



Investment Committee

Agenda Item 5a

June 20, 2023

Item Name: Revisions to the CalPERS Investment Policy for Insider Trading

Program: Total Fund

Item Type: Action

Executive Summary

This item is seeking approval from the Investment Committee (Committee) to update the CalPERS Investment Policy for Insider Trading.

Strategic Plan

This agenda item supports the CalPERS Strategic Plan goal to strengthen the long-term sustainability of the pension fund.

Background

The existing Statement of Investment Policy for Insider Trading (Insider Trading Policy) was approved by the Board in May 2014. The Insider Trading Policy is intended to ensure that CalPERS Board members and team members are aware of and comply with the anti-fraud provisions of the federal securities laws. The Policy is reflective of the requirements and prohibitions of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, which prohibit the purchase or sale of securities on the basis of material, non-public information in breach of a duty of trust or confidence.

Analysis

Under Section II of the existing Insider Trading Policy, there is a presumption that if any team member receives material nonpublic information (MNPI) on a publicly traded security, the knowledge is imputed to all team members for insider trading purposes. This provision requires that CalPERS implement trading restrictions in public asset classes (i.e., Global Public Equity and Global Fixed Income) in cases where a private asset class (i.e., Private Equity, Real Assets, and Private Debt) is evaluating a potential transaction, such as a "take private" co-investment deal involving a publicly traded security. As a result, a trade-off exists between the benefits to a private asset class (e.g., participating in a no-fee, no-carry co-investment) and the drawbacks to a public asset class (e.g., taking unintended risk and tracking error created by the inability to trade the security under evaluation by the private asset class).

One solution is to ring-fence the private teams that receive MNPI using well-designed information barriers (physical and technological walls), which ensures that there is no actual knowledge possessed by, and therefore no restriction applied to, the public teams. Information barriers are widely used by asset owners, asset managers, and broker-dealers to mitigate insider trading-related compliance risks and conflicts of interest.

As CalPERS continues to pursue more private market transactions and more active and innovative investment strategies, INVO, in collaboration with the Legal Office, is seeking to implement information barriers consistent with industry best-practice so that both public and private asset classes may continue to grow and evolve without negatively impacting each other.

Section IV of the existing Insider Trading Policy specifies the circumstances when securities of companies on the Restricted List may still be traded by CalPERS notwithstanding CalPERS possession of MNPI about the company. The revisions to this section economize on and streamline policy language while simultaneously affording the Legal Office the ability to work with INVO to avail CalPERS of any exceptions that are appropriate, such as information barriers.

In addition to the proposed changes listed above, further updates have been made to conform the policy to the existing policy format as well as other ministerial changes to reflect readability, clean-up, and formatting.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

The changes support maintenance of a strong risk and controls framework for the management of the System's assets.

Attachments

Attachment 1 – California Public Employees' Retirement System Statement of Investment Policy for Insider Trading (clean view)

Attachment 2 – California Public Employees' Retirement System Statement of Investment Policy for Insider Trading (mark-up view)

Attachment 3 -- Consultant Opinion Letter -- Wilshire Associates (General Pension Consultant)

Amy Deming
Investment Director
Investment Controls & Operational Risk

Michael Cohen
Interim Chief Operating Investment Officer

Nicole Musicco
Chief Investment Officer

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
INSIDER TRADING**

[Month DD, YYYY]

This Policy is effective immediately upon adoption and supersedes all previous insider trading policies.

I. PURPOSE

CalPERS, its Board members, and employees are subject to the anti-fraud provisions of the federal securities laws and the Rules of the Securities and Exchange Commission ("SEC"). Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act") and SEC Rule 10b-5 under the 1934 Act prohibit the purchase or sale of securities on the basis of material, nonpublic information in breach of a duty of trust or confidence. In addition, CalPERS and CalPERS employees who fail to prevent insider trading may be subject to civil penalties under Section 21A of the 1934 Act. This policy is intended to ensure that CalPERS, its Board members and employees comply with federal law, and with their fiduciary responsibilities as set forth in the CalPERS Total Fund statement of policy.

II. CONFIDENTIAL INFORMATION

It is imperative that CalPERS exercise control over the circumstances in which it and its Board members and employees receive material, nonpublic and other confidential information. In view of this policy, it is essential that CalPERS employees not obtain information that may be material and nonpublic without the prior approval of, for investment personnel, the Managing Investment Director in their direct chain of command or, for all other employees, the Deputy Executive Officer in their direct chain of command or the General Counsel.

CalPERS Board members and employees who possess material nonpublic information concerning a publicly traded company must safeguard the information and not intentionally or inadvertently communicate it to any person (including family members and friends) unless the person has a need to know such information for legitimate reasons directly related to his or her duties as a CalPERS Board member or employee.

In addition, CalPERS Board members and employees who come into possession of material nonpublic information concerning a publicly traded company must immediately inform the Legal Office. The Legal Office will add the company to which the information relates to the Restricted Company List.

