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December 13, 2019


The Honorable Holly J. Mitchell
Chair, Joint Legislative Budget Committee
1020 N Street, Room 553
Sacramento, California 95814

Dear Senator Mitchell:

Pursuant to Section 92603 of the Education Code, enclosed is the University of California's report to the Legislature on *Office of the Chief Investment Officer Diversity*.

If you have any questions regarding this report, Associate Vice President David Alcocer would be pleased to speak with you. David can be reached by telephone at (510) 987-9113, or by email at David.Alcocer@ucop.edu.

Yours very truly,


Janet Napolitano
President

Enclosure

cc: Senate Budget and Fiscal Review
The Honorable Richard D. Roth, Chair
Senate Budget and Fiscal Review Subcommittee #1
(Attn: Ms. Anita Lee)
(Attn: Ms. Jean-Marie McKinney)

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The Honorable Kevin McCarty, Chair
Assembly Budget Subcommittee #2
(Attn: Mr. Mark Martin)
(Attn: Ms. Carolyn Nealon)

Ms. Jennifer Troia, Joint Legislative Budget Committee

Ms. Erika Contreras, Secretary of the Senate

Ms. Tina McGee, Legislative Analyst's Office

Ms. Amy Leach, Office of the Chief Clerk of the Assembly

Mr. E. Dotson Wilson, Chief Clerk of the Assembly

Mr. Jeff Bell, Department of Finance

Mr. Chris Ferguson, Department of Finance

Ms. Rebecca Kirk, Department of Finance

Ms. Tina McGee, Legislative Analyst's Office

Mr. Gabriel Petek, Legislative Analyst Office

Ms. Jennifer Pacella, Legislative Analyst Office

Mr. Jason Constantouros, Legislative Analyst Office

Provost and Executive Vice President Michael Brown

Vice Provost Susan Carlson

Interim Executive Vice President and Chief Financial Officer Paul Jenny

Senior Vice President Claire Holmes

Vice Provost and Chief Outreach Officer Yvette Gullatt

Vice President and Chief Investment Officer Jagdeep Bachher

Associate Vice Provost Elizabeth Halimah

Associate Vice President David Alcocer

Associate Vice President and Director Kieran Flaherty

UNIVERSITY OF CALIFORNIA

Office of the Chief Investment Officer Diversity Report

The University of California provides the following report in response to Section 92603 of the Education Code (Added by Stats. 2018, Ch. 912, Sec. 2.), which states:

(a) The regents are urged to direct their Office of the Chief Investment Officer (OCIO) to do all of the following:

(1) Use reasonable efforts to encourage diversity, such as implementing a hiring strategy that requires that candidates from underrepresented groups be given full consideration whenever an OCIO position is to be filled.

(2) Request partner firms it invests in use reasonable efforts to encourage diversity, such as implementing a hiring strategy that requires that candidates from underrepresented groups be given full consideration whenever a position is filled.

(3) Launch an emerging manager program. The OCIO shall define the term “emerging manager” for the purpose of this section.

(4) Encourage startup firms to increase efforts to develop diverse executive teams and to recruit diverse managerial talent, as applicable.

(b) The OCIO shall submit a report to the chairs of the appropriate policy committees of each house of the Legislature, on or before January 1, 2020, describing its progress addressing the requirements of the regents set forth in subdivision (a). The report shall also include pertinent statistics setting forth the OCIO’s internal diversity metrics. The report required by this section shall comply with Section 9795 of the Government Code.

(c) Nothing in this section shall require the regents or the OCIO to take action that is inconsistent with its fiduciary duties.

Summary

This report describes the progress that UC Investments has made in 2019 to further diversity and inclusion. As part of the University of California, UC Investments is fully committed to diversity and inclusion, recognizing the inherent benefits of both. Diversity is one of the eight pillars of UC Investments’ Framework for Sustainable Investing, which we adopted in 2015.

While we have more work to do, we have made significant progress in advancing diversity in our workforce and among our investment partners. We designed a holistic and innovative diversity strategy that we began implementing in 2019. UC Investments adopted several best practices in recruiting and hiring. We have engaged in dialogue with our investment partners around their diversity and inclusion policies, programs and metrics, and developed baseline data regarding the demographics of our partner firms. While diversity among our investment partners is greater

than the aggregate national numbers for the asset management industry, UC Investments has the opportunity to increase our access to top performing firms owned by women, African Americans and Latinx. To do so, we designed a program we call “Diversified Returns,” which we will begin implementing in 2020. To gain more knowledge and expand our networks, UC Investments also participated in numerous third-party “emerging managers” conferences and established formal relationships with associations of women and minority investment professionals.

Beginning in 2020, we will prepare an annual report on our diversity and inclusion (“D&I”) strategy and progress and share it with the University of California Board of Regents and interested members of the public.

