Investment Committee

California Public Employees' Retirement System

Agenda Item 5a

May 13, 2013

ITEM NAME: Adoption of Delegation Resolution for the Opportunistic Program

PROGRAM: Opportunistic Program

ITEM TYPE: Policy & Delegation – Action

RECOMMENDATION

Approve the proposed Opportunistic Program Delegation Resolution for Professional Staff Delegation No: 13-01-INV as shown in Attachment 1. The Wilshire opinion letter is provided as Attachment 3.

EXECUTIVE SUMMARY

Approval of the proposed Opportunistic Program Delegation Resolution will ensure clarity and authority in regards to the Opportunistic Investments policy approved by the Investment Committee (IC) in June of 2009.

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan to cultivate a high-performing, risk-intelligent and innovative organization. To maintain current and accurate delegated authority documentation is a key mitigation for investment and operation risk.

BACKGROUND

In August 2009, the IC adopted the Opportunistic Investments Policy (Attachment 2). The establishment of the Opportunistic Program enabled Staff to invest in opportunities that may not fit neatly within existing asset classes or may be subject to narrow limits. The goal of the program is to afford Staff the ability to invest in these opportunities in a timely and flexible manner, while retaining a focus on risk management and adhering to policy guidelines.

In order to ensure clarity and authority related to the Opportunistic Program, Staff is recommending that the IC approve the proposed Opportunistic Delegation Resolution for Professional Staff that delegates the authority for the Program from the IC to the Chief Investment Officer.

There are no new costs associated with the approval proposed delegation.

BENEFITS/RISKS

Failure to approve the proposed Opportunistic Delegation Resolution for Professional Staff may result in unclear roles, responsibilities, and authority, resulting in decreased efficiencies in the management of the Opportunistic Program.

ATTACHMENTS

Attachment 1 – Opportunistic Program Delegation Resolution for Professional Staff
Attachment 2 – Opportunistic Program Policy
Attachment 3 – Consultant Opinion Letter

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JOSEPH A. DEAR
Chief Investment Officer

STATE OF CALIFORNIA
PUBLIC EMPLOYEES' RETIREMENT SYSTEM
BOARD OF ADMINISTRATION
INVESTMENT COMMITTEE

DELEGATION RESOLUTION

Subject: Professional Staff Opportunistic Program

Delegation No: 13-01-INV

WHEREAS,

1. In accordance with Government Code section 20120, the Board of Administration of the California Public Employees' Retirement System (the Board) is charged with the administration and management of the California Public Employees' Retirement System (CalPERS), and

2. In accordance with Government Code section 20171, the Board is also charged with the exclusive control of the administration and investment of the Public Employees' Retirement Fund (the Fund), and

3. In accordance with Article XVI, section 17 of the California Constitution, the Board has plenary authority and fiduciary responsibility for the investment of CalPERS assets, and

4. In accordance with Government Code section 20099, the Board is authorized to appoint a committee of one or more of its members to perform any act within the power of the Board itself to perform, and may through express delegation authorize any such committee to act finally, and

5. In accordance with Government Code section 20099, the Board may authorize its Chief Executive Officer (CEO) to perform any act within the power of the Board itself to perform, and may through express delegation authorize the CEO to act finally, and

6. The Board has adopted a Board of Administration Governance Policy relevant to the granting of delegations, and

7. Through Board Delegation Resolution No. IC-11-01 and pursuant to Government Code section 20191, the Board delegated to its Investment Committee the authority to make, through final action and by the affirmative vote of at least seven members, any investment authorized by law, and to re-delegate its authority to others, and

8. Through Board Delegation No. EXEC-11-01, the Board has delegated to the CEO principal authority and responsibility to direct and manage staff to execute the policies adopted by the Board and administer the various programs consistent with the policies, and to re-delegate to others, and

9. The Board and its committees retain the implied authority, pursuant to Government Code section 20099, to re-delegate their authority directly to the Chief Investment Officer (CIO) and Senior Investment Officers and such re-delegations are deemed to have been made through the CEO and the CIO.

RESOLVED,

(A) Recognizing the respective roles of the CEO as the internal leader of the organization and the CIO as the principal investment expert, and yet also wishing to gain the full benefit of the unique Opportunistic Program, the Investment Committee hereby delegates to the CIO the authority described in the attached Opportunistic Program Delegations (the "Delegations").

