

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

**FOR
GLOBAL FIXED INCOME PROGRAM**

~~May 14, 2012~~ December 10, 2012

This policy is effective immediately upon adoption and supersedes all previous Global Fixed Income Program, Dollar-Denominated Fixed Income Program, Externally Managed Active International Fixed Income Program, and Foreign Debt policies.

I. PURPOSE

The California Public Employees Retirement System ("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.

This document sets forth the investment policy ("Policy") for the Global Fixed Income Programs ("GFI Programs"). The design of this Policy ensures that investors, managers, consultants, and other participants selected by CalPERS take prudent and careful action while managing the GFI Programs. Additionally, use of this Policy assures sufficient flexibility in managing investment risks and returns associated with the GFI Programs.

This Policy is the controlling document for the following GFI Programs:

- A. Attachment A – Dollar-Denominated Fixed Income Program (Domestic Program);
- B. Attachment B – International Fixed Income (International Program); and
- C. Attachment C – [Foreign Debt Policy](#).

II. STRATEGIC OBJECTIVE

The GFI Programs shall be managed to accomplish the following:

- A. Diversify CalPERS overall investment programs;
- B. Dampen the overall risk of CalPERS investment programs; and
- C. Enhance CalPERS total returns.

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. Reporting to the Committee annually and more if needed about the performance of the GFI Programs.
3. Monitoring internal and [external managers](#) in the implementation of, and compliance with, the Policy. Staff shall report, concerns, problems, material changes, and all violations of Policies at the next Committee meeting, or sooner if deemed necessary. These reports shall include explanations of any violations and appropriate recommendations for corrective action.

B. The [General Pension Consultant](#) (“Consultant”) is responsible for:

Monitoring, evaluating, and reporting at least annually, to the Committee, on the performance of the GFI Programs relative to the benchmark and Policy.

C. The [External Manager\(s\)](#) (“Manager(s)”), is/are responsible for aspects of portfolio management as set forth in each Manager’s contract with CalPERS and shall fulfill the following duties:

1. Communicate with Staff as needed regarding investment strategy and investment results.
2. Monitor, analyze, and evaluate performance relative to the agreed upon benchmark.
3. Cooperate fully with CalPERS Staff, [Custodian](#), and Consultant concerning requests for information.

IV. PERFORMANCE OBJECTIVE AND BENCHMARK

The specific performance objective and the benchmark for each GFI Program is specified in the Benchmarks Policy.

V. INVESTMENT APPROACHES AND PARAMETERS

The specific Investment Approaches and Parameters for each GFI Program are detailed in the appropriate attachment.

VI. LEVERAGE POLICY**A. Guidelines**

1. Non-recourse debt is prohibited.
2. Recourse debt is prohibited.
3. Notional leverage is created when a derivative position either lacks full collateralization, or when non-cash collateral underlies a derivative exposure. Global Fixed Income shall only incur notional leverage through the use of investment grade non-cash collateral and such exposure shall not exceed 10% of the Global Fixed Income market value. Gross market exposure shall not exceed 100% of the asset class allocation.
4. Foreign currency hedges are treated separately and controlled within this Policy under Attachment B, Section II.B.8.

VI.VII. 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.

VIII. GLOSSARY OF TERMS

Key words used in the policy and attachments are defined in CalPERS Master Glossary of Terms.

Global Fixed Income Program

Approved by the Policy Subcommittee:	April 21, 2008
Adopted by the Investment Committee:	May 12, 2008
Technical Revision to Reflect Benchmark Name Change:	December 15, 2008
Revised by the Policy Subcommittee (CLNs):	December 15, 2008
Approved by the Investment Committee:	February 17, 2009
Revised by the Policy Subcommittee:	April 17, 2009
Approved by the Investment Committee:	May 11, 2009
Administrative changes made due to Policy Review Project:	June 16, 2009
Administrative changed due to adoption of Benchmark Policy:	October 28, 2009
Revised by the Policy Subcommittee:	August 16, 2010
Approved by the Investment Committee:	September 13, 2010
Approved by the Investment Committee:	May 14, 2012
Approved by the Investment Committee:	December 10, 2012