Background

As part of the University of California, UC Investments is fully committed to diversity and inclusion. As stated in U.C. Regents Policy 4400:

The diversity of the people of California has been the source of innovative ideas and creative accomplishments throughout the state’s history into the present. Diversity – a defining feature of California’s past, present, and future – refers to the variety of personal experiences, values, and worldviews that arise from differences of culture and circumstance. Such differences include race, ethnicity, gender, age, religion, language, abilities/disabilities, sexual orientation, gender identity, socioeconomic status, and geographic region, and more.

[The University of California is committed] to the full realization of its historic promise to recognize and nurture merit, talent, and achievement by supporting diversity and equal opportunity in its education, services, and administration, as well as research and creative activity. The University particularly acknowledges the acute need to remove barriers to the recruitment, retention, and advancement of talented students, faculty, and staff from historically excluded populations who are currently underrepresented.

Diversity is one of the eight pillars of UC Investments’ Framework for Sustainable Investing, adopted in 2015. This framework recognizes the social, economic and environmental benefits of diversity at all levels of our society. Since putting the framework in place we have sought to broaden our knowledge about D&I, an effort that has been informed by two recently published landmark studies.

The first, known as the Knight Foundation study, reported comprehensive findings on diversity in the asset management industry.¹ The Knight Foundation study definitively debunked the myth

¹ See, “Diversifying Investments: A Study of Ownership and Performance in the Asset Management Industry,” Lerner, Josh et al., 2019. <https://knightfoundation.org/reports/diversifying-investments-a-study-of-ownership-diversity-and-performance-in-the-asset-management-industry/>

that diverse owned firms (defined as firms that are at least 25 percent owned by women or racial/ethnic minorities) underperform compared to their non-diverse peers. It found that diverse owned firms were over-represented in the top quartile of fund investment performance in the public equity, private equity and hedge fund asset classes.² Its analysis of hundreds of firms found that in those three asset classes, there was no statistically significant difference in returns between funds managed by diverse firms and those managed by non-diverse firms.³

Yet, despite the performance of diverse-owned asset management firms, the Knight Foundation study also found that, aggregating across public and private equity, hedge funds and real estate, firms whose ownership is greater than 25% female or minority account for just 1.3% of the \$69.1 trillion in assets under management (AUM) in the United States.⁴

Later in 2019, the Proceedings of the National Academy of Sciences published a study which found, among other things that “evidence of racial bias in the investment decisions of asset allocators . . . could contribute to stark racial disparities in institutional investing.”⁵ This study went on to find that “these results suggest first that underrepresentation of people of color in the realm of investing is not only a pipeline problem, and second, that funds led by people of color might paradoxically face the most barriers to advancement after they have established themselves as strong performers.”⁶

Executive Leadership

Successful diversity and inclusion efforts share a key characteristic: strong executive leadership. Jagdeep Singh Bachher, chief investment officer of the University of California, is deeply committed to catalyzing D&I within his team and among the institution’s investment partners. In 2019, he took several steps in furtherance of his commitment, starting with adding D&I to his 2020 performance goals. In addition, the CIO named his chief operating officer Arthur R. Guimarães responsible for leading UC Investments’ diversity and inclusion work. In 2019, a new, senior professional level position was created to further develop our D&I programs and Wendy Pulling was hired to fill the position. The CIO also formed a diversity advisory committee, consisting of innovative leaders from the private and non-profit sectors, as well as the provost of the University of California. Topics discussed by the committee in 2019 included, for example, potential partnerships among UC Investments and third parties to promote financial literacy among UC students of color; how UC Investments can leverage the diversity and inclusion programs already in place at UC; and how UC Investments can develop scalable approaches that facilitate exposure of women and minorities to careers in the finance industry.

² Ibid., at 6.

³ Ibid., at 3.

⁴ Ibid., at 5.

⁵ Lyons-Padilla, et al., “Race influences professional investors’ financial judgment,” Proceedings of the National Academy of Sciences at 17225. www.pnas.org/cgi/doi/10.1073/pnas.1822052116

⁶ Id.

Diversity on the UC Investments Team

The business case for diversity is clear and compelling: academic and corporate research establishes that diverse and inclusive teams perform better than homogeneous teams. Investing is a team sport at UC, and the cognitive diversity that comes with diverse backgrounds and experiences is a competitive advantage. While UC Investments has long been committed to diversity among its employees, in 2019, we took important steps to make that commitment more systematic and to incorporate best practices in recruiting and hiring.

