parameters that allow small firms at the initial investment to remain in the program as they grow:[1] ● Equity: up to approx. $10 billion ● Fixed income: up to approx. $12 billion ● Absolute Return: funds 1, 2 or 3 with AUM under $2 billion
NYSCRF	Generally, under $2 billion but can vary by asset class, and institutional funds I, II, or III.	Generally, $4 billion or less for public equity and a higher limit of $10 billion for fixed income.
NYC Systems	Generally a fund under $1 billion; firm AUM of $5 billion or less (can vary by asset class); and institutional fund 1, 2, or 3.	Firm AUM under $5 billion for Public Equities and under $10 billion for Public Fixed Income
TRS of Texas	Firm size of $3 billion or less; a fund of $1 billion or less; and 4th generation or earlier institutional funds.	Firm size of $3 billion or less

[1] Parameters are intentionally broad to reduce potential barriers that may preclude managers from being awarded an assignment or result in arbitrary termination based on strict AUM limits.

GOVERNANCE STRUCTURES AND CHALLENGES

Most of the pension funds interviewed have core staff that run their emerging manager programs, aided to varying degrees by consultants. The amount of responsibilities outsourced to consultants varies by program. In some instances, each asset class's dedicated staff is also involved in the emerging manager program with a consultant assisting each asset class. Some funds also use consultants to help source potential managers, conduct operational and investment due diligence, and provide analysis of the emerging manager program.

Several funds use a manager of managers or fund of funds model within each asset class to improve the efficiency of onboarding and managing many small investment firms. For example, the Connecticut Retirement Plans and Trust Funds issued a request for proposals (RFP) for a manager of managers, and then the selected manager of managers identifies, vets and manages emerging and diverse investment managers within its purview.

While this structure relieves small emerging managers, which have limited or no administrative staff, from the burden of completing a response to a formal RFP, we heard from the emerging managers we interviewed that manager of managers, or fund of funds, arrangements can sometimes raise challenges related to the distribution of allocations, fee structure, and alignment with the goals of the emerging manager program.

- Arrangements in which a manager of managers receives an allocation from the pension fund to distribute among smaller emerging managers can sometimes result in allocations in the range of $15 million to $30 million to individual managers. These allocations are too small to make a meaningful difference for both the emerging manager and the pension fund.
- A challenge that sometimes arises in manager of managers arrangements is the fee structure. Since the manager of managers and the emerging managers each need to receive fees, but the pension funds understandably want to keep overall fees low, the emerging managers sometimes feel that they get squeezed. This can deprive them of much-needed revenue to reinvest in their firms in order to grow. There are creative ways to restructure fees so the economics work on all sides. For

example, provide emerging managers with a more favorable share of fees early in their development with the understanding that once they hit a certain size threshold, they provide a fee rebate.

- A manager of managers structure can be an impediment to graduation. In some arrangements, the manager of managers may not be incentivized to help emerging managers graduate to the core fund. High performing emerging managers that get a direct allocation means that the manager of managers will have to go through the time-consuming task of finding a manager to replace them. Also, the fees structure described above impedes the ability of the emerging manager to grow their business to the level where they can graduate.

Notwithstanding the findings above, it is important to note that not all managers of managers are the same. One emerging manager spoke highly of a manager of managers they work with, praising its transparency, constructive feedback, and development support that has helped their firm get new business and begin to grow.

ASSET CLASSES

Among several pension funds, there are emerging manager strategies associated with each asset class in the core fund. Smaller emerging manager programs typically operate in fewer asset classes. And in other cases, an asset class may be excluded from the emerging manager program due to the size of the assets involved. For example, NYC Systems does not have an emerging manager program in its hedge fund asset class as hedge funds only account for one percent of total AUM.

PROGRAM SIZE

The dollar amount and percentage share of AUM managed by emerging and diverse managers are a strong indicator of the size of an emerging manager program. Aspirational goals can help motivate growth while caps on the amount allocated can constrain growth.

Table 2: Emerging Manager Program Size

This table should not be used for comparison purposes. The figures reported by pension funds are based on differing metrics and definitions of emerging manager.
Includes the most recent figures available, as provided by the pension funds in Aug./Sep. 2024.

Pension Fund	Assets Managed by Emerging Managers	Share of Pension Fund's Total AUM	Goals or Caps
CalPERS	Between Jan. 1, 2022 and June 2023: $1.3 billion in NAV in programmatic structures (fund of funds); and $1 billion committed to a programmatic structure. Since Jan. 1, 2021: $1.8 billion committed to emerging managers directly.	Share of total AUM/NAV data expected to be available October 2024.	No goals or caps
CRPTF	$2 billion[2]	3.4%[3]	Aspirational goal of 5 to 10% of total AUM with diverse and emerging managers
IMRF	$14 billion*	26%*	Aspirational goal of 22% of total AUM with diverse managers.
TRSIL	In EMP: $1.4 billion[4] Across entire portfolio: ~$20 billion	29.5%*	Internal Board approved aspirational goal of 22% of total AUM with diverse managers
MSRPS	$5.06 billion	7.4% of plan assets (9.3% of externally managed assets)	No goals or caps
NYSCRF	$10.9 billion as fiscal year 2024	7.1% of actively managed assets	No goals or caps. Emerging manager pacing goals are set by each asset class.
NYC Systems	$10 billion	3.9%	Aspirational goal of 10% emerging managers by 2029. Emerging manager pacing goals are set by each asset class.
TRS of Texas	$6.2 billion	Not Available	Capped allocation: 1.1% of the total AUM.

