MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

INVESTMENT COMMITTEE

OPEN SESSION

ROBERT F. CARLSON AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

MONDAY, JUNE 15, 2015

10:00 A.M.

JAMES F. PETERS, CSR
CERTIFIED SHORTHAND REPORTER
LICENSE NUMBER 10063

A P P E A R A N C E S

COMMITTEE MEMBERS:

Mr. Henry Jones, Chairperson

Mr. Bill Slaton, Vice Chairperson

Mr. Michael Bilbrey

Mr. John Chiang, represented by Mr. Frank Moore

Mr. Richard Costigan

Mr. Rob Feckner

Mr. Richard Gillihan, represented by Ms. Katie Hagen

Ms. Dana Hollinger

Mr. J.J. Jelincic

Mr. Ron Lind

Ms. Priya Mathur

Ms. Theresa Taylor

Ms. Betty Yee

STAFF:

Ms. Anne Stausboll, Chief Executive Officer

Ms. Cheryl Eason, Chief Financial Officer

Mr. Ted Eliopoulos, Chief Investment Officer

Mr. Matthew Jacobs, General Counsel

Mr. Eric Baggesen, Senior Investment Officer

Mr. Danny Brown, Chief, Legislative Affairs Division

Ms. Tiffani Harter, Committee Secretary

Mr. Curtis Ishii, Senior Investment Officer

APPEARANCES CONTINUED

STAFF:

Mr. Brian McQuade, Portfolio Manager

Ms. Anne Simpson, Senior Portfolio Manager

Mr. Wylie Tollette, Chief Operating Investment Officer

Mr. Laurie Weir, Senior Portfolio Manager

ALSO PRESENT:

Ms. Julia Bonafede, Wilshire Associates

Mr. Allan Emkin, Pension Consulting Alliance

Mr. Andrew Junkin, Wilshire Associates

Ms. L.R. Roberts, California State Retirees, Chapter 2

Mr. Bern Vernazza, Financial 2nd Opinions & Precision Fudiciary Analytics

Mr. Tom Woefel, Pacific Community Ventures

I N D E X

I N D E X C O N T I N U E D

P R O C E E D I N G S

CHAIRPERSON JONES: I'd like to call the Investment Committee meeting to order, please. The first order of business is roll call, please.

COMMITTEE SECRETARY HARTER: Henry Jones?

CHAIRPERSON JONES: Here.

COMMITTEE SECRETARY HARTER: Bill Slaton?

VICE CHAIRPERSON SLATON: Here.

COMMITTEE SECRETARY HARTER: Michael Bilbrey?

COMMITTEE MEMBER BILBREY: Good morning.

COMMITTEE SECRETARY HARTER: John Chiang represented by Frank Moore?

ACTING COMMITTEE MEMBER MOORE: Here.

COMMITTEE SECRETARY HARTER: Richard Costigan?

COMMITTEE MEMBER COSTIGAN: Here.

COMMITTEE SECRETARY HARTER: Rob Feckner?

COMMITTEE MEMBER FECKNER: Good morning.

COMMITTEE SECRETARY HARTER: Richard Gillihan represented by Katie Hagen?

ACTING COMMITTEE MEMBER HAGEN: Here.

COMMITTEE SECRETARY HARTER: Dana Hollinger?

COMMITTEE MEMBER HOLLINGER: Here.

COMMITTEE SECRETARY HARTER: J.J. Jelincic?

COMMITTEE MEMBER JELINCIC: Here.

COMMITTEE SECRETARY HARTER: Ron Lind?

COMMITTEE MEMBER LIND: Here.

COMMITTEE SECRETARY HARTER: Priya Mathur?

COMMITTEE MEMBER MATHUR: Morning.

COMMITTEE SECRETARY HARTER: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Here.

COMMITTEE SECRETARY HARTER: Betty Yee?

COMMITTEE MEMBER YEE: Here.

CHAIRPERSON JONES: Okay. Thank you very much. Before we start our meeting, I would like to take a moment of personal privilege regarding a lifetime achievement aware that one of our members -- staff members received. Anne Simpson, CalPERS Senior Portfolio Manager, and Director of Global Governance was given a lifetime achievement award for her corporate governance work by the International Corporate Governance Network at their 2015 annual meeting earlier this month in London.

The award is given annually to individuals who have demonstrated exceptional achievements in the field of corporate governance and contributed to significant improvements in one or more jurisdictions. In giving the award, ICGN recognized Anne for being associated with the creation and practice of good corporate governance principles around the world for the last 30 years.

Anne has dedicated much of her career to working for more effective and transparent corporate governance principles, including increased shareowner rights. This award is well deserved and all of us at CalPERS are very proud of her. So why didn't you join me in congratulating Anne.

(Applause.)

CHAIRPERSON JONES: And on a separate note, CalPERS received a commendation from the Best Responsible Investment Report by a Large Pension Fund for Responsible Investor for its second sustainability publication titled, *Towards Sustainable Investment & Operations*, *Making Progress*.

This is the second time CalPERS has been recognized by Responsible Investor for their sustainability report. The report explains the fiduciary framework for CalPERS has adopted to integrate sustainability and across the total fund, illustrates recent achievement, and outlines a vision for the future.

I understand Anne and her team are here this morning in the auditorium. On behalf of the Investment Committee, thank you for all of the great work. So thank you, Ms. Simpson.

(Applause.)

CHAIRPERSON JONES: Okay. Thank you.

Now, we will go to the Executive Report, Chief Investment Officer Briefing. Mr. Eliopoulos.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Terrific. Mr. Committee Chair, Mr. Jones, thank you so much. Good morning, Committee members.

I'll be on the briefer side today in my comments, because we have a very full agenda in front of us today.

But some -- two important topics. One, last month we presented the Investment Office Roadmap update that included a discussion of the cross-over point between the level of contributions and investment income that we receive on the one hand, and the increasing costs and benefit payments that we pay out on the other.

To address this new cash flow environment, we are, as the Committee is aware, taking many steps over the past few years to restructure our portfolio in order to reduce cost, risk, and complexity throughout the portfolio. Our vision for the next five years is towards repeatable, predictable, and scalable strategies.

In the area of external management, we currently have approximately $90 billion invested with external managers. We want to continue to have access to external investment talent, but at the right number, scale, and cost. As we have restructured the portfolio in favor of a more total fund strategy between 2007 and now, we've reduced the total number of external managers from approximately 300 to 200.

Over the next five years, we hope to streamline this number further to have approximately 100 external managers going forward. Streamlining to seasoned proven managers with larger capital commitments ensures more competition for our capital, better performance we believe, and more favorable fee structures.

Our goal is to have fewer, more strategic relationships with external managers. As I mentioned last month, this strategic portfolio restructuring includes our ongoing commitment to emerging managers and the creation, as we'll hear later in the agenda today, of a new opportunity for successful emerging managers to compete for new capital commitments and transition to larger direct relationships in CalPERS portfolio.

This new opportunity provides CalPERS continued access to a pipeline of successful new investment platforms, and you'll hear more about that in our agenda item later today. And Laurie Weir will be leading that discussion.

Second, and lastly, I did -- apropos of recognizing our tremendous corporate governance team that we have here at CalPERS, the proxy voting season is drawing to a close, and as this Committee is very well aware the long-standing priority for CalPERS in the area of access to the proxy. Proxy access, as we've been reporting to the Committee, has been what really is the focal point of the 2015 proxy season.

Proxy access helps to ensure that corporate boards are accountable to the shareowners. It gives shareowners and the United States the right to nominate director candidates on a company's ballot or proxy statement. As the proxy season now draws to a close, we've had several notable proxy access victories in 2015, including at Chevron, at Kohl's -- it's a company that CalPERS filed a shareowner proposal -- McDonald's, Occidental Petroleum, and Duke Energy.

To date, our corporate governance staff have tallied 78 shareowner votes on proxy access in this proxy season, and we've been successful in 51 of the 78. That's a 65 percent approval rate. We think that is a tremendous tipping point for this issue, and we're very gratified that so many shareowners across the country have really worked together to make this such a pivotal year.

Lastly, one shout-out for our website redesign project, which is undergoing, which has the tangential effect of allowing us to enhance our proxy voting disclosures. So coming in July, the Global Governance Section of the CalPERS website will include a link to the proxy voting section that will give the public access to all our votes at CalPERS once they are cast. And this will be another great enhancement to what we're already doing.

So with that, Mr. Chair, that's my report. Be glad to take any questions.

