

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

**FOR  
ABSOLUTE RETURN STRATEGIES PROGRAM**

**June 24, 2014**

*This policy is effective immediately upon adoption and supersedes all previous Absolute Return Strategies (formerly known as Risk Managed Absolute Return Strategies) Program policies.*

**I. PURPOSE**

The California Public Employees' Retirement System ("CalPERS") Investment Beliefs Policy and Total Fund Statement of Investment Policy adopted by the CalPERS Investment Committee ("Committee") set forth CalPERS overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the investment policy ("Policy") for the Absolute Return Strategies Program ("Program", "ARS"), formerly known as the Risk Managed Absolute Return Strategies (RMARS) Program. The design of this Policy ensures that investors, managers, consultants, and other participants selected by CalPERS take prudent and careful action while managing the Program. Additionally, use of this Policy assures sufficient flexibility in managing investment risks and returns associated with this Program.

**II. STRATEGIC OBJECTIVE**

The Program's strategic objective is to broaden the opportunity set of CalPERS investment portfolio by utilizing Absolute Return Funds to capitalize upon investment opportunities not available using traditional approaches to investing in public markets.

The Program's role is to provide diversification to the equity growth risk in the CalPERS overall investment program.

**III. RESPONSIBILITIES**

A. CalPERS Investment Staff ("Staff") is responsible for the following:

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

2. Evaluating and selecting Absolute Return Fund investment opportunities.
3. Reporting to the Committee no less than annually, and more often if needed, about the Program's composition and performance.
4. Monitoring the implementation of, and compliance with, the Policy. Staff shall report material violations of this Policy at the next Committee meeting, or sooner if deemed necessary. Staff will also report material concerns, problems or changes related to the Policy and Program to the Committee as appropriate. These reports shall include explanations of any violations or other matters and appropriate recommendations for corrective action.
5. Evaluating and selecting Absolute Return Strategic Advisor(s) ("Strategic Advisor(s)"). The selection process shall use specific criteria with the objective of identifying and selecting Strategic Advisor(s) that have, but are not limited to, the following characteristics:
  - a. Multiple senior personnel with significant amount of experience in the Absolute Return Fund industry.
  - b. Breadth of expertise across many fund strategies.
  - c. Robust quantitative disciplines for risk controls.
  - d. Sound quantitative process for constructing a portfolio.
  - e. Proper alignment of interests with CalPERS, including but not limited to attractive fee arrangements.
  - f. Willingness and ability to work with CalPERS in a labor intensive fashion, including but not limited to training CalPERS staff.
  - g. Commitment to providing CalPERS access to the most senior people within their organization.
  - h. Willingness and ability to assist CalPERS as necessary to secure capacity, proper alignment of interests, appropriate levels of CalPERS control of assets, and position level transparency from Absolute Return Funds.

6. Monitoring the Program’s investments and Investment Manager performance to determine if the managers’ actions are consistent with this Policy and other applicable CalPERS policies.
  7. Overseeing the reconciliation of each investment by the Program’s Hedge Fund Administrator in accordance with Generally Accepted Accounting Principles on a monthly basis. The Hedge Fund Administrator shall provide an accounting ledger each month to Staff.
  8. Continually reviewing the efficacy of absolute return oriented investing.
  9. Voting all proxies and voting instructions in a manner consistent with CalPERS Global Principles of Accountable Corporate Governance (Global Principles) when the Investment Manager is managing a limited partnership or other legal entity exclusively on CalPERS behalf.
- B. The **General Pension Consultant** (“Consultant”) is responsible for:
1. Monitoring, evaluating, and reporting to the Committee no less than annually on the performance of the Program relative to appropriate benchmarks and this policy and other applicable CalPERS policies.
  2. Continually reviewing the efficacy of absolute return oriented investing.
- C. Strategic Advisor(s)’ responsibilities may include, but are not limited to, the following:
1. Assisting Staff in conducting the initial screening of potential Absolute Return Fund investments.
  2. Assisting Staff in performing front and back office due diligence and evaluating the legal terms of prospective Absolute Return Fund investments.
  3. Providing written opinions regarding Staff’s recommendations to take significant actions such as allocating to or redeeming from an Absolute Return Fund.

