

# 2013-15 Investment Office Roadmap Update

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# Agenda

## Purpose

- Communicate the Investment Office's (INVO) alignment with CalPERS Strategic Plan
- Provide update on INVO Roadmap accomplishments and upcoming efforts

## Order of Discussion

- Integrated Strategic Plans: CalPERS and INVO
- INVO Roadmap
  - Core Priorities and Actions Needed
  - Accomplishments and Upcoming Efforts
- Recap

# Integrated Strategic Plans

## CalPERS and INVO Roadmap Alignment

# Integrated Strategic Plans During 2013



## CalPERS Enterprise Mission

Provide responsible and efficient stewardship of the System to deliver promised retirement and health benefits, while promoting wellness and retirement security for members and beneficiaries.

## Investment Office Mission

To be the leading public investment organization in the world by engaging the talents of our people and partners in executing innovative and sustainable investment strategies and products that generate superior risk adjusted returns to enhance the financial security for all who participate in our System.

# INVO Roadmap

Priorities, Objectives, Evolution and Status

# INVO Roadmap: Strategic Priorities



INVO Roadmap is aligned around three strategic priorities:

- ➔ **Performance**: Achieve our target rate of return without exposing the fund to undue risks
- ➔ **Plumbing**: Develop and implement the systems, controls, and processes necessary to assure the integrity of operations
- ➔ **People**: Ensure that we have the right number of people with the right skills to enable investment performance improvement and control of operations

*The INVO Roadmap is a set of objectives, initiatives and milestones to achieve these priorities, aligned with CalPERS Strategic Plan.*

# Why is the Roadmap needed?



	Core Issue	Actions Needed
<b>Performance</b>	A challenging performance target and a need to resolve the ranking of returns relative to peers	<ul style="list-style-type: none"> <li>✓ Restructure legacy investments to improve risks, returns and cost effectiveness</li> <li>✓ Continue to identify and use cost/fee savings to self-fund increases in Plumbing and People</li> </ul>
<b>Plumbing</b>	Functional gaps in systems and controls create operational risks	<ul style="list-style-type: none"> <li>✓ Implement the systems and controls (plumbing) needed to support the desired investment processes and strategies</li> </ul>
<b>People</b>	Complex portfolio management issues without the right mix of investment expertise	<ul style="list-style-type: none"> <li>✓ Attract and retain talent capable of implementing sustainable risk-aware investment processes</li> <li>✓ Create an environment that continuously replenishes the right investment skills for the future</li> </ul>

***Establish the “table stakes” needed for an innovative investment culture that seeks to improve the long-term investment performance and sustainability of employee benefit programs***

# INVO Roadmap: Revised Strategic Priorities & Objectives



Performance	Investment Performance	<ul style="list-style-type: none"> <li>• Deliver consistent risk-adjusted investment returns.</li> </ul>
	Investment Beliefs	<ul style="list-style-type: none"> <li>• Establish beliefs about capital markets and investor behavior to inform investment strategies and improve governance.</li> </ul>
	Investment Risk Management	<ul style="list-style-type: none"> <li>• Establish a comprehensive portfolio risk management system and practices to measure, manage and communicate investment risks.</li> </ul>
	Capital Allocation	<ul style="list-style-type: none"> <li>• Implement a risk-based, dynamic asset allocation approach.</li> </ul>
	Cost Effectiveness	<ul style="list-style-type: none"> <li>• Enhance cost effectiveness of the investment program to improve net returns on assets.</li> </ul>
	Emerging Investment Manager Strategy	<ul style="list-style-type: none"> <li>• Implement 5-year plan for emerging and diverse managers in our investment program.</li> </ul>
	ESG Investment Strategy	<ul style="list-style-type: none"> <li>• Integrate relevant environmental, social and governance risk considerations into investment decision making across the Total Fund.</li> </ul>
Plumbing	Organization, Systems, and Controls	<ul style="list-style-type: none"> <li>• Design, develop &amp; implement a robust operating model that minimizes complexity, improves transparency, &amp; strengthens processes, systems &amp; controls.</li> <li>• Reduce operational risk by developing a risk aware culture with clear metrics &amp; operational risk management processes/governance.</li> </ul>
People	Talent Management	<ul style="list-style-type: none"> <li>• Enhance the ability of INVO to recruit, develop and retain a highly skilled, diverse &amp; motivated team to ensure success.</li> </ul>