CHAIRPERSON JONES: Okay. Seeing no questions. Thank you, Mr. Eliopoulos.

The next item on the agenda is Consent Action items. Do I have a motion.

COMMITTEE MEMBER LIND: Moved.

COMMITTEE MEMBER MATHUR: Second.

CHAIRPERSON JONES: Moved by Mr. Lind. Second by Mrs. Mathur.

Seeing no discussion.

All in favor say aye?

(Ayes.)

CHAIRPERSON JONES: Opposed?

Seeing none. The item passes.

The next item on the agenda is Consent Information Items. And, Mr. Jelincic, you have a quick question or -- because if it's a discussion, I want to pull it off and put it at the end.

COMMITTEE MEMBER JELINCIC: I think it's a quick question.

CHAIRPERSON JONES: Okay.

COMMITTEE MEMBER JELINCIC: On the federal lobbyist, one of the things that happened this week is the markup of the SEC spending bill, which leaves it flat, rather than the increase that the administration had asked for. It limits the SEC's ability to use its reserves. And most problematic, it actually bars the agency from adopting regs to require political disclosure. And so my question is what has staff been doing on this, and separately, what has K&L Gates been doing on it?

CHIEF INVESTMENT OFFICER ELIOPOULOS: There have been many times in the past where CalPERS has moved to encourage Congress to make available funding to the SEC in the past. I'll have to follow up with you on this particular instance in this past week with the representative and our Corporate Governance staff.

Danny.

COMMITTEE MEMBER JELINCIC: And Danny is going to take the other half of the question.

LEGISLATIVE AFFAIRS DIVISION CHIEF BROWN: Danny Brown, CalPERS staff.

This will be an item that we'll definitely be able to report more on next month. Mr. James Andrus is actually in D.C. this week with K&L Gates having some meetings, meeting with the Senate Finance Committee staff, both Dems and Republicans, to talk about this funding issue for both SEC and CFTC, and meeting with a number of

California delegates. So it is something that we're aware of and working on, and so we'll report back on the progress.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON JONES: Okay. Thank you.

Okay. Seeing no further requests for information on these items, we will now move to the next item, which is the Item 5, Global Governance Policy Ad Hoc Subcommittee Report. And for a report on that, I call on the Vice Chair of the Global Governance Policy Ad Hoc Subcommittee, Mr. Slaton.

VICE CHAIRPERSON SLATON: Okay. Thank you, Mr. Chairman.

The Global Governance Policy Ad Hoc Committee met on May 20th, 2015. The Subcommittee elected Henry Jones as Chair and myself as Vice Chair and reviewed the purpose and a draft workplan for the Subcommittee.

The Subcommittee will meet on June 17th to review the Core Principles of the Global Governance Principles. And that completes my report.

CHAIRPERSON JONES: Okay. Thank you, Mr. Slaton.

Okay. The next item, action agenda items. We go to Item 6, Revision of the Total Fund Investment Policy Regarding the Liquidity Asset Class.

Mr. Baggesen.

SENIOR INVESTMENT OFFICER BAGGESEN: Good morning. Eric Baggesen, Senior Investment Officer for Asset Allocation and Risk Management. I'm joined by Andrew Junkin from Wilshire Associates and Allan Emkin from Pension Consulting Alliance.

Agenda Item 6A is a continuation of information that's been brought to you in both the April and May time frame. This agenda item deals with the interim asset allocation targets, and most specifically the discussion around the liquidity asset class.

As requested by the Investment Committee Chair, we've written this agenda item, which is an action item. We've written this with two options. Option 1, which is the staff recommendation, incorporates a reduction to the liquidity asset class target from two percent to one percent, and expands the range around the liquidity asset class target to a range of plus or minus three percent centered on that one number.

There are some common elements in options 1 and 2. The common elements are a simplification of the purpose of the liquidity asset class to being cash available to meet expenses, and also to simplify the benchmark for the asset segment to the 91-day T Bill, which we believe is consistent with the cash type of a benchmark.

Option 2 maintains that target for liquidity at its current level of two percent and maintains the range around that liquidity target at plus or minus one percent. So that just maintains the status quo.

There is, in Attachments 1 and 2, policy language related to each of these options. And then in Attachments 3 and 4 we have a opinion letters from Wilshire Associates and Pension Consulting Alliance.

And before asking if you have any questions, I would just make three simple comments about this agenda item. The staff recommendation is for Option 1, but the staff are completely comfortable implementing either Option 1 or Option 2 at the Investment Committee's discretion.

The recommendation of Option 1 reflects activities that have happened in the Finance and Administration Committee where the concept of a reserve account under the control of the Finance Office and our Chief Financial Officer has been established. We believe this reserve account is actually one of the underpinnings that allow us to make the recommendation that we have in Option 1 to reduce the liquidity asset class.

It's important to recognize though that there's still discussion to be happening about the structure of the reserve account. That information will be brought by the Chief Financial Officer, I believe, beginning in the August meeting. And that information will be brought to the Finance and Admin Committee, particularly to establish an understanding about the target level for the reserve account, and also around the parameters that would impact changing the reserve account level.

One of the elements also that I would like to comment on is that should the Investment Committee approve Option 1, the staff will not implement the concept of borrowed liquidity, until we have brought an information item to this Committee that would reflect both enhanced reporting on the potential leverage attached to Option 1, and also to outline the procedures by which this kind of capability would be controlled.

And I think with those comments, I would ask if you have any questions or if you'd care to inquire of PCA or Wilshire Associates regarding their opinion letters which are supportive of Option 1.

CHAIRPERSON JONES: Okay. Thank you, Mr. Baggesen.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: So, at this point, the issue of the size of that reserve fund is still up in the air, and the issue of who manages and how it gets managed is also still to be resolved, correct?

SENIOR INVESTMENT OFFICER BAGGESEN: Yes, I believe that those would be elements that would be part of the discussion when the Chief Financial Officer brings that to the Finance and add minute Committee, Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Okay. So, at this point, they're not resolved as far as you know?

SENIOR INVESTMENT OFFICER BAGGESEN: That's correct.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON JONES: Mr. Lind.

COMMITTEE MEMBER LIND: I can't believe there is one additional shred of information that staff could bring to us on this item.

(Laughter.)

COMMITTEE MEMBER LIND: As both of the consultants said, this is a tool for our Investment staff to use. I am confident they will use it well. And I would -- I'll make a motion that we adopt a recommendation -- or Option number 1, the staff's recommendation.

VICE CHAIRPERSON SLATON: Second.

CHAIRPERSON JONES: Okay. It's been moved by Mr. Lind to adopt Recommendation 1, staff's recommendation, second by Mr. Slaton.

All those in favor, say aye?

(Ayes.)

CHAIRPERSON JONES: Oppose?

Hearing none. The item has passed. Thank you very much.

SENIOR INVESTMENT OFFICER BAGGESEN: Thank you very much.

CHAIRPERSON JONES: Okay. We're on to Agenda Item 6B, which is another agenda item from our asset allocation area. Agenda Item 6B, again, is a continuation of information that's been put before this Committee most recently at the May meeting. This is related to the Long-Term Care Fund and the periodic asset allocation work that is required by the policy guiding the investment activities around that fund.

The staff recommendation in relation to this is to maintain the existing asset allocation structure that was established in 2012. This recommendation is predicated on the simple element of further activities to happen within the stabilization program that's been in implementation phase for the last couple of years.

And until that stabilization program has been completed, it's very difficult to know exactly the structure of the liabilities. And therefore, it sort of makes moot the issue of asset allocation activity until we can understand that.

So I think with that comment, I would ask if you have any questions, with the notation that there is a bit of policy language in the attachments to this agenda item. The policy language is basically working to bring the structure of asset allocation for the Long-Term Care Program into a consistent framework that we use for the PERF. So we're establishing a liquidity asset class with a target of zero and a range of plus one percent. There is no negative range on that.

And we're also inserting some language that would allow us to bring an agenda item to this Committee asking for approval to postpone asset allocation-related activity, where it could be foreseen that we would not be able to come to a conclusion of that activity for a variety of reasons. And it's simply just a workload management kind of an issue, and it is at the discretion of the Investment Committee. And I'd be happy to take any questions.

CHAIRPERSON JONES: Thank you.

Mrs. Mathur.

COMMITTEE MEMBER MATHUR: Thank you.

Well, I think this -- the staff's recommendation is consistent with the Pension and Health Benefits Committee's and the Board's desire to really stabilize the

Long-Term Care Fund and program. And I think we've actually made quite a lot of progress over recent years.

