

Investment Compliance Program Update

June 17, 2013



Investment Office
Investment Compliance and Operational Risk

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I. Investment Compliance

A. Program Role & Scope

Introduction to Investment Compliance

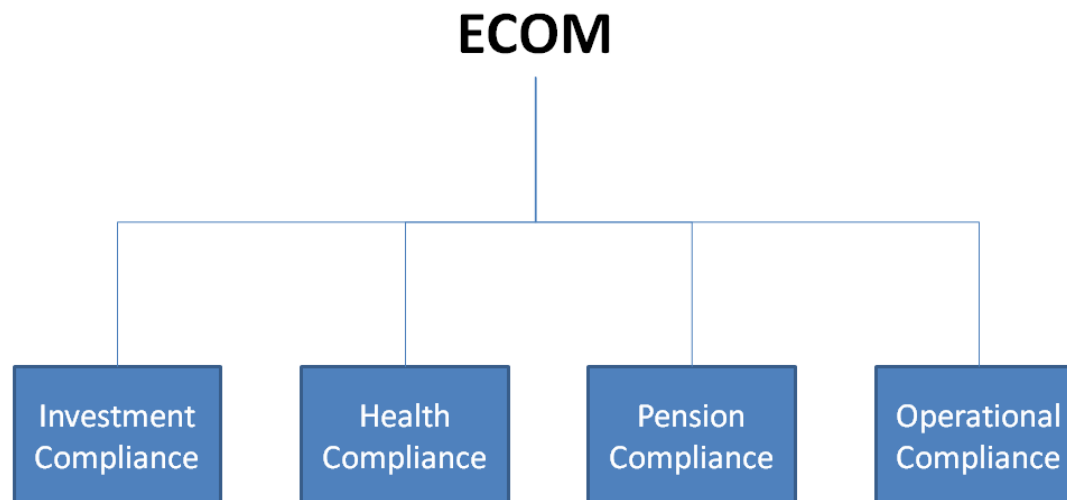
- In 2010, INVO developed a Risk Heat map and Target Operating Model (TOM)
 - Objective was to design, develop and implement a robust operating model that minimizes complexity, improves transparency and strengthens processes, systems and controls
 - The 2010 Risk Heat map and TOM initiative identified gaps in the INVO organization and a plan to address them
 - Two initiatives – Investment Policy and Monitoring and Operational Risk Governance and Management – were identified as high priorities and were incorporated as Roadmap objectives for INVO

Introduction to Investment Compliance

- In September 2011, INVO established the Investment Compliance and Operational Risk (ICOR) Division to perform investment compliance and operational risk management functions within INVO
- ICOR created a compliance program to ensure CalPERS Investment Office maintains ongoing compliance with regulatory requirements modeled after best practices found at regulated external managers hired by CalPERS
- The establishment of ICOR exemplifies INVO's objective to promote an organizational culture that seeks to eliminate or mitigate compliance risks

Oversight Model

- Enterprise Compliance Division (ECOM) has an important oversight role over INVO and ICOR, just as they do over the other divisions and branches within CalPERS

