We are CalPERS

Operations Summary
Year Ended June 30, 2006
CalPERS Profile

The California Public Employees’ Retirement System (CalPERS) is the nation’s largest public pension fund with assets at June 30, 2006 of approximately $212.1 billion.

Headquartered in Sacramento, CalPERS provides retirement and health benefit services to nearly 1.5 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 1,048,895 active and inactive members from the State, school, and local public agencies, and 448,271 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.
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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 the fiscal year ended June 30, 2006.

The Board welcomed a new member in 2006. Maeley L. Tom was appointed as the representative of the State Personnel Board. In elections held in Fall 2005, school members reelected Kurato Shimada and all members reelected Charles P. Valdes to the Board.

Fiscal year 2005-06 was a landmark year for our organization, as we surpassed $200 billion in assets. It is notable that while it took us 64 years to reach $100 billion, it only took nine more years to reach $200 billion. This impressive growth reflects the Board’s diversified investment strategy and demonstrates our staff’s nimble response to changing market conditions.

We achieved an 11.8 percent return net of fees this fiscal year, marking the third consecutive year that we surpassed our 7.75 percent actuarial assumed rate of return. Our diversified portfolio helped us weather the volatile domestic public equity market, with strong performances in real estate, international stocks, and private equity. Prudent selection of investments that support our goals while contributing to environmental protection enabled us to positively impact the future of our members and society as a whole. Our active engagement with the companies in which we invest continued, as we pressed for the use of pay-for-performance compensation standards for corporate executives and more transparent disclosure of environmental risks.

As a further demonstration of our commitment to promoting corporate accountability, we participated in the formulation of the United Nations Principles for Responsible Investing (PRI). The PRI is composed of six guidelines, which describe possible global actions on environmental, social, and corporate issues. The principles are consistent with our investment philosophy and strategy.

Fundamental to our mission is our fiduciary responsibility to ensure that beneficiaries receive the pension and health benefits they have been promised. Our Strategic Plan is the blueprint that guides our organization in meeting that responsibility. During the
fiscal year, the Board approved an updated Strategic Plan and a new three-year business plan.

Diversity in all our business activities is a key imperative of our Strategic Plan. We are establishing a pool of consultants that specialize in investment diversity, and we are compiling a database of emerging investment managers and brokers. Diversity will provide us a sustainable competitive advantage and ensure that we remain on the cutting edge of innovation in the investment arena. We are also taking steps to encourage diversity among our other business partners as well as promoting the value of a diverse staff.

This year's employer contribution rates were the first calculated under our new rate smoothing policy. That policy was implemented in response to our employers’ need for more stability in their contributions. Rates are expected to stabilize over the next few years as the smoothing policy begins to have an impact. At the request of many employers, we are actively exploring ways to help them meet the new Governmental Accounting Standards Board requirements regarding accounting for post-retirement medical benefit obligations.

In the health care arena, we continue to aggressively address several marketplace challenges. We are pursuing transparency in reporting the true cost of health care and the creation of uniform standards for quality, performance, and pricing for hospitals, medical groups, and prescription drugs. We have made substantial progress in receiving more value for our dollars, and we will continue to evaluate every approach that could further enhance that value.

The exceptional service we provide to our customers is a direct result of the efforts put forth by our nearly 2,000 employees. Each day, our employees demonstrate their commitment to our principles and to the members and employers who have put their trust in our organization. I thank each employee for their dedication.

The efforts to replace defined benefit plans with defined contribution plans that required much of our attention last year have not been at the forefront this year. But those efforts could begin again, and we will remain vigilant in educating the public about the advantages of defined benefit plans, and the economic role of CalPERS in the State and the nation.

In 2007, we will mark 75 years of meeting the retirement and health needs of public employees. Our commitment now is as strong as it was 75 years ago. We will continue to exercise global leadership to ensure the sustainability of the System’s pension, health benefits, and investment programs.

Rob Feckner
CalPERS Board President
We are Customer Driven.
We administer pension benefit services in a customer-oriented and cost-effective manner.

We are CalPERS

As the nation’s largest public pension system, we are entrusted with safeguarding the financial, retirement, and health security of nearly 1.5 million members. The strength of our organization is rooted in the expertise and dedication of our 2,000 employees who enable us to provide exceptional service. Many of these employees interact regularly with members, employers, and other interested parties, while hundreds more work behind the scenes. Whatever an individual’s role, each employee performs tasks that are vital to fulfilling our strategic goals and keeping our organization operating smoothly.