And so as a result, I will move that with respect to the Long-Term Care Fund, we maintain the current asset allocation for the fund, we approve the proposed revisions to the Statement of Investment Policy, and we approve the proposed revisions to the CalPERS Total Fund Investment Policy.

COMMITTEE MEMBER LIND: Second.

CHAIRPERSON JONES: It's been moved by Mrs. Mathur, second by Mr. Lind.

Any further questions?

All those in favor say aye?

(Ayes.)

CHAIRPERSON JONES: Oppose?

Hearing none. The item passes.

Thank you very much.

SENIOR INVESTMENT OFFICER BAGGESEN: Thank you very much.

CHAIRPERSON JONES: Okay. Now, we move to Item 7A, Request for Approval of Contract for Responsible Contractor Policy Consultant.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Great. I'll be joined shortly by Ms. Laurie Weir.

This -- 7A is an action item. And it's a request for approval of a contract for a Responsible Contractor Policy consultant. And I'll turn it over to Laurie.

SENIOR PORTFOLIO MANAGER WEIR: Good morning, Investment Committee members. Laurie Weir, Targeted Investment Programs.

Investment Committee approval is needed whenever staff seeks to engage a Board consultant. Over the past many years, staff has worked with PCA on revisions to and the administration of the Responsible Contractor Program Policy as well as labor issues across the total fund.

Staff has come before the Investment Committee several times in the past two years requesting minor extensions to or amendments to PCA's contract.

With this agenda item, staff recommends the Investment Committee provide the authority to enter into a contract with PCA for up to five years and up to $150,000. This will reduce the need for interim agenda items authorizing changes to the PCA contract.

But before I end this brief presentation, I wanted to take a quick moment to provide an update on staff's engagement with SEIU on their work related to negotiations of security and janitorial contracts across the State of California.

Staff has encouraged relevant real estate managers, those are real estate managers with assets in areas where negotiations are either ongoing or expected, to keep good lines of communication open and to urge appropriate parties to negotiate in good faith.

Several of CalPERS managers have met with or have agreed to those open discussions with SEIU. Staff well encourage -- will continue to engage with labor and managers and encourage all parties to continue to talk until resolution is reached.

And that ends my presentation. And I'm happy to answer any questions. Thanks very much.

CHAIRPERSON JONES: Thank you, Mrs. Weir.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Well, Allan and Curtis are about the only two people in the Investment Office who were here when I got here. And I certainly value institutional knowledge. I also acknowledge that Allan has done a good job. He's had the labor folks that have dealt with him have felt he's a straight shooter.

But I do want to raise the question of what was staff's discussion about whether it's time to put some new eyes on this just because it's been so long?

SENIOR PORTFOLIO MANAGER WEIR: Yeah. So staff always considers the best and most highly qualified consultant when seeking consultant advice and services. And staff carefully considered this and determined that

PCA has unusual and unique qualifications in this instance. PCA and Allan Emkin's role, as you alluded to, Mr. Jelincic, with CalPERS on labor-related issues predates the establishment of the RCP Policy. Allan helped draft the very first RCP Policy and has been involved in the administration and improvement of the policy over the last 20 years.

Allan is a credible advisor on labor-related issues and is viewed as objective and fair and reasonable in his advice on these issues across the total fund. And it was for those reasons that we determined that PCA continued to have unusual and unique qualifications and staff decided this was the best course of action.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON JONES: Ms. Taylor.

COMMITTEE MEMBER TAYLOR: Laurie, I wanted to thank you for that. And I agree, I think that PCA has got the experience necessary, in my opinion, to do this. But I also wanted to thank you for pointing out that you're looking into the program's with the labor folks that came and spoke. I think they work for Universal or something like that. And I appreciate that you're monitoring that and that you're going to keep monitoring that moving forward. We appreciate your work on that.

So thank you.

CHAIRPERSON JONES: Okay. Thank you. This is a action item.

COMMITTEE MEMBER JELINCIC: I'll move it.

COMMITTEE MEMBER HOLLINGER: Second.

CHAIRPERSON JONES: Okay. Moved by Mr. Jelincic and seconded by Mrs. Hollinger.

Any further discussion?

All those in favor say aye?

(Ayes.)

CHAIRPERSON JONES: Opposed?

Hearing none. The item passes.

Thank you for the report.

Next item on the agenda is 8A, Targeted Investment Programs and Manager Restructure Update.

(Thereupon an overhead presentation was presented as follows.)

SENIOR PORTFOLIO MANAGER WEIR: And we have a PowerPoint. I'll just give this a second here. There we go.

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SENIOR PORTFOLIO MANAGER WEIR: Ted, did you have any opening remarks. I can just allude to your -- okay. So Ted did a fabulous job of teeing up this conversation in his CIO remarks a bit earlier this morning. And so I will go straight to --

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SENIOR PORTFOLIO MANAGER WEIR: -- Slide 4. Laurie Weir, Targeted Investment Programs. Emerging Manager Transition Program. As staff engaged with emerging manager firms and stakeholder groups during the development of the five-year plan, staff heard clearly from all parties that there was an issue.

And that issue was that we have robust emerging manager programs, but once a manager grows big enough to grow beyond the definition of an emerging manager, which is typically a fund 1, fund 2 and less than a billion dollars of assets under management, that those firms go into a kind of a limbo where they are not big enough necessarily to compete for large capital commitments in large established manager pools.

And so in response to that concern, we included a workstream in the five-year plan to establish parameters and criteria for transitioning managers to direct mandates.

The establishment of this manager transition program is particularly timely in light of the portfolio restructuring that Ted referenced earlier this morning that will result in fewer relationships with larger investment managers across the total fund. The new Manager Transition Program will help fill the gap between emerging managers and large established managers.

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SENIOR PORTFOLIO MANAGER WEIR: As illustrated on this slide, emerging manager investment commitments range from a low of about $8 million to a high of $150 million. And emerging manager programs include external manager, mentoring manager, fund of fund, or advisor oversight. On the other hand, the pool of established managers is expected to have investment commitments that start from a low of $350 million and move quickly to in excess of multi-billion dollar relationships with CalPERS.

So how does a manager grow from the new small emerging phase to become large enough to compete for a spot in our established manager pool, and importantly, how did CalPERS continue to have access to new investment platforms that have demonstrated early success?

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SENIOR PORTFOLIO MANAGER WEIR: The establishment of a new manager transition program answers both of these questions. The asset classes that have emerging manager programs, private equity, real estate, and global equity will have the opportunity for continued investment with successful emerging manager firms through the new manager transition program.

While each asset class is different, in each case, the manager transition program will provide the opportunity to invest in follow-on funds and incrementally larger commitment amounts with significant additional time to test and prove the skills and capacity of investment manager firms.

The goal is to establish a pipeline of external manager talent to invest with managers as they grow large enough to compete for significant investment strategies when there is an opening and an opportunity to do so in our pool of large established managers.

Asset classes will be able to review potential transition candidates from our emerging manager programs as well as from outside emerging manager programs where managers meet our definition of a transitioning manager.

The evaluation criteria to determine transition candidates are the same for all manager decisions across the total fund. The key categories of that evaluation are, first, historical performance, second, strategy and value creation, management team and talent, asset allocation and portfolio fit, and finally alignment of interests with CalPERS.

The parameters of the transition program are purposefully broad to allow asset classes thoughtful and flexible administration of the program going forward. Managers will have to constantly compete to meet or exceed expectations in order to remain in the manager transition program. Asset class staff will make all decisions to invest or to remove a manager from the transition program should their performance not meet expectations.

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SENIOR PORTFOLIO MANAGER WEIR: Over the course of the next five years, the transition program will commit up to $7 billion to approximately 15 transitioning managers. As you can see from this chart, with continued commitment to our emerging manager programs of up to $4 billion dollars, the combined capital commitments to emerging and transitioning managers is up to $11 billion. To assure asset class flexibility, it is important to note that these amounts are not hard investment targets, but estimated program amounts. Based on investment opportunities that are pursued, actual commitment amounts may be less than the maximum stated here.

Staff will track and report activity on both emerging and transitioning manager programs and will report to the Investment Committee on commitment amounts, as well as issues and successes as the program matures in the come years.

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SENIOR PORTFOLIO MANAGER WEIR: The objectives of the manager transition program are to generate appropriate risk-adjusted returns by investing with managers with demonstrated success in their first and second investment strategies, to have continued access to investment opportunities with successful firms and increased representation of women and minority-owned firms in CalPERS portfolio, and finally, to provide a path of growth and opportunity for emerging managers at to build their firms to a size large enough to compete for entry into our pool of large established managers.

