CalPERS Profile

The California Employees’ Retirement System (CalPERS) is the nation’s largest public pension fund with assets at June 30, 2005 of approximately $189 billion.

Headquartered in Sacramento, CalPERS provides retirement and health benefit services to more than 1.4 million people and more than 2,500 public employers. The System also operates eight Regional Offices located in San Francisco, Glendale, Orange County, Fresno, Sacramento, San Bernardino, San Diego, and San Jose.

CalPERS is led by a 13-member Board of Administration, consisting of member-elected, appointed, and ex officio members.

Our membership consists of 1,016,982 active and inactive members from the State, school districts, and local public agencies, and 425,094 retirees, beneficiaries, and survivors. Established by legislation in 1931, the System became operational in 1932 for State employees only. In 1939, public agencies were allowed to contract with CalPERS to provide retirement benefits for their employees. We began administering health benefits to State employees in 1962 under the Public Employees’ Medical and Hospital Care Act. Local public agencies joined in our Health Program on a contract basis five years later.
I am honored to serve as president of the CalPERS Board of Administration, and I am pleased to present this CalPERS Operations Summary and Comprehensive Annual Financial Report showing our accomplishments for fiscal year ended June 30, 2005.

The Board welcomed three new members in 2005: Ron Alvarado, representing the State Personnel Board; Marjorie Berte for the insurance industry and Tony Oliveira, as the Board representative of local government.

Fiscal year 2004-05 was a demanding year. There were efforts to replace defined benefit plans with defined contribution plans.

We responded vigorously to this challenge. We provided education to members and stakeholders about the advantages of a defined benefit plan. We demonstrated that defined benefit plans do much more than provide retirement and health security to public workers.

Such plans are a key thread in the State and national economy. CalPERS invests more than $20 billion in California. If defined benefit plans for public employees were eliminated, skilled and talented individuals would have less motivation to work in vital State jobs or in equally essential local public service positions throughout California.

I am pleased to report that we more than met our investment objectives this fiscal year, posting a 12.3 percent return. This exceeds our actuarial assumed rate of return of 7.75 percent and the 9.53 percent median rate of return for all large pension funds with assets exceeding $1 billion for the same time period (reported by the Trust Universe Comparison Service®).

In keeping with our mission, we continue to take our fiduciary responsibility seriously. We are undertaking a focused corporate governance agenda plan to advocate an end to exorbitant corporate executive compensation plans and to press for the use of pay-for-performance standards. We recognize that the way we deploy investment capital can shape the financial future of our investment portfolio, but also the future of our communities, our society, and our environment for decades to come. In doing so, we have launched several environmental initiatives that marry finance and the capital markets with public purpose. Our goals are to achieve positive financial returns, while fostering sustainable growth and sound environmental practices.
We continue to work diligently to fulfill our mission and meet our obligations to employers. Because we understand our employers’ need for more stability in their contributions, we enacted a plan that will provide significant relief. We continue to explore options to lessen the financial burden on employers without compromising the quality and security that our members have been promised.

In the health care arena, our efforts to rein in the drivers of health premium costs are showing results. We negotiated the lowest average premium increase since 1999 for our members, and those increases were significantly less than the national average. We are pursuing other actions that will continue to have a positive impact on health care costs. Recognizing that many strands working together are stronger than one, we formed a health benefits purchasers’ coalition.

As always, our Strategic Plan and Three-Year Business Plan create the fabric that shapes our goals and objectives. We are currently undertaking a major re-evaluation of those goals to ensure that they mesh with the changing business, health care, and political world in which we operate.

The strongest threads in the fabric of our organization are the more than 1,800 employees and management staff who strive every day to ensure that we continue to create the value that public employees and employers need. I thank them for their commitment.

The coming fiscal year will present new challenges. We will remain vigilant and continue to do the best job possible to provide retirement and health security to our members.

Sincerely,

Rob Feckner, President
CalPERS Board of Administration
Introduction

In serving our members, we provide value for life by weaving together the many threads that form the fabric of retirement and health security.
Introduction

As the nation's largest public pension system, we are entrusted with safeguarding the financial, retirement, and health security of our more than 1.4 million members.

In serving our members, we provide value for life by weaving together the many threads that form the fabric of retirement and health security. One such thread is the expertise of our employees and consultants who offer members outstanding service and manage our investment portfolio to maximize returns on investments. Another key thread is our use of technology to keep members informed and to efficiently process their benefits. Fostering strong relationships with employers is also a vital part of the value we provide. And, we take an active role in the political and business environments to protect the interests of members, employers, and shareowners.

Throughout the pages of this Operations Summary, you will see the ways in which we knit together all these threads to provide the value and security that our members and employers need. You will also see how our influence and impact are intertwined throughout the State, the nation, and the world.

Although CalPERS manages 14 funds, the Operations Summary highlights the financial activities of the Public Employees’ Retirement Fund, our primary operating fund. Information regarding our other funds is included in our Comprehensive Annual Financial Report (CAFR). The Operations Summary is a supplemental booklet to the CAFR, and both are available on our Web site at www.calpers.ca.gov.
Financial Highlights

Public Employees’ Retirement Fund\(^1\)
(Dollars in Thousands)

<table>
<thead>
<tr>
<th>Assets</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash &amp; Cash Equivalents</td>
<td>$5,399,361</td>
<td>$312,032</td>
</tr>
<tr>
<td>Investments at Fair Value</td>
<td>193,867,878</td>
<td>194,916,574</td>
</tr>
<tr>
<td>Receivables</td>
<td>36,139,100</td>
<td>3,136,877</td>
</tr>
<tr>
<td>Other Assets</td>
<td>352,633</td>
<td>267,510</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>$235,758,972</strong></td>
<td><strong>$198,632,993</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Assets Held in Trust for Pension Benefits</strong></td>
<td>$189,630,881</td>
<td>$167,584,099</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Additions &amp; Deductions</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Additions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Member Contributions</td>
<td>$3,176,781</td>
<td>$2,266,445</td>
</tr>
<tr>
<td>Employer Contributions</td>
<td>5,774,120</td>
<td>4,261,347</td>
</tr>
<tr>
<td>Net Investment Income</td>
<td>21,893,728</td>
<td>24,265,850</td>
</tr>
<tr>
<td>Other</td>
<td>473</td>
<td>6,723</td>
</tr>
<tr>
<td><strong>Total Additions</strong></td>
<td><strong>$30,845,102</strong></td>
<td><strong>$30,800,365</strong></td>
</tr>
</tbody>
</table>

| **Deductions**               |            |            |
| Retirement, Death & Survivor Benefits | $8,434,119    | $7,639,085 |
| Refunds                      | 155,236    | 151,526    |
| Administrative Costs         | 208,965    | 188,361    |
| **Total Deductions**         | **$8,798,320** | **$7,978,972** |
| Increase in Net Assets Held in Trust for Pension Benefits | $22,046,782 | $22,821,393 |

Complete financial information on all the funds administered by CalPERS can be found in the Comprehensive Annual Financial Report for the year ended June 30, 2005.

Note:
\(^1\) Differences in the amount shown for investment assets in these financial highlights and the investment portfolio amount reported in the Investments Section of this summary are due to differences in reporting methods. In accordance with Governmental Accounting Standards Board Statement No. 28, the financial statements include securities lending collateral. In addition net investment receivables/payables are not included here.
The perspectives and skills of our Board Members help create a strong forward-moving organization.
CalPERS Board of Administration

**Rob Feckner, President**  
Employee Member  
(elected by school members)  
Glazing Specialist, Napa Valley  
Unified School District  
*Term Ends: January 15, 2007*

**Robert F. Carlson, Vice President**  
Retired Member  
(elected by retirees)  
Retired, Chief Counsel,  
Department of Transportation  
*Term Ends: January 15, 2008*

**Ron Alvarez**  
State Personnel Board Member  
(designated by the State Personnel Board)  
*Term Ends: Serves at the pleasure of the SPB*

**Philip Angelides**  
State Treasurer  
Ex Officio Member

**Majorie Berte**  
Official of Life Insurer¹  
Vice President, California State Automobile  
Association, Retired  
*Term Ends: January 15, 2009*

**Willie L. Brown, Jr.**  
Elected Official of Local Government¹  
Former Mayor of San Francisco  
*Term Ended: September 15, 2005*

**George Diehr**  
Employee Member  
(elected by State members)  
Professor, CSU San Marcos  
*Term Ends: January 15, 2007*

**Priya Mathur**  
Employee Member  
(elected by public agency members)  
Economist, Bay Area Rapid Transit  
*Term Ends: January 15, 2007*

**Michael Navarro**  
Director, Department of Personnel Administration  
Ex Officio Member

**Tony Oliveira**  
Elected Official of Local Government¹  
Appointed on September 15, 2005  
*Term Ends: January 15, 2007*

**Milo Quevedo, Jr.**  
Public Representative²  
*Term Ends: January 15, 2008*

**Kuwata Shimada**  
Employee Member  
(elected by all members)  
Retired, Supervisor of Operations,  
Oak Grove School District  
*Term Ends: January 15, 2010*

**Charles P. Valdes**  
Employee Member  
(elected by all members)  
Counsel, Department of Transportation  
*Term Ends: January 15, 2010*

**Steve Westly**  
State Controller  
Ex Officio Member

**Notes:**  
¹ Governor appointee.  
² Appointed jointly by the Speaker of the Assembly  
and the Senate Rules Committee.
In addition to their regular duties, Board Members also serve on permanent and ad hoc committees to review specific programs, projects, or issues and make recommendations to the Board. The following committees were active as of June 30, 2005.

**CalPERS Board Committees**

**Benefits & Program Administration**
*Kuwat Shimada, Chair*
*Rob Feclaner, Vice Chair*
Ron Alvarado
Philip Angelides
Robert F. Carlson
George Diehr
Priya Mathur
Michael Navarro
Tony Oliveira
Steve Westly

This committee reviews all matters related to benefit program structure, actuarial studies and rate setting, retirement program policy, and administrative issues.

