



**CalPERS Review of Investment Beliefs Implementation  
Presentation for May 18 Investment Committee**

**Roger Urwin  
Adam Gillett**

**May 2015**

## Outline of this presentation

- Scope of the Implementation Review
  - To apply oversight to the beliefs by assessing the effectiveness of their usage
  - To consider ways for their content to be enhanced but noting the beliefs were long-term and so no immediate reason exists to change them
  - To provide a positive feedback loop to secure the further commitment of the organization to the use of the beliefs
- Investment beliefs
  - Investment beliefs in global best practice
  - General background to investment beliefs
- Outline to this Review – coverage and process
- Survey results
  - Summary of results
  - Key comments
  - Heatmap of challenging beliefs
  - Comparison to Reference Group
- Key issues and recommendations

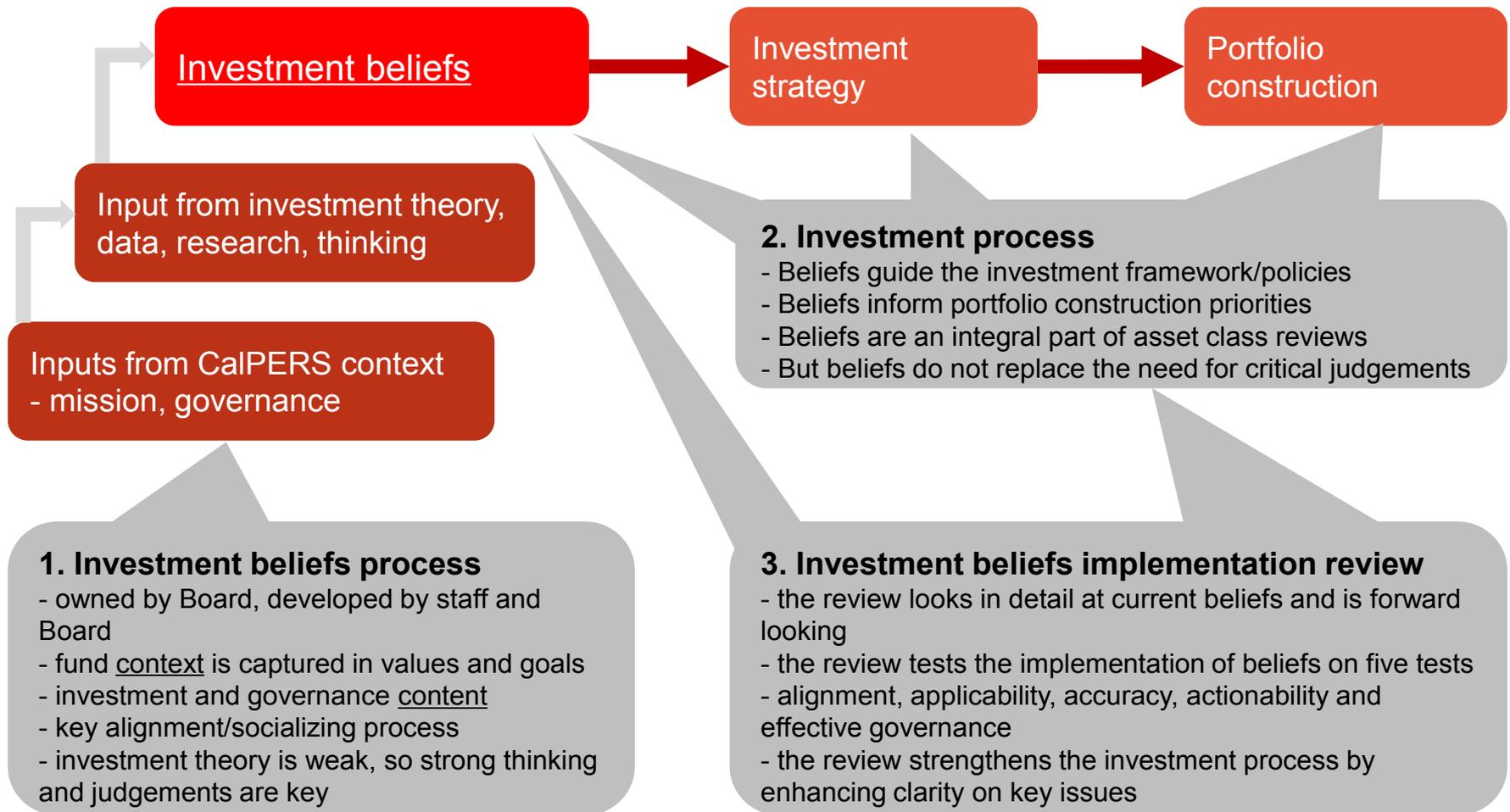
## Context: Global best-practice investment governance