So the next part of my presentation will go on to talk about diversity and inclusion initiatives. So Mr. Chair, if this is an appropriate time to pause and see if there's any questions, that might be good.

CHAIRPERSON JONES: Yes, that's correct, Laurie.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: I've never been a big fan of contracting out, in case you hadn't gotten the hint along the way. But one of the things that I notice is that we do not have an Emerging Manager Program in fixed income and historically we have not. Why is that?

CHIEF INVESTMENT OFFICER ELIOPOULOS: I'm going to ask Curtis to come up here.

COMMITTEE MEMBER JELINCIC: The other old-timer come on down.

CHIEF INVESTMENT OFFICER ELIOPOULOS: It's a relatively -- the external piece is a relatively small part of the fixed income program, and fairly specialized. With that, I'll --

SENIOR INVESTMENT OFFICER ISHII: Curtis Ishii, global fixed income.

So that's a good question. We use external managers for specialist type -- specialty type products in general, bank loan products, some high yield. We haven't found a lot of diversity managers in that space. We did find one high yield manager, and they proved to be unsuccessful.

In general, our model is one of internal management, as you well know. So you could see it's -- in general, the use of external managers for fixed income is trying to what we define as a strategic relationship. And we define that as information and services. Services being their analysts and things of that nature. So they tend to have to be bigger than us.

That tends not to fit the diversity model, because they tend not to be big enough. So international is a good example. We got no -- when we did a search for emerging markets, we got no managers applying, even though we reduced the number of the hurdles.

So it is difficult for us to find managers in the fixed income space. If we had a core product and we went outside, I think we would have more managers apply. But as you well know, we do that internal and we've never gone outside on that.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON JONES: Okay. Mrs. Mathur.

COMMITTEE MEMBER MATHUR: Thank you, Mr. Chair.

Well, I think is a real step up in our Emerging Manager Program, and I appreciate so much all of the work that you and your team have gone to develop this. Clearly, you identified a hole that we had in our program, and made this a much more meaningful and hopefully effective program for both the managers themselves and for CalPERS. And I think it also demonstrates a meaningful commitment to the emerging manager space, particularly at a time when we're reducing the number of managers sort of across the -- across our entire portfolio. So I'm really pleased with the work that you have done, and look forward to seeing how it plays out over time as we implement it. Thank you.

SENIOR PORTFOLIO MANAGER WEIR: Thank you.

CHAIRPERSON JONES: Okay. Thank you. And I will echo Ms. Mathur's comments. I know that we have been -- you've been working on this for some time. And at the beginning of your effort to work on this project, I know people wanted immediate answers. And you said, no, there's a process that we have to follow, including outreach to those managers that are affected.

And as a result of that, it seems to be a high degree of support throughout the industry. So I just want to applaud you for the work you're doing and also not losing site, however, that our main goal is returns, so that we can pay benefits. So I appreciate the work on this.

I do have one question. On the -- it's 240 of the iPad, and I don't see the page of the report, but it's the Diversity and Inclusion Steering Committee work.

SENIOR PORTFOLIO MANAGER WEIR: Um-hmm.

CHAIRPERSON JONES: And it talks about the Investment Office talent management diversity recruitment efforts. And what's the status of that, because I know that's been discussed before, but I haven't seen the fruits of that labor yet?

SENIOR PORTFOLIO MANAGER WEIR: I couldn't have asked for a better segue to the next section of my presentation. Are there any other -- are we good with questions about transition?

CHAIRPERSON JONES: Yes.

SENIOR PORTFOLIO MANAGER WEIR: All right. So moving on. Under the direction of the CIO, the Investment Office has established a steering committee to lead all of the Investment Office diversity and inclusion initiatives. The steering committee is guided by Investment Belief number 10, which states strong processes and team work and deep resources are needed to achieve CalPERS goals and objectives, diversity of talent, including a broad range of education, experience, perspectives and skills at all levels, Board, staff, external managers and corporate boards is important.

The steering committee is comprised of the CIO and the COIO, the SIO of Global Equity, as well as two senior portfolio managers, that's Anne Simpson and myself, as well as two investment officers.

To ensure that the investment initiatives are aligned with CalPERS as a whole, the steering committee collaborates with the the broader enterprise, including Human Resources, our Diversity Office Program, and the Legal Office. The steering committee develops goals and priorities and provides direction and oversight on the three diversity and inclusion workstreams, which are corporate boards, external managers, and talent management.

There are significant efforts underway in each of these three areas. You are most familiar with our efforts under Anne Simpson's leadership around Board diversity. You've often heard from me about emerging and diverse manager initiatives related to our external investment manager diversity and inclusion initiatives.

Currently, much of the steering committee's focus is on initiatives to better understand and to increase the diversity of our Investment Office staff. Talent management efforts include continuing our important relationships with the Toigo Foundation including welcoming a new Toigo Fellow as an intern later this month on the Investment Office; expanding the posting of job opportunities and engagement with the diverse stakeholder groups to assist in securing diverse candidate pools to compete for open positions in the Investment Office.

We are about to launch a survey of Investment Office staff to better understand and to establish a baseline of the survey -- of the Investment Office diversity so that we can judge the success of our future efforts as we go forward.

We are seeking to establish new strategic partnerships with diverse organizations to inform and align the Investment Office with industry best practices, and understanding the diversity of the pipeline of talent that is entering the institutional investment and finance fields today.

And we're doing that by finding -- doing research and finding information on, for instance, the diversity of

University of California and MBA programs across the country. And we are also seeking to better understand and we will be reporting this at a next opportunity before you, the diversity, for instance, of the CFA institute and members of the CFA as an organization.

The D&I work related to talent management is in different phases of maturity. In some cases, the work is long established and ongoing, such as our relationship with Toigo and the posting of job opportunities on diverse stakeholder websties. In other cases, the work is new and developing in scope and process, and staff will provide more detailed reports on these efforts as progress is made and milestones are met.

The work we are doing across all three of these workstreams has informed the development of the agenda for our upcoming diversity and investment forum slated for September 10th at the Sacramento Convention Center. And Mr. Chair, if I haven't answered your question, I'm happy to try to do so.

Thanks very much.

CHAIRPERSON JONES: Okay. Thank you very much. I'll circle back.

Mrs. Mathur

COMMITTEE MEMBER MATHUR: Thank you. I just wanted to commend the sort of redoubled efforts around the

Investment Office demographics where I think we have sort of a persistent issue. And I know you've been -- you've been working on it, but this is an area that I think we really need to improve in. So thanks.

CHAIRPERSON JONES: Okay. Mr. Bilbrey.

COMMITTEE MEMBER BILBREY: Thank you, Mr. Chair. I just wanted to note on Attachment 1 such a comprehensive report and detailed work that the staff has done this year. This has been an excellent report for me to see all the work that's been going on. And I thank all of you on my behalf and on behalf of the Board and the members for this work.

I also wanted to note -- I noted that the workers who came and spoke last month from SEIU. I noted you have done some interaction with them and are moving forward. So I thank you for that work as well.

SENIOR PORTFOLIO MANAGER WEIR: Thank you.

CHAIRPERSON JONES: Thank you.

Yeah, I have -- it's kind of a question and a comment on the database, the data -- 3-D, the Board database. And as most know, that CalPERS and CalSTRS invested in an initiative to identify potential candidates to serve on corporate boards throughout America. And that was in response to corporate America saying they couldn't find diverse candidates, women and minorities, to serve on those boards.

So we're saying now here's a list, and that some 400 members, as I understand it, is now on that list. But then when I checked the hit ratio of that list, it's dismal. And so now the question is, is they're saying that part of the problem is that board directors are staying so long and the boards are not being refreshed, so there's no openings.

And the question is, is at Toigo last week they talked about -- certain companies was talking about having advisory Board members to bring in minority and women to serve in advisory capacity, so that when the current director step downs, they would already be ready to step in. So what is our view on that particular issue? Maybe Anne can.

SENIOR PORTFOLIO MANAGER SIMPSON: Thank you very much. Anne Simpson, Director of Global Governance. As you rightly note, Chair, we've got a problem with boards in many countries, which is boards being stale. And particularly in the United States, tenure is getting longer. Now in due course, nature will take its course eventually --

(Laughter.)

SENIOR PORTFOLIO MANAGER SIMPSON: -- but we really don't want to wait that long, so this was the logic behind our proxy access campaign. One group of companies that we focused on were companies where the Board patently lacked diversity. And as Ted mentioned earlier some of the companies where we've won, for example at eBay, those companies were targeted because of the lack of board diversity.

