



Agenda Item 6a

August 18, 2014

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

PROGRAM: Investment Compliance and Operational Risk

ITEM TYPE: Policy & Delegation - Action

RECOMMENDATION

Approve Staff to submit the final rule making file for proposed Regulation 557, External Investment Resource Conflicts of Interest, to the Office of Administrative Law (OAL).

EXECUTIVE SUMMARY

In 2009, the Statement of Investment Policy for Consultant Conflicts of Interest (the Policy) was adopted to address various conflict issues involving pension consultants. In 2012, Investment Compliance and Operational Risk (ICOR) reviewed the Investment Office processes for collecting information concerning conflicts of interest of External Managers. Based on that review, Staff recommended that the Investment Committee (the Committee) adopt revisions to broaden the scope of the Policy to include:

“Any Consultant, External Manager or other entity which provides any investment management or investment advisory services related to the administration of CalPERS investment programs.”

On August 13, 2012, the Committee adopted revisions to the Policy to broaden its scope and include Consultants in the definition of External Investment Resource and change the name to the External Investment Resource Conflict of Interest Policy. On August 20, 2012, OAL received a petition alleging that the Policy was an underground regulation. Once the petition was accepted by OAL for consideration, CalPERS informed OAL that it would not enforce the previously adopted Policy. On February 19, 2013, the Committee authorized Staff to begin the rule making process to adopt the proposed regulation in place of the previous Policy. The agenda item from that Committee meeting is provided as Attachment 3 for reference.

During the public comment period, no one requested a public hearing. One person provided written comments on the proposed regulation.

These comments involved technical issues such as the need for references to authority and the description of cost impacts, as well as general comments regarding the need for the regulation and a possible alternative approach. Staff has added an authority and reference notes to the proposed regulation. Staff does not believe any further revisions to the proposed regulation are necessary. Responses to each written comment can be found in the Final Statement of Reasons provided as Attachment 1. Staff now seeks to finalize the rulemaking process by submitting the final statement of reasons and the final text of the regulation (Attachment 2) to the OAL.

STRATEGIC PLAN

This agenda item 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.

INVESTMENT BELIEFS

This agenda item supports CalPERS Investment Belief 5 that CalPERS must articulate its investment goals and performance measures and ensure clear accountability for their execution. This item particularly addresses the sub-belief that each asset class should have explicit alignment of interest principles for its external managers. This regulation will allow CalPERS to have a strong process around managing conflicts of interest of External Investment Resources and ensuring alignment of interests exist with External Investment Resources for each asset class.

BACKGROUND

The Administrative Procedures Act (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 (Attachment 2) be adopted as a regulation following the guidelines of the APA. Upon approval by the Committee, the regulation package will be submitted to the OAL.

BUDGET AND FISCAL IMPACTS

Not applicable.

BENEFITS/RISKS

The original Policy was developed to improve the Investment Office'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 an investment and operational risk that conflicts of interest will neither be identified nor evaluated.

ATTACHMENTS

- Attachment 1 – Final Statement of Reasons
- Attachment 2 – Proposed Text of Regulation
- Attachment 3 – February 2013 Agenda Item

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