



## Agenda Item 6a

December 10, 2012

**ITEM NAME:** Adoption of the Global Equity Program Policy and Repeal of Legacy Policies

**PROGRAM:** Global Equity

**ITEM TYPE:** Policy & Delegation – Action

### **EXECUTIVE SUMMARY**

This agenda item is a follow-up to the first reading of the Global Equity Policy (GE Policy) presented at the November 13, 2012 Investment Committee meeting. At the November meeting, several questions were raised about specific aspects of the GE Policy. Staff and Wilshire Associates have had multiple discussions leading to revised language related to some of the specific risk parameters and new glossary definitions.

Additional changes were suggested by an array of Investment Office (INVO) staff and these have been incorporated where appropriate.

### **STRATEGIC PLAN**

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability. The adoption of a clear, updated, and unified GE Policy will enhance CalPERS ability to achieve the System's investment objectives.

### **BACKGROUND**

The review and consolidation of Global Equity investment policies continues to constitute an important step in the ongoing restructure of the asset class. The legacy policy documents contain a significant amount of procedural language as well as restate some of the parameters contained in other INVO policies such as those dealing with derivatives and leverage. The development of the new GE Policy has been undertaken in conjunction with a comprehensive investment procedure review and update effort within the asset class. The new GE Policy reflects the refinement of multiple processes and objectives within the Global Equity Program.

### **ANALYSIS**

Key elements within the new GE Policy include:

- Refocusing the policy language to the entire asset class and away from sub-segments and strategies
- Incorporation of risk targeting or budgeting concepts
- A process to evaluate the effects of any explicit investment threshold being breached and to take action as necessary

- Recognition that monitoring various aspects of the asset class thresholds occurs not only within the Global Equity asset class, but also within the INVO Risk Management and Investment Compliance teams
- Uniform categorization of strategies as either “index” (managed within a 50 basis point tracking error threshold) or “active” for strategies with tracking error greater than 50 basis points.

Following the first reading of the GE Policy, specific sections of the proposed Policy were modified to address comments from Wilshire Associates. Additional information on the specific changes per section is included below:

1. Section V.B.3 Asset Class Tracking Error – In the original proposed policy, a limit on forecast tracking error of 75 basis points was included. Wilshire Associates questioned this limit as effectively doubling the degree of active risk currently being deployed in the asset class. This risk parameter has been changed to a target range of 25 to 50 basis points of forecast tracking error. As Global Equity redefines our capabilities and processes relative to active risk taking, should a larger range appear warranted, staff will return to the Investment Committee for additional discussion.
2. Section V.B.5 Notional Leverage – The original language focused more on derivatives than leverage. This language has been altered to explain how derivatives may create leverage and what limitations shall exist. Derivative positions shall be fully collateralized with either cash or non-cash assets.
3. Section V.B.6 Illiquidity – Global Equity is typically thought to be a very liquid asset class. The revised language, in conjunction with a glossary definition for “illiquidity,” creates a specific limit on the allocation to illiquid investment vehicles or assets.

Wilshire Associates has provided an updated opinion letter (Attachment 10) regarding the proposed GE Policy.

#### **ATTACHMENTS**

Attachment 1 – Proposed Global Equity Program Policy and glossary

Attachment 2 – Strike-through version of the Externally Managed Strategies Policy

Attachment 3 – Strike-through version of the Global Equity Emerging Manager Fund of Funds Policy

Attachment 4 – Strike-through versions of the Global Equity Sub-Asset Class Allocation Ranges Policy

Attachment 5 – Strike-through version of the Internally Managed Affiliate Equity Index Funds Policy

Attachment 6 – Strike-through version of the Internally Managed Global Enhanced Equity Strategies Policy

Attachment 7 – Strike-through version of the Internally Managed Global Equity Index Funds Policy

Attachment 8 – Strike-through version of the Manager Development Program I and II (MDP) Policy and Manager Transition Policy

Attachment 9 – Strike-through version of the Monitoring Externally Managed Portfolios Policy

Attachment 10 – Wilshire Associates Opinion Letter

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ERIC BAGGESEN  
Senior Investment Officer  
Global Equity

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JOSEPH A. DEAR  
Chief Investment Officer