Each employee is also a part of a unit: a team of employees with specific responsibilities. Working together, all of our teams form the highly respected organization that is CalPERS. Throughout this Operations Summary, you will see profiles of some of the teams that work daily to provide health and retirement security for California’s public employees and their families.

Within these pages are sections that describe the activities of the fiscal year related to our three primary lines of business: pension plan services for members and employers, health benefits, and investments. Additional sections address our enterprise-wide operations that support our primary lines of business and our activities in the State and federal legislative arenas. The final section provides a preview of our plans for the year ahead.
Introduction

We are CalPERS

We are dedicated to providing the highest level of service. Our Pension Resumption Project (PSR) is aimed at developing a consolidated pension information system that will harness the power of the Internet, and ultimately provide for faster, more reliable, and more cost-effective service to our members and employers. Our PSR team is more than 100 employees strong. Their skill, knowledge, and expertise are helping us build our new modernized database system.
## Financial Highlights

### Public Employees’ Retirement Fund

(Dollars in Thousands)

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash &amp; Cash Equivalents</td>
<td>$397,530</td>
<td>$5,399,361</td>
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<tr>
<td>Investments at Fair Value</td>
<td>250,079,288</td>
<td>193,867,878</td>
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<tr>
<td>Receivables</td>
<td>3,894,234</td>
<td>36,139,100</td>
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<tr>
<td>Other Assets</td>
<td>391,636</td>
<td>352,633</td>
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<td><strong>Total Assets</strong></td>
<td>$254,762,688</td>
<td>$235,758,972</td>
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<tr>
<td><strong>Liabilities</strong></td>
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<td></td>
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<tr>
<td><strong>Net Assets Held in Trust for Pension Benefits</strong></td>
<td>$211,190,801</td>
<td>$189,630,881</td>
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### Additions & Deductions

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Additions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Member Contributions</td>
<td>$3,080,879</td>
<td>$3,176,781</td>
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<tr>
<td>Employer Contributions</td>
<td>6,095,029</td>
<td>5,774,120</td>
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<tr>
<td>Net Investment Income</td>
<td>22,041,265</td>
<td>21,893,728</td>
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<tr>
<td>Other</td>
<td>—</td>
<td>473</td>
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<tr>
<td><strong>Total Additions</strong></td>
<td>$31,217,173</td>
<td>$30,845,102</td>
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<tr>
<td><strong>Deductions</strong></td>
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<td></td>
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<tr>
<td>Retirement, Death &amp; Survivor Benefits</td>
<td>$9,236,073</td>
<td>$8,434,119</td>
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<tr>
<td>Refunds</td>
<td>170,929</td>
<td>155,236</td>
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<tr>
<td>Administrative Costs</td>
<td>236,212</td>
<td>208,965</td>
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<tr>
<td>Other Expenses</td>
<td>14,039</td>
<td>—</td>
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<tr>
<td><strong>Total Deductions</strong></td>
<td>$9,657,253</td>
<td>$8,798,320</td>
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<tr>
<td><strong>Increase in Net Assets Held in Trust for Pension Benefits</strong></td>
<td>$21,559,920</td>
<td>$22,046,782</td>
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</table>

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, 2006.

**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.
Back row standing (from left to right): David Gilb, Marjorie Berte, Charles P. Valdes, Philip Angelides, Debbie Endsley (DPA Representative), Mike Quevedo, Jr., Robert F. Carlson, Steve Westly, Karen Greene Ross (State Controller Representative), and Kurato Shimada. Front row seated (from left to right): Maeley L. Tom, Tony Oliveira, Priya Mathur, Rob Feckner, and George Diehr.
CalPERS Board of Administration

Rob Feckner, President
Employee Member
(elected by school members)
Glazing Specialist, Napa Valley Unified School District
*Term Ends: January 15, 2011*

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

Philip Angelides
State Treasurer
Ex Officio Member

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

George Diehr
Employee Member
(elected by State members)
Professor, CSU San Marcos
*Term Ends: January 15, 2011*

Priya Mathur
Employee Member
(elected by public agency members)
Economist, Bay Area Rapid Transit
*Term Ends: January 15, 2011*

David Gilb
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*

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

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

Maeley L. Tom
State Personnel Board Member
(designated by the State Personnel Board)
*Term Ends: Serves at the pleasure of the SPB*

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.
CalPERS Board Committees

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, 2006.

Benefits & Program Administration
Kurato Shimada, Chair
Rob Feckner, Vice Chair
Robert F. Carlson
George Diehr
David Gilb
Priya Mathur
Tony Oliveira
Maeley L. Tom
Steve Westly
This committee reviews all matters related to benefit program structure, actuarial studies and rate setting, retirement program policy, and administrative issues.

