



Agenda Item 6a

September 15, 2015

ITEM NAME: Investment Beliefs Implementation Review Findings

PROGRAM: Total Fund

ITEM TYPE: Total Fund – Information

EXECUTIVE SUMMARY

This item is part of the 2015 Investment Beliefs Implementation Review Project (Review) and contains information on the following:

- The outcomes of the July 2015 Board and Executive Offsite session exploring CalPERS' Investment Beliefs interpretation in areas that appeared "unsettled."
- Summary recommendations and staff's proposed path forward.

The Review, undertaken by Mr. Roger Urwin with Towers Watson began in March 2015 and included an in-depth documentation review, surveys and interviews with Board members and staff, evaluation of CalPERS compared to a global peer reference group, a presentation of findings in May 2015, and a facilitated session at the July 2015 Board and Executive Offsite. Attachment 2 provides a summary of the key recommendations identified throughout the course of the Review.

Overall, the Review indicated that CalPERS has had success in embedding and articulating our Beliefs in our business processes and culture and that the Board and staff are largely united on many issues; however, as to be expected in this type of work, there are continuous opportunities for improvement.

Many of the recommendations identified by Towers Watson in the course of the Review appear to be in alignment with existing workstreams and strategic initiatives for both the Board and staff. This consistency underscores CalPERS' continued commitment to strengthening the use of our Beliefs, our governance and business processes.

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability.

BACKGROUND

CalPERS' Investment Beliefs are not a checklist to be applied to every decision. Rather, they are a guide for making judgments and decisions that often require balancing multiple, interrelated factors. The Investment Beliefs create a framework for the strategic management of the investment portfolio and inform organizational priorities. They also serve to increase alignment between CalPERS Board members, staff, and external managers.

Development of the Investment Beliefs began in 2012 through a collaborative effort with facilitation by Towers Watson. Using a thorough and disciplined process, the Committee and staff achieved strong consensus around a set of 10 Investment Beliefs in the summer of 2013.

- All Board members reported that they “agreed with,” or could “live with” eight of the 10 proposed Beliefs in an interactive voting session conducted at the July 2013 Board and Executive Staff Offsite.
 - Only two of the proposed Belief statements received single votes indicating disagreement with the proposed Belief statements (Beliefs 5 and 7 respectively).
- In September 2013 the Committee adopted CalPERS' Investment Beliefs, and adopted a Statement of Investment Policy for the Investment Beliefs the following month.

An update on Beliefs integration activities was provided to the Committee in August of 2014. The 2014 update included the results of an Investment Office staff survey using the ADKAR framework, which showed a high degree of awareness and desire to integrate, but a lack of knowledge on “how,” particularly with regard to environmental, social, and governance (ESG) related Beliefs.

Following feedback from the August 2014 item, an in-depth review of CalPERS' implementation of the Investment Beliefs was incorporated as a key topic in the 2015 Committee calendar. The 2015 Implementation Review was undertaken by Mr. Roger Urwin with Towers Watson. Towers Watson presented the findings of the Review at the May 2015 Committee meeting. A key issue identified in the Review was that the Investment Beliefs were not leading to settled positions in the areas of:

- Investment risk (particularly Beliefs 1 and 9), and
- ESG (including Beliefs 2, 3 and 4).

An interactive session was then conducted at the July 2015 Board and Executive Offsite to further explore CalPERS' Investment Beliefs interpretation in the two areas that appeared “unsettled.”

ANALYSIS

The 2015 July Offsite session included interactive voting and small table discussions by Board members, senior staff from the Executive, Investment, Actuarial, and Financial Offices, and the Board's Investment Consultants (Wilshire Associates, Pension Consulting Alliance Inc., and StepStone). The session demonstrated that the group was largely united on many issues, and explored areas where differences exist. Highlights of the July session are included in the sections below, with additional detail available in Attachment 1.

Risk-Related Beliefs Session Findings and Near-Term Next Steps

The group was largely in agreement and responded to the risk-related Beliefs questions relatively consistently. The ability to better understand and articulate risk in a meaningful way is a shared priority and challenge facing many leading pension funds.