### The Clark and Urwin study identified 12 factors associated with best-in-class organizations

Core factors	1. Mission clarity	Clarity of the mission and the commitment of stakeholders to the mission
	2. Effective time budget	Resourcing each element in the investment process with an appropriate budget considering impact and required capabilities
	3. Leadership	Leadership, being evident at the board, IC and executive (investment team) level, with the key roles being the IC Chairman, CIO and CEO
	4. Strong beliefs	Strong investment philosophy and beliefs that command fund-wide support, align with operational goals and inform all investment decision-making
	5. Risk budget	The risk budget framework captures the key measures of prospective risk and return being aligned to goals and incorporating an accurate view of alpha and beta and factor-exposures
	6. Manager line-up process	The portfolio construction making effective use of external managers, governed by clear mandates, aligned to goals, selected with rigorous application of fit for purpose criteria
Exceptional factors	7. Investment executive	The use of a highly investment competent investment function tasked with clearly specified responsibilities, with clear accountabilities to the IC
	8. Required competencies	Selection to the board and senior staff guided by: numeric skills, capacity for logical thinking, ability to think about risk in the probability domain
	9. Effective compensation	Effective compensation practices used to build bench strength and align actions to the mission, different strategies working according to fund context
	10. Competitive positioning	Frame the investment philosophy and process by reference to the institution's comparative advantages and disadvantages
	11. Real-time decisions	Utilise decision-making systems that function in real-time not calendar-time
	12. Learning culture	Work to a learning culture which deliberately encourages change and challenges the commonplace assumptions of the industry

**Source:** Best-practice investment management: Lessons for asset owners from the Oxford University-Watson Wyatt project on governance, Gordon L Clark and Roger Urwin, September 2007.

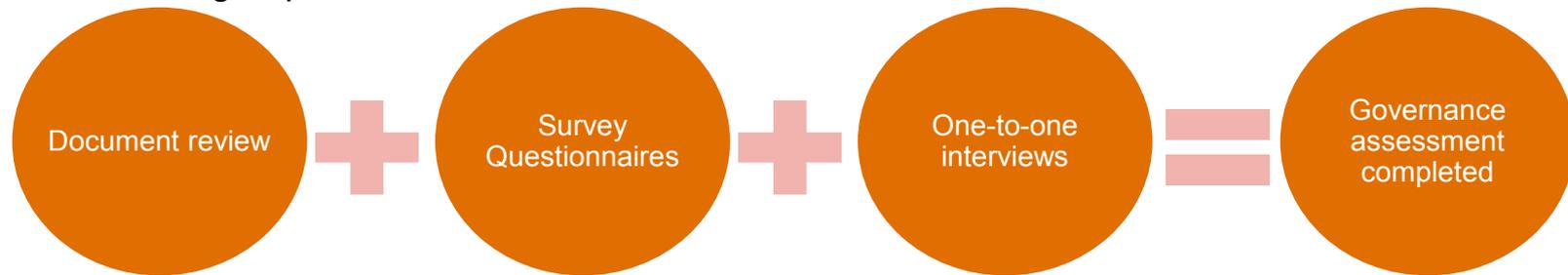
## Investment beliefs background



## Outline to this Review - coverage and process

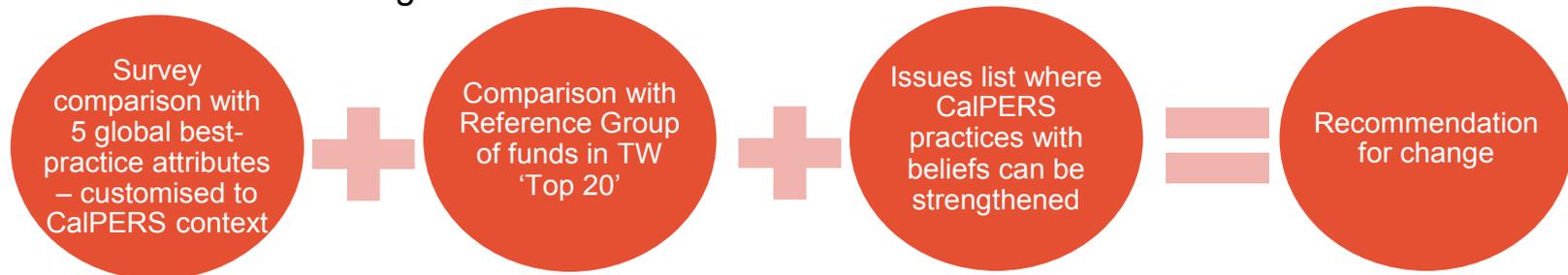
### The discovery coverage

The research inputs were derived from document review, questionnaires and interviews with the key stakeholder groups.



