

Asset Liability Management: Timeline, Concepts, and Framework

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Investment Committee
February 16, 2021

Our Objectives: Constitution of California

SEC. 17.

The State shall not in any manner loan its credit, nor shall it subscribe to, or be interested in the stock of any company, association, or corporation, **except that the State and each political subdivision, district, municipality, and public agency thereof is hereby authorized to acquire and hold shares of the capital stock of any mutual water company or corporation when the stock is so acquired or held for the purpose of furnishing a supply of water for public, municipal or governmental purposes; and the holding of the stock shall entitle the holder thereof to all of the rights, powers and privileges of the stock as such holder is entitled to by law upon other holders of stock in the mutual water company.**

fiduciary responsibility

Notwithstanding any other provision of law or this constitution to the contrary, the retirement board of a public pension or retirement system shall have plenary authority and **fiduciary responsibility** for investment of moneys and administration of the system, subject to all of the following:

(a) The retirement board of a public pension or retirement system shall have the sole and exclusive responsibility for the assets of the public pension or retirement system and shall invest the assets in a manner that will assure the prompt delivery of benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.

assure prompt delivery of benefits

(b) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, **minimizing employer contributions** and their beneficiaries' expenses.

minimizing employer contributions

(c) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a **prudent person acting in a like capacity** and familiar with the business would exercise.

prudent person acting in a like capacity

(d) The members of the retirement board of a public pension or retirement system shall have the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system.

(f) With regard to the retirement board of a public pension or retirement system which includes in its composition elected employee members, the number, terms, and powers of such members, as otherwise in effect on July 1, 1991, shall not be changed, unless the change is made by an act of the Legislature which is enacted by the Legislature and is ratified by a majority vote of the electors of the jurisdiction in which the participants of the system are or were, prior to retirement, employed.

maximize the rate of return

(g) The Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section.

minimize the risk of loss

(h) As used in this section, the term "retirement board" shall mean the board of directors, or other governing body or board of a public employees' pension or retirement system; provided, however, that the term "retirement board" shall not be interpreted to mean or include a governing body or board created after July 1, 1991 which does not administer pension or retirement benefits, or the elected legislative body of a jurisdiction which employs participants in a public employees' pension or retirement system.

(Sec. 17 amended Nov. 3, 1992, by Prop. 162. Initiative measure.)

CalPERS Investment Strategy

1. Design a portfolio with the realistic expectation over the long term (decades), of paying benefits while prudently ‘minimizing’ contributions. This portfolio is the focus of the ALM program.
2. Prudently manage portfolio risk of loss over the medium term. (years)
3. Invest opportunistically to add value.

ALM Objectives

1. Deliver a small number of candidate long term portfolios, each designed to balance the objectives and risks of the CalPERS pension system over the long term.
 - a) Candidate portfolios having a reasonable expectation of delivering 7%
 - b) Candidate portfolios with risk and return characteristics differing from those in (a)
2. Understand the demographic, economic and financial uncertainties affecting our candidate long term portfolios and, knowing our choice will likely be 'wrong' for future circumstances, explore the extent of our potential disappointment.
3. An ongoing process to monitor and review our choice and assumptions.