Health Benefits
George Diehr, Chair
Priya Mathur, Vice Chair
Philip Angelides
Marjorie Berte
Rob Feckner
David Gilb
Tony Oliveira
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.

Performance & Compensation
Priya Mathur, Chair
Tony Oliveira, Vice Chair
Philip Angelides
Robert F. Carlson
David Gilb
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.

Finance
Robert F. Carlson, Chair
Steve Westly, Vice Chair
Philip Angelides
Marjorie Berte
Tony Oliveira
Kurato Shimada
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.
R Street Subcommittee
Charles P. Valdes, Chair
Robert F. Carlson, Vice Chair
Priya Mathur
Tony Oliveira
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
Marjorie Berte
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.

Investment
Charles P. Valdes, Chair
George Diehr, Vice Chair
Philip Angelides
Marjorie Berte
Robert F. Carlson
Rob Feckner
David Gilb
Priya Mathur
Tony Oliveira
Mike Quevedo, Jr.
Kurato Shimada
Maeley L. Tom
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
Marjorie Berte, Vice Chair
Robert F. Carlson
Tony Oliveira
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.
Back row standing (from left to right): Russell Read, John Hiber, Ron Seeling, Kathie Vaughn, Patricia K. Macht, Jarvio A. Grevious, Anne Stausboll, Peter H. Mixon, and Gloria Moore Andrews.

Front row seated (from left to right): Terri Westbrook, Ken Marzion, Ronald E. Reich, and Fred Buenrostro.
CalPERS Executive Staff

Fred Buenrostro  
Chief Executive Officer

Gloria Moore Andrews  
Deputy Executive Officer  
Operations

Jarvio A. Grevious  
Deputy Executive Officer  
Benefits Administration

John Hiber  
Assistant Executive Officer  
Administrative Services  
(Curtis Howard through November 2006)

Patricia K. Macht  
Assistant Executive Officer  
Public Affairs

Ken Marzion  
Assistant Executive Officer  
Actuarial & Employer Services

Peter H. Mixon  
General Counsel

Russell Read  
Chief Investment Officer  
Investment Office  
(Mark J.P. Anson through January 2006)

Ronald E. “Gene” Reich  
Assistant Executive Officer  
Information Technology Services

Ron Seeling  
Chief Actuary  
Actuarial & Employer Services

Anne Stausboll  
Assistant Executive Officer  
Investment Operations

Kathie Vaughn  
Assistant Executive Officer  
Member & Benefit Services

Terri Westbrook  
Assistant Executive Officer  
Health Benefit Services
Division Chiefs & Senior Investment Officers
(through June 30, 2006)

Richard Aldama
Diversity Outreach Program

Teri Bennett
Pension System Resumption Project

Sandra Felderstein
Office of Health Policy & Program Support

Curtis Ishii
Senior Investment Officer Global Fixed Income

Larry Jenson
Office of Audit Services

Holly Fong
Office of Employer & Member Health Services

Russell Fong
Fiscal Services

Susan Garrett
Strategic Management Services Division

Tim Garza
Innovative Services Division

Lisa Hammond
Office of Governmental Affairs

Matthew Flynn
Investment Administrative & Operational Services Division
(Greg Hood through April 2006)

Geraldine Jimenez
Supplemental Savings Program
(Dave Mullins through May 2006)

Sherry Johnstone
Office of Enterprise Compliance

Ron Kraft
Customer Service & Education Division

Richard Krolack
Office of Health Plan Administration

Peter Lai
Technology Services & Support Division

Donna Lum
Benefit Services

Debbie Martin
Office of Information Security
(Jeff Lung through April 2006)

Carol McConnell
Deputy General Counsel

Michael McCook
Senior Investment Officer Real Estate

Lori McGartland
Employer Services

Alan Milligan
Actuarial Office

Rick Nelson
Operations Support Services

Ken Nitschke
Office of Policy & Program Development

Chris O’Brien
Human Resources

Diana Proctor
Headquarters Expansion Project

Patricia Pinkos
Senior Investment Officer Asset Allocation & Risk Management

Leon Shahinian
Senior Investment Officer Alternative Investment Management Program

Darryl Watson
Member Services

Christianna Wood
Senior Investment Officer Global Equity Public

Regional Office Managers

Peter Alhlstrom
Sacramento
(Debra Gibson through March 2006)

June Copple
San Bernardino

Laura Duran
Orange County

Edith Mercer
Glendale

Elwin Nash
San Jose

Priscilla Neal
San Francisco
(Anita Commer through December 2005)

Evelyn Perez
Fresno

Jean Walker
San Diego
Pension Plan Services for Members & Employers

We are CalPERS

Our goal is to make the transition into retirement as easy as possible. During the year, changes in law created a backlog of disability retirement applications. We launched an aggressive effort to eliminate the backlog by enacting our RADAR (Retirement Applications for Disability Accelerated Response) team. Thanks to the dedication of our employees, more than 4,500 applications were processed in six months.