### The discovery research and benchmarking process

CalPERS practices were benchmarked against the five attributes in Global Best Practice and the selected Reference Group. This generated an issues list where strengthened practice is possible, and led to the key recommendations for change.



## Survey results

Investment Beliefs that ideally:	How well have the Investment Beliefs worked in practice?			
	Board	Staff	Dispersion	Respondents
a) Have the alignment of staff, reflecting settlement	3.5	3.1	H	17
b) Have produced alignment between Board and staff	3.6	2.9	H	25
c) Provide guidance on the considerations of wider stakeholders	3.3	3.0	M	19
d) Capture CalPERS-specific and unique context including liabilities, success measures, stakeholders	4.3	3.7	M	19
e) Reflect Board wishes and priorities	4.1	4.0	L	25
f) Reflect staff priorities, are focused on all portfolio relevant areas and guide portfolio priorities, apply to all individual asset classes equally	4.0	3.1	M	17
g) Have been evident in various policy and portfolio actions and decisions	3.3	3.7	M	25
h) Have correlated with investment experience; investment outcomes in the recent past have been consistent with investment beliefs	NA	3.4	L	14
i) Have supported the development of the investment framework and the development of investment policies, e.g. ALM, SAA	4.4	3.6	H	19
j) Have been a contributor to governance effectiveness; have been cited in tangible forms – papers, artifacts, stakeholder relations, press coverage	4.1	3.6	M	25

Scoring: 1 – Not at all; 2 – Somewhat; 3 – Fair; 4 – Good; 5 – Exceptional

Dispersion calculated as standard deviation of total results across Board and staff, calibrated to Low, Medium, High

Results received confidentially from 15 senior staff and 10 Board members

## Survey results – summary

### Overall survey assessment of CalPERS implementation of investment beliefs

- The average of the five global best practice attributes were

Alignment	3.1 out of 5	Fair score
Applicability	3.7 out of 5	Good score
Actionability	3.5 out of 5	Good score
Accuracy	3.4 out of 5	Good score
Good governance	3.8 out of 5	Good score

- The Board and the INVO leadership view the investment beliefs more favorably than other staff in several categories
- The Board though had a weaker view of implementation and whether investment beliefs ‘have been evident in various policy and portfolio actions and decisions’

### Gaps which respondents describe in current practice

- There were multiple mentions of the following areas as ‘gaps’ in practice:
  - Incorporation of long-term investment horizon
  - Alignment of compensation structure with long-term time horizon
  - ESG factor integration
  - Measurement and assessment of risk and beliefs
  - Dealing with large number/set of beliefs and sub-beliefs
- There were various comments on the challenges of achieving strategic dialogue between Board and INVO leadership

## Key comments taken from Board and INVO input

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- Board views on beliefs implementation are in most areas in line with INVO leadership but more positive than the staff respondents as a whole
  - The weaker staff views reflect the reality that the beliefs have a less significant footprint in some places; for example in private markets
  - The Board sense of ownership of the beliefs is particularly strong and they are positive that they exercise some strategic influence through beliefs
  - The Board though senses that the conversation about beliefs could be considered stronger than the implementation of beliefs
  - In this respect the need for more measurement of beliefs is seen as desirable – separating cause and effect if possible; that said there was acceptance that broader ‘assessment’ is a more effective tool in this context
  - A minority of staff and Board members viewed the beliefs as too numerous to be effective; staff viewed the separation of beliefs into the six ‘core’ investment beliefs and the four others as operationally helpful; the Board suggested that the others group might be termed ‘key’ to make sure these were appropriately ranked
  - The staff viewed the beliefs as a positive factor in talent attraction and senior staff on-boarding; they also recognised the positive overall effect to the Board-staff dynamic and its impacts on improved collaboration
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## Survey results – heatmap

Investment Beliefs that ideally:	Which Investment Beliefs are especially challenging in this context? *									
	1	2	3	4	5	6	7	8	9	10
a) Have the alignment of staff, reflecting settlement		3-5	6-10	6-10					3-5	
b) Have produced alignment between Board and staff		3-5	6-10	6-10					3-5	
c) Provide guidance on the considerations of wider stakeholders			6-10	3-5						
d) Capture CalPERS-specific and unique context including liabilities, success measures, stakeholders	3-5	3-5	3-5						3-5	
e) Reflect Board wishes and priorities		3-5	6-10	3-5				3-5	3-5	
f) Reflect staff priorities, are focused on all portfolio relevant areas and guide portfolio priorities, apply to all individual asset classes equally			6-10	6-10	3-5	3-5	3-5		3-5	3-5
g) Have been evident in various policy and portfolio actions and decisions	3-5	3-5	3-5	3-5			3-5		3-5	
h) Have correlated with investment experience; investment outcomes in the recent past have been consistent			3-5	3-5			3-5			
i) Have supported the development of the investment framework and the development of investment policies, e.g. ALM, SAA	3-5		3-5	3-5					3-5	
j) Have been a contributor to governance effectiveness; have been cited in papers, artifacts, stakeholder relations, press coverage			3-5	3-5					3-5	

\* Heatmap to reflect total count beliefs identified by respondents: 2 or fewer responses - blank 3-5 responses  6-10 responses

## Reference Group of 'Top 20'

### Reference Group

The composition of the Reference Group selected for comparison reflects a combination of their size (averaging \$400bn), transparency and strong governance.