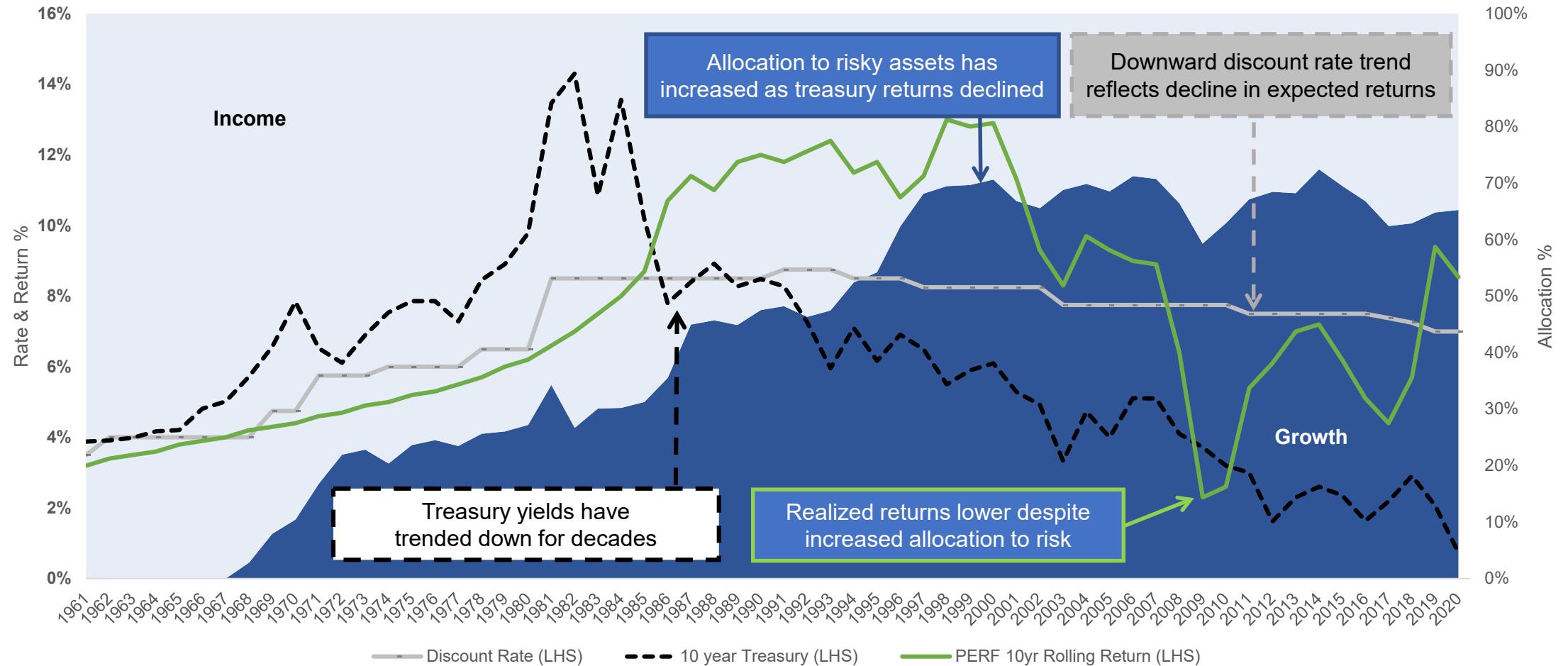
Risks to Achieving our Objectives

ALM process will focus on assessing and managing these risks:

