

May 27, 2026

Mr. Kevin Palkki
Chair of the Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95811

Re: Agenda Item 5a: Total Fund Policy Review – Second Reading

Dear Mr. Palkki:

At the March meeting, Wilshire provided an opinion letter on the project to restructure the Total Fund Investment Policy to align with the Total Portfolio Approach (TPA). The recommended modular approach to policy aims to enhance readability and useability by streamlining content and reducing redundancy. This includes introducing a central umbrella CalPERS Statement of Investment Policy that will link to other fund investment policies, governance and sustainability principles, and investment beliefs.

Since the first reading in March, Staff has made several substantive edits in response to Board feedback. All other content presented in the first reading remains unchanged. Wilshire has reviewed each of these revisions and confirms they are appropriate and consistent with prudent governance.

The changes are as follows:

- CalPERS Statement of Investment Policy (Umbrella): The strategic investment objective has been updated to incorporate long-term pension sustainability. Wilshire supports this revision as it appropriately broadens the framing of the Fund's investment purpose, aligns the umbrella policy with the Board's fiduciary responsibilities, and strengthens the policy's alignment with CalPERS' long-term mission.
- PERF Investment Policy – Active Risk Language: The section covering the Active Risk Limit has been revised with the goal of simplifying the description for the reader of the policy. Wilshire confirms that the language preserves the substance and intent of the active risk governance framework while improving accessibility.
- PERF Investment Policy – Reporting Frequency: The frequency of certain reports has been updated from annually to semi-annually. Wilshire views this as a positive enhancement to Board oversight, providing more timely visibility into portfolio performance and risk.
- PERF Investment Policy – Reference Portfolio Benchmarks: Reference Portfolio benchmarks have been added to the appendix. This addition provides important transparency and allows the Board to clearly evaluate portfolio performance relative to the approved TPA framework.

Discussion

As noted in our opinion letter at the 1st reading, in many cases content from the current Total Fund policy has been moved to the central Investment Policy without change. These include the Governance & Sustainability Principles, Responsible Contractor Program, Private Equity Outsourcers, and Divestment policies. The Board should be confident that the governance established in these policies remains firmly in place.

Staff recommend standing up a new PERF Investment Policy to codify the investment governance around TPA. Strategically, the Investment Committee continues to set the PERF target level of market risk by establishing a Reference Portfolio, along with a limit on active risk. Board consultant roles remain embedded in fund-level governance and tied to specific tools/procedures around active risk modeling, leverage calculations, and benchmark oversight. Notably, the new PERF policy augments the consultant role in oversight on portfolio construction and the active risk model.

Wilshire views this as a meaningful enhancement to the governance framework, ensuring that the Board's consultants have clearly defined responsibilities in the areas most critical to TPA implementation, including how portfolio construction decisions translate into total fund risk and how active risk is measured and monitored.

Regarding active risk oversight, Wilshire would highlight two important points made in the March opinion letter:

- Active risk governance is underpinned by forward looking active risk models. These models are meant to provide a look-through estimate of true economic volatility, accounting for the lower frequency valuations for illiquid assets.
- Realized active risk can look quite different from forward looking active risk estimates. These variances are driven primarily by the valuation lags inherent in private asset markets.

Wilshire supports using forward-looking risk modeling as the primary active risk governance tool, as laid out in the new PERF policy. Wilshire has been actively engaged in discussions around the risk modeling process to ensure appropriate procedures are in place to govern the use of active risk in driving strong portfolio returns. These procedures include a description of the active risk model, key assumptions, inputs and data sources, and the calculation methodology. It is worth noting that the procedures specify the use of a 3rd party risk model as a primary input to provide a measure of independence in the active risk calculation. Wilshire believes these procedures are robust and ready for the official launch of TPA in July.

Going forward, the policy provides for consultant review of the key inputs into the active risk model, including funding mixes, equity equivalent exposure (EEE), and strategy benchmarks, as well as review and approval of the pertinent portfolio-related procedure guidelines. Wilshire has independently assessed strategy funding mixes based on our own capital market assumptions and believe them to be reasonable. We have also examined sensitivity analysis of the active risk modeling given underlying assumptions around equity exposure and correlation estimates. We believe this analysis supports the analytical rigor of the risk modelling methodology.

As the Board's general consultant, Wilshire examines proposed policy changes through the lens of reinforcing Board governance and ensuring the appropriate tools and reporting are in place to drive strong portfolio results. This policy project codifies the governance structure and guardrails necessary to successfully implement the Board approved change to TPA for the PERF, while continuing to manage the

Affiliate Funds under the strategic asset allocation framework. Wilshire has provided regular input during this project to ensure a high level of Board governance is maintained under the new structure. **Overall, Wilshire affirms that the revised policy structure aligns with a robust governance framework.**

The process of updating the investment policies supports 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 #6 – CalPERS will take risk only where we have a strong belief we will be rewarded for it.
- 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

This second reading reflects targeted refinements that are responsive to Investment Committee feedback and strengthen the proposed policy framework. Wilshire has reviewed the proposed revisions in detail, including the substantive changes made since the first reading. We believe that the changes promote effective governance and further implementation effectiveness under TPA. Please do not hesitate to contact us should you require anything further or have any questions.

Regards,



Thomas Toth, CFA

Managing Director, Wilshire Advisors