



June 17, 2013

ITEM NAME: 2013 Asset Liability Management Workshop
a. Risk-Factor-Based Asset Allocation and Future Portfolio Considerations
b. Sustainable Investment Research Initiative: Review of Evidence

PROGRAM: Total Fund

ITEM TYPE: Investment Committee Workshop – Information

EXECUTIVE SUMMARY

The following topics will be explored in a workshop setting:

1. Risk-factor-based asset allocation,
2. Projected conditions that may impact the CalPERS portfolio in the future, including considerations on cash yield and liquidity,
3. Review of evidence on sustainability factors to inform the development of CalPERS Investment Beliefs.

While each of these topics is substantial in and of itself, together they are a synergistic exploration of how CalPERS is evaluating its long-term investment objectives, values, and further refining its strategic role.

STRATEGIC PLAN

This item supports the CalPERS Strategic Plan goal of improving long-term pension and health benefit sustainability. The development of CalPERS Investment Beliefs, along with this year's Asset Liability Management (ALM) Process, allows CalPERS to explore the strategic direction of the Fund in a focused way to support effective and informed long-term planning.

BACKGROUND

The ALM Process is an important step to help ensure that contributions, plus investment returns, are sufficient to pay the benefits and expenses of the California Public Employee' Retirement System. Every three years staff presents, to the Investment Committee, potential allocations to each asset class that are estimated to allow CalPERS to realize its long-term assumed rate of return while maintaining prudent levels of risk.

Concurrent with the ALM work, CalPERS launched the Sustainable Investment Research Initiative (SIRI) to drive innovative thought leadership to inform and advance our understanding of sustainability factors and the impact they may have on companies, markets, and investment intermediaries. This includes a comprehensive review of evidence comprising of a bibliography of over 700 academic studies on sustainability factors and seven selected papers, from over 90 submissions, for a rigorous academic debate.

ANALYSIS

Conducting a robust and thorough discussion of the topics outlined above, in a holistic fashion, helps to ensure alignment between this year's ALM Process and development of CalPERS Investment Beliefs. It is critical that the decisions and strategic direction of the ALM work do not inadvertently violate the beliefs held by the wider organization.

For this year's ALM Process, CalPERS will embark on the next step in utilizing a more quantifiable, transparent, and holistic asset allocation approach – risk-factor-based asset allocation. Risk-factor-based asset allocation will support the Investment Committee in selecting the most appropriate Policy Portfolio with consideration of the “hidden” links between asset classes, and the associated actuarial considerations. In addition to the factor-based framework, there are future conditions that may affect the CalPERS portfolio. These considerations, namely cash yield and liquidity, will be explored to provide additional context to the 2013 ALM Process. Additional information on these topics can be found in Attachments 1, 2, 3, and 4.

Sustainability issues range from climate change, labor practices and human rights, to executive compensation. CalPERS has framed this agenda through our sustainable value creation framework built upon the effective management of the three forms of capital: financial, physical and human. This is why we are concerned with environmental, social and governance issues. Board and staff discussions in relation to the Investment Beliefs development process have highlighted the need for a review of evidence to provide clarity on the definition of sustainability and its potential impact on investment risk and return across the portfolio.

As part of SIRI, we partnered with the UC Davis Graduate School of Management (UC Davis) to conduct a comprehensive review of evidence of over 700 academic studies on sustainability factors and to host the inaugural *Sustainability & Finance Symposium* on June 7, 2013. The Symposium Program Committee, co-chaired by UC Davis and Columbia Law School, comprised of leading scholars, issued a call for papers seeking empirical and theoretical research from academics and investment practitioners in the fields of finance, economics, accounting, law and business that would contribute to a rigorous debate and discussion on sustainable long-term value creation and capital market stability. The Committee received over 90 submissions and selected seven papers to be presented and debated at the Symposium. These research findings will contribute to CalPERS Investment Beliefs and inform CalPERS

Total Fund Sustainability strategy. Additional information on this topic can be found in Attachments 5 and 6.

BENEFITS/RISKS

Should these topics not be taken up and discussed in a holistic fashion, CalPERS runs the risk of inadvertently conducting activities, through the ALM work, that conflict with the investment beliefs of the organization as a whole.

The key benefit of bringing these topics together for discussion is that we are purposefully working to establish a shared understanding of these complex issues and their interactions. This will help ensure that we are “of one mind” as CalPERS proceeds through these initiatives.

ATTACHMENTS

Attachment 1 – Topic Overview: Risk-Factor-Based Asset Allocation and Future Portfolio Considerations

Attachment 2 – 2013 ALM Process Overview

Attachment 3 – Factor-Based Analysis of Asset Returns

Attachment 4 – Cash Yield and Liquidity Considerations

Attachment 5 – Topic Overview: SIRI - Review of Evidence

Attachment 6 – SIRI: Review of Evidence – Research Findings and Areas for Further Inquiry

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