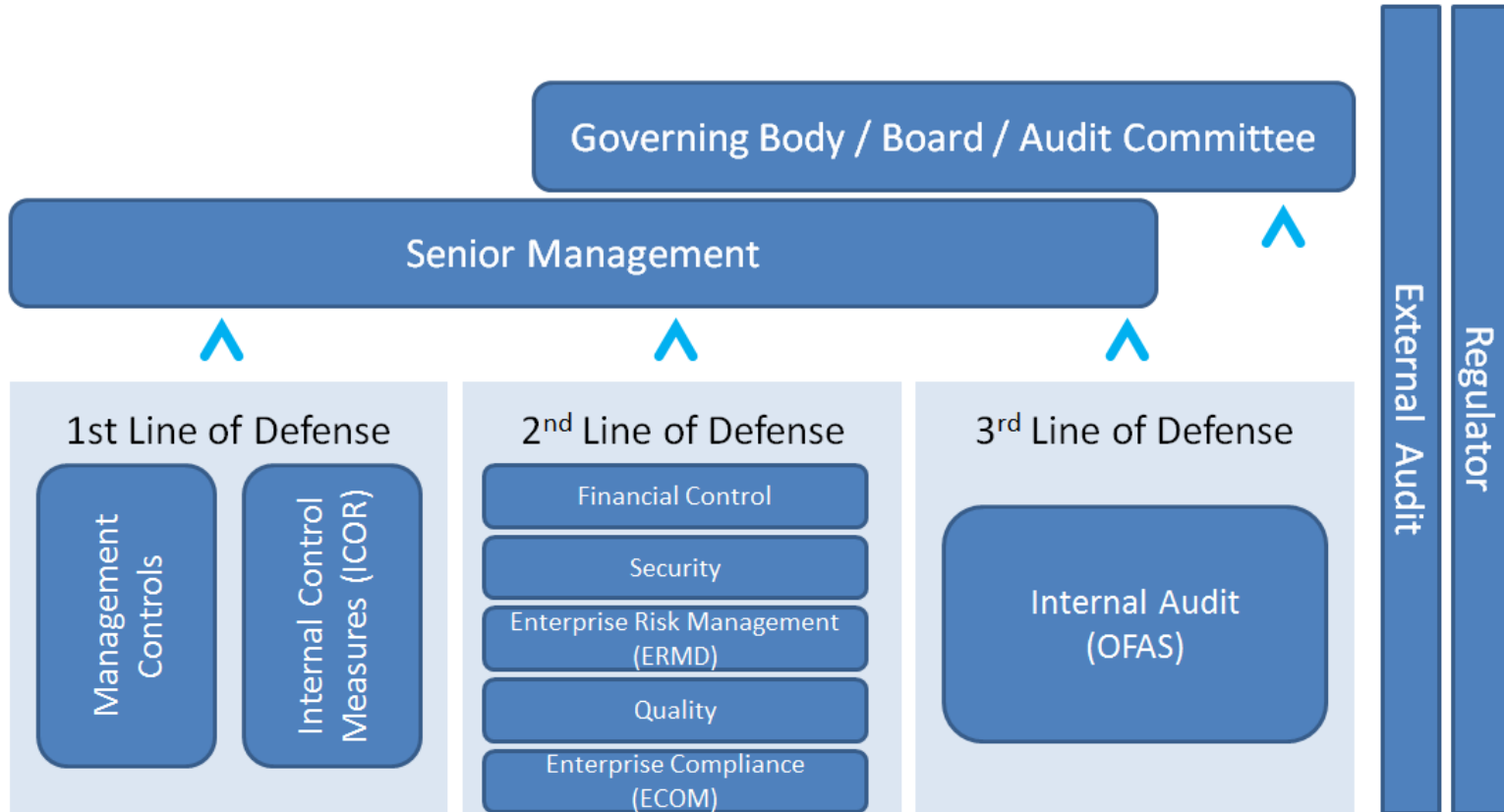


Oversight Model

- While ICOR is primarily responsible for investment-related compliance functions, ECOM has defined roles and responsibilities in providing oversight to INVO's activities and works collaboratively with ICOR

Cultivating a Risk Intelligent Organization through Effective Risk Management & Control

The Three Lines of Defense Model



Adapted from ECIIA/FERMA *Guidance on 8th EU Company Law Directive, article 41*

Managing Compliance Risk

- Compliance involves an assessment of legal, regulatory and operational risk
- An effective compliance program benefits performance and reputation
- Effective compliance requires a partnership and commitment among various stakeholders
- Managing compliance risk requires an investment in time, people and technology (e.g., personal trading system)
- Failure to manage compliance risk is often more costly (e.g., monetary losses, reputational risk, regulatory scrutiny)

Operating Principles

- ICOR's primary function is to support the Investment Office in implementing its strategic objectives while complying with applicable laws, regulations and policies
- Compliance is an organization-wide responsibility that is fundamental
- Management of compliance risk is best accomplished through application of compliance controls embedded into asset class practices and routines – First Line of Defense
- The program is built upon the working partnership between ICOR and INVO senior staff with input from Office of Enterprise Risk Management (OERM), ECOM, Legal Office (LEGO) and Office of Audit Services (OFAS)
- ICOR works with staff in fostering a proactive “getting compliance right the first time” approach
- CalPERS enterprise compliance function is managed through multiple channels and ICOR is expected to be aligned with CalPERS enterprise compliance structure

Comparison of ICOR's and Institutional External Managers' Compliance Programs

Typical Compliance Functions of Institutional External Managers	Responsibility Within CalPERS *
Daily portfolio compliance monitoring – Public Markets	ICOR
Personal trading monitoring of staff	ECOM
Risk assessment of processes, policies, and procedures	ICOR / OERM
Periodic testing of policies/procedures	ICOR / OFAS
Maintenance of investment policies and procedures	ICOR / Asset Classes
Annual (or more frequent) investment compliance training of all employees	ICOR
Managing investment-related regulatory examinations	ICOR / LEGO
Investment-related participant complaint correspondence (e.g., SIP, CERBT)	Customer Account Services Division (CASD) / ECOM
Regulatory reporting/filing (e.g., Section 13 filings)	Investment Servicing Division (ISD)

* In addition to the specific duties described above, ECOM retains primary responsibility for all investment compliance oversight activities, including oversight of compliance monitoring efforts by other CalPERS staff.

Comparison of ICOR's and Institutional External Managers' Compliance Programs

Typical Functional Areas for an Asset Manager	Responsibility Within CalPERS *
Inventory of rules and regulations relevant to investment actions	ECOM / ICOR
Employee investigations / Ethics Hotline incidents affecting investment staff	ECOM / ICOR / LEGO / Human Resources Services Division (HRSD)
Analysis and implementation of compliance processes related to new regulations that impact investment activities (e.g., Dodd Frank)	ICOR / Asset Classes
Identification and assessment of compliance risk for new and emerging investment-related initiatives (e.g., new security types)	ICOR

* In addition to the specific duties described above, ECOM retains primary responsibility for all investment compliance oversight activities, including oversight of compliance monitoring efforts by other CalPERS staff.

