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

Re: Policy Subcommittee Delegation and Revised Polices

You requested our opinion regarding the agenda item presented by Staff that rescinds the Policy Subcommittee delegation and reports changes to several policies that have been changed by Staff. Due to nature of this agenda item, we will address each item separately below.

Rescinding of Investment Policy Subcommittee Delegation

Given the direction of the Investment Committee to eliminate the Investment Policy Subcommittee, rescinding all delegations to this committee is appropriate. In addition, we have reviewed Staff's proposed language for determining whether an item is administrative or substantive and have no objections to their proposed criteria.

We note that in the event some revision falls into a gray area between administrative and substantive, all future policy revisions will be reviewed by the general pension consultant and will also be presented to the Investment Committee on a routine basis. If what should have been considered a substantive change is improperly made by Staff, it will still have an opportunity to be reviewed at the next presentation of edited items.

Policy for Plan Level and Asset Class Transition Portfolios

The update to this policy changes repeated references to the SIO for Asset Allocation and Risk Management (currently an open position) to "designated Staff". This is an ambiguous term but does allow for a wide range of people within CalPERS to create and utilize transition portfolios. At the same time, we note that the reporting duties for transition portfolios have been consolidated under the COIO, increasing oversight over the use of these portfolios.

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Restricting PE Investments in Public Sector Outsourcers

The only change to this policy replaced every reference to "AIM" with "PE" (Private Equity). This change does not meaningfully change the intent of this policy but broadens its scope. Were another asset class to engage in a Private Equity transaction, this policy would now apply to those investments, too.

Private Equity (PE) Program

References to AIM or Alternative Investment Management within this policy have been changed to Private Equity (PE). In addition, references to "Customized Investment Accounts" have been added to this policy.[1] The change from AIM to PE has broad implications for CalPERS across a wide variety of reports and there will likely be references to both for some time. Since the industry definition of PE is slightly different than AIM, as some might consider investments like Hedge Funds or Real Estate to be "alternative investments", this change should slightly clarify the role of the AIM / PE program to the broader public and marketplace.

Benchmarks

Staff has made several changes to this policy, including, first, a change to the outperformance / underperformance calculation for Real Estate. Formerly, Real Estate was charged with exceeding the benchmark before fees were deducted. The change presented by Staff results in a performance calculation for Real Estate that is now net of fees, a slightly harder hurdle to beat and the generally accepted practice.

Second, the benchmarks are now delineated for each asset class in each of the Affiliate Funds. Formerly, the policy simply stated that the benchmarks would be the same as for the PERF. While the benchmarks still match up with those used within the PERF, this restructuring of the document will allow for future changes to the benchmarks for any of the Affiliate Funds as may become necessary. This is not a change in substance at this time.

Third, the benchmark for ARS has been deleted from the Growth section of this document and moved to the end. The benchmark has not been changed. This is a formatting change only.

Securities Lending

In addition to some minor formatting changes and the inclusion of Eurobonds as a lendable security (to which we have no objection), this policy deletes the explicit reference to the minimum counterparty credit rating in at least two locations. As we understanding it, all

[1] Our letter to the Investment Committee of April 24, 2012 contained our thoughts regarding Customized Investment Accounts.

references to counterparty credit rating have been removed because CalPERS has put in place a global fixed income-wide counterparty risk assessment which now rules. Given the dynamic nature of that risk assessment, maintaining a static statement of minimum quality standards in this policy is redundant. Since this counterparty exposure is reported to the Investment Committee on a quarterly basis, we are comfortable with this change to the Securities Lending policy.

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

Best regards,

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