

February 25, 2022

Mr. David Miller
Chair of the Investment Committee
California Public Employees' Retirement System
400 P Street
Sacramento, CA 95814

Re: Agenda Item 8a: PERF Total Fund and Global Fixed Income Policies First Reading

Dear Mr. Miller:

You requested Wilshire's opinion on Staff's presentation of the Total Fund and Global Fixed Income, Investment Policies. As this is a first reading of the proposed policy changes, we welcome input from the Investment Committee.

The establishment of the portfolio's strategic asset allocation targets in November 2021 was the culmination of an extended period of analysis, discussion, and debate. The Investment Policy Statements (IPS) are meant to codify that decision in policy to serve as governance documents for managing the portfolio. As the Board's consultant, Wilshire has been closely involved in the drafting of the policy revisions with the overarching goal of enhancing Board governance and ensuring the appropriate tools and reporting are in place to move the portfolio towards the adopted asset allocation targets. **In aggregate, Wilshire is comfortable that the proposed changes are consistent with a strong governance framework and appropriately adjust policy to align with the approved asset allocation.**

This opinion letter will step through important changes in the order in which they appear in the documents along with the rationale.

Total Fund

The first substantive changes are found under Implementation on page 8, which outlines an adaptable framework for managing liquidity for pension cashflows and capital calls. As the Investment Committee has discussed previously, liquidity management is a critical component of Total Fund portfolio management, so Wilshire is supportive of this addition. In addition the policy language now specifically includes a consideration of private asset valuations on policy compliance, which takes on added importance given the increase in private asset exposure established by the new ALM targets.

Under Investment Leverage, it is important to point out that the strikeouts reflect movement of policy language to improve the flow of the document and not removal of guidelines on Staff activity. Based on Committee feedback during the ALM process, the policy revision reflects a reduction in the incremental active leverage that Staff might utilize from 20% to 15%, and specifically defines what is considered incremental leverage. Further, Wilshire continues to act in a Board oversight role in reviewing the methodology for calculating and reporting on leverage exposure for the PERF. Lastly, the policy revision

in this section clarifies the timeline for plan development in the event of a guideline breach, and specifies that Staff will act prudently to move the portfolio back into allocation ranges while accounting for the market environment. We do not expect these revisions to impinge on Board oversight, as guideline deviations continue to be incorporated into regular Board reporting.

Section VIII provides guidelines for the new Private Debt allocation. Of note, policies for other asset classes are currently maintained as separate documents. **Wilshire recommends that the Investment Committee consider incorporating policies previously reserved in separate governance documents (Private Equity, Global Fixed Income, etc.) into the Total Fund Policy.** This will increase the consistency, readability and usability of the documents without loss of governance oversight. If the Investment Committee is amenable to that consolidation, those edits can be brought back as part of the second reading. The Private Debt policy language appropriately includes investment parameters and Staff authority limits, while reporting requirements and investment responsibilities are provided in later Appendices. At this time, Wilshire is comfortable with the broad strategy ranges in the Investment Parameters table given the program is ramping up. **However, future consideration should be given to establishing specific targets for each strategy, similar to those in the Private Equity policy.** Staff authority limits remain consistent with those previously found for Opportunistic Strategies, which were primarily focused on private debt commitments. **Wilshire notes that the revised policy does not include a table delineating program responsibilities for the new Private Debt allocation and recommend including a table covering similar parameters as those in the Private Equity table on page 42.** Wilshire feels the Private Debt policy language sufficiently covers the appropriate governance items for the new asset class, and would be enhanced with the aforementioned table.

Section XII on Securities Lending aligns the program with the utilization of leverage approved by the Board and does not change how the program is executed or the risks involved.

In Appendix 4 starting on page 48, the Strategic Asset Allocation Targets and Ranges Table is updated to include only asset class segments and benchmarks that were explicitly approved in the ALM process and eliminates those that do not have defined strategic targets. These additions include emerging market sovereign debt, private debt, and strategic leverage. Wilshire believes the focus on strategic targets enhances the clarity of the table. Wilshire also supports the increase in the range associated with Private Equity, given its increased target, and the relatively wider range associated with Private Debt as a new defined asset class. The other edits in the table to segment naming conventions are meant to increase consistency and do not indicate a change in strategy or benchmark construction.

In Appendix 5 Table 1, the PERF policy benchmark is defined to align with the new asset allocation. It incorporates benchmarks for the new asset classes along with a benchmark to measure strategic leverage implementation. **Wilshire believes these benchmarks broadly meet best practices in benchmarking, align with the investment expectations of the portfolio segments, and are appropriate for measuring the effectiveness of Total Fund portfolio management.** Wilshire was involved in discussions around the benchmark implementation and are comfortable with the policy revisions together with the implementation considerations to be presented to the Investment Committee during March closed session. Wilshire will continue to act in an oversight role regarding changes to benchmark construction,

and will elevate those changes deemed material for approval by the Investment Committee as outlined in the Total Fund Investment Policy under “Benchmark Oversight.”

Table 2 in Appendix 5 has been deleted as the information is either extraneous or described elsewhere in policy and is no longer pertinent. The benchmark names in the tables following that have been adjusted to align with industry changes and to be more consistent across policy. It is worth noting the inclusion of a footnote under the Supplemental Income Plans regarding the flexible construction of the Real Assets benchmark, which improves transparency within the policy.

Finally, the Opportunistic Strategies investment parameters removes the specified horizon for reducing exposure below the 5% limit in the event of a market dislocation and specifically requires CIO approval for strategic changes within the segment. In Wilshire’s estimation, **this is prudent portfolio management flexibility given the less liquid nature of the opportunites present in the program**, and notes that allocation deviations will continue to be reported to the Board and managed back towards policy as market conditions allow.

Global Fixed Income

Wilshire believes all the suggested revisions are necessary to bring the policy in line with the new ALM targets. These include delineating investments’ constraints and limitations which were previously grouped together within the Spread segment, and now have defined strategic targets.

Investment Beliefs

Wilshire believes the proposed revisions support a number of CalPERS’ Investment Beliefs:

Investment Belief 4: “Long term value creation requires effective management of three forms of capital: financial, physical and human; Governance is the primary tool to align interests between CalPERS and managers of its capital”

Investment Belief #5 – “CalPERS must articulate its investment goals and performance measures and ensure clear accountability for their execution.”

Investment Belief #10 (sub-belief C) - “CalPERS will be best positioned for success if it 1) has strong governance, 2) operates with effective, clear processes...”

Conclusion

While this is a first reading of the proposed Policies and we welcome Investment Committee feedback, Wilshire has reviewed the proposed revisions in detail and provided feedback along with some additional recommendations for consideration. We are comfortable that the changes proposed within the policies promote more effective governance. Please do not hesitate to contact us should you require anything further or have any questions.

Regards,

A handwritten signature in black ink, appearing to read 'T. Toth', with a stylized flourish at the end.

Thomas Toth, CFA

Managing Director, Wilshire Advisors