B. Duties & Responsibilities

INVO Duties & Responsibilities

INVO Senior Staff

- Develop and document appropriate procedures and processes
- Implement controls to prevent regulatory and policy violations
- Address control weaknesses through the automation of manual processes, use of technology, documenting procedures, training etc.
- Meet regularly with ICOR staff to communicate changes in business plans

ICOR SPM

- Update program operating plan, procedures and inventory of policies and laws
- Conduct investment compliance reviews and communicate results to senior staff
- Provide investment compliance training and disseminate compliance related information to INVO staff
- Provide periodic summary reporting to INVO senior management
- Ongoing review of Conflicts of Interest
- Address substantive regulatory requirements applicable to the business of INVO
- Periodic self-assessment of the effectiveness of the ICOR Investment Compliance Program

ECOM Duties & Responsibilities

- Develop, document and implement procedures, processes and controls related to investment compliance oversight and monitoring
- Conduct compliance reviews of investment activities (including compliance activities performed by INVO staff) and communicate results to INVO staff.
- Monitor investment exceptions for effective safeguard implementation
- Meet regularly with ICOR staff to coordinate investment compliance oversight efforts
- Ongoing review of Conflicts of Interest
- Monitor and administer Personal Trading Regulation and platform

II. Alignment of INVO TOM Functions & ICOR Roadmap Objectives

Progress to Date

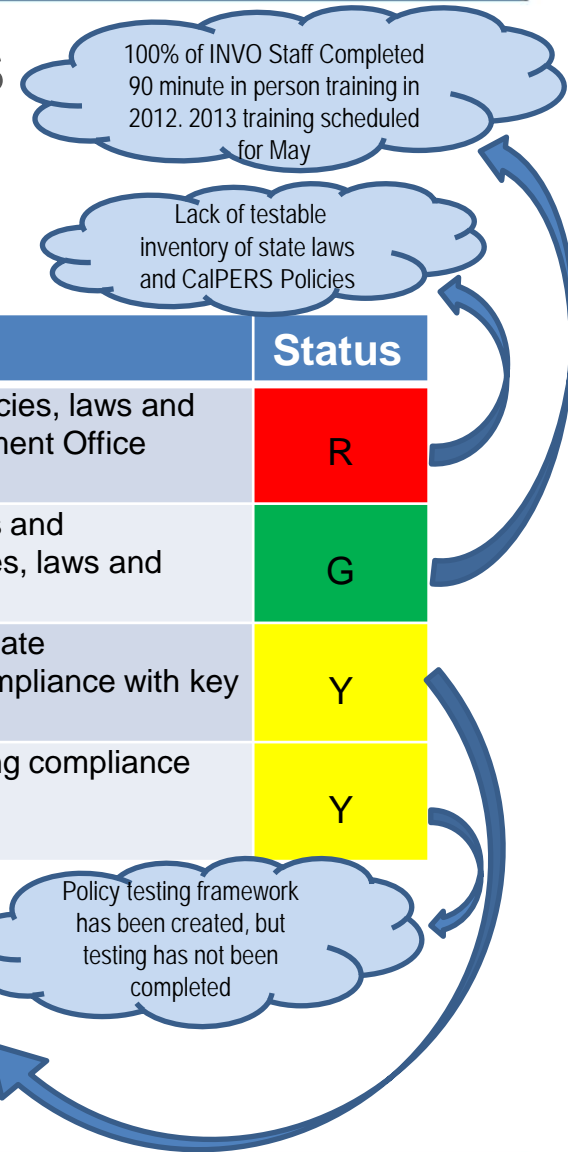
- ICOR's framework and core functions are driven from the Investment Office Target Operating Model (TOM) and ICOR Roadmap
- Several INVO TOM initiatives have been assigned to ICOR as part of refresh activities conducted in 2012-2013
- ICOR has allocated resources to complete these initiatives and has integrated these initiatives into the ICOR Roadmap

Progress to Date



Status of ICOR Roadmap Objectives

Investment Compliance Monitoring function remains high risk in TOM



From:	To:	Status
– No inventory of key policies, laws and regulations that impact INVO	– Ensure compliance with key policies, laws and regulations that impact the Investment Office	R
– Lack of detailed and comprehensive compliance training for INVO staff	– Ensure staff have full awareness and understanding of applicable policies, laws and regulations	G
– Inconsistent documentation of compliance with key policies, laws and regulations	– Ensure INVO staff retains adequate documentation to demonstrate compliance with key policies, laws and regulations	Y
– Lack of consistent monitoring of compliance with policies	– End to end process for monitoring compliance with policies	Y

2013 INVO TOM Initiatives for ICOR

INVO TOM Initiative	Corresponding Roadmap ICOR Initiative
Investment Compliance Monitoring	Completion of Detailed Policy Testing
Investment Policy Revisions	Streamline, Simplify and Reduce Number of Investment Policies
Manager Selection & Monitoring – Standards & Compliance	Completion of Annual Compliance Questionnaire Conflict of Interest Process for Selection of External Managers

