

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

**FOR
LEVERAGE**

November 14, 2011

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.

The use of financial leverage magnifies investment returns, both positively and negatively, and could increase the volatility of returns. Market illiquidity may substantially increase the risk of a leveraged investment particularly under certain crisis scenarios. Leverage needs to be managed prudently and within specified limits.

The purpose of the Leverage Policy ("Policy") is to set forth a framework for comprehensively identifying, measuring, managing, and reporting various forms of leverage. It requires that the Asset Allocation/Risk Management unit report on leverage to the Committee. The Policy also specifies limits on forms of leverage not included in existing policies and requires that leverage be aggregated when reporting at the Total Fund.

II. STRATEGIC OBJECTIVE

The Policy is intended to set limits and standards on the use of leverage that reasonably balance investment flexibility with risk management. Consistent measurement and periodic reporting of leverage as directed in this Policy should enable CalPERS to employ leverage in the programs and time periods when the expected return to risk tradeoff is most attractive.

The Policy is also intended to result in greater consistency across investment units, and in greater ability of the Committee to direct policies concerning leverage. A Fund-wide Policy should also better account for the effect that leverage may have on debt costs and in the ability to maintain asset class weights within policy ranges.

III. RESPONSIBILITIES

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

1. Staff in each asset class unit are responsible for monitoring leverage, complying with policies, and reporting quarterly to the Risk Management unit, regarding actual leverage for the programs that the asset class unit manages. The Asset Allocation/Risk Management unit is responsible for leverage policy development and monitoring and reporting leverage aggregated at the Total Fund level.
2. 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 any violations and appropriate recommendations for corrective action.
3. The Asset Allocation/Risk Management unit shall report quarterly to the Committee on:
 - a. Recent estimates by asset class on recourse debt, non-recourse debt, and notional leverage. Leverage for the Currency, Credit Enhancement, and Securities Lending programs shall be reported separately from asset class leverage.
 - b. The amount of debt previously classified as recourse that CalPERS paid in the prior year.

B. The General Pension Consultant ("Consultant") is responsible for evaluating the Policy.

IV. PERFORMANCE OBJECTIVE AND BENCHMARK

Not applicable.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Prohibitions

1. Use of leverage is prohibited unless expressly permitted in the relevant asset class or program policy.

2. Direct debt, except for unsettled loss positions on non-exchange traded contracts, is prohibited unless authorized by the Committee for a defined purpose.

B. Guidelines

1. All Forms of Leverage

- a. The Policy applies to all CalPERS investments.
- b. In determining the appropriate amount of leverage where permitted, Staff shall consider relevant factors such as the expected incremental return and risk, debt service coverage ratio, stability and certainty of cash flows, and liquidity.
- c. A capital commitment does not represent leverage or direct debt.

2. Non-recourse Debt

- a. Policies for Private Real Estate, Infrastructure, and Forestland shall include limits on the use of non-recourse debt.
- b. The amount of non-recourse debt shall be measured by the debt to market value ratio of the asset, or by the debt to cost ratio if obtaining an approximate market value is not feasible as determined by the Staff responsible for the investment.
- c. The policies of Global Equity (public market equity) and AIM (private equity) shall address the management of leverage as a risk factor, and specify limits as appropriate.

3. Recourse Debt

- a. Since recourse debt is a call on capital of the CalPERS Total Fund, the use of recourse debt may be permitted as an exceptional case if approved in the relevant program policy.
- b. Any policy that permits the use of recourse debt shall include the following terms:
 - (1) a limit on the amount of recourse debt;
 - (2) diversification requirements on the assets with recourse debt; and,

- (3) due diligence standards on the assets with recourse debt.
 - c. Recourse debt is prohibited for investments in Absolute Return Strategies (“ARS”) or other programs that do not have complete transparency on all investment positions. The maximum potential loss on these positions shall be the amount of investment.
4. Notional Leverage
- a. Notional leverage results in exposure to non-cash-like-securities that exceeds the value of the capital employed. It is created primarily through the use of derivative instruments or reinvestment of cash collateral of lent securities.
 - b. Examples of notional leverage include the following:
 - (1) A strategy involving long positions in equity futures and investment of the collateral in non-cash-like securities; and,
 - (2) A securities lending program in which the cash collateral is invested in non-cash-like securities.
 - c. Any program policy that permits the use of notional leverage shall include risk management guidelines and a limit on the amount of notional leverage.
 - d. The use of currency swaps does not result in notional leverage because the swaps merely convert exposure from one currency to another.
 - e. For any program or asset class, the amount payable on over-the-counter financial contracts may not exceed \$500 million at any time unless the value of the debt in excess of \$500 million is secured by an equivalent value of dedicated cash-like securities, except for brief periods as a result of extreme market volatility.
 - f. Calculation of net exposure requires access to information on portfolio investments. For ARS investments and other strategies for which this information is unavailable, net exposure shall be measured as the estimated global equity beta. A program equity beta in excess of 100%, inclusive of dedicated cash-like securities, represents notional leverage.

- g. The notional value of noncash collateralized equitization shall not exceed the gross notional value of the ARS program.

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.

VII. GLOSSARY OF TERMS

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

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