

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

**FOR  
GLOBAL EQUITY**

**October 13, 2014**

*This policy is effective immediately upon adoption and supersedes all previous Global Equity 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 Global Equity program. The design of this Policy ensures that investors, managers, consultants, and other participants selected by 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 this program.

**II. STRATEGIC OBJECTIVE**

Set of investment beliefs that govern how Global Equity is structured and managed are:

- A. Global Equity investment returns will reflect a diversified exposure to global economic growth.
- B. Global Equity is managed from the perspective of relative return and risk as compared to the overall strategic benchmark for the asset class.
- C. Forecasted tracking error is the primary risk attribute used to describe the degree of normal volatility relative to the benchmark.
- D. Global Equity is managed as an overall composite portfolio combining an index-oriented core with actively managed portfolios. Each portfolio has a role such as reducing risk, producing excess return, providing a systematic factor or risk exposure or a combination of these attributes.

- E. The size of the Global Equity asset class exposure provides both challenges and opportunities (challenges to make material tactical shifts and opportunities to gain access to intellectual capital to make information advantaged investment decisions).
- F. Global Equity shall incorporate CalPERS Investment Beliefs when investing to influence sustainability issues including governance, risk management, human capital and environmental practices, subject to such influence being consistent with the pursuit of maximizing long-term returns within acceptable risk levels.

### **III. RESPONSIBILITIES**

- A. CalPERS Investment Staff ("Staff") is responsible for the following:
  - 1. Monitoring external and internal strategies in the implementation of, and compliance with, the Policy and with investment manager contracts. Staff shall report 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.
  - 2. Designing and implementing a process for capital allocation within the asset class including reporting on all strategies and relationships to provide the basis for assessment of strategies and decisions on capital allocation.
  - 3. Sourcing, researching, selecting, developing, contracting and terminating investment strategies to fulfill the Global Equity mission including transitioning global equity emerging managers into direct, standard investment manager contracts. Staff anticipates using, where appropriate, an exemption from competitive bidding to contract with selected emerging managers who transition out of the emerging manager program.
  - 4. Achieving alignment of interests in key aspects of business relationships (e.g. fees, benchmarks, constraints, measures of success).
  - 5. Portfolio management and trading of internal strategies.
  - 6. Reporting to the Committee no less than annually, on the structure, metrics and plans for the overall Global Equity Portfolio. Global Equity will also report on Specific Risk Parameters as identified in section V.B.

7. Coordinating information with other asset classes (e.g., research, relationship information, market intelligence) that contribute to overall Asset Allocation for the total fund.
  8. Assuring overall compliance with policy and procedures through interaction with the **General Pension Consultant** (“Consultant”), Compliance and Internal Audit functions.
- B. The Consultant is responsible for:
1. Providing independent perspective and counsel to the Committee which includes routine communication with each asset class and periodic reviews of processes and procedures.
  2. Monitoring, evaluating, and reporting no less than annually to the Committee on the performance of the Global Equity program relative to the benchmark and Policy.

#### **IV. PERFORMANCE OBJECTIVES AND BENCHMARKS**

- A. The primary performance objective for the Program is to obtain the return generated by global public equities as represented by the benchmark. A secondary objective is to utilize active management in an effort to earn a rate of return in excess of the benchmark. The degree of active management deployed is constrained by various risk limits for the asset class.
- B. The benchmark for the Global Equity program is specified in the Benchmarks Policy.

All individual Global Equity strategies have benchmarks that are supportive of the overall asset class objectives. Each strategy benchmark is documented within the Global Equity procedure documents or investment guidelines for individual strategies. Benchmarks are assigned to appropriately assess relative performance by representing the universe and characteristics of each investment strategy.

#### **V. INVESTMENT APPROACHES AND PARAMETERS**

- A. Approach

In the management of the overall Global Equity portfolio, investments are made with a specific purpose. Included strategies may be index-oriented (which closely replicate an index selected as the benchmark) or active strategies (which take significant tracking error risk relative to a

benchmark). All strategies shall be categorized as “index-oriented” or “active.”

