

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

**~~FOR  
EXTERNALLY MANAGED STRATEGIES~~**

**~~April 21, 2008~~**

*~~This Policy is effective immediately upon adoption.~~*

**~~I. PURPOSE~~**

~~The 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 Global Equity Externally Managed Strategies ("Program"), including:~~

- ~~• Domestic Active Equity~~
- ~~• Domestic Enhanced Indexing Equity~~
- ~~• Domestic Relaxed Long-Only Equity~~
- ~~• International Active Equity~~
- ~~• International Enhanced Indexing Equity~~

~~The design of this Policy ensures that investors, managers, consultants, and other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Program. Additionally, use of this Policy assures sufficient flexibility in controlling investment risks and returns associated with these segments of the global capital markets.~~

**~~II. STRATEGIC OBJECTIVE~~**

~~Capturing returns of domestic and international equity markets while diversifying risk is the strategic objective for the Program.~~

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

- ~~A. Diversify CalPERS overall Equity Program by complementing the Passive Domestic and Passive International Equity Programs;~~
- ~~B. Enhance the expected return of CalPERS investment program; and~~
- ~~C. Hedge against active member (pre-retirement) liabilities.~~

**III. ~~RESPONSIBILITIES~~**

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

- ~~1. All aspects of portfolio oversight including monitoring, analyzing, and evaluating performance relative to the appropriate benchmark.~~
- ~~2. Reporting to the Committee at least annually about the performance of the Program.~~
- ~~3. Monitoring the implementation of, and compliance with, the Policy and all external managers' guidelines. Staff shall report material concerns, problems and changes relating to any external manager at the next Committee meeting, or sooner if deemed necessary. These reports shall include explanations of any violations and appropriate recommendations for corrective action.~~
- ~~4. Recommending action concerning outside money management firm(s) ("Managers") retained under contract to implement the Program.~~

B. ~~The General Pension Consultant ("Consultant") is responsible for monitoring, evaluating, and reporting periodically, to the Committee, on the performance of the Program and each Manager relative to the benchmark and Policy, and other pertinent issues as deemed appropriate.~~

C. ~~The External Managers ("Manager") 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 strategies and investment results.~~
- ~~2. Monitor, analyze, and evaluate performance relative to the agreed-upon benchmark.~~
- ~~3. Cooperate fully with CalPERS Staff, Custodian, and General Pension Consultant concerning requests for information.~~

**IV. ~~PERFORMANCE OBJECTIVE AND BENCHMARK~~**

~~Please see attachments for the individual strategies. The benchmark for the Externally Managed Strategies Program is specified in the Benchmark Modification and Benchmark Details Policy.~~

~~V. INVESTMENT APPROACHES AND PARAMETERS~~~~A. Approaches~~

- ~~1. Please see attachments for descriptions of the individual strategies.~~
- ~~2. The Program shall be implemented through the retention of external managers. External manager selection shall occur in accordance with Section V.B. of this Policy.~~
- ~~3. CalPERS shall continually review the viability of the program, conducting a formal review at least every five (5) years.~~

~~B. External Manager Selection~~

- ~~1. Please see attachments for the criteria used for the individual strategies.~~
- ~~2. The selected managers shall be registered, or appropriately exempt from registration, with the Securities and Exchange Commission.~~
- ~~3. CalPERS shall select the managers in accordance with the applicable California laws and regulations, and CalPERS policy.~~

~~C. Investment Parameters~~

~~The Managers shall operate under a set of specific guidelines that outlines their investment philosophies and approaches, representative portfolio characteristics, permissible and restricted securities and procedures, benchmark, and performance objectives.~~

~~Implementation of this Program shall comply at all times with CalPERS investment policies including, but not limited to, the following parameters:~~

- ~~1. Statement of Investment Policy for Derivatives - External Money Managers;~~
- ~~2. Proxy Voting Policies;~~
- ~~3. Monitoring Externally Managed Portfolios; and~~
- ~~4. Manager-specific Investment Management Guidelines.~~

**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 CalPERS Custodian.~~

**VII. GLOSSARY OF TERMS**

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

Externally Managed Strategies

~~Approved by the Policy Subcommittee: March 17, 2008  
 Adopted by the Investment Committee: April 21, 2008  
 Administrative changes made due to Policy Review Project: June 16, 2009  
 Admin changes due to adoption of Benchmark Policy: November 23, 2009~~

~~The following attachments were previously individual policies and are now consolidated into the Externally Managed Strategies policy. The dates below reflect the revision history for each document~~

Attachment A — Domestic Active Equity:

