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Mr. Rob Feckner
Chair of the Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Annual Review of Investment Policies – First Reading

Dear Mr. Feckner:

Overview

As part of the annual effort to review policies, Staff is bringing forward revisions to the Total Fund policy for a first reading. Wilshire encourages the Investment Committee to provide feedback, but regards this draft as having addressed the appropriate issues for this proposed revision.

The proposed changes to the Total Fund policy document are focused within four categories, which are listed below:

- 1. Strategic Asset Allocation**
- 2. Total Fund Leverage Management**
- 3. Sustainable Investments Program and Principles**
- 4. General *ad hoc* changes**

In total, there were 97 changes proposed among these categories. A vast majority were either ranked ministerial or low (80%), with the remaining ranked medium, or having a high degree of materiality. Wilshire reviewed all changes; with considerable time spent on the more impactful changes to the policy.

Strategic Asset Allocation (SAA) changes were focused on updating the policy with the new SAA target and range information, now that the implementation has been completed. In addition, the relevant asset class benchmarks have also been updated in the policy.



Total Fund Leverage Management changes were made to the policy in relation to a centralized focus on Total Fund performance that now permeates the culture within the organization. As part of that change, it was deemed more appropriate to have leverage consolidated and managed at the Total Fund within the Trust Level Portfolio Management (TLPM) team, rather than managed in silos via the individual asset classes. The change to the policy reflects the necessary governance changes that are needed to facilitate this structural shift. Leverage is an important risk to consider, as it can materially affect the overall performance of the portfolio, so these changes were analyzed rigorously, including additional discussion with Staff to examine them in more detail.

Wilshire agrees with the overall concept of centralizing leverage within TLPM, however the details of that implementation are equally as important. This is simply the beginning of what will be a long, deliberate, thoroughly vetted process. In the end, Wilshire and Staff believe that CalPERS can more effectively use leverage when it is contemplated at the total fund level. While it may continue to be implemented in certain asset classes or even strategies within those asset classes (Real Assets, or high quality core office space within the Real Assets portfolio, as examples), understanding the total leverage exposure for the total fund should lead to more effective risk controls and could save CalPERS financing costs.

As we walked through the detail, Wilshire's major concern was the removal of the Appendix 6, which references the leverage limits within each asset class, and replaced with a total fund limit of 20%. Wilshire's view was that while the details of the budgeting of the 20% limit were finalized, removing that appendix could (from a policy standpoint) permit excessive leverage taking. As a solution to that concern, Staff has relocated that appendix to an Investment-Policy Procedures & Guideline (IPPG), which is subject to oversight by the Boards consultants. Wilshire believes that this provides the necessary controls.

Sustainable Investments Program and Principles changes were made with the "Governance and Sustainability Strategy" section of the policy and Appendix 8. Just over 50% of the proposed policy changes were related to this category and Wilshire had no major issues regarding the substance of the changes. Wilshire suggested some clarifying language within the section, which Staff incorporated into this version of the proposed policy.

General *ad hoc* changes were primarily minor in regards to materiality. Modifications to the role of the Board's consultants were changed in two areas:

1. Benchmark changes - Wilshire
2. Prudent Person Opinions (PPO) - Meketa



The changes were reviewed, and deemed reasonable, but the Investment Committee should review the revisions to the investment amounts that require PPOs.

Investment Beliefs

Wilshire believes the changes support CalPERS' Investment Beliefs:

Investment Belief 4: "Long term value creation requires effective management of three forms of capital: financial, physical and human; require strong governance in the form of robust policies and procedures..."

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

In addition, Wilshire agrees as stated in the Staff memo that the more streamlined Policies support:

Investment Belief #10 (sub-belief C) - "CalPERS will be best positioned for success if it 1) has strong governance, 2) operates with effective, clear processes..."

Conclusion

Wilshire supports the changes in the policy document. In regards to Total Fund leverage centralization, changing governance is the right path forward but considerable work remains. The changes to maintain the existing leverage limits in an IPPG while the details are finalized is a good intermediate step. The additional changes throughout other sections of the policy are also reasonable and enhances CalPERS' operational processes through a reduction in duplicative and potentially conflicting language across policies.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

A handwritten signature in black ink, appearing to read 'Andrew Junkin'.

Andrew Junkin
President

A handwritten signature in black ink, appearing to read 'Ali Kazemi'.

Ali Kazemi
Managing Director