# Factors Impacting Speed of Delivery and Quality



Investment Office  
2013-15 Roadmap

<b>Dependencies</b>	Sequencing initiatives so they build and support each other – within INVO and across the Enterprise
<b>Recruitment</b>	Recruiting, hiring and retaining experienced investment professionals
<b>Deep Investment Skills</b>	Engaging experienced investment specialists to address complex investment management, operational, legal/contractual and accounting issues
<b>Organizational Bandwidth</b>	Adjusting expectations on the pace of change to recognize the limits on the amount of change INVO can absorb

# INVO Roadmap: Evolution and Current Outlook



2008 – 2010  
“Triage”

- Managed impact of the financial crisis
- Ensured liquidity and mitigated immediate risks
- Managed placement agent, special review and FPPC investigation issues

2010 – 2012  
“Establish Foundation”

- Developed INVO Vision and Roadmap
- Identified issues and developed strategic plans to remedy
- Built a core leadership team and restructured the organization
- Developed new asset allocation framework
- Achieved significant wins and improvements

**2012– 2016**  
“Heavy Lifting”

Updated

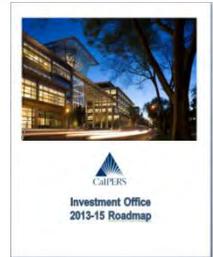
- Substantially implement Roadmap initiatives
- Establish a sustainable organization – build repeatable processes and develop a deep bench of people

**2014 – Forward**  
“Continuous Improvement”

Updated

- Completed initiatives will be transitioned to “Continuous Improvement”
- Continually innovate to adapt to changing market conditions
- Enhance processes and systems on an ongoing basis
- Manage ongoing people development process

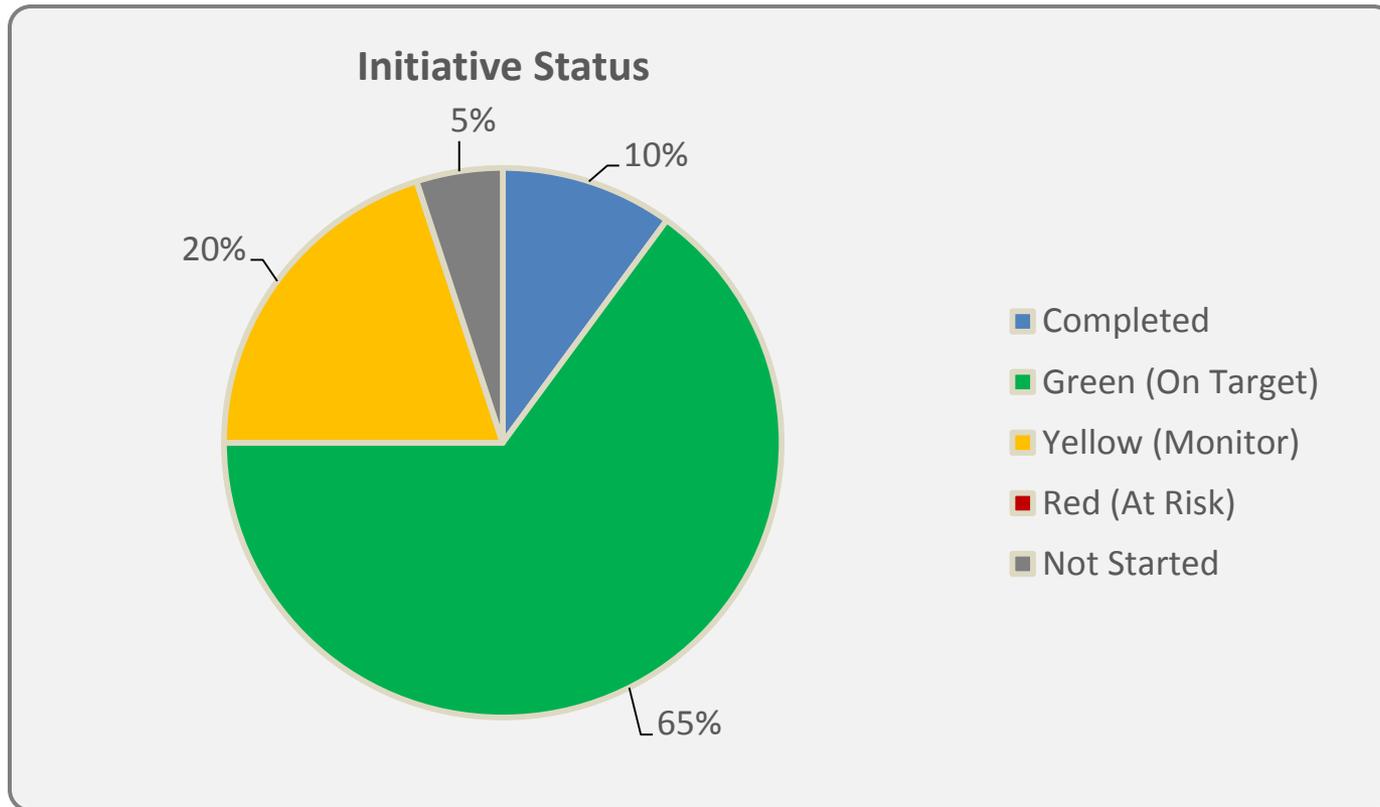
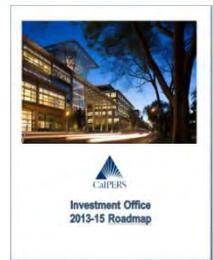
## Evolution: Status Summary (Checkpoint)



