CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
INVESTMENT BELIEFS

~~September 16, 2013~~**October 14, 2013**

This policy is effective immediately upon adoption.

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 CalPERS Investment Beliefs ("Investment Beliefs"). The design of this Policy ensures that the Committee and the CalPERS Investment Staff ("Staff"), along with external managers and investment consultants, take prudent and careful action when managing CalPERS assets. This Policy requires that CalPERS develop and maintain a set of Investment Beliefs.

The Investment Beliefs are included as Attachment A.

II. STRATEGIC OBJECTIVE

CalPERS investment goals are broad in nature. The overall objective of CalPERS investment program is to provide members and beneficiaries with benefits as required by law. This will be accomplished through a carefully planned and executed long-term investment program that efficiently and effectively allocates and manages the assets of CalPERS.

Managing the CalPERS investment program requires exercising judgment in the face of considerable uncertainty. The Investment Beliefs provide a framework for exercising judgment and making investment decisions. Investment Beliefs:

- Provide a basis for strategic management of the investment portfolio
- Inform organizational priorities
- Ensure alignment between the Committee and Staff
- Become part of the CalPERS culture

Investment Beliefs also provide context for CalPERS actions. They reflect CalPERS values and acknowledge CalPERS responsibility to sustain its ability to pay benefits for generations. The Investment Beliefs also acknowledge the

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critical importance of a strong and durable economy in achieving CalPERS objectives.

The Investment Beliefs are not a checklist to be applied by rote to every decision. They are a guide for making judgmental decisions that often require balancing multiple, inter-related decision factors.

III. RESPONSIBILITIES

A. Staff is responsible for the following:

1. Facilitating a periodic review of the Investment Beliefs in conjunction with the Strategic Asset Allocation process.

2. Reporting to the Committee on investment program strategy and its consistency with the Investment Beliefs.

3. Integrating the Investment Beliefs into Committee and Staff orientation and ongoing Staff communication programs.

B. The General Pension Consultant ("Consultant") is responsible for participating in the periodic review of the Investment Beliefs.

IV. PERFORMANCE OBJECTIVE AND BENCHMARK

Not applicable.

V. CALCULATIONS AND COMPUTATIONS

Not applicable.

VI. GLOSSARY OF TERMS

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

Adopted by the Investment Committee: October 14, 2013

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Attachment A

INVESTMENT BELIEFS

September 16, 2013

I. Liabilities must influence the asset structure.

A. Ensuring the ability to pay promised benefits by maintaining an adequate funding status is the primary measure of success for CalPERS.

B. CalPERS has a large and growing cash requirement and inflation-sensitive liabilities; assets that generate cash and hedge inflation should be an important part of the CalPERS investment strategy.

C. CalPERS cares about both income and appreciation components of total return.

D. Concentrations of illiquid assets must be managed to ensure sufficient availability of cash to meet obligations to beneficiaries.

II. A long time investment horizon is a responsibility and an advantage.

Long time horizon **requires** that CalPERS:

A. Consider the impact of its actions on future generations of members and taxpayers.

B. Encourage investee companies and external managers to consider the long-term impact of their actions.

C. Favor investment strategies that create long-term, sustainable value and recognize the critical importance of a strong and durable economy in the attainment of funding objectives.

D. Advocate for public policies that promote fair, orderly and effectively regulated capital markets.

Long time horizon **enables** CalPERS to:

A. Invest in illiquid assets, provided an appropriate premium is earned for illiquidity risk.

B. Invest in opportunistic strategies, providing liquidity when the market is short of it.

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C. Take advantage of factors that materialize slowly such as demographic trends.

D. Tolerate some volatility in asset values and returns, as long as sufficient liquidity is available.

III. CalPERS investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries.

A. As a public agency, CalPERS has many stakeholders who express opinions on investment strategy or ask CalPERS to engage on an issue. CalPERS preferred means of responding to issues raised by stakeholders is engagement.

B. CalPERS primary stakeholders are members / beneficiaries, employers and California taxpayers as these stakeholders bear the economic consequences of CalPERS investment decisions.

C. In considering whether to engage on issues raised by stakeholders, CalPERS will use the following prioritization framework:

1. Principles and Policy – to what extent is the issue supported by CalPERS Investment Beliefs, Principles of Accountable Corporate Governance or other Investment Policy?

2. Materiality – does the issue have the potential for an impact on portfolio risk or return?

3. Definition and Likelihood of Success – is success likely, in that CalPERS action will influence an outcome which can be measured? Can we partner with others to achieve success or would someone else be more suited to carry the issue?