So as you rightly say, we were focusing on supply, because we were told that was the problem. Now, we need to focus on demand. The issue of advisory boards isn't something that we've looked at, but I think this would be a really good issue sit down with Toigo and talk to them about and see whether this is something where we could work together.

CHAIRPERSON JONES: Okay. Thank you very much. Okay. Thank you. You can proceed.

SENIOR PORTFOLIO MANAGER WEIR: There we go. Are we ready to move on to CalPERS for California or are there any other --

CHAIRPERSON JONES: Yes. Thank you, Laurie. I see no further questions, so we'll move on to the next item on the agenda. CalPERS for California Report.

SENIOR PORTFOLIO MANAGER WEIR: Thank you so much. Right. Thanks.

So Agenda Item 8B. This agenda item presents the 2014 CalPERS for California Report. Key findings of the report include California investments total $25.7 billion, or eight and a half percent of the total fund during the reporting period.

During that time, over 320,000 jobs were supported in private equity and real estate and infrastructure asset classes. The report is compiled each year with the help of Pacific Community Ventures. And Tom Woefel of PCV is here to present the highlights of this year's report.

Tom.

(Thereupon an overhead presentation was presented as follows.)

MR. WOEFEL: Great. Thank you, Laurie, and thank you all for having us today. My name is Tom Woefel. I'm with Pacific Community Ventures, and this is the fifth year that we'll be presenting findings from the CalPERS for California Report. And we'll also be sharing some highlights from this year's California Initiative Report.

So to begin with, the CalPERS for California Report.

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MR. WOEFEL: This report is a comprehensive examination of CalPERS in-State investments as of June 30, 2014. And the report employs a number of methodologies, including GIS, or geographic information systems, mapping to understand where each of CalPERS investments are occurring in California. We also look at the total number of jobs that are supported within the private markets asset class, and then we also do case studies for individual investments in the private markets asset classes.

And the private equity section, I should note, has a break-out box for the California Initiative Report, and it includes an electronic link to the PDF electronic version of the full report on the CalPERS website.

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MR. WOEFEL: So some of the high level findings that Laurie mentioned. As of fiscal year 2014, CalPERS California investments totaled $25.7 billion. This represents a 24 percent increase from 20.8 billion as of last fiscal year-end. Additionally, these investments represent 8.5 percent of the total fund's activity as of fiscal year-end.

And then within the private markets assets classes, they support a total of 320,000 jobs. Now, within the public equities and fixed income asset classes, the companies that are receiving investment employ just over one million people.

However, the public markets asset class has a less direct relationship to CalPERS capital and the underlying operations of those companies, given CalPERS is one of many investors in public markets.

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MR. WOEFEL: So this next slide depicts the location of each of CalPERS investments across the State. And the different colored dots represent the different asset classes. And then the larger the dot, the larger investment that CalPERS has made. And so you can see that CalPERS investment activity is centered within the Bay Area as well as within the greater Los Angeles area.

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MR. WOEFEL: New turning to some highlights from this year's California Initiative Report. So private equity's California Initiative has the primary objective to achieve appropriate risk-adjusted returns that meet or exceed industry benchmarks.

But as an ancillary objective, it also seeks to invest in traditionally underserved areas where opportunities may have been bypassed, really aiming to impact the economic infrastructure of the State of California.

So our research with the California Initiative Report seeks to really look at these ancillary objectives of the California Initiative. And since inception in 2001, the California Initiative has received over $1 billion. And based on the current active companies within the California Initiative, there's a total of $309 million, of which 222 million, or 72 percent is invested in California companies. And California companies are defined as companies that are either headquartered in the State or have a plurality of facilities or employees within the State.

And so similarly, there's 156 total active companies. And of those, there are 108, which are defined as California companies.

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MR. WOEFEL: So this next slide depicts the ancillary benefits for the California Initiative, and some of the highlights there. So as of fiscal year-end, amongst active companies, there was 35 percent employment growth since the time of investment. That exceeds California as well as U.S. employment growth benchmarks for the private sectors.

Thirty-six percent of California Initiative companies are located in traditionally underserved areas from institutional equity capital, and then 48 percent of employees are considered low to moderate income. This indicates that the California Initiative portfolio companies are providing opportunities to individuals from underserved communities.

And then 32 percent of dollars are invested in companies that have at least one woman officer, and 38 percent of dollars are invested in companies that have at least one minority officer. So amongst the portfolio companies, it's clear that there are -- there's leadership -- diverse leadership as well as women leadership amongst the companies, and this exceeds U.S. benchmarks.

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MR. WOEFEL: Now, this last slide, before I turn it over for questions, depicts the total number of jobs that have been created through the California Initiative. So this is different from jobs supported, in that these are jobs that have been created since the capital infusion into each of these companies.

And so looking at all of the companies that have received investment over the life of the California Initiative, there have been a total of 27,256 total jobs that have been created. And amongst that number, there have been 10,433 jobs that have been created in California.

And the different shading of the bars depicts the number of jobs that have been created amongst the first phase of the California Initiative, as well as the second phase, known as the Golden State Investment Fund. So you can see that amongst the total jobs that have been created, phase 2 has really been driving a lot of the job creation results.

And so with that, I'm happy to turn it over for questions.

CHAIRPERSON JONES: Okay. Yeah, I have a question. It's on page three of the presentation. And it talked about companies headquartered in California receiving investments through CalPERS created over a million jobs, employ over a million people. And so some places you talk about in California, but I'm assuming this is headquartered in California, so how much or to what degree are those really in California?

MR. WOEFEL: Right. So on this slide, all those jobs that you see are California based jobs. And there is different methodologies that we employ for the private markets asset class versus the public markets. And when we're talking about the jobs that CalPERS investments are really supporting, we look primarily at the private asset classes, private equity, infrastructure, and real estate, given there's a much more direct relationship between the capital that CalPERS is deploying and the underlying operations of those companies that are receiving investment.

In the case of the public markets, really that one million figure is to give you a sense for the size and breadth of the companies that are located in California that are within the public markets that are receiving investment. So it's much more difficult to kind of make that linkage between the capital that CalPERS is providing to those companies, given CalPERS is one of thousands of investors oftentimes in these same companies.

CHAIRPERSON JONES: Okay. Thank you.

Okay. Seeing no further questions, thank you for the report.

MR. WOEFEL: Thank you.

CHAIRPERSON JONES: We now go to Item 8C, Investment Compliance Program Review.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Thank you, Mr. Chairman. Wylie Tollette, Chief Operating Investment Officer from the CalPERS Investment Office. Joining me is Brian McQuade who is a manager in our Investment Compliance Program.

(Thereupon an overhead presentation was presented as follows.)

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: And this standing Committee item is our third year in a row presenting the annual review of the Investment Compliance Program. This year's presentation is actually remodeled on the program review outline approved by the Investment

Committee, so many of the pages will look familiar to you.

Similar to the other program reviews, it requires adaptation to each investment program we use it for, and you'll see that.

The way this discussion will progress is I'll provide introductory remarks covering the executive summary, and how this program integrates with our Investment Beliefs. I'm going to turn the middle of the deck over to Brian who's going to cover key elements of the investment compliance activities. And then finally, I'll wrap it up with a review of the new elements within the program and our strategic direction. So I look forward to your questions and your feedback during the presentation.

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CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: An executive summary of where we stand is the investment compliance program is in a maturation phase. We continue to progress this effectively. You heard some elements of that last month as we covered the Target Operating Model element. Compliance is essential to ensure that all of the different elements of our investment activities and operations perform in accordance with investment policy, relevant regulation, laws, and regulatory pronouncements. That's really what they're focus is.

Our core upcoming initiatives are really designed to continue to enhance our compliance activities, as well as to work more closely with our enterprise compliance program. And you'll hear more about that as we progress through the deck.

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CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: This slide should look familiar. I don't -- it's been a few months since we've actually presented a program review using the typical template, but you might remember that the green boxes are where we have sort of nexus with one of our activities, and one of our Investment Beliefs. The yellow boxes are where we have nexus with one of our activities in the Investment Beliefs. And there's some work to do or some degree of tension or outstanding activity. I'll quickly highlight some of those.

