

CalSTRS Process/Timeline for Developing Investment Beliefs

**October 2015
Board Offsite
Initial Education
on Investment
Beliefs**

● **Background**—Starting in 2010 pension funds started developing “investment beliefs” to help clarify both to an internal and external audience their views on how to invest their respective portfolios. Internally, this statement helped align their Board, staff, consultants and the implementation of their investment portfolio around a common set of core views. Funds have used these as a basis for their investment decisions and for trimming their portfolio ideas or investments that were not congruent. Externally, posting their investment beliefs helped their members and stakeholders evaluate the investment program and provided more background for current and future decisions.

Review—Examples from other large institutional investors across the globe, including Japan, Canada, United Kingdom, Netherlands, New Zealand and US Funds.

Discuss—In review of peers’ beliefs, found five common concepts:

- Maximize returns
- Risk management
- Diversification
- Active Management
- ESG integration

Areas that are explicit to CalSTRS due to the State Constitution and/or fiduciary law:

- Exclusive benefit for the members and beneficiaries
- Understanding liabilities
- Investment costs
- Long-term horizon
- Risk factor allocation

Heard from Roger Urwin from Towers Watson, who is a global expert on developing investment beliefs, as well as Henry Jones, CalPERS Investment Committee Chair, explaining their recent process, and finally Allan Emkin, Board consultant who will serve as facilitator of the project.

**April 2016
Investment
Committee
Step One**

● **Ultimate Goal**—With the help of Board consultants and staff, develop, draft and finalize a core set of investment beliefs as outlined in the 15–16 and 16–17 Investment Committee Workplan.

To begin, the Board will:

- Identify the primary/core topics for investment beliefs.
- Discuss the level of consensus by the Board to qualify a topic as a full belief, for example 75% agreement, two-thirds agreement or unanimous support.
- Agree that beliefs should be concise, to the point, less than 10 statements.
- Discuss the possible format and tone.

There was broad agreement to put the State Constitutional mandates in the preamble to the beliefs and not list them as beliefs.

General agreement to put the beliefs in the following six categories: long-term horizon, diversification, costs, investment process, governance, sustainability.

**June 2016
Investment
Committee
Step Two**

● Begin to discuss, debate, and if possible, obtain agreement on:

- The opening statements to the Beliefs, called legal framework and preamble.
- The first three Investment Beliefs statement on Long-term horizon, diversification, and costs.
- Begin to discuss the next three or more Belief statements that deal with the investment process, governance, and sustainability.

**July 2016
Investment
Committee
Step Three**

● Continue to build upon the robust discussion from the previous meeting with the end goal of adopting a formal set of Beliefs.

The Board consultant has taken the lead at this stage in the project and has proposed a series of options to consider for Belief #1 – Diversification Benefits and #2 – Global Investment Markets.

**July 2016
Investment
Committee
Step Three
(continued)**

● Beliefs that have been agreed upon:

- #1—Diversification Benefits
- #3—Long-term Benefits of Managing Investment Costs
- #4—Internal Management is a Critical Capability

The consultant will conduct a survey and interviews with the Board and staff to discuss the beliefs individually.

**September
2016
Investment
Committee
Step Four**

● The Board consultant presented their findings based on their survey and interviews of the Board members and staff. They discussed areas of agreement and the areas that exhibit disparate points of view.

At this point there is agreement on the legal framework, preamble statement and three of the beliefs.

The consultant recommends adding the following three beliefs:

- The Global Publicly Investment Markets are largely, but not completely efficient
- Proactive corporate governance is beneficial
- CalSTRS can potentially capture an illiquidity risk premium

The following belief should be discussed further:

- Managing short-term drawdown risk impacts CalSTRS' long-term health

After discussion, staff and the consultant recommended the Committee add these additional beliefs statements and review the Investment Beliefs document as a first reading at the next committee meeting.

**October 2016
Offsite
Stakeholder and
Labor Group Input**

● At this meeting, four stakeholder and labor groups—California Teachers Association (CTA), Service Employees International Union (SEIU), California Federation of Teachers (CFT), and Unite Here—participated on a panel to share their views and opinions on the beliefs that have been written to date with the Board.

**November
2016
Investment
Committee
First Reading**

● At the September and October meetings the Committee heard stakeholder and public comments about expanding the corporate governance beliefs to incorporate more of an ESG/Sustainability statement in all asset classes. This meeting allowed for the first comprehensive reading and review of the draft Investment Beliefs document.

The Committee considered the following:

- Should language in Belief five be expanded or enhance to include a stronger statement regarding ESG/Sustainability?
- Should the Committee add Belief seven dealing with short fall risk?
- Should the Committee discuss Belief eight, dealing with managers and alignment of interests?

The committee approved five Beliefs at this meeting:

- Belief 1 – Diversification Benefits
 - Belief 2 – The Global Public Investment Markets are Largely, but Not Completely, Efficient
 - Belief 3 – Long-term Benefits of Managing Investment Costs
 - Belief 4 – Internal Management is a Critical Capability
 - Belief 5 – CalSTRS can potentially capture an illiquidity risk premium
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**April 2017
Investment
Committee
Revision**

● The Committee considered Beliefs 6 and 7 as written, and debated the addition of Belief 8 to the final list of CalSTRS Investment Beliefs. The Committee approved:

- Belief 6 – Managing short-term drawdown risk can positively impact CalSTRS ability to meet its long-term obligations.
- Belief 7 – Responsible corporate governance, including the management of environmental, social and governance (ESG) factors, can benefit long-term investors like CalSTRS.

To date, the Committee is still considering whether it will adopt Belief 8 – tentatively titled “Alignment of interests between CalSTRS and its advisors is critical.” Concurrently, the Committee also reviewed an initial draft of the revised ESG policy.

**February and
July 2018
Investment
Committee
Final Approval**

● In February, the Committee considered and approved Investment Belief 8 as written below. In July, the Board reviewed the language again for minor clarifying copy revisions to finalize the document and the final 8 Investment Beliefs:

- Belief 1 – Diversification strengthens the fund.
- Belief 2 – The Global public investment markets are Largely, but not completely, efficient.
- Belief 3 – Managing investment costs yields long-term benefits.
- Belief 4 – Internal management is a critical capability.
- Belief 5 – CalSTRS can potentially capture an illiquidity risk premium.
- Belief 6 – Managing short-term drawdown risk can positively impact CalSTRS ability to meet its long-term obligations.
- Belief 7 – Responsible corporate governance, including the management of environmental, social and governance (ESG) factors, can benefit long-term investors like CalSTRS.
- Belief 8 – Alignment of financial interests between CalSTRS and its advisors is critical.