

August 26, 2025

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

Re: Consultant Trust Level Review

Wilshire's 2025 Trust Level opinion letter covers the "firm" review that accompanies the individual program reviews provided under separate cover. This opinion letter is focused on a qualitative assessment of INVO's activities this fiscal year to supplement the quantitative performance information provided by both Staff and Wilshire in the Trust Level Review agenda item. In evaluating the quality of an asset management organization, Wilshire assesses factors contributing to the stability of the organization and the alignment of incentives between the team and the organization's long-term objectives. Past Wilshire reviews have highlighted our concerns over Staff stability, as a successful investment program requires a true long term investment horizon that comes from a consistent and enduring investment philosophy. The organization recognizes this importance given Investment Belief #2 – A long time investment horizon is a responsibility and an advantage. Driving strong portfolio returns requires consistency, deep resources, a thorough understanding of the opportunity set, and accountability.

The overall Firm evaluation remains consistent with the score from last year. This reflects both the limited tenure of the current CIO, the retirement of the Deputy CIO for Capital Markets, the announced retirement of the MID-TFPM at the end of this year, and the hiring of a new MID of Private Debt. Turnover at the senior investment positions is a risk factor in the portfolio management process. Stability in leadership is critical to successfully implementing the strategic portfolio and risk target approved by the Board. Wilshire would expect the broader organization score to increase over time should greater stability within INVO's senior team be realized.

The new Chief Investment Officer has been in place for the full fiscal year. Wilshire has regular discussions with the CIO and other senior professionals across the organization to understand strategic initiatives and ongoing work streams. These interactions remain crucial to evaluating effectiveness across INVO. The discussion topics initially focused on a total portfolio approach (TPA) to investment decision-making. This requires setting a portfolio risk tolerance and limits on active risk taking around that risk level. The Board is set to continue that discussion at the September Investment Committee meeting.

The CIO's actions around culture, engagement, and leadership development within INVO remain a work in progress. A cultural shift is necessary to build a resilient investment program under TPA. Successful implementation of TPA requires alignment across investment teams, and it takes time to ensure buy-in and support. Team members need to share a common investment language,

trust, and focus on Total Fund performance rather than individual benchmarks. A collaborative culture should be inclusive, with an openness from everyone to consider investment proposals originating from any part of INVO. While it is too early to fully assess the level of buy-in across INVO, Wilshire has seen evidence of this collaboration in our discussions with various teams and will continue monitoring these efforts.

The CIO continues to emphasize and reinforce a culture of investment risk taking to improve Total Fund performance. This evolution can occur by improving accountability for performance relative to appropriate benchmarks, at all levels of the portfolio. This includes establishing a cost of capital framework that allows for relative comparisons of different investment strategies for inclusion in the Total Fund. Wilshire's independent estimation of the cost of capital, using our capital market assumptions, has generally aligned with INVO's modeling. We will continue to discuss the details of INVO's framework over the next few months with the goal of finalizing the initial strategic framework prior to going live with TPA in mid-2026. Wilshire is confident there is sufficient time to complete this important governance structure. It is also worth noting that the framework will likely change as investment teams adapt to developing integrated investment plans. Wilshire supports this continual improvement. Through this process, Wilshire will play an integral role in the governance of this risk-taking framework on behalf of the Board.

Wilshire will continue to engage with the team around these topics, discuss changes in team structure and highlight them for the Board as necessary. While it is not necessary to have absolute certainty about the team structure, Wilshire would like to see additional progress around lines of reporting and investment decision making. Additional workstreams include investment data & technology, culture, and people. Investment in timely data, quantitative models, and internal expertise to implement adjustments efficiently strives to drive a performance edge in a competitive capital market.

These initiatives are in line with Investment Beliefs #4 – long-term value creation requires effective management of three forms of capital: financial, physical, and human; and #10 - strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives. Active risk management is a strategic priority, and the CIO has deep experience in driving value-add activities in institutional portfolios. These opportunities should be measured relative to expectations established as part of a risk budget, further increasing Staff accountability for results. Active return targets (alpha) should reflect both portfolio strategy and the Board's risk tolerance. If set too low, the portfolio may closely follow the benchmark and miss active opportunities; if set too high, it could promote excessive risk taking or unrealistic expectations. Balancing these targets is essential for consistent performance over time and in volatile markets.