III. RESTRICTIONS ON TRADING IN RESTRICTED LIST COMPANIES

If a company is on the Restricted Company List, Restricted Persons may not buy or sell any security of the company during the time period the company is on the Restricted Company List. In addition, no Restricted Person shall trade the security on CalPERS behalf unless an exception applies. In addition, no Restricted Person shall use any type of derivative (or any other instrument or device) to avoid the requirements or prohibitions contained in this policy.

A Restricted Person includes: those positions designated as Covered Persons in 2 Cal. Code Regs., Section 558.1(a)(5).

IV. EXCEPTIONS TO THE RESTRICTIONS ON CALPERS TRADES IN RESTRICTED LIST COMPANIES

Exceptions will be made consistent with the affirmative defenses provided for under Rule 10b5-1(c) of the Securities Exchange Act of 1934. All exceptions to the restrictions on CalPERS trades in a Restricted Company must be authorized by the Legal Office.

V. MATERIALITY

Generally speaking, information is material where there is a substantial likelihood that a reasonable investor would consider the information important in deciding whether to buy or sell the securities in question, or where the information, if disclosed, could be viewed by a reasonable investor as having significantly altered the total mix of information available. Where the nonpublic information relates to a possible or contingent event, materiality depends upon a balancing of both the probability that the event will occur and the anticipated magnitude of the event in light of the totality of the activities of the issuer involved.

Common, but by no means exclusive, examples of what may involve "material" information includes:

- A. Dividend changes

INSIDER TRADING

B. Declarations of stock splits and stock dividends

- C. Financial forecasts, especially earnings estimates
- D. Changes in previously disclosed financial information
- E. Mergers, acquisitions, or tender offers
- F. Proposed issuances of new securities
- G. Stock repurchase programs
- H. Major litigation
- I. Significant changes in management or operations
- J. Significant increases or declines in backlog orders or the award of a significant contract
- K. Significant new products to be introduced and significant discoveries of oil and gas, minerals, or the like
- L. Extraordinary borrowings or liquidity problems
- M. Purchase or sale of substantial assets
- N. Governmental investigations, criminal actions, or indictments and any collateral consequences, including potential debarment from government contracts

If an employee has any doubt whether certain information is "material," the information should be considered to be and treated as material.

VI. POTENTIAL LIABILITY FOR INSIDER TRADING BY CaIPERS PERSONNEL

As stated above, anti-fraud provisions of the federal securities laws generally prohibit the purchase or sale of securities on the basis of material, nonpublic information in breach of a duty of trust or confidence. In addition, Section 21A(b) of the 1934 Act provides the SEC with the authority to bring a civil action against any "controlling person who knows of, or recklessly disregards, a likely insider trading violation by a person under his control and fails to take appropriate steps to prevent the violation from occurring". Persons who violate these prohibitions are subject to potential civil damages and criminal penalties. The civil damages can consist of disgorgement of any illicit profits and a fine of up to three times the profit gained or loss avoided. The criminal penalties can be as much as \$1 million and 10 years imprisonment per violation.

INSIDER TRADING

Because of the serious consequences of any insider trading violation, the CalPERS Legal Office should be contacted immediately if there is any possibility of a violation of the policy or an insider trading violation.

VII. GLOSSARY OF CALPERS-SPECIFIC TERMS

Bold Italicized terms appearing in the Policy are CalPERS specific in nature and are defined in the [CalPERS Specific Glossary of Terms](#).

Approved by the Policy Subcommittee	November 20, 1998
Adopted by the Investment Committee	February 16, 1999
Revised by the Policy Subcommittee	December 10, 2004
Approved by the Investment Committee	February 14, 2005
Revised by the Policy Subcommittee	December 15, 2008
Approved by the Investment Committee	February 17, 2009
Approved by the Investment Committee	May 19, 2014
Administrative changes to reflect the Policy Glossary of Terms Update Project	July 22, 2014

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
INSIDER TRADING**

[Month DD, YYYY] ~~July 22, 2014~~

This Policy is effective immediately upon adoption and supersedes all previous insider trading policies.

I. PURPOSE

CalPERS, its Board members, and employees are subject to the anti-fraud provisions of the federal securities laws and the Rules of the Securities and Exchange Commission ("SEC"). Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act") and SEC Rule 10b-5 under the 1934 Act prohibit the purchase or sale of securities on the basis of material, nonpublic information in breach of a duty of trust or confidence. In addition, CalPERS and CalPERS employees who fail to prevent insider trading may be subject to civil penalties under Section 21A of the 1934 Act. This policy is intended to ensure that CalPERS, its Board members and employees comply with federal law, and with their fiduciary responsibilities as set forth in the CalPERS Total Fund statement of policy.

II. CONFIDENTIAL INFORMATION

It is imperative that CalPERS exercise control over the circumstances in which it and its Board members and employees receive material, nonpublic and other confidential information. ~~Because of the number of CalPERS employees, the close-knit working environment at CalPERS, and the logistical problems raised by attempting to "wall-off" certain Board members and employees who possess material, nonpublic information, CalPERS hereby adopts the policy that material, nonpublic information possessed by any CalPERS Board member or employee—acting in that capacity or within the scope of his or her employment or position with CalPERS—will generally be treated as if the information were in fact possessed by CalPERS and all Restricted Persons.~~ In view of this policy, it is essential that CalPERS employees not obtain information that may be material and nonpublic without the prior approval of, for investment personnel, the Managing Senior Investment Director ~~Officer~~ in their direct chain of command or, for all other employees, the Assistant Deputy ~~Executive~~ Officer in their direct chain of command or the General Counsel.