(B) Where such Delegations do not prohibit sub-delegation, the CIO is authorized to re-delegate to his or her responsible subordinates any portion or all of the responsibility delegated to the CIO.

(C) Where such Delegations do not specifically require the Investment Committee's review or ratification prior to action, the CIO has the authority to act finally, and to re-delegate, and will be responsible and accountable for his or her actions.

(D) The exercise of authority under the Delegations shall be reported to the Investment Committee in sufficient detail to keep the Investment Committee appropriately informed and in order for the Investment Committee to monitor the performance of the CIO.

(E) Upon adoption by the Investment Committee all Delegations will expressly supersede all prior delegations regarding the Opportunistic Program.

(F) It is understood that the Opportunistic Program Delegation and the grant of authority are created with the intent to fully comply, in letter and in spirit, with all federal and state laws and regulations, as well as CalPERS Policies and procedures as approved by the Investment Committee or the full Board of Administration.

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HENRY JONES
CHAIR, INVESTMENT COMMITTEE
BOARD OF ADMINISTRATION
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

I accept this delegation.

Dated: ______________

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JOSEPH A. DEAR
CHIEF INVESTMENT OFFICER
INVESTMENT OFFICE
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Opportunistic Program Delegations

Within each of the following subject areas (as shown in italics), the Investment Committee delegates (as shown in bold) the following authority to the CIO:

I. Authority to Allocate Assets

A. Authority to Establish Asset Classes and Asset Allocation (Targets and Ranges) for the Total Fund (no Delegation)

B. Authority to Establish Programs/Sectors Within an Existing Asset Class (no Delegation)

C. Authority to Make Allocation Decisions Within the Asset Class and Among Programs/Sectors

1. **To allocate capital to fund the Opportunistic Program as set forth in policy approved by the Investment Committee.**
Opportunistic Program Policy, Section V

a. **Investment in Opportunistic funds may be up to 3% of the Total Fund.**
Opportunistic Program Policy, Section V, A

II. Authority to Make Investment Decisions

A. Authority to Directly Invest In and Dispose of Public Securities

1. **To direct the purchase or sale of public securities as needed to implement an opportunistic position.**

B. Authority to Select, Commit Funds to, and Dispose of/Exit Investments in Private Investment Vehicles

1. **To allocate capital to the Opportunistic Program as set forth in policy approved by the Investment Committee.**
Opportunistic Program Policy, Section V, D

a. **The market value of the Opportunistic Program non-publicly traded investments (excluding fixed income securities) shall not represent more than 1.5% of the Total Fund.**
Opportunistic Program Policy, Section V, F

C. Authority to Directly Invest In and Dispose Of Private Securities

1. **To contribute private securities when allocating capital to, or dispose of private securities received from, an Opportunistic fund.**
   Opportunistic Program Policy, Section V, D

   a. **The market value of the Opportunistic Program non-publicly traded investments (excluding fixed income securities) shall not represent more than 1.5% of the Total Fund.**
      Opportunistic Program Policy, Section V, F

D. Authority to Fund Investment Managers Retained through a Contractual Arrangement (pursuant to public contracting process)

1. **To fund external managers as set forth in policy approved by the Investment Committee.**
   Opportunistic Program Policy, Section V, H

E. Authority Relating to Shareowner Resolutions and Proxy Execution

1. **To vote proxies in compliance with CalPERS Global Proxy Voting Principles.**
   Global Proxy Voting, Section IV, A, 2

2. **To respond to corporate actions as set forth in policy approved by the Investment Committee.**

F. Authority to Directly Invest In and Dispose of Derivative Instruments

1. **To contribute derivative instruments when allocating capital to, or direct the disposal of private securities received from, an Opportunistic Program portfolio.**
   Opportunistic Program Policy, Section V, D

III. Authority to Make Contracting Decisions

A. Authority to Select and Terminate Investment Managers (obtained through public contracting process)

1. **To terminate an external manager.**
   Opportunistic Program Policy, Section V, H

B. Authority to Select and Terminate Investment Consultants Other than the Board's Investment Consultants

1. **To establish an Opportunistic Program "spring-fed pool" consisting of consultants, tools, and data, and similar services and service providers, to meet program needs.**

C. Authority to Enter into Derivative Contracts (no Delegation)

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
OPPORTUNISTIC PROGRAM

August 17, 2009

This Policy is effective upon adoption.