4. Assisting staff in monitoring and evaluating the performance of the Program's investments relative to appropriate benchmarks and this Policy and other applicable CalPERS policies, in accordance with its agreement with CalPERS.
  5. Providing advice and feedback on strategic initiatives and policies for the Program's future success.
- D. The Investment Manager(s) is responsible for aspects of portfolio management as set forth in the Investment Manager's agreement with CalPERS and shall fulfill the following duties:
1. Communicating with Staff as needed regarding investment strategy and investment results. The Investment Manager is expected to monitor, analyze, and evaluate performance relative to any agreed-upon benchmarks.
  2. Cooperating with information requests by Staff and the Program's Hedge Fund Administrator and Strategic Advisor(s).
  3. Complying with CalPERS reporting requirements, including but not limited to, accounting for fees and expenses.

**IV. PERFORMANCE OBJECTIVE AND BENCHMARK**

A. Performance Objectives

The Program shall pursue the following objectives:

1. Targeted Risk

Program level risk shall be no greater than 8% annualized volatility. The Program shall be managed so that in any one month the decline in net asset value shall not exceed 7% of the net asset value of the ARS Program.

2. Targeted Return

The Program level return target shall be the return of the one-year U.S. Treasury Bill rate plus 5% over a full market cycle (three to five years).

3. Targeted Liquidity

The majority of Program assets are expected to be convertible to cash within 90 days in ordinary liquidity conditions.

4. Targeted Equity Market Beta

The program level exposure to the Global Equity market will be 0.2 or less on average.

B. Benchmark

The benchmark for the Absolute Return Strategies Program is specified in the Benchmarks Policy. These benchmarks shall be established prior to investment and shall be documented with each Investment Manager.

**V. INVESTMENT APPROACHES AND PARAMETERS**

A. Investment Approach

The Program shall invest in Absolute Return Funds with the intent to enhance CalPERS Total Fund return while diversifying CalPERS Total Fund risk. ARS Program investments should not overlap significantly with investments undertaken by other CalPERS investment groups or asset classes. Absolute Return Funds may include exposure to leverage (including implicit leverage through derivatives), short selling of securities, derivatives or all three. All transactions involving derivatives are governed by the Global Derivatives and Counterparty Risk Policy.

ARS Program investments should focus on management of total risk and on generation of returns independent of broad market movements. This differs from “benchmark-driven investing,” where risk management and return generation are measured by reference to a broad market benchmark; in such instances, most or all of an investment’s total risk may be broad market risk.

Successful Absolute Return Fund investing focuses on unique investment strategies and styles and on Investment Managers who possess unique skillsets and specialized expertise. The likelihood of Program success is enhanced where Investment Managers make a meaningful effort toward limiting asset growth in the strategy, ensuring a proper investment time horizon, and protecting CalPERS (or enabling CalPERS to protect itself) from potential negative impacts from actions of other investors. The approaches selected for inclusion in the ARS Program should not mirror traditional active management. The fees and expenses of investing in Absolute Return Funds may be higher than traditional active management,

and CalPERS shall not invest in “absolute return” funds that simply engage in traditional active management approaches at higher fees.

B. Investment Selection

1. Absolute Return Funds may be selected if they enhance the Program’s ability to achieve its overall investment objective. Absolute Return Funds may include investments in equity, fixed income, commodities, currencies, and other investments through approaches that may include, but are not limited to, the following *strategies* (as defined by the leading industry-recognized absolute return fund indices):
  - a. Directional Trading
  - b. Event Driven
  - c. Fund of Absolute Return Funds
  - d. Multi-Process
  - e. Security Selection
  - f. Specialist Credit
2. The following absolute return fund investment *styles* shall be considered for the Program that may include, but are not limited to, the following (as defined by the leading industry-recognized absolute return fund indices):
  - a. Commodity Trading Advisors (CTA)
  - b. Convertible Arbitrage
  - c. Distressed Securities
  - d. Fixed Income Arbitrage
  - e. Long/Short Credit
  - f. Long/Short Equity
  - g. Market Neutral
  - h. Merger Arbitrage

- i. Multiple Arbitrage
  - j. Statistical Arbitrage
  - k. Global Macro
3. Staff shall develop and maintain selection guidelines for prospective absolute return funds. To ensure conformity to the Committee's risk and return expectations, these criteria shall be subject to review by:
- a. Staff;
  - b. Strategic Advisor(s); and
  - c. The Consultant.