- **Established a “Foundation” between 2008 and 2012:** Reasonable levels of progress during this period considering the staffing levels
  - **Performance:** Portfolio restructuring began across asset classes
  - **Plumbing:** Target Operating Model (TOM) initiatives started and are well under way
  - **People:** Talent Management is more effective and is ramping up to desired staffing levels
- **2014 - Well into the “Heavy Lifting” phase:** Recognized the need to extend the heavy lifting period to reflect pace of achievable change with current resources and the revisions to new strategic initiatives.
  - **Performance - Investment Beliefs, ALM and Investment Risk:** Implementing Investment Beliefs, Asset Liability Management (ALM) and a robust Investment Risk framework. These will provide a long-term foundation for managing investment programs.
  - **Performance - Restructuring Investments:** Restructuring investments and implementing investment strategies in asset classes will further strengthen the investment program.
  - **Plumbing – Organization, Systems, and Controls:** Completing TOM initiatives will reduce key operational risks.
  - **People - Speed of Delivery and Sustainability:** Need to maintain focus on expanding organizational bandwidth by increasing the pool of investment talent available in CalPERS.

# Status of Roadmap Initiatives

The INVO Roadmap consists of approximately 70 initiatives related to 9 strategic objectives. Currently 75% of initiatives are completed and/or on target.



## **INVO Roadmap – Performance**

Objectives, Accomplishments and Upcoming Efforts

# Performance: Objectives



CalPERS  
Investment Office  
2013-15 Roadmap

	<b>Investment Performance</b>	<ul style="list-style-type: none"> <li>• Deliver consistent risk-adjusted investment returns.</li> </ul>
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<b>Plumbing</b>	<b>Organization, Systems, and Controls</b>	<ul style="list-style-type: none"> <li>• Design, develop &amp; implement a robust operating model that minimizes complexity, improves transparency, &amp; strengthens processes, systems &amp; controls.</li> <li>• Reduce operational risk by developing a risk aware culture with clear metrics &amp; operational risk management processes/governance.</li> </ul>
<b>People</b>	<b>Talent Management</b>	<ul style="list-style-type: none"> <li>• Enhance the ability of INVO to recruit, develop and retain a highly skilled, diverse &amp; motivated team to ensure success.</li> </ul>

# Performance: Key Accomplishments

## Investment Performance

- ✓ Achieved a return of 13.7% for first three quarters of fiscal year, is above the 7.5% ALM target
- ✓ Continued restructuring investments in Real Estate, Private Equity, Global Equity, Fixed Income and Absolute Return Strategies

## Investment Beliefs

- ✓ Adopted Investment Beliefs and established a Rapid Results project to develop key implementation activities to integrate the Investment Beliefs into the investment process, policies, and decision making

## Investment Risk Management

- ✓ Reformatted and enhanced the Total Fund asset allocation, performance, and risk information for more consistent and effective reporting to the Investment Committee

## Capital Allocation

- ✓ Adopted a new strategic asset allocation along with selecting several actuarial parameters to be used in establishing valuations and setting contribution rates for the next several years at the February 2014 Board meeting

## Performance: Key Accomplishments (cont.)

### Cost Effectiveness

- ✓ Fiscal Year to Date cost savings of \$49.5 million

### Emerging Investment Manager Strategy

- ✓ Submitted the Year-One Annual Report to the California Legislature on the CalPERS Five-Year Plan for Emerging Managers
- ✓ Initiated work on nine out of ten workstreams in CalPERS Emerging Manager Five-Year Plan
- ✓ Completed work on four workstreams in the Plan