* Includes firms of any size, as long as they meet the Illinois statutory definition for emerging manager: 51% or more owned by minorities, women, or persons with a disability.

[2] Includes both diverse and emerging managers.
[3] Includes both diverse and emerging managers.
[4] TRSIL utilizes its Emerging Manager Program (EMP) to source, invest, and grow with younger, diverse firms in private capital mandates. It serves as an incubator for diverse talent. All assets managed by EMP participants fall within the emerging manager total for the entire TRSIL portfolio, which are of any size, as long as they meet the Illinois statutory definition for emerging manager.

PROGRAM STRUCTURE AND OBJECTIVES RECOMMENDATIONS
for New and Existing Emerging Manager Programs

- **Clearly define the goals of the program.** This provides everyone within the pension fund, the emerging managers, consultants, and other stakeholders with clarity on what they are working toward. The goals should be written into a policy that governs the emerging manager program that is part of the pension fund's overall investment policy.

  These goals should be reviewed and approved by all of the relevant decision makers and investment staff. This includes trustees, chief investment officers, and the principal investment offers for each asset class, among others.

- **Reconsider the balance between dedicated staff and outsourcing functions to consultants.** While consultants can play a significant role that enhances the impact of emerging manager programs, pension funds should examine the trade-offs that come with relying on consultants too heavily. For example, relying entirely on consultants to source new managers cedes a degree of control of the program and weakens the fund's connectedness to the managers that are tasked with serving its beneficiaries.

- **Structure manager of managers relationships to ensure maximum alignment with the mission of the emerging manager program.** This alignment should include practices that support the success of emerging managers, including fairer fee structures, greater transparency, and requirements to provide meaningful development support.

- **Integrate the emerging manager program into asset classes.** Several of the pension funds identified one of the factors of their success as being the integration of the emerging manager program within each of their asset classes, rather than segregating the program from the asset classes. In the integrated model, the investment officers responsible for each asset class play a role in the selection of emerging managers for their asset class and become invested in their success. This relationship makes for a smoother graduation process when the emerging manager is large enough to receive a direct allocation from the asset class.

- **Define diversity broadly.** For those emerging manager programs that require or promote diversity among their participants, the focus on ownership misses the opportunity to engage emerging managers that have diverse day-to-day leadership handling the firm's management of investments. Even if a firm's ownership does not meet the definition of diversity, it can still serve as an employer and incubator of diverse talent that diversifies the industry.
- **Build growth into the structure of the program.** By establishing a percentage allocation of the overall portfolio toward the emerging manager program, rather than a dollar amount, the size of the program will grow as the portfolio grows, so the program team can focus on running the program successfully without having to repeatedly make the case for an increased allocation.

V. SELECTION AND EVALUATION CRITERIA

Most pension funds we interviewed maintain the same due diligence standards for participants in emerging manager programs as they do for managers in the core fund. This includes references, an assessment of how much risk the manager is taking, and information about their operations, legal, fund administrators, and the service providers they use. In a couple of exceptions, those programs that use a manager of managers or fund of funds structure defer to the lead manager or fund to use their own due diligence process for the emerging managers they recruit.

Emerging managers expect an appropriate amount of rigor in application and due diligence processes. However, most of the emerging managers we interviewed found that the application process for many emerging manager programs lacked transparency, was confusing, and was not appropriately tailored to small firms.

Emerging managers often encountered a lack of transparency when application processes involved consultants or a fund of funds. In these instances, there often is not sufficient clarity or consistency on what the role of the consultant is, what standards are used to make a decision, who the ultimate decision-maker is, the timeline of the process, or the reason for the ultimate decision. There are also added concerns about whether the consultants' interests are aligned with the mission of the program versus simply getting their fee. These dynamics create inefficiencies and consume applicants' limited time and energy, which is especially burdensome for such small firms.

Emerging managers see a lot of room for improvement in the due diligence process, in particular by better tailoring the process to reflect the firms' size. The amount of documentation to review and complete is particularly voluminous, with many questions that are not relevant to small firms or the strategy for which the firm is being contracted to pursue. Extensive reporting requirements, or requirements to acquire certain software and have certain staff positions, may make sense for a firm managing billions of dollars but not for firms at earlier stages in their development.

Some pension funds do indeed modify selection criteria for emerging managers. This can include understanding their commitment to diversity, equity and inclusion; or relaxing the expectation for emerging manager owners to invest their own money in the funds they manage since newer, smaller managers are less likely to have discretionary capital.[5]

While some funds use RFPs for selecting emerging managers, others do not, or have a modified RFP that is less administratively burdensome. It is worth noting that emerging managers had better experiences with responding to RFPs that were run directly by the pension fund's program staff, rather than by a consultant. These processes are typically clearer and more transparent, and once approved, asset managers were able to quickly get started on the actual work without delay.

Due diligence processes that include opportunities for constructive dialogue and two-way feedback throughout the process can be beneficial. This can result in helpful advice to the emerging manager, such as on operational adjustments they need to make that both satisfy due diligence concerns and better position the firm to attract additional clients. Constructive dialogue during the process can also give emerging managers the opportunity to explain why certain requirements are not relevant to them, resulting in adjustments to those requirements by the pension fund.