Americas	Europe, Middle East, Africa	Asia Pacific
<ul style="list-style-type: none"> <li>• CalPERS (US)</li> <li>• CalSTRS (US)</li> <li>• New York City (US)</li> <li>• Texas Teachers (US)</li> <li>• Yale (US)</li> <li>• CPPIB (Canada)</li> <li>• Ontario Teachers (Canada)</li> </ul>	<ul style="list-style-type: none"> <li>• NPIFG (Norway)</li> <li>• ABP/APG (Netherlands)</li> <li>• PFZW/PGGM (Netherlands)</li> <li>• ATP (Denmark)</li> <li>• British Telecom PS (UK)</li> <li>• ADIA (Abu Dhabi)</li> <li>• GEPF (South Africa)</li> </ul>	<ul style="list-style-type: none"> <li>• CIC (China)</li> <li>• GPIF (Japan)</li> <li>• PFA (Japan)</li> <li>• GIC (Singapore)</li> <li>• NPS (Korea)</li> <li>• Future Fund (Australia)</li> </ul>

### Comparisons with Reference Group

15 of the 20 funds have published their investment beliefs

In this sample of 15 funds, Towers Watson assesses the CalPERS adoption and implementation of investment beliefs as:

- Above average in staff alignment
- Average in Board-staff alignment
- Above average in positive impact of investment beliefs adopted (this factor combines applicability, actionability and accuracy)
- Above average in reflecting good governance

## Issues summary and recommendations

	Issues	Recommendations
<b>1. Investment Beliefs embedded in staff practices</b>	<ul style="list-style-type: none"> <li>Investment beliefs have progressed at CalPERS well; Board, leadership and staff all deserve credit for progress</li> <li>But there is room to improve practice further and attain global best practice</li> </ul>	<p>Staff take these 'soft' steps as follows:</p> <ul style="list-style-type: none"> <li>Develop the Program reviews</li> <li>Embed beliefs as part of performance review and compensation</li> <li>Add to culture/leadership impacts</li> </ul>
<b>2. The traction of Investment Beliefs with staff</b>	<ul style="list-style-type: none"> <li>Staff applying investment beliefs at times need to draw them from short-term memory; the number of beliefs may be too large for effective use</li> <li>Staff difficulty with competing beliefs</li> </ul>	<ul style="list-style-type: none"> <li>Separate the beliefs into a 'prism' presentation, using two groups: 'Core' and 'Key'</li> <li>Fill out narrative and evidence supporting the investment beliefs</li> </ul>
<b>3. Investment Beliefs embedded in IC practices</b>	<ul style="list-style-type: none"> <li>Investment beliefs have been successfully taken on/embedded by IC</li> <li>There is room to improve practice with respect to investment beliefs further</li> </ul>	<p>IC takes these 'soft' steps as follows</p> <ul style="list-style-type: none"> <li>Increased unity</li> <li>Board annual adoption of beliefs</li> <li>Incorporate consulting input</li> </ul>

## Issues summary and recommendations (2)

	Issues	Recommendations
<b>4. Investment Beliefs in unsettled areas</b>	<ul style="list-style-type: none"> <li>▪ Investment beliefs act as effective guides to thinking in many areas of the CalPERS portfolio</li> <li>▪ But in the areas of risk and ESG the beliefs are not leading to settled positions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Board offsite in July to explore the strategic dialogue in two sessions               <ul style="list-style-type: none"> <li>- Risk and investment goals</li> <li>- Long-term investing/global governance</li> </ul> </li> </ul>
<b>5. Dialogue between IC and staff</b>	<ul style="list-style-type: none"> <li>▪ There are obstructions to effective governance at CalPERS</li> <li>▪ One fundamental area that the IC can add value in is increasing the strategic dialogue with staff leadership</li> </ul>	<ul style="list-style-type: none"> <li>▪ The dialogue culture is developed between IC and staff leadership</li> </ul>

## Contact details and limitations of reliance

- **Roger Urwin**
  - Global Head of Investment Content
  - Watson House | London Road | Reigate | Surrey | RH2 9PQ
  - T +44 1737 284 849
  - roger.urwin@towerwatson.com

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