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## **FACT SHEET: INVESTMENTS**

# **CalPERS Stock Trading Model**

### **NEW PROCESS, COMPETITIVE PRICES, BROKER DIVERSITY**

#### **BACKGROUND**

- CalPERS Internal Global Equity officers trade a high volume of shares each year with an ever-expanding lineup of brokers.
- During the past few years, the complexity of internal trading activity has grown by leaps and bounds as Global Equity has shifted more assets from external to internal management. While CalPERS has had good results in trades with brokers during this period, rapidly declining trading costs have reduced the amount of available commissions. CalPERS needs to reduce its broker roster so that each broker relationship can be of a meaningful size.
- CalPERS has a strong commitment to trading through emerging and diversity brokers and expects that those brokers who are selected will benefit because they will have meaningful trading relationships.
- Tools now exist to assist with the broker selection process and help CalPERS keep pace with the increasingly complex market.

#### **MODEL OBJECTIVES**

- Enable CalPERS staff to select a limited set of brokers who collectively have the attributes necessary for CalPERS to effectively run the business;
- Provide an environment where all brokers are evaluated based on the criteria of execution quality, operational capability and added value;
- Segment the universe of brokers who complete the questionnaire into Core, Developmental and Queue pools based on objective, quantitative scores and provide each with feedback. All brokers have the opportunity to advance as needs arise and they can demonstrate their capabilities; and
- Provide opportunity for emerging brokers to develop, compete and move into a relationship with CalPERS.

## DEVELOPMENT OF BROKER SELECTION MODEL

- Beginning in the last quarter of 2007, CalPERS staff and its diversity consultant, Mosaic Investment Advisors, developed a self-administered questionnaire for brokers.
- The questionnaire measured three key factors that CalPERS needs from each of its brokers:
  - Execution Quality – the quantitative results of execution prices, net of commission, vs. the target price;
  - Operational Capability – the broker’s ability to receive, process and settle trades in a robust and efficient manner; and
  - Value-added – the number and quality of particular, often proprietary items that a broker can provide to help staff manage the portfolio, including research of various types, specific analytical software, access to new equity offerings, and the ability to commit capital, if needed.
- In early January 2008, the survey was sent to 130 firms on a list of brokers developed by CalPERS and Mosaic. It included brokers in current CalPERS relationships and emerging brokers who weren’t doing business with the pension fund but who might have an interest in being added to the broker list. Sixty-seven firms responded to the questionnaire.

## BROKER EVALUATION, SELECTION

- Evaluation methodology determines scores for “execution quality,” “operational capability,” and “value-added” for each broker.
- For brokers who have track records, CalPERS, staff and Mosaic are computing a final aggregate score to place brokers in three categories:
  - Core: must meet or exceed expectations for a material, mutually beneficial relationship;
  - Developmental: be placed under evaluation to determine capability and utility of the broker’s products; and
  - Rejected: have results that are below threshold.
- Both emerging and established brokers seeking potential relationships completed the survey.
- CalPERS and Mosaic are reviewing each questionnaire with a “blind scoring” approach that conceals the identity of the broker.

- Brokers are being placed into the “developmental” category or on Mosaic’s “queue” list of brokers desiring to do business with CalPERS. Those in the developmental group will have the opportunity to demonstrate their capabilities and advance into the core group, as warranted. Queue brokers will have the opportunity to advance into the developmental pool.
- Mosaic will contact both “queue” and “rejected” brokers to indicate why they were not selected and give them an opportunity to improve their scores as results warrant.

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