### ESG Investment Strategy

- ✓ Completed the annual Principles for Responsible Investment Framework (an INVO-wide survey for CalPERS to report on how we implement responsible investments)

# Performance: Upcoming Efforts

## Investment Performance

- ✓ Achieve our target rate of return without exposing the fund to undue risks
- ✓ Continue restructuring investments strategies and processes in Real Estate, Private Equity, Global Equity, Fixed Income and Absolute Return Strategies that contribute to Total Fund returns

## Investment Beliefs

- ✓ Implement the recommendations from the Rapid Results Project

## Investment Risk Management

- ✓ Partner with the Chief Financial Officer and Financial Office (FINO) on Liquidity and Cash Management framework

## Capital Allocation

- ✓ Implement the revised asset allocation targets approved by the Board resulting from the ALM workshop
- ✓ Evaluate the liquidity and cash management framework needed to manage fund level performance and investment risks

## Performance: Upcoming Efforts (cont.)

### Cost Effectiveness

- ✓ Continue to press for fee reductions for consultants, external managers/partners and vendor services
- ✓ Continue to improve expense management and reporting capabilities

### Emerging Investment Manager Strategy

- ✓ Present findings from the External Manager Diversity Survey and the CalPERS Peer Diversity Survey to the Investment Committee

### ESG Investment Strategy

- ✓ Publish the second edition of the CalPERS Towards Sustainable Investment: Making Progress report by Spring 2014
- ✓ Vote over 10,000 company proxies consistent with CalPERS Global Principles of Accountable Corporate Governance and running successful shareowner campaigns on CalPERS filed proposals by achieving majority shareholder support

## INVO Roadmap – Plumbing

Target Operating Model, Functional Risk Levels,  
Initiative Status and Accomplishments

# Plumbing: Objectives



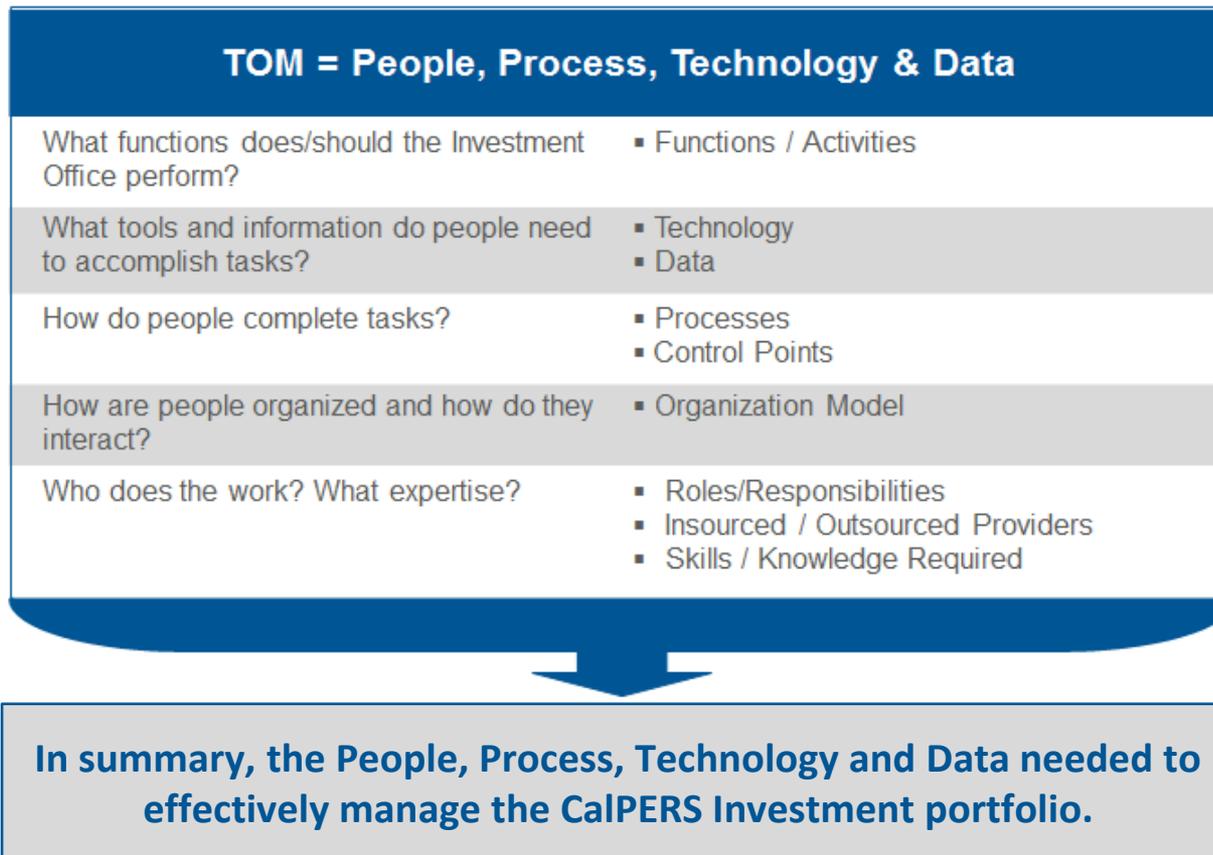
CalPERS  
Investment Office  
2013-15 Roadmap