- Enhanced risk, performance, and exposure reporting is a key priority for CalPERS and is included as an initiative in the Investment Office 2020 Vision. Additional information on the Investment Office 2020 Vision will be brought to the Committee in the Investment Office Roadmap Update, currently scheduled for November 2015. Staff anticipates this work will be iterative over the next 12 to 36 months.
- Multi-year initiatives related to the exploration of risk factors, and implications for strategic asset allocation and better understanding of our liabilities are also underway and will continue to be a priority.

ESG-Related Beliefs Session Findings and Near-Term Next Steps

Opinions between Board members, staff, and the Board's Investment Consultants were more wide ranging on the ESG-related questions. Voting results appear to indicate:

- A majority of Board members and staff agreed that engagement, not additional divestment, is most appropriate for CalPERS' future plans.
- There are conflicting opinions on the extent to which carbon/ESG factors have been priced into the markets.
- There is a greater appetite among Board members than staff for targeted ESG investing/strategic tilting.
- Board members and staff are in agreement that more information, evidence, and research are needed and wanted.
- The issue of accountability for Board-directed investment policy stances deserves additional discussion to establish a common understanding between the Board and staff.

Staff proposes the following near-term steps to continue to explore the issues raised in the voting:

- Continue with efforts to gather additional ESG data, research, and evidence:
 - Continue the ongoing evaluation of the environmentally focused investment strategy currently active within the Global Equity Program.
 - Implement Phase 2 of the Sustainable Investment Research Initiative (SIRI), originally undertaken in 2012, in partnership with U.C. Davis and U.C. Berkeley to review for further evidence of the risk and return impact of ESG factors
 - Evaluate the Manager ESG Expectations pilot currently underway and return to the Committee with an update in spring/summer of 2016.
- Staff will continue to work with the Committee Chair to create additional opportunities to discuss ESG-related Beliefs issues, such as a review of the Fund's carbon/fossil fuel footprint analysis at an upcoming Offsite session (2016).
- Additionally, work has been underway to enhance staff's internal Investment Strategy Group governance, including the establishment of a standing subcommittee focused on issues of governance and sustainability (2015).

On the issue of accountability for Board-directed investment policy stances, staff believes it is important to address the disparity of opinion between the Board and staff that was identified through the interactive polling at the Offsite session. Upcoming Committee agenda items reviewing CalPERS' divestments (2015) are expected to provide opportunities to further discuss this issue.

Overall Investment Beliefs Implementation Review Findings, Recommendations and Proposed Path Forward

The amount of effort, attention, and discussion that has centered on CalPERS' Investment Beliefs to-date demonstrates that the Beliefs are a priority for CalPERS' Board and staff. Towers Watson assessed CalPERS' implementation of Investment Beliefs and found:

- CalPERS' adoption and implementation of Investment Beliefs as "above average" overall compared to a peer reference group of 15 funds
- Strong Board and staff values and talent are driving the organization forward
- CalPERS has the ability to undertake complex change processes successfully

CalPERS has had solid success embedding and applying our Investment Beliefs since adoption. However there continues to be room for improvement.

Attachment 2 provides a summary of the recommendations identified by Mr. Urwin in his presentation to the Committee on May 18, 2015, and in follow up to the July 2015 Offsite session. Attachment 2 also includes staff's interpretation of those recommendations. It is important to note that many of the recommendations are related to topics and challenges that are complex, evolving, and likely require multi-year effort to address through iterative work.

Encouragingly, many of the recommendations appear to be consistent with existing or upcoming initiatives and workstreams. We believe this further reflects the consistency and shared priorities of the Board and staff in embedding these values and principles in our work and culture.

BUDGET AND FISCAL IMPACTS

Not Applicable

BENEFITS/RISKS

Not Applicable

ATTACHMENTS

Attachment 1 – Investment Beliefs Implementation Review Presentation

Attachment 2 – Implementation Review Recommendations Summary

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