I. PURPOSE

The CalPERS Total Fund Statement of Investment Policy, adopted by the CalPERS Investment Committee ("Committee"), sets forth CalPERS overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the investment policy ("Policy") for the Opportunistic Program ("Program"). The design of the Policy ensures that investors, managers, consultants, and other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Program. Additionally, use of the Policy assures sufficient flexibility in making investment decisions.

The Program enables greater investment in assets perceived to be substantially undervalued, and the Policy specifies guidelines to manage the concurrent risks. The Program also permits the establishment of innovative portfolios.

II. STRATEGIC OBJECTIVE

The Program shall be managed to accomplish the following:

A. Outperform the program benchmark, and

B. Invest prudently and in a diversified manner.

III. RESPONSIBILITIES

A. The Investment Committee is responsible for review and approval of the Policy and corresponding delegation of authority.

B. The Chief Investment Officer (CIO) and the Senior Investment Officers (SIOs) are collectively responsible for the Program including:

1. All aspects of portfolio management including monitoring, analyzing, and evaluating performance relative to the appropriate benchmark.

2. Clear assignment of investment management responsibility for each Program asset.

3. Reporting to the Committee annually, and more frequently if needed, about Program investments, returns, risks, and activity.

4. Monitoring the implementation of, and compliance with, the Policy. Staff shall report concerns, problems, material changes, and all violations of the Policy at the next Committee meeting, or sooner if deemed necessary. These reports shall include explanations of the violations and appropriate recommendations for corrective action.

5. Providing recommendations on Policy revisions to the Committee.

C. The General Pension Consultant ("Consultant") is responsible for:

Monitoring, evaluating, and reporting periodically, to the Committee, on the performance of the Program.

IV. PERFORMANCE OBJECTIVE AND BENCHMARK

The benchmark for the Policy on Opportunistic Investments is specified in the Benchmark Modification and Benchmark Details Policy.

The performance objective is to outperform the Program benchmark over rolling three-year periods, net of all Program costs and fees.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Allocation

The market value of Program investments shall not exceed 3% of the Total Fund. A violation of this limit shall be restored in a timely manner not to exceed three months, with the exact time period primarily dependent on transaction costs and liquidity.

B. Any transfer of assets between a Program account and another CalPERS account requires CIO pre-approval of all terms of the transfer.

C. Leverage

The Program shall be managed in compliance with the leverage policy. The use of recourse debt in the Program is prohibited. For each Program investment, the maximum potential loss shall be the amount of the investment.

D. Permitted Instruments

Any asset not prohibited by this policy is permitted. Typically, all investable public and private securities or assets are permitted.

E. Prohibited Instruments

The following investments are prohibited:

1. Tobacco company investments,

2. Uncovered options; and,

3. Any investment prohibited by CalPERS Insider Trading Policy or Restricted Company list.

F. Diversification Guidelines

The market value of Program non-publicly traded investments (excluding fixed income securities) shall not represent more than 1.5% of the Total Fund.

The market value of any Program strategy or type of asset shall not exceed 2% of the Total Fund.

The aggregate market value of Program assets of a single country other than the United States shall not exceed 1% of the Total Fund.

G. Risk Monitoring

Staff shall generate monthly estimates of both realized and forecast Program risks relative to benchmark.

H. External Manager Investment Guidelines

Program investments may be managed internally, or by external managers, or by a combination of internal and external managers.

1. Manager Selection

    a. Managers retained in the Program shall have demonstrated expertise in their assigned mandate.

    b. The selected managers shall be registered, or appropriately exempt from registration, with the Securities and Exchange Commission.

c. Managers shall be selected in accordance with the applicable California laws and regulations, and CalPERS policy.

2. Investment Manager Guidelines

Program Managers shall operate under guidelines that describe their investment philosophies and approaches, representative portfolio characteristics, permissible and restricted securities and procedures, benchmark and performance objectives. Manager guidelines shall not conflict with any CalPERS investment policy.