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# Plumbing: What is a Target Operating Model (TOM)?

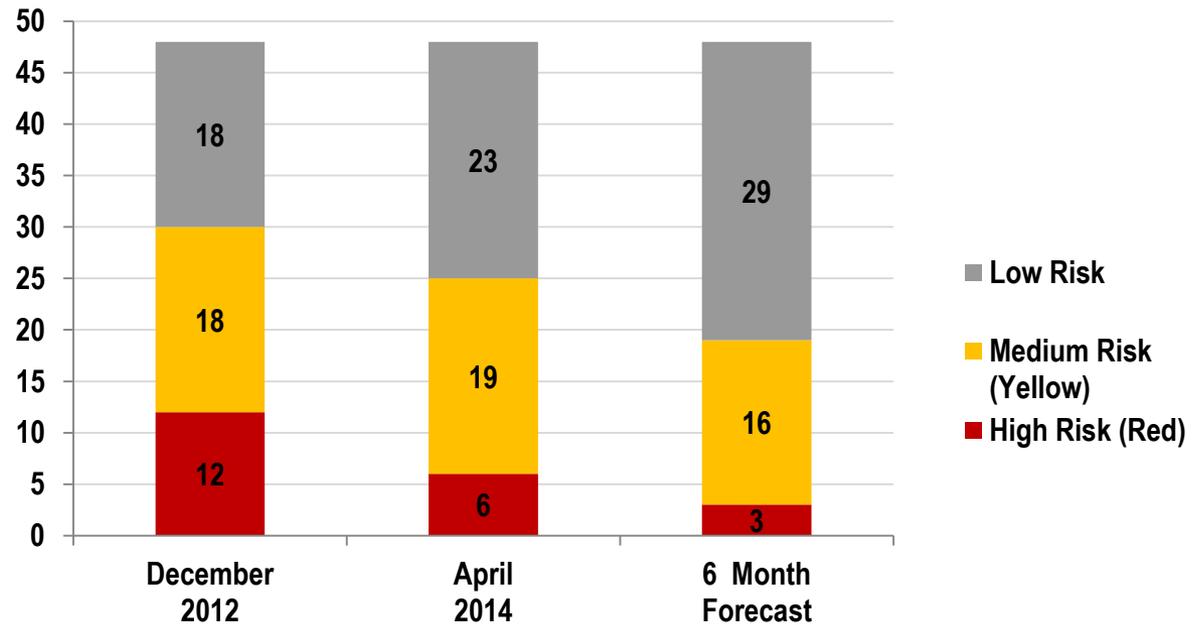
## INVO Roadmap Priority: Organization Systems and Controls