So under Investment Belief 2, the long-term horizon, the business model there really has to do with all of the work that this Committee has seen around our investment policy revisions project. The investment policies for CalPERS have been developed and refined over many, many years. And as we briefed the Committee on in February and March, we are undergoing a multi-year effort to clean those up, because they've -- over those many years, they've really -- they've grown significantly in complexity. They've incorporated procedures into them, and so we're still -- we're about two-thirds of the way through that effort. We'll be coming back with additional policy revisions relative to each of the individual investment programs later in the year. And you'll hear a little bit more about that from Brian in a moment. The yellow box there reflects the fact that we're only halfway or two-thirds of the way through that effort.

Under Investment Belief 5, you'll see a yellow box there at the top relative to the program role. And that has to do with our relationship with the enterprise compliance. That has been a sort of -- source of ongoing discussion within CalPERS. And I have an update on where that discussion is going. And it's actually going I think in a very good place. You'll also hear about that in the Risk and Audit Committee later this week.

The yellow box under 7, under sort of risks must be rewarded. That has to do with the scope of our program and essentially the fact that we have, as you've just heard from Laurie and Ted, many external managers. And this year, we've made a more fulsome effort to actually conduct, what we call, operational due diligence on all of those managers. And there's a lot of managers, and we have one operational due diligence fellow. So he's very busy. You'll hear about that in just a moment. I have a slide to cover what operational due diligence covers in more detail. We're making good progress, but the fact that it's yellow really reflects the fact that we have quite a large amount of work ahead of us over the next few years in that space.

And then finally, the yellow under 10, which is really team work and resources, that has to do with the fact that up until very recently we had a senior position in our ICOR team that was open, the Senior Portfolio Manager position. But I'm excited to report that's been resolved and I'll be talking about that a little bit later.

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CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: So with that, I'll turn it over to Brian.

PORTFOLIO MANAGER McQUADE: Great. Well, thank you, Wylie. And good morning, Committee members. My name is Brian McQuade. I'm a portfolio manager within the Investment Compliance and Operational Risk Division within the Investment Office. And I'm pleased to provide you with yet another annual update regarding the progress the team that I lead has made in promoting a culture of compliance within the Investment Office.

Beginning on slide 5, I want just highlight that our group and its functions are really based upon what we see from external investment managers. So it's our view that we should hold ourselves to the same standards that one would find in an external investment manager like one that CalPERS would hire.

Additionally, CalPERS -- or, I'm sorry, ICOR works with staff at all levels to foster a proactive and collaborative approach with an emphasis on getting compliance right the first time. Further more, we know that failure to manage compliance risk is often more costly than not having a function at all.

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PORTFOLIO MANAGER McQUADE: Our core functions are incorporated into a robust governance and oversight framework both within -- both within and outside the Investment Office. As you can see on slide 6, my group has a collaborative working relationship with key internal CalPERS stakeholders, including the Enterprise Compliance Division, the Legal Office, and the Office of Audit Services. We provide periodic reporting of ICOR's activities to the Investment Office's Operating Committee, in addition to monthly reports that you're aware of on items such as policy violations, placement agent disclosures, investment proposal activities.

This governance structure that's in place provides me with the ability to report out on our activities to multiple oversight bodies, and provides me, you know, with great support within this governance structure, you know, to address issues as they come up.

This governance structure is really what allows me to effectuate our business model, which Wylie will cover in a bit.

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PORTFOLIO MANAGER McQUADE: These next two slides I shared with you last year. I wanted just to update you as to the progress and the status of our implementation efforts on various functions, since my group was started in late 2011. As you can see, this critical first line of defense function is maturing very well, and in most cases, is at a business-as-usual state.

One of the core functions that we've developed within the Investment Compliance Program is training. And the training is mandatory for all full-time investment staff. On slide 23, which I won't pull up here, you can see that if you wish in the appendix, I've listed the various topics that investment staff are required, you know, to listen to every year.

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PORTFOLIO MANAGER McQUADE: On the next slide, I did want to come back to an issue that I brought up last year to you. I'd expressed concerns in my remarks then about the progress being made up to that point obtaining an inventory of laws. So an inventory of laws is key in my playbook, if you will, to making sure that we're complying with everything.

I'm pleased to now report that earlier this year working with our Legal Office, I've received a very comprehensive inventory of State of California laws for several key areas, thereby moving this initiative forward.

I'll be working closely with the Enterprise Compliance Division using as a basis much of the work provided by our Legal Office to strengthen compliance and internal control functions. You'll receive an important update on this and other activities from Kami Niebank tomorrow at the Risk and Audit Committee.

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PORTFOLIO MANAGER McQUADE: On slides 10 and 11, I wanted to provide the Committee with a couple of key updates to demonstrate how we are maturing the Investment Compliance Program.

Directing your attention to the middle of slide 10, you are, of course, familiar with our past efforts to identify, report, and remediate policy exceptions, and also the work that we are doing to help revise and review the current state of policies and move them to a more robust framework.

As those surveillance functions are now firmly in place, I introduced some additional reviews that I refer to as forensic testing within my group, where my team was evaluating patterns of data to identify practices that might warrant further attention. a couple of examples here might be changes in portfolio turnover rates. Another example might be the appearance of window dressing, which would be certainly, you know, an improper activity.

I do provide periodic reporting on these and other initiatives to our senior investment officers. And I'm pleased to report that there have been no findings in this area -- in these areas.

Finally, I have implemented robust reporting to Wylie and the Operating Committee that he chairs on a variety of topics ranging from policy testing activity to the status of outstanding internal audit issues, in order to keep this important oversight body aware of open issues and emerging trends.

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PORTFOLIO MANAGER McQUADE: On slide 11 -- let me go back here. There we go.

On slide 11, our group has taken the lead on the identification of new laws, rules, or regulations that could apply to the Investment Office. In the past year, there was an example I did want to note to the Committee of something that we actually did have to put in place.

You may be aware of certain U.S. sanctions that the U.S. placed on Russian companies that were doing business with Ukraine. So the Investment Office needed to take steps to comply with these requirements as they came out about a year ago.

When these came out, my group analyzed the requirements in consultation with our Legal Office and took appropriate steps to place restrictions on trading in certain equity and fixed income issues within our trading systems Charles River Development, and BlackRock Aladdin.

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PORTFOLIO MANAGER McQUADE: Moving to slide 12, I wanted to highlight some of our work benchmarking against peer organizations. For some backgrounded, I administer a group that was originally founded in 2007 of audit risk and compliance professionals affiliated with pension funds, foundations, endowments and sovereign wealth funds.

Today, we have about 100 members from almost 65 different organizations around the world. I facilitate peer exchanges on a variety of interesting topics, ranging from personal trading to best execution. A list is on slide 22, if you care to look at the various topics that our group discusses on a routine basis.

Importantly, in 2014, my group designed and administered a survey to identify the staffing and the structure, organizational reporting, and core functions of the membership in their compliance functions. And we received a very high turnout, about two-thirds of our membership responded to that.

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PORTFOLIO MANAGER McQUADE: A couple of key takeaways from that survey I wanted to share with you are on slide 13. One is is the major takeaway is that we observed that there is a wide diversity and practice among compliance. So there -- one thing that we noticed in particular is that only about half of our peer organizations have actually identified a Chief Compliance Officer.

Another observation, mostly about large plans, which is on the right-hand part of that slide that I wanted to share is that the vast majority of our peers actually do have investment compliance functions, and personal trading policies in place, similar to CalPERS. And I would say that that would make sense, given that the typical large public fund is going to have a mix of internal and externally managed investments which certainly increases their complexity level.

In reviewing the results, I can tell you that

CalPERS is a leader in compliance practices among its peers. And with that, I'd like to turn it back over to Wylie, who will discuss or business model and upcoming initiatives.

Thank you.

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CHAIRPERSON JONES: Maybe this is a good time to have -- see if -- they have a couple questions.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: And this may be setting you up for the next part of your talk. You know I'm concerned about whether -- where this is housed. It is a -- it's been decided it's a conflict of interest for me to set the criteria for evaluating the CEO, because I might go back to work at least part-time, and the SEIU contract is likely to still be in place, and it may or may not have the same incentive language it does.

And, at that point, the Chief Executive Officer could direct the CIO to direct the SPM to misevaluate the PM so as to impact my salary. I think it's really farfetched. And quite frankly, if the CEO, the CIO or the SPM we believe would do that, we've got other problems. But that is what it is.

So we've now got ICOR reporting to the CIO, who has been delegated the authority of setting the compensation and the incentive comp for that unit. The people in ICOR are largely in the group that gets incentive pay, which is in part based on the performance of the whole fund. So I see some very real potential conflicts there.