~~Approved by the Policy Subcommittee: August 11, 1999  
 Adopted by the Investment Committee: October 18, 1999  
 Revised by the Policy Subcommittee: December 10, 2004  
 Approved by the Investment Committee: February 14, 2005  
 Revised by the Policy Subcommittee: March 17, 2008  
 Approved by the Investment Committee: April 21, 2008  
 Admin changes due to adoption of Benchmark Policy: November 23, 2009~~

Attachment B — Domestic Enhanced Indexing Equity:

~~Approved by the Policy Subcommittee: December 10, 2004  
 Adopted by the Investment Committee: February 14, 2005  
 Revised by the Policy Subcommittee: March 17, 2008  
 Approved by the Investment Committee: April 21, 2008  
 Admin changes due to adoption of Benchmark Policy: November 23, 2009~~

Attachment C — Domestic Relaxed Long-Only Equity:

~~Approved by the Policy Subcommittee: October 16, 2006  
 Adopted by the Investment Committee: November 13, 2006  
 Revised by the Policy Subcommittee: March 17, 2008  
 Approved by the Investment Committee: April 21, 2008  
 Admin changes due to adoption of Benchmark Policy: November 23, 2009~~

Attachment D — International Active Equity:

~~Approved by the Policy Subcommittee: August 11, 1999  
 Adopted by the Investment Committee: October 18, 1999~~

Revised by the Policy Subcommittee:	December 10, 2004
Approved by the Investment Committee:	February 14, 2005
Revised by the Policy Subcommittee:	March 17, 2008
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Admin changes due to adoption of Benchmark Policy:	November 23, 2009

Attachment E – International Enhanced Indexing Equity:

Approved by the Policy Subcommittee:	December 9, 2005
Adopted by the Investment Committee:	February 14, 2006
Revised by the Policy Subcommittee:	March 17, 2008
Approved by the Investment Committee:	April 21, 2008
Admin changes due to adoption of Benchmark Policy:	November 23, 2009

**ATTACHMENT A****~~DOMESTIC ACTIVE EQUITY~~****~~I. PERFORMANCE OBJECTIVE AND BENCHMARK~~**

~~The Active Domestic Equity Program encompasses the Externally Managed Domestic Equity Strategies (Domestic Active Equity, Domestic Enhanced Indexing Equity, and Domestic Relaxed Long-Only Equity) and the Internally Managed Dynamic Completion Fund ("DCF"). The Program is expected to outperform the custom Dow Jones Wilshire 2500 Index, net of fees.~~

~~Within the Program, Managers or portfolios or both are expected to achieve performance objectives as stated in their Investment Management Guidelines. CalPERS shall measure individual Managers against appropriate style benchmarks. The benchmark for Externally Managed Strategies Program is specified in the Benchmark Modification and Benchmark Details Policy.~~

**~~II. INVESTMENT APPROACHES AND PARAMETERS~~****~~A. Approaches~~**

~~Active domestic equity strategies shall be identified based upon their ability to add value above a style-specific benchmark on a risk-adjusted basis. The DCF will be used to attempt to neutralize any style bias within the Active Domestic Equity Program.~~

**~~B. External Manager Selection~~**

~~CalPERS shall retain managers that have recognized expertise in the analysis and selection of U.S. equity securities or approved derivatives.~~

**ATTACHMENT B****DOMESTIC ENHANCED INDEXING EQUITY****I. PERFORMANCE OBJECTIVE AND BENCHMARK**

The Active Domestic Equity Program encompasses the Externally Managed Domestic Equity Strategies (Domestic Active Equity, Domestic Enhanced Indexing Equity, and Domestic Relaxed Long-Only Equity) and the Internally Managed Dynamic Completion Fund ("DCF"). The Program is expected to outperform the custom Dow Jones Wilshire 2500 Index, net of fees.

Within the Program, Managers or portfolios or both are expected to achieve performance objectives as stated in their Investment Management Guidelines. CalPERS shall measure individual Managers against appropriate style benchmarks. The benchmark for the Externally Managed Strategies Program is specified in the Benchmark Modification and Benchmark Details Policy.

**II. INVESTMENT APPROACHES AND PARAMETERS****A. Approaches**

Acceptable investment approaches may include equity-based and synthetic strategies.