SELECTION AND EVALUATION RECOMMENDATIONS
for New and Existing Emerging Manager Programs

- **Create a clear and transparent process.** Establish a clear and transparent application process so that applicants understand what is expected of them, how decisions will be made, and what the timeline will be.
- **Adapt the application and selection process to small firms.** Tailor the application, due diligence, and selection criteria to take firm size and maturity into consideration.
- **Foster feedback and dialogue.** Provide opportunities for feedback and dialogue during the application process, and make adjustments to requirements as warranted.
- **Harmonization.** Harmonize the application processes across jurisdictions, to the degree feasible.

[5] In our interviews, several emerging managers stressed the point that expecting an emerging manager to put hundreds of thousands of dollars into their fund one is not realistic as they simply do not have that much money during the early stages of their firm.

VI. ONBOARDING AND FEEDBACK

Emerging managers greatly value programs that provide them with quality onboarding processes, opportunities to provide and receive feedback, and support for growing their business.

Pension funds we interviewed receive feedback from management firms in their emerging managers programs differently. Some rely on feedback filtering through their consultants or fund of funds managers, and others use a survey instrument. Two shared that they directly engage managers to solicit feedback on how the program is running, either through one-on-one conversations or forums that are part of their conferences. One has a written policy that staff from the fund need to meet with each emerging manager at least once every two years to, among other things, receive feedback on the program.

Onboarding. As stated earlier in this report, emerging managers see the feedback process ideally starting as early as the application stage. They argue that it should also be part of the onboarding process. Emerging managers described a quality onboarding process as including workshops and webinars that explain how the program will work and the requirements, such as those related to reporting and capital calls, along with accessibility of program staff so that emerging managers' questions can be addressed along the way. Strong onboarding processes also include opportunities to meet senior officials responsible for overseeing the pension fund such as treasury officials or the comptroller, depending on the jurisdiction.

Ongoing feedback. Emerging managers value opportunities for candid feedback, advice, and discussion throughout their engagement, whether on their current strategies or issues related to running and growing their business. This is especially the case when the emerging manager is able to directly communicate with the pension fund's investment officers and other staff. Going through consultants for this type of support yields mixed results. A couple emerging managers shared that consultants tend to give feedback that is less clear or actionable, and recounted instances of consultants who were supposed to provide trainings but since they lacked experience running an asset management firm, their efforts were not helpful.

Soliciting feedback from participating emerging managers can lead to program improvements. For example, in response to feedback from a survey of its emerging manager program participants in 2017, the Maryland State Retirement and Pension System (MSRPS) learned that managers desired the ability to meet directly with the system's staff, as opposed to only interacting with manager of managers. MSRPS subsequently changed its processes to allow for direct meetings with all of its participating emerging managers.

ONBOARDING AND FEEDBACK RECOMMENDATIONS

for New and Existing Emerging Manager Programs

- **Provide feedback and encourage dialogue.** Ensure emerging managers have opportunities to receive continuous feedback and advice, as well as opportunities to provide their recommendations for improving emerging manager programs.
- **Ensure a thorough onboarding process.** Emerging managers that are new to a pension fund should receive a comprehensive onboarding that provides them with a thorough understanding of expectations and deliverables that also includes opportunities to hear from and interact with staff from the pension fund.

VII. SUPPORT AND DEVELOPMENT INITIATIVES

MENTORSHIP, EDUCATIONAL, AND NETWORKING OPPORTUNITIES

Almost every pension fund we interviewed is involved in efforts to provide emerging managers with educational and networking opportunities. Several of them host conferences that bring together pension fund staff, emerging managers, consultants, and peers from other funds in order to provide emerging managers with opportunities to network and learn best practices that will help them gain new clients and grow their business. Conference programs include panels and workshops with asset allocators, other emerging managers, and content on business development, marketing, how the RFP process works (where relevant), and best practices on back office legal and administrative issues, among other topics.

The most active directors of emerging manager programs mentor emerging managers and serve as a helpful resource to anyone in the ecosystem who calls upon them. They are also on the road a lot, attending and speaking at their peers' conferences as well as industry group conferences focused on particular asset classes or diverse emerging managers. The most commonly attended industry group conferences focused on diversity include those hosted by the National Association of Security Professionals (NASP), which primarily serves African American managers; the New America Alliance (NAA), which primarily serves Hispanic/Latino managers, the Asian American Association of Investment Managers (AAAIM), National Association of Investment Companies (NAIC), and Private Equity Women Investor Network (PEWIN).

Every emerging manager we interviewed expressed deep appreciation for these networking, mentorship, and learning opportunities. This includes making direct introductions to peers at other pension funds, limited partners, other potential investors, and other managers.

These activities strengthen an inclusive investment management ecosystem that fosters greater diversity. In the short and medium term, they result in identifying new managers to invest in. Over the longer term, activities specifically targeted at providing greater knowledge, networks, and business opportunity to diverse asset managers enhances the diversity of the field and positions diverse asset managers to succeed. This serves the end goal of every pension fund – to achieve greater returns for their beneficiaries.

Some pension funds may not have the staff to carry out all of the functions above and therefore rely on program partners, such as fund of funds managers, to provide mentorship and development services to emerging managers, and make this one of the criteria for choosing them.

GRADUATION FROM EMERGING MANAGER PROGRAM

Graduation is often a shared goal among the emerging managers and the emerging manager programs alike. Directors of emerging manager programs take great pride in the graduation of their emerging managers. Beyond being a reflection of the talents of the manager, it is also the culmination of deliberate efforts by the program staff, consultant partners, asset class investment officers, and others across the fund – from the initial sourcing of the manager to their review and selection, as well as the support provided to help the manager grow their business through curated networking, learning, and mentoring opportunities. From a financial perspective, pension funds that develop a close relationship with their emerging managers and help them grow are also better positioned to negotiate more favorable fees once the manager has graduated.

