



Investment Committee

Agenda Item 6a

June 14, 2021

Item Name: Long-Term Care Investment Policy Update

Program: Trust Level Portfolio Management & Implementation

Item Type: Action

Recommendation

Adopt the proposed updates to the Long-Term Care (LTC) policy that are associated with the Asset Liability Management Review. The policy updates are proposed to be implemented as an administrative update in the month in which the assets transfer to the new strategy, which is targeted for August/September of 2021.

The Investment Policy updates, which are detailed in Attachment 1, include:

- Strategic Asset Allocation Targets and Ranges
- Benchmark Composition
- Tracking Error Limit

Executive Summary

The CalPERS LTC Program offers voluntary coverage that helps policyholders pay for care when they need long-term care assistance and is funded solely by policyholder premiums and investment income. The CalPERS team completed the Asset Liability Management Review for the LTC Fund in 2020/21 and a candidate portfolio was selected at the March 2021 Investment Committee (IC) meeting. Following on from the portfolio selection, this agenda item presents the associated updates that are necessary for the LTC Investment Policy (Policy).

Strategic Plan

These items further the CalPERS 2017-22 Strategic Plan by supporting strong governance and effective process to cultivate a risk-intelligent organization.

Investment Beliefs

This agenda item supports the following CalPERS Investment Beliefs:

- Investment Belief 4: Long-term value creation requires effective management of three forms of capital: financial, physical, and human. Sub-belief: Governance is the primary

tool to align interests between CalPERS and managers of its capital, including investee companies and external managers.

- Investment Belief 5: CalPERS must articulate its investment goals and performance measures and ensure clear accountability for their execution.

Background

This item is being brought to the IC to document in the LTC Policy the changes that are necessitated by the completion of the Asset Liability Management review and the portfolio selection from the March IC meeting.

Analysis

Highlights of the proposed revisions to the Policy are outlined below:

Strategic Asset Allocation Targets and Ranges

The Strategic Asset Allocation Targets were presented and approved at March IC and are proposed to be slightly adjusted for the Policy update.

1. Include U.S. TIPS in the Global Fixed Income asset class allocation – this modification does not change the expected risk/return profile of the portfolio and will facilitate operational and trading efficiency in the management of the portfolio.
2. Include a Liquidity asset class for operational cash flows – this asset class is in current Policy and is presented here to confirm its continuation.

The Strategic Asset Allocation Ranges provide room for the allocations to float with market movement between quarterly rebalances. The proposed ranges for Global Equities and Global Fixed Income are wider than current Policy to help mitigate the need to rebalance mid-quarter, which would move the allocations away from the benchmark and introduce active risk. The remaining ranges are the same or lower than in the current Policy.

Benchmark Composition

The proposed Benchmark Components are industry indices from MSCI, FTSE, Bloomberg Barclays, and JPMorgan and many are the same or similar to benchmarks currently in use for the LTC Fund.

Tracking Error Limit

The proposed Tracking Error Limit creates a specific limit for the LTC Fund and strengthens governance and reporting.

Budget and Fiscal Impacts

Not applicable.

Benefits and Risks

The proposed Policy updates support a strong governance framework for the management of the LTC Fund assets. There are no anticipated risks.

Attachments

Attachment 1 – Long-Term Care: Investment Policy Update

Attachment 2 – Wilshire Associates Opinion Letter

Sterling Gunn
Managing Investment Director
Trust Level Portfolio Management & Implementation

Dan Bienvenue
Interim Chief Investment Officer

Long-Term Care Fund Investment Policy Update

Christine Reese, Investment Director – TLPPI
Investment Committee
June 14, 2021

Executive Summary

The Asset Liability Management review for the Long-Term Care Fund necessitates the following policy updates:

1. Strategic Asset Allocation Targets and Ranges
 2. Benchmark Composition
 3. Tracking Error Limit
- The Strategic Asset Allocation Targets were approved in March and are presented with slight amendments to include the U.S. TIPS¹ allocation in the Global Fixed Income asset class and to confirm the Liquidity asset class, which is currently in policy.
 - Recommendation: Adopt the proposed policy updates for the Long-Term Care fund, to be implemented as an administrative policy update in the month in which the assets transfer to the new strategy.

Strategic Asset Allocation Targets

Asset Class	Approved Policy Target ¹	Proposed Policy Target
Global Equities	30%	30%
Global Fixed Income	54%	60%
U.S. TIPS	6%	-
REITs ²	7%	7%
Commodities	3%	3%
Liquidity	n/a	0%

The Strategic Asset Allocation Policy Targets approved in March included U.S. TIPS as a separate asset class and did not include a Liquidity asset class, which is currently in Policy.

Proposal:

- 1) Include the TIPS allocation with the Global Fixed Income asset class to align the allocation with the asset class management and account structure.
- 2) Include a Liquidity asset class with a target of zero to allow for operational cash flows.

Ranges relative to policy are presented on the following page.

Strategic Asset Allocation Targets and Ranges

Asset Class	Proposed Policy Target	Proposed Policy Range	Current Policy Target	Current Policy Range
Global Equities	30%	+/- 7%	15%	+/- 4%
Global Fixed Income	60%	+/- 7%	60%	+/- 5%
U.S. TIPS	-	-	6%	+/- 2%
REITs	7%	+/- 3%	11%	+/- 4%
Commodities	3%	+/- 2%	8%	+/- 2%
Liquidity	-	+ 2%	0%	+ 2%

- The proposed policy ranges are intended to allow for market drift between quarterly rebalances. The wider ranges for the new allocation are to mitigate the need to rebalance the portfolio mid-quarter and away from the benchmark.
- There will be no active asset allocation between asset classes in the investment strategy.
- The +2% liquidity range is constrained to frictional/operational cash flows.