# Plumbing: Changes in Functional Risk Levels

50% reduction in High Risk Functions achieved

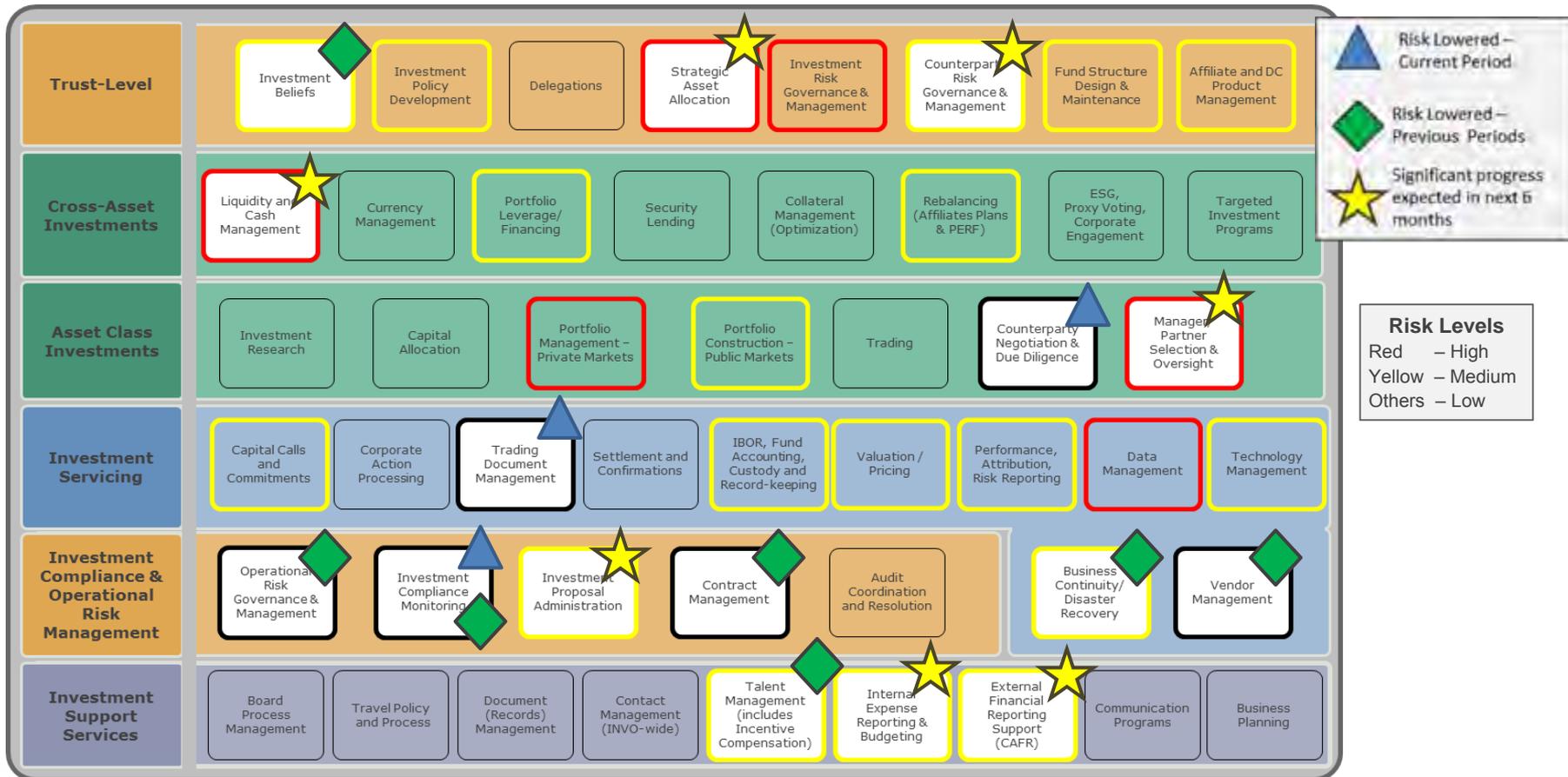
TOM Hot Spots (Functional Risk Levels)



The operational risk framework is used to monitor all functions. Operating events are analyzed to identify additional on-going operational improvements.

# Plumbing: Hotspots – Progress Report since TOM Refresh

Functions highlighted below either have lower risk levels or notable progress has been made made.



# Plumbing: Current Status of TOM Roadmap

Extended the schedule for select initiatives to reflect a current understanding of the effort required.

Business Initiative		Status	2013			2014				2015		
			2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q +
ID												
1	PM2: "Public Markets Portfolio Management"	Y						Added				
2	PE Portfolio Management, Accounting & Data Services (PEARS)	Y										
3	INVO Expense Management & CAFR Support	G										
4	Derivatives Central Clearing & Processing	Completed										
5	Contract Management – INVO Workflow Management	G				Added						
10	Trust (Fund) Structure Validation & Redesign	G										
11	Performance Measurement & Attribution	Y										
21	Incentive Compensation Reengineering (INVO)	Y				Added						
12	Pricing / Valuation (INVO)	G										
25	Affiliate Investment Program – Roles & Responsibilities	Completed				Added						
24	Affiliate Investment Program – Process & Technology	G										
6	Investment Compliance Monitoring	Completed										
23	Investment Proposal Administration Enhancements	Completed										
7	Travel Policies & Procedures	Completed										
9	Operational Risk Governance & Management	Completed										
8	Manager Selection & Monitoring – Standards and Compliance	Y				Added – 1. Selection Phase			2. Monitoring Phase			
26	Operational Delegation of Authority (Non-investment related)	Completed										
15	Vendor Management	Completed										
14	Technology Management	G										
20	ARS Legal Structure & Technology	G										
13	Cash Management – Processing & Controls (INVO)	G										
19	Investment Policy Revisions	Y										
22	Disaster Recovery / Business Continuity	G										
18	Contact & Relationship Data Mgt – Current Business Partners Only	n/a				Defer						
17	Data Management - Core Capabilities	n/a				Defer						
16	Records Retention, Document Management	n/a				Defer						