Index-oriented strategies seek to generate a return and risk profile similar to the public equity market segment as defined by the benchmark. Typical attributes of index-oriented strategies are:

1. Investment universe substantially constrained to the assets contained in the underlying benchmark and derivatives thereof.
2. Non-benchmark exposures are limited to those acquired by corporate action, anticipated index reconstitution, effects of CalPERS restricted list activity and derivatives.
3. Forecast tracking error will be monitored and managed as defined in each strategy’s guidelines.

Active strategies are deployed with the expectation of earning longer-term rates of return in excess of the relevant benchmark segment. Active strategies result in significant amounts of forecasted tracking error. The risk taken within active strategies are based on several investment techniques including, but not limited to:

1. Individual stock or security selection.
2. Direct company engagement on topics such as environmental or social related issues, governance and capital usage in alignment with CalPERS sustainability initiatives and Global Principles of Accountable Corporate Governance.
3. Out of benchmark exposure.
4. Allocation variations to specific factors or parameters such as geographic region, market capitalization segment (large versus small companies), economic sector, industry group, investment style (value versus growth) or fundamental parameters (high quality versus low quality).
5. Substitution such as using derivative instruments.

The analytic framework underlying the active investment techniques may be based on fundamental, quantitative or technical analysis, either individually or in combination.

Each strategy is monitored and evaluated using several criteria:

1. Conformance with all applicable investment guidelines, policies and restrictions.
2. Contribution to overall objectives (e.g. market exposure, excess return generation, specific systematic risk exposures, diversification or proprietary input to the capital allocation process).
3. Stability of investment process and key decision makers (designated role in the overall composite asset class portfolio).
4. Performance versus benchmark (evaluated over time, in context of the investment environment and risk attributes).

Managers of active strategies will be encouraged to consider sustainability factors in their process. Staff encourages broad diversity among CalPERS investment managers in the belief that both diversity and sustainability awareness contribute to long-term sustainable competitive advantage.

#### B. Specific Risk Parameters

Investing in global public equity markets brings attendant risks including market and currency volatility, varying regulatory environments, foreign investor restrictions, liquidity and potential operational issues. Many of these risks are systemic and unavoidable. Specific risk categories and limits include:

1. CalPERS Investment Office Policies – Global Equity shall be managed to comply with all applicable policies established for the Investment Office.
2. All Global Equity internal and external portfolio managers shall consider CalPERS Global Principles of Accountable Corporate Governance and exercise their best judgment after taking all relevant factors, principles and trends into account. These principles are among the decision factors employed in the investment process but do not necessarily require managers to invest in accordance with each individual principle. By adopting the Principles, CalPERS strives to influence companies by advancing a dialogue about important issues of concern to institutional and other investors and to provide guidance in making investment decisions.

3. Investment Opportunity Set – The primary universe of allowable investment assets within Global Equity shall be publicly traded global equity securities and derivatives thereof as described in the Global Derivatives and Counterparty Risk Policy. Securities identified as prohibited by the Committee shall be excluded from the policy benchmark. For investment instruments where CalPERS does not have discretionary control (e.g. commingled funds, exchange traded funds), the assets are exempt from divestment. Any future investment subsequent to adoption of the Policy involving assets identified as being primarily associated with another CalPERS asset class shall only be undertaken upon:
  - a. Being reviewed by the Chief Investment Officer (“CIO”) and Investment Strategy Group.
  - b. Being reviewed by the Committee.
4. **Asset Class Tracking Error** – The target range for the amount of aggregate forecast tracking error for Global Equity is 25 to 50 basis points as measured by the CalPERS Risk Management system.
5. Leverage – Global Equity shall not use leverage to increase net equity exposure above the current cash market value of the asset class.
6. Notional Leverage – Notional leverage is created when a derivative position either lacks full collateralization, or when non-cash collateral underlies a derivative exposure. Global equity notional leverage will be calculated on a **net exposure** basis and shall not exceed 10% of the Global Equity market value.
7. Illiquidity – The allocation of assets to investment vehicles or instruments meeting the conditions of illiquidity shall be limited to 15% of the Global Equity asset class exposure at the time of such allocation.