The following attachments were previously individual policies and are now consolidated into the Global Fixed Income Program policy. The dates below reflect the revision history for each document

Attachment A – Dollar-Denominated Fixed Income Program:

Approved by the Policy Subcommittee:	September 14, 2001
Adopted by the Investment Committee:	November 13, 2001
Revised by the Policy Subcommittee:	September 10, 2004
Approved by the Investment Committee:	October 18, 2004
Revised by the Policy Subcommittee:	September 16, 2005
Approved by the Investment Committee:	October 17, 2005
Revised by the Policy Subcommittee:	December 14, 2007
Approved by the Investment Committee:	February 19, 2008

Attachment B – Externally Managed Active International Fixed Income:

Approved by the Policy Subcommittee:	August 11, 1999
Adopted by the Investment Committee:	October 18, 1999
Revised by the Policy Subcommittee:	June 11, 2004
Approved by the Investment Committee:	August 16, 2004
Revised by the Policy Subcommittee:	September 16, 2005
Approved by the Investment Committee:	October 17, 2005
Revised by the Policy Subcommittee:	April 13, 2007
Approved by the Investment Committee:	May 14, 2007

Attachment A

DOLLAR-DENOMINATED FIXED INCOME PROGRAM

~~May 14, 2012~~ December 10, 2012

I. PERFORMANCE OBJECTIVE AND BENCHMARK

The performance objective for the Dollar-Denominated Fixed Income Program (“Domestic Program”) is to exceed the return of the [Barclays Capital Long Liabilities Index](#) (“BCLL Index”) while maintaining a high level of diversification.

The benchmark for the Domestic Program is specified in the Benchmarks Policy.

II. INVESTMENT APPROACHES AND PARAMETERS

A. Investment Approach

Staff will identify opportunities across [bond](#) market sectors and invest where risks are both understood and manageable while complying with specifications in this Policy. [Corporate](#), [sovereign](#), and [mortgage-backed securities](#) may receive a greater allocation than the BCLL Index given the higher return expectations. Studies indicate that optimal sector allocations in fixed income favor corporate and mortgage-backed securities over U.S. Treasuries and Agencies relative to the BCLL Index. Equally important for management of the Domestic Program is flexibility in managing durations. In general, the program is expected to remain duration-neutral to the BCLL Index unless real returns and [economic analysis](#) dictate otherwise. This flexibility is expected to add value versus a passive approach.

B. Specific Risk Parameters

CalPERS shall manage the following major categories of fixed income risk:

1. [Benchmark Risk](#) was reviewed by the Consultant who determined that the BCLL Index is the appropriate reference point.
2. [Interest Rate Risk](#) must be controlled using duration management. [Duration](#) shall be maintained at $\pm 10\%$ of the BCLL Index on an option-adjusted basis. Decisions shall be managed using historical [real return relationships](#) and economic analysis.
3. [Yield Curve Risk](#) must be managed in a controlled, disciplined fashion by monitoring key rate durations and [principal component analysis](#).

4. [Convexity Risk](#) must be managed using [option-adjusted](#) and [scenario analysis](#).
5. [Sector Risk](#) must be controlled using the ranges below. Based on the economic outlook, [historical factors](#), and [break-even analysis](#), Staff shall estimate the impact on various sectors' spreads and make allocations accordingly.

Sector Ranges - The following are ranges by which actual allocations can fluctuate from the benchmark sector weightings:

TOTAL DOMESTIC PROGRAM WEIGHTINGS

Sector	BCLL Index	Permitted Sector Ranges
U.S. Treasury & Government Sponsored	40%	10% - 80%
Mortgage	30%	15% - 45%
Corporate	24%	10% - 40%
Opportunistic	3%	0% - 12%
Sovereign	3%	0% - 10%
Total	100%	N.A.

