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

~~FOR CREDIT ENHANCEMENT PROGRAM~~

~~May 19, 2014~~

~~This Policy is effective immediately upon adoption and supersedes all previous Credit Enhancement 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 Credit Enhancement Program ("Program"). The design of this Policy ensures that investors, managers, consultants, and other participants selected by the 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 the management and oversight of the Program.~~

~~II. STRATEGIC OBJECTIVES~~

~~The Program shall be managed to accomplish the following:~~

~~Earning fee income through a zero loss underwriting standard. Fees will be generated from annual commitments, up front closings, amendments, and waivers.~~

~~CalPERS expects strict conformity with the Policy and will allow the market to set pricing for credit enhancement vehicles.~~

~~III. RESPONSIBILITIES~~

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

~~1. All aspects of portfolio management, including monitoring, analyzing, and evaluating performance;~~

~~2. Reporting to the Committee no less than annually and more often, if necessary, about the performance of the Program;~~

3. ~~Monitoring the implementation of, and compliance with, the Policy. Staff shall report, orally or in writing, concerns, problems, material changes, and any violations of the Policy immediately to the Senior Investment Officer ("SIO")~~

4. ~~Preparing a Prudence Certificate for each transaction.~~

B. ~~The ***General Pension Consultant*** is responsible for monitoring, evaluating, and reporting no less than annually to the Committee on the performance of the Program.~~

~~IV. VIOLATION REPORTING~~

A. ~~The violation reporting process shall be as follows:~~

1. ~~Staff shall report orally, or in writing, all Policy violations immediately to the Senior Investment Officer, Global Fixed Income Unit.~~

2. ~~The Senior Investment Officer, Global Fixed Income Unit (SIO) shall immediately report orally, or in writing, any Policy violation to the Chief Investment Officer (CIO), and the Chief Operating Investment Officer.~~

3. ~~The CIO shall determine the appropriate means of further reporting based on his or her judgment of the magnitude, sensitivity and severity of the violation.~~

   a. ~~All Policy violations shall be reported to the Committee as part of a quarterly report agenda item on the Committee's regular agenda.~~

   b. ~~Depending on the Policy violation, and at the discretion of the CIO, reporting may also be made to the Committee as a separate agenda item or as a portion of the CIO Report at the next scheduled Committee meeting. These reports shall include explanations of the violations and appropriate recommendations for corrective action.~~

   c. ~~If a Policy violation is to be reported to the Committee, the Consultant shall be asked to provide an opinion as to the impact of the Policy violation to the Program and overall fund.~~

~~V. INVESTMENT APPROACHES AND PARAMETERS~~

~~A. Eligible vehicles for credit enhancement:~~

~~1. Letters of Credit These are irrevocable obligations used to provide credit and liquidity on variable or fixed rate note and bond transactions. The legal obligation to fund under these documents is **unconditional**. Letters of Credit are irrevocable draws by the Trustee and will be funded according to the established funding procedures.~~

~~2. Lines of Credit – These are also referred to as Standby Bond or Note Purchase Agreements or Liquidity Lines. These are designed to provide liquidity (as opposed to credit enhancement) in the event of financial market disruption. The legal obligation to fund under these vehicles is **conditional**. These are also referred to as revocable vehicles~~

~~B. Exclusions:~~

~~1. CalPERS will not provide direct funded loans.~~

~~2. The Program will not consider transactions with municipal issuers or conduit issuers on their behalf (obligors) that have declared bankruptcy in the last fifteen years.~~

~~3. The Program will not consider Certificates of Participations (COPs) other than those transactions for Essential Municipal Services.~~

~~C. Credit Ratings:~~

~~1. All issuers under the Program shall be rated investment grade by at least two nationally recognized credit rating agencies (e.g., Moody's, Investors Service, Standard and Poor's and Fitch Ratings) and any outstanding rating must be investment grade by at least two nationally recognized credit rating agencies. In addition, such an issuer should not have been rated in the non-investment grade category by any nationally recognized credit rating agencies at any time within the last five years.~~

~~2. If an issuer is not initially rated, an independent Rating Category Determination (RCD) letter shall be procured from at least two nationally recognized credit rating agencies. The RCD will provide a determination as to whether a proposed transaction is of investment grade quality.~~

~~D. Credit Rating Portfolio Limits:~~

~~1. The average credit quality of the Program's portfolio shall be "single-A" long-term credit rating designation (A2 by Moody's, A by S&P and A by Fitch. See Appendix I for equivalent ratings by Moody's, S&P and Fitch).~~

