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**Testimony for House Bill 542
State Retirement and Pension System - Investment Committee - Use of Minority Business
Enterprises (Diversity Among Asset Managers Act of 2022)
House Appropriations Committee**

**February 17, 2022
3:00 P.M.**

**Andrew Palmer
Chief Investment Officer
State Retirement Agency**

The Board of Trustees for the State Retirement and Pension System (System) wishes to provide the Appropriations Committee with informational testimony regarding House Bill 542, State Retirement and Pension System - Investment Committee - Use of Minority Business Enterprises (Diversity Among Asset Managers Act of 2022). As introduced, this legislation requires the Investment Committee of the Board to use minority business enterprises to provide at least 20% of the brokerage and investment management services to the Board and to manage at least 20% of the assets of the System. However, since the introduction of House Bill 542, we have been informed by the sponsor that the bill will be amended to require that a disparity study be performed to determine if minority business enterprises (MBEs) are underutilized for purposes of investment management to the System. We have also been informed that additional amendments will be offered by the sponsor that will require, based on the findings of the disparity study, that consistent with its fiduciary duties, the Board shall continue to use to the greatest extent feasible, MBEs to provide investment management to the System. In light of these amendments to House Bill 542, we would like to take this opportunity to provide the Appropriations Committee with a brief overview of the efforts the Board and the Investment Division of the State Retirement Agency (Agency) have been making to address the issue of diversity regarding the investment program for the System.

The Board is committed to diversity, equity and inclusion in all aspects of the administration of the System. The System has long been considered a leader in promoting access and fairness in its manager selection processes. In 2007, the System initiated an emerging manager program to provide access to investment management opportunities for smaller firms that might not be identified through more traditional procurement practices. This program, expanded and transformed into the Terra Maria program in 2008, has resulted in significant representation of minority-owned firms through open access channels. The program expanded into private investments and facilitated a significant expansion of the use of large MBE-owned firms.

As of June 30, 2021, MBE firms managed 15.3% of total System assets. However, when looking solely at those assets that are externally managed, that percentage increases to 17.2%. These levels of minority

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participation place the System near the top among other large pension plans across the country. For perspective, minority-owned firms' share of System assets and brokerage was approximately 11% in 2015 and both have been higher than 20% in recent years. In any given year, the percentage is impacted by the effectiveness of specific managers, portfolio implementation needs of the System and the competitive landscape of the equity brokerage business. Two important aspects of implementation are the amount of assets managed by internal agency staff and the amount of assets managed by non-U.S. based managers.

One of the key initiatives of the System is to impact the net return available to beneficiaries by minimizing the fees paid to managers. A primary driver of this initiative is to manage assets directly, with internal staff based in Maryland. As of December 31, 2021, the System was internally managing directly \$9.3 billion in stocks and bonds representing 13.2% of assets.

The System, like most of its peers, is a global investor and partners with managers located outside of the United States to implement its asset allocation. The target allocation to non-U.S. stocks is 19% of the total fund. While the System employs U.S.-based companies to manage a significant portion of this percentage, including many minority-owned firms, several international managers are also utilized. Firms headquartered outside of the U.S. also manage assets on behalf of the System in private equity and real estate. For these strategies, it is important to have a physical presence in the local market to have a complete understanding of the investment opportunity set, regulations and customs. As an example, Asian private equity represents a significant portion of the System's benchmark and attractive investment characteristics like higher population and economic growth rates. Because of this, the System has invested in this sector with some managers located in Asia based on a demonstrated track record and specialized knowledge of the local markets. In many cases, minority managers in the U.S. do not offer these kinds of specialized products. As of December 31, 2021, international firms managed roughly \$11.2 billion for the System, representing 15.8% of the total fund.

Combined, the internal and non-U.S. manager segments of the portfolio sum to 29% of assets as of year-end, with the result that MBE managers were more than 21% of U.S. based external managers.

Access for smaller and MBE firms have historically been challenged by traditional procurement processes driven by consultants. With the Investment Division's leadership, the System's public and private market consultants developed expertise in evaluating emerging managers and sponsored conferences and education sessions for their clients regarding current trends in the emerging and diverse manager industry. In addition to the role of consultants, the hiring practices of many asset owners did not maximize access for small and minority owned businesses. In responses, the Investment Division took specific actions to promote access including:

- providing direct access to both Investment Division staff and the System's consultants and program managers on the Agency's website,
- participating on advisory boards and attending emerging manager conferences,
- speaking at industry events relating to diversity in asset management, and
- hosting diverse managers at events to introduce them to Maryland-based investors.

Dana Johns, a Senior Portfolio Manager on the System's private equity team, is the chair of the Investment Division's Diversity, Equity and Inclusion Committee. Examples of her activities and the industry's recognition for her work on diversity, equity and inclusion can be found in Attachment A. Ms. Johns has been supported in this work by the Chief Investment Officer for the System and other Investment Division staff where they could be most effective.