**Performance & Compensation**
*Willie L. Brown, Jr., Chair*
(through September 15, 2005)
*Priya Mathur, Vice Chair*
(Chair, from September 15, 2005)
Robert F. Carlson
George Diehr
Michael Navarro
Kurato Shimada
Charles P. Valdes

This committee studies and evaluates compensation mechanisms and criteria, develops policies and procedures, and makes recommendations to the Board concerning compensation of key personnel.

**Health Benefits**
*George Diehr, Chair*
*Priya Mathur, Vice Chair*
Ron Alvarado
Philip Angelides
Robert F. Carlson
Rob Feckner
Michael Navarro
Charles P. Valdes
Steve Westly

This committee oversees the administration of the Public Employees’ Medical & Hospital Care Act program and the Public Employees’ Long-Term Care Act program.

**Finance**
*Robert F. Carlson, Chair*
*Steve Westly, Vice Chair*
Philip Angelides
Willie L. Brown, Jr.
George Diehr
Priya Mathur
Charles P. Valdes

This committee provides financial oversight on all budget matters, evaluates funding alternatives, oversees preparation and recommends approval of the CalPERS budget, and oversees the CalPERS annual and periodic audits by both internal and external audit units.
**Investment**

**Charles P. Valdes, Chair**

**George Diehr, Vice Chair**

Ron Alvarado  
Philip Angelides  
Marjorie Berte  
Willie L. Brown, Jr.  
(Robert F. Carlson)  
Rob Feckner  
Priya Mathur  
Michael Navarro  
Tony Oliveira  
Mike Quevedo, Jr.  
Kurato Shimada  
Steve Westly  

This committee reviews investment transactions, the investment performance of both internal and external managers, and establishes investment policy and strategy.

**Investment Policy Subcommittee**

**Priya Mathur, Chair**  
**Steve Westly, Vice Chair**

Philip Angelides  
Robert F. Carlson  
Charles P. Valdes  

This subcommittee conducts an inventory of all existing investment policies, procedures, and guidelines for review by the Investment Committee and reviews and recommends revisions to these on a priority basis. It is also charged with developing a manual of policies, procedures, and guidelines, and a process for periodic revisions.

**R Street Subcommittee**

**Charles P. Valdes, Chair**

**Robert F. Carlson, Vice Chair**

Ron Alvarado  
Priya Mathur  
Kurato Shimada  

This subcommittee oversees the CalPERS headquarters expansion project, including the selection of contractors, approval of building designs, and approval of expenditures and budgets.

**Ad Hoc Board Governance Committee**

**Rob Feckner, Chair**

**George Diehr, Vice Chair**

Willie L. Brown, Jr.  
Robert F. Carlson  
Priya Mathur  
Kurato Shimada  
Charles P. Valdes  

This ad hoc committee reviews and recommends to the Board any changes in Board policy that the committee deems appropriate to enable Board members to improve their ability to perform their fiduciary duties.
Our Executive Staff is committed to advancing the financial and health security for those we serve.

Front row seated (from left to right): Fred Buenrostro, Patricia K. Macht, Curtis Howard, Jarvio A. Grevious, Robert D. Walton, and Ron Seeling.
CalPERS Executive Staff

Fred Buenrostro
Chief Executive Officer

Gloria Moore Andrews
Deputy Executive Officer
Operations

Jarvis A. Gervais
Deputy Executive Officer
Benefits Administration

Mark J. P. Anson
Chief Investment Officer
Investment Office

Curtis Howard
Assistant Executive Officer
Administrative Services Branch
(Robert D. Walton through April 2005)

Patricia K. Macht
Assistant Executive Officer
Public Affairs

Ken Marzian
Assistant Executive Officer
Actuarial & Employer Services

Peter H. Miron
General Counsel

Ron Seeling
Chief Actuary
Actuarial & Employer Services

Anne Stauboll
Assistant Executive Officer
Investment Operations

Kathie Vaughan
Assistant Executive Officer
Member & Benefit Services

Robert D. Walton
Assistant Executive Officer
Governmental Services

Tami Westbrook
Assistant Executive Officer
Health Benefit Services
Division Chiefs

Richard Attuna
Diversity Outreach Program

Ted Bennett
Pension System
Resumption Project

Chris O’Brien
Human Resources
(Pat Chappie through August 2005)

Sandra Felderstein
Office of Health Decision & Program Support Services

Holly Fong
Office of Employer & Member Health Services
(Curtis Howard through April 2005)

Susan Garret
Strategic Management Services Division

Tim Garza
Innovative Services Division

Greg Hood
Investment Administrative & Operational Services Division

Larry Jensen
Office of Audit Services

Sherry Johnstone
Office of Enterprise Compliance

Ron Kraft
CalPERS Customer Contact Center and Regional Offices

Richard Keohok
Office of Health Policy & Plan Administration

Peter Lai
Technology Services & Support Division

Donna Lau
Benefit Services

Jeff Lung
Office of Information Security

Carol McConnell
Deputy General Counsel

Lori McGarth
Actuarial & Employer Services

Dave Mullins
Supplemental Savings Program

Rick Nelson
Operations Support Services

Lisa Hammond
Office of Governmental Affairs
(Karen Neuwald through July 2005)

Ken Mitchel
Office of Policy & Program Development

Diana Proctor
Headquarters Expansion Project

Russell Fong
Fiscal Services
(Holly Fong through April 2005)

Darryl Watson
Member Services

Regional Office Managers

Anita Commer
San Francisco

June Cappell
San Bernardino

Laura Duan
Orange County

Debra Gibson
Sacramento

Edith Mercer
Glendale

Elwin Nash
San Jose

Evelyn Perez
Fresno

Jean Walker
San Diego
Year in Review

We are customer-focused, and our decision-making process is threaded by value and quality.
The Year in Review

Focused on Value.

We operate in a complex political and economic environment. Many intertwined agendas and issues can create challenges for us. Our commitment to our mission, reflected in our Strategic Plan, keeps us focused on our primary lines of business and creates the pattern for the activities of our organization and employees.

During fiscal year 2004-05, the essential fabric of defined benefit plans like CalPERS was threatened by efforts to replace such plans with defined contribution plans. We met this challenge by becoming an important educational resource.

Our dedication to our mission — to advance the financial and health security of our members — was the driving force behind our response to this challenge. To help unravel the confusion about the two types of plans, CalPERS executive staff traveled throughout California to meet with various member and employer groups to educate them about the defined benefit/defined contribution issue.

We also established an online Pension Debate Information Center to keep our members and employers abreast of developments on this very important issue and to provide information from CalPERS experts and others outside the System. The information demonstrated why defined benefit plans are vital to the retirement security of our members. The threat to defined benefit plans has lessened for now, but we will remain vigilant and continue to oppose legislation that will negatively impact our members’ retirement security.

Serving Our Members

Efficiently processing benefits is one way we provide outstanding service to all our members. This year, we continued to enhance our benefit management and services to provide faster, more reliable service, while maintaining our core workload and meeting business demands.

Our staff responded to increasing workloads in several areas of our member benefits program. We processed 26,321 new service retirements, an increase of more than 3,000 over last year. We paid more than $8.4 billion in retirement, death, and survivor benefits, also an increase over last year. In addition, 97 percent of newly-retired members received their first checks within 30 days of retirement.

We also processed 25,705 requests for refunds and provided those funds to members within 30 days. Staff also processed 50,459 requests for direct deposit of retirement checks.

Recognizing that disability fraud increases costs for everyone, we took active steps to crack down on such fraud. We launched a Disability Fraud Tip Line that allows self-identified or anonymous callers to report CalPERS members suspected of misrepresenting their disabilities to collect retirement benefits. We are also pursuing legislation to improve the definition of fraud and to establish penalties for committing such fraud. This fiscal year, staff completed 2,938 disability determinations.

In fiscal year 2004-05 member requests for retirement estimates remained about the same as the previous year, processing 98,897 estimates. Our eight Regional
Offices assisted 61,214 walk-in visitors and scheduled 4,768 appointments. In addition, our field representatives completed 727 educational sessions at employer sites. We also conducted more than 1,500 financial planning seminars and retirement planning workshops for our members.

Demonstrating our commitment to our members, we established a dedicated team that successfully eliminated the backlog of Additional Retirement Service Credit requests. The backlog was created by the popularity of a January 2004 legislative provision that allowed our members to purchase up to five years of service credit. We also responded to legislation enacted in 2005 by developing processes to implement a new Domestic Partner provision, which provides certain retirement and health benefits to legally registered domestic partners.

Providing Customer Service
This past year, we continued to advance one of our primary objectives — providing high-quality customer service. We recognize that our Customer Contact Center and Regional Offices are the primary conduits for members to obtain information and assistance. To improve consistency and continuity of service to our members, our Regional Offices are now part of the Customer Contact Center. This change in management structure enables us to have a single point of contact for customer service. Staff from both areas receive the same training and have access to the same tools to assist members. Given the challenge of the changing language demographics in our State, we also made advancements in the way we serve our members. We employ a cadre of 80 employees who are bilingual. These employees speak 18 different languages other than English.

Both members and employers can call one number — (888) CalPERS (or 888-225-7377) — to obtain assistance. Our Interactive Voice Response (IVR) system routes member calls to our Customer Contact Center and employer calls to our Employer Contact Center. Highly-trained staff are available to respond to questions. This past year, we enhanced the IVR to include synonyms, and we adjusted the voicemail tree to provide the most common subjects up front.