Recruiting and Hiring

One of the recommended best practices in advancing diversity and inclusion in hiring is to use structured, consistent hiring processes. In 2019, UC Investments hired a dedicated HR specialist charged with systematizing our hiring processes. As a result, UC Investments now systematically:

- Develops clear core competencies before beginning a search to determine the qualities that ideal candidates should offer and compares all prospects against the same list.
- Asks each candidate the same interview questions.
- Focuses the interview questions on factors that directly affect job performance.
- Has the same people interview all candidates so prospects can be consistently and fairly assessed.

Pilot to Require Diverse Candidate Pool in Hiring and Recruiting

To reap the benefits of diversity in the workplace, leading employers often start by ensuring a large, diverse pool of talented candidates. One way to do so is to require that candidate pools be diverse before the hiring process may advance. In 2019, UC Investments piloted the use of such a requirement in one of our asset classes. The hiring manager, a senior managing director, worked with our dedicated HR specialist to post the position and publicize it with diverse investment professional associations. The applicant pool was gender and racially diverse and the hiring manager proceeded with the hiring process. He then assembled a diverse hiring panel to interview candidates. The finalist pool was also diverse. In addition, UC Investments successfully piloted this approach for a management role in the Operations department.

Our pilot demonstrated that intentionality and access to expanded networks can yield diverse, highly qualified candidate pools. Going forward, we will use the approach across all open positions at UC Investments. The chief operating officer will develop and track metrics to measure our adherence to – and hold managers responsible for – ensuring a diverse candidate pool for open positions.

Studies show that internal teams tend to refer people who are similar to themselves in terms of race, education, and background, which can contribute to maintaining a homogenous workforce; thus, reaching beyond personal networks is key to assembling a diverse candidate pool. UC Investments recognizes the importance of expanding recruiting networks and will systematically

partner with professional associations targeting the inclusion and development of women and people of color and take other steps to reach under-represented talent pools.

Starting in 2020, UC Investments will also create an internal diversity and inclusion workgroup, led by the chief operating officer, which will develop additional recommendations for recruiting, hiring and inclusion best practices. The workgroup will consider, for example, ensuring that all interview panels include women; using software products to ensure position descriptions are inclusive; leveraging the expertise of UC’s faculty and administration to advance D&I at UC Investments; requiring unconscious bias training for hiring managers; and establishing metrics for D&I in hiring managers’ goals.

Internal Diversity Metrics

UC Investments’ workforce diversity statistics (by gender and race) over the past five years are summarized in the tables on the following page and are up to date as of April 2019. We intend to track and report UC Investments’ employee demographics trends annually.

Table 1: UC Investments Workforce Diversity Trends

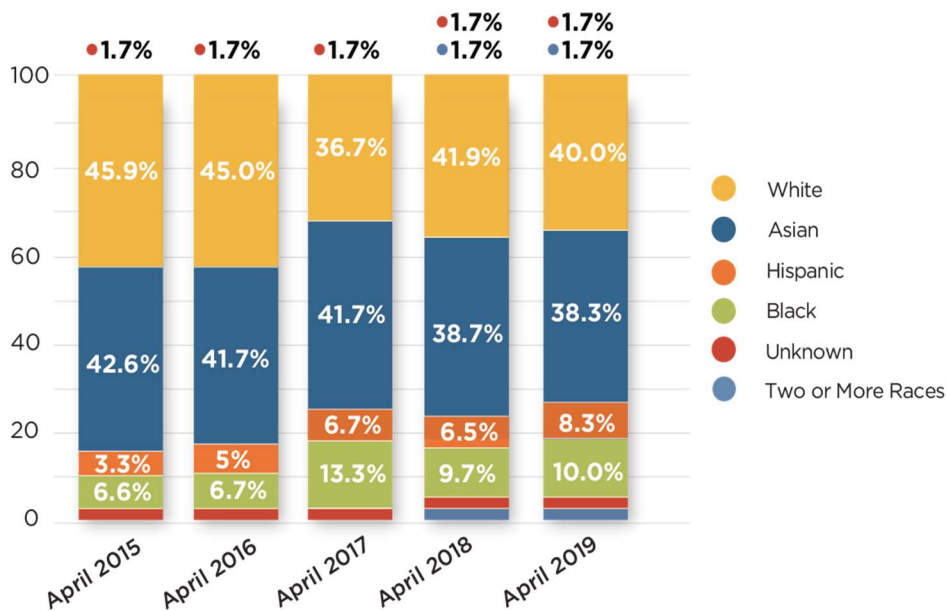
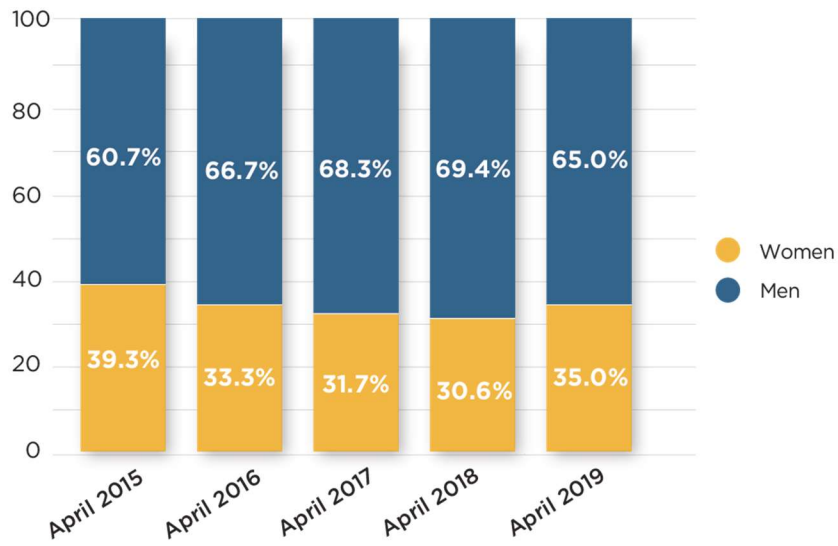


