



Agenda Item 5a

August 13, 2012

ITEM NAME: Revision of the Statement of Investment Policy for Consultant Conflict of Interest

PROGRAM: Investment Compliance and Operational Risk

ITEM TYPE: Policy & Delegation – Action

RECOMMENDATION

Approve the revised CalPERS Statement of Investment Policy for Conflicts of Interest (“the Policy”) developed by Investment Staff in connection with their review of existing policies and processes for reporting and evaluating potential conflicts of interest. Staff recommends expanding the applicability of the Policy to include all external managers, general partners and other participants selected by CalPERS to provide investment management or investment advisory services related to the administration of its investment policy (“External Investment Resources”). Additionally, change the name of the Policy from “CalPERS Statement of Investment Policy for Consultant Conflict of Interest” to “Statement of Investment Policy for External Investment Resource Conflict of Interest.” A copy of the current Policy with proposed revisions is provided as Attachment 1.

EXECUTIVE SUMMARY

This agenda item provides the analysis and recommendation to make the Statement of Investment Policy for Consultant Conflict of Interest (the “Policy”) applicable to all External Investment Resources, who could have economic or personal interests that may not be fully aligned with CalPERS and therefore may be unable to provide impartial information or advice to CalPERS. The policy governs disclosure and evaluation of circumstances that may create actual, potential or perceived conflicts of interest or bias (Disclosable Interests). It also highlights an improved process to implement the Policy.

BACKGROUND

Currently, the Policy adopted by the Investment Committee in 2005, and amended in 2009, applies only to Consultants. The Policy does not apply to External Managers or other entities, e.g. General Partners, who may have Disclosable Interests.

To comply with the Policy, Staff have sent out various non-standard communications to Consultants, but not External Managers or General Partners, inquiring as to the existence of any Disclosable Interests and reviewed with each Consultant all Disclosable Interests. The process for collecting information pertaining to Disclosable Interests has been inconsistent among asset classes, and there has not been a

consistent process across the Investment Office for evaluating the information received.

ANALYSIS

Investment Compliance and Operational Risk (ICOR) staff reviewed the processes for collecting and evaluating information pertaining to Disclosable Interests across the Total Fund. In addition to the obligations under the Policy, there are provisions of California state law and CalPERS standard contractual agreements that require entities doing business with CalPERS to identify in writing the circumstances and nature of all Disclosable Interests.

In addition, all registered investment advisers and pension consultants are required to file the United States Securities and Exchange Commission ("SEC") Form ADV, Parts 1 and 2 ("Form ADV"). All of our U.S. domiciled External Managers and Pension Consultants are registered with the SEC, and a majority of our General Partners have a registered investment adviser. These External Managers and some of our General Partners already provide their Form ADV to CalPERS.

The instructions to Part 2 of Form ADV provide, in part, that the Adviser must "provide the client with sufficiently specific facts so that the client is able to understand the conflict of interest [the Adviser has] and the business practices in which [it engages], and can give informed consent to such conflicts or practices or reject them." The Form ADV is provided as Attachment 2.

Although there have been multiple processes for collecting disclosure information, there was no integrated review, evaluation or monitoring of disclosure-related documents, or a single point of accountability for these processes in the Investment Office. In addition, the Form ADV's of the External Investment Resources were not reviewed as part of the conflict disclosure process. Ownership of this process has now been clearly established within ICOR. In addition, instead of sending a separate communication, the Investment Office will rely on the Form ADV. The Policy is being revised to conform to the instructions of Form ADV.

In late March 2012, ICOR sent out a survey to approximately 360 Consultants, External Managers and General Partners to confirm their reporting obligations with respect to Form ADV. For CalPERS External Investment Resources that are required to file a Form ADV, ICOR staff will use the Form ADV as the primary disclosure document for determining whether staff should obtain additional information, or conduct a review with an External Investment Resource. Staff will review the Form ADV and compare it to all other state or contractual documentation provided by the External Investment Resource related to Disclosable Interests (e.g. Form 700, Placement Agent Information Disclosure Form).

For any Consultants or External Managers that are not required to file a Form ADV, Staff will send the relevant questions from the Form ADV to the External Investment

Resource and review any other documentation related to Disclosable Interests. For all Consultants who do not provide investment management or investment advisory services, ICOR will review the state and contractually mandated disclosure documentation.

BENEFITS/RISKS

By having ICOR be accountable for coordinating the review of all conflict disclosure documentation and having a consistent procedure for all External Investment Resources, staff will be able to analyze the cumulative effect of any Disclosable Interests across the Total Fund. By relying on the Form ADV information instead of a separate communication, the conflict collection, review, evaluation and monitoring will be consistent and efficient. In addition, instead of relying on a communication sent to whoever is identified as the contact person for the External Investment Resource, Staff will be relying on the Form ADV, which is filed with the SEC after a rigorous process including review by, and usually a signature of, the Chief Compliance Officer. This analysis and consolidation of information is anticipated to lower the risk that CalPERS will receive biased information or advice from its External Investment Resources.

ATTACHMENTS

- Attachment 1 – Statement of Investment Policy for Consultant Conflict of Interest with proposed revisions
- Attachment 2 – SEC Form ADV, Part 2
- Attachment 3 – Consultant Opinion Letter

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