Ensuring that CalPERS continues to have the tools necessary to recruit and retain qualified, diverse candidates remains a strong focus for the new CIO. It is critical to ensure that sufficient resources are in place to execute on the Board's strategic investment direction. As a governmental entity, CalPERS continues to face some unique organizational risks that for-profit enterprises have greater flexibility in managing, such as the inability to provide employees with direct and indirect

ownership opportunities. These long-term forms of incentives are common within private sector investment organizations and can serve as significant retention tools. The absence of such compensation structures can expose the organization to the increased risk of losing intellectual capital at the INVO Senior Staff level to asset managers and other financial institutions. We reiterate that the organization has made strides to adjust pay scales to be more competitive in the marketplace, as well as aligning incentive compensation with Total Fund performance objectives. FY 2025 provides a compelling example of that alignment as the Long Term Incentive Plan (LTIP) return thresholds were exceeded this year.

CalPERS must compete for talent in a reasonably tight labor market, so any compensation changes must consider potential risks. These may include higher staff turnover, recruitment difficulties, or effects on portfolio risk management. Turnover can be beneficial, but maintaining investment continuity and progress requires strong recruiting efforts.

Investment governance within INVO currently runs through committees made up of the most senior investment professionals, across multiple market segments, providing diversity of experience and insight. This includes a Total Fund Management Committee, the Investment Underwriting Committee, and the Portfolio Integration Committee. The CIO has adjusted the structures to align with his vision for managing the PERF in a holistic fashion with investments competing for capital. As the Board consultant, we will monitor their functions and modifications as the committees evolve, staying attuned to flux in reporting lines and responsibilities which could impact Staff stability.

Sustainable Investments Highlights

While sustainability has been part of CalPERS's philosophy for decades, the team evolved and expanded in the 2023 fiscal year through the creation of the Sustainable Investments (SI) team which is part of INVO and reports to the CIO. The SI MID is tasked with setting the vision, strategy, and governance for CalPERS's sustainability work as well as leading all aspects of the fund's efforts to develop and implement ESG research and processes to support ESG integration into the investment decision-making process. Under the SI MID, there are three teams, each lead by an Investment Director (ID) and supported by additional staff: Sustainable Investments Policy and Partnerships, Sustainable Investments Private Markets Portfolio, and Sustainable Investments Public Markets Portfolio.

This past fiscal year, SI continued its recruitment efforts, including filling the vacant ID role for the Sustainable Investments Private Markets Portfolio. While the efforts continue, they have slowed considerably with only a handful of IO positions left to fill. As of the end of the fiscal year, the team consisted of 14 contributors, three support staff, and two open positions. The remaining open positions are expected to be filled in the coming months.

Broadly, SI is responsible for a wide range of priorities: financial markets advocacy; human capital management; stakeholder engagement; sustainability research; sustainability-related investment

support and reporting; the emerging and diverse manager program; and diversity, equity and inclusion work. The SI team is also responsible for ESG integration, which involves incorporating ESG into investment making decisions and sustainability data and reporting, all of which are trust-wide efforts across multiple asset classes. The breadth of the SI team is impressive amongst peers and the depth continues to grow. To this end, the team has made considerable progress towards being fully staffed and continues to work diligently to collaborate across CalPERS to execute on all that falls under the team's remit, which is sizable.

We believe that the Sustainable Investments team is appropriately positioned, reporting directly to the CIO and operating as an integrated part of INVO. The SI MID has now been in the role for several years, effectively leading the team as they execute the initiatives outlined later in this section. Given the strength and size of the team, CalPERS is positioning itself to be best-in-class for sustainable investing.

In recent years, human capital has been a focus for SI, with two critically important advances. First, the Labor Principles were approved by the Board and adopted thereafter last fiscal year. The Labor Principles are incorporated into the CalPERS Governance & Sustainability Principles and are a five-point framework of beliefs that seek to address short-term and long-term labor risks and opportunities. External managers must acknowledge and conform to these principles. Second, meaningful progress was made to refresh the Responsible Contractor Policy (RCP), with updates to the RCP made this fiscal year and the finalized version expected in fiscal year 2026.

