Investment Committee

Agenda Item 8a

November 18, 2019

Item Name: Public Asset Class Program Policy Revisions – Second Reading

Program: Global Equity and Global Fixed Income

Item Type: Action

Recommendation

Approve the revised Global Fixed Income Investment Policy and Global Equity Investment Policy as presented by staff.

Executive Summary

This item seeks the Investment Committee's (Committee's) consideration and action regarding the proposed updates and revisions to the Global Fixed Income Investment Policy and Global Equity Investment Policy (Program Policies) resulting from this year's annual investment-policy review process. Subsequent to the first reading of the Program Policies, staff has proposed an additional ministerial change regarding the naming convention for policy-related procedure documents, highlighted in the mark-up view.

Strategic Plan

Supports the Fund Sustainability element of the CalPERS 2017-22 Strategic Plan by contributing to the effective management and oversight of investment activities.

Investment Beliefs

This item supports CalPERS Investment Belief 10, particularly sub-belief C.

Background

Proposed changes to the Program Policies were presented to the Committee for a first reading at the September 16, 2019 meeting of the Committee. More information can be found at Agenda Item 9a[1] for that earlier committee meeting.

[1] Agenda Item 9a, Public Asset Class Program Policy Revisions – First Reading, available in the CalPERS Board of Administration - Investment Committee meeting archives

Analysis

As noted in the Executive Summary, staff is proposing an additional ministerial change to reflect the renaming of “Investment-Policy Procedures and Guidelines” (also referred to as IPPGs or IPGs) to “Policy-Related Procedures” or “PRPs.” PRPs are subject to a change-control process that includes oversight by the Board’s Investment Consultants. The new name is part of the transition to the use of more uniform terminology across asset classes.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

The changes support appropriate maintenance of the Program Policies. There are no anticipated risks.

Attachments

Attachment 1 – Proposed Global Fixed Income Policy (clean view)

Attachment 2 – Proposed Global Fixed Income Policy (mark-up view)

Attachment 3 – Proposed Global Equity Policy (clean view)

Attachment 4 – Proposed Global Equity Policy (mark-up view)

Attachment 5 – Consultant Opinion Letter – Wilshire Associates

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Katherine H. Crocker
Investment Director
Investment Controls & Operational Risk

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Dan Bienvenue
Interim Chief Operating Investment Officer

CalPERS Investment Policy for Global Fixed Income Program

Effective Date

This Policy is effective [Month DD, Year] and supersedes all previous Global Fixed Income Program investment policies.

Contents

Introduction

The California Public Employees' Retirement System (CalPERS) Total Fund Investment Policy, adopted by the CalPERS Investment Committee (Committee), sets forth the CalPERS investment beliefs and overarching investment purposes and objectives with respect to its investment programs. The CalPERS Total Fund Investment Policy specifically covers key areas of investment strategy, including performance objectives, asset allocation strategies, benchmark selection, investment risk management, and derivatives, leverage, and divestment policies, among other elements that are applicable to all asset classes and programs at CalPERS.

This document sets forth the investment policy (Program Policy) for the Global Fixed Income Program (Program). The design of this Program Policy ensures that staff, investors, managers, consultants, and other participants selected by CalPERS take prudent and careful action while managing the Program. Additionally, use of this Program Policy assures sufficient flexibility in managing investment risks and returns associated with the Program.

This Program Policy should be read in conjunction with and is subject to conditions contained within the CalPERS Total Fund Investment Policy (Total Fund Policy). This Program Policy shall also be managed to comply with all applicable Investment Office policies.

Strategic Objective

The Program has three strategies: Long Treasury, Long Spread, and High Yield, each defined as an "Asset Segment" and having the strategic objectives outlined below.

A. The Long Treasury Segment of the Program has the following strategic objective:
    - To serve as an economic diversifier to equity risk and be a reliable source of liquidity.

B. The Long Spread Segment of the Program has the following strategic objective:
    - To provide a reliable source of income and an additional source of liquidity.

C. The High Yield Segment of the Program has the following strategic objective:
    - To provide exposure to economic growth and be a reliable source of income.