6. [Credit Risk](#) must be controlled by requiring minimum [ratings](#) by sector as outlined below in Section II.B.6.a-d. Credit Risk must be actively managed on a risk/return basis. A downgrading of a [security](#), which causes a violation of the guidelines, shall not require an immediate sale if the [Senior Investment Officer of Global Fixed Income](#) determines that no further risk of credit deterioration exists or the sale diminishes the total return to CalPERS. The CalPERS' internal research staff and the external rating agencies shall analyze such situations to ensure that an informed decision is made. The following is the minimum quality for each of the sectors:
 - a. Treasury & Government Sponsored

Interest rate swaps are allowable and excluded from the minimum credit calculation. All swaps must comply with Section III.A.
 - b. [Investment Grade](#) Corporate
 - 1) Holdings in the investment grade [corporate sector](#) shall, at a minimum, be rated investment grade by a

recognized [credit rating](#) agency (at least Baa3 by [Moody's](#) or BBB- by [S&P](#) or by [Fitch Ratings](#)). This sector includes both domestic and foreign U.S. dollar and hedged into U.S. dollars public utilities, transportation, industrials, and bank and finance companies.

- 2) Non-rated bonds must receive an investment grade [rating](#) (BBB- or above) from the CalPERS internal research staff at the time of purchase. The CalPERS' internal research staff shall review at least annually all corporate issuers, where the investment decision was driven by the attractiveness of the individual issuer. Where the investment in corporate bonds is driven by a favorable macro-view of the corporate sector versus either Treasuries or mortgages, the annual review of issuers shall not apply, as credit risk shall be managed through extensive issue diversification and industry constraints to minimize [event](#) and [idiosyncratic risk](#).
- 3) The corporate sector may include [credit mortgages](#). All credit mortgages must receive an investment grade rating (BBB- or above) from the CalPERS' internal research staff at the time of purchase and shall be reviewed at least annually.
- 4) Investment grade [Local Currency debt](#) of corporations must meet the requirements of the [Foreign Debt Policy](#) (Attachment C).

c. Mortgage

- 1) Holdings in the mortgage sector must at a minimum be rated investment grade by a recognized credit rating agency (at least Baa3 by Moody's or BBB- by S&P or by Fitch). This category includes mortgage-backed and [asset-backed securities](#). Additionally, it includes commercial mortgages where the primary focus for rating purposes is the underlying collateral and leases.
- 2) Non-rated bonds must receive an investment grade rating (BBB- or above) from the CalPERS' internal research staff at the time of purchase. Staff shall review each investment at least annually.

d. Sovereign

- 1) Holdings in the sovereign sector must at a minimum be rated investment grade by a recognized credit rating agency (at least Baa3 by Moody's or BBB- by S&P or by Fitch Ratings).
 - 2) All sovereign securities must be U.S. dollar-denominated or non-dollar securities hedged into U.S. dollars. All holdings must meet the requirements of the Foreign Debt Policy (Attachment C).
7. [Structure Risk](#) must be managed using option-adjusted scenario and [prepayment analysis](#).
 8. [Reinvestment Risk](#) must be managed through [call risk](#) and cash flow analysis.
 9. [Liquidity Risk](#) is reduced due to CalPERS' strong cash flow.
 10. [Currency Risk](#) is reduced by requiring all securities to be denominated or hedged into U.S. dollars.

C. **Restrictions and Prohibitions**

1. Except for U.S. Treasuries and Agencies, investments in a single [issuer](#) shall not exceed 1% of the **total** Domestic Program. For asset-backed securities, each separate trust (pool of assets) is defined as a separate issuer. For AAA rated mortgage-backed securities, CalPERS [High Quality LIBOR](#), CalPERS [Short Duration Program](#), and Short Term Investment Program, no single issuer limit exists.
2. Total [non-investment grade](#) securities shall not exceed a maximum of 12% of the **total** Domestic Program. Sub-sector limits are as follows:
 - a. Non-investment grade corporate securities must not exceed 10% of the total Domestic Program.
 - b. Non-investment grade mortgage securities must not exceed 5% of the total Domestic Program.
 - c. Non-investment grade sovereign securities must not exceed 5% of the total Domestic Program.
3. Section II.B.2 specifies the Interest Rate Risk parameters.

4. Section II B.5 specifies the Sector Risk parameters.
5. Non-investment grade [collateralized](#) bond, loan, or debt obligations (CBO/[CLO/CDO](#)) must not exceed a maximum of 3% of the total Domestic Program.
6. Tobacco company investments are prohibited.
7. Shorting will be limited to investment grade securities. Section III.A.1 governs the [short selling](#) of securities.