~~2. Where a credit transaction has a split rating, i.e. BBB+/A from two or more credit rating agencies, Staff shall use the lower rating for purposes of calculating the average credit quality of the Program's portfolio.~~

~~E. Portfolio Average Maturity~~

~~The weighted average maturity of the Program's portfolio shall not exceed 5 years.~~

~~F. Portfolio Diversification~~

~~1. Geographic Distribution~~

~~a. Philosophy: Municipalities in ten States – **California**, **New York**, **Florida**, **New Jersey**, **Texas**, **Pennsylvania**, **Illinois**, **Massachusetts**, **Michigan** and **Ohio** – have the largest municipal issuance volume and have consistently been in the "top-ten" states for municipal issuance for at least the last ten years. The Program's portfolio will be aligned with states having the largest populations and largest municipal issuance volume.~~

~~b. Implementation: Staff will construct a credit enhancement portfolio, using an aggregate dollar total, that will be distributed on a parallel basis to municipal issuance across the entire market with limitations as shown in Table 1 below.~~

~~2. Direct State Government Issued Debt Limits (Table 1)~~

~~a. Philosophy: The overall mission of the Program is to earn fee income on an expected zero loss underwriting basis. The Program envisions the majority of primary obligors to be municipalities, not state governments.~~

~~b. Implementation: To further control risks and increase portfolio diversification, Direct State Government Issued Debt (voter or non voter approved) shall not exceed 40% of the Total Aggregate Program Portfolio within a particular state.~~

~~**Table 1: State Geographic Distribution and Debt Limits**~~

~~**State Geographic Distribution**~~	~~**Percentage of Aggregate Program Portfolio**~~	~~**Direct State Government Issued Debt Limits**~~
~~California~~	~~Not to exceed 45%~~	~~Not to exceed 18%~~
~~New York~~	~~Not to exceed 35%~~	~~Not to exceed 14%~~
~~Florida~~	~~Not to exceed 30%~~	~~Not to exceed 12%~~
~~All Other States*~~	~~Not to exceed 20%~~	~~Not to exceed 8%~~

~~** Includes the other 47 states and US Territories & Possessions (Guam, Midway Islands, Puerto Rico, US Virgin Islands and Wake Islands)*~~

~~3. Municipal Sector Exposure~~

~~a. Philosophy: Only those entities rated investment grade within the traditional municipal sectors, secured by revenues from the particular entity or back stopped by the taxing authority of the municipality, and with demonstrated low default rates will be eligible for the Program.~~

~~b. Implementation: The Program's portfolio exposure within each state shall be diversified through transactions in different municipal market sectors. All of the issuers within the portfolio shall come from one of the outlined governmental and public sectors below (including non-profit 501(c)(3) institutions) that comprise the U.S. municipal market:~~

~~For any issuer which is a public agency employer for purposes of participation in CalPERS credit enhancement program or entity that might become a public agency employer, a written opinion of counsel for issuer is required that either:~~

~~i. Issuer's securities are exempt pursuant to Section 3(a)(2) of the Securities Act of 1933 (as security issued by a state or any political subdivision of a state or by any public instrumentality of a state or any political subdivision thereof); or~~

~~ii. Issuer's securities are exempt pursuant to section 3(a)(4) of the Securities Act of 1933 (the 501(c)(3) exemption).~~

~~Table 2: Municipal Sector Limits~~

~~Sector Nos.~~	**~~Market Sectors~~**	**~~Percentage of Total Aggregate Program Portfolio~~**
~~1~~	~~General Obligation/Short Term General Fund/Cash Flow Notes~~	~~Not to Exceed 100%~~
~~2~~	~~Public Infrastructure, Facilities and Equipment~~	~~Not to Exceed 80%~~
~~3~~	~~Transportation and Highway~~	~~Not to Exceed 70%~~
~~4~~	~~Water and Waste Water~~	~~Not to Exceed 70%~~
~~5~~	~~Education~~	~~Not to Exceed 60%~~
~~6~~	~~Municipal Utility Systems~~	~~Not to Exceed 50%~~
~~7~~	~~Airport and Marine Ports~~	~~Not to Exceed 40%~~
~~8~~	~~Student Loan and Pooled Loan Programs~~	~~Not to Exceed 30%~~
~~9~~	~~Housing~~	~~Not to Exceed 25%~~
~~10~~	~~Securitization Programs~~	~~Not to Exceed 15%~~
~~11~~	~~Public Supported Stadiums/Arenas~~	~~Not to Exceed 15%~~
~~12~~	~~Solid Waste Facilities/Resource Recovery/Environmental~~	~~Not to Exceed 10%~~
~~13~~	~~Healthcare~~	~~Not to Exceed 10%~~
~~14~~	~~Other*~~	~~Not to Exceed 10%~~

