

December 18, 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) as key components of the CalPERS Business Plan.

### **Strategic Plan**

This agenda item supports the CalPERS Strategic Plan Goals to strengthen the long-term sustainability of the pension fund and reduce complexity across the enterprise. 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.

### **Investment Beliefs**

In 2014, staff introduced to the Investment Committee (Committee) the INVO 2020 Vision, a five-year business plan with key objectives of reducing risk, cost, and complexity within INVO operations and the Total Fund. The INVO 2020 Vision was formed on the foundation of the Pension and Investment Beliefs, and 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.

### **Background**

In alignment with the five-year CalPERS 2017-22 Strategic Plan and the annual CalPERS 2017-18 Business Plan, the INVO 2017-18 Roadmap (Roadmap) is an annual business plan which communicates strategic objectives and initiatives supporting the CalPERS' mission, and the INVO 2020 Vision. The Roadmap is executed through five strategic objectives:

- Enhanced Capital Allocation Framework
- Business Effectiveness
- Investment Beliefs and Environmental Social and Governance (ESG) Risk Integration
- Investment Platform and Controls
- Investment Risk Management and Performance Attribution

Integrated into the Roadmap is the Target Operating Model (TOM), which defines the people, process, technology, and data needed to effectively manage the CalPERS' investment portfolio. Through periodic risk assessments and comparisons to industry benchmarks each TOM function

is evaluated to determine the current level of operational risk and inform the development of Roadmap initiatives and allocation of resources.

### **Analysis**

At the close of fiscal year 2016-17, INVO Executive staff completed a mid-cycle assessment of the INVO 2020 Vision Step Plan. Staff evaluated alignment with the CalPERS 2017-22 Strategic Plan and objectives, changes in complexities within INVO's operational environment, the current and future state of the market, and planned pace of the INVO 2020 Vision. As a result, modifications were made to the remaining steps of the INVO 2020 Vision work plan, as well as identifying additional organizational realignments, as highlighted in Attachment 1.

Subsequent to the mid-cycle assessment, staff developed the current Roadmap which encompasses 30 initiatives and 20 program projects focused on building repeatable, predictable, and scalable portfolios and investing practices. Roadmap initiatives tend to be cross-asset class or multi-branch projects, whereas program projects are more asset-class centric. The portfolio of 50 projects was thoughtfully designed to drive forward progress on the INVO 2020 Vision. Project management oversight and monthly reporting to the Investment Management Committee is provided by the Investment Core Services team, with project governance handled by assigned INVO governance committees.

In May 2017, staff informed the Committee of the initiation of a TOM refresh project, with the goal of a simplified structure, framework, and reduced complexity. In collaboration with Cutter Associates, staff provided a comparison of CalPERS capabilities versus an investment peer group, along with industry gaps and challenges, and made recommendations to the Operating Committee (OC).

In October 2017, the OC approved the refined TOM Dashboard, with new, more broadly defined functions and sub-functions that capture the operational activities found within INVO and the investment industry. This resulted in a simplification of the overall TOM, from 46 sub-functions in the previous model to 24 in the current version. In support of CalPERS' specific portfolio objectives, the Engagement function was added to Cutter's standard model to house sub-functions focused on engagement activities with portfolio companies, industry peers, and relevant stakeholders, acknowledging the scope and breadth of these activities have a particular focus and emphasis at CalPERS.

The current risk assessments reflect a translation of the May 2017 TOM risk-levels. The comprehensive risk assessment process managed by the Investment Compliance and Operational Risk program is currently underway. As communicated to the Committee in December 2016, the risk assessment process includes an evaluation of changes in external and internal operating environments, significant operating events, and completion of risk mitigation strategies with changes to risk levels reviewed and approved by the OC.

Going forward, the semi-annual Roadmap and TOM updates will be integrated into the enterprise reporting process and presented to the appropriate Board committee.

### **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 2017-18 Roadmap initiatives are an integral part of managing INVO's operational risks. As initiatives are completed, the following benefits are expected:

- Decrease in severity of critical operational risks
- Decrease in cost and complexity
- Optimized fund and strategy level decision making and reporting capabilities
- Enhanced business models
- Increased understanding of investment risk and performance attribution
- Enhanced governance and oversight
- Ability to attract highly skilled, diverse, and high performance workforce

Conversely, risks of not completing the Roadmap initiatives include:

- Weak performance attribution capabilities
- Unnecessary complexities and increased costs
- Inefficient infrastructure and technology platforms
- Less pro-active management of emerging risks

## **Attachments**

Attachment 1 – Investment Office Roadmap and Target Operating Model Update

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