D. Authorized Securities

1. U.S. Treasury and [Government Sponsored Securities](#) including [derivative](#) securities whose deliverable instrument is a U.S. Treasury or government obligation, but excluding mortgages and mortgage-backed securities (MBS);
2. U.S. Publicly Traded Investment Grade Corporate Bonds;
3. U.S. [Privately Placed](#) Investment Grade Corporate Bonds;
4. U.S. Publicly Traded Investment Grade Mortgage-Backed Securities including derivative securities whose deliverable instrument or underlying collateral is a U.S. [mortgage-backed security](#);
5. U.S. Privately Placed Investment Grade Mortgage-Backed Securities including single-family residences, commercial loans, and other privately placed mortgage-backed securities;
6. Investment Grade Asset-Backed Securities;
7. Investment Grade Global bonds;
8. Investment Grade [Municipal bonds](#);
9. Investment Grade [Preferred Stock](#);
10. Investment Grade Non-Dollar Bonds Hedged into U.S. dollars that are consistent with the Foreign Debt Policy (Attachment C);
11. Derivatives, subject to the requirements of Section III; and,
12. Opportunistic Securities pursuant to Section IV.

III. DERIVATIVES ~~AND LEVERAGE~~ POLICY

A. Financial Futures, Swaps, and Options

All transactions involving derivatives and leverage are governed by CalPERS' Statement of Investment Policy for Development of Derivatives Strategies or CalPERS' Statement of Investment Policy for Derivative-External Money Managers (collectively "Derivatives Policies"). In addition to the restrictions defined in the Derivatives Policies, the following conditions apply:

1. Short selling of securities is allowed in the following areas:
 - a. Financial futures and investment grade indices;
 - b. Investment grade corporate securities or derivatives thereon where the actual cash position of any short securities plus the notional value of any derivatives is subject to a maximum limit of 5% of the total Domestic Program;
 - c. Investment grade sovereign securities or derivatives thereon where the actual cash position of any short securities plus the notional value of any derivatives is subject to a maximum limit of 5% of the total Domestic Program;
 - d. Investment grade mortgage securities or derivatives thereon where the actual cash position of any short securities plus the notional value of any derivatives is subject to a maximum limit of 2% of the total Domestic Program.
- ~~2. Leverage is prohibited except when using futures position. When purchasing financial futures, there must be an associated cash position which effectively creates a synthetic bond;~~
- ~~3.2.~~ The Staff may buy or sell the following fixed income related derivatives: Credit Default Swaps (CDS) both on securities and indices (examples are CDX and ABX), financial futures, options on financial futures, options on volatility, options on underlying securities, and options on securities indices, which includes over-the-counter options (as specified in Section II. D. 1.); and,
- ~~4.3.~~ Acceptable strategies include bona fide hedges (to help achieve the target durations or short positions that stay within the duration and sector range parameters set forth in Section II.B.2 and 5) and strategies that exploit the market's erroneous estimation of the volatility of interest rates. Other acceptable strategies include taking

advantage of inaccurately priced instruments or using a more efficient method of implementing the investment objectives of the Domestic Program.

B. Restrictions and Prohibitions

1. [Uncovered call](#) writing is prohibited.
2. [Speculation](#) or [arbitrage](#) between two derivatives is prohibited. If a derivative is more attractively priced than the underlying security, the transaction is considered a substitution.
3. A maximum of 2% of the total Domestic Program may be invested in mortgage securities that are leveraged (e.g., [inverse floaters](#)).

C. Counterparty Exposure for Options, Swaps and Futures

1. The greater of \$500 million or 25% of the total notional derivative exposure can be maintained with any one counterparty for non-exchange-traded derivatives (e.g., swaps, [caps](#), [floors](#), and options).
2. Transactions shall be executed with only domestic or non-U.S. brokers registered in the U.S. or the U.K. who have a short-term debt rating by at least two of the following three rating agencies:

A1 (S&P) and P1 (Moody's), or F1 (Fitch Ratings), or rated on a long-term basis A3 (Moody's) A- (S&P), or A- (Fitch Ratings Services). The CalPERS internal research staff shall actively review these brokers.