**Status Changes**  
 4 completed  
 3 upgrades  
 4 downgrades

Status
G = On Target
Y = Monitor
R = At Risk
Level of Effort
Significant
Moderate

# Plumbing: Key Accomplishments

## Operational Risk Governance & Management

- ✓ Established an Operational Risk Framework used to guide the tracking of operating events and implementation of appropriate enhancements to operational / internal controls

## Investment Proposal Administration Enhancements

- ✓ Established business owner and completed enhancements to internal processes and improved the usability of the technology, Investment Proposal Tracking System (IPTS)

## Affiliate Investment Programs

- ✓ Completed Affiliate Investment Program – Roles & Responsibilities initiative
- ✓ Initiated work to redesign processes and upgrade technology used to manage the Affiliate Investment Programs

## Cash Management Processing & Controls

- ✓ Developed a liquidity report used by INVO and FINO to increase visibility into cash balances and forecasts

## Technology Management

- ✓ Completed the INVO Technology Strategy refresh and finalized the Memorandum of Understanding with Information Technology Services Branch.

## INVO Expense Management & Comprehensive Annual Financial Report Support (CAFR)

- ✓ Significantly improved comprehensive expense reporting

## Investment Compliance Monitoring

- ✓ Completed the initiative to establish compliance processes that follow defined protocols and industry practices

# Plumbing: Upcoming Efforts

## PM2: "Public Markets Portfolio Management"

- ✓ Complete parallel testing and implement the technology solution that will improve controls and increase capacity for Global Equity's internally managed portfolios

## Contract Management – INVO Workflow Management

- ✓ Complete implementation of a more effective contract management process and technology

## Cash Management Processing and Controls

- ✓ Complete high-priority improvements need for forecasting, reporting and controls related to cash and cash processing

## Disaster Recovery / Business Continuity

- ✓ Complete the final round of testing needed to assure key investment activities can be recovered during disasters

## INVO Expense Management & CAFR Support

- ✓ Complete core improvements needed (1) for better expense management, allocation of expenses to investment trusts, and investment programs, and (2) to support production of CAFR