Responsibilities

Details regarding various levels of responsibility for this Program are provided in Appendix 1, Reporting to the Investment Committee, and Appendix 2, Investment Responsibilities, to this Program Policy.

Investment Approaches & Parameters

All investment programs shall have specific written guidelines. The guidelines shall outline the investment approaches, permissible and restricted activities, and a performance objective that is commensurate with the program's purpose.

Staff shall rely on short- or long-term ratings from authorized nationally recognized statistical rating organizations (NRSROs) only. Staff shall maintain and annually update internal ratings for securities that are not rated by any authorized NRSROs.

Investment Constraints/ Limitations

See Appendix 3 for program investment constraints.

Glossary of CalPERS Specific Terms

Italicized terms appearing in the Program Policy are CalPERS-specific in nature and are defined in the CalPERS Specific Glossary of Terms.

Policy Document History

See Appendix 4 for historical details of Investment Committee adoption of and revisions to this Program Policy.

Appendices

See the Total Fund Investment Policy appendices for overarching reporting requirements and responsibilities for the Investment Committee, staff, ***General Pension Consultant, Private Asset Class Board Investment Consultant***, and ***External Manager***.

Appendix 1: Reporting to the Investment Committee

The following tables provide details regarding reporting to the Investment Committee:

- Investment Office staff
- ***General Pension Consultant***

Table 1: Investment Office Staff Reporting Responsibilities

Ref #	Report Content	Frequency
1.	Staff shall provide an Annual Program Review that will include a program overview, investment review, and business review in general conformance with the Annual Program Review Template.	No less than annually

*Table 2: **General Pension Consultant** Reporting Responsibilities*

Ref #	Report Content	Frequency
1.	The Consultant shall monitor, evaluate, and report on the performance of the Program relative to the benchmark and this Program Policy and other applicable CalPERS Policies.	No less than annually

Appendix 2: Investment Responsibilities

The following sections provide details regarding investment related responsibilities for the:

- Investment Office staff
- ***General Pension Consultant***
- ***External Manager***

Investment Office Staff Responsibilities

1. All aspects of portfolio management, including monitoring, trading, analyzing, evaluating performance relative to the appropriate benchmark, and selecting and contracting with managers.
2. Monitor the internal and external managers in the implementation of, and compliance with, the Program Policy and the Total Fund Policy.
3. Develop and maintain investment procedures, program guidelines, and sub-program guidelines.

General Pension Consultant *Responsibilities*

1. Provide independent perspective and counsel to the Committee, to include routine communication with the Investment Office staff and periodic reviews of processes and procedures.

External Manager *Responsibilities*

1. Manage the fund in accordance with each manager’s contract with CalPERS, the Total Fund Policy, and the Program Policy.
2. Communicate and cooperate with Investment Office staff and authorized third parties regarding the management of the fund.

Appendix 3: Investment Constraints/Limitations

The following table provides details regarding investment constraints/limitations related to the following Asset Segments:

- Long Treasury Segment
- Long Spread Segment
- High Yield Segment

Investment Constraints/Limitations by Global Fixed Income Asset Segment
Long Treasury Segment 1. Interest rate risk will be controlled using duration management. Duration will be maintained at +/-10% of the benchmark. 2. Further restrictions regarding liquidity and use of derivatives are outlined in the Policy-Related Procedures (PRP) for the Global Fixed Income Program. **Long Spread Segment** 1. Sector Risk will be controlled by sector ranges that specify the degree by which allocations may fluctuate from the benchmark weights. Permitted sector ranges for each strategy will be maintained within +/-10% of the benchmark weight with a minimum weight of 0%. 2. Further restrictions regarding duration, ratings, concentration, currency, geography, and use of derivatives are outlined in the PRP for the Global Fixed Income Program. **High Yield Segment** 1. Restrictions regarding duration, ratings, concentration, out of index bets and use of derivatives are outlined in the PRP for the Global Fixed Income Program.

Additional details regarding investment constraints/limitations and risks are outlined in each Program Segment specific written procedures.