1. Enhanced index domestic equity-based strategies shall be identified based upon their ability to add value above an appropriate benchmark on a risk-controlled basis. The managers are expected to add consistent alpha above the passive index by controlling tracking error at a level that is below traditional active management. The DCF will be used to attempt to neutralize any style bias.
2. Enhanced index domestic synthetic strategies shall be identified based upon their ability to add value above an appropriate benchmark on a risk-adjusted basis. Synthetic strategies shall be managed to maximize return and minimize risk through the use of equity index futures, swaps or both for underlying equity exposure and managing fixed income securities to add excess return. The fixed income portion will be managed by the selection and allocation across sectors, maturities, durations, credits, and approved derivative instruments. In addition, the managers will consider macro and relevant micro-economic factors including, but not limited to, economic growth, inflation, monetary and fiscal policy, the credit risk of market and issuer, and risk-adjusted yields. This program shall be invested in investment grade securities (securities rated no lower than Baa by Moody's Investor Service, or

~~BBB by Standard & Poor's) or their equivalent; unless specified otherwise in the manager specific Investment Manager Guidelines, up to a maximum of 10% in below investment grade securities (securities rated no lower than B by Standard & Poor's).~~

**B. External Manager Selection**

- ~~1. CalPERS shall retain *equity-based* managers that have recognized expertise in the analysis and selection of U.S. equity securities or approved derivatives.~~
- ~~2. CalPERS shall retain *synthetic* managers with recognized expertise in the analysis and selection of fixed income securities, credit analysis, approved derivatives, and the ability to efficiently and effectively roll equity index futures.~~



**ATTACHMENT C****DOMESTIC RELAXED LONG-ONLY EQUITY****I. ~~PERFORMANCE OBJECTIVE AND BENCHMARK~~**

~~The Active Domestic Equity Program encompasses the Externally Managed Domestic Equity Strategies (Domestic Active Equity, Domestic Enhanced Indexing Equity, and Domestic Relaxed Long-Only Equity) and the Internally Managed Dynamic Completion Fund (“DCF”). The Program is expected to outperform the custom Dow Jones Wilshire 2500 Index, net of fees.~~

~~Within the Program, Managers or portfolios or both are expected to achieve performance objectives as stated in their Investment Management Guidelines. CalPERS shall measure individual Managers against appropriate style benchmarks. The benchmark for Externally Managed Strategies Program is specified in the Benchmark Modification and Benchmark Details Policy.~~

**II. ~~INVESTMENT APPROACHES AND PARAMETERS~~****A. ~~Approaches~~**

- ~~1. The Relaxed Long-only Domestic Equity Program allows managers to underweight securities by more than the benchmark weight. The Program involves the short selling of securities to a maximum of 35% of the portfolio while maintaining a Beta at or near 1.0.~~
- ~~2. Relaxed Long-only Domestic Equity strategies shall be identified based upon their ability to add value above the appropriate benchmark on a risk-adjusted basis. The managers are expected to add consistent alpha above the passive index while controlling tracking error. The DCF will be used to attempt to neutralize any style bias.~~

**B. ~~External Manager Selection~~**

~~CalPERS shall retain managers that have recognized expertise in the analysis and selection of U.S. equity securities or approved derivatives and have a minimum of three years experience shorting stocks.~~

**ATTACHMENT D****INTERNATIONAL ACTIVE EQUITY****I. ~~PERFORMANCE OBJECTIVE AND BENCHMARK~~**

~~The External International Equity Program includes International Active Equity and International Enhanced Indexing Equity strategies. The International Active Equity strategy may include the following mandates: (1) All-World ex-U.S.; (2) Europe only; (3) Pacific Basin only; (4) Developed Markets only; and (5) Emerging Markets only. The Program is expected to outperform the CalPERS FTSE All-World ex U.S., net of fees.~~

~~Within the Program, Managers or portfolios or both are expected to achieve performance objectives as stated in their Investment Management Guidelines. CalPERS shall measure individual Managers against the appropriate CalPERS Financial Times Stock Exchange (FTSE) benchmark, which may be customized. The benchmark for the Externally Managed Strategies Program is specified in the Benchmark Modification and Benchmark Details Policy.~~

**II. ~~INVESTMENT APPROACHES AND PARAMETERS~~****A. ~~Approaches~~**

~~The Active International Equity Portfolio shall be invested to maximize return, within acceptable risk parameters, through the selection of publicly traded equity securities available in international equity markets.~~

**B. ~~External Manager Selection~~**

~~CalPERS shall retain managers with recognized expertise in the analysis and selection of international equity securities or approved derivatives.~~

## ATTACHMENT E

### INTERNATIONAL ENHANCED INDEXING EQUITY

#### I. ~~PERFORMANCE OBJECTIVE AND BENCHMARK~~

The External International Equity Program includes International Active Equity and International Enhanced Indexing Equity strategies. The International Enhanced Indexing Equity strategy may include the following mandates: (1) All-World ex-U.S.; (2) Europe only; (3) Pacific Basin only; (4) Developed Markets only; and (5) Emerging Markets only. The Program is expected to outperform the CalPERS FTSE All-World ex U.S., net of fees.

