

# Investment Compliance Program Annual Review

June 15, 2015

# Executive Summary

- Program is in a maturation phase:
  - Investment compliance functions continue to progress effectively as contemplated by the Target Operating Model
- Substantial progress made on several key strategic initiatives that are underway:
  - Manager selection and monitoring procedures
  - Investment policy review and simplification
- Upcoming initiatives designed to improve program oversight and enhance INVO internal controls

# Review Outline

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Legend: Investment Beliefs Map					
1	Liabilities	4	Three Forms of Capital	7	Risk Reward
2	Long-Term Horizon	5	Accountability	8	Costs Matter
3	Stakeholders	6	Strategic Allocation	9	Multi-faceted Risk
				10	Resources/Process

# I. Program Overview

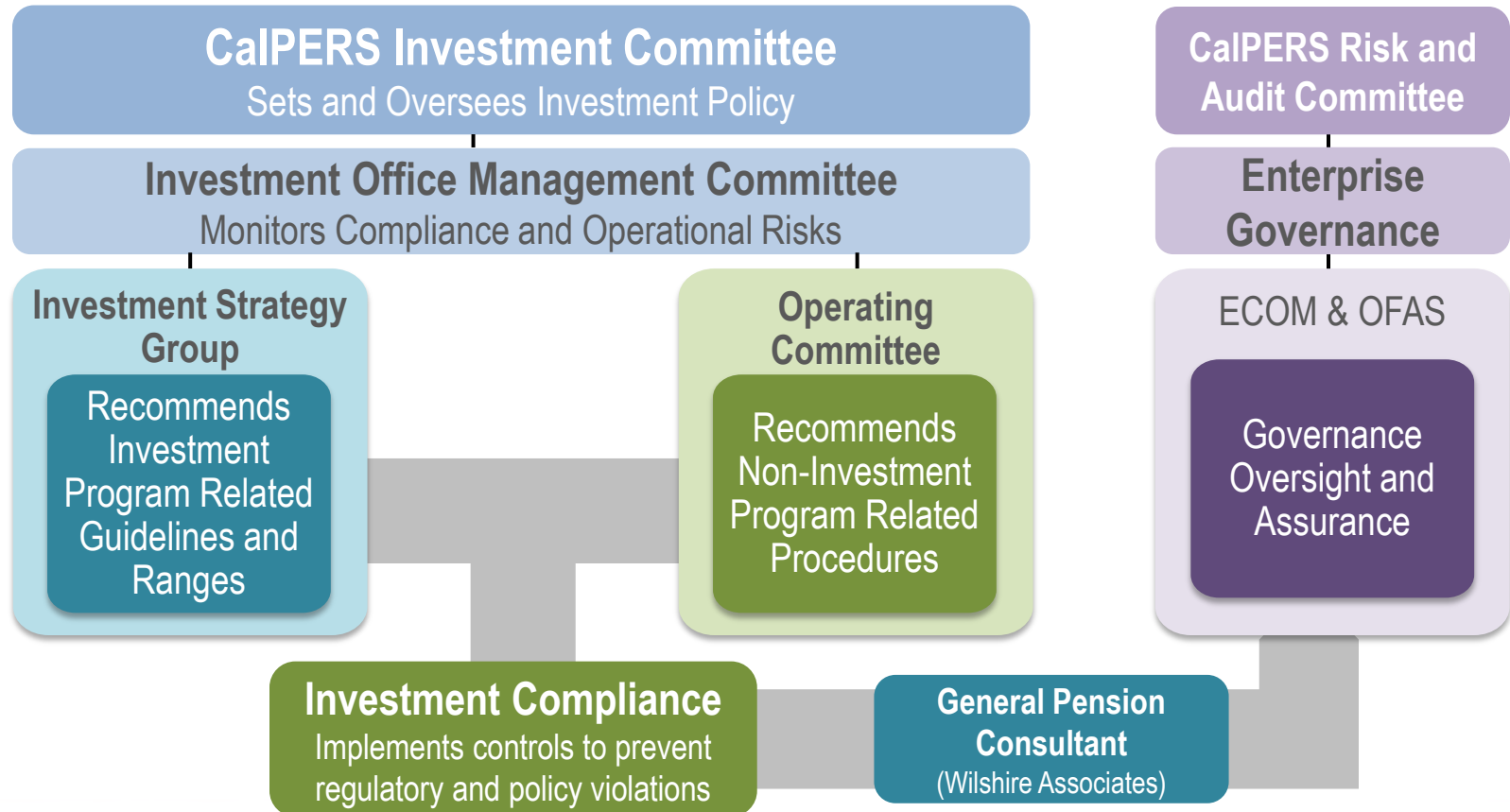
# Program Role

## Core Function Capabilities

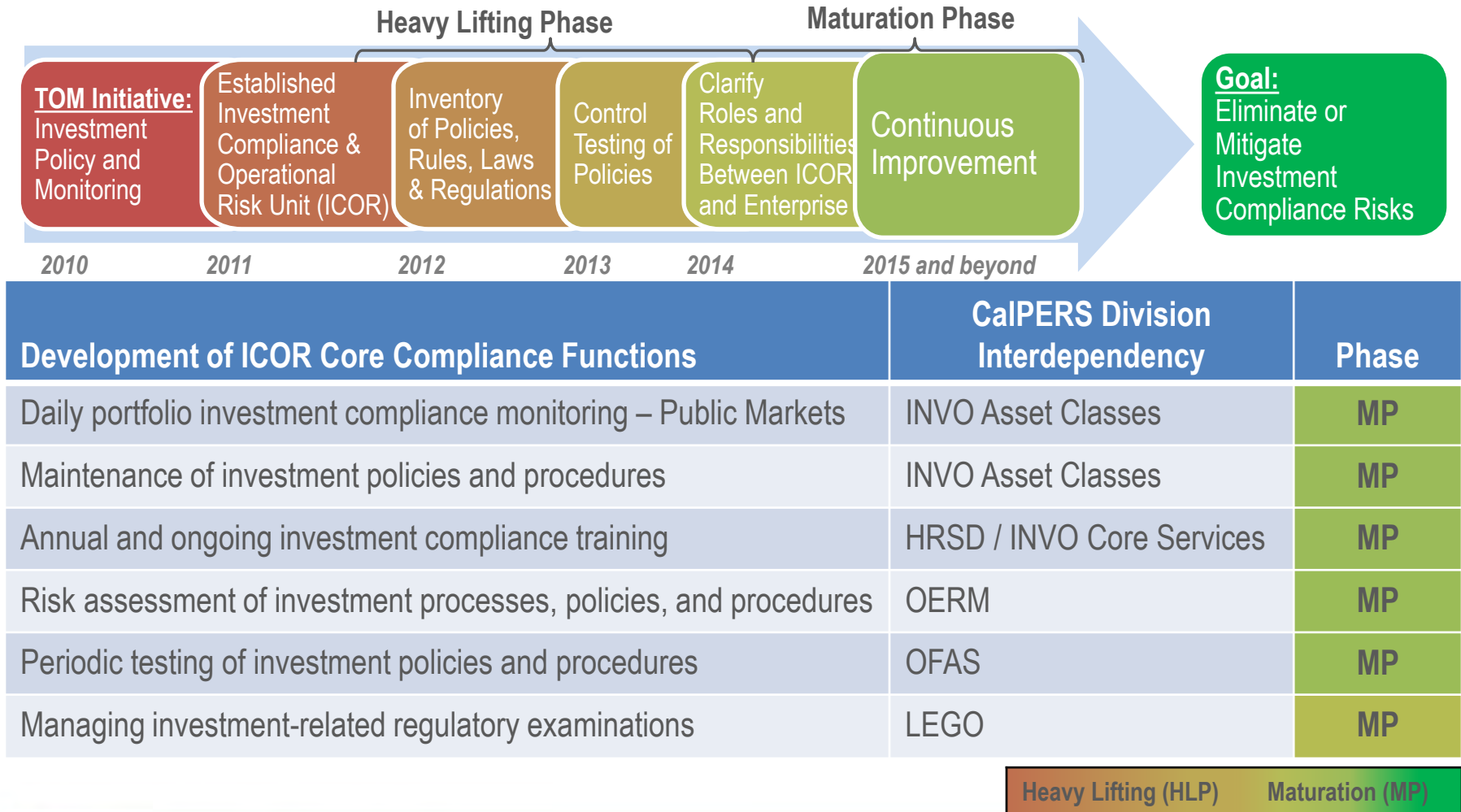
- ICOR's functions are modeled after best practices found at regulated external managers
- The work of this program area seeks to ensure that INVO maintains ongoing compliance with regulatory and investment policy requirements
- ICOR's staff, in concert with senior management, seek to promote an organizational culture that eliminates or mitigates investment compliance risks