Appendix 4: Policy Document History

Table 3: Global Fixed Income Program Policy History

Date	Detail
2015-11-16	Approved by the Investment Committee Reformatted to incorporate Investment Policy Revision Project and Investment Delegation Restructuring Project revisions. The Credit Enhancement Program Policy was consolidated with the Global Fixed Income Program Policy and was repealed on November 16, 2015.
YYYY-MM-DD	[Approved by the Investment Committee Updates were made to reflect the new asset segments. Administrative changes to migrate policy into an accessible template.]

CalPERS Investment Policy for Global Fixed Income Program

Effective Date

~~November 16, 2015~~

This Policy is effective ~~immediately upon adoption~~[Month DD, Year] and supersedes all previous Global Fixed Income Program ~~and Credit Enhancement Program~~ investment policies.

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This document sets forth the investment policy (Program Policy) for the Global Fixed Income Program (Program). The design of this Program Policy ensures that staff, investors, managers, consultants, and other participants selected by CalPERS take prudent and careful action while managing the Program. Additionally, use of this Program Policy assures sufficient flexibility in managing investment risks and returns associated with the Program.

This Program Policy should be read in conjunction with and is subject to conditions contained within the CalPERS Total Fund Investment Policy (Total Fund Policy). This Program Policy shall also be managed to comply with all applicable Investment Office policies.

Strategic Objective

The Program ~~seeks to~~ has three strategies: Long Treasury, Long Spread, and High Yield, each defined as an "Asset Segment" and having the strategic objectives outlined below.

A. The Long Treasury Segment of the Program has the following strategic objective:
   - ~~diversify and reduce overall risk for CalPERS investment programs while enhancing CalPERS total returns.~~ To serve as an economic diversifier to equity risk and be a reliable source of liquidity.

B. The Long Spread Segment of the Program has the following strategic objective:
   - To provide a reliable source of income and an additional source of liquidity.

C. The High Yield Segment of the Program has the following strategic objective:
   - To provide exposure to economic growth and be a reliable source of income.

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Details regarding various levels of responsibility for this Program are provided in Appendix 1, Reporting to the Investment Committee, and Appendix 2, Investment Responsibilities, to this Program Policy.

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All investment programs shall have specific written guidelines. The guidelines shall outline the investment approaches, permissible and restricted activities, and a performance objective that is commensurate with the program's purpose.

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See Appendix 3 for program investment constraints.

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~~2.~~	~~Staff shall report concerns, problems, material changes, and all violations of the Policy. These reports shall include explanations of any violations and appropriate recommendations for corrective action.~~	~~At the next Committee meeting, or sooner if deemed necessary~~

*Table 2: **General Pension Consultant** Reporting Responsibilities*

Ref #	Report Content	Frequency
1.	The Consultant shall monitor, evaluate, and report on the performance of the Program relative to the benchmark and this Program Policy and other applicable CalPERS Policies.	No less than annually

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General Pension Consultant *Responsibilities*

1. Provide independent perspective and counsel to the Committee, to include routine communication with the Investment Office staff and periodic reviews of processes and procedures.

External Manager *Responsibilities*

1. Manage the fund in accordance with each manager's contract with CalPERS, the Total Fund Policy, and the Program Policy.
2. Communicate and cooperate with Investment Office staff and authorized third parties regarding the management of the fund.

Appendix 3: Investment Constraints/Limitations

The following ~~tables provide~~ table provides details regarding investment constraints/limitations related to the following ~~programs~~Asset Segments:

- ~~Dollar-Denominated Fixed Income~~
- ~~International Fixed Income~~
- ~~Credit Enhancement~~

~~Ranges for Domestic and International Programs relative to the benchmark are listed below.~~

