CALSTRS

Investment Committee

Item Number 6a – Open Session

Subject: Special Mandates Review

Presenter(s): June Kim and Margot Wirth

Item Type: Action

Date & Time: May 1, 2024 – 10 minutes

Attachment(s): Attachment 1 – Meketa Opinion Memo

Attachment 2 – Global Equity and Private Equity Evaluation and Recommendations

PowerPoint(s): None

Item Purpose

This item is required under the reporting guidelines of the Special Mandate Policy. In accordance with the Special Mandate Policy, the Investment Committee, as part of a fiduciary review, must affirmatively vote to continue each special mandate on terms satisfactory to the Investment Committee. The Investment Committee may also terminate or revise the mandate at any time.

Recommendation

Staff recommends maintaining the Developing Manager program, Private Equity-Clean Tech legacy investments, and the Private Equity-Proactive Program, as Special Mandates named in the Special Mandate Policy.

Executive Summary

Special Mandates are comprised of:

1. Global Equity-Developing Manager Program
2. Private Equity-Proactive Program
3. Private Equity-Clean Tech legacy investments

The **Global Equity-Developing Manager Program**, established in 2004, facilitates engagement with newer, smaller investment management firms. In 2016, as part of the transition to global index weights, the program was restructured from all U.S. equities to a combination of less efficient U.S. small-cap and non-U.S. developed market equities. Although the restructured program experienced a performance improvement, it has not yet met its established excess return objective. The U.S. Developing Manager portfolio has underperformed its benchmark over most periods, and the non-U.S. Developing Manager portfolio has outperformed its benchmark by 10 basis points since inception. Staff will continue oversight of the existing investment program and consider developing managers when conducting manager searches. Staff recommend maintaining the Developing Manager Program as a special mandate.

The **Private Equity-Proactive Program,** established in the early 2000s, is comprised of the Urban and Rural (UR) and the New and Next Generation (NNG) portfolios. In the early stages of the program, it was challenging to find suitable, institutional-quality investment opportunities within the specified mandate. Performance was particularly poor, but over time has improved due to the following factors: (1) an enlarged geographical mandate that is now U.S.-focused rather than California-focused; (2) a maturation of the segment which has significantly deepened the pool of suitable investment opportunities; and (3) the increased skill of our fund-of-funds manager learned over a decade of experience in this specialized segment. Staff believe that the current benchmark is not the most appropriate for this program, in large part because it does not include fund-of-funds, yet this program is administered primarily through a fund-of-funds structure. Staff recommend maintaining the Proactive Program as a special mandate.

The **Private Equity-Clean Energy and Technology Program** established in 2005, is currently comprised of legacy-mandated investments only. The portfolio demonstrated poor performance, primarily due to market timing and mandated deployment into an immature market. The Investment Committee adopted to remove the program on a go-forward basis as of July 2018. Therefore, the legacy assets are what remains within the special mandate. Much has changed in the clean energy and technology industry where wind and solar have become much more mainstream. Private equity investments have also become more mainstream in this sector. CalSTRS Private Equity and Sustainable Investment & Stewardship Strategies staff have collaborated on several investments outside of special mandates in accordance with CalSTRS ESG initiatives. Staff recommends maintaining the Clean Tech legacy investments as a special mandate.

Staff provided an assessment of each program and analysis of the historical performance (attachment 2) to support the Investment Committee's voting decision in accordance with the Special Mandates Policy.

Background

CalSTRS has a history of considering specialized mandates/investment strategies dating over multiple decades and in December 2015, the Teachers' Retirement Board expressed a desire for a more formalized process for Board members to refer and approve Special Mandates. In June 2016 the Committee adopted a formal Special Mandate Policy that requires annual reporting. Special Mandates, in addition to the primary objective of appropriate risk-adjusted returns with good investment performance, are expected to provide ancillary benefits focused on diversity and ESG principles.

The last review of Special Mandates was conducted in September 2018, when the Committee reviewed and adopted:

a. Addition of Low Carbon strategy as a Special Mandate.
b. Re-categorized some mandates as mainstream strategies and removed them from Special Mandate Policy.
c. Merge and re-classify two private equity programs as the Proactive Portfolio.
d. Removal of Clean Tech investments on a go-forward basis for new investments effective July 1, 2018, since these strategies became more commonplace and part of the broader portfolio of investments.

In July 2020, the Committee adopted the removal of the Low-Carbon Index strategy from Policy into the construction of the Sustainable Investment & Stewardship Strategies (SISS) Portfolio.

Lastly, in November 2023, Meketa re-evaluated the programs and provided an updated assessment of the original expected economic risks and opportunities, and any material developments since the approval of the mandates for the Committee's review. Meketa informed the Committee that staff will return in 2024 with further analysis and recommendations to support the Committee's fiduciary review and decision regarding the retention of these programs as Special Mandates.

Strategic Plan Linkage: Trusted Stewards

Board Policy Linkage: Special Mandate Policy

Optional Reference Material:

Special Mandates Report and Meketa Opinion Memo, November 2023, Investment Committee

Special Mandates Policy Annual Report FY22-23, September 2023, Investment Committee