The selection guidelines shall include, but are not limited to, the following:

- a. Minimum requirements with respect to the following:
  - (1) Investment Manager Investment Experience
  - (2) Basic Investment Vehicle Terms
  - (3) Investment Goals and Objectives
  - (4) Degree of Leverage
- b. Performance criteria
- c. Due diligence process
- d. Legal constraints or requirements
- e. Reporting requirements
- f. Quality control processes including, but not limited to, investment monitoring and risk control
- g. Other relevant parameters that may apply.

C. Investment Parameters

Investment Managers in Absolute Return Funds shall operate under specific, written investment guidelines. The guidelines shall outline the Investment Manager's investment philosophy and approaches, representative portfolio characteristics, permissible and restricted securities and procedures, and a performance objective commensurate with the investment risk to be incurred.

Implementation of this Program shall comply at all times with applicable CalPERS investment policies.

D. Risk Parameters

Each Program investment shall have a specified set of risk parameters appropriate for that investment. Staff shall utilize the risk platform (internally and/or externally developed) to measure and monitor quantitatively the economic and investment risks associated with the Program, and shall further utilize the judgments and advice of the Strategic Advisor(s) and the Consultant to assess the qualitative risks inherent in managing the Program.

The Program shall not invest more than 10% of Program assets into any single Absolute Return Fund at the time an investment into that Absolute Return Fund is made.

E. Investment Structuring

1. The Program shall invest in Absolute Return Funds through limited partnerships or other legal structures such as limited liability companies (LLCs) which provide a financial firewall. Such legal structures are important because of the potential for Absolute Return Funds to utilize derivatives and leverage. CalPERS, as a limited partner or member, benefits from limited liability in Absolute Return Funds structured in such a manner.
2. The negotiation of terms and conditions in Absolute Return Funds shall protect the interests of CalPERS and shall address at a minimum the following issues:
  - a. Alignment of Interests: Vehicle terms including fees shall be negotiated in an effort to align the Investment Manager's interest with CalPERS. The fee structure, performance objective, restrictions on permitted investments, lock-up period, and other relevant terms shall seek to protect



CalPERS in the event of adverse performance results, while ensuring that limited liability status is maintained.

- b. Control of Assets: Vehicle terms shall be negotiated to minimize the likelihood of loss of control of CalPERS assets through the inappropriate use of suspensions, gates, or other actions which unnecessarily prevent CalPERS from taking the course of action most appropriate to fit CalPERS needs and duties.
- c. Transparency of Risks and Exposures; Reporting Requirements: Vehicle terms shall be negotiated to ensure that Staff has adequate portfolio and position information to properly assess the risks and exposures associated with investment in a given Absolute Return Fund. Each Investment Manager will be required to provide financial and investment reports which comply with geographically appropriate accounting standards (e.g., U.S. GAAP, International Financial Reporting Standards) and which provide Staff adequate information to properly assess and account for performance, fees, expenses, invested capital, and any other items affecting the investment. Monthly and quarterly investment updates are expected of each Investment Manager.

## VI. 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 and the Hedge Fund Administrator.

## VII. GLOSSARY OF CALPERS SPECIFIC TERMS

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

The Absolute Return Strategies Program was previously the Risk Managed Absolute Return Strategies Program. The dates below reflect the revision history of that program:

<b>Risk Managed Absolute Return Strategies Program</b>	
Approved by the Policy Subcommittee	June 11, 2004
Adopted by the Investment Committee	September 13, 2004
Revised by the Policy Subcommittee	December 10, 2004
Approved by the Investment Committee	February 14, 2005
Revised by the Policy Subcommittee	February 20, 2007
Approved by the Investment Committee	March 12, 2007
Revised by the Policy Subcommittee	March 17, 2008
Approved by the Investment Committee	April 21, 2008
Administrative changes made due to Policy Review Project	June 16, 2009
Administrative changes due to adoption of Benchmark Policy	November 23, 2009
<b>Absolute Return Strategies Program</b>	
Revised by the Policy Subcommittee	October 17, 2011
Approved by the Investment Committee	November 14, 2011
Approved by the Investment Committee	April 15, 2013
Administrative changes to update template format and to align this policy with the Global Derivatives and Counterparty Risk Policy	December 24, 2013
Administrative changes to standardize reporting frequencies to the Investment Committee to "no less than annually"	June 24, 2014
Administrative changes to reflect the Policy Glossary of Terms Update Project	June 24, 2014