

May 15, 2017

Item Name: Investment Office Roadmap and Target Operating Model Update

Program: Total Fund

Item Type: Information

Executive Summary

This agenda item provides an update on the Investment Office (INVO) business plan and related initiatives, including progress on the INVO Roadmap and Target Operating Model (TOM), key components of the CalPERS overall Business Plan.

Strategic Plan

This agenda item supports the CalPERS Strategic Plan Goal A: Improve long-term pension and health benefit sustainability. Specifically, the INVO Roadmap supports delivering target risk-adjusted investment returns by implementing programs and initiatives that improve investment performance and ensure effective systems, operations, and controls.

Background

In alignment with the five-year CalPERS Strategic Plan and the two-year CalPERS business plan, the INVO Roadmap communicates strategic objectives and initiatives supporting key priorities and the CalPERS mission.

The “INVO 2020 Vision”, a five-year business plan driving strategic direction, was first introduced in 2014. The key objectives of the INVO 2020 Vision are to reduce risk, cost, and complexity in the Investment Office and in the portfolio. Foundational to the INVO 2020 Vision is the CalPERS Strategic Plan and the Pension and Investment Beliefs. These helped shape new INVO Mission and Vision statements, first communicated to INVO staff and the Investment Committee in December 2014. These statements articulate INVO’s mission of managing the CalPERS investment portfolio in a cost effective, transparent, and risk-aware manner in order to generate returns to pay benefits.

As presented in December 2016, the INVO 2016-17 Roadmap (Roadmap) is a 2-year business plan, executed through five strategic objectives with underlying projects and initiatives designed to create forward progress on long-term INVO 2020 Vision objectives.

Integrated into the Roadmap is the TOM, which defines the people, process, technology, and data needed to effectively manage the CalPERS Investment portfolio. Through periodic risk assessment and comparison to industry benchmarks each TOM function is evaluated to determine the current level of operational risk. The level of operational risk informs the development of Roadmap initiatives and allocation of resources.

Analysis

In December 2016, staff reported on the status of the overall Roadmap to the Investment Committee. Since that time progress has been made on the 18 Roadmap initiatives, with all but four anticipated to be complete by 2016-17 Fiscal Year end. Two of the remaining four initiatives had been anticipated to take 18-24 months to complete and remain on schedule. The other two initiatives are targeting completion by December 2017 and all four items will be monitored and reported through the 2017-18 Roadmap process.

In addition to the reported progress on the Roadmap, staff is presenting an updated TOM Dashboard from what was previously presented in December. Indicated changes are the result of an ongoing internal risk assessment including analysis of completed 2016-17 Roadmap initiatives, changes in external and internal operating environments, significant operating events, and completion of risk mitigation strategies. Over the next six months, INVO will be undertaking efforts to simplify and further refine the TOM by partnering with an experienced external Operational Risk consultant to evaluate current structure and functions. This review will include peer benchmarking, industry and environmental considerations, and further alignment with the INVO 2020 Vision and Enterprise goals. The Committee can look forward to a refreshed TOM in December.

For the April 2017 Risk Assessment, the INVO Operating Committee approved updates to four TOM Functions, three of which had risk levels lowered due to completion of mitigation strategies and enhanced infrastructure and processes. The TOM functions with lowered risk levels are as follows:

- *Collateral Management* - Reduced from Moderate to Low-risk
- *Business Continuity/Disaster Recovery* - Reduced from High to Moderate-risk
- *Expense Allocation, Financial Reporting and Budgeting* - Reduced from Moderate to Low-risk, incorporates TOM functions *Internal Expense Reporting and Budgeting* and *External Financial Reporting Support (CAFR)*

One TOM function, the *Affiliate and DC Product Management*, had its risk level raised from Low to Moderate-risk due to impacts of complexity arising from the decision to expand Tobacco divestment to the Affiliate funds. 2016-17 Roadmap accomplishments and the revised TOM are highlighted in Attachment 1.

With the completion of the 2016-17 Roadmap, staff is focusing efforts on developing the 2017-18 Roadmap initiatives, to align with the newly approved 2017-22 CalPERS five-year Strategic Plan and the annual CalPERS business plan. The five strategic objectives will remain the same with initiatives developed to focus on addressing moderate to high-risk TOM functions and enhanced Trust-level decision making. Staff will report on specific accomplishments in December.

Budget and Fiscal Impacts

Funding for Roadmap activities is included in the approved and existing INVO budget.

Benefits and Risks

The progress and completion of the 2016-17 Roadmap initiatives are an integral part of managing INVO's operational risks. As initiatives are completed, the following benefits are expected:

- Decreased severity of critical operational risks and events
- Increased understanding of investment risk and performance attribution
- Enhanced governance and oversight
- Increased ability to attract a highly skilled, diverse, and high performing workforce

Conversely, risks of not completing the Roadmap initiatives include:

- Weak performance attribution capabilities and understanding of portfolio risk and return drivers
- Unnecessary complexity and increased cost
- Inefficient infrastructure and technology platforms

Attachments

Attachment 1 – Investment Office Roadmap and Target Operating Model Update

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