It is therefore no surprise that pension funds often provide support to emerging managers to grow their AUM and graduate from the emerging manager program to the core fund. Most of the activities described in the preceding section apply to helping existing emerging managers within the portfolio succeed on their path to graduation as much as, if not more so, than recruiting potential new managers.

> **"Success is graduation. We give emerging managers every opportunity to be successful. We serve as references. We try to grow their AUM, and build out the profile to make it as healthy as possible, so hopefully they'll get the necessary capital that will allow them to be a graduation candidate."**
>
> Kirk Sims, Emerging Manager Program Senior Director, TRS of Texas

The exact criteria for graduation vary from fund to fund and across asset classes within a fund. Typically, this include a mix of the following:

- Quantitative factors, mainly centered around the value of assets managed by the emerging firm reaching a particular threshold.
- Qualitative factors:
    - How the emerging managers are performing
    - Longevity of the firm
    - Retention of key staff
    - Compliance practices
    - Diversity and inclusion practices.

One fund drives graduation decisions based on the needs of the portfolio: when an appropriate emerging manager is identified to fill a need in the overall portfolio, a graduation opportunity arises. Another fund avoids the term graduation altogether as emerging managers are already in the core fund from the outset.

Emerging managers identified a couple ways to improve the graduation process. First is setting clear criteria for graduation, and the second is for the pension fund's emerging manager program staff to proactively communicate with emerging managers about the graduation process. Some managers may be reluctant to ask about graduation lest it come across as not being focused on the job immediately in front of them – to successfully manage the funds already entrusted to them.

A couple of the pension funds we interviewed take the view that graduation will not necessarily be the goal for every small asset management firm as some have strategies that do not lend themselves to being scaled up. For those firms, success can be achieved while staying small.

SUPPORT & DEVELOPMENT RECOMMENDATIONS
for New and Existing Emerging Manager Programs

- **Develop structured and clear graduation processes.** Structure and transparency in this process will help ambitious and high-performing emerging asset managers grow their business and strengthen their relationship with the pension fund.
- **Create transitional opportunities for emerging managers.** Pension funds should consider whether characteristics of certain asset classes lend themselves to tailored

programs that provide a stepping stone toward graduation. For example, the NYC Systems has a Direct Emerging Manager Program in the private equity asset class that provides qualified emerging managers with direct allocations from the core fund that are three to four times the size of what is available in the traditional emerging manager program.

- **Create networking and learning opportunities** for emerging managers to learn about the fund's emerging manager program, meet with staff, and receive training on various business practices.
- **Prioritize network-building and mentorship.** Ensure the emerging manager program director's role includes taking ownership of cultivating a network of emerging managers and providing mentorship.
- **Raise the profile of graduations and performance.** Doing so can be a way to build support for the emerging manager program and make the case for increasing its asset allocation. This should include publicly listing the emerging managers that have graduated.

Graduation Case Study

STELLEX CAPITAL MANAGEMENT

Stellex Capital Management is a value-focused private equity firm headquartered in New York City, co-founded by Ray Whiteman and Michael Stewart. Mr. Whiteman, who is African American, owns 51% of the management company.

In 2015, NYC Systems made a $70 million investment through its dedicated Emerging Manager program (EM 2015) in Stellex's inaugural fund, Stellex Capital Partners I LP. In 2021, Stellex graduated into the core portfolio, with NYC Systems investing $168 million in their second fund, Stellex Capital Partners II LP. All five retirement systems that constitute NYC Systems participated in both Fund I and Fund II. The firm has experienced significant growth since NYC Systems' initial investment, with Fund I closing at $870 million and Fund II at $1.77 billion.

At the time of Stellex's initial selection, the majority of its client base consisted of high-net-worth individuals, corporate pension plans, foundations, and endowments. Since NYC Systems' early investments, Stellex has expanded both its client base and service offerings. Public plans now represent more than 70% of Stellex's $2.6 billion in assets under management. The firm has also grown to over 40 employees, with 45% of them being professionals of color and women.

VIII. FUNDING AND INVESTMENT STRATEGIES

There is significant variation across the pension funds we interviewed in how they allocate funding to emerging managers. TRS of Texas has a cap of 1.1% of the fund's entire portfolio that can be allocated to the emerging manager program, while other pension funds have no cap at all.

In terms of the amount allocated to each particular emerging manager, that varies depending on several factors – whether they are receiving allocations through a fund of funds or directly; characteristics of the asset class; both business and investment risk; the strategy; and fund size. The pension funds we interviewed reported allocations to individual emerging managers generally ranging from $25 million to $75 million, with some receiving significantly larger allocations. For example, at CalPERS, some emerging managers receive direct allocations outside of the emerging manager program in the range of $75 million to $500 million in the private equity asset class. In some rare circumstances, allocations can be as small as $5 million to $10 million but it is difficult for such a small allocation to produce meaningful returns for the pension fund or be profitable for the asset manager.

The pension funds we interviewed all reported different asset classes and strategies as being particularly successful for the participants in their emerging managers programs. For example, NYC Systems shared that public equities small cap, private equity, alternative credit and infrastructure have recently had the best performance for emerging managers. Private equity has also been a strong performer in TRS of Texas' emerging manager program. Interviewees who have been in the industry for a long time noted how changes in the broader investment environment and each fund's chosen strategies lead to changes in which asset class or strategy performs best in any given year.