# Program Role (continued)

## Governance & Oversight



# Program Scope



# Program Scope (continued)

Development of ICOR Core Compliance Functions (Cont'd)	CalPERS Division Interdependency	Phase
Inventory of existing rules and regulations relevant to investment activities	ECOM / LEGO	HLP
Analysis and implementation of compliance control processes for new rules regulations relevant to investment activities (e.g., Dodd Frank)	INVO Asset Classes	As Needed
Identification and assessment of compliance risk for new and emerging investment-related initiatives (e.g., new security types)	INVO Asset Classes	As Needed

Examples of ICOR Non-core Compliance Support Functions	CalPERS Division Interdependency
Regulatory reporting/filing of investment activity (e.g., Section 13 filings)	INVO Investment Servicing Division (ISD)
Employee investigations / Ethics Hotline incidents affecting investment staff	ECOM / LEGO / HRSD

Heavy Lifting (HLP)

Maturation (MP)





## II. Investment Compliance Review

# ICOR Core Functions

## Selected Accomplishments and Milestones

Functional Groups	Selected FY 2014-15 Accomplishments and Milestones
Risk Assessment	<ul style="list-style-type: none"> <li>• Compliance risk assessment of processes, policies and procedures               <ul style="list-style-type: none"> <li>✓ Identified gaps and designed enhancements to existing processes that further mitigate the risk of violating existing laws, rules and policies</li> <li>✓ Established additional compliance processes and defined protocols that follow industry practices</li> </ul> </li> </ul>
Surveillance, Testing & Reviews	<ul style="list-style-type: none"> <li>• Identify, report and remediate policy violations:               <ul style="list-style-type: none"> <li>✓ Total Fund Monthly Update reporting of exceptions to Investment Committee</li> </ul> </li> <li>• Daily portfolio compliance monitoring for public market asset classes</li> <li>• Initiated forensic testing of public market asset class investment activities</li> <li>• Improved reporting of compliance activities to INVO Operating Committee</li> </ul>
Policies & Procedures	<ul style="list-style-type: none"> <li>• Constructed the policy development strategic framework for INVO               <ul style="list-style-type: none"> <li>✓ Recommended revisions to total fund investment policy statements (Investment Policy Revision Project - Phase I)</li> </ul> </li> <li>• Consolidated into one glossary CalPERS-specific investment terms</li> </ul>

# ICOR Core Functions

## Selected Accomplishments and Milestones

Functional Groups	Selected FY 2014-15 Accomplishments and Milestones
Education & Training	<ul style="list-style-type: none"> <li>• Substantially all INVO staff completed one and a half of hours of mandatory in person training in 2014</li> <li>• Organized “onboarding” compliance training for staff who are new to INVO in August 2014 and May 2015</li> </ul>
Surveillance, Testing & Reviews	<ul style="list-style-type: none"> <li>• Initiated process to identify new laws, regulations, and rules that could impact INVO</li> <li>• Led the process to adopt CalPERS External Investment Resource Conflict of Interest Regulation</li> <li>• Added new compliance processes to address new or emerging regulatory changes:               <ul style="list-style-type: none"> <li>✓ Ukraine-related sanctions</li> <li>✓ “Bad actor” certifications</li> <li>✓ Municipal adviser rule and related certification</li> </ul> </li> <li>• Collaborated with LEGO to obtain additional guidance from FPPC regarding travel payments</li> </ul>

# 2014 Peer Benchmarking Study

## Survey of Public Fund Compliance Officers Group

- Founded in 2007 by about 20 audit and compliance professionals, this network grew to 63 members as of October 2014
- ICOR staff involvement is leading best practices exchange among group members since re-establishing the network in March 2012:
  - Coordinate schedule and agenda for standing conference calls
  - Organize regularly scheduled calls with the membership
  - Facilitate information exchange via social network site
  - Administered two best practice surveys
- High response rate was obtained for the 2014 survey:
  - 40 professionals provided responses about their organization's core compliance functions

