

# Total Fund Policy Review – Second Reading

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Investment Controls and Operational Risk

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The Investment Team is seeking approval from the Investment Committee regarding the proposed structure, revisions, and repeals, to Investment Policy resulting from the adoption of a Total Portfolio Approach (TPA), and direction from the Board to improve the user experience. This is the second read of the proposed changes presented in the March Committee meeting.

Key updates based on Board feedback in March:

1. CalPERS Statement of Investment Policy (Umbrella)
  - Incorporated pension sustainability into the Policy's strategic investment objective
2. PERF Investment Policy
  - Clarified Active Risk language
  - Increased the frequency of certain reports
  - Added the Reference Portfolio benchmarks

# New Policy Structure

## OBJECTIVES

- Incorporate Total Portfolio Approach
- Enhance user experience
- Design PERF and Affiliate investment policies in accordance with their specific objectives

## STRUCTURAL CHANGES

- Establish overarching Statement of Investment Policy (Umbrella policy) with content from the Total Fund Policy
- Link all investment policies, principles, and beliefs to the Umbrella
- Reorganize existing Total Fund and other investment policy content into a new modular structure
- Stand up a new PERF Investment Policy
- Incorporate all relevant content from Total Fund Policy to Affiliate Fund Policies



# Tracking Changes Approach

## 1. **What has moved but not changed** (no redline).

- Responsible Contractor Program
- Private Equity Outsourcers
- Governance and Sustainability Principles
- Divestment

**Goal:** Change policy only where it is needed or where it is helpful and reflect the changes in the most transparent way possible.

## 2. **What has moved with minor changes** will be shown as clean with redline for new or altered content.

- Affiliate Investment Funds. Content from the Total Fund policy that relates to the funds has been migrated.
- Investment Beliefs. Minor changes to align with a Total Portfolio Approach.
- Statement of Investment Policy. New overarching investment policy using existing Total Fund Policy content.

## 3. **What is new** will be shown in a clean format for ease of reading.

- PERF Policy. This is a new document and designed to reflect good governance under TPA.

## 4. **What will be repealed**

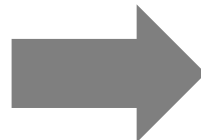
- Total Fund Policy. Each section will be tagged with “moved” or “removed” and a brief explanation.
- Absolute Returns Strategies and Inflation Assets Program policies are no longer necessary under a Total Portfolio Approach.

# PERF Policy | Key Investment Constraints

*From many different risk measurements and limits totaling ~450 bps of active risk leeway to a single Active Risk Limit of 400 bps*

**From**

Strategic Asset Allocation – Asset Class Targets and Ranges



**To**

Reference Portfolio

Multiple total fund and strategy risk limits:  
(Tracking error, duration, credit quality, strategy, or geography)



One Active Risk Limit – 400bps

Total Fund Leverage  
(15% Active + 5% Strategic)



Total Portfolio Leverage Limit – 20%

Deal Requirements  
(Staff Authority Limits, PPOs, exposure limits to a General Partner, or concentration limits to a fund)



No Change

# Summary of Key Changes

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## **Umbrella Policy and Investment Beliefs**

- Updated references to Strategic Asset Allocation, and revised to accommodate a Total Portfolio Approach

## **Affiliate Funds**

- Moved policy benchmarks to individual Fund policies
- Incorporated relevant requirements from the Total Fund Policy

## **PERF**

- New PERF policy was designed to reflect Board adoption of Reference Portfolio and Active Risk Limit
- Added an outline of investment governance, including oversight of allocation and risk management
- Streamlined asset class descriptions and consolidated their reporting requirements and responsibilities into a single list
- Augmented Wilshire and Meketa roles to provide additional oversight on portfolio construction approach and active risk model

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**Repeal and Replace:**

1. Repeal current Total Fund Policy and replace with new CalPERS Statement of Investment Policy and PERF Investment Policy

**Adopt new standalone policy documents (no content changes):**

1. CalPERS Governance and Sustainability Principles
2. CalPERS Divestment Policy

**Adopt proposed content changes to existing policy documents:**

1. CalPERS' Investment Beliefs
2. Public Employees' Long-Term Care Fund Investment Policy
3. California Employers' Retiree Benefit Trust Fund Investment Policy
4. California Employers' Pension Prefunding Trust Fund Investment Policy
5. Legislators' Retirement Fund Investment Policy
6. Judges' Retirement Fund Investment Policy
7. Judges' Retirement System II Fund Investment Policy
8. Public Employees' Health Care Fund Investment Policy
9. Supplemental Income Plans Investment Policy
10. CalPERS Investment Specific Glossary