This was the first full year of our Quality Assurance Program, which was established to ensure that we meet our customer service objectives. Calls were monitored and rated based on key factors, including knowledge of CalPERS benefits and programs and timely processing of requests. We are pleased to report that customer satisfaction scores increased from 76 percent at the start of the program to a score of 96 percent this past fiscal year.

Many of our actions this year provided new ways for members to obtain information about retirement and health issues. More than three million visitors accessed CalPERS On-Line, and as our site grows in popularity, we continue to enhance its capabilities.
The Year in Review

One new feature is our Health Plan Chooser, which enables members to compare and rate plans based on cost, quality, services, and the availability of doctors. A new toolbar allows members to print, increase text size, and bookmark a page at the click of button. And, members can now view streaming video on a variety of subjects, right from their computers. Video topics include creating a retirement strategy, prescription drugs, and our Home Loan Program.

While regular distribution of the CalPERS member newsletter continues, current and recent issues are now available online. Members, employers, and other interested parties can stay informed about our activities by subscribing to our new eNews and ePress Releases.

We further improved educational resources through the consolidation of 22 member benefit publications into four comprehensive benefit booklets.

Retirement Planning Month is a popular annual event that we hold to educate members about their CalPERS defined benefit plan, Social Security benefits, and options for growing their own personal savings. This year’s event focused on the need for members to properly plan for retirement to ensure they have the resources to maintain their desired standard of living.

As part of our goal to make these events accessible to as many members as possible, we expanded the number of sites to 13 locations throughout the State, including our eight Regional Offices. This year, we piloted mini-seminars on CalPERS On-Line at three of the fairs. The seminars were well attended, and we are researching ways to provide more seminars for the 2006 Benefits and Resources Fairs.

Most attendees received a free CalPERS Member Network video, which addressed the defined benefits/defined contribution debate and health benefits. Members met with staff and experts from other retirement-related programs to learn about effective retirement planning and to get answers to benefit questions. They also learned about other CalPERS programs, such as our Member Home Loan and Long-Term Care Programs. Retirees received special information to help them continue to plan for a secure future.

CalPERS Supplemental Savings Program

This program is one more thread in the fabric of retirement security that we offer members. Through this voluntary program, local public agency and school members can make contributions that will enhance their retirement security.

Retirement Program Highlights

- **1,016,982** active & inactive members
- **425,094** retirees, beneficiaries & survivors
- **27,748** new service & disability retirees
- **$8.4 billion** paid in benefits
- **2,582** public agency employers (including school districts)
Our CalPERS Public Agency 457 Deferred Compensation Program, which is available to local public agency and school members, welcomed an additional 2,123 new participants and 35 new agencies this past fiscal year. The program now has 19,455 members and 524 participating employers. Assets totaled $442.8 million at year end, a 19.3 percent increase from the previous year. Contributions and transfers received were $158.4 million, investment gains of $21.8 million and $108.7 million was paid to participating plan members for distributions and withdrawals. This increase in distributions was due primarily to our members converting their CalPERS 457 Program account balances to purchase up to five years of Additional Retirement Service Credit to enable them to retire earlier and/or with a higher benefit.

The State Peace Officers’ and Firefighters’ Defined Contribution Program realized plan growth for its 34,922 participants. This employer-paid program is available to Correctional Peace Officers. Net assets increased by 27.4 percent to $236.8 million at June 30, 2005. Benefits paid out during the year were $5.4 million and contributions increased 1.2 percent to $41.4 million.

The CalPERS Supplemental Contributions Program is a voluntary supplemental savings plan available to State members and is entirely member funded. Contributions are made on an after-tax basis. At the end of fiscal year 2004-2005, there were 930 participants and net assets were valued at $20.5 million. Contributions were $0.5 million for the year, and $2.2 million was paid in participant withdrawals.

CalPERS Member Home Loan Program

Owning a home is a dream for most families, and our Member Home Loan Program has helped members realize that dream for 24 years. We have offered our members security, protection, and choice when purchasing or refinancing a home.

Available nationwide, our program continued to offer our members free 60-day interest rate protection coupled with two float-down opportunities. This feature allows most members to receive the lowest interest rate as of the date of lock-in, date of loan approval, or date the loan documents were drawn. The program controls lender closing costs (including points that brokers charge) and offers a very competitive rate on the variety of loan options.

CalPERS Member Home Loan Program funded 3,933 real estate loans totaling $771,884,059 last fiscal year.
The Year in Review

Connecting with our Employers
During the past fiscal year, our Board approved an Employer Rate Stabilization Policy presented by the CalPERS Chief Actuary. The new policy provides our employers with pension contribution stabilization; it spreads the System’s market value asset gains and losses over 15 years rather than the previous three years, and widens the “corridor” limits for establishing the actuarial value of assets from 90-110 percent of market value to 80-120 percent of market value. These policy changes will reduce significant swings in employers’ pension costs caused by investment return volatility. It will also allow for our employers to better plan for the expense in their government budgets from year to year.

In addition, we provided special Actuarial and Health seminars at various employer sites throughout California. The Actuarial portion of our seminars addressed topics on contribution rate volatility, rate stabilization, a preview of 06/07 rates, and how pooling adds smoothing and simplicity. In our Health seminars, we provided highlights of our Health Benefits Program. These included a background overview, program features, membership eligibility, vesting, employer costs, and regional health plan premiums for contracting agencies.

In the fall, we hosted our fifth annual Educational Forum in Anaheim, California. The Forum provided education and information to our contracting employers and allowed our employers to share their thoughts and voice their concerns to our Board Members and staff. Employers also had the opportunity to meet one-on-one with their actuary and visit 17 exhibit booths representing CalPERS programs.

More than 580 employer representatives participated in our three-day event. Its theme, “Strong by Design,” emphasized the strength that makes CalPERS a truly unique organization since its inception more than 70 years ago. Not only did the theme refer to the strength derived from our close collaboration with employers, but also to the design of our retirement and health benefit programs, that have endured the test of time.

In our Employer Contact Center (ERCC), customer service remained a key focus for our staff. During the year, our ERCC provided service to more than 103,000 callers on their initial point of contact with us. In addition, we completed the Interactive Voice Response (IVR) enhancements by adding synonyms and adjusting the voicemail tree to provide the most common subjects from callers up front in the system, which reduced the average IVR time by nearly two minutes.

We continued our employer education efforts, including training and education on our business functions and programs. We conducted 194 workshops, which provided education to more than 1,728 employees from 723 State, public agencies, and schools districts. We also added more services to 360 employers on our Automated Communications Exchange System (ACES).
ACES allows our employers to submit electronic health benefit, membership, and payroll transactions via the Internet. This online business system significantly reduces the volume of paper we receive. These paperless transactions allow us to post in a more timely fashion, providing employers with faster services.

During the year, staff mailed 2,038 public agency annual valuation reports and 1,599 Annual Employer Statements on schedule; we processed more than 69,000 membership enrollments and over 52,000 State member transactions submitted by employers; 46,000 payrolls; and also completed more than 190 public agency contract amendments. Staff performed more than 3,700 member record compensation reviews — a seven percent increase from the previous fiscal year. In addition, staff assisted our Investment Office with coordinating our first-ever Institutional Investors’ Cleantech Conference. Attending were more than 300 representatives from public pension funds, endowments, and institutional investors.

Enhancing Our Organizational Effectiveness

Many different strands woven together make CalPERS a strong and effective organization. These include our technology, our security and compliance with necessary regulations, and our leadership and staff. This past year, we took a variety of actions to strengthen the fabric of our organization.

The Corporate Online Member Employer Transactions Project called for the creation of one unified repository for housing all pension information needed by CalPERS and our business partners. Our new Pension System Resumption Project envisions CalPERS becoming a “virtual” pension system that uses the Internet as a primary channel for conducting business and processing transactions.
The Year in Review

Information security has always been a top priority at CalPERS. We have a special internal team whose sole responsibility is to weave a web of protection around all our computer systems to ensure the safety of confidential information. Through the conscientious efforts of our employees and the use of high-level anti-virus software, we prevented nearly 30,000 viruses a month from invading our computer system. In addition we blocked more than 100,000 SPAM messages a month from reaching staff’s desktops, blocked 41 significant cyber attacks directed at our System, and investigated 43 fraudulent personal identification number registrations.

Additional protection is provided by our internal and field audit programs. Our Office of Audit Services ensures that programs, policies, and other legal requirements are met. During the year, the office completed 38 public agency audits, provided consultation on 16 more projects, conducted 24 internal audits, and completed six health plan and 17 real estate audits, and other contracted audits. As a further check on compliance with internal policies and external regulations, in 2004, we established an independent Office of Enterprise Compliance. The office monitors CalPERS business activities and procedures to assure that all program areas comply with necessary requirements.

As a public institution serving the nation’s most ethnically diverse state, we have a moral obligation to provide equal employment opportunity and equal business opportunities. To strengthen that commitment, we launched a Diversity Outreach Program, which will weave diversity into core areas of staff training and hiring, contracting, and investing. Action steps are incorporated into top management objectives. All employees participated in the training “Living CalPERS Core Values: Appreciating Diversity and Preventing Harassment.”

We are initiating strategies to ensure that opportunities to contract with CalPERS are available to a variety of entities. And, we are taking steps to bring diversity into our investment portfolio in ways that mesh with our investment goals.

Our employees are an important part of the quality of service we provide. By investing in our staff, the results will be satisfied employees who have the knowledge and skills to provide outstanding service to our members and employers. To ensure that members receive consistent and accurate information, we established an Education Development and Implementation Team to enhance our internal educational programs. We also offer staff development classes which include a variety of core topics as well as electives designed to mirror CalPERS business needs, methodology, and best practices.