# 2014 Peer Benchmarking Study (continued)

## Comparison of Key Program Attributes by Organization Size

Survey Questionnaire Topical Area	Smaller Plans (< \$15 billion USD) n=8	Midsize Plans (\$15 - \$50 billion USD) n=12	Larger Plans (> \$50 billion USD) n=20
Investment portfolio complexity	75% responded that 100% of the organization's total AUM is externally managed	58% responded that 94% or more of the organization's total AUM is externally managed	69% responded that 45% or less of their organization's total AUM externally managed
Enterprise compliance functionalization	63%	27%*	80%
Employ a Chief Compliance Officer	63%	42%	55%
Investment compliance functionalization	75%	82%*	90%
Monitors personal trading by employees	25%	55%*	85%

### Key point:

**CalPERS Investment Office is a leader among similar sized pension plans**

\* Eleven responses received for this particular question (i.e., n=11)

## III. Business Review

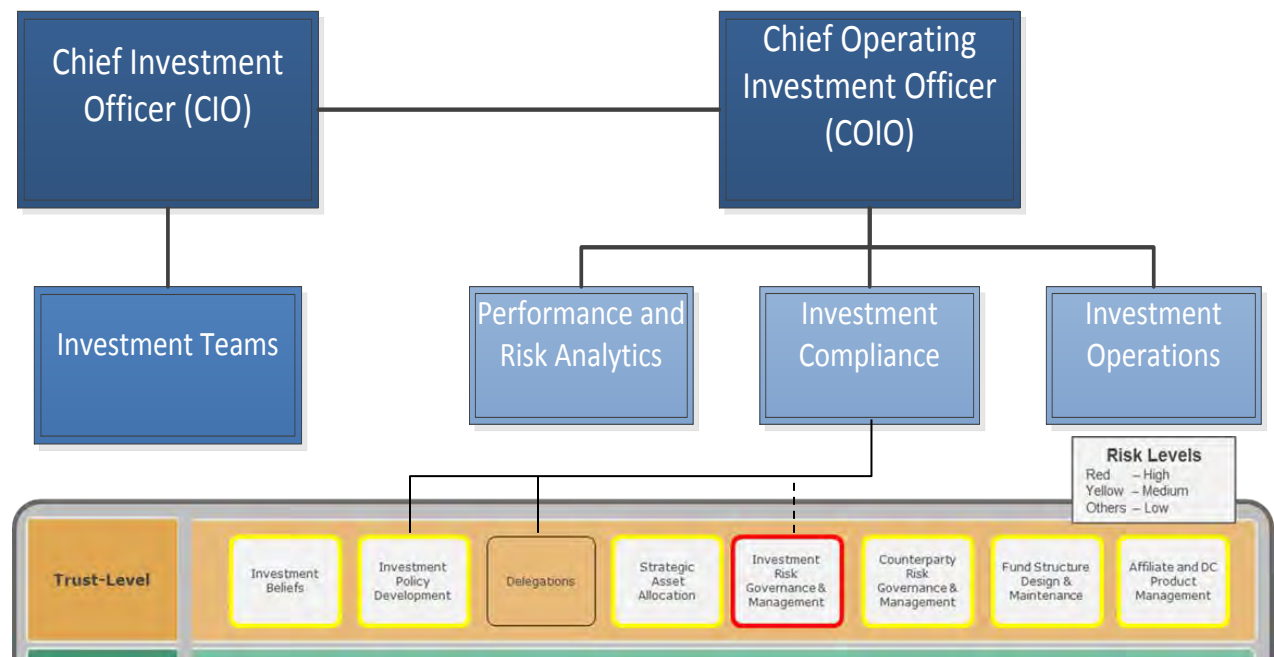