FUNDING AND INVESTMENT STRATEGIES RECOMMENDATIONS

for New and Existing Emerging Manager Programs

- **Regularly review and adjust funding allocations.** Planning for periodic adjustments can serve both the overall portfolio and participating managers well.
- **Provide meaningful allocations.** Ensure that minimum allocation sizes are sufficiently large to be lucrative for small asset management firms.

IX. DIVERSITY AND INCLUSION

Pension funds with an explicit commitment to diversity as part of their emerging manager program or as a goal that runs parallel to it, tend to have a higher proportion of diverse managers. In Illinois, where state statute requires diversity in the emerging manager program and sets a 20% target, 26% of the Illinois Municipal Retirement Fund's (IMRF) portfolio is managed by diverse emerging managers and 29.5% of the Teachers Retirement System of Illinois' portfolio is managed by diverse managers (includes both emerging and non-emerging). In New York, which has a statute defining diversity for asset managers, but no statutory goal, for statewide pension funds, the numbers are still strong: 24% of NYSCRF's actively managed portfolio is managed by minority- and women-owned firms (includes both emerging and non-emerging).

In the absence of statutory requirements or goals, several pension funds still pursue efforts to diversify their asset managers. Diversity goals and/or strategies can still be adopted by the public officials responsible for overseeing pension funds (such as state or city treasurers or comptrollers) or the leadership of the pension fund. In one state, a disparities study is being conducted as a precursor to establishing diversity goals for contracting and this is expected to help inform a goal for the emerging manager program.

In states where statutes and statewide elected leaders are hostile to setting diversity goals, diversity can still be supported through the emerging manager program by engaging in intentional outreach to diverse asset managers, such as through industry group conferences focused on diverse managers and other steps to build a diverse pipeline of prospective emerging managers.

Our interviews found that regardless of the state in which they are based, the staff that run diverse and emerging manager programs can make a big difference in growing the share of total AUM managed by diverse asset managers if they embrace the premise that minority and female asset managers can perform at par with their non-diverse peers, and if they are genuinely committed to strengthening diversity in the industry. They can do the latter by organizing and attending conferences, creating learning opportunities, speaking on panels, providing thought leadership, and making themselves available as a resource – to emerging managers, their peers, industry groups, and consultants who play an important role in the industry. They can also ensure that the fund of funds that are given allocations from the emerging manager program have the expertise and capacity to engage with diverse emerging managers – in the selection process, through development and support activities, and data collection. These efforts help ensure diverse applicant pools, lead to a greater share of AUM managed by diverse asset firms, and, more broadly, collectively contribute to the long-term strength and growth of diverse asset managers.

Table 3: Diversity in Emerging Manager Programs

This table should not be used for comparison purposes. The figures reported by pension funds are based on differing metrics and definitions of diverse manager.
Includes the most recent figures available, as provided by the pension funds in Aug./Sep. 2024.

Pension Fund	Approach to Diversity	State Law	Definition of Diversity	Share of Portfolio Managed by Diverse Managers[6]
CalPERS	No diversity requirement or preference, but tracks diversity data.	State law prohibits preferential treatment for diverse managers.	Uses two definitions: substantially diverse and majority diverse.[7]	Share of total AUM/ NAV data expected to be available in the coming months. Jan. 1, 2022 through June 30, 2023: $7.2 billion[8]
CRPTF	Promotes and encourages participation by diverse managers. Aspirational goal of 5 to 10% of total AUM with diverse and emerging managers	State law defines diverse-owned (see adjacent column).	Owned in a majority form by either minority individuals, women, veterans, persons who identify as LGBTQ+ or persons with a disability.[9]	$2 billion[10] 3.4% of AUM
IMRF	Requires that emerging managers be diverse. Aspirational goal of 22% of total AUM with diverse managers.	State law defines emerging managers as diverse managers and provides an aspirational goal of 20% of total AUM with diverse asset managers.	51% or more ownership by minorities, women, or persons with a disability.[11]	$14 billion 26% of AUM

[6] Includes emerging and non-emerging managers.
[7] CalPERS tracks diversity data and uses the following definitions:
- 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.

[8] Diverse managers may be emerging or established; and all are outside the Emerging Manager Program.
[9] As defined by state law in Connecticut General Statutes Section 4a-60(a)(1).
[10] Includes both diverse and emerging managers.
[11] As defined in the state of Illinois' Business Enterprise for Minorities, Women, and Persons with Disabilities Act.

This table should not be used for comparison purposes. The figures reported by pension funds are based on differing metrics and definitions of diverse manager. Includes the most recent figures available, as provided by the pension funds in Aug./Sep. 2024.				
Pension Fund	Approach to Diversity	State Law	Definition of Diversity	Share of Portfolio Managed by Diverse Managers[6]
TRSIL	Requires that emerging managers be diverse. Internal Board approved aspirational goal of 22% of AUM with diverse managers.	State law defines emerging managers as diverse managers and provides an aspirational goal of 20% of total AUM with diverse asset managers.	51% or more ownership by minorities, women, or persons with a disability.[12]	~$20 billion 29.5% of AUM
MSRPS	MSRPS promotes and encourages participation by diverse managers.	State procurement regulations do not permit race or gender to be used as a factor in awarding contracts unless a disparity has been established through a study.	Minority- and women-owned business enterprises (MWBE).	2023: $8.5 billion, 13.1% of plan assets (16.3% of externally managed assets) 2024: $8.3 billion, 12.1% of plan assets (15.2% of externally managed assets)
NYSCRF	No diversity requirement in the emerging manager program (which has 62% MWBE representation), and promotes and encourages participation by diverse managers through a parallel MWBE program.	State law codifies an MWBE strategy that includes the MWBE definition, requires annual reports, and an annual conference.	At least 51% minority or women owned.[13]	As of fiscal year 2024: $36.8 billion, 24% of actively managed AUM
NYC Systems	No diversity requirement, but encourages participation by women and minority owned firms. Has an aspirational goal of 20% MWBE across the entire portfolio.	None.	Minority- and women-owned business enterprises.	$19.5 billion 12.68% of U.S.-based actively managed assets

