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**April 18, 2016**

**Item Name:** Revision of Total Fund Investment Policy and Repeal of Legacy Policies – Third Reading

**Program:** Total Fund

**Item Type:** Action

**Recommendation**

Approve the revised Total Fund Investment Policy as shown in Attachment 1 and repeal the five legacy investment policies included as Attachment 3.

**Executive Summary**

An updated version of the Total Fund Investment Policy (Updated Policy) was presented to the Investment Committee (Committee) for a second reading on March 14, 2016. The Committee Chair directed staff to revise specific language and return to the Committee for further review.

The Updated Policy for the third reading is included as Attachment 1. Attachment 1 reflects all changes presented at the first and second readings as well as further revisions made since the second reading based primarily on feedback from the Committee, all of which relate to the divestment section. Changes made to the Updated Policy since the second reading are denoted by track changes and highlighted in orange in Attachment 2. Attachment 3 provides the full text of the policies recommended for repeal following adoption of the Updated Policy. Wilshire Associates' Opinion Letter is provided as Attachment 4.

Staff proposes the following recommendations for Committee action:

- Adopt the Updated Policy as presented, which will supersede and replace the current Policy; and
- Repeal the five legacy investment policies to be superseded by the consolidated Policy:
  1. Currency Overlay Program
  2. Liquidity Program
  3. Low Duration Fixed Income Program
  4. Multi-Asset Class Partners Program
  5. Securities Lending Policy

**Strategic Plan**

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

## **Investment Beliefs**

This agenda item supports CalPERS Investment Belief 9, Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error, and Belief 10, Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives.

## **Background**

CalPERS Investment Policies represent the Committee's primary direction to staff on the management of the CalPERS investment portfolios. The total overhaul of the Policy in March 2015 was a major step toward completion of the Investment Policy Revision Project, which is a key initiative of both the 2014-16 Investment Office Roadmap and the Target Operating Model (TOM). The initial effort involved the consolidation of 14 separate investment policies, elimination of procedural language, and removal of untestable elements from investment policy documentation. Staff had committed to bring the Policy back after a one-year period, once further progress had been made on (1) the alignment of the individual program investment policies within the new framework of the Policy, and (2) the incorporation of limits and constraints heretofore located solely within delegated authorities. The Updated Policy reflects those updates as well as the more recent input from the Committee and others as described above.

## **Analysis**

The changes made to the Updated Policy since the second reading in March 2016 are detailed below.

### Divestment Section

1. The "Fiduciary Duty Standard per California Constitution" section has been expanded to include more subsections and reflect the language in Article 16, Section 17 of the California Constitution *verbatim*.
2. The "Divestment Loss Mitigation" section has been removed and will be discussed as a separate agenda item.
3. The "Definitions" section has been removed as it related only to the "Divestment Loss Mitigation" section, which has been removed.
4. Appendix 1 "Reporting to the Investment Committee" and 2 "Investment Responsibilities" have been updated to remove any reporting requirements or responsibilities that related to the "Divestment Loss Mitigation" process.
5. The appendix (former "Appendix 8") regarding "Existing Divestment Initiatives" has been removed.

The Asset Allocation Strategy Section and the Terminated Agency Pool (TAP) Program Section updates proposed during the second reading remain unchanged.

## **Budget and Fiscal Impacts**

Not Applicable.



## **Benefits and Risks**

Staff's recommendations are consistent with the TOM objectives to design, develop, and implement a robust operating model that minimizes complexity, improves transparency, and strengthens processes, systems, governance, and controls. The recommendations are also consistent with CalPERS' Investment Belief 10, which stresses the need for strong processes and governance.

The revised Policy is expected to provide the following benefits:

- Reduce operational risk through the use of clear and specific language considering both the Committee's and staff's roles and responsibilities
- Enhance alignment and consistency with the program-specific policies that were revised during the 2015 annual program review cycle
- Strengthen overall governance by ensuring that investment policies are consistent with one another and tie to enterprise policies when applicable
- Enhance staff's ability to more effectively monitor compliance by clearly specifying and centralizing limits and constraints within the appendices to the Policy
- Reduce duplication and complexity by consolidating and repealing legacy policies

Risks associated with not adopting the recommendations include:

- Potential elevation in operational-risk-related events due to unclear, conflicting, or difficult-to-locate Committee directives, limits, and constraints

## **Attachments**

Attachment 1 – Updated Policy (Proposed)

Attachment 2 – Track-changes version of Updated Policy identifying proposed revisions

Attachment 3 – Policies proposed for repeal

Attachment 4 – Wilshire Associates' Opinion Letter

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