**Repeal:**

1. Absolute Return Strategies Program Policy
2. Inflation Assets Program Policy

# Appendix

# Investment Beliefs | Summary of Changes

Changes limited to updating beliefs #6 and #10 to align with TPA

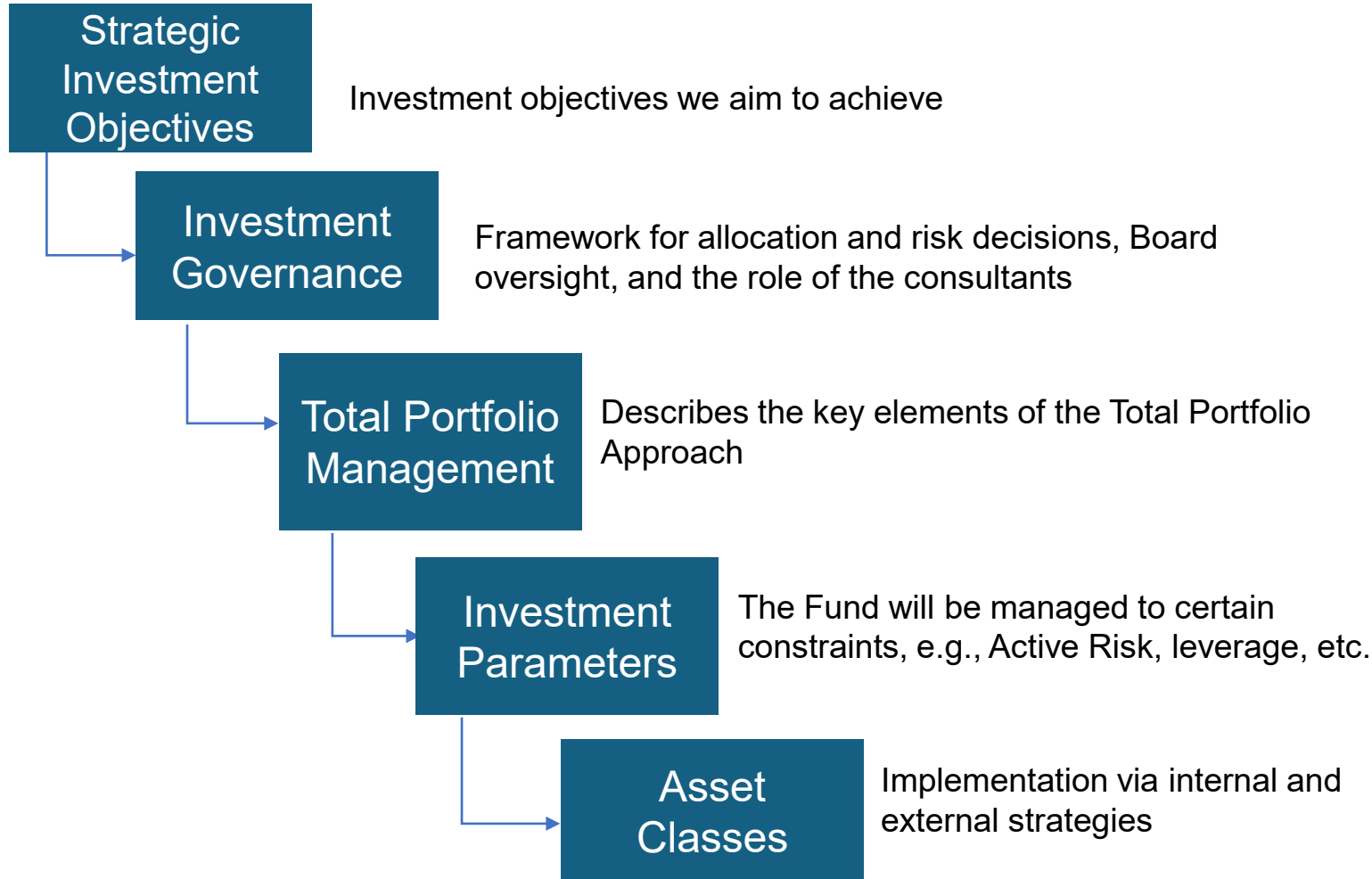
## 6. ~~Strategic~~ Asset allocation is the dominant determinant of portfolio risk and return.

- ~~CalPERS strategic asset allocation process transforms the fund's targeted rate of return to the market exposures that staff will manage.~~
- CalPERS will construct portfolios with the appropriate amount of market risk necessary to achieve its long-term objectives.
- CalPERS will aim to diversify its overall portfolio across distinct risk factors / return drivers.
- CalPERS will seek to add value with disciplined, dynamic asset allocation processes, such as mean reversion. The processes must reflect CalPERS characteristics, such as time horizon and size of assets.
- CalPERS will consider investment strategies if they have the potential to have a material impact on portfolio risk and return.

## 10. Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives.

- Diversity of talent (including a broad range of education, experience, perspectives and skills) at all levels (Board, staff, external managers, corporate boards) is important.
- CalPERS must consider the government agency constraints under which it operates (e.g., compensation, civil service rules, contracting, transparency) when choosing its ~~strategic~~ asset allocation and investment strategies.

## Structure Logic



## Table of Contents

- I. Introduction
- II. Strategic Investment Objective
- III. Investment Governance
  - A. Strategic Investment Parameters
  - B. Investment Policy and Delegation and Authority
  - C. Allocation Governance and Investment Management
  - D. Oversight and Transparency
- IV. Total Portfolio Management
  - A. Reference Portfolio
  - B. Value-Add and Active Risk
  - C. Portfolio Construction
  - D. Investment Risk Management
- V. Investment Parameters
  - A. Active Risk Measurement and Limit
  - B. Leverage
  - C. Liquidity
  - D. Derivatives and Counterparty Risk
  - E. Additional Constraints and Limitations
- VI. Implementation
  - A. Total Fund
  - B. Global Equity
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  - D. Real Assets
  - E. Private Equity
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  - G. Opportunistic and Innovation
- VII. Terminated Agency Pool
- VIII. Reporting and Responsibilities
- IX. Investment Constraints and Limitations
- X. Policy Document History
- Appendices