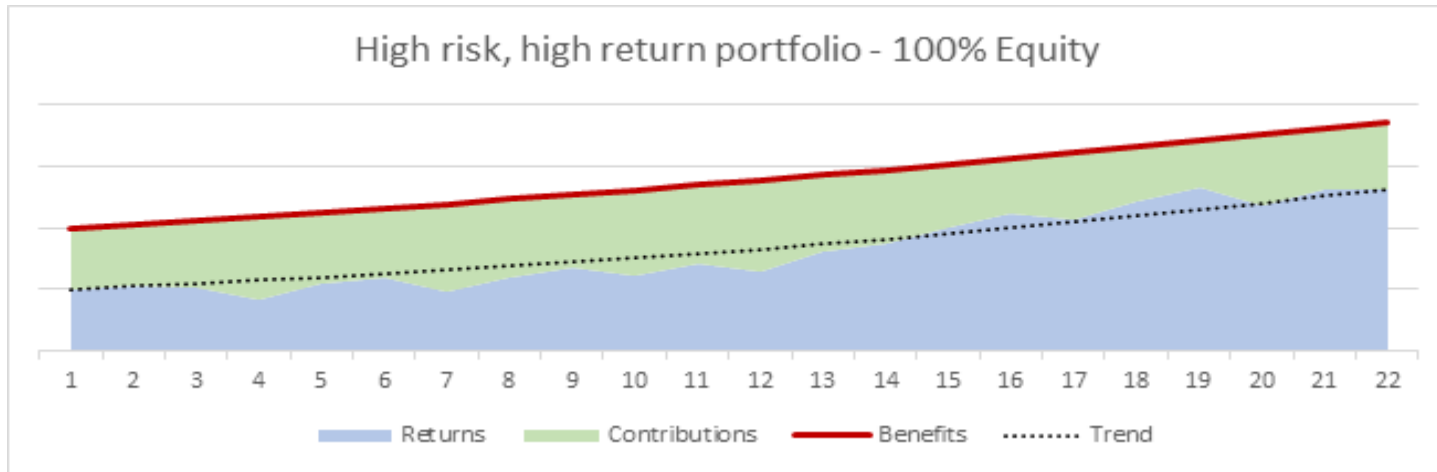
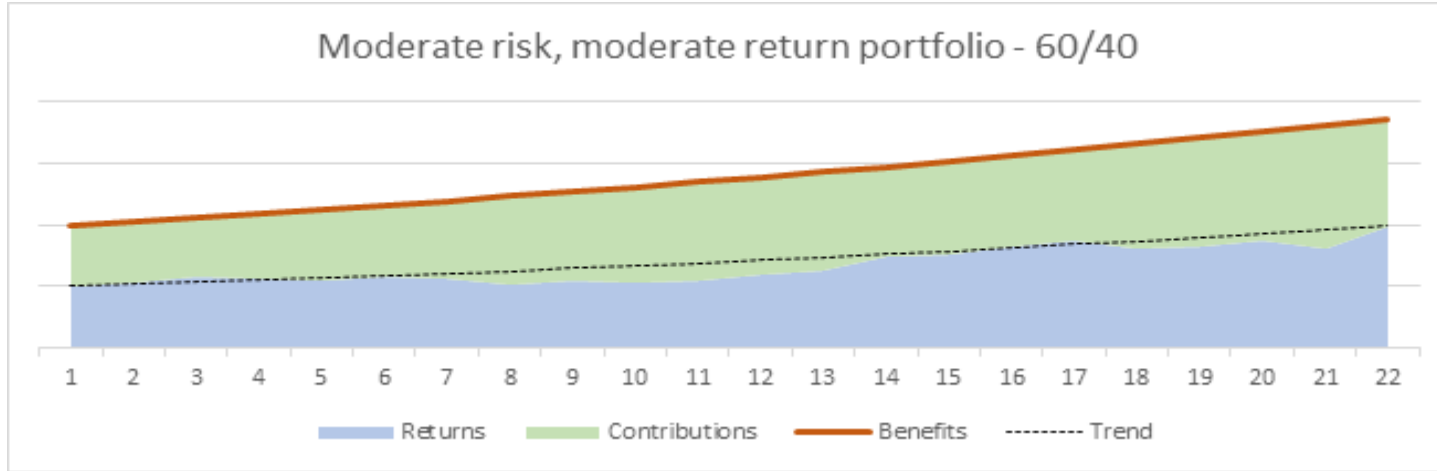
- Insufficient liquidity
- Contributions becoming excessive and/or overly variable
- Exceeding our capability to prudently execute our investment strategy
- Long term systematic risk factors
- Excessive drawdowns, diminishing the capacity of our portfolio to serve as a buffer for future contributions
- Sensitivity to assumptions

Our ALM process will consider a range of potential outcomes.

Reward to Risk is Trending Lower



Stylized Portfolios – Illustrating Key Risks



	60/40	100
Long term return trend	Lower	Higher
Return variability	Lower	Higher
Long term contribution trend	Higher	Lower
Contribution variability	Lower	Higher