4. Capacity – does CalPERS have the expertise, resources and standing to influence an outcome?

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IV. Long-term value creation requires effective management of three forms of capital: financial, physical and human.

A. Governance is the primary tool to align interests between CalPERS and managers of its capital, including investee companies and external managers.

B. Strong governance, along with effective management of environmental and human capital factors, increases the likelihood that companies will perform over the long-term and manage risk effectively.

C. CalPERS may engage investee companies and external managers on their governance and sustainability issues, including:

1. Governance practices, including but not limited to alignment of interests.

2. Risk management practices.

3. Human capital practices, including but not limited to fair labor practices, health and safety, responsible contracting and diversity.

4. Environmental practices, including but not limited to climate change and natural resource availability.

V. CalPERS must articulate its investment goals and performance measures and ensure clear accountability for their execution.

A. A key success measure for the CalPERS investment program is delivery of the long-term target return for the fund.

B. The long time horizon of the fund poses challenges in aligning interests of the fund with Staff and external managers.

C. Staff can be measured on returns relative to an appropriate benchmark, but Staff performance plans should include additional objectives or key performance indicators to align Staff with the fund's long-term goals.

D. Each asset class should have explicit alignment of interest principles for its external managers.

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VI. Strategic asset allocation is the dominant determinant of portfolio risk and return.

A. CalPERS strategic asset allocation process transforms the fund's required rate of return to the market exposures that Staff will manage.

B. CalPERS will aim to diversify its overall portfolio across distinct risk factors / return drivers.

C. CalPERS will seek to add value with disciplined, dynamic asset allocation processes, such as mean reversion. The processes must reflect CalPERS characteristics, such as time horizon and size of assets.

D. CalPERS will consider investment strategies if they have the potential to have a material impact on portfolio risk and return.

VII. CalPERS will take risk only where we have a strong belief we will be rewarded for it.

A. An expectation of a return premium is required to take risk; CalPERS aims to maximize return for the risk taken.

B. Markets are not perfectly efficient, but inefficiencies are difficult to exploit after costs.

C. CalPERS will use index tracking strategies where we lack conviction~~,~~ or demonstrable evidence~~success,~~ that we can add value through active management.

D. CalPERS should measure its investment performance relative to a reference portfolio of public, passively managed assets to ensure that active risk is being compensated at the Total Fund level over the long-term.

VIII. Costs matter and need to be effectively managed.

A. CalPERS will balance risk, return and cost when choosing and evaluating investment managers and investment strategies.

B. Transparency of the total cost to manage the CalPERS portfolio is required of CalPERS business partners and itself.

C. Performance fee arrangements and incentive compensation plans should align the interests of the fund, Staff and external managers.

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D. CalPERS will seek to capture a larger share of economic returns by using our size to maximize our negotiating leverage. We will also seek to reduce cost, risk and complexity related to manager selection and oversight.

E. When deciding how to implement an investment strategy, CalPERS will implement in the most cost effective manner.

IX. Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error.

A. CalPERS shall develop a broad set of investment and actuarial risk measures and clear processes for managing risk.

B. The path of returns matters, because highly volatile returns can have unexpected impacts on contribution rates and funding status.

C. As a long-term investor, CalPERS must consider risk factors, for example climate change and natural resource availability, that emerge slowly over long time periods, but could have a material impact on company or portfolio returns~~, such as natural resource availability~~.

X. Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives.

A. Diversity of talent (including a broad range of education, experience, perspectives and skills) at all levels (Board, Staff, external managers, corporate boards) is important.

B. CalPERS must consider the government agency constraints under which it operates (e.g., compensation, civil service rules, contracting, transparency) when choosing its strategic asset allocation and investment strategies.

C. CalPERS will be best positioned for success if it:

1. Has strong governance.

2. Operates with effective, clear processes.

3. Focuses resources on highest value activities.

4. Aligns interests through well designed compensation structures.

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5. Employs professionals who have intellectual rigor, deep domain knowledge, a broad range of experience and a commitment to implement CalPERS Investment Beliefs.

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Asset Class Glossary: CalPERS Investment Policy Statement
Policy: Investment Beliefs
October 14, 2013

General Pension Consultant
An individual or organization that provides specialized professional assistance to the Investment Committee in determining the pension fund's asset allocation model or optimal combination of investments in order to maximize risk-adjusted investment returns in a manner consistent with the State's long-term pension liabilities.