# Business Model

## Trust Level Organizational Alignment

### Key point:

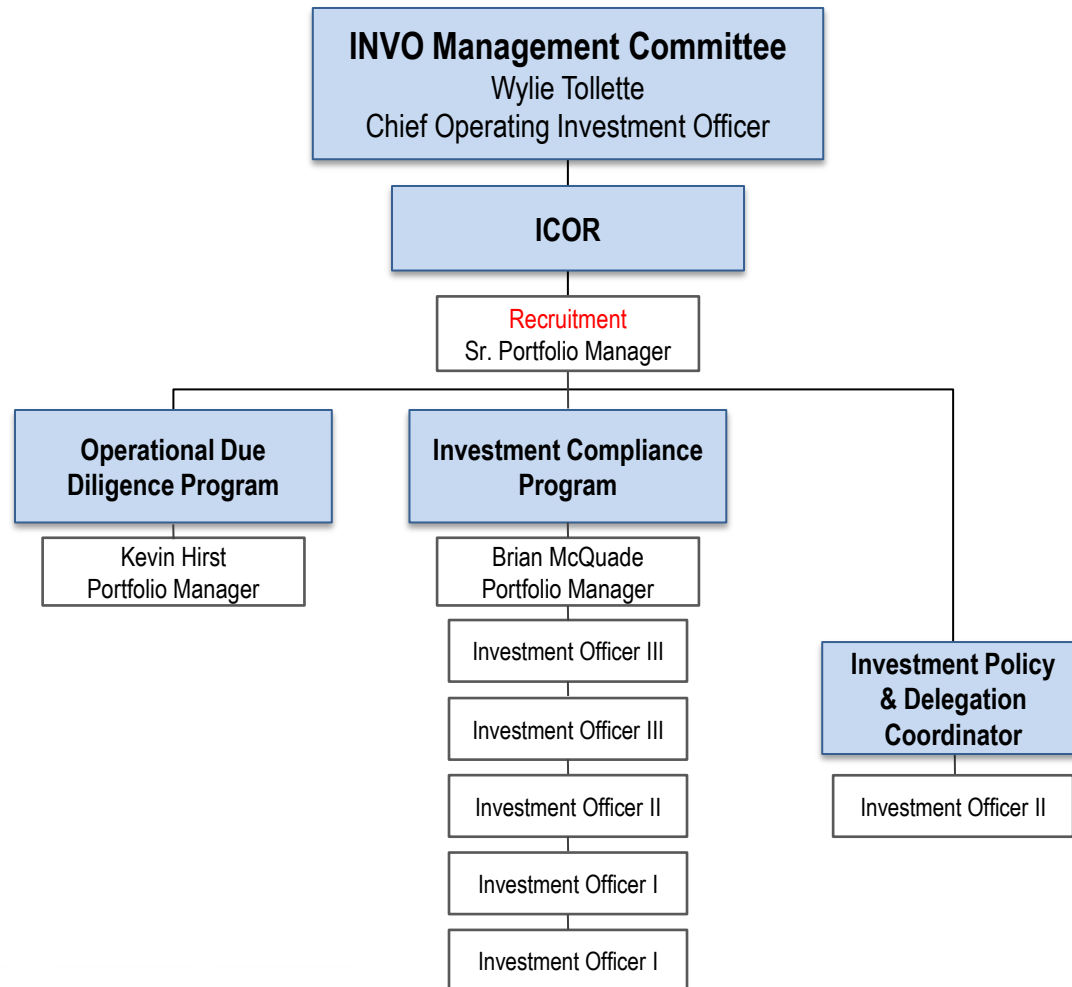
Risk taking & risk monitoring control functions are separate

### Investment Teams Supported by Dedicated Functional Groups



*Team Oriented Approach with Support Areas that act as Key Internal Partners While Maintaining Clear Segregation of Duties*

# Staffing Overview





# Strategic Plans

## Overarching Objectives to Mature the Program

- Our vision is to:
  - Improve oversight of and transparency into end-to-end investment process
  - Continue refining internal processes and governance to enhance the control environment
  - Evolve INVO culture to approach “getting compliance right the first time”
- Our goal is continuous improvement of the program by:
  - Institutionalizing completed initiatives
  - Incorporating industry best practices (preventative vs. detective)
  - Adapting core functions in response to changes in environment, markets and INVO investment strategy
  - Incorporating practical learning into staff education and training