Table 2: UC Investments Workforce Diversity Trends



UC Investments' 60 employees are roughly evenly split between investment professionals and those who work in Operations, Risk and Treasury. The tables below provide the racial and gender demographics of the investment team and the three other teams as of April 2019.

Table 3: UC Investments Workforce Diversity by Job Type

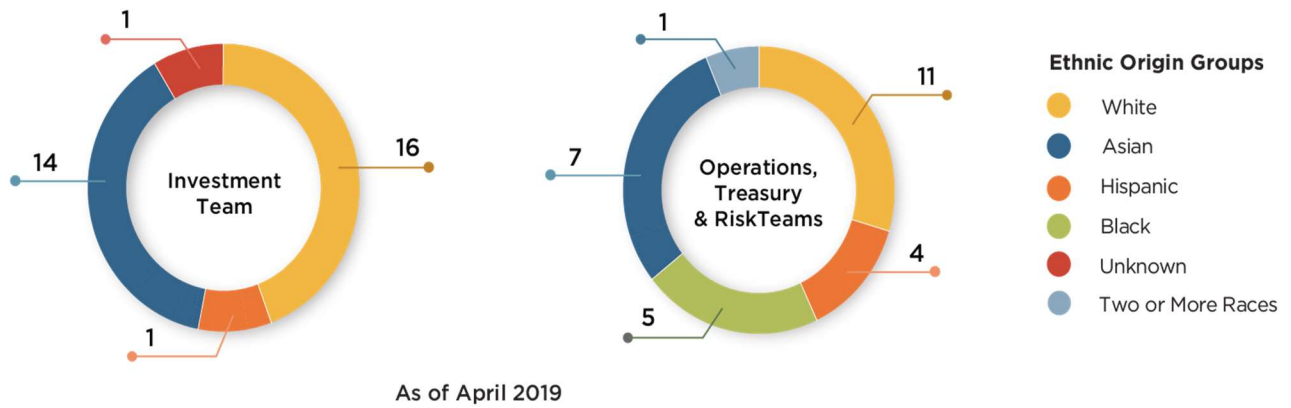


Table 4: UC Investments Workforce Diversity by Job Type



Partner Firms

UC Investments' small team leverages its market opportunities by partnering with third party investment partners across all asset classes. Engaging with our existing investment partners around D&I is critical to advancing it in the broader marketplace. Women and people of color who end up founding their own funds often start their careers at big, established asset management firms, including several of our existing investment partners. These established firms play an important role in developing a pipeline of diverse talent.

To communicate the importance of diversity and inclusion to our investment partners, UC Investments implemented a multi-pronged strategy in 2019, as outlined below.

Demographic Survey

In 2019, we undertook the first ever demographic survey of our investment partners in every asset class. We set out to answer two questions in particular:

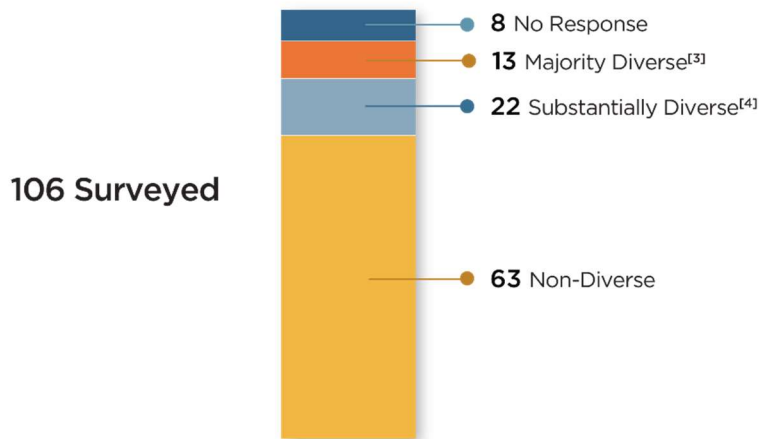
1. What percentage of our assets under management is managed by women or diverse populations?
2. How many of our investment partners are firms owned or led by women or diverse populations?