## INVO Roadmap – People

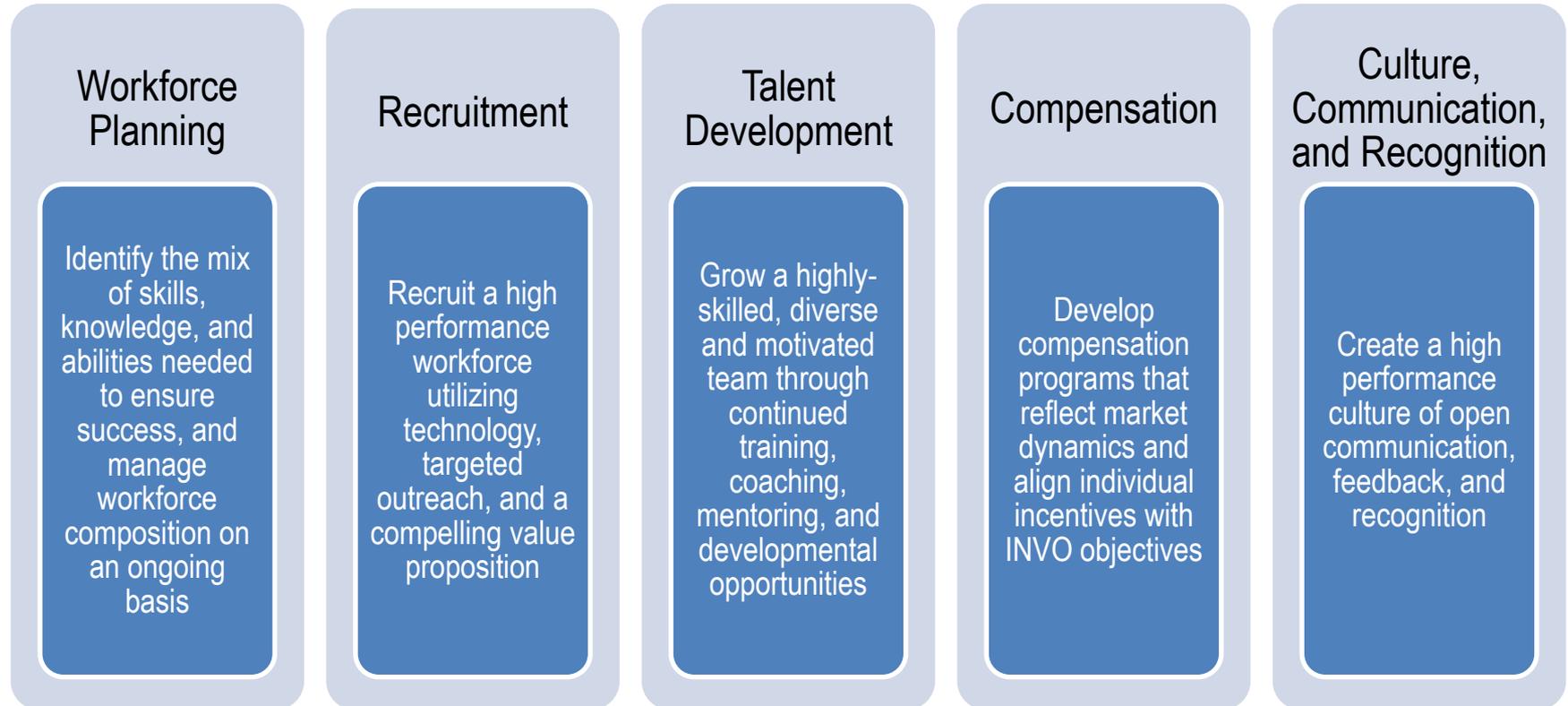
### Objectives, Accomplishments and Upcoming Efforts

# People: Objectives



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# People: Achieving INVO's Talent Management Strategy



# People: Key Accomplishments

## Talent Management

- ✓ Decreased the vacancy rate from 17% to 10% since July 2013
- ✓ Received approval of 7 positions for the Fiscal Year 2014-15, progressing towards target staffing level of 450
- ✓ Initiated the INVO Resource Strategy Project which will include identification of leading edge diversity practices, strategies, and tactics for use in attracting and retaining the diverse talent pipeline necessary to align with industry benchmarks and address significant gaps identified in the TOM
- ✓ Developed focused onboarding course for new and existing leaders to share in discussion of key values and leadership behaviors needed to build a strong culture
- ✓ Ensured all Portfolio Managers and above participated in semi-annual performance discussion and received meaningful feedback and coaching from direct manager

# People: Upcoming Efforts

## Talent Management

- ✓ Partner with Human Resources Division (HRSD) to develop clear roles and responsibilities, service level agreements, and process flows related to the Year-End Incentive Compensation Process
- ✓ Lead the Inaugural INVO Smart Cohort of approximately 54 staff through completion of required courses and on to graduation in June 2014
- ✓ Design and implement modifications to the Fiscal Year 2014-15 performance plan template ensure desired business results are aligned with an individual's contribution
- ✓ Partner with HRSD to implement INVO Classification and Organization Redesign Project recommendations

## Issues to Track

- ✓ INVO Classification and Organization Redesign Project status has remained at Yellow due to the prolonged review period within CalHR
  - Next phase of Classification Redesign Project (IO Series) on hold until completion of current phase
  - Corrective Actions: Discussions between CalPERS and CalHR needed for progression
- ✓ Incentive Compensation Review for Staff and Board status changed from Green to Yellow as the Executive Compensation Policy Review Project is upcoming
  - Corrective Actions: Partner on the development of presentation and recommendations to the Board
- ✓ Incentive Compensation Reengineering Project is taking longer to complete than shown on the TOM
  - Corrective Actions: Continue to support and discuss the project with HRSD to complete the project

# Recap

# Recap

- Achieved a 50% reduction in the number of high risk functions and continue to improve the TOM risk levels
- Extended “Heavy Lifting” phase to reflect the pace of achievable change
- Continue to make significant progress in the INVO Roadmap and initiatives, noting that 75% are currently complete or on target

	Core Issue	Actions Needed
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