



Consent

Agenda Item 4c

February 19, 2013

ITEM NAME: Proposed Regulation Relating to the External Investment Resource Conflict of Interest Policy

PROGRAM: Total Fund

ITEM TYPE: Policy & Delegation – Consent Action

RECOMMENDATION

Grant approval for staff to initiate the rule making process to adopt a regulation regarding External Investment Resource Conflicts of Interest pursuant to the Administrative Procedures Act (APA).

EXECUTIVE SUMMARY

On August 13, 2012, the Investment Committee (the Committee) adopted revisions to the External Investment Resource Conflict of Interest Policy (the Policy). On August 20, 2012, the Office of Administrative Law (OAL) received a petition alleging that by adopting the Policy, CalPERS had issued, used, enforced, or attempted to enforce an underground regulation. Once the petition was accepted by OAL for consideration, CalPERS, by letter dated October 31, 2012, notified OAL that it would not enforce the previously adopted policy. Staff now seeks to adopt the Policy as a regulation pursuant to the APA rulemaking procedure. Until the rulemaking process is complete, CalPERS will continue to include, in our contracts with external investment resources, specific terms and conditions related to conflicts of interest. CalPERS will also continue to review and take appropriate action regarding all conflicts of interest involving external resources of which it becomes aware.

STRATEGIC PLAN

This agenda supports the CalPERS Strategic Plan goal to cultivate a high-performing, risk-intelligent and innovative organization. The adoption of the External Investment Resource Conflict of Interest Regulation enhances CalPERS ability to mitigate investment and reputational risks.

BACKGROUND

The APA requires, with few exceptions, that state agencies adopt regulations following the procedures laid out in the APA with the OAL. California Government Code section 11342.600 defines a regulation as:

"Regulation means every rule, regulation, order, or standard of general application or the amendment, supplement, or revision of any rule, regulation, order, or standard adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure."

A rule is called an "underground regulation" if a state agency issues or attempts to enforce a rule without following the guidelines in the APA. State agencies are not allowed to issue or enforce underground regulations.

ANALYSIS

To ensure that the Policy can be enforced going forward, staff recommends that the Policy be adopted as a regulation following the guidelines of the APA. The proposed regulation is provided as Attachment 1. A copy of the August 13, 2012 "Revision of the Consultant Conflict of Interest Policy" marked to show changes made in the regulation to clarify certain defined terms and add specific timeframes, where appropriate, is provided as Attachment 2. Upon approval by the Committee, the regulation adoption process will begin in February 2013.

BENEFITS/RISKS

The original Policy was developed to improve INVO's processes regarding identifying and evaluating conflicts of interests. During the period it will take to finalize the regulation, CalPERS is prohibited from implementing the policy and supporting processes. Accordingly, there is a risk that conflicts of interest will neither be identified nor evaluated.

ATTACHMENTS

Attachment 1 – Proposed Regulatory Action by CalPERS

Attachment 2 – August 13, 2012 "Revision of the Consultant Conflict of Interest Policy" with Changes Marked

Attachment 3 – Wilshire Opinion Letter

CAROL MOODY
Senior Portfolio Manager
Investment Compliance and Operational Risk

JANINE GUILLOT
Chief Operating Investment Officer