# Strategic Initiatives Update

## Upcoming Projects FY 15-16

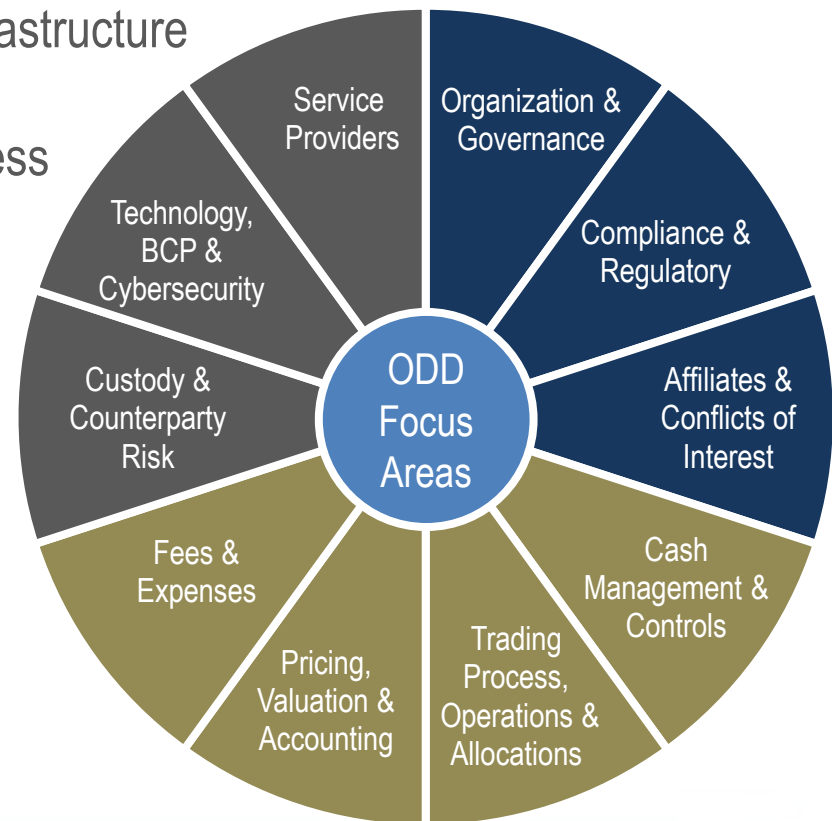
- Investment Policy Revision Project - Phase II
- Collaborate with ECOM building out the integrated assurance framework
- CalPERS Insider Trading Policy Revision Project
- Placement Agent Regulation Revision Project
- Manager review and monitoring functionalization project
- Continue to advance compliance and due diligence reviews within the private market asset classes

# Strategic Initiatives Update (continued)

## Operational Due Diligence (ODD) Strategic Goals

- Identify potential business (non-investment) risks of an external manager
  - Evaluate people, policy, process and infrastructure of an external manager's operations
  - Identify potential business risks and assess sufficiency for mitigating such risks

Asset Class	Integration into Manager Selection & Monitoring	ODD Visits (FY 14-15)
PE	<ul style="list-style-type: none"> <li>✓ Adopted into underwriting process</li> <li>✓ Planned adoption into monitoring process</li> </ul>	7
GE	<ul style="list-style-type: none"> <li>✓ ODD on potential and existing relationships</li> <li>❖ Discussing further refinements to integrate</li> </ul>	2
GFI	<ul style="list-style-type: none"> <li>✓ ODD on potential and existing relationships</li> <li>❖ Discussing further refinements to integrate</li> </ul>	7
REU/IFG	<ul style="list-style-type: none"> <li>❖ Initiate integration planning in FY 15-16</li> </ul>	



# Conclusion

## Summary and Next Steps

- We have made significant progress transitioning from *de novo* status to a mature investment compliance program
- Continuous improvement by operationalizing recently completed initiatives
- ICOR staff continue to collaborate across CalPERS enterprise divisions to provide subject-matter expertise and guidance

