
November 13, 2017**Item Name:** Public Asset Class Investment Policies – Second Reading**Program:** Total Fund**Item Type:** Action**Recommendation**

Adopt the revised Total Fund Investment Policy, which reflects feedback received at the September 2017 Investment Committee meeting.

Executive Summary

Following feedback received during the first reading, the proposed Total Fund Policy (Policy) has been updated to remove the proposed “implied rating” process for the Low Duration Fixed Income Program and retain “Fixed Income” in the Low Duration Fixed Income Program title. This resulting item proposes the following revisions to the Policy for the Investment Committee’s review and direction:

1. Low Duration Fixed Income Program
 - Removal of the High Quality LIBOR (HQL) and Short Duration (SD) sub-components of the Low Duration Fixed Income Program
2. Liquidity Program
 - Revision of the “Purpose” statement and policy benchmark for the Liquidity Program to better reflect the program’s role within the Total Fund
 - Revision of Appendix 7 for the Liquidity Program, adjusting the minimum credit rating required for non-dollar treasury bills of foreign sovereign countries

In addition to the above changes, minor ministerial changes have been made to reflect recent Investment Office organizational changes, such as the transition of investment risk monitoring responsibilities to the Investment Risk and Performance group.

For ease of review “clean” and “mark-up” versions of the Policy reflecting these proposed revisions are provided as Attachments 1 and 2 respectively. A consultant opinion letter from Wilshire Associates is provided as Attachment 3.

Strategic Plan

This item does not directly support the CalPERS 2017-22 Strategic Plan. The proposed revisions, as part of a clear and actionable policy framework, will contribute to the effective management and oversight of investment activities.

Investment Beliefs

This item does not directly support the CalPERS Investment Beliefs.

Background

General Annual Review Process

As part of the annual program review cycle, programs within the Investment Office review their respective statements of investment policy, delegations, and related governance documents. This annual review process helps to ensure the governing documents of the CalPERS Investment Program remain current and accurately reflect business processes, requirements, and guidelines.

Analysis

Low-Duration-Fixed-Income-Program-Related Changes

Following the appointment of the Opportunistic Strategies Managing Investment Director, program ownership of the Low Duration Fixed Income section of the Policy has transitioned from the Global Fixed Income team to the Opportunistic Strategies team. The HQL and SD subcomponents were identified as inactive programs, prompting their removal from the Policy. The Low Liquidity Enhanced Return (LLER) subcomponent of the Low Duration Fixed Income Program remains active.

Liquidity-Program-Related Changes

The core purpose of the Liquidity Program is to provide liquidity for the day-to-day liquidity needs of the CalPERS Total Fund. To better articulate the program's role in relation to the broader portfolio, staff has proposed:

- An adjustment to the program's purpose statement in the Policy; and
- Revision of the policy benchmark from a 91-day Treasury Bill to a 30-day Treasury Bill benchmark.

In addition to the above changes, this item proposes an expansion of the investable universe for the Liquidity Program by setting the minimum long-term credit rating for sovereign securities at Baa2/BBB/BBB. As part of the annual review of the Policy conducted in April 2017, Appendix 7 was updated with respect to the Liquidity Program to define the minimum required credit rating for long-term sovereign securities as Baa1/BBB+/BBB+. While this update enabled access to the majority of the target-investment-opportunity set, the Liquidity investment team believes that a further extension of the permissible universe to include the Baa2/BBB/BBB level is required in order to enable the full implementation of their investment strategy goal. The rationale for the change as presented in the April 2017 agenda item remains unchanged:

“The Global Fixed Income investment team has identified opportunities for increased returns, with attractive risk characteristics, within sovereign debt securities. The short-term sovereign debt securities have historically experienced lower default rates than similarly rated industrial and financial commercial paper investments (currently allowed in the portfolio). Therefore, staff believes the expanded investment universe may result in lower levels of credit risk within the portfolio. Additionally, in the current market conditions, yields for these sovereign debt securities are attractive, even after the cost of a currency hedge back to US dollars is applied to manage currency risk.”

Other Ministerial Changes

Ministerial changes have been made, primarily in Appendices 1 and 2 of the Policy, noting:

1. The establishment of the Opportunistic Strategies Program.
2. The transformation of the “Asset Allocation and Risk Management” group to the “Trust Level Portfolio Management” group, including the transition of several investment risk reporting responsibilities to the Investment Risk and Performance group.
3. Revision of Appendix 1, number 22 to reflect submission of legislatively mandated divestment reports to the Investment Committee as informational items, per guidance from CalPERS General Counsel and the Investment Committee Chair.
4. Notation within Appendix 5 (Benchmarks) relocating from the Total Fund Policy Benchmarks section certain Total-Fund-level program benchmarks (as they do not receive strategic allocations) to more clearly denote them as such.
5. Additionally in Appendix 5 for the Affiliate Funds, the “Liquidity” benchmark reference for the Long-Term Care (LTC) Fund has been proposed for deletion, as the LTC fund has a 0% allocation to Liquidity. This change is recommended by staff in the interest of simplicity and consistency.

Budget and Fiscal Impacts

Not Applicable

Benefits and Risks

The benefits and risks associated with the recommended policy changes are outlined in the sections below.

Liquidity Program - Long-term Sovereigns Minimum Credit Rating.

Staff believes the expansion of the investable universe to the Baa2/BBB/BBB level will support the anticipated benefits as noted in the April 2017 agenda item, including:

- Increased portfolio diversification; and
- Potential reduction of the credit risk of the portfolio.

Risks associated with this change will be mitigated by updating risk monitoring and control processes to address the expanded investment universe, and ongoing monitoring of sovereign credit risk (including by the Investment Risk and Performance group).

Other Changes

No risks have been identified for the other proposed changes. Removing references to inactive programs and making updates to reflect organizational changes help to mitigate confusion and ensure key governance documents remain current and accurate.

Attachments

Attachment 1 – Revised Total Fund Investment Policy – Clean Version

Attachment 2 – Revised Total Fund Investment Policy – Mark-Up Version

Attachment 3 – Board Investment Consultant Opinion Letter – Wilshire Associates



Katherine H. Crocker
Investment Director
Investment Compliance & Operational Risk

Wylie Tollette
Chief Operating Investment Officer