Within the Program, Managers or portfolios or both are expected to achieve performance objectives as stated in their Investment Management Guidelines. CalPERS shall measure individual Managers against the appropriate CalPERS Financial Times Stock Exchange (FTSE) benchmark, which may be customized. The benchmark for the Externally Managed Strategies Program is specified in the Benchmark Modification and Benchmark Details Policy.

#### II. ~~INVESTMENT APPROACHES AND PARAMETERS~~

##### A. ~~Approaches~~

Acceptable investment approaches shall include equity-based strategies. Enhanced index international equity-based strategies shall be selected for their ability to consistently add value above an appropriate benchmark on a risk-controlled basis, defined as having a tracking error that is below traditional active management.

##### B. ~~External Manager Selection~~

CalPERS shall retain equity-based managers that have recognized expertise in the analysis and selection of international equity securities or approved derivatives.

~~Asset Class Glossary: Equities  
Policy: Externally Managed Strategies~~

**Beta**

~~A measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole~~

**CalPERS Custom Wilshire 2500 Index**

~~The Wilshire 2500 Index, excluding tobacco stocks, and with dividends reinvested. The standard Wilshire 2500 comprises the top 2500 securities of the Wilshire 5000 Index, including Real Estate Investment Trusts and tobacco stocks, based on market capitalization, and is reconstituted annually. The Wilshire 5000 is an index that measures the performance of all U.S. headquartered equity securities with readily available price data.~~

**CalPERS Financial Times Stock Exchange All World, ex-US, ex-Tobacco**

~~The benchmark for the international equity asset class. The benchmark is created by Financial Times and reflects specific customizations, such as the exclusion of tobacco stocks as identified by the Investor Responsibility Research Center. The benchmark can be broken down into its underlying countries.~~

**Custodian**

~~A bank or other financial institution that provides custody of stock certificates and other assets of an institutional investor.~~

**Derivative**

~~An instrument whose value is based on the performance of an underlying financial asset, index, or other investment. Classes of derivatives include futures contracts, options, currency forward contracts, swaps, and options on futures.~~

**Dynamic Completion Fund**

~~A custom portfolio designed to control the capitalization or style misfit present in a plan sponsor's investment program.~~

**Emerging Equity Market**

~~A market classified by FTSE as an emerging market based on an assessment of World Bank gross national income per capita, as well as factors related to the market and regulatory environment, custody and settlement, trading, development of a derivatives market and size of the country's stock market. Emerging Equity Markets are distinguished from: (1) Developed Markets which are markets domiciled in high-income countries, as defined by the World Bank, that most investors consider to have a well-developed operating and regulatory structure for its capital markets. These markets are included in the FTSE Benchmark Classification as Developed Markets. (2) Frontier Markets which are markets domiciled in low-income countries, as defined by the World Bank, whose capital market structure and regulatory mechanisms are not developed enough to be included in Emerging Markets. These are markets that are investable but~~

not classified by FTSE as Developed or Emerging Markets. (3) Uninvestable Markets which are those markets that are not classified by FTSE as Developed, Emerging, or Frontier Markets. These markets generally lack a convertible currency and do not allow for investment by non-residents.

### **Equity Based Strategy**

Combination of active stock selection with risk mechanism designed to minimize tracking error relative to the benchmark. Seek to add value through minor variances relative to the market in sector/industry weightings, style (growth/value) tilts or stock weightings. Key inputs into the process come from either analysts' fundamental research or quantitative models.

### **External Manager**

An outside money management firm retained under contract by CalPERS.

### **Financial Times Stock Exchange (FTSE)**

The index publisher that produces the Custom FTSE All World ex-US Index for CalPERS. FTSE is partially owned by the London Stock Exchange and Financial Times.

### **Short Selling**

Selling securities that are not owned and buying them back later to take advantage of an anticipated decline in price.

### **Style Benchmark**

A custom benchmark composed of individual securities or a combination of published benchmarks with returns closely tracking an individual manager's returns. Style benchmarks help determine what portion of a manager's performance can be explained by its style and what portion can be attributed to stock selection.

### **Style Bias**

The difference between an aggregate or individual manager benchmark and the target.

### **Synthetic Strategy**

Combination of obtaining market exposure via futures contracts or swaps and enhancing return through the management of the underlying cash portfolio. The market exposure is achieved through a long S&P 500 futures position and the remaining capital is invested in money market instruments with a maturity of 90 days or longer that have greater duration or credit risk.

### **Tracking Error**

The annualized standard deviation of the difference between the total return of the portfolio and the total return of the benchmark. The term tracking error is frequently used to describe return deviation, the total return of a portfolio, minus the total return of a benchmark index.