



Investment Committee

Agenda Item 8a

September 24, 2018

Item Name: Review of Investment Policy Updates – First Reading

Program: Total Fund

Item Type: Information

Executive Summary

In connection with the annual review of applicable statements of investment policy by the investment teams, this item proposes several policy revisions for the Investment Committee's (Committee's) review and direction. Changes are proposed for the Total Fund Policy and the Real Assets Program Policy.

Copies of each policy in both "clean" (all proposed changes accepted) and mark-up (proposed revisions shown in blackline) are provided as Attachments 1 through 4. Opinion letters from the Board's Investment Consultants are provided as follows:

- For the proposed changes affecting the Total Fund Policy and the Forestland portfolio component of the Real Assets Program Policy, an opinion letter from Wilshire Associates, the Committee's General Pension Consultant, is provided as Attachment 5.
- For the proposed changes to the Real Assets Program Policy that address the Real Estate component of the program, an opinion letter from Pension Consulting Alliance, the Committee's Real Estate Consultant, is provided as Attachment 6.
- For the proposed changes to the Real Assets Program Policy that address the Infrastructure component of the program, an opinion letter from Meketa Investment Group, the Committee's Infrastructure Consultant, is provided as Attachment 7.

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 supports CalPERS Investment Belief 10, particularly sub-belief C, which states, "CalPERS will be best positioned for success if it 1) has strong governance, [and] 2) operates

with effective, clear processes....” Conducting an annual review ensures that the Policy is aligned with the ongoing refinements of the Investment Office’s organization and business processes.

Background

General Annual Review Process

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

Ongoing Policy Refinement

In addition to the focused “program-specific” review of policy content, these items also provide another opportunity to continue the refinement of our policy framework consistent with the goals of the 2014-16 Policy Revision Project, specifically, to:

- Focus policy content on the key strategic elements required to support the Committee in its oversight capacity, as well as guide staff in the management of the investment program
- Remove language identified as duplicative in nature
- Revise language to increase clarity and ease of reading, as well as improve consistency throughout CalPERS’ investment policies

Our statements of investment policy are living documents. As such, they can be expected to evolve over time as our policy and governance frameworks continue to evolve.

Analysis

Highlights of the proposed revisions to the policies are outlined in the following sections:

1. Total Fund Policy
2. Real Assets Program Policy

1. Total Fund Policy Changes

The Total Fund Policy changes are primarily focused on content related to the “Investment Risk Management” and “Asset Allocation Strategy” sections, as well as Appendix 4 (Asset Allocation Targets) and Appendix 5 (Policy Benchmarks). These changes can be further broken into three categories, specifically changes that reflect:

- 1.1 Organizational changes within the Investment Office
- 1.2 Updating of legacy content to reflect business-process enhancements and updates
- 1.3 Continued refinement of policy content consistent with the goals of the 2014-16 Policy Revision Project

A handful of ministerial changes are also included in Attachment 2. Due to the non-substantive nature of those changes they will not be discussed in this item, with the exception of a change to Table 1 of Appendix 5 (page 44 of 97), updating the title of the Real Assets benchmark. Due

to rebranding by the index provider, the title of the index has changed. This change is “in name only” and does not impact the constituents or characteristics of the index.

Additional information on the remaining changes is available in the sections below.

1.1 Organizational changes

In the course of the annual policy review for the Total Fund Policy, staff determined that the term “program” as used in the Investment Risk Management section of the Total Fund Policy had become ambiguous.

- Staff understands references to the “program” in this context are likely an artifact of when the investment risk management activities (analysis, reporting, monitoring, and investment decision making through the asset allocation process) were consolidated with the TLPM team, formerly known as the “Asset Allocation and Risk Management” team.
- As previously discussed in the April 2018 and June 2018 meetings of the Committee, the investment risk and performance analysis, reporting, and monitoring functions have transitioned from the TLPM team to the Investment Risk and Performance (IRP) team.

Therefore, on page 12 of 97, staff has rephrased several paragraphs to remove generic references to the “program.”

1.2 Updating of Legacy Content to Reflect Business-Process Enhancements and Updates

In addition to the organizational changes that are expected to occur over time, business processes also evolve as new efficiencies can be realized, or roles and requirements shift. In the course of their annual reviews, the TLPM and IRP teams identified a number of changes that would better reflect updates to business processes and roles. The key changes of this type are on pages:

- a. 30 and 31 of 97– Revision of number 10, and deletion of numbers 17 and 18. Consolidates IRP’s leverage reporting duties into one section of the reporting appendix (under “Risk Management”), to eliminate redundancy and potential ambiguity arising out of slight variations in formulation/wording.
- b. 31 of 97 – Elimination of reporting responsibility number 16 (regarding scenario analysis). This responsibility is being proposed for elimination because scenario analysis is more appropriately addressed within 1) IRP-owned reporting responsibility number 14 (on page 30 of 97), and 2) staff responsibility 14 on page 34 of 97.
- c. 34 of 97 – Revision of responsibility number 11, noting that staff’s evaluation will include 1) realized 5-year tracking error, and for the Public Employees’

Retirement Fund, 2) forward looking tracking error estimate with an industry-accepted risk model.