Preparing for future leadership needs is vital to maintaining organizational effectiveness. Our Succession Management program, which began last year, moved ahead with a workforce assessment that

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CalPERS Benefits Paid
Five-Year Review
(Dollars in Billions)

<table>
<thead>
<tr>
<th></th>
<th>'01</th>
<th>'02</th>
<th>'03</th>
<th>'04</th>
<th>'05</th>
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<tbody>
<tr>
<td>Benefits Paid</td>
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<td>$6.4</td>
<td>$6.9</td>
<td>$7.6</td>
<td>$8.4</td>
</tr>
</tbody>
</table>

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identified critical leadership positions and established a framework to ensure that we have the necessary talent to fill the positions. We are also developing ways for experienced staff to pass on their wisdom prior to leaving the organization. In this way, the threads of knowledge will be connected from one generation of leaders and staff to the next.

Recognizing our connection to the larger community, our employees participated in a variety of local nonprofit organizations and community charitable events. Thanks to the dedication of staff, our 2004 contribution to the California State Employees’ Charitable Campaign increased 9.7 percent over 2003. For the fourth consecutive year, we were the State agency donating the largest amount of food — 134,063 pounds — to the State Employees’ Food Drive. Our employees also gave 323 pints of blood through several blood drives. And, a team of more than 70 walkers — including employees, family, and friends, participated in the March of Dimes WalkAmerica, raising nearly $25,000 for the charity.

**Headquarters Expansion**

Our Headquarters Expansion Project is complete. We opened our second and third building in the fall of 2005 to accommodate our increased size and complexity and to accommodate our need for advanced technology to serve our 1.4 million members and 2,582 employers.

The three-building complex accommodates today’s need for office space and our future needs for the next twenty years. The complex is wired for cost effective, efficient trading and for quality customer service, enabling us to provide a one-stop shop for Sacramento regional members to handle retirement and health questions. The new complex provides sufficient space and efficiencies to help sustain quality service now, and into the future.

Our new building complex received the U.S. Green Building Council’s stamp of approval for leadership in energy and environmental design. We have applied for the Council’s silver LEED (Leadership in Energy and Environmental Design) status. The LEED Green Building Rating System® is a voluntary, consensus-based national standard for developing high-performance, sustainable buildings.

**Feedback and Recognition**

Recognizing our employees for their dedication and hard work is important. At our annual ceremony on May, 21 employees were honored as 2005 APEX nominees. The APEX (Achieving Performance Excellence) is our peer-driven formal recognition program that acknowledges employees who demonstrate commitment to CalPERS core values and customer service principles, excellent technical and interpersonal skills in pursuit of self-development, and the overall success of CalPERS. More than 350 employees received an ACE (Achieving Communication Excellence) award.

In addition, our Chief Executive Officer Fred Buenrostro and Board President Rob Feckner received the California Environmental Leadership award from Global Green USA. The Global Green Millennium award was given to CalPERS for its environmental leadership in investing and contributing to a sustainable and secure future.

We were also awarded the “Certificate of Achievement for Excellence in Financial Reporting” for the eighth consecutive year. And finally, for the first time, the Government Finance Officers Association granted CalPERS the “Award for Outstanding Achievement in Popular Annual Financial Accounting.”
Health for Life

Providing focus and leadership to influence the evolution of changes in health care.
CalPERS Health & Long-Term Care

Willing To Do Things Differently.

The Value Proposition
A key thread in weaving health security for our members is value: obtaining quality care at affordable prices. In today’s challenging health care market, pursuing value is vital to ensuring sustainable health benefit programs that are responsive to our members and employers.

In the 2004-05 fiscal year, we achieved improved returns for our health care dollars through efforts to restrain premium increases and enhance the quality and safety of patient care. Significant cost increases were averted by the introduction of a new hospital network for members of Blue Shield, aligning premiums for public agencies more closely to regional marketplace costs, and encouraging the use of cost-effective prescription drugs. We realized additional savings by moving more Medicare-eligible enrollees from Basic to Medicare supplemental plans. At the close of the fiscal year, our self-funded preferred provider plans (PPOs), PERS Choice and PERSCare, remained strong.

The ‘Value Proposition’ was also evident in other parts of our health benefits administration. We planned new assessments to identify effective disease management programs. The Rural Health Task Force explored how to expand member access in areas not served by health maintenance organizations (HMOs). The Long-Term Care Program responded to market needs by adjusting its plan options, investment of asset allocations, and underwriting criteria to maintain strength of the program.

The Market Picture
Our commitment to value enabled us to perform well in the marketplace compared with other U.S. employer purchasers. The 2005 premiums for our Basic plans increased by 11.4 percent for HMOs, an average of 6.4 percent for PPOs, and 6.8 percent for Association plans. Medicare plan premiums fell by 10.7 percent for HMOs and 12.5 percent for PPOs. Medicare plan premiums rose by 0.5 percent for Association plans.

By comparison, analysts projected HMO premium increases averaging 13.7 percent for major U.S. purchasers in 2005. While many purchasers lowered projected increases by drastically reducing benefits and raising copays, CalPERS did not. Most of our 1.2 million enrollees experienced no major changes in copayments for office visits and prescription drugs in 2005.

Health Program Highlights

- 1,190,212 employees, retirees & family participants
- 62 percent are State members
- 38 percent are public agency & school members
- $4.0 billion paid in annual health premiums
Although the cost spiral subsided, marketplace inflation for all U.S. employer purchasers, including CalPERS, was still three times higher than increases in employee wages. Industry analysts attributed much of the continuing cost pressure to extra services for an aging population, new technology and pharmaceuticals, health care wage growth, consolidations of hospitals and other providers, and increased payments to doctors.

To keep pace with the difficult and changing market, our Board adopted several new and expanded strategic initiatives in December 2004. The initiatives include continuing to evaluate the effectiveness of health plan programs in disease management and high-intensity case management; establishing specialized services such as Centers of Expertise and telemedicine; and addressing member engagement and incentives. All these initiatives are tied to our goals of lowering cost and/or improving value, improving stability, providing meaningful choice, and assuring high quality.

### Disease Management and High Intensity Case Management Programs

Our plan partners provide various disease management and preventive health programs for chronic conditions such as asthma, cholesterol management, congestive heart failure, coronary artery disease, diabetes, and depression.

We planned new assessments to identify the most effective programs. Assessments focused on detailed disease prevalence, program structure, program processes, member participation, and clinical and utilization outcome data. Our CalPERS Data Warehouse evaluated any changes in disease prevalence to identify the potential need for additional disease management programs. Results from the 2005 Health Plan Member Satisfaction Survey and other quality measures indicated that management of these diseases was improving.

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**Basic HMO Premium Averages**

Percent Decrease or Increase

Based on a weighted average of all CalPERS HMOs
We also explored the feasibility of expanding high-intensity case management for enrollees in the later stages of life or for other members requiring extraordinary medical services. Blue Shield extended, for another three years, a pilot program to provide educational and psychosocial support to patients diagnosed with certain late-stage illnesses. It expanded the treatment population to include infants admitted into neonatal intensive care units, severe burn victims, and trauma patients with conditions such as brain or spinal cord injuries.

PERS Choice and PERSCare provided individualized case management to members experiencing complex, acute chronic illness or catastrophic injuries. Blue Cross, the medical administrator of these PPOs, used case managers to coordinate, monitor, and evaluate health care options and services. Blue Cross offered a health coaching model to members identified as high risk, and connected them to a multidisciplinary team of health care professionals led by registered nurses. Teams included dieticians, exercise physiologists, health educators, and social workers to address members’ needs. This model focuses on helping members set individual goals to manage their health conditions and guide them through behavioral changes.

Kaiser Permanente provided similar care to its members through an integrated delivery system. Using clinical information to identify member results, Kaiser reported that its disease management approach had achieved dramatic health improvements for patients and reduced hospitalization rates for diabetes, heart failure, and coronary artery disease. Emergency room visits for asthma also declined for CalPERS members, contributing to premium savings.

Specialized Services
Our plan partners operated Centers of Expertise (COE) programs, which required enrollees to receive specified surgeries at hospitals that have the best performance records. Organ transplants and non-emergency coronary artery bypass grafts were performed at COEs for members of Blue Shield, Kaiser, PERS Choice, and PERSCare. Blue Shield planned to initiate bariatric surgery COEs by mid-2006 in Southern California and Statewide by the end of 2006.

To help members in underserved rural areas, the CalPERS Rural Health Task Force explored ways of improving access to specialists and other services. One such method includes telemedicine, which uses high-speed communications technology to provide patients and their primary care doctors with long-distance links to specialists. Blue Cross planned to offer about 90,000 PERSCare and PERS Choice Basic plan members with services in selected rural areas beginning January 1, 2006. Options for
extending telemedicine to Medicare members will be explored later. Members in rural areas would receive access to designated specialists (including dermatologists, cardiologists, neurologists, and psychiatrists) through existing local telemedicine programs. They would travel to local sites where primary care doctors could present their cases to specialists via live video conferencing or specialized “store-and-forward” software, which captures x-rays and other information for later review.

**Member Engagement Efforts**

We stepped up our member engagement effort by launching the successful Health Plan Chooser Tool, an online decision-making resource to help enrollees choose the best health plan for their needs. The Web tool includes advanced search features, pop-up guides, and physician profiles.

By mid-2005, Phase II of our Member Engagement Initiative was released — the CalPERS Health Wallet, a credit card-sized folder with plastic sheaths to hold cards for emergency telephone numbers, medical conditions, and prescription drug information.

Also in the works were plans that offer potential member incentives to participate in health improvement ventures like Blue Shield’s Healthy Lifestyle Rewards Program. The program offered cash incentives to nearly 1,000 CalPERS members for making lifestyle changes and reducing health risk factors. Ninety-two percent of participants indicated success in achieving healthier lifestyles.