Implementation of this Program shall comply at all times with the Manager guidelines and all CalPERS investment policies.

VI. DERIVATIVES AND LEVERAGE

A. Strategies

The Program shall be managed in compliance with the derivatives policy. Financial futures contracts, forward contracts, swaps, options, combinations of these derivatives, exchange traded funds, and structured notes may be used in the Program to take investment positions or to hedge investment exposures.

B. Justification

Derivatives have several advantages over securities including:

1. Minimizing transaction costs,

2. Increasing the speed of transactions, and thus the ability to respond quickly to volatile capital markets, and

3. Minimizing disruption of CalPERS portfolios.

C. Risks

Any use of derivatives in the Program shall be in compliance with all CalPERS policies. Guidelines intended to mitigate key derivative risks are described below:

1. Pricing risk,

2. Liquidity risk; and,

3. Counterparty risk.

   Liquidity and counterparty risk shall be managed by adherence to the Policy diversification guidelines (V.F) and to the following:

   a. Non-exchange traded derivative agreements shall be made only with counterparties for which CalPERS has an executed International Swaps and Derivatives Association (ISDA) agreement.

   b. Counterparty creditworthiness, for non-exchange traded derivatives, shall be at a minimum of "A3" as defined by Moody's, "A-" by S&P and "A-" by Fitch. The use of counterparties holding a split rating with one of the ratings below A3/A- is prohibited. The use of unrated counterparties is prohibited unless the counterparty is a wholly owned affiliate of a parent company that guarantees payment and meets the above credit standards.

   c. Contracts on all non-exchange traded instruments shall be settled quarterly or more frequently.

   d. Program exposures to an individual counterparty for non-exchange traded derivatives, is limited to 0.5% of the Total Fund, at inception of positions.

   e. Any entity acting as counterparty shall be regulated in either the United States or the United Kingdom.

4. Exchange-traded derivatives used in the Program shall be traded on an exchange regulated by the SEC, CFTC (Commodity Futures Trading Commission) or the FSA (Financial Services Authority) of the United Kingdom.

VII. CALCULATIONS AND COMPUTATIONS

Investors, managers, consultants, and other participants selected by CalPERS shall make all calculations and computations on a market value basis as recorded by CalPERS Custodian.

VIII. GLOSSARY OF TERMS

Key words used in this policy are defined in CalPERS Master Glossary of Terms.

Approved by the Investment Policy Subcommittee:	June 15, 2009
Adopted by the Investment Committee:	August 17, 2009
Admin changes due to adoption of Benchmark Policy:	September 29, 2009

Michael C. Schlachter, CFA
Managing Director & Principal

April 20, 2013

Mr. Henry Jones
Chair, Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: New Opportunistic Program Delegation Resolution

Dear Mr. Jones,

You requested our opinion regarding the agenda item from Staff that presents the newly created Delegation Resolution for the Opportunistic Program.

Recommendation

Wilshire recommends that the Investment Committee adopt the Delegation Resolution as presented by Staff.

Discussion

In 2009, at the request of Staff, the Investment Committee agreed to allocate a maximum of 3% of Total Fund assets to Opportunistic investments as determined by Staff. These are investments that are shorter term in nature than is typical of CalPERS investments, may be made in concentrated positions, and may fall outside of traditional asset classes. Many Opportunistic investments result from market dislocations and cannot be capitalized on during the typical triennial asset liability process. Due to the possibility that Opportunistic Investments may provide unique sources of value added for CalPERS, we supported the creation of this portfolio at the time. Given that no Delegated Authority accompanied the adoption of the policy in 2009, and the nature of Opportunistic investments often requires quick action that makes it impractical to always seek Investment Committee approval, Delegated Authority to manage this program is appropriate.

While it does not lessen our support of the Delegation Resolution, we do note, however, that the risks associated with this item are more extensive than, and not as one-sided as, the agenda item implies. While failure to approve this item may result in operational confusion as Staff notes, approval of the item also could result in Staff investing in opportunities that lose money, investments that pose non-investment risks for CalPERS (headline risk), or investments which the Investment Committee might not approve were they subject to debate and vote.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

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