Because we were not satisfied with the mainstream institutional investor approach to collecting the data needed to answer these two questions, we developed our own approach. To gather high quality, comprehensive data, we needed to achieve a high response rate, which in turn meant we needed to eliminate obstacles to responding, including potential respondents' concerns about privacy.

Our first step was to define diversity. UC Investments' definition spans multiple dimensions: gender and gender identity, race and ethnicity, sexual orientation, veteran status, and disability status.

Survey Results: We achieved a 92% response rate to our survey, representing 98% of the assets surveyed. Out of 106 investment partners surveyed, 35 are substantially or majority diverse or woman owned.

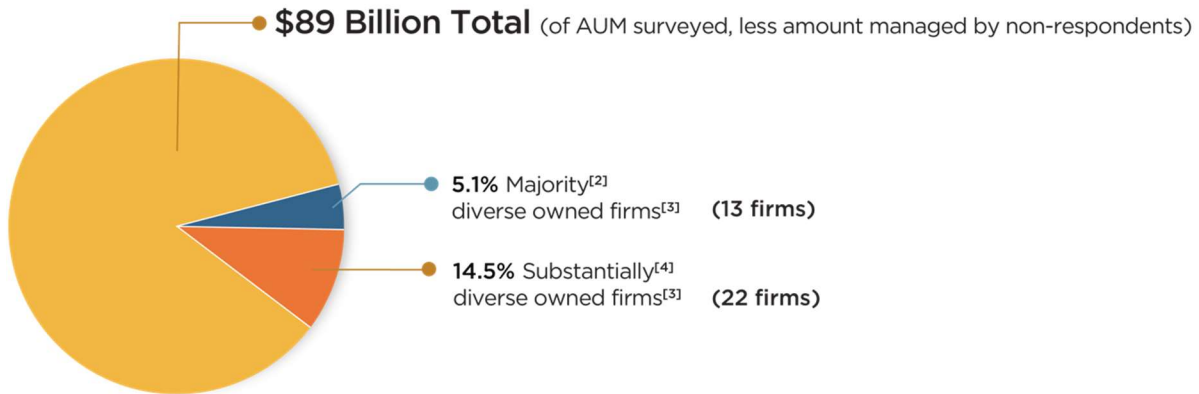
Table 5: Number of Diverse^[1]-owned^[2] Investment Partners



[1] UC Investments' survey defines "diverse", to include: women, Latinx, Native American, Black, Asian/Pacific Islander, LGBTQ, veteran and disabled.
[2] For the purposes of this chart, "diverse-owned" covers both ownership of private companies and leadership of the teams managing UC's investments at public companies.
[3] "Majority Diverse" means 50% or more diverse-owned.
[4] "Substantially Diverse" means 25-50% diverse-owned.

In reporting and aggregating the data, we tracked the same two ownership/leadership thresholds – 25% and 50% - that the Knight Foundation report tracked. As the tables below indicate, substantially or majority diverse or woman owned investment partners manage 19.6% of the AUM surveyed. While diversity among our investment partners is significantly greater than the aggregate national numbers reported by the Knight Foundation, UC Investments has the opportunity to earn more diversified returns, particularly from firms owned by women, African Americans and Latinx.

Table 6: Diversity^[1] as a Percentage of AUM



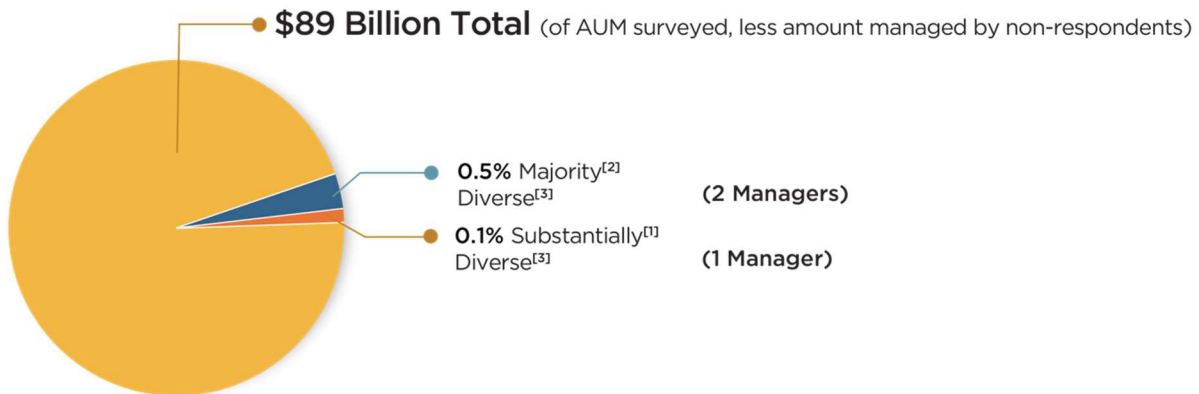
[1] UC Investments' survey defines "diverse", to include: women, Latinx, Native American, Black, Asian/Pacific Islander, LGBTQ, veteran and disabled.