**Rate Relief for 2006**

Adoption of the exclusive Blue Shield-CalPERS Provider Network averted some $31 million in additional costs in the 2005 contract year. The Health Program’s 1,142 public agencies and schools paid varying premiums under the new regional pricing formula, which averted $40 million in added Program cost. The plan also prevented the threatened exodus of agencies in the South, where market health care prices are lower than in the North. Incentives for members to use over-the-counter prescription drugs, where appropriate, and mail-order refills for long-term maintenance drugs saved another $27 million.

Shifting Medicare-eligible members from Basic to Medicare supplemental plans saved almost $19 million.

We factored those economies into our 2006 rate negotiations completed in mid-June 2005, when our Board approved the smallest HMO rate increase for Basic plan members since 1999. Premiums would be 8.7 percent higher in 2006 — nearly 3 percent lower increase than in 2005. By comparison, industry consultants projected preliminary HMO premium increases of 12.4 percent over what U.S. insurers paid in 2005. After negotiations and plan changes, actual premium increases were expected to fall by a few percentage points. But unlike many of those plan sponsors, CalPERS planned no benefits or copay changes.

Overall, premiums would go up by 9.5 percent for Basic plans of our PPOs and by 8.3 percent for HMO’s three affiliated public safety association plans. On average, premiums would decrease 7 percent for HMO Medicare-supplement plans and increase 18.6 percent for PPO Medicare members.

PERS Choice and PERSCare experienced positive cash flows in 2004 and finished the year with strong asset levels. That trend continued into the first two quarters of 2005 with assets equal to or exceeding 150 percent of reserve requirements for Basic and Medicare supplemental plans. Positive cash flows confirmed that the rates approved for the 2006 plan year would be sufficient to finance benefits and maintain adequate reserves.
New Hospital Initiatives

In February 2005, our Board approved two initiatives to promote performance transparency, manage hospital reimbursements, and ensure a high-value hospital network. The first initiative established a Hospital Reimbursement Project to assess hospital performance and manage hospital reimbursements. The second initiative set up a process to ensure that a high-value hospital network would be available to our members through review of performance criteria and application of objective standards to determine which hospitals would be included in the Blue Shield-CalPERS Provider Network.

These initiatives became the CalPERS Partnership for Change: Promoting Value in Hospital Care, a long-term effort to improve quality, patient safety, and the cost-effectiveness of California hospitals. By mid-2005, plans were in place for recruiting dozens of major purchasers to form a coalition. We also prepared to contact some 450 public and private purchasers of health care to attend a fall conference on hospital quality and reimbursement issues.

In a partnership with Pacific Business Group on Health, CalPERS planned a working group to develop standardized efficiency measures for adoption by all Partnership for Change participants, and to be used in negotiations with hospital providers. Representatives of the California HealthCare Coalition and the State’s top four network-type health plans — Blue Cross, Blue Shield, Health Net, and PacifiCare — will assist the working group.

CalPERS also endorsed the California Hospital Assessment and Reporting Task Force Phase 1 Project, a coalition of purchasers, health plans, hospitals, and consumer stakeholders formed to develop a standardized, universal performance report card for California hospitals.

PPOs Target RX Pricing

Moving for fuller disclosure of prescription drug pricing, we issued groundbreaking contract requirements for the pharmacy benefits manager for our self-funded health plans. A three-year contract will take effect on July 1, 2006 to provide prescription drugs to more than 297,000 PERSCare and PERS Choice members. Contract terms include a fiduciary role for the pharmacy benefits manager that require it to ensure that its formulary has drugs of the highest quality and value and to list pharmaceuticals based on sound clinical findings. The bid proposal also required unprecedented transparency of information about pricing and operations.

Long Term Care Program

We provide members additional value for life through our Long-Term Care Program. More than 175,000 California public employees, retirees, spouses, parents, parents-in-law, and adult siblings are enrolled in the program, which began providing fi nancial protection from the high cost of extended care in January 1995. Heading into the next decade, we approved the program’s fi rst major revision of underwriting criteria and reallocation of assets to reduce risk from stock market swings — while maintaining investment returns. Our 10-year-old Long-Term Care Program began its annual application period in May 2005 with new plan options and rates.

In past years, the not-for-profits, self-funded program offered three plans with differing benefi ts and premiums for care in nursing homes, assisted living facilities, and in the home and community. Beginning in 2005, the Long-Term Care Program added a six-year option to current three-year and lifetime coverage options, and daily basic allowance choices of $130, $150, $170, $200, and $250, with infl ation protection for those who selected it. Program subscribers receive benefi ts when they are unable to perform at least two activities of daily
living without help — for example, dressing, bathing, or eating. The previous benefit threshold was three activities.

Three main plans continued with differing benefits and premiums for care in nursing homes, assisted living facilities, and in the home and community. The Comprehensive Plan, preferred by more than two-thirds of enrollees, offered personal care, temporary (respite) help for care-givers who need time off, and hospice care. The plan also provided home health aid, adult day care, assisted living/residential facility services, and nursing home care.

The Nursing Home/Assisted Living Facility-Only Plan covered respite and hospice care, and nursing home or assisted living care. The Partnership Plan also provided comprehensive coverage including respite and hospice care, and the plan contained a Medi-Cal asset protection feature.

CalPERS offers the nation’s first self-funded, not-for-profit long-term care program. We will continue to provide plans that are competitive with the commercial marketplace.

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### Long-Term Care Program Highlights

- **173,807** participants
- **$1,441** average annual premium
- **$242.4 million** in annual premium income
- **$64.1 million** paid in benefits

### LTC Program Membership by Member Type

1. Active Employee Spouses - **14.1%**
2. Parents - **3.6%**
3. Siblings - **0.5%**
4. Active Employees - **44.9%**
5. Retirees & Spouses - **36.9%**

### LTC Membership by Plan Type

1. Facilities Only Plan - **21.7%**
2. Partnership Plan - **4.2%**
3. Comprehensive Plan - **74.1%**
Investments for Life

Weaving the best retirement and financial security possible for our members and their beneficiaries for years to come.
CalPERS Investments

Managing Our Investment Portfolios Cost Efficiently Without Sacrificing Quality.

CalPERS Investment Portfolio

Hits Record High

CalPERS earned a 12.3 percent investment return for the one-year period ended June 30, 2005, raising our portfolio’s market value to a record $189.8 billion. For the second straight year, we achieved double-digit returns, exceeding our actuarially assumed rate of return of 7.75 percent.

We surpassed industry benchmarks in three out of five major asset classes, and added $23.5 billion to the fund. Nearly $2.5 billion of that amount was generated by our investment staff’s value added decisions, taking advantage of unique market opportunities that presented themselves during the year.

Our performance was good news for our members, employers, and taxpayers. These strong returns, combined with our new employer rate smoothing policy, will result in more stable and potentially lower employer contribution rates in the future for the State and public agencies.

Our investments in real estate, private equity, and international stocks were the main performance drivers during the year. The greatest single asset class rate of return was our real estate portfolio, which is largely office, retail, apartment, and industrial assets. It returned nearly 30.2 percent, more than double the NCREIF benchmark, which earned 15.6 percent.

Our Alternative Investment Management Program, which specializes in private equity and venture capital holdings generated the second highest rate of return at 23.1 percent, exceeding its benchmark of 12.2 percent.

Growth of Investment Portfolio

at Market Value
Five-Year Review
(Dollars in Billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
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<td>$148.8</td>
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<td>'04</td>
<td>$166.4</td>
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<tr>
<td>'05</td>
<td>$189.8</td>
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Performance Benchmarks

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Benchmark</th>
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<tbody>
<tr>
<td>Global Fixed Income</td>
<td>Lehman Long Liability Index</td>
</tr>
<tr>
<td></td>
<td>Lehman World Government Bond Index, ex U.S.</td>
</tr>
<tr>
<td></td>
<td>(Net Italy Tax)</td>
</tr>
<tr>
<td>Equity</td>
<td>PERS Wilshire 2500 Tobacco-Free Index</td>
</tr>
<tr>
<td>Domestic</td>
<td></td>
</tr>
<tr>
<td>International</td>
<td>PERS SSGA Custom Index</td>
</tr>
<tr>
<td>Alternative Investments</td>
<td>Venture Economics Custom Young Fund Universe</td>
</tr>
<tr>
<td>Real Estate</td>
<td>NCREIF Property Index</td>
</tr>
</tbody>
</table>
International stocks earned 17.5 percent compared with the benchmark of 16.9 percent, while absolute return strategies had an 8.4 percent return, exceeding the benchmark of 6.7 percent.

Our corporate governance funds that target ailing public companies also performed well, posting a 20.4 percent return. Global fixed income investments returned 10.8 percent, a bit short of the benchmark of 10.9 percent, while domestic stocks earned 7.3 percent, just shy of the 7.6 percent benchmark.

### CalPERS Asset Allocation
(Dollars in Billions)

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Market Value</th>
<th>Current Allocation</th>
<th>Current Target</th>
<th>Previous Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Equivalents</td>
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<td>1.3%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Global Fixed Income</td>
<td>$49.1</td>
<td>25.9%</td>
<td>26.0%</td>
<td>26.0%</td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic</td>
<td>$75.6</td>
<td>39.8%</td>
<td>40.0%</td>
<td>39.0%</td>
</tr>
<tr>
<td>International</td>
<td>42.2</td>
<td>22.2%</td>
<td>20.0%</td>
<td>19.0%</td>
</tr>
<tr>
<td>Alternative Investments/Private Equity</td>
<td>9.4</td>
<td>4.9%</td>
<td>6.0%</td>
<td>7.0%</td>
</tr>
<tr>
<td>Total Equity</td>
<td>$127.1</td>
<td>66.9%</td>
<td>66.0%</td>
<td>65.0%</td>
</tr>
<tr>
<td>Total Real Estate</td>
<td>$11.0</td>
<td>5.8%</td>
<td>8.0%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Total Fund</td>
<td>$189.8(^1)</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Notes:
\(^1\) Target allocation effective January 1, 2005.
\(^2\) Differences between investment values above and the values on the Summary of Investments on page 79 of the CAFR are due to differences in reporting methods. The Summary of Investments includes Net Investment Receivables/Payables.
CalPERS Investments

At the end of the fiscal year, 66.9 percent of the CalPERS portfolio was invested in public and private equity, 25.9 percent in bonds and other fixed income, and 5.8 percent in real estate.