You know, in loan -- no loan review reports to the loan production people. They tend to report to the risk people. And so my question really is why do we house this in Investments rather than move it over to Risk and Compliance and ECOM and over there?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Thank you for the question, Mr. Jelincic. I think that's actually -- I'll address the question in two parts, first in terms of sort of the reporting structure, and then second, relative to the incentive compensation.

So first, relative to the reporting structure, the topic is actually covered quite specifically in the Risk and Audit Committee a little bit later this week. So I'm hesitant to sort of steal all of their thunder, but I'll do a bit of a preview.

COMMITTEE MEMBER JELINCIC: Just -- I will -- it's coming up there too, so, yeah.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: So late in 2014 and early into 2015, staff and the Enterprise Compliance Unit in conjunction with the leader of our internal audit function convened a working group to examine this exact question, and how we're structured, and how the ICOR team is governed and reports.

And this question was relevant not just for the ICOR team, but actually for the development of compliance functions throughout the enterprise covering other areas of the business, such as benefits, health, operations, contracting. You can think about compliance having relevance throughout the office not -- investments is certainly an active area, where we already have that in place, but it's likely that we have compliance activities occurring throughout the enterprise.

And that working group's charge was to look at the structure, as well as best practices as highlighted here in Brian's deck, what some peer -- similar peer organizations were doing.

As you'll hear in Risk and Audit, staff's recommendation -- assessment and recommendation was to progress what's called an integrated compliance model. And an integrated compliance model essentially relies on program level resources, such as Brian and his team, who are experts in their particular area being embedded within each of those programs, Investments now, but in the future potentially having similar types of subject matter experts focused on compliance within other programs, Benefits, Health, Operations, Contracting, et cetera, with centralized oversight, reporting, and accountability within the enterprise compliance team.

So the enterprise compliance team would still have policy authority, oversight, and receive regular reporting and have the ability to dip down into all of those various investment compliance activities, benefit compliance activities, health compliance activities to make sure that they were being done in accordance with CalPERS standards, and the responsibility of centralized reporting up through Risk and Audit.

And that is essentially the answer. And I hope I didn't steal too much of Risk and Audit's thunder, but the short answer is, is that we believe the integrated compliance model is the right model for an organization as large and with as many complex and differing business activities.

If we were just doing investments, you wouldn't necessarily have enterprise compliance and investment compliance be in separate units. But because we're doing investments, we're doing health plans, we're doing benefit programs, we have many other very diverse business activities occurring in the office, the idea of trying to centralize subject matter expertise and sort of pull it into a unit, I think that there was -- there was consternation and concern around the sustainability of that model over the long term, being able to retain subject matter experts in a unit that is somewhat disconnected from the underlying business units.

Like I said, you're going to hear this again in Risk and Audit, but it's definitely a subject of -- has been a subject of much discussion. And I'm pleased that staff came forward with the recommendation to progress this integrated model. I think it's the right model.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON JONES: Mrs. Mathur.

COMMITTEE MEMBER MATHUR: Thank you, and thank you, Mr. McQuade for your presentation. You mentioned that you're trying to create this culture of compliance. And it seems to me that compliance and risk management, its sister program, are sort of a balance between checklist and judgment. We're -- philosophically, sort of where do you think we land and where do you think we should be in terms of compliance sort of balancing those two elements or any other elements that you think are relevant that I haven't mentioned?

PORTFOLIO MANAGER McQUADE: Yeah, I mean, I would say that that's a really valid question, and I'm happy to answer that. So I think within the Investment Office, speaking for the Investment Office, I would say that we have a good mix there. So we certainly have defined processes, and the ability to address issues as they come up.

But one of the things that I know that I can tell you anecdotally, that I know that the culture of compliance is working, is that I have staff approach me all the time to say, "Brian, I'm thinking of doing something, is this okay or not?"

You know, so I'm not necessarily, you know, pointing them to a checklist, but it's that culture that our group is accessible and that we're not viewed as a cop, if you will, so -- and that we're there really to make sure that staff feel comfortable to bring issues. And that if they do, they're certainly not retaliated against, that there's a, you know, culture of openness and that sort of thing. So I don't know if that answers your question.

COMMITTEE MEMBER MATHUR: That is helpful. There's been a lot of research done around operating room settings and other medical settings where there's sort of a surgeon, or a doctor, there are nurses, there are other support staff. And where there has been sort of this culture of having this top person, the doctor or surgeon, have the final say and fear among those below them of actually raising questions if they have concerns about how something has been -- being done or you've missed a step or maybe you should consider this, I think that is important also in this context, that they're not be that sort of -- yes, there's a hierarchy to some degree, but there ought to be this openness and -- to questioning and input from all levels. And are we cultivating that and how are we doing that?

PORTFOLIO MANAGER McQUADE: Yeah, I mean, I would say that we have gone to great lengths to ensure that folks have the ability to come forward and not face retaliation. We have multiple ways to do that between an ethics helpline, you know, coming to me. I have office hours sessions during Form 700 time, you know, when people have questions there. We have various governance committees where folks can come there.

So I can tell you that there isn't one person who's invoking fear within folks that would prevent them from bringing things forward.

COMMITTEE MEMBER MATHUR: And I'm not trying to cast aspersions or indicate that there might be a problem, but I think it's more to me about team work and how teams work, and that everybody has valid say, and there's no fear sort of reprisal for raising questions or concerns, particularly among the junior -- the more junior staff.

And I guess -- so maybe that's really under the

CIO's purview.

CHIEF INVESTMENT OFFICER ELIOPOULOS: No, I was going to jump in, because I think we've done a really good job over the course of the last three years building out a very positive environment. One of the key pieces that Brian is an advocate for and has worked really well is this notion of operating events. So we've built a very positive, inclusive environment that anyone in the office can raise their hand and say, hey, this operating event -- something happened that -- not according to our procedures, and it's a very safe environment, is a very encouraged environment.

In fact, we went through -- I think it was about three years ago when we brought this forward. Lot's of discussions with all levels of the staff to say this is a very welcoming environment. We want to get as many examples of operating events as possible, because that's the only way we're going to know how to fix things, you know, what's broken. And we were -- particularly during the first year rolling that out, very insistent on congratulating people for raising their hands just for that very reasons, because you want a very positive environment for people to have that discussion about what's working well, what's not working well. If you have a negative environment, then you'll never get to that fixing. And I think your allusion to the hospital setting is very apt.

COMMITTEE MEMBER MATHUR: Thank you.

CHAIRPERSON JONES: Okay. Thank you. You may proceed.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Thank you. Another element that I believe actually helps foster the type of environment where everyone in the office is actually encouraged and free to question activities is the fact that we have carved off the risk taking and monitoring functions into a separate line of reporting up to the COIO position. And Brian mentioned earlier the Operating Committee, which is the governance -- our internal governance committee within the Investment Office that oversees the investment compliance activities that Brian covered.

And, in fact, we review the operating events that Ted just mentioned in detail at that committee, and the -- again, to try to foster the environment where people are encouraged to talk about operating events, mistakes that they may have made, and how -- what we can do to improve the control environment in the -- in our activities to help make sure that they don't happen again.

Our activities are conducted by humans, and humans make mistakes. That's -- it's important to acknowledge that. And it's, in fact, important to actually be as open and as honest and as sort of free to talk about that. And we really make great strides and efforts in our operating committee to do that. And, in fact, Brian and his team review the operating events at each Operating Committee.

Sometimes some months there's none, some months there's four or five, but they're a significant part of our discussion at the operating committee.

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CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

This is the high level organizational structure for the ICOR function. You can see Brian's name on there as well. And as I mentioned earlier, we've had a significant sort of hole in the functions since Carol Moody left earlier this year. But I'm quite pleased to report that we have successfully recruited and hired our newest team member her name is Kit Crocker. She'll be joining us in July to fill the senior portfolio manager position highlighted on this. And I think Kit may be in the audience. And, Kit, if you wouldn't mind waving and saying hello. There she is.

SENIOR PORTFOLIO MANAGER CROCKER: Delighted to be here. Thank you.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Thank you very much. We're very excited to have Kit join us. She brings over 25 years of experience to the team, very relevant experience. As you may recall from our discussion on the Target Operating Model last month, one of the things that the Investment Office is increasingly realizing is that our asset management activities are very much governed towards the liability structure of the organization. That positions us in a fashion similar to an insurance company. And that is exactly where Kit Crocker hails from. It was several different insurance companies, both Alliance and Norcal Mutual, under belt. We're really looking forward to having that new perspective coming in to the investment compliance function.