[2] "Majority Diverse" means 50% or more diverse-owned.

[3] For the purposes of this chart, "diverse-owned" covers both ownership of private companies and leadership of the teams managing UC's investments at public companies.

[4] "Substantially Diverse" means 25-50% diverse-owned.

Table 7: Percentage of AUM Managed by Black-Owned Investment Partners

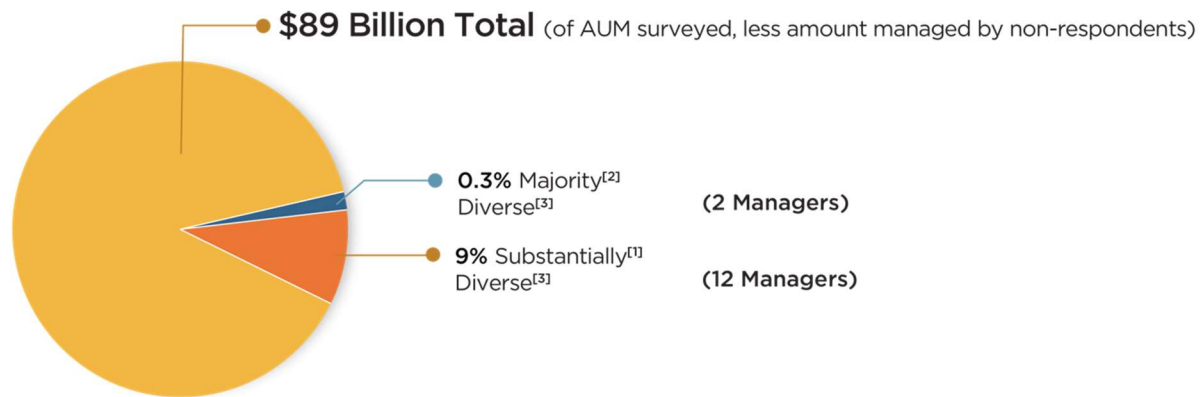


[1] "Substantially Diverse" means 25%-50% diverse-owned.

[2] "Majority Diverse" means 50% or more diverse-owned.

[3] For the purposes of this chart, "diverse-owned" covers both ownership of private companies and leadership of the teams managing UC's investments at public companies.

Table 8: Percentage of AUM Managed by Women-Owned Firms

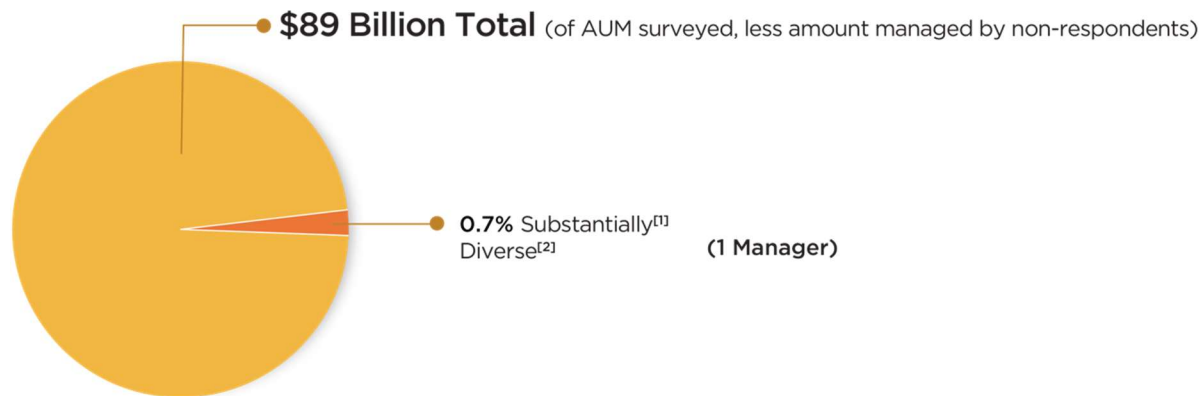


[1] "Substantially Diverse" means 25%-50% diverse-owned.

[2] "Majority Diverse" means 50% or more diverse-owned.