- Long Treasury Segment
- Long Spread Segment
- High Yield Segment

~~**Domestic Program**~~**Investment Constraints/Limitations by Global Fixed Income Asset Segment**
~~International Program~~**Long Treasury Segment** 1. Interest rate risk will be controlled using duration management. Duration will be maintained at +/-10% of the benchmark. 2. Further restrictions regarding liquidity and use of derivatives are outlined in the ~~Investment Procedures and Guidelines (IPG)~~ Policy-Related Procedures (PRP) for the Global Fixed Income Program. **Long Spread Segment** 1. Sector Risk will be controlled by sector ranges that specify the degree by which allocations may fluctuate from the benchmark weights. Permitted sector ranges for each strategy will be maintained within +/-10% of the benchmark weight with a minimum weight of 0%. 2. Further restrictions regarding duration, ratings, concentration, currency, geography, and use of derivatives are outlined in the ~~IPG~~ PRP for the Global Fixed Income Program. **High Yield Segment** 1. Restrictions regarding duration, ratings, concentration, out of index bets and use of derivatives are outlined in the ~~IPG~~ PRP for the Global Fixed Income Program.
~~**Dollar-Denominated Fixed Income Program**~~
~~1. Interest Rate Risk must be controlled using duration management. Duration shall be maintained at -50% to +10% of the Barclays Capital Long Liabilities (BCLL) Index on an option-adjusted basis. Decisions shall be managed using historical real return relationships and economic analysis.~~
~~2. Sector Risk must be controlled using the ranges below. Based on the economic outlook, historical factors, and break-even analysis, staff shall estimate the impact on various sectors' spreads and make allocations accordingly.~~

~~Sector Ranges – The permitted sector ranges are expressed as a percentage of the total Dollar-Denominated Fixed Income Program portfolio.~~

~~Total Domestic Program Weightings~~

~~Sector~~	~~BCLL Index~~	~~Permitted Sector Ranges~~
~~U.S. Treasury & Government Sponsored~~	~~40%~~	~~10% - 80%~~
~~Mortgage~~	~~30%~~	~~15% - 45%~~
~~Corporate~~	~~24%~~	~~10% - 40%~~
~~Opportunistic~~	~~3%~~	~~0% - 12%~~
~~Sovereign~~	~~3%~~	~~0% - 10%~~
~~Total~~	~~100%~~	~~N/A~~

~~International Fixed Income Program~~

1. ~~Interest Rate Risk must be managed by the Manager within -50% to +10% of the benchmark duration~~

2. ~~Sector Risk will be controlled using the ranges below. Managers are responsible for determining appropriate allocations based on market analysis.~~

   ~~Sector Ranges – The following table specifies the ranges within which allocations can fluctuate from benchmark weights, with the exception of Governments (ex US), for which the permitted sector range is expressed as a percentage of the total International Fixed Income Program portfolio:~~

~~Total International Program Weightings~~

~~Sector~~	~~Benchmark~~	~~Permitted Sector Ranges~~
~~Governments (ex US)~~	~~100%~~	~~90% - 100%~~
~~U.S. Treasury (ex TIPS)~~	~~0%~~	~~-10% - +10%~~
~~Investment Grade Corporate~~	~~0%~~	~~-10% - +10%~~
~~Mortgages~~	~~0%~~	~~0% - +10%~~
~~Non-Investment Grade Corporate~~	~~0%~~	~~0% - 5%~~
~~Total~~	~~100%~~	~~N/A~~

~~Note: The total of non-government securities cannot exceed 10% of the total International Program.~~

~~Credit Enhancement Program~~
~~1. Credit Rating Portfolio Limits – The average credit quality of the Program's portfolio shall be "single-A" long-term credit rating designation (A by S&P, A2 by Moody's, and A by Fitch).~~
~~2. Program Transaction Limits – The maximum holding in any given transaction in California shall be 25% of the issue in order to be in compliance with the Safe Harbor rules established under Section 503(e) of the Internal Revenue Code (IRC).~~

Additional details regarding investment constraints/limitations and risks are outlined in each Program Segment specific written procedures.

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~~The Credit Enhancement Program Policy was consolidated with the Global Fixed Income Program Policy and was repealed on November 16, 2015.~~

CalPERS Investment Policy for Global Equity

Effective Date

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CalPERS

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Strategic Objective

The Program has two strategies, the Market Capitalization Weighted Segment and the Factor Weighted Segment, each defined as an "Asset Segment", and having the strategic objectives specified below.

A. The Market Capitalization Weighted Segment of the Program has the following strategic objective:
    - To provide exposure to economic growth and be a reliable source of liquidity.

B. The Factor Weighted Segment of the Program has the following strategic objective:
    - To provide exposure to economic growth with reduced overall volatility and some diversification of equity risk.