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CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: So in terms of strategic plans where are we going? I'm very much looking forward to working with Kit and the team to help refine our strategic plan. At a high level, I think our key is to continue refining our internal processes and the governance to enhance that control environment, and in particular, working with the enterprise compliance team, which continues to build out its strategic direction. And as I keep saying, you'll be hearing more on that as Risk and Audit tomorrow.

And we're very much looking forward to making sure we refine that, and that that works to be An effective relationship over the long term.

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CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Strategic initiatives for the coming fiscal year. As I mentioned earlier, we're going to be entering phase two of our investment policy revision project. You might recall that phase 1 involved pooling many procedural elements out of the investment policy and placing those into staff procedures. The second piece of that is to go through each of the programs continue to refine them. And we'll probably have to take another pass at the total fund policy. It's still a pretty hefty document and we're looking forward to continuing to refine that and simplify it consistent with our overall goal of looking at ways to reduce complexity in the office. I think the complexity of our documentation is another area where that complexity lives, so we're going to be continuing to try to ferret that out and simplify it where possible.

I've mentioned working with ECOM closely. And finally, manager review and monitoring. As you heard from Ted earlier in the discussion, the way we assess and monitor managers is going to be very critical over the coming five years as we look to really refine the list of managers we want to work with, how we look at and review those managers is -- also needs to be refined.

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CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: And to that end, I'm going to talk about a new element of the ICOR program here on slide 19, operational due diligence. The primary purpose of operational due diligence is to identify and assess the non-investment risks within an investment manager. ODD, as operational due diligence as is sometimes referred to, complements investment due diligence and underwriting, so the two should work hand in hand. So you're looking at the investment returns and structure. And then you're also looking at the operations of a different -- of a particular investment manager.

The focus of ODD is on operational elements, such as the custodial elements, the trading relationships, their auditor, their -- how they address their internal accounting, how they address their internal compliance functions within that external manager. On-site visits by specialized CalPERS staff support this complementary assessment.

Last year, with the dissolution of the Absolute Return Strategies Program, our hedge fund program, we -- the ICOR team was able to adopt Kevin Hirst, who's a portfolio manager, who has five years of operational due diligence experience in the hedge fund space. Hedge -- operational due diligence really grew up in the hedge fund segment of the investment industry, primarily following the Madoff scandals or sort of the mid-2008 where sort of the independence of the auditor, the independence of the custodian with hedge funds came under a great deal of scrutiny. And investment owners took it on themselves to either contract out for operational due diligence, which was actually the most common way of approaching this task or to insource it.

CalPERS took the option to insource it, so we're very happy to have Kevin's experience progressing the operational due diligence - it's kind of a mouthful - elements within the program. And you can see there in the table on the lower left, the visits that have been undertaken so far this year. And that's really just in the first half of 2015 focused primarily in private equity. And we're getting to the point where we're almost all the way through the global fixed income program.

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CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Excuse me. Frog in my throat.

In conclusion, made very significant progress transitioning from de novo status. I included de novo in there as a bit of a tribute to Carol Moody. That was her

Latin. And I wish her well in her semi-retirement.

We continue to improve the operations of our ICOR function. And again, we'll work this year, in particular, to collaborate with our ECOM partners to build out -- to help build out their internal functioning.

So with that, I think we've reached the end of our presentation, but I'm quite happy to take questions Mr. Chair.

CHAIRPERSON JONES: Okay. Seeing no further questions. Thank you for the report. Appreciate that.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: Thank you.

CHAIRPERSON JONES: We do have a request from the public to speak on this item. Mr. Ben Vernazza from Financial 2nd Opinions and Precision Fiduciary Analytics.

This speaker is on and you will have three minutes and you can see the timer right before us here.

MR. VERNAZZA: My name is Ben Vernazza. I've been a CPA for 54 years, a registered investment advisor for 38 years. And I sold my investment advisory practice in 2012.

I'm going to talk today about the stepchild of modern portfolio theory, which is uncompensated risk. The statement of trusts says it's necessary for you to deal with diversification and removal of uncompensated risk.

Fiduciaries do a good job of managing compensated risk. But by doing so, they ignore what uncompensated risk might be left. Until recently, academics have come up with programs to analyze uncompensated risk, but they were not realistic in the real world, so the managers really ignored them. But now we have big math and algorithms. So uncompensated risk is no longer an orphan. It's a stepchild.

Now, as a fiduciary, you're responsible for uncompensated risk on the entire portfolio getting the 100 or 200 managers and putting them into what is your portfolio. Now, last month, there was a very significant Supreme Court case nine zip, 9-0 on the vote. And it was Tibble versus Edison. And it basically said it's necessary to have a prudently established monitored uncompensated risk strategy, because if you are in breach of that or anyone -- any fiduciary is, the six-year statute of limitations doesn't start until you end the breach. Very significant.

That means there's a clawback indefinitely. Now, I looked -- so the takeaway from that case is that it's important to install a prudent procedural process for managing and monitoring uncompensated risk. So I looked at CalPERS investment policy statement. I looked at the 20-member SACRS, each of their investment policy statements, and only three out of 21 investment policy statements mentioned anything about compensated, uncompensated, systematic unsystematic risk.

So let's give an example of what might -- could occur from paying more attention to this. You have $300 billion, SACRS has 135. Let's say there's 65 --

CHAIRPERSON JONES: Mr. Vernazza your time is up.

MR. VERNAZZA: Pardon me?

CHAIRPERSON JONES: Your time is up.

MR. VERNAZZA: Okay. Can I just --

CHAIRPERSON JONES: No, your time is up.

Thank you. Thank you. That concludes the -- if you have some paperwork, certainly leave it with our staff that --

MR. VERNAZZA: Yes. And it's in -- and you also have a copy of it in the back of the public --

CHAIRPERSON JONES: Thank you. Thank you. Okay Okay. Thank you. Okay. So that reaches the end of our Committee meeting. And I guess we could pause for five minutes and then go right into closed session.

Oh, Public comment. Okay. Sorry about that.

L.R. Roberts CSR Chapter 2. I'm sorry about that.

MS. ROBERTS: Thanks to staff for noticing that I said Item 10 instead of 9.

I spoke with you in the past about your real estate policy regarding displacement, but how you also have a relationship through your Health Benefits with CVS. And CVS is investing in real estate for their new stores. CVS, since I was here last time, successfully got rid of the local market, a minority-owned grocery store at Franklin and Sutterville, the closest grocery store to my family's home in central Oak Park.

CVS is now battling the Curtis Park neighborhood on how the store is set up. Part of the -- this is a part of an ongoing problem between huge corporations and neighborhoods. Examples are the successful battle that we had in Oak Park to keep McDonald's out of Oak Park, the Fresh & Easy decided not to come to Oak Park, because they -- partly due to their refusal to follow our community norms.

Recently, I was approached in my role in another organization, the Women's League, where I was their Housing Chair and served still on their public policy committee. Petrovich and Safeway are battling Curtis Park concerns in the old railyards. Safeway wants to put in 16 pump stations at the old raidyards within blocks of the the Sacramento Children's Home. Petrovich is developing their railyard. Neighborhoods -- neighbors are complaining about housing not matching the neighborhood's design. Disability and senior groups are complaining about units with several stair cases and no ramps.

I see this development all over. The townhouse style of housing, which has a staircase inside, which will not be a place where we can age in place, and then there's stairs going to the outside. They're building this housing everywhere.

Petrovich had a party at this development and did not invite the neighbors. And when the neighbors showed up to complain, they were told to go back where they came from. So we need to think about our real estate investment, especially when it's sort of -- it's through somebody we have a health care relationship with.

And one last concern, rents are soaring, not only in Oak Park where I live, but in the Bay Area. And now I notice that housing prices are soaring. And the last time that happened, we had a bubble burst. So this is concerning to me.

Thank you.

CHAIRPERSON JONES: Okay. Thank you very much for your comments.

Okay. So that concludes the open session. We will take a five minute break to -- so that we may break into closed session. So that concludes the open session meeting.

Thank you very much.

(Thereupon California Public Employees' Retirement System, Investment Committee meeting open session adjourned at 11:36 a.m.)

C E R T I F I C A T E OF R E P O R T E R

I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Investment Committee open session meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California, and was thereafter transcribed, under my direction, by computer-assisted transcription;

I further certify that I am not of counsel or attorney for any of the parties to said meeting nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 18th day of June, 2015.

JAMES F. PETERS, CSR
Certified Shorthand Reporter
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