[3] For the purposes of this slide, "diverse-owned" covers both ownership of private companies and leadership of the teams managing UC's investments at public companies.

Table 9: Percentage of AUM Managed by Latinx-Owned Investment Partners



[1] "Substantially Diverse" means 25%-50% diverse-owned.

[2] For the purposes of this chart, "diverse-owned" covers both ownership of private companies and leadership of the teams managing UC's investments at public companies.

In addition to the data summarized in tables 5 through 9, our survey results also found that a fractional amount of our AUM surveyed is managed by LGBTQ owned and military veteran owned investment partners. We received no responses to our question about disability status and therefore have no data to report.

Survey Methodology: To gather comprehensive data, we designed our survey to cover both privately and publicly owned investment partners. For privately owned firms, we asked about the demographics of their ownership, broken down by individual ownership percentages. For publicly owned firms, we asked about the demographics of the decision makers on the team managing UC's investments.

We designed the survey to be anonymous and confidential. A third-party survey administrator compiled the survey responses and aggregated the data across diversity dimensions and asset classes, per our instructions.

We surveyed our investment partners across all asset classes and covering the following products: General Endowment Pool, UC Retirement Program, UC Retirement Savings Plan and the Total Returns Investment Pool. Our survey covered roughly \$91 billion – or 72% - of UC Investments' \$126 billion AUM. However, the diversity percentages are calculated using \$89 billion, which is the surveyed amount less the amount managed by non-respondents.

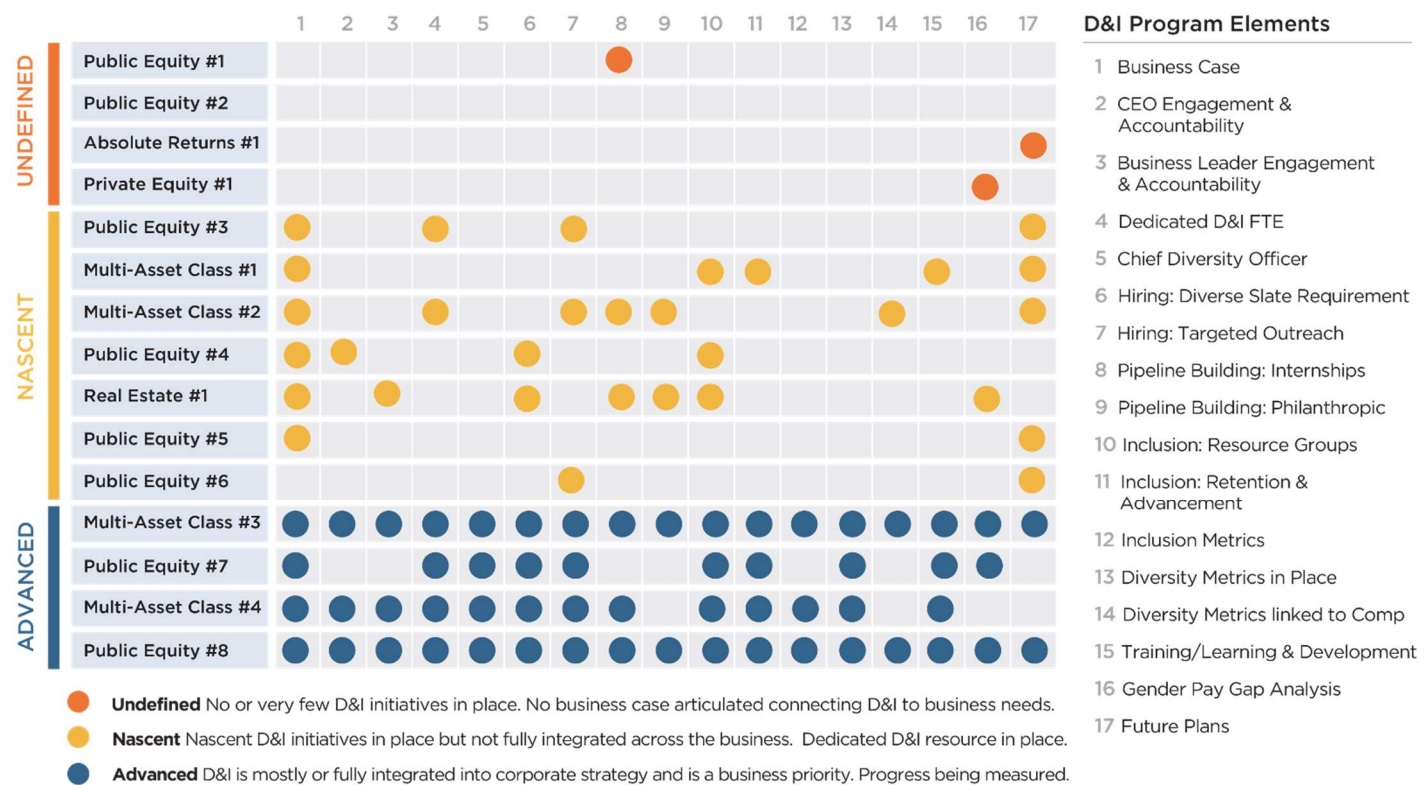
Not included in the survey were products and asset classes that UC Investments manages internally (i.e., Fiat Lux, Blue & Gold, Short Term Investment Pool and part of Fixed Income). Furthermore, we did not survey investment partners headquartered outside of the United States and those whose relationship with UC Investments was scheduled to end in 2019. We excluded firms headquartered outside of the US (responsible for managing roughly 5% of our AUM) because designing a survey that complied with myriad foreign laws was a “bridge too far” in the first year of our demographic survey.

