CalPERS

Investment Committee
Agenda Item 6a

April 17, 2017

Item Name: Private Asset Class Roles and Benchmarks

Program: Asset Allocation & Risk Management

Item Type: Information

Executive Summary
This agenda item introduces proposed recommendations from staff regarding aspects of the private asset portions of the CalPERS investment portfolio for use in the periodic Strategic Asset Allocation portion of the Asset-Liability Management (ALM) process.

For Real Assets, staff recommends the consolidation of all three previous segments into one Real Asset Class and adoption of an MSCI Investment Property Databank (IPD) benchmark.

For Private Equity, staff recommends a consolidation of Private Equity and capitalization weighted Global Equity to form a combined growth related segment. In addition, staff recommends adoption of the FTSE All-World Index, All Capitalization benchmark plus a return hurdle for the combined segment.

Strategic Plan
This agenda item supports the strategic plan goal of Fund Sustainability: Strengthen the long-term sustainability of the pension fund. In order to deliver targeted, risk-adjusted investment returns, Investment Office staff strives to build an efficient portfolio by defining the strategic roles of Private Asset Classes, evaluating their characteristics including opportunity cost and managing their risk exposures in a transparent manner and from a top-down total fund perspective.

Investment Beliefs
The ALM process and associated Strategic Asset Allocation are primary activities underlying the exercise of fiduciary responsibility by the CalPERS Board and staff. Most of CalPERS' Investment Beliefs are associated with this activity and agenda item, including:

Investment Belief 1:
Liabilities must influence the asset structure.

Investment Belief 2:
A long time horizon is a responsibility and an advantage.

Investment Belief 5:
CalPERS must articulate its investment goals and performance measures and ensure clear accountability for their execution.

Investment Belief 6:
Strategic asset allocation is the dominant determinant of portfolio risk and return.

Investment Belief 7:
CalPERS will take risk only where we have a strong belief we will be rewarded for it.

Investment Belief 8:
Costs matter and need to be effectively managed.

Investment Belief 9:
Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility and tracking error.

Investment Belief 10:
Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives.

Background
CalPERS conducts an ALM workshop every four years. During this process, staff examines and re-affirms the strategic role for each asset class, estimates the Capital-Market Assumptions, and constructs an efficient frontier based on this information. This agenda item is a portion of that examination and the ALM.

Analysis
As part of the ALM, staff has been examining the concept of "segments" or partitions of the asset classes and benchmarks. This assessment has led staff to recommend some changes to the private asset classes.

The first recommendations involve the Real Asset portion where staff recommends the consolidation of three segments (Real Estate, Infrastructure and Forestland) into one Real Asset Class. This recommendation is based on:

1. Similar underlying investment characteristics of each segment
2. Historic inability to acquire material representation within Infrastructure and Forestland
3. Fostering greater teamwork between the segment silos.

Additionally, such consolidation is consistent with the Asset Class Criteria specified in the CalPERS Total Fund Investment Policy. Another recommendation related to Real Assets, is to shift the benchmark provider from the National Council of Real Estate Investment Fiduciaries (NCREIF) to MSCI. This change would provide:

1. Virtually identical investment characteristics
2. Simplified vendor relationships
3. Allows the potential extension to global real estate and Infrastructure should those segments become significant enough to warrant specific inclusion or re-inclusion

The next set of recommendations relates to Private Equity. This asset class is subject to significant challenges identified during the November 2015 Private Equity Workshop which included controlling exposure and identifying sources of risk.

The first recommendation is a simplification of the role statement for Private Equity. The next and most substantial recommendation is to consolidate Private Equity with capitalization weighted Global Equity to form a growth related asset segment. The primary objectives underlying this recommendation are to:

1. Improve CalPERS ability to control the exposure to economic growth
2. Enable the search for additional sources of excess return across the entire segment
3. Enable the potential to explicitly manage the risks deriving from the idiosyncratic company exposures inherent in Private Equity
4. Foster greater teamwork between the asset class teams

The final recommendation is to adopt the FTSE All World All Capitalization based benchmark (used for Global Equity) plus a return hurdle for the combined segment.

Budget and Fiscal Impacts
Not Applicable.

Benefits and Risks
The benefits associated with the recommendations are to increase the materiality of the Strategic Asset Allocation choices, to enable greater control of the resulting exposures, to enable the potential better management of the risks derived from idiosyncratic Private Equity investment activity, and to foster greater teamwork.

The predominant risk associated with the recommendations is the potential to offset intentional market risks undertaken by the Private Equity general partners.

Attachments
Attachment 1 – Private Asset Class Roles and Benchmarks

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