Our Account Managers are the lifeline for our employers. They represent our retirement and health programs to our employers and serve as a liaison to local government officials, community leaders, and member organizations. We believe ongoing communication with our employers will help strengthen our relationship and better serve their needs.
We are Responsive to our Members & Employers.

We develop and administer quality, sustainable retirement programs that are responsive to, and valued by, our members and employers.

We are CalPERS
Administering retirement plans for California public employers and their employees is our main line of business. More than 2,500 public employers and nearly 1.5 million public employees, retirees, and their families are covered by our pension plan. As of June 30, 2006, we provided retirement benefits for 1,048,895 active and inactive members and 448,271 retirees. The CalPERS membership is divided approximately in thirds among current and retired employees of the State, schools, and public agencies.

Serving Our Members
This past year, the CalPERS Customer Contact Center and eight Regional Offices continued to provide exceptional customer service. In 2005, the division’s name was changed to the Customer Service and Education Division to better define its role and the services it provides. Public outreach and member education are the number one focus, along with assisting members who contact us daily.

This fiscal year we processed nearly 25,000 new service retirement applications and more than 5,000 disability retirement applications. We paid more than $9.2 billion in retirement, death, and survivor benefits, an increase over the prior year. In addition, 99 percent of new retirees received their first benefit check within 30 days of retirement. We assisted 60,000 members at our public counters and responded to more than 600,000 telephone calls and 53,000 e-mail/postal mail inquiries.

The Regional Offices implemented several changes to respond to our growing membership and the need for one-on-one interaction with our staff. When members come to our public counters, we direct them to either the appropriate person to meet their needs or to a retirement planning workshop or seminar. As a result of this new system, we conducted an additional 1,000 retirement counseling sessions last year.

To meet the increasing demand for telephone assistance, we hired additional phone agents in our Contact Center. Telephone agents now have more time to attend training on in-depth subject matter which will allow more member inquiries to be completed without referring callers to another area. In January 2006, we initiated “skill-based” routing of member telephone calls, which directs callers to the most qualified staff. Skill-based routing and the additional staff have reduced wait times and abandon rates on the phone, providing our members with a more pleasant customer service experience.

In response to member comments, we improved our Interactive Voice Response (IVR) system to make it more user friendly. The initial prompt asks if the caller is a member or employer. Members are asked if they are actively employed or retired, and they are given additional choices based on their status. We also enhanced CalPERS On-Line in a similar way. Users can access information for members, employers, or business partners, or they can select general information about investments. Members further identify themselves based on their employment status and type of employer. The information provided is customized depending on the user’s view, and a set of quick links feature the most commonly requested topics for each type of member.

Recognizing that our members are becoming more Internet savvy, we enhanced our Internet-based self-service tools. Members can now use CalPERS On-Line to view the status of their service credit...
purchase request or their disability retirement application. Another online service allows retirees and beneficiaries to view their benefit statement online. Retirees and others who receive benefit payments can view up to five years of past statements and choose to opt out of receiving a monthly statement in the mail if they use direct deposit of benefits. Members, employers, and others can subscribe to “eAgenda Alerts,” to receive e-mail notification when CalPERS Board of Administration notices or agendas are available online. A new searchable glossary assists members and others in understanding investment terminology.

In addition to the IVR and Web site enhancements, we developed the CalPERS, “When You Need Us” publication, available for both members and employers. Each brochure provides information about the best way to reach CalPERS for services you need.

One of our strategic goals is educating members and employers to make informed decisions that lead to a secure retirement. During the year, we conducted 194 financial planning seminars and 1,577 retirement planning workshops. We also assisted more than 4,000 members during one-on-one counseling appointments. For the first time, we conducted retirement planning workshops for CalPERS members in Chicago, Texas, and New York using videoconferencing technology.

With baby boomers beginning to retire, we recognize the need for expanded member education about retirement and financial planning. This year we began planning for online education — the creation of a comprehensive Customer Education Solution, which will use technology to accommodate the growing education and counseling needs of both members and employers.