Qualitative Interviews

In 2019, UC Investments initiated a conversation with our investment partners around diversity and inclusion. We sought to let our investment partners know that UC Investments places a priority on D&I and to learn how our partners were themselves engaging on D&I. Our conversations covered a range of topics including, but not limited to, the firm's business case for diversity; the firm's approach to recruiting, hiring and promoting diverse talent; programs for expanding the diverse talent pipeline; metrics linking D&I performance to compensation; and programs in place for fostering an inclusive workplace.

Out of the 106 investment partners surveyed, we selected 30 with whom to dialogue directly. 15 of those 30 firms manage more than half our total AUM; the other 15 are a representative cross-section of the firms that manage the rest of our AUM. Table 10 displays what we learned in our first 15 interviews, with the high-level information anonymized and broken down by asset class. Relative to one another, most of these 15 firms have diversity and inclusion programs that we view as nascent, while four of the 15 have programs we view as advanced and the remaining four have little to no program elements in place to advance D&I at their firms. As of this writing, we are in the process of interviewing the remaining 15 investment partners.

Table 10: Summary of D&I Approaches at 15 Investment Partner Firms



Going Forward: With its baseline now established, UC Investments will track the demographics of our investment partners – and make the results public – annually. We will track our results over time, since the trend line, rather than the baseline, is the critical indicator of progress. In addition, we plan to engage in a D&I dialogue with our investment partners annually and to make what we learn public. We will incorporate the demographic survey and the D&I conversations as part of our standard operating procedure and will consider taking other reasonable steps, as needed, to encourage diversity and inclusion among our investment partners.

“Diversified Returns” Program

To advance our learning and expand our networks, members of the UC Investments team participated in numerous “emerging managers” conferences organized by third parties, including GCM Grosvenor, Texas Teachers Retirement System and the Hispanic Heritage Foundation. UC Investments also established formal relationships with associations of minority investment professionals such as the NAIC, New America Alliance and Asian American Association of Investment Managers. We researched “emerging manager” and diverse manager programs at public pension funds, public university endowments and private foundations, looking for ingredients of success and of failure. We read relevant academic and other research and followed with interest the proceedings of the newly created House Financial Services Committee Sub-Committee on Diversity and Inclusion.

We learned that the term “emerging manager” does not do justice to the talented women and minority owned investment management firms that may, or may not be, small or new. The term may connote inexperience and may not respectfully characterize seasoned female and minority fund managers whom asset allocators across the US have overlooked.

Starting in 2020, UC Investments will launch our “Diversified Returns Program” in order to access the superior returns often associated with firms owned or led by women and people of color. Diversified Returns will consist of three pillars. The first pillar is to ensure a diverse pool of qualified potential partners in all of our searches for investment partners. The annual performance goals of each asset class leader will link to this new approach. UC Investments will also use this approach when searching for other potential partners in the Operations, Risk and Treasury areas of our organization.

The second pillar of Diversified Returns is tracking and reporting the demographics of our investment partners and comparing it to the baseline we created in 2019. We will make this information public annually.

Finally, given the findings of the “Race influences professional investors’ financial judgment” study, the third pillar of UC Investments’ Diversified Returns program will identify and address cognitive racial and gender biases in our investment processes. The study recommends that institutional investors train their teams “to overcome their biases by revamping their investment criteria and strategies and ensuring they are knowledgeable about the success of firms led by people of color.”⁷ To our knowledge, there are no off-the-shelf processes available in the marketplace, so we will develop a comprehensive approach, potentially in partnership with leading academics and other interested asset owners. Overcoming the cognitive racial and gender biases present in the investing process will take commitment, persistence and patience. This is a systemic issue, not limited to UC Investments. Going forward, we commit ourselves to taking action, measuring our results and sharing our work with the public.

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⁷ Lyons-Padilla, et al. at 17229.