INSIDER TRADING

CalPERS Board members and employees who possess material nonpublic information concerning a publicly traded company must safeguard the information and not intentionally or inadvertently communicate it to any person (including family members and friends) unless the person has a need to know such information for legitimate reasons directly related to his or her duties as a CalPERS Board member or employee.

In addition, CalPERS Board members and employees who come into possession of material nonpublic information concerning a publicly traded company must immediately inform the Legal Office. The Legal Office will add the company to which the information relates to the Restricted Company List.

III. RESTRICTIONS ON TRADING IN RESTRICTED LIST COMPANIES

~~The Legal Office will maintain and update the Restricted Company List.~~

If a company is on the Restricted Company List, Restricted Persons may not buy or sell any security of the company during the time period the company is on the Restricted Company List. In addition, no Restricted Person shall trade the security on CalPERS behalf unless an exception applies. In addition, no Restricted Person shall use any type of derivative (or any other instrument or device) to avoid the requirements or prohibitions contained in this policy.

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IV. EXCEPTIONS TO THE RESTRICTIONS ON CALPERS TRADES IN RESTRICTED LIST COMPANIES

Exceptions will be made consistent with the affirmative defenses provided for under Rule 10b5-1(c) under of the Securities Exchange Act of 1934. ~~for the following CalPERS trades of securities of companies that appear on the Restricted Company List:~~

- A. ~~The trade is authorized by the company on the Restricted Company List.~~
- B. ~~Trades in funds where the fund strictly replicates the constituents and weights of the benchmark index.~~
- C. ~~Trades in a Transition Account made at the direct behest of an **External Manager** where the External Manager represents and warrants in writing that the securities to be purchased by CalPERS have been selected at the External Manager's sole discretion and without receiving any company-specific information from CalPERS.~~

- ~~D. Trades where it is demonstrated that, before becoming aware of the material nonpublic information, the person(s) responsible for the CalPERS trade had: (1) entered into a binding contract to purchase or sell the security; (2) received instructions from another person to purchase or sell the security for the instructing person's account, or (3) adopted a written plan for trading securities.~~
- ~~E. The contract, instructions or written plan must have been complied with and must have:~~
- ~~1. Specified the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold;~~
 - ~~2. Included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; or~~
 - ~~3. Prohibited the person from exercising any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who did exercise such influence must not have been aware of the material nonpublic information when doing so.~~

All exceptions to the restrictions on CalPERS trades in a Restricted Company must be authorized by the Legal Office.

V. MATERIALITY

Generally speaking, information is material where there is a substantial likelihood that a reasonable investor would consider the information important in deciding whether to buy or sell the securities in question, or where the information, if disclosed, could be viewed by a reasonable investor as having significantly altered the total mix of information available. Where the nonpublic information relates to a possible or contingent event, materiality depends upon a balancing of both the probability that the event will occur and the anticipated magnitude of the event in light of the totality of the activities of the issuer involved.

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June 2, 2023

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

Re: Agenda Item 5a Revisions to the CalPERS Investment Policy for Insider Trading

Dear Mr. Miller:

Wilshire has reviewed the proposed revisions to the Insider Trading Policy. The revised policy in Section II. covers the handling of material non-public information (MNPI) and represents a shift in treatment. The previous policy took the view that possession of MNPI by any Board member or employee would be treated as if it were possessed by *all* team members. This umbrella view is no longer appropriate given the increase in private market activity and subsequent potential for INVO personnel to come into contact with MNPI. As the potential volume of MNPI grows, the current treatment also increases the risk of inadvertent policy violations.

In order to ensure that the investment teams can continue managing their portfolios without undue restrictions, INVO recommends adopting information barriers to help mitigate the risk that MNPI is used inappropriately. The barriers are designed such that the investment teams who have *not* come into contact with MNPI remain unrestricted in their portfolio management and trading activities. These physical and technical barriers maintain MNPI within a reasonably proscribed number of employees who, while aware of the information, are not utilizing it in violation of applicable securities law and regulation. The information barriers are further supplemented with compliance training to ensure that INVO personnel understand the appropriate steps to take regarding MNPI. It is also worth noting that these information barriers are widely used by other complex investment organizations in managing the risks around insider trading. The revisions to Section IV. are designed to directly reference applicable securities laws, allowing CalPERS to utilize all lawful exemptions and making the policy more evergreen.

As the Board's consultant, Wilshire reviewed and discussed the revisions with Staff. The previous policy language, while straight forward, is no longer appropriate given the portfolio evolution towards private markets and innovative opportunities. **Wilshire is comfortable that the proposed changes support strong compliance in a more complex investment environment.**

Regards,



Thomas Toth, CFA
Managing Director, Wilshire Advisors