Through its work in implementing the Terra Maria program, the Investment Division gained a deeper appreciation of the importance of diversity of thought in the investment process, itself. Staff found a disconnect between its focus on MBE managers and the diversity policies and hiring practices of most of the System's non-MBE managers. After 10 years of working to promote diversity through the manager hiring practice, it was apparent that there was little change in the hiring practices of the domestic investment industry. The CIO created the Diversity, Equity and Inclusion Committee in 2017 to provide focus on these issues for the Investment Division, its managers and their investments. The work of that Committee has focused on improving the recruitment and retention practices of the Investment Division and working with managers to improve their use of diversity as an enhancement to their process and products.

Within the Investment Division the Diversity, Equity and Inclusion Committee:

- arranged for two rounds of diversity training on the topics of unconscious and implicit bias that were expanded to the entire Agency;
- worked to revamp the job posting and advertising processes for the Investment Division to ensure inclusive language that encouraged applications from as large and diverse a pool as possible;
- established the practice to have a Committee member participate in every hiring process;
- established contacts with local universities to facilitate recruitment of interns and associates;
- developed an associates program to provide training for junior staff in the Investment Division;
- made a presentation to Morgan State finance students on pension investing;
- began a relationship with United Negro College Fund to expand its Lighted Pathways internship program to Maryland; and
- led the procurement for the services of Lenox Park.

Lenox Park will provide a more comprehensive and accurate assessment of the System's diversity at the manager level and within the total fund. Each manager, minority- and majority-owned, will be asked to complete a diversity survey and will be assigned an impact score. This score will be compared to an industry average and serve as a starting point for conversations regarding the managers' diversity and inclusion policies and how these policies can be strengthened to better promote diversity objectives.

The Board and the Investment Division are committed to promoting diversity and inclusion in everything they do. The Terra Maria program is a recognized leader in the industry for providing access and opportunities to minority-owned firms, and the System's current level of diversity is among the highest among its peer group. The Board and Investment Division believe there are more holistic ways to advance diversity objectives and are in the process of implementing a program that will have greater reach and deeper impact than one focused solely on firm ownership.

We would like to conclude by thanking the sponsor of the bill for reaching out to the State Retirement Agency regarding House Bill 542 and meeting with us to discuss the efforts the Board and the Investment Division have made in the area of diversity with regard to the System's investment program. We also appreciate being given the opportunity to share this information with the Committee and stand ready to provide any further information or services the Committee might request.

ATTACHMENT A

Dana Johns, Senior Portfolio Manager and Chair of the Investment Division's Diversity Equity Inclusion Committee

Ms. Johns is a recognized leader in this area and is involved in several industry organizations:

- Private Equity Women Investor Network (PEWIN) - Co-Chief Executive Officer
- Institutional Limited Partner's Association (ILPA) - Diversity & Inclusion Advisory Council
- Academy for Institutional Investors Editorial Committee
- AIF Women's Leadership Steering Committee
- SEO - Alternative Investments Limited Partner Advisory Council

Industry recognition in 2021 highlighted Ms. Johns' work in transforming the private equity industry with a focus on diversity, equity and inclusion:

- Institutional Investor's Global List of Top 50 Women in Investment Management
- Trusted Insight's list of Top Public Pension Investors Directors
- PEWIN's Member of the Year 2021

PEWIN North American LP Award 2018 and 2020 for transforming the private equity industry by supporting increased diversity

- Invest in next generation funds that are led by women fund managers
- Organized forum for MSRA CIO to meet with prospective diverse fund managers
- Active participation in Project Pinklight, providing guidance to experienced female fund managers who are raising their first or second fund

ILPA Diversity in Action Framework

- Ms. Johns led the process for the Investment Division to become a signatory to the ILPA Diversity in Action

Ms. Johns has raised the visibility of the System and made it an attractive limited partner for difficult to access managers through her participation in industry events.

- Texas TRS/ERS Emerging Manager Conference
- New York State Common Emerging Manager Conference
- ILPA GP Summit - Emerging Manager Meetings
- NAIC LP Meetup
- SEO AICON
- New America Alliance CIO and Asset Class Connection
- PEWIN Pinklight Project
- ILPA Diversity in Action Initiative
- Sahar Global Summit – Gender Equity in Private Equity Summit
- RFK Compass Investor Roundtable
- Big Path Capital – Impact & Diversity PE Manager Showcase
- Women's Private Equity Summit
- MFA Network 2022

UpSurge Baltimore – Equitech 2030 – Co-Leader on the Government & Policy Team

- Ms. Johns educated and expanded local investment partner relationships through her Maryland In-State investment outreach

Lenox Park Solutions

- Ms. Johns led the RFI evaluation process to hire Lenox Park Solutions which provides DEI Assessment Tools and Scores for all surveyed external managers in the System network