CalPERS Shakes Up Manager Selection under New Regime

By Tim Sturrock March 18, 2015

The $296 billion California Public Employees Retirement System has changed its approach to manager selection over the last year or so as it has revamped its senior investment staff. The pension giant is shaking things up as its new leaders focus on cutting fees, reducing volatility and seeking repeatable returns.

In recent months, CalPERS execs have already made several high-profile moves such as dumping its $4 billion hedge fund program and placing a $1 billion PIMCO international bond mandate on watch.

The changes coincide with CalPERS new CIO Ted Eliopoulos taking the helm in January 2014, on an interim basis, before a permanent appointment in September. Wylie Tollette took the role of chief operating investment officer role in February 2014. They and the rest of their team now face the new challenge of managing a plan that, as of 2014, pays more in benefits than it receives in contributions.

The senior team, with guidance from 2013 changes to the investment beliefs, now places a larger emphasis on lowering fees and volatility and simplifying its investment approach, say Tollette.

"Repeatability, predictability and scalability are really the new way in which we are examining everything in a very complex portfolio with the goal of trying to simplify it, and make it more flexible," he says. "We have many, many managers in the portfolio and it's a bit like steering a battleship."

To satisfy the repeatability requirement, CalPERS will choose managers whose strategies are not focused on any one person or star but rather on a team that can reproduce results even after turnover, Tollette says.

Although, CalPERS is satisfied with PIMCO’s performance, Bill Gross’ departure last year presents an example of how the changes are affecting CalPERS’ approach.

"Because Bill Gross was such a strong influence at the firm we, like many investors, are keeping a close eye on that account," he says. "It more has to do with the firm itself and the wide variety of changes in a short amount of time."

The new manager selection criteria also weighed heavily on the decision to eliminate the hedge fund allocation, with scalability, fees and complexity becoming chief issues.

The importance of scalability is also causing the fund to reexamine its smaller strategies since scale can heavily influence fees, he says.
"Anything less than a $1 billion is not going to move the dial [on a $300 billion fund]," he says. "We really have to examine those smaller strategies and be thoughtful as to why we are doing them."

The fund’s emerging manager program is not being examined.

The fund is already reducing its roster of private equity managers and chopping the allocation from 14% to 10%. CalPERS will emphasize cutting fund of fund of managers with a double layer of fees, according to a spokesman.

Many of the further changes will be incremental as the staff examines the portfolio, with cash flow status looming largely over decisions, Tollette says.

If more money is coming in than going out, a fund can generally wait out a bad market and pay benefits out of contributions. But that’s no longer the case at CalPERS, so managing volatility will be more important, Tollette adds.

Although investment guidelines do play a role in how pensions choose managers, a change of CIOs generally does influence how those guidelines are interpreted and enforced, says Davis Walmsley, v.p. of investment management at Greenwich Associates.

"Around the edges, how they [invest] is driven by the CIO and what they like and are the comfortable with," he says.

Reducing complexity will be a challenge in general as products and strategies become complicated and funds pursue avenues that can produce alpha in an expected lower return environment, he says.

A fund like CalPERS certainly has the staff to handle complexity, he says, adding that he is surprised to hear a move away from it.

"It really gets down to what you are trying accomplish," he says.

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