



**Thomas Toth, CFA**  
**Managing Director**

May 20<sup>th</sup>, 2020

Ms. Theresa Taylor  
Chair of the Investment Committee  
California Public Employees' Retirement System  
400 P Street  
Sacramento, CA 95814

Re: Agenda Item 7A: Revision of the Total Fund Investment Policy – First Read

Dear Ms. Taylor:

You requested Wilshire's opinion as it relates to the first reading of the Total Fund Investment Policy revisions. Wilshire has discussed the proposed revisions extensively with Staff and provided feedback with the express purpose of increasing accountability through better benchmarking; and providing a strategic framework for the planning and implementation of the Opportunistic Strategies (OS) portfolio. Wilshire is comfortable that the proposed changes associated with benchmarking and the implementation of the OS portfolio work to enhance CalPERS' governance framework.

This opinion letter will step through each change along with the rationale for each revision. The change to the benchmarking methodology is codified on page 46. Wilshire was involved in discussions around the benchmark methodology implementation and are comfortable that the policy revisions proposed here are consistent with the changes discussed with the Investment Committee at the end of 2019 and implemented on January 1<sup>st</sup>, 2020. Wilshire will continue to act in an oversight role regarding changes to benchmark construction, and will elevate those changes deemed material for approval by the Investment Committee as outlined in the Total Fund Investment Policy under "Benchmark Oversight."

Changes to the policies specific to Opportunistic Strategies start on pages 31 and 37. The responsible party has been changed from Trust Level Portfolio Management to Opportunistic Strategies to accurately capture that the interim MID-Opportunistic Strategies and her team are responsible for the day-to-day implementation of the portfolio and reporting to the Investment Committee. Page 38 adds the Opportunistic Strategies program to the list of General Pension Consultant investment program responsibilities as a means of providing oversight for the Investment Committee.

On page 52, there are two meaningful changes. The first is an increase in the maximum target for Opportunistic Strategies from 3% to 5%. This revision is in recognition of the increased



market opportunity set, as the COVID-19 pandemic has impacted the global economy to an unprecedented degree. Credit spreads across market segments have increased materially. Ratings downgrades and defaults are climbing, while dealer inventories and market making ability are more constrained. CalPERS can utilize its long investment horizon to take advantage of investment opportunities that provide strong risk-adjusted expected returns. Because OS does not have a specified target allocation weight, the Opportunistic Strategies investments are an active position relative to the asset allocation, and will continue to be governed by the Total Fund tracking error limit of 1.5% approved by the Investment Committee (page 50 in the policy). Even with the increase in the maximum allocation, the active risk limit of 1.5% still acts as a primary governance mechanism for limiting the Total Fund's risk exposure.

In conjunction, the implementation guidelines for Opportunistic Strategies have been expanded to include details on the underlying allocation ranges and limits on Staff authority to commit capital to external managers. Previously, the Opportunistic guidelines provided only high level diversification parameters, and hence Wilshire feels these guidelines provide stronger oversight for the Investment Committee. The allocation ranges are intentionally broad given the challenges of predicting exactly which market segments are going to prove to be the most attractive. The Staff authority limits for investments with external managers were structured similarly to that for Private Equity, across fund investments, co-investments, and customized investment accounts. A higher commitment level for an investment opportunity requires specific approval from more senior Staff up to the limits approved by the Investment Committee here. Wilshire is comfortable that these limits will provide diversification among external investment opportunities, when used in concert with the allocation ranges introduced in this Total Fund policy revision.

### **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; Governance is the primary tool to align interests between CalPERS and managers of its capital . . . ."*

*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 revised Total Fund Investment Policy supports:

*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 is comfortable that the changes proposed within the Total Fund policy promote more effective governance. Please do not hesitate to contact us should you require anything further or have any questions.

Sincerely,

A handwritten signature in black ink, appearing to be 'T. B.' followed by a horizontal line.