Monitoring of the specific risk parameters is undertaken within the asset class as well as involving Investment Risk Management and Investment Compliance functions. Should any breach of a specific risk parameter be identified, the identifying team shall notify the other monitoring teams, the CIO and the Chief Operating Investment Officer in writing by e-mail.

Following identification these steps shall be completed:

1. Activity Hold – Any pending or ongoing activity expected to exacerbate a breach shall be stopped or paused. Activity which

mitigates a breach may continue.

2. Analysis – An analysis of the situation shall be completed and include these components:
  - a. Cause – The circumstances underlying a breach may include:
    - (1) Specific investment action including changes to the allocation of assets within the asset class or overall plan.
    - (2) Change in market conditions.
    - (3) Change in definitions or model specifications.
  - b. Risk Assessment – Estimation of the risks associated with a breach.
  - c. Mitigation Plan – Identification of steps and timetable which may mitigate the risks associated with a breach. These steps may include:
    - (1) Trading assets.
    - (2) Continued monitoring of the situation allowing time to elapse and conditions to change.
    - (3) Modification of the specific risk parameters within the policy document.
  - d. The Committee shall be apprised of the situation and the complete analysis presented at the next available opportunity. A staff recommendation requesting Committee action shall accompany the analysis.

### C. Investment Selection

Global Equity has two internal committees to select then allocate capital. The Global Equity Investment Review Committee reviews and approves internal and external strategies forming the pool of eligible investment strategy alternatives. The Global Equity Capital Allocation Committee is responsible for the allocation of capital to and from eligible strategies.

The mechanism for sourcing and selecting new **external managers** shall be the **Alternate Solicitation Process** which incorporates the Investment Proposal Tracking System (“IPTS”) as a solicitation and data collection vehicle. The Alternate Solicitation Process includes a structured due diligence approach and consideration of all the criteria mentioned in the Investment Approaches and Parameters section of this Policy.

Global Equity Emerging Managers shall be selected by advisors and may be transitioned outside of the Emerging Manager Program into direct, standard investment manager contracts. Staff anticipates using, where appropriate, an exemption from competitive bidding to contract with selected Emerging Managers who transition out of the Emerging Manager Program.

D. Investment Parameters

All investment strategies shall have specific, written guidelines. The guidelines shall outline the investment philosophy and approaches, representative portfolio characteristics, permissible and restricted activities and a performance objective which is commensurate with the strategy’s purpose.

## 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 the CalPERS Custodian.

## VII. GLOSSARY OF CALPERS SPECIFIC TERMS

**Italicized** terms appearing in the Policy are CalPERS specific in nature and are defined in the [CalPERS Specific Glossary of Terms](#).



**GLOBAL EQUITY**

Adopted by the Investment Committee	December 10, 2012
Approved by the Investment Committee	November 18, 2013
Administrative changes to update template format and to align this policy with the Global Derivatives and Counterparty Risk Policy	December 24, 2013
Administrative changes to standardize reporting frequencies to the Investment Committee to “no less than annually”	May 15, 2014
Administrative changes to reflect the Policy Glossary of Terms Update Project	May 15, 2014
Approved by the Investment Committee	October 13, 2014

The following Polices were repealed December 10, 2012:

- Global Equity Policy
- Externally Managed Strategies Policy
- Global Equity Emerging Manager Fund-Of-Funds Policy
- Global Equity Sub-Asset Class Allocation Ranges Policy
- Internally Managed Affiliate Equity Index Funds Policy
- Internally Managed Global Enhanced Equity Strategies Policy
- Internally Managed Global Equity Index Funds Policy
- Manager Development Program I and II (MDP) Policy and Manager Transition Policy
- Monitoring Externally Managed Portfolios Policy