[12] As defined in the state of Illinois' Business Enterprise for Minorities, Women, and Persons with Disabilities Act.

[13] As defined by state law. See S.6888-C (Hassell-Thompson) / A.9976-C (Peoples-Stokes) from the 2009-10 New York State Legislative Session, available at https://nyassembly.gov/leg/?default_fld=&leg_video=&bn=S06888&term=2009&Summary=Y&Text=Y

This table should not be used for comparison purposes. The figures reported by pension funds are based on differing metrics and definitions of diverse manager. Includes the most recent figures available, as provided by the pension funds in Aug./Sep. 2024.				
Pension Fund	Approach to Diversity	State Law	Definition of Diversity	Share of Portfolio Managed by Diverse Managers[6]
TRS of Texas	No diversity requirement or preference, but tracks diversity data within the emerging manager program.	None.	33% (for private capital) or 51% (for public markets) ownership by women, minorities, people with a disability, or veterans.	No data for total portfolio, 53% of committed capital within the emerging manager program has been allocated to diverse managers.

Note that none of the pension funds we interviewed relax due diligence or selection criteria in pursuit of diversity. Rather, they take proactive steps to identify and encourage high-performing diverse asset managers and fund of funds with a strong bench of diverse managers to apply for opportunities to manage parts of their portfolios.

> "In our 2023 Emerging Manager and MWBE report we highlighted the performance of our diverse managers. MWBE managers have historically generated alpha for the five New York City retirement systems since 2015. In Public Markets all MWBE managers have generated excess returns net of fees. In Private Markets the MWBE firms in the Systems portfolio have outperformed their respective benchmarks with an average PME Spread of 4.9%."
>
> Taffi Ayodele, Director of Emerging & Diverse Manager Strategy, NYC Systems

DIVERSITY AND INCLUSION RECOMMENDATIONS
for New and Existing Emerging Manager Programs

- **Develop a definition of diversity and ways to measure it.** Dimensions of diversity most commonly include ethnic and racial minorities and women, and can also include disability, veteran status, sexual orientation, and gender identity. Defining whether a firm qualifies as diverse can include any combination of ownership, operational leadership, and staff. While the exact definition may vary from one jurisdiction to another, the goal should be to have a clear definition and way to measure it.

- **Goal-setting.** Set clear diversity and inclusion goals where permitted by law.
- **Outreach plan.** Develop and implement an outreach plan to build a diverse candidate pool that identifies diverse emerging managers and encourages them to apply for opportunities with the pension fund.
- **Use Fund of Funds with diversity expertise.** When using a fund of funds to manage allocations for an emerging manager program, ensure they have experience and expertise in working with and supporting diverse emerging managers and require reporting on diversity within the fund of funds and sub-managers.
- **Collect and report diversity data.** Many emerging manager programs use specialized consultants with expertise in collecting such data.

Diversity and Inclusion Case Study

ILLINOIS TREASURER

While not a pension fund, the Illinois Treasurer's approach to managing funds provides lessons on how allocators can boost the share of assets managed by diverse and emerging asset managers. The Illinois Treasurer's office manages nine pools of funds totaling approximately $66 billion in assets. The office sources asset managers to manage the capital in eight of those pools, totaling roughly $55 billion in externally managed assets.

Over the course of nine years, the Treasurer's team increased the amount of assets managed by minority, women, veteran, and disabled (MWVD) asset managers[14] from $18 million in 2014 to $3.9 billion in 2023 – a 217-fold increase. Several factors contributed to this significant growth:

- **Leadership:** Illinois State Treasurer Michael W. Frerichs came into office in 2014 with a commitment to making equity, diversity, and inclusion a priority, resulting in the addition of diversity at the leadership level and bringing new perspectives and experiences to the decision-making process.
- **Clear Objectives:** The Treasurer's office makes expanding opportunity and preferences for MWVD firms a clear objective that is written in all of its

[14] The Treasurer's office defines MWVD firms as those with more than 50% ownership by minorities, women, veterans, and/or people with disabilities; and, within private equity, more than 50% of the economic interest going to minorities, women, veterans, and/or people with disabilities.

investment policies and within procedural guidelines around due diligence for managers.