Investment Policy & Strategy

Asset allocation is one of the most important decisions the CalPERS Board of Administration makes. The way in which we diversify stocks, bonds, real estate, and other investments determines our long-term performance. Studies have shown that approximately 95 percent of variation in pension plan investment performance is attributable to the asset allocation policy.

The asset allocation plan is the working framework for the selection and weighting of asset classes. The CalPERS Board sets a strategic asset allocation policy and a range around the target allocations. The allocation reflects the long-term outlook for each asset class. Our Board sets tactical asset allocation ranges that enable investment managers to take advantage of buying or selling opportunities and provide the flexibility for day-to-day management.

A Closer Look at AIM

Portfolio Diversification by Strategy

<table>
<thead>
<tr>
<th>Portfolio Strategy</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Corporate Restructuring</td>
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<tr>
<td>Distressed Securities</td>
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<tr>
<td>Expansion Capital</td>
<td>16</td>
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<tr>
<td>Mezzanine Debt</td>
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<tr>
<td>Secondary Interests</td>
<td>3</td>
</tr>
<tr>
<td>Special Situation</td>
<td>3</td>
</tr>
<tr>
<td>Venture Capital</td>
<td>21</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

The CalPERS asset allocation mix is decided following an extensive review of a variety of factors. Analysts simulate economic scenarios for global financial markets and consider future liabilities and expected future contributions by employers.

CalPERS Investment Performance Goals

In addition to setting overall asset allocation policies, the Board establishes investment policies for each portfolio and annual performance benchmarks for each asset class. These policies are formally reviewed through the Board's Investment Policy Subcommittee and receive final approval by the Investment Committee. Our investment policies are posted on our Web site at www.calpers.ca.gov.

Alternative Investment Management (AIM) Program

Our private equity investments earned a 23.1 percent return for the one year period ended June 30, 2005. We made $4.5 billion in new commitments during the year, with an eye toward renewing relationships with existing top quartile partners who participate in our portfolio. We also expanded the portfolio overseas to provide greater international diversification. Our primary focus was investments in Europe and Asia.

We successfully launched our Environmental Technology Program, which will target investments in environmental technology solutions that are more efficient and less polluting than existing technologies. This includes recycling; minimizing the use of natural resources; and reducing emissions, refuse, and contamination to air, water, and land.
We committed up to $145 million in five new early-stage clean technology funds that will focus on investments in water, advanced materials, and clean energy sectors. Our goal is to achieve positive financial returns, while fostering sustainable growth and sound environmental practices.

The AIM Program has earned more than $7.2 billion in cash since it began in 1990. Approximately 52 percent of our investments have generated 80 percent of the Program’s total returns. Distressed securities, corporate restructuring, and secondary interest investments have outpaced other investment styles, earning double digit returns since inception.

At the end of the year, we completed a strategic review of the AIM Program designed to enhance the Program’s overall effectiveness, capabilities, and long-term performance. We will be implementing some of the key recommendations in the coming year, which include reducing the number of investment relationships in our portfolio, leveraging third parties to access investments in the small- and mid-size market, and transitioning our internal staff to a more vertical organization.

**Real Estate**

Real estate was the strongest thread in our investment portfolio, earning a 51.4 percent return before fees. This was the highest one-year period return on record for the portfolio.

The strong performance was driven by unprecedented market prices paid by buyers of quality core real estate assets in the United States. We sold more than $6 billion in apartment, industrial, office, and retail properties last year, locking in substantial gains and earning attractive returns.

The shift from core assets to higher returning investments allowed us to expand the portfolio into opportunistic and international investments. Last year, we invested approximately $3 billion in 25 new funds that targeted investments in areas such as distressed real estate, residential and retail development in international markets, and low-income housing.

During the year, we teamed up with Shea Homes, the nation’s largest privately-owned homebuilding and residential land development company, to design and build master planned communities primarily oriented to active adults over age 55. We invested $200 million to build active adult communities in California, Colorado, Arizona, and Washington. Our capital will develop Shea’s “Trilogy” brand communities, which include 1,200 to 2,500 home sites within a golf course resort community. They are designed and developed to offer buyers a full range of amenities together with their new homes, including fitness centers, ballrooms, libraries, cyber cafes, tennis courts, swimming pools, and continuing education programs.

In the coming year, we expect to complete a strategic review of our real estate portfolio to help manage the impact of shifting from core assets to more specialized investments. The challenges that we expect to address include greater complexity due to higher volume of investment programs; currency, legal, and political risks from international investment exposure; and the need for enhanced technologies to track and monitor our investments.
**CalPERS Investments**

**A Closer Look at Real Estate**

Investments & Commitments
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Core Real Estate</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Private</td>
<td></td>
</tr>
<tr>
<td>Apartment</td>
<td>$1,341.6</td>
</tr>
<tr>
<td>Industrial</td>
<td>2,306.4</td>
</tr>
<tr>
<td>Office</td>
<td>513.5</td>
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<tr>
<td>Retail</td>
<td>2,880.6</td>
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<tr>
<td>AFL-CIO Building</td>
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<td>Investment Trust</td>
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</tr>
<tr>
<td>CIM Urban REIT</td>
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</tr>
<tr>
<td>Public (REITs)</td>
<td></td>
</tr>
<tr>
<td>PREES - Enhanced Core</td>
<td>94.4</td>
</tr>
<tr>
<td><strong>Total Core Real Estate</strong></td>
<td><strong>$7,261.7</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Specialized Real Estate</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Private</td>
<td></td>
</tr>
<tr>
<td>Agricultural Land</td>
<td>$106.3</td>
</tr>
<tr>
<td>California Urban Real Estate (CURE)</td>
<td>634.6</td>
</tr>
<tr>
<td>Housing</td>
<td>1,099.7</td>
</tr>
<tr>
<td>International</td>
<td>266.4</td>
</tr>
<tr>
<td>Opportunistic Funds</td>
<td>134.3</td>
</tr>
<tr>
<td>Real Estate Technology</td>
<td>548.7</td>
</tr>
<tr>
<td>Senior Housing</td>
<td>297.6</td>
</tr>
<tr>
<td>Timberland</td>
<td>130.6</td>
</tr>
<tr>
<td>Public</td>
<td></td>
</tr>
<tr>
<td>Catellus</td>
<td>179.7</td>
</tr>
<tr>
<td>PREES - Extended Market</td>
<td>283.1</td>
</tr>
<tr>
<td><strong>Total Specialized Real Estate</strong></td>
<td><strong>$3,680.9</strong></td>
</tr>
<tr>
<td><strong>Total Real Estate</strong></td>
<td><strong>$10,942.7</strong></td>
</tr>
</tbody>
</table>

**Note:**

1 Differences between investment values above and the values on the Summary of Investments on page 79 of the CAFR are due to differences in reporting methods.

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**Global Public Markets**

**Global Equity**

Our internally managed equity portfolios benefited from several accomplishments last year. We launched a developmental portfolio that is designed to allow CalPERS staff to create new strategies and implement new investment ideas. We began managing a small portion of our passively managed international equity investments in-house. We expanded and improved the management operations of our internal enhanced equity portfolio to ensure efficiency and mitigate risks. We also made significant improvements in our equity order management system to complement CalPERS enterprise-wide compliance goals.

Performance in our externally managed equity portfolios improved during the year. We trimmed back and eliminated some underperforming managers and initiated multiple pools to provide a more flexible investment management structure.

Ten investment managers were chosen to be part of a pool that will manage up to $6 billion in U.S. equity enhanced index strategies. We expect enhanced indexing to help us squeeze a little more active return out of our investment portfolio and round out our global equity investment strategy opportunity set. To enable us to respond more quickly to developments in today’s rapidly changing marketplace, we also selected eight managers to be part of pools that will manage international equity enhanced index strategies and international active management.

Finally, as part of our environmental investment program, we invested $75 million in the iShares KLD Select Social Index Fund managed by Barclay’s Global Investors. The Fund seeks to maximize exposure to large capitalized companies that have positive social and environmental characteristics, while at the same time maintaining risk and return characteristics.
Global Fixed Income
Last year we adopted a policy for investing in emerging market debt based on the credit ratings issued by major rating agencies, Moody’s, Standard & Poor’s, and Fitch. In evaluating credit risk, these agencies look at country economic factors as well as political risk, transparency, and labor practices.

Today, we invest in debt issued by national governments in their local, emerging markets, and in debt of emerging market sub national governments and corporations, only if it carries a BBB- rating or higher. A minimum rating of BB- is required for the debt of national governments issued in developed markets. Under the policy, our investment managers can invest in global debt in China, Colombia, Egypt, Indonesia, Morocco, and Russia.

We believe the use of credit rating systems is an effective and sound process for investing in foreign debt because ratings reflect a full evaluation of a country’s sovereign risk.

We also launched our National Credit Enhancement Program, to assist municipalities in California and elsewhere in accessing the bond market more efficiently by leveraging CalPERS size, experience, and expertise. The program will generate fee income for the pension fund.

Our securities lending program — which lends billions of dollars in global fixed income and global equities to other institutional investors, including pension funds and mutual funds — generated more than $155 million in profit.

Corporate Governance
We launched two major corporate governance initiatives during the year. They were aimed at reining in abusive compensation practices in corporate America and shining light on corporate environmental liabilities.