Responsibilities

Details regarding various levels of responsibility for this Program are provided in Appendix 1, Reporting to the Investment Committee, and Appendix 2, Investment Responsibilities, to this Program Policy.

Investment Approaches & Parameters

A. Approach
   In the management of the overall Global Equity portfolio, investments are made with a specific purpose. Included strategies may be index-oriented (which closely replicate an index selected as the benchmark) or active strategies (which permit ***asset class tracking***

error within specified parameters). All strategies shall be categorized as "index-oriented" or "active."

Global Equity utilizes both internally managed and externally managed strategies to meet the Strategic Objective. The Program seeks to facilitate meaningful information transfer from the external investment managers to Staff to help Staff develop scalable, sustainable, and efficient methods of increasing the likelihood of meeting Global Equity's investment return goals over the long term.

B. Investment Opportunity Set

The primary universe of allowable investment assets within Global Equity shall be publicly traded global equity securities and derivatives thereof as described in the Total Fund Policy, Global Derivatives and Counterparty Risk Section, and associated procedure.

C. Investment Selection

Global Equity has internal committees to select desired strategies and allocate capital. The Global Equity committees review and approve internal and external strategies forming the pool of eligible investment strategy alternatives and allocate capital to and from those eligible strategies.

D. Investment Parameters

All investment strategies shall have specific, written guidelines. The guidelines shall outline the investment philosophy and approaches, permissible and restricted activities and a performance objective that is commensurate with the strategy's purpose.

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See Appendix 3 for program investment constraints.

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3. Develop and maintain investment procedures, program guidelines, and sub-program guidelines.
4. Design and implement a process for capital allocation within the asset class.

General Pension Consultants *Responsibilities*

1. Provide independent perspective and counsel to the Committee, to include routine communication with the Investment Office Staff and periodic reviews of processes and procedures.

External Manager *Responsibilities*

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The following table provides details regarding investment constraints/limitations related to the following Asset Segments:

- Market Capitalization Weighted Segment
- Factor Weighted Segment

Investment Constraints/Limitations by Global Equity Asset Segment
Market Capitalization Weighted Segment 1. Active risk will be managed using tracking error. On average, the aggregate forecasted tracking error is to be maintained between 0 and 50 basis points as measured by the CalPERS Risk Management system while allowing for slight deviations from this range depending on market conditions. 2. Further restrictions regarding concentration risk, out-of-benchmark bets, and use of derivatives are further outlined in the Policy-Related Procedures (PRP) for the Global Equity Program. **Factor Weighted Segment** 1. Active risk will be managed using tracking error. On average, the aggregate forecasted tracking error is to be maintained between 0 and 50 basis points as measured by the CalPERS Risk Management system while allowing for slight deviations from this range depending on market conditions. 2. Further restrictions regarding concentration risk, out-of-benchmark bets, and use of derivatives are outlined in the PRP for the Global Equity Program.

Appendix 4: Policy Document History

Table 3: Global Equity Program Policy Document History

Date	Detail
2012-12-10	Adopted by the Investment Committee
2013-11-18	Revisions approved by the Investment Committee
2013-12-24	Administrative changes to update template format and to align this policy with the Global Derivatives and Counterparty Risk Policy
2014-05-15	Administrative changes to standardize reporting frequencies to the Investment Committee to “no less than annually”
2014-05-15	Administrative changes to reflect the Policy Glossary of Terms Update Project
2014-10-13	Revisions approved by the Investment Committee
2015-11-16	Approved by the Investment Committee Reformatted to incorporate Investment Policy Revision Project and Investment Delegation Restructuring Project revisions
YYYYY-MM-DD	[Approved by the Investment Committee Updates were made to reflect the new asset segments. Administrative changes to migrate policy into an accessible template.]

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Strategic Objective

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~~A. The Program seeks to meet or exceed the return generated by global public equities as represented by the benchmark, specified in the CalPERS Total Fund Investment Policy benchmark appendix, while managing volatility relative to this benchmark.~~

~~B. The Program seeks to utilize active management in an effort to earn a rate of return in excess of the benchmark. The degree of active management deployed is constrained by various risk limits for the asset class to manage relative volatility~~

A. The Market Capitalization Weighted Segment of the Program has the following strategic objective:
   - To provide exposure to economic growth and be a reliable source of liquidity.

