



## Agenda Item 8a

February 17, 2015

**ITEM NAME:** Proposed Consolidation of Total Fund Investment Policy and Repeal of Legacy Policies – Initial Review

**PROGRAM:** Total Fund

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

### **EXECUTIVE SUMMARY**

The purpose of this item is to update the Investment Committee (Committee) on the proposed consolidation of the Total Fund Investment Policy (Policy) and the repeal of related legacy policies.

On November 17, 2014 staff updated the Committee on the status of initial phases of the Investment Policy Revision Project (Project) outlining milestones and next steps. Staff has since completed the current phase of the Project.

### **STRATEGIC PLAN**

This agenda item supports the CalPERS Strategic Plan to cultivate a high-performing, risk-intelligent and innovative organization. The proposed policy, once approved by the Committee, will strengthen CalPERS' ability to achieve the System's investment objectives through clear, actionable, and measurable investment policies.

Wilshire Associates opined in November 2014 that "policies touch on a number of CalPERS Investment Beliefs such as Belief #9 – Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error and Belief # 10 – Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives."

### **BACKGROUND**

The Project is a key initiative of both the 2014-16 Investment Office Roadmap and Target Operating Model (TOM). Investment Policy Development is a Trust Level process of the TOM and was identified as being at a medium risk level during Fiscal Year 2013-14. Trust Level processes typically involve investment policies, strategies, governance and legal issues and other activities requiring interactions with the Committee and senior Investment Office staff. As the Investment Office has evolved in complexity and maturity, several key strategic initiatives in recent years have identified a need to periodically review the content and format of all investment policies.

During 2013 staff from the Investment Compliance and Operational Risk Program (ICOR) conducted comprehensive testing to ascertain compliance with all existing investment policies. ICOR's testing results identified a handful of technical policy exceptions, which were subsequently remediated. This testing also led to three main observations:

- The existing policies exhibit a high degree of inconsistency regarding how to measure performance and compliance against policy guidelines.
- Duplication and lack of clarity in language within the existing policies creates operational risks for the Investment Office.
- Numerous individual policy revisions over time, including incremental changes to nearly all of CalPERS' investment policies, have resulted in inconsistencies in content, format, style, and inclusion of detailed procedural elements.

These observations led staff to develop a set of guiding principles and a methodology (Attachment 1) for the holistic review of CalPERS' investment policies.

#### **ANALYSIS**

Subsequent to the November 2014 Committee meeting, staff consolidated, developed, and refined the Total Fund Investment Policy included as Attachment 2. Staff utilized the set of guiding principles and methodology in developing the proposed Policy, balancing the Committee's need to conduct, set, approve, or oversee a particular investment activity with staff's need for clear, measurable, and specific language to minimize operational complexity and risk.

Staff notes that additional refinement to the Policy will be needed in order to achieve alignment with individual Program policies. Therefore no content changes in the proposed Policy were made, other than the removal of duplicative, aspirational or editorial language. Further, these changes are one of multiple steps in an iterative process which will incorporate Committee feedback over time.

Staff's proposed Policy, if approved, will reduce the total number of investment policies from 46 to 32 (see Attachment 3, policy inventory) largely by incorporating the existing content into the proposed Policy and appendices, eliminating duplicative language. This will also reduce operational risks by more clearly defining the Committee's desires and intentions with respect to staff's role in implementing investment policies.

Should the Committee approve these changes, staff will continue to utilize these same guiding principles and methodology to continue to refine the Policy and effect revisions to individual asset-class specific policies to be presented to the Committee over the next 12-18 months as part of required Annual Program Reviews, as well as other initiatives.

Wilshire Associates' Opinion Letter is provided as Attachment 4.

Pending Committee feedback, staff anticipates the following recommendations for Committee action at the March 2015 meeting:

- Adopt the proposed Policy as presented (Attachment 2), subject to the inclusion of any Committee input.
- Repeal the 15 legacy investment policies to be superseded by the consolidated Policy. See Attachment 3 (policy inventory) and Attachment 5 (full text of the policies).

#### **BUDGET AND FISCAL IMPACTS**

Not Applicable.

#### **BENEFITS/RISKS**

Staff's recommendations are consistent with the TOM objectives to design, develop, and implement a robust operating model that minimizes complexity, improves transparency, and strengthens processes, systems, governance, and controls. The recommendations are also consistent with CalPERS' Investment Beliefs.

Additionally, the Policy will provide the following benefits:

- Enhance consistency and completeness as compared with current policies
- Reduce operational risk by supporting implementation of clear metrics and operational risk management processes/governance
- Improve processes for developing new policies
- Provide a platform for staff to more effectively manage policy revisions and monitor compliance as requirements are more clearly specified
- Reduce duplication and complexity by consolidating and repealing legacy policies

Specific risk associated with the recommendation is:

- That completion of the Project may be delayed or that implementation of the Project may not achieve desired outcomes

**ATTACHMENTS**

Attachment 1 – Presentation and Policy Review Guiding Principles

Attachment 2 – Proposed Total Fund Investment Policy

Attachment 3 – Investment Policy Inventory

Attachment 4 – Wilshire Associates' Opinion Letter

Attachment 5 – Black-Lined Policies Proposed for Repeal

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