Our annual Retirement Planning Fairs continue to be a popular and convenient way for members to receive useful retirement planning information. This year we hosted 19 fairs in 10 cities. With a theme of “Plan now. Have a choice”, the fairs encouraged CalPERS members to plan ahead for retirement so that they will have choices during retirement rather than being forced into a less desirable lifestyle because of financial constraints. Fair participants received information about their retirement and health benefits, CalPERS Member Home Loan Program, our CalPERS 457 Deferred Compensation Savings Plan, our Long-Term Care Program, and other services. Participants also had the opportunity to attend seminars on service credit and how to use CalPERS On-Line.

In the area of disability retirements, CalPERS expanded its focus. A 2004 California Supreme Court decision (Nolan v. City of Anaheim) significantly changed the criteria used to make disability retirement determinations. After the decision was issued, processing of disability retirement applications was put on hold pending evaluation of the new criteria and development of new application procedures. The temporary suspension of application processing produced a backlog.
that could not be eliminated by business as usual. To address the backlog, at the end of 2005 we launched an aggressive effort called “Retirement Applications for Disability Accelerated Response.” Thanks to the teamwork and dedication of our employees, we eliminated a backlog of 4,500 applications by June 30.

Last fiscal year, we also moved forward with a project to replace our core “legacy” mainframe computer systems with a state-of-the-art integrated corporate database. The cutting-edge system will simplify our information technology infrastructure, increase operational capacity, enable quicker response to business changes, allow online business transactions via the Internet, and reduce maintenance and operational costs.

**Serving Our Employers**

Our Employer Contact Center (ERCC) is our primary customer service point of contact for contracting CalPERS employers. During the fiscal year, the ERCC serviced more than 128,000 assistance calls from employers. We unveiled a redesigned CalPERS On-Line that provides links to information relevant to employers. We also made the CalPERS Public Agency Procedures Manual available on CalPERS On-Line.

To help us improve our service to employers, we conducted a telephone survey of 400 randomly selected employers. When asked about the quality of the customer service they receive when calling CalPERS, respondents gave an 8.39 average rating (out of a possible score of 10). Respondents rated their organization’s overall working relationship with CalPERS at an average of 8.16, and they rated their overall satisfaction with CalPERS services at an average of 7.5. Survey questions also highlighted areas in which we could improve our services. In response to comments...
about our IVR system, we simplified the menu and created the publication *Connecting Employers to CalPERS* to assist employers in using the IVR system.

In an effort to provide better service to employers, we established the Constituent Relations Office within our Employer Services Division.

We held our sixth Employer Education Forum in Monterey with more than 650 employer representatives attending — the highest attendance ever. The theme for the 2005 event — “Leading Through Challenges” — acknowledged the obstacles we have overcome in the past and addressed how we can partner with employers to meet future challenges. We increased the number of breakout sessions from 28 to 35. One of the most popular sessions was a first time ever hands-on computer-based payroll workshop. The Forum provided employer representatives an opportunity to meet with CalPERS staff and members of our Board to share their thoughts and gain valuable information about our services. As in past years, attendees also had an opportunity to meet one-on-one with their actuary.

The Account Manager Unit is a management partnership between CalPERS and our employers. The Account Manager represents the CalPERS retirement, health benefits, and supplemental savings programs and serves as a liaison and advisor to local government officials, community leaders, and member organizations about our programs. We believe an ongoing relationship between employers and a designated Account Manager will enable us to better meet employers’ needs.

Employer education is one of the key services we provide. To assist employers in understanding the new criteria used to make disability retirement determinations, we conducted 30 employer workshops across the State. In addition to these special workshops, we continued to hold regular training about our programs and business functions. To keep employers informed about the rate stabilization method we implemented in 2005 and the advantages of risk pooling, our Actuarial and Employer Services and Health Benefits Branches presented employer seminars at nine locations across the State.

We conducted 182 workshops for 1,927 employer representatives during 795 visits to State offices, school districts, and public agencies. We also conducted 22 special request workshops. And we held training sessions on our Automated Communications Exchange System (ACES), which is now used by more than 2,500 employers. By allowing employers to electronically submit membership, payroll, and health benefits transactions via the Internet, ACES provides for timely posting of employee transactions and reduces the volume of paperwork for employers.
As a result of the growing use of ACES, we posted 115 million ACES payroll records — a 44 percent increase — and more than 195,000 ACES member transactions — a 25 percent increase. In response to employer requests, we enhanced the capabilities of ACES, adding access to the Annual Member Statement Employer Report and the Service Purchase Credit Status.

Finally, our Actuarial and Employer Services Branch mailed 1,575 Annual Employer Statements on schedule, processed more than 25,000 membership enrollments, posted more than 33,000 member transactions submitted by employers, and completed 46,000 payroll reports, and 163 public agency contract amendments. Staff also conducted more than 4,070 compensation reviews of member records — a 10