The CalPERS Board approved a three-year strategic plan to advocate for executive compensation reforms on a national level by addressing issues of transparency and design with the Securities and Exchange Commission (SEC), the financial exchanges, and the compensation consulting industry. As part of the plan, we are working with the SEC on proposed regulations to ensure that publicly-traded companies provide investors with greater transparency about compensation packages.

A Closer Look at Global Public Markets
(Dollars in Billions)

<table>
<thead>
<tr>
<th></th>
<th>Domestic</th>
<th>International</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Income</td>
<td>$43.7</td>
<td>$5.4</td>
<td>$49.1</td>
</tr>
<tr>
<td>Equities</td>
<td>75.6</td>
<td>42.2</td>
<td>117.8</td>
</tr>
<tr>
<td><strong>Total Global Public Markets</strong></td>
<td><strong>$119.3</strong></td>
<td><strong>$47.6</strong></td>
<td><strong>$166.9</strong></td>
</tr>
</tbody>
</table>
## CalPERS Investments

### International Equity & Fixed Income Investments

#### Country Diversification

<table>
<thead>
<tr>
<th>Investment Range</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to $25 million</td>
<td>Argentina, Czech Republic, Cayman Islands, Peru</td>
</tr>
<tr>
<td>$25 to $50 million</td>
<td>Poland</td>
</tr>
<tr>
<td>$50 to $100 million</td>
<td>Chile, Philippines, New Zealand, Thailand</td>
</tr>
<tr>
<td>$100 to $300 million</td>
<td>Austria, Luxembourg, Greece, Hungary, Ireland, Israel, Poland, India</td>
</tr>
<tr>
<td>$300 to $500 million</td>
<td>Belgium, Luxembourg, Norway, Denmark, Singapore, Finland, South Africa, Mexico</td>
</tr>
<tr>
<td>$500 million to $1 billion</td>
<td>Brazil, Hong Kong, Korea, Sweden, Netherlands, Taiwan, Japan</td>
</tr>
<tr>
<td>More than $1 billion</td>
<td>Australia, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Switzerland, United Kingdom</td>
</tr>
</tbody>
</table>

We also plan to engage the self-regulatory organizations and the exchanges to advocate national executive compensation reform. And, we began a dialog with the compensation consulting industry about our preferred compensation philosophies, policies, and practices.

In the coming year, we will publicly target individual compensation committee directors who support egregious pay packages as well as some of the companies in our investment portfolio that have the worst practices. But we won’t always be pointing fingers. We will also recognize corporations that are leaders in designing good compensation packages using pay for performance standards.

On the environmental front, our Board began to take actions to improve transparency and timely disclosure of environmental impacts. We signed on to the Global Carbon Disclosure Project, an international effort to improve the transparency of business risks associated with climate change due to rising levels of greenhouse gases (GHG). We are exploring ways to develop a model GHG reporting project that ensures timely and standardized disclosure of environmental data in the utilities industry. And, we have plans next year to recognize individual companies that demonstrate best practices in environmental data transparency.

We expect environmental corporate stewardship to play a greater role in corporate governance over the next ten years as data on corporate environmental impact will be one of the best sources for investors to measure related investment risks.

Keeping the pressure on other companies in our investment portfolio, we released our Focus List of companies that are the most representative examples of poor financial and governance performance. This year’s list included American International Group, AT&T, Delphi, Novell, and Weyerhaeuser.
In an effort to generate better returns and long-term performance, we pushed a variety of corporate governance improvements at these companies. We also began to engage a select group of companies in our investment portfolio about their business operations in the Sudan. We believe that a company associated with genocide in Sudan poses a serious risk to creating sustainable and responsible long-term value.

Finally, we increased our commitment to investment partners that have a common strategy to improve corporate governance in our capital markets. We committed $500 million to three funds that will target underperforming companies in the United States and Great Britain.

The Role of California Investments
CalPERS investments are a critical thread in the economic fabric of California. Our record of investing in California extends back to the early 1980s, with investments in real estate mortgages and real estate equity. As of June 30, 2005, approximately $20.7 billion was invested or committed for investment in California.

California investments are part of each asset class in our investment portfolio and are expected to deliver a return commensurate with similar investments of comparable risk. Our Board considers California investments — and all other investments as well — on the sole basis of investment merit. Investments must be financially comparable to other available investment alternatives. The CalPERS Board judges comparability on a risk-adjusted basis. Under existing policy, we will accept no less in return, and may incur no additional risk or cost, for a California-oriented investment.

Investments in California may have the ancillary benefit of creating jobs, housing, and improvements to the State’s general infrastructure. More importantly, such investments serve the broad interests of CalPERS members. By strengthening the State’s economy and the well-being of our employers, California investments support the continued ability of employers to make contributions to the System.

Today, we invest nearly $11.6 billion in California companies. These include established publicly-traded corporations and young entrepreneurial businesses that rely on CalPERS private placement capital for growth and expansion. Our fixed income assets, largely held in mortgage pass-throughs, total approximately $2.8 billion. We have earmarked more than $6 billion for housing, real estate development, and redevelopment in urban areas of California. And our Member Home Loan Program, implemented in 1981, has made more than 124,000 real estate loans, totaling more than $19.4 billion.

Members and employers can depend on us to continue to develop effective investment programs that provide value for life.
Legislative Update
Interweaving the legislative changes into the design of our programs.
Legislative Update

Effectively Advocating Our Position on Issues Impacting Our Members.

An important strand in the fabric of services we provide is the impact of State and federal legislation. This past year, the CalPERS Board worked diligently with staff to develop legislative positions and proposals that served the best interests of our members and employers. Through our collaborative efforts with interested stakeholders, we supported or sponsored legislation that provided improvements to our benefits or enhanced program design. The Board uses its Legislative Policy Standards as a guide in formulating positions.

State Legislative Update

The following is a brief summary of some of the CalPERS-related legislation enacted during the first year of the 2005-06 Session of the California Legislature. (New laws become effective January 1, 2006 unless otherwise noted.)

**AB 139, Chapter 74 (Committee on Budget)**

Among other provisions, this bill states the Legislature’s intent that representatives of the Department of General Services (DGS), the University of California, and CalPERS meet regularly and share information regarding the procurement of prescription drugs. DGS is required to report to the Legislature no later than January 10, 2006, and annually thereafter, regarding those collaborative activities.

**AB 256, Chapter 708 (De La Torre)**

Requires the CalPERS Board to conduct a study to examine the feasibility and cost-effectiveness of creating a single statewide health care pool that would cover all public school employees working in school districts, county offices of education, community colleges, and entities established by those school employers, as specified. The study will also address the alternative possibility of including all school employees under PEMHCA. Results of the study will be reported to the Legislature. The bill states that the study is contingent upon the ability to secure or budget for funding to cover the costs. The bill also expands the definition of “local sheriff” to include district attorney investigators for Solano County.

**AB 277, Chapter 288 (Mountjoy)**

Removes the January 1, 2006 sunset provision in the Bagley-Keene Open Meeting Act statute that authorizes a State body to hold closed sessions to consider matters posing a threat of criminal activity against State personnel or property, where disclosure of this information could compromise their safety. It also authorizes the CalPERS Board to hold closed sessions when considering matters relating to the development of rates and competitive strategies for the Long-Term Care Program.

**AB 587, Chapter 527 (Negrete McLeod)**

States that an employee, annuitant, or family member enrolled in Medicare Part D may not be enrolled in a CalPERS health benefit plan. The bill does not apply to an individual receiving coverage through the Medicare Advantage Program.

**AB 1044, Chapter 322 (Aghazarian)**

Provides that an elected public official convicted of a felony involving a bribe; embezzlement, extortion, or theft of public money; perjury; or conspiracy to commit any of these crimes, shall forfeit all rights and specified benefits under any public retirement system in which they are a member. Forfeiture would be limited to benefits accrued during or on account of the office held when the offense occurred.
**AB 1045, Chapter 532 (Frommer)**
Requires each hospital to compile a list of the 25 most common inpatient and outpatient procedures, grouped by Medicare diagnostic-related groups, and submit that list to the Office of Statewide Health Planning and Development (OSHPD). OSHPD is then required to post the information on their Web site. With the exception of emergency services, the bill requires that upon the request of a person without health coverage, hospitals provide a written estimate of charges for the services, procedures, or supplies that are reasonably expected to be provided to the person by the hospital. Information about financial assistance programs and charity care must also be provided.

**SE 439, Chapter 258 (Sim jemand)**
Amends the California Public Records Act to establish a clear standard for the scope of private equity investment information that is subject to public disclosure by public retirement systems.

**SB 973, Chapter 418 (Kuehl)**
Allows members who retired before the establishment of the domestic partnership registry to qualify their domestic partners for survivor continuance benefits. The bill also clarifies the administration of domestic partner community property settlements to ensure compliance with federal law. And, it eliminates PEMHCA provisions that discriminate against domestic partners in the provision of health benefits.

**SB 1108, Chapter 22 (Committee on Judiciary)**
Makes technical, nonsubstantive changes in various provisions of law to effectuate recommendations made by the Legislative Counsel to the Legislature.

**Federal Legislative Update**
Social Security was expected to be the big issue in Washington, D.C. in 2005, but fierce opposition, and an even fiercer Hurricane Katrina, stalled the effort by President Bush and some congressional Republicans to make personal investment accounts a part of the program.

The president had hoped to make the partial privatization of Social Security the centerpiece of his second term, but Democrats strongly opposed it. Other groups, including CalPERS, also rejected the notion of replacing a portion of Social Security’s guaranteed benefits with investment accounts. While GOP leaders had hoped to bring an overhaul package...
to a vote in Congress in the fall, those plans were shelved as lawmakers focused on providing relief for victims of Hurricane Katrina and investigating the federal government’s initial response to the disaster.

The window of opportunity for Social Security reform has probably closed for some time. For our members and other public employees not covered by Social Security, observers believe this means that the government pension offset (GPO) and windfall elimination provision (WEP) will probably not be revised soon.