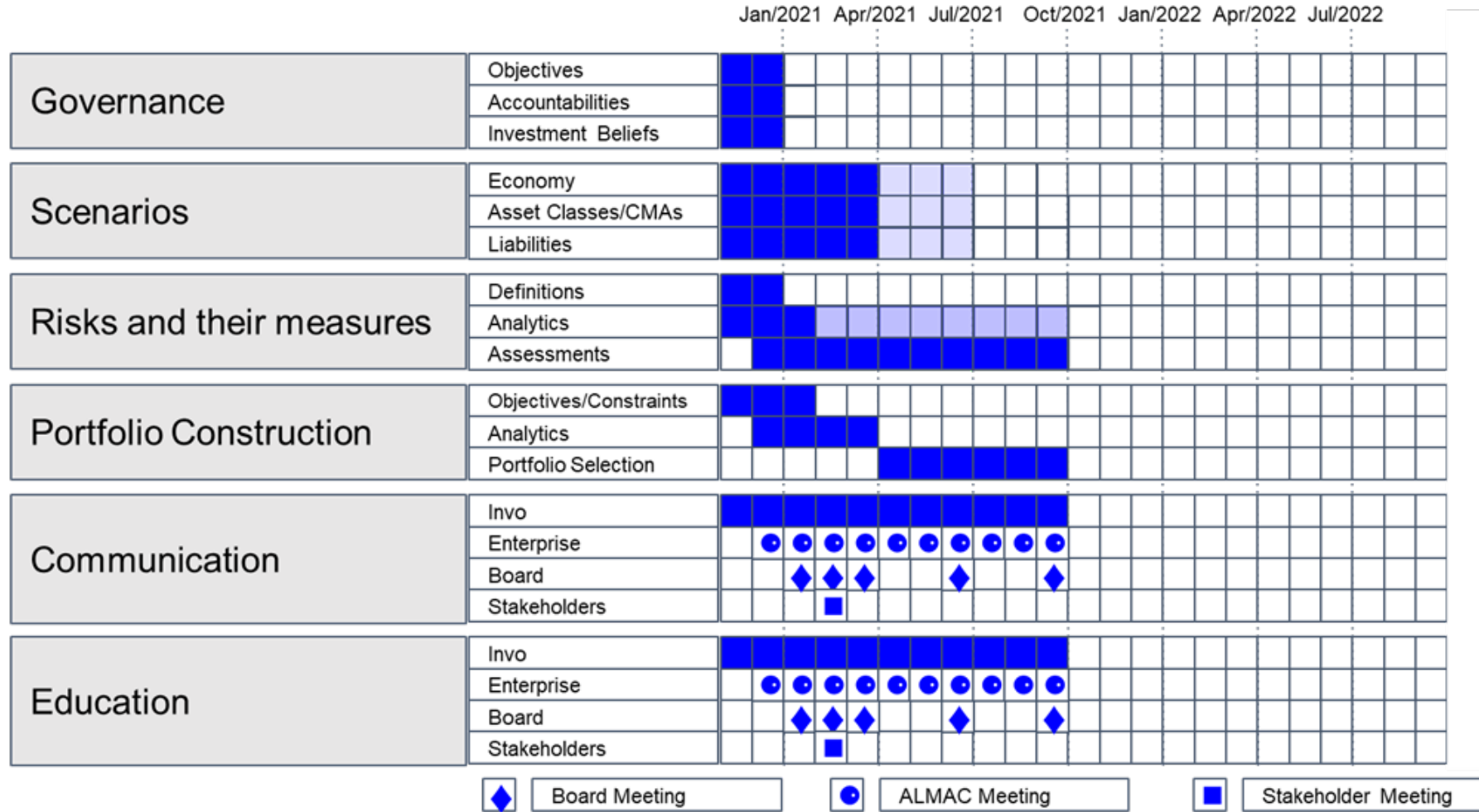
ALM Program 2021

- Governance: objectives, accountabilities
- Scenarios: projections of possible demographic, economic, and financial futures
- Risks: risks to achieving our objectives, and how to measure them
- Portfolio construction: process of building and selecting a portfolio aligned with objectives
- Education: helping achieve shared understanding of CalPERS objectives and ALM process
- Communication: managing the ways we can deliver information and gain stakeholder input

Guiding principles

- Risk is multi-faceted
- Risk is more certain than returns
- Reality will differ from our Capital Market Assumptions
- Discount rate and risk are linked
- Construct portfolios based on risk, and assess return implications
- Select a portfolio from candidates with acceptable risks

The ALM Program – Prospective Timeline



Appendix

Constitution of California, Article XVI, Section 17

SEC. 17.

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Notwithstanding any other provisions of law or this Constitution to the contrary, the retirement board of a public pension or retirement system shall have plenary authority and **fiduciary responsibility** for investment of moneys and administration of the system, subject to all of the following:

(a) The retirement board of a public pension or retirement system shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will **assure prompt delivery of benefits** and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.

(b) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, **minimizing employer contributions** thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.

(c) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a **prudent person acting in a like capacity** and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.

(d) The members of the retirement board of a public pension or retirement system shall diversify the investments of the system so as to **minimize the risk of loss** and **to maximize the rate of return**, unless under the circumstances it is clearly not prudent to do so.

(e) The retirement board of a public pension or retirement system, consistent with the exclusive fiduciary responsibilities vested in it, shall have the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system.

(f) With regard to the retirement board of a public pension or retirement system which includes in its composition elected employee members, the number, terms, and method of selection or removal of members of the retirement board which were required by law or otherwise in effect on July 1, 1991, shall not be changed, amended, or modified by the Legislature unless the change, amendment, or modification enacted by the Legislature is ratified by a majority vote of the electors of the jurisdiction in which the participants of the system are or were, prior to retirement, employed.

(g) The Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section.

(h) As used in this section, the term "retirement board" shall mean the board of administration, board of trustees, board of directors, or other governing body or board of a public employees' pension or retirement system; provided, however, that the term "retirement board" shall not be interpreted to mean or include a governing body or board created after July 1, 1991 which does not administer pension or retirement benefits, or the elected legislative body of a jurisdiction which employs participants in a public employees' pension or retirement system.

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