- **Structure:** The Treasurer's office has a dedicated staff of nine people focused on sourcing, conducting due diligence, and monitoring external asset managers. They engage consultants that provide recommendations and serve as an extension of staff, but all decisions are made by staff. The Treasurer does not use manager of managers of fund of funds as they have the staff capacity and structure to engage asset managers directly.
- **All-hands-on-deck:** The Treasurer's office does not have a diverse and/or emerging manager program. Rather, the entire investment team is dedicated toward increasing the participation of diverse and emerging managers.
- **Sourcing:** Known as the **"**Garcia Rule," the Illinois Treasurer requires the inclusion of at least one diverse manager in the candidate pool for any investment manager search.
- **Adjusted selection criteria:** All asset management firms, regardless of their size or whether they are MWVD, are expected to meet rigorous standards and goals, but adjustments are made to take new and small firms into account. This includes trying to break down historically challenging artificial hurdles, such as length of track record and minimum AUM that have prevented quality firms from being evaluated. This flexibility has given the Treasurer's office access to quality opportunities, such as a lot of first-time funds, which tend to perform the same as, if not outperform, the average fund.
- **Support and Development:** Newer and smaller managers receive opportunities for mentoring, networking, connections to other allocators, and guidance on due diligence and operations. This helps emerging managers grow and succeed, which provides success for the Treasurer's funds in the form of strong returns over the long run.

Note on state law: that while public pension plans have specific requirements within state law, the Treasurer's Office also sets goals for itself based on the State Treasurer Act, 15 ILCS 505/30 which sets an aspirational goal for the Illinois State Treasurer to use businesses owned by or under the control of qualified veterans of the armed forces of the United States, qualified service-disabled veterans, minority persons, women, or persons with a disability ("MWVD Persons") for not less than 25% of the total dollar amount of funds under management, purchases of investment securities, and other contracts.

X. OTHER CONSIDERATIONS

RISK MANAGEMENT AND OVERSIGHT

Most of the pension funds interviewed approach risk management and oversight no differently for emerging managers than every other manager in the portfolio. Consultants are typically involved in monitoring and providing reports, which are reviewed by investment staff and relevant committees at the fund.

In evaluating performance, emerging manager programs use key performance indicators appropriate for the asset class that the emerging manager falls within.

Funds with the most successful emerging manager programs tend to have monthly or quarterly touch points with their program partners to monitor, review, and discuss managers' performance.

FUTURE OUTLOOK AND SUSTAINABILITY

The pension funds we interviewed are keeping an eye on evolutions in the marketplace. They have steady, incremental plans for expansion and generally feel confident about their emerging manager program's prospects for growth and longevity. For example, one of the funds is looking for ways to further engage directly with emerging managers through in-person events. Another stresses that they intentionally make changes at a modest pace, cognizant that sudden, radical changes can jeopardize progress and returns.

COLLABORATION AND INDUSTRY ENGAGEMENT

Most of the directors of the emerging managers of the pension funds we interviewed spend a lot of time engaging with others across the industry, including going to conferences, meeting with their peers, current and potential emerging managers, other allocators and investors, and various experts. The heads of asset classes, principal investment officers, chief investment officers, and state treasurers also participate in their corresponding associations. Such engagement helps funds to stay current on emerging trends, learn best practices, and cultivate a network that can be helpful to them in sourcing new managers or addressing challenges that may arise.

COLLABORATION AND INDUSTRY ENGAGEMENT RECOMMENDATION
for New and Existing Emerging Manager Programs

- **Make industry engagement a priority.** Engage with the wider industry and cultivate a strong network to leverage for the pension fund, its emerging manager program, and participating emerging managers.

TECHNOLOGY AND INNOVATION

Leveraging technology for program efficiency and transparency is not on the mind of most emerging manager program directors. However, a couple did share how their emerging manager programs use software platforms that enable them to easily pull helpful analytics on the programs and individual managers, which helps with sourcing and evaluating managers. Others rely on their consultants to maintain and use databases to share research on current and potential managers.

TECHNOLOGY AND INNOVATION RECOMMENDATION
for New and Existing Emerging Manager Programs

- **Harness technological innovation.** Explore new technologies and innovative practices to improve program efficiency.

REGULATORY COMPLIANCE AND ETHICAL CONSIDERATIONS

The emerging manager programs in the pension funds we interviewed all apply the overall funds' compliance and ethical rules to the emerging managers program.

STAKEHOLDER ENGAGEMENT AND COMMUNICATION

The pension funds we interviewed all share information about their emerging manager programs publicly, typically with several pages on the funds' website, as well as in regular public reports. For example, NYSCRF issues a detailed annual MWBE report specifically on its minority- and women-owned business enterprise and emerging managers strategy, and TRSIL and IMRF do so in an annual report to the governor that covers both emerging and diverse managers. NYC Systems voluntarily began issuing a public report in 2022. An example of a less common publication is the fact sheet that MSRPS created for state legislators about the emerging manager program to help them answer questions from their constituents.

STAKEHOLDER ENGAGEMENT AND COMMUNICATION RECOMMENDATION
for New and Existing Emerging Manager Programs

- **Provide clear and accessible external communications.** Develop easily accessible public communications about the emerging manager programs, including descriptions of how the program operates, metrics, and participating managers. This should be a best practice even if governors or legislators do not require such reports by law or other public policies.

XI. CHALLENGES AND LESSONS LEARNED

COMMON CHALLENGES

- **Sourcing.** Being able to find the right managers, with the right strategies, at the right time, can be a challenge, especially for emerging manager programs that have a small core staff and/or are newer and therefore lack the deep networks that more established programs have been able to cultivate over time.

- **Managing Manager of Managers.** While using consultants can bring competencies, connections, and functions that smaller program teams lack, it can be time consuming to monitor their work and ensure they're sharing all the information that needs to be shared and raising any concerns in a timely manner.