In addition, with no solution in place to solve Social Security’s long-term funding problem, the possibility remains that Congress will eventually force all newly-hired State and local workers to participate in the program in order to increase revenues. This is a move that some key lawmakers have declined to rule out. (CalPERS submitted a statement for the record of a June 9, 2005 House Ways and Means Social Security Subcommittee hearing urging lawmakers to support GPO and WEP reform and oppose mandatory coverage and partial privatization of Social Security.)

Lawmakers had also hoped to pass a pension reform package that would revise funding rules for private sector pensions after several large companies declared bankruptcy and shifted their pension liabilities onto the federal government’s Pension Benefit Guaranty Corporation. In the House, Republicans had intended to attach a pension bill to Social Security reform legislation, but given the fate of the Social Security reform effort, that plan had to be shelved.

Some congressional leaders continued to push for the bill as a stand-alone measure. A Senate bill appeared to have momentum until a pair of senators objected to a provision that would link a company's credit rating to its pension funding status. The Senate legislation included several measures important to CalPERS, including some related to purchase of service credit rules, minimum distribution rules, and waivers of certain early withdrawal penalties for public safety employees.

In 2005, we continued to press the federal government to provide guidance on investments in companies that do business in countries subject to U.S. sanctions, particularly Sudan. In June, CalPERS signed on to two letters to federal agencies requesting such guidance. We also signed on to a June letter asking five companies about their dealings in Sudan. Despite these requests, the federal government has not provided the “bright-line” guidance regarding which companies to avoid.

Congress did little to address health care in 2005, despite continuing sharp increases in costs and the number of uninsured Americans. Lawmakers did pass a bill that permits the creation of association health plans. Dozens of other bills stalled, including a CalPERS-supported measure to improve the use of information technology in health care from Senate Majority Leader Bill Frist (R-TN) and Senator Hillary Rodham Clinton (D-NY). CalPERS moved to pressure Congress to address the issue by leading the creation of the National Public Sector Healthcare Roundtable, an organization of state and local pension funds and other groups that advocate for reform.

Finally, the Equal Employment Opportunity Commission (EEOC) was almost given the go-ahead to issue a rule allowing employers to offer different levels of retiree health benefits based on Medicare eligibility. The EEOC rule was drafted after a federal judge in 2000 ruled that employers cannot give retirees who are eligible for Medicare health benefits that are not equal to those provided their younger counterparts. In April 2005, the EEOC was blocked from implementing the rule, but this ruling was reversed in September. The EEOC was then ordered
to continue to hold the rule until the American Association of Retired Persons, which filed the lawsuit challenging it, has the opportunity to appeal.

Next Years Actions Uncertain
The coming year is likely to see the return of many issues described above. Lawmakers might also consider proposals that could fundamentally change the way employers provide benefits to employees. Among the recommendations of a tax reform panel appointed by the president is a suggestion that the federal government cap income tax deductions for employer-provided health insurance.

In addition, a congressional committee recommended that employer “pick-ups” of employee pension plan contributions be made immediately taxable. (The contributions now are made on a tax-deferred basis.) CalPERS wrote to members of the California congressional delegation in June urging them to oppose the change in pick-up rules. With elections looming in November 2006, substantive action by Congress on any of these issues does not appear likely.
The Year Ahead

Looking forward to more opportunities to create better value for our members and employers.
This Operations Summary has described some of our key accomplishments for fiscal year 2004-05. While we successfully addressed many of the year’s challenges, we are already planning for the opportunities that lie ahead.

In the coming fiscal year, we will move forward with our new strategic goals. They will shape our future actions and allow us to respond to changes in the marketplace and in our customers’ needs. Our goals address enterprise-wide operations, as well as our primary lines of business; pension benefits, health benefits, and investments. Intertwined throughout all the goals is our commitment to enhance the value of our programs for members, employers, and to all those we serve.

One of our goals is to ensure the sustainability of CalPERS pension and health benefit programs. Our defined benefit system is the key thread in the fabric of our members’ retirement security. Efforts to unravel defined benefit plans by replacing them with defined contribution plans or to otherwise weaken them may not be over. The Legislature and Governor have not reached an agreement on the issue, but we are prepared to forcefully defend defined benefit plans if it becomes necessary.

Our strategic goals also address the management of our pension and health benefit programs. We are committed to providing sustainable pension benefit products and services and administering them in a customer-oriented and cost-effective manner. We will continue to develop and administer quality sustainable health benefit programs that are responsive to and valued by members and employers. We will achieve these goals by exploring innovative ways of ensuring that we are doing the best job for members while minimizing costs to employers.

As more baby boomers approach retirement, the demand for our services will shift. We will seek ways to augment customer service capabilities to make them more flexible and responsive to members’ needs. One way we will accomplish this is through the ongoing development of a comprehensive Internet-based information and transaction system. We are also in the process of developing a new and comprehensive customer service strategy that will help to ensure that our members have a positive experience and receive consistent information, regardless of whether they are contacting us by telephone, office visit, mail or the Internet. Implementation of this strategy will allow us to provide better service by directing our members to the service delivery process that best provides the requested product or service, quickly and accurately.

In the area of retirement estimates for example, our younger members and those not close to retirement would be encouraged to utilize our online Retirement Planning Calculator. In doing so, those members would be using the service delivery process that is the most appropriate for them, while enabling us to focus available resources on members closer to retirement, and those requiring detailed analysis and special intervention.

The increasing number of baby boomer retirements also impacts our service. We will continue to build the next generation of leaders through cross-functional training and other developmental opportunities.
We will take steps to ensure that we have qualified and well-trained staff through expanded internal training programs.

Recognizing that educational needs depend on family situation, career path, and other life events, we will be adapting and expanding our educational workshops to address different needs. We will also seek ways to enhance CalPERS On-Line to provide resources that are tailored to members at various stages of their lives and careers.

Communicating with employers and keeping them informed about our benefits and activities is equally important. We are developing new educational courses that will respond to the specific needs of different types of employers. And, we will continue to encourage employer input on ways we can augment our services. While the actions we took this year should begin to smooth out fluctuating contributions, our commitment to helping employers with their bottom line remains firm.

In the health care area, our focus will be on value — obtaining quality health care at affordable prices without diminishing members’ choices or the stability of our health plans. We will pursue value by leveraging our size to get the best possible return for our dollars.

We will also advance the components of our “Partnership for Change” — a coalition of purchasers that will press for structural reforms to promote higher quality and more cost-effective care. One such reform is the establishment of objective efficiency and quality criteria that can be used to differentiate value among hospitals. A second reform is requiring standardized and detailed accounting of profit and efficiency by individual hospitals. We will also advocate legislation that will allow purchasers to negotiate different reimbursement rate schedules for individual hospitals within the same network.

To address concerns about medication costs, we are initiating a comprehensive evaluation of potential companies to manage our pharmacy benefits. The evaluation will consider retail and mail order networks, formularies, drug utilization programs, utilization management, and customer service. The new pharmacy management program will take effect on July 1, 2006.

A key health care goal is to promote the ability of members and employers to make informed decisions that result in improved lifestyle choices and health outcomes. We will do this by expanding measures to treat high-intensity cases and chronic conditions such as diabetes and asthma. We will also educate members about how certain actions — including improper use of emergency room care or failing to manage a chronic condition — result in added health care costs.

In our investment operations, we will continue our long-term planning horizon, which supports our investment goals: to effectively manage the risk and volatility of assets and liabilities and to achieve long-term, sustainable, risk adjusted returns. We will develop new investments and strategies that leverage existing portfolios, are cost-effective, and add value to the Fund.
The need for greater corporate accountability remains a vital issue, and we are committed to taking a leadership role, particularly in the areas of excessive executive compensation and potential conflicts of interest. We will actively promote executive compensation reform on the national level by addressing the issue with the Securities and Exchange Commission, the financial exchanges, and the compensation consulting industry. Our initiatives will call for greater transparency and pay-for-performance compensation guidelines.

Recognizing the significance of environmental impacts on investment performance, we will continue to pursue several initiatives to improve environmental data transparency, including advocating greenhouse gas disclosure requirements.

As we look ahead, we remain mindful of the strengths that allow us to provide ongoing value to members and employers. Those strengths include our leadership, our employees, and our ties to members and employers. We will continue to reinforce those ties, as we harness future opportunities. Above all, we will do everything in our power to promote and protect the defined benefit pension system that has worked well for nearly 75 years.
Acknowledgements
The woven textiles and weaver’s loom, showcased in the photographs throughout the CAFR and the Operations Summary, belong to artistic designer and weaver, Verena Reckendorf Borton. She’s a third generation weaver, originally from the Netherlands. Ms. Reckendorf Borton is a retired CalPERS member and currently lives and teaches weaving classes at the Davis Art Center in Davis, California.

Environmental Benefits
The 2004-05 CalPERS Comprehensive Annual Financial Report and Operations Summary are printed on Mohawk Options 100 percent PC paper which is made with process-chlorine-free 100 percent postconsumer waste fiber. The paper is certified by Green Seal and the Forest Stewardship Council, which promotes environmentally appropriate, socially beneficial, and economically viable management of the world’s forests. The paper was also manufactured using non-polluting, wind-generated energy.

This project used 21,510 pounds of 100 percent postconsumer waste paper. The savings derived from using this paper in lieu of virgin fiber paper on this project is equivalent to:

- 258 trees not cut down;
- 745 lbs. waterborne waste not created;
- 109,093 gallons wastewater flow saved;
- 11,633 lbs. of solid waste not generated;
- 22,735 lbs. atmospheric emissions eliminated; and
- 148,580,869 BTUs of energy not consumed.

Values were derived from Mohawk Papers Interactive Environmental Savings Calculator available at www.mohawkpaper.com.