## IV. Appendix

# Public Fund Compliance Officers Group

## Best Practices Discussion Topics

### Compliance Officers Group Conference Call Discussion Topics

2012	2013	2014	2015
<ul style="list-style-type: none"> <li>• Monitoring regulatory issues and How to build an enterprise compliance program for an investment office</li> <li>• Insider Trading and Information Barriers</li> <li>• Business Continuity and Disaster Recovery Planning</li> <li>• Insider Trading: A Primer for U.S. Pension Fund Compliance Professionals</li> <li>• Target Operating Model (TOM)</li> <li>• External Investment Manager Oversight</li> </ul>	<ul style="list-style-type: none"> <li>• Today's Compliance Environment Challenges</li> <li>• Due Diligence: Compliance Consultant's Perspective</li> <li>• Drafting Policies and Procedures</li> <li>• OFAC, AML, and Pension Funds</li> <li>• ISDA Protocol and Dodd-Frank</li> <li>• Fraud Risk</li> <li>• Monitoring External Managers</li> <li>• Conflict of Interest Monitoring</li> <li>• Counterparty Risk</li> <li>• Federal Securities Laws Applicable to Public Pension Funds</li> <li>• Foreign Regulation Monitoring and Reporting</li> <li>• How do we spend our time?</li> </ul>	<ul style="list-style-type: none"> <li>• Section 13 Regulatory Filings</li> <li>• Trading and Portfolio Management</li> <li>• Contract Terms Part 1: Timing, and Alignment</li> <li>• Best Execution and Fiduciary Duty</li> <li>• eGRC Solutions</li> <li>• Building a Compliance Program in a Public Pension Fund</li> <li>• Contract Terms Part 2</li> <li>• CalSTRS Proxy Voting</li> <li>• Cybersecurity Update</li> <li>• 2014 CCO Survey</li> <li>• NSCP Public Pension Fund Overview</li> <li>• Contract Terms Part 3</li> </ul>	<ul style="list-style-type: none"> <li>• 2014 CCO Survey Response Analysis Report</li> <li>• Class Action Lawsuits</li> <li>• <i>Foreign Account Tax Compliance Act</i></li> </ul>

# Investment Compliance Training

## Mandatory Annual Investment Compliance Training

### Core Curriculum: Topics Covered Annually (Laws, Rules, or Regulations and Ethics Related Policies Requirements)

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>FPPC Form 700 Filing</li> <li>Personal Trading Regulations</li> <li>CalPERS Restricted List Process</li> <li>Staff Ethical Decision Making Policy</li> </ul> | <ul style="list-style-type: none"> <li>CalPERS Gift Policy</li> <li>Statement of Incompatible Activities for Officers/Employees</li> <li>Conflicts of Interest</li> <li>Contracts Related Disclosures</li> </ul> |
|---|--|

2013	2014	2015 (Proposed)
<ul style="list-style-type: none"> <li>Operational Risk &amp; Operating Events</li> <li>Approval of Outside Employment</li> <li>Post-Employment Restrictions</li> <li>Using the Ethics Helpline</li> <li>Protocols and Guidelines for CalPERS Board Communication with Staff</li> <li>Bagley Keene Open Meeting Act</li> <li>Role of Stakeholders at CalPERS</li> <li>Undue Influence Policy</li> </ul>	<ul style="list-style-type: none"> <li>Introduction to Operational Risk Framework</li> <li>CalPERS Restricted Contact Policy</li> <li>Attorney Client Privilege</li> <li>Placement Agent Policy and Regulation</li> <li>Selected New INVO Policies               <ul style="list-style-type: none"> <li>Portfolio Holdings Disclosure Policy</li> <li>Records Retention</li> <li>Derivatives &amp; Counterparty Risk</li> </ul> </li> </ul>	<p><u>Core Curriculum Focus Areas:</u></p> <ul style="list-style-type: none"> <li>Statement of Incompatible Activities for Officers/Employees               <ul style="list-style-type: none"> <li>Guidelines for CalPERS Staff</li> <li>Communication with Media and Legislative Staff</li> </ul> </li> <li>Select New or Updated INVO-related Policies and Regulations               <ul style="list-style-type: none"> <li>External Investment Resource Conflict of Interest</li> <li>Staff Ethical Decision Making Policy</li> <li>INVO Travel Policy Update</li> <li>Employee Confidentiality Policy</li> </ul> </li> </ul> <p><u>Elective Curriculum:</u></p> <ul style="list-style-type: none"> <li>Industry speaker series</li> </ul>