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4. Design and implement a process for capital allocation within the asset class.

General Pension Consultants *Responsibilities*

1. Provide independent perspective and counsel to the Committee, to include routine communication with the Investment Office Staff and periodic reviews of processes and procedures.

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Appendix 3: Investment Constraints/Limitations

~~Specific Risk Parameters~~

1. ~~***Asset Class Tracking Error*** – On average, the aggregate forecast tracking error for Global Equity is 0 to 50 basis points as measured by the CalPERS Risk Management system; however, allowing for slight deviations from this range depending on certain market conditions.~~
2. ~~Illiquidity – The allocation of assets to illiquid investment vehicles or instruments shall be limited to 15% of the Global Equity asset class exposure at the time of such allocation.~~

~~Prohibited Securities –The Committee through resolution, or the State or Federal government through enactment of rules or laws, may prohibit CalPERS from holding certain securities. CalPERS will remove such securities from relevant benchmarks. This section will not be applicable for investment funds where CalPERS does not have discretionary authority (e.g., commingled funds, exchange-traded funds) except as required by Federal law.~~The following table provides details regarding investment constraints/limitations related to the following Asset Segments:

- Market Capitalization Weighted Segment
- Factor Weighted Segment

Investment Constraints/Limitations by Global Equity Asset Segment
Market Capitalization Weighted Segment 1. Active risk will be managed using tracking error. On average, the aggregate forecasted tracking error is to be maintained between 0 and 50 basis points as measured by the CalPERS Risk Management system while allowing for slight deviations from this range depending on market conditions. 2. Further restrictions regarding concentration risk, out-~~-~~of-~~-~~benchmark bets, and use of derivatives are further outlined in the ~~Investment Procedures and Guidelines (IPG)~~ Policy-Related Procedures (PRP) for the Global Equity Program. **Factor Weighted Segment** 1. Active risk will be managed using tracking error. On average, the aggregate forecasted tracking error is to be maintained between 0 and 50 basis points as measured by the CalPERS Risk Management system while allowing for slight deviations from this range depending on market conditions. 2. Further restrictions regarding concentration risk, out-~~-~~of-~~-~~benchmark bets, and use of derivatives are outlined in the ~~IPG~~ (PRP) for the Global Equity Program.

Appendix 4: Policy Document History

Table 3: Global Equity Program Policy Document History

Date	Detail
2012-12-10	Adopted by the Investment Committee
2013-11-18	Revisions approved by the Investment Committee
2013-12-24	Administrative changes to update template format and to align this policy with the Global Derivatives and Counterparty Risk Policy
2014-05-15	Administrative changes to standardize reporting frequencies to the Investment Committee to "no less than annually"
2014-05-15	Administrative changes to reflect the Policy Glossary of Terms Update Project
2014-10-13	Revisions approved by the Investment Committee
2015-11-16	Approved by the Investment Committee Reformatted to incorporate Investment Policy Revision Project and Investment Delegation Restructuring Project revisions
YYYYY-MM-DD	[Approved by the Investment Committee Updates were made to reflect the new asset segments. Administrative changes to migrate policy into an accessible template.]

Wilshire

Rose Dean, CFA
Managing Director

November 1, 2019

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

Re: Second Review of Global Equity and Global Fixed Income Program Policy Revisions

Dear Mr. Feckner:

You requested Wilshire's opinion as it relates to the second reading of the Public Asset Class Program Policy Revisions for Global Equity (GE) and Global Fixed Income (GFI). Wilshire has reviewed both documents and is comfortable with the proposed changes. The changes for both policies are administrative. The incremental revisions since the first reading reflect the change in the naming convention for the "Investment-Policy Procedures and Guidelines" (also known as IPPGs or IPGs) to "Policy-Related Procedures" or "PRPs" in efforts to utilize uniform terminology across asset classes.

Wilshire is comfortable with the changes proposed within both the GE and GFI policy documents. Please do not hesitate to contact us should you require anything further or have any questions.

Sincerely,