- i. Note, to support consistency and alignment throughout the policy staff proposes deletion of the last sentence of item B.1. in Appendix 7 (page 51 of 97), to strike reference to a 3-year period.
- d. 34 of 97 – Revision of responsibility number 16 to better focus on a core role for the IRP team, that being the development and maintenance “of methodologies for the effective measurement of investment risk for the Total Fund.” The legacy language is comparatively peripheral to that core function.
- e. 46-48 of 97 – Revision of Table 3, the Affiliate Fund policy benchmarks, specifically the public equity and real estate investment trusts (REITS) segments of the Legislator’s Retirement System and Judges Retirement System II allocations. These updates reflect index changes only and do not constitute a material change in the exposure or characteristics of the asset classes or the funds. The specific index changes reflect a modification in the management structure of the Affiliate Funds.
- f. 51 of 97 – Minor revision of the title for item B, to clarify that it is a Total Fund tracking-error limit.

1.3 Ongoing Content Refinement

As noted earlier in this item, several of the proposed changes are in furtherance of the goals of the 2014-16 Policy Revision Project, specifically to increase consistency and clarity, and where appropriate remove duplicative content or content that would be more appropriate for staff-level guidelines or procedures. Key changes of this type are found on pages:

- a. 12 of 97 – Revisions to the introductory paragraphs to:
 - i. Remove ambiguous references to “herein” and “program”
 - ii. Rephrase the second paragraph to improve clarity and reduce complexity
 - iii. Remove reference to legal and operational risks from the “Investment Risk Management” section as management of those risks is “business as usual,” and doesn’t appear appropriate for placement within the investment policy statement.
- b. 13 of 97 – Similar to item 1.3a above, removal of references to “herein” as it is 1) unclear what “herein” encompasses given the current structure of the Total Fund Policy, and 2) the addition of “herein” doesn’t appear to add sufficient value to offset the potential for ambiguity.
- c. 13 of 97 – Deletion of item “B” as it appears largely duplicative of the prior item “A” and doesn’t add value from a strategic direction/policy perspective.

- d. 13 of 97 – Revision of item C.1 (becoming the new “B”), and elimination of items C.II-C.IV. Items C.II-C.IV are largely duplicative of several reporting responsibilities within the Investment Risk Management section of Appendix 1. Staff believes refocusing item C.1 to focus on active risk, and eliminating C.II through C.IV, as they are either redundant or more procedural in nature, will improve the structure of the Total Fund Policy as a strategic-level document.
- e. 43 of 97 – Elimination of several duplicative references, including:
 - i. The second and third sentences, addressing the use of interim targets, as that concept is addressed on the following page
 - ii. The “Benchmark” column of Table 1, as 1) Appendix 4 is specific to asset allocation targets and ranges (not indices), and 2) the index names are provided on the following page (Appendix 5).
- f. 44 of 97 – Similar to item 1.3e above, elimination of duplicative references including:
 - i. The “policy weight” column of Table 1, as that information is displayed on the immediately preceding page (in the Asset Allocation Targets and Ranges Appendix).
 - ii. The third sentence, regarding staff’s use of active strategies, as this is duplicative of item E in the Asset Allocation Strategy section (page 6 of 97), as well as Appendix 7, Asset Allocation Strategy, which addresses an active tracking error limit.
- g. 44 of 97 – Revisions to the introductory paragraphs to improve clarity and ease of reading.
- h. 46-48 of 97 – Revision to the “benchmark description” blocks for several of the Affiliate Fund programs to improve clarity and ease of reading.

2. Real Assets Program Policy Changes

The proposed changes to the Real Assets Program Policy fall largely into the categories of 1) ongoing content refinement (clarification, remove redundant information, etc.), and 2) revision of legacy content to reflect business process updates and refinements. Key changes are focused on pages:

- a. 2 of 8 – Revisions to Investment Approach and Parameters item number 3, to note that the net asset value threshold applies to leverage limits, as well as region and risk classification limits.
- b. 4 of 8 – Staff responsibility number 3, minor wording adjustments and inclusion of a reference to the Real Assets Strategic Plan as a consideration for proposal evaluations
- c. 6 of 8 – Item 3 (Geography), elimination of the second sentence below the table as the content is procedural in nature and doesn’t appear to add value at the strategic direction/policy level.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

Staff does not anticipate any risks associated with the proposed policy revisions. Anticipated benefits and other considerations for the broad change categories are outlined below.

- Ensuring that policies are updated to reflect organizational and business process changes is a good general “maintenance” practice and helps ensure lines of responsibility remain clear.
- Staff’s proposals for the deletion of duplicative and/or “business as usual” content supports the principle that our policy documentation should be clear, focused at the strategic level, and meaningful for the management of the investment program. Policy documentation is not intended to be operational, procedural, or a restatement of professional staff’s duty statements.

Attachments

Attachment 1 – Total Fund Policy (clean view)

Attachment 2 – Total Fund Policy (mark-up)

Attachment 3 – Real Assets Program Policy (clean view)

Attachment 4 – Real Assets Program Policy (mark-up)

Attachment 5 – Board Investment Consultant Opinion Letter – Wilshire Associates

Attachment 6 – Board Real Estate Investment Consultant Opinion Letter – Pension Consulting Alliance

Attachment 7 – Board Infrastructure Investment Consultant Opinion Letter – Meketa Investment Group

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