Over the past two fiscal years, the SI team worked with the individual asset classes to establish asset class-specific plans, in association with the SI 2030 Strategy. This work involved significant, proactive collaboration across INVO. The asset class plans are foundational as CalPERS looks to invest \$100 billion across climate solutions by 2030. Buy-in was strong and broad-based from the asset classes, as they each developed a robust, comprehensive plan to find and invest in attractive climate solutions to drive strong portfolio returns. Stemming from these plans, the team has continued to commit capital within private markets, with significant progress made this fiscal year and a pipeline that remains robust. Moreover, with the buildout of the SI Private Markets Program and the caliber of the new hires, the ability to evaluate climate investment opportunities is enhanced.

The previous fiscal year saw the development of the CalPERS FTSE Climate Transition Index (CTI). The SI team, in collaboration with the Global Equity team, worked with FTSE-Russell to customize the CTI which seeks to mitigate climate risk and capitalize on the transition to a low carbon economy. The CTI was adopted, following Board approval in June 2024. This fiscal year, the Policy Benchmark reflects the inclusion of CTI within the factor-weighted segment of GPE. While the track record remains limited, since its adoption, the CTI has performed in line with expectations from a return and tracking error perspective.

Another key function of the SI team is the work done with emerging and diverse managers. CalPERS invests in emerging managers in three primary ways: 1) direct (non-intermediary), GP

seeding/staking, and fund of funds. A comprehensive review of the Emerging & Diverse Manager Program took place this fiscal year. The review showcased a strong and evolving commitment from the program to DEI and manager diversification, with an emphasis on the data supporting the alpha opportunities associated with investing in the space. As part of the review, the team conducted a DEI survey, which saw high engagement from managers. Private markets remain the focus of the existing investments with emerging and diverse managers. The team continues to build on the initial efforts of the Mosaic program, collaborating closely with external advisors, including external emerging and diverse manager specialists TPG and GCM Grosvenor, with the goal of enhancing returns by investing in next-generation managers. Beyond the Mosaic program, SI will continue to lead CalPERS Emerging Manager strategy across the private asset classes, supporting implementation through research, engagement, and manager evaluation. Moreover, INVO is actively exploring ways to expand emerging manager investments, similar to its approach in Private Equity, across all private asset classes.

Advocacy remains an area of focus for SI as well, particularly given the current environment where ESG has become controversial. Rather than retreating, CalPERS has continued to be a voice for asset owners who believe sustainability is in alignment with long-term goals and fiduciary duties. We encourage the team to continue to focus on arguments that are financial and data driven.

Under the leadership of the MID and his Investment Directors, CalPERS's SI team is implementing the Board approved SI 2030 Strategy. The SI 2030 Strategy has five primary objectives including: generating portfolio alpha; improving portfolio resilience; implementing a Net Zero plan; promoting greater inclusion and representation; and building and promoting efficient and equitable financial markets. These are ambitious efforts that require frequent and effective collaboration across multiple teams, senior buy-in, along with a sizable team to support the efforts. We believe CalPERS is taking the necessary steps to make significant progress towards these goals, including hiring talent who are contributing to the 2030 Strategy objectives and adding to the team's strength as an industry leader.

Finally, as CalPERS seeks to have a sustainable program, navigating, reporting on, responding to, and capitalizing on the transition to a low carbon economy remain key areas of focus for the organization and the SI team specifically. Here, we note the importance of maintaining a return-driven approach to sustainable investing and having the discipline to refrain from devoting resources to non-return related distractions. This is particularly important given the current environment where sustainability and ESG-related practices have become politicized and have fallen under increased scrutiny. Going forward, we expect the SI team to continue to develop and enhance its SI tracking and reporting capabilities including, but not limited to, tracking performance attribution from climate solutions across all CalPERS' investments. We also anticipate the SI team demonstrating its leadership by sharing best practices with peers, serving as a voice for asset owners in industry initiatives, and leading collaborative efforts that support sustainability-aware policy and advocacy.

Conclusion

In summary, we continue to monitor the stability of the investment organization and believe there remains room for improvement in the overall evaluation score. As for any investment management organization, we would like to see evidence of senior investment team stability and will monitor the CIO-led initiatives. We are optimistic that the CIO's experience in driving strong portfolio results in large institutional portfolios will continue to push the Total Fund in a positive direction.