- **Time for Networking.** Emerging manager program staff have an interest in knowing as many emerging managers as possible in order to ease immediate and future sourcing needs, but time constraints limit the reach they are able to have.

- **Capital Constraints.** Very active program staff with extensive networks face the opposite problem from that described above: they have many emerging managers they would like to bring on, but not enough funds to allocate to them all.

LESSONS LEARNED

In our conversations with pension fund interviewees, we asked them to share any lessons learned. Many of these lessons overlap with subjects covered earlier in this report and contributed to the recommendations in those sections. We include them all here to reflect particular topics that the interviewees deemed important to raise.

- **Staffing.** A successful emerging manager program needs to have a dedicated in-house team with the resources needed for sourcing, selection, and monitoring. Robustly staffing the team, rather than outsourcing most functions, also provides for greater agility. As one program director shared: "You need to be able to make decisions as you go along and make adjustments to your guidelines as needed. This is easier to do internally than with a third party where you need to change the contract."

- **Buy-in.** Any successful emerging manager program needs to have buy-in from top to bottom and others in between, otherwise it will likely face obstruction at various stages that will hinder the program's effectiveness. This includes trustees, the CIO, the asset class investment officers, legal counsel and operations.

  An emerging manager's performance is a strong argument when convincing peers about the value of the emerging manager program. And in cases where emerging managers are very new and do not have a long record of performance, the program staff can point to what peers in other pension funds have been able to accomplish with their emerging manager programs.

  The value of buy-in comes to play at several stages. When a manager is due for graduation and if the asset class investment officers have not bought into the program and had no role in the selection of that emerging manager early on, they will not recognize the quality opportunity that the manager presents and be less likely to green light a direct allocation to them. In another example, if an emerging manager hits a rough patch, and the asset class team had a role in their selection process, then they are more likely to stick with the manager and defend them.

- **Measuring Diversity.** When compiling diversity data, be mindful of situations where a fund of funds manager is diverse but some of the fund managers under them are not diverse. In such an instance, not all of the fund of funds' dollars can be counted as being a diverse allocation, because the underlying investments are where the actual dollars go. For these and other reasons, it is especially important for pension funds to work with consultants and fund of funds partners that have experience conducting due diligence and evaluations of diverse and emerging managers. See additional recommendations regarding diversity in section VIII.

- **Personal capital requirements.** A common practice among pension funds is to expect asset managers to have "some of their own skin in the game" – namely a share of their personal wealth tied to the investment strategy they pursue as an incentive to perform well. However, being mindful of the racial and gender wealth gaps, expectations need to be adjusted when considering the level of personal wealth that diverse asset managers are able to put into their fund.

- **Policy and Structure.** Any emerging manager program should have clear policies that articulate the goals, strategy, and guidelines of the program, and a structure that will enable it to function effectively. This includes identifying which asset classes to invest in, how to integrate with the asset classes, whether there will be a dedicated team and how large it will be, roles of team members and program partners, how to determine how much capital is set aside for the program, and a minimum or maximum lifespan for the program.

- **Target asset classes.** When launching an emerging manager program, identify the asset classes in which smaller managers are more likely to succeed and begin the program with a focus on just those asset classes.
- **Keep conducting research.** The investment universe is always an evolving space, so continuously do research to help understand the state of investment firms and revise the parameters and definitions of "emerging manager" within each asset class.

XII. CONCLUSION

Emerging manager programs have the potential to play a significant role in cultivating the next generation of asset managers, creating a more inclusive economy, and providing strong returns that support pension fund beneficiaries. Programs' ability to deliver on these opportunities rely on having a clear objective; leadership by a talented and dedicated staff; buy-in among key external and internal stakeholders, from public officials to chief investment officers to the investment officers for each asset class; transparent policies; support for emerging managers' development; and engagement with the wider asset management community.

Most, if not all, emerging manager programs have opportunities to adapt their practices and undertake innovations to further improve their impact. A commitment to continued research, collaboration, and adaptation will position pension funds well as they continue to seek the best returns for their beneficiaries over the long term.

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Many thanks to all of our interviewees for their time, candor, and feedback.

PENSION FUNDS INTERVIEWED

- CalPERS – Michael Silva, Associate Investment Manager
- Connecticut Retirement Plans and Trust Funds - Anastasia Rotheroe, Principal Investment Officer, Public Equity & Director, Corporate Governance
- Teacher Retirement System of Texas (TRS of Texas) - Kirk Sims, Senior Director, Emerging Manager Program
- Teachers Retirement System of Illinois (TRSIL) - Jose Gonzalez, Senior Investment Officer, Diverse and Emerging Managers
- Illinois Municipal Retirement Fund (IMRF) - Rosa Perez, Investment Officer, Diversity Programs and Total Portfolio
- Maryland State Retirement and Pension System (MSRPS) – Andrew Palmer, CFA, Chief Investment Officer
- New York State Common Retirement Fund (NYSCRF) – Sylvester "Sly" McClearn, Director of Emerging Manager Program
- New York City Retirement Systems (NYC Systems) - Brad Lander, NYC Comptroller, and Taffi Ayodele, Director of Diversity, Equity and Inclusion & Emerging Manager Strategy

OTHER INTERVIEWEES

- Joe Aguilar, Chief Investment Officer, Illinois State Treasurer
- Emerging managers. The report does not include any identifiable information for the eight asset managers interviewed for this project. This was done in agreement with the asset managers to ensure that they could be open and honest about their experiences, without possibly harming any of their business interests.

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