IV. OPPORTUNISTIC INVESTMENTS

- A. Securities or sub-asset classes, which are candidates for inclusion, shall have risk, return, and correlation profile sufficiently different from other sectors such that its inclusion or exclusion can affect the risk and return expectations of the Domestic Program. The criteria for inclusion into this classification shall include, but are not limited to:
1. Sufficient size, liquidity, and cost efficiency to allow a meaningful amount to be invested and have an impact on the total return.
 2. Availability of sufficient internal or external investment and technical expertise to insure prudent implementation of an investment in that sub-asset class.

3. Presence of diversification, return enhancement, or some other readily identifiable attribute which is sufficiently different from other asset classes and which enhances the Domestic Program's ability to achieve the strategic objectives outlined in this Policy.
 4. Acceptance by other large money managers or financial institutions as a viable and meaningful sub-asset class or in the absence of such acceptance, academic basis, or foundation for its inclusion.
 5. Availability of sufficient data, history, or expertise to assess the viability or benefit of the asset class to the Domestic Program and to have an investment outcome that is measurable from such an asset class. Further, the asset class must have a basis for developing expected investment return, risk, and correlations for purposes of the financial study.
- B. A sub-asset class may be approved for investment provided that it meets the criteria above and that the [Senior Investment Officer of Global Fixed Income](#) has reviewed educational literature and other sources or both to fulfill fiduciary responsibility and has received approval by the [Chief Investment Officer](#).
- C. Permitted Opportunistic Investments
1. Non-Investment Grade Domestic and Hedged Non-Dollar corporate, including corporate zero coupon and [PIK](#) securities;
 2. [Leveraged](#) and [Un-leveraged Bank Loans](#);
 3. [Asset Based Loans](#);
 4. Non-investment grade CBO/CLO/CDO/[CLN](#) securities;
 5. [Convertible Bonds](#);
 6. [CMO](#) residuals;
 7. Non-Investment Grade Dollar Denominated and Non-Dollar Global Sovereign Bonds hedged into U.S. dollars that are consistent with the Foreign Debt Policy (Attachment C);
 8. Non-investment grade mortgage securities; and,
 9. Other sub-asset classes may be added if they meet the criteria outlined in Section IV, A and B.

Attachment B

INTERNATIONAL FIXED INCOME PROGRAM

~~May 14, 2012~~ December 10, 2012

I. PERFORMANCE OBJECTIVE AND BENCHMARK

The performance objective for the International Fixed Income Program (“International Program”) is to exceed the return of the [Barclays Capital International Fixed Income Index](#) (“BCIFI Index”).

The benchmark for the International Program is specified in the Benchmarks Policy.

II. INVESTMENT APPROACHES AND PARAMETERS

A. Approach

1. The International Program shall be managed to:
 - a. Maximize risk adjusted returns through the selection and allocation of permissible [bond](#) markets.
 - b. Within those markets, manage the selection and allocation of maturities, [durations](#), credits, currencies, and approved [derivative](#) instruments.
 - c. Consider macro and relevant micro-economic factors including, but not limited to, economic growth, inflation, monetary and fiscal policy of permissible countries, the credit risk of market and [issuer](#), and risk-adjusted yields.
2. The International Program shall be implemented through internal and [external manager](#)(s) (“Manager” or “Managers”).
3. Each external manager shall operate under a set of manager specific guidelines that outlines its investment philosophy, representative portfolio characteristics, authorized and restricted securities and procedures, and strategic and performance objectives. All guidelines will be consistent with the Investment Parameters set forth in Section II, III, and the Foreign Debt Policy (Attachment C).
4. The viability of the International Program shall be reviewed annually.