Benchmark Composition

Asset Classes/Components	Benchmark
Total Portfolio	Custom Weighted Based on Asset Class Benchmarks
Global Equities	Custom Weighted Based on Component Benchmarks
US Large Cap Equities	MSCI Developed – US Total Return Index Gross
Developed Ex-US Equities	MSCI World ex-US Hedged Index Net
Emerging Market Equities	MSCI Emerging Market Index Net
Global Fixed Income	Custom Weighted Based on Component Benchmarks
US Cash	Bloomberg Barclays T-bill 1-3 Month Index
US Government 10+ years	Bloomberg Barclays Long Government Index
Global ex-US Treasuries	Bloomberg Barclays Global Aggregate Treasury Index ex-US Hedged
US Investment Grade Credit - Long Bonds	Bloomberg Barclays US Long Credit Index
US Investment Grade Credit – Long BBB	Bloomberg Barclays Long Corporate Index BBB
US High Yield	Bloomberg Barclays US Corp High Yield 2% Issuer Capped Index
US Inflation Linked Government Bonds	Bloomberg Barclays US Treasury Inflation 15Yr+ Index
ABS in USD	Bloomberg Barclays ABS Index
US Agency MBS	Bloomberg Barclays MBS Index
US CMBS	Bloomberg Barclays CMBS, Eligible for US Aggregate Index
US CMBS Sub	Bloomberg Barclays US CMBS ex-AAA Index
EM Bonds (USD denominated)	JP Morgan EMBI Global Diversified Index
REITs	FTSE EPRA/NAREIT Developed REITs 100% Hedged to USD Net Index
Commodities	Bloomberg Commodity Total Return Index

Tracking Error Limit

The proposed Tracking Error limit of up to 1% for the Long-Term Care Fund is in alignment with the proposed limit for the Total Fund.

- Current Policy: The Fund will be managed within a target forecast annual tracking error as described in the CalPERS Total Fund Investment Policy, Asset Allocation Strategy Section.
- Proposed Update: The Fund shall be managed with an active risk target consistent with forecast tracking error up to 1% relative to the Policy benchmark. The tracking error will be monitored regularly, and in the event of a breach, staff will inform the Board of the cause and develop a plan to move the tracking error within the target range, if deemed advisable, taking into account strategy horizon, transaction costs, and liquidity conditions.

Recommendation and Next Steps

Recommendation:

Adopt the proposed policy updates for the for the Long-Term Care fund, to be implemented as an administrative policy update in the month in which the assets transfer to the new strategy.

1. Strategic Asset Allocation Targets and Ranges
2. Benchmark Composition
3. Tracking Error

Next Steps:

1. Complete Contracting – June/July
2. Complete Setup and Implementation – Aug/Sept¹

Asset Allocation Timeline

Milestone	2020									2021								
	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S
Evaluate Current Portfolio																		
Conduct Research																		
Draft & Release RFP																		
Receive Proposals																		
Evaluate Proposals																		
Approve Discount Rate (Nov IC)																		
Prepare Allocation Recommendation																		
Adopt Asset Allocation (March IC)																		
Contracting & Planning																		
Approve Investment Policy (June IC)																		
Complete Contracting																		
Complete Setup and Implementation																		

Wilshire

Thomas Toth, CFA
Managing Director

May 24, 2021

Ms. Theresa Taylor
Chair of the Investment Committee
California Public Employees' Retirement System
400 P Street
Sacramento, CA 95814

Re: Agenda Item 6a: Long-Term Care Investment Policy Update

Dear Ms. Taylor:

You requested Wilshire's opinion regarding the Long-Term Care (LTC) asset allocation policy update presented by Staff. The policy update is meant to align with the asset allocation adopted by the Investment Committee earlier this year. There are three specific points to highlight.

First, there are two modifications to the LTC asset class categorizations. U.S. Treasury Inflation Protected Securities (TIPS) were originally a line item in the approved target allocation. In discussion with the manager, the Policy incorporates U.S. TIPS as a sub-asset class within Global Fixed Income given that portion of LTC will be managed as one portfolio. This allows for some flexibility in structuring the fixed income exposure, and is not expected to change the overall strategic return or risk profile of the LTC portfolio as the sub-asset class weight matches the previously approved target allocation. Staff also proposes adding a Liquidity asset class at a 0% target to account for operational cash flows. Wilshire is comfortable with both adjustments.

Second, the constituent benchmarks align with the asset allocation modeling, which was the basis for the recommendation and subsequent adoption of the new target allocation. The granularity and transparency around the sub-asset classes should provide the Investment Committee with a clear understanding of the asset class make up and provide an appropriate basis to measure the relative performance. Active management within asset classes is expected to generate above-benchmark returns over time, and an accurate benchmark provides clear accountability for active results. Further, Wilshire provides independent benchmarking oversight and will elevate issues to the Committee's attention if necessary to maintain a strong control environment.

HEADQUARTERS

1299 Ocean Avenue, Suite 700
Santa Monica, CA 90401

Wilshire

Third, the revised Policy is more explicit around the portfolio's active risk (tracking error) limit by specifying a 1% tracking error threshold. In addition, the Policy incorporates an expectation to communicate violations to the Board along with a plan of action, which Wilshire feels enhances the oversight provided by the Investment Committee for the LTC portfolio.

Conclusion

It is Wilshire's opinion that the Policy update aligns with the adopted asset allocation and maintains an appropriate level of oversight for the Investment Committee.

Sincerely,

A handwritten signature in black ink, appearing to be "T. B.", written over a light gray rectangular background.