~~** This category is established for exceptions to the Policy. It is desirable to respond to changing market conditions and to take advantage of key opportunities that might not specifically fit into the Policy. .*~~

~~4. Special Assessment Districts~~

~~a. Philosophy: Some studies have generally categorized Special Assessment Districts as having a higher default profile in the municipal bond market.~~

~~b. Implementation: Accordingly, the Program shall only consider such tax allocation/special assessment bonds with the following characteristics:~~

~~i) The location is within the geographic region or city limit of a substantial, investment grade rated entity with an identifiable level of past and likely future growth and demand for housing and related infrastructure;~~

~~ii) The District is not a "start up", with at least five years of existing track record and debt servicing record;~~

~~iii) Raw land sales have been steady or increasingly strong due to demographic demand and population growth; and~~

~~iv) The developer or sponsor is of investment grade quality with excellent debt repayment history and strong construction/management experience.~~

~~G. Program Transaction Limits~~

~~The maximum holding in any given transaction in California shall be 25% of the issue in order to be in compliance with the Safe Harbor rules established under Section 503(e) of the Internal Revenue Code (IRC).~~

~~H. Program Partnerships~~

~~The Program shall co invest with at least one Financial Partner on each transaction. The Financial Partner(s) shall contribute to a sizeable interest on the transaction.~~

~~VI. CALCULATIONS AND COMPUTATIONS~~

~~A. Computations and calculation shall be based upon the total aggregate amount of $10 billion committed to the Program.~~

~~B. The "primary obligor" shall be used in computing geographic distribution limits, direct State government issued debt limits and municipal market sector limits.~~

~~VII. GLOSSARY OF CALPERS SPECFIC TERMS~~

~~***Italicized*** terms appearing in the Policy are CalPERS specific in nature and are defined in the CalPERS Specific Glossary of Terms.~~

~~Approved by the Policy Subcommittee~~ ~~Adopted by the Investment Committee~~	~~September 12, 2003~~ ~~October 14, 2003~~
~~Revised by the Policy Subcommittee~~ ~~Approved by the Investment Committee~~	~~December 10, 2004~~ ~~February 14, 2005~~
~~Revised by the Policy Subcommittee~~ ~~Approved by the Investment Committee~~	~~June 16, 2006~~ ~~August 14, 2006~~
~~Revised by the Policy Subcommittee~~ ~~Approved by the Investment Committee~~	~~October 12, 2007~~ ~~November 13, 2007~~
~~Approved by the Investment Committee~~	~~June 16, 2008~~
~~Administrative changes made due to Policy Review Project~~	~~June 16, 2009~~
~~Administrative changes to standardize reporting frequencies to the Investment Committee to “no less than annually”~~	~~May 19, 2014~~
~~Administrative changes to reflect the Policy Glossary of Terms Update Project~~	~~May 19, 2014~~

~~APPENDIX I~~

~~Equivalent Credit Ratings~~

~~**Credit Risk**~~	~~**Moody's***~~	~~**Standard & Poor's****~~	~~**Fitch****~~
~~**INVESTMENT GRADE**~~			
~~Highest quality~~	~~Aaa~~	~~AAA~~	~~AAA~~
~~High quality (very strong)~~	~~Aa~~	~~AA~~	~~AA~~
~~Upper medium grade (strong)~~	~~A~~	~~A~~	~~A~~
~~Medium grade~~	~~Baa~~	~~BBB~~	~~BBB~~
~~**NON INVESTMENT GRADE**~~			
~~Lower medium grade (somewhat speculative)~~	~~Ba~~	~~BB~~	~~BB~~
~~Low grade (speculative)~~	~~B~~	~~B~~	~~B~~
~~Poor quality (may default)~~	~~Caa~~	~~CCC~~	~~CCC~~
~~Most speculative~~	~~Ca~~	~~CC~~	~~CC~~
~~No interest being paid or bankruptcy petition filed~~	~~C~~	~~C~~	~~C~~
~~In default~~	~~C~~	~~D~~	~~D~~

~~*Source: The Bond Market Association*~~
~~** The ratings from Aa to Ca by Moody's may be modified by the addition of a 1,2 or 3 to show relative standing within the category.*~~
~~*** The ratings from AA to CC by Standard and Poor's and Fitch may be modified by the addition of a plus or minus sign to show relative standing within the category.*~~