B. Specific Risk Parameters

1. [Benchmark Risk](#) was reviewed by the Consultant who determined that the BCIFI Index is the appropriate reference point.
2. [Interest Rate Risk](#) must be managed by the Manager within $\pm 10\%$ of the index duration.
3. [Yield Curve Risk](#) must be managed by the Manager.
4. [Credit Risk](#) is managed by using specific credit limits. Minimum [credit ratings](#) for sovereign credit are specified in the [Foreign Debt Policy](#) (Attachment C).
5. [Convexity Risk](#) must be managed by the Manager.
6. [Reinvestment Risk](#) must be managed by the Manager.
7. [Liquidity Risk](#) is reduced due to CalPERS strong cash flows.
8. [Currency Risk](#) will be controlled using the ranges below.

The following table specifies ranges within which net [currency](#) positions may be taken:

Net Individual Currency Ranges Relative to the BCIFI Index

Reserve Currency Benchmark Markets (EUR, JPY, GBP)	-15% - +15%
Other Benchmark Countries	-10% - +10%
Non-benchmark countries (ex USD)	-5% - +5%
U.S. dollar	-15% - +15%
Emerging Markets	-5% - +5%

Maximum cumulative long currency exposure relative to benchmark +30%
 Maximum cumulative short currency exposure relative to benchmark -30%

9. [Sector Risk](#) will be controlled using the ranges below. Managers are responsible for determining appropriate allocations based on market analysis.

Sector Ranges - The following table specifies ranges within which allocations can fluctuate from benchmark weights:

Total International Program Weightings

Sector	BCIFI Index	Permitted Net Ranges
US Treasuries (ex TIPS)	0%	-10 - +10
Governments (ex US)	100%	90% - 100%
Invest. Grade Corporate	0%	-10% - +10%
Mortgages	0%	0% - +10%
Non-Investment Grade Corporate	0%	0% - 5%

Note: The total of non-government securities cannot exceed 10% of the total International Program.

10. [Country Risk](#) will be controlled using the ranges below. Managers are responsible for determining appropriate country allocations based on market analysis.

Net Country Permitted Ranges - The following table specifies ranges within which country allocations can fluctuate from benchmark weights:

Net Individual Country Range Relative to Index

Reserve Currency Benchmark Markets (EUR, JPY, GBP)	-15% - +15%
Other Benchmark Countries	-10% - +10%
Non-benchmark countries (ex USD)	-5% - +5%
U.S. dollar	-10% - +10%
Emerging Markets	-5% - +5%

C. Restrictions and Prohibitions

1. Emerging Market bond exposure is limited to $\pm 5\%$ of the benchmark weight on a Manager's combined holdings as well as a concentration limit of the benchmark weight $\pm 5\%$ of the benchmark weights on holdings of a single country.
2. Shorting [non-investment grade](#) bonds and U.S. [mortgage backed securities](#) is prohibited.
3. ~~No leverage is allowed. Foreign currency hedges are treated separately in calculating International Program leverage.~~
43. The maximum total International Program net short bond or currency position is 30%.

54. The International Program must comply with the Foreign Debt Policy, (Attachment C).
55. The maximum net long or net short holdings per [corporate](#) issuer is 1% of the total International Program.

D. Authorized Securities

1. Non-dollar and U.S. dollar bonds issued by national governments, subnational governments (i.e. provincial, state, and municipal), and supranational entities that meet the requirements of Foreign Debt Policy (Attachment C). Subnational governments may be substituted for the sovereign national government or any entity that has full faith and credit of the sovereign. Supranationals may also be a substitute for national governments.
2. Non-U.S. dollar and U.S. dollar publicly traded corporate bonds that meet the requirements of Foreign Debt Policy (Attachment C).
3. U.S. Treasury and [Government sponsored securities](#).
4. U.S. dollar Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), and Government National Mortgage Association (GNMA) securities.
5. [Structured](#) products denominated in major developed currencies and the U.S. dollar, including but not limited to, ABS, ABL, and CDS.
6. Derivatives, subject to the requirements of Section III.

III. DERIVATIVES AND LEVERAGE POLICY

All transactions involving derivatives managed by both internal and external managers are governed by CalPERS Statement of Investment Policy for Derivatives - External Money Managers, except that [leverage](#) and shorting will be permitted in accordance with this Policy as outlined in Sections II, B and C.

A. Permitted and Restricted Instruments

Managers may buy and sell the following derivatives: currency forward contracts, currency [options](#), [swaps](#), credit default swaps, structured notes, [financial futures](#), options on financial futures, options on volatility, options on underlying securities, options on securities indices, including [over-the-counter](#) options.

B. Counterparty Exposure for Options, Swaps, and Futures

1. A maximum 33% of the total notional derivative exposure can be maintained with any one counterparty for non-exchange traded derivatives (e.g., swaps, [caps](#), [floors](#), and options). An exception is allowed if total derivative exposure in the International Program is less than \$100 million. Where netting agreements approved by CalPERS' [Chief Investment Officer](#) or his or her authorized designee are in place with the counterparty, only the net amount applies toward the \$100 million limit.
2. Transactions shall be executed with only domestic or non-U.S. brokers registered in the U.S. or U.K. who have a short-term debt rating by at least two of the following three rating agencies:

A1 (S&P) and P1 (Moody's), or F1 (Fitch), or rated on a long-term basis A- (S&P), A3 (Moody's), or A- (Fitch).
3. Counterparty creditworthiness shall equal or exceed "A3" as defined by Moody's or "A-" by S&P. The use of counterparties holding a split rating with one of the [ratings](#) below A3/A- is prohibited. External managers shall notify CalPERS if a counterparty is downgraded below A3/A- while an instrument held in the International Program is outstanding with that counterparty. The use of unrated counterparties is prohibited.
4. Any entity acting as a counterparty shall be regulated in either the United States or the United Kingdom.

C. Reporting Requirements

External managers shall prepare a monthly report for CalPERS Staff outlining the following information:

1. The derivatives and the counterparties used and the market value, cost-value, gain or loss, notional exposure, and amount of exposure;
2. A description of the strategy and the expected outcome of the derivative use; and,
3. The quantified impact to the International Program.

Attachment C

FOREIGN DEBT POLICY

~~May 14, 2012~~ December 10, 2012

Global Debt Issued by National Governments

The policy stipulations for global debt issued in major markets differ somewhat for holdings denominated in major non-dollar currencies and for holdings denominated in the dollar. The differences are found in the approach to limiting portfolio concentration in [emerging markets](#), while minimum [credit rating](#) requirements are the same for both. The stipulations are as follows:

1. For both externally and internally managed programs, global bonds issued by national governments must have a credit rating of BB- or higher from [S&P](#) or Fitch, or Ba3 or higher from [Moody's](#).
2. Holdings of global bonds are counted toward the aggregate limit of the benchmark weight +5% on internal or [external manager's](#) combined holdings of emerging market debt and are subject to the benchmark weight +5% limit on holdings of a single country.

Local-Currency Debt of Foreign National Governments and All Debt of Foreign Corporations and Subnational Governments (i.e., Provincial, State, and Municipal)

1. The debt is eligible for investment if both the [issuer](#) and the issuer's national government (if the issuer is not the national government itself) are rated [investment grade](#), at least BBB- by S&P or Fitch, or Baa3 by Moody's. Even in the case of local-[currency](#) debt, this requirement must be satisfied by long-term foreign currency ratings instead of local-currency ratings, which are generally higher because a country can easily print more of its own currency to meet its local debt obligations. This unconventional, very conservative application of the rating requirement will give extra protection against the special foreign-exchange valuation and retrieval risks of local-currency debt. In addition:
2. The country must be part of the Barclays Capital Global Aggregate Index, a widely followed index which includes only those local markets that are fairly liquid and fairly well developed.
3. The country's currency must be fully convertible in the spot market for foreign investors, so that managers may retrieve CalPERS funds without limit or obstruction.
4. Holdings of [local currency debt](#) are subject to an aggregate limit of the benchmark weight +5% on a Manager's combined holdings of emerging market debt, as well as a concentration limit of the benchmark weight +5% on a Manager's holdings of a single country.

5. The exception to requirements 1 through 4 is as follows: If corporate debt or debt of subnational governments is below investment grade, it is eligible for investment if both the issuer's country of domicile and the country under whose laws the debt is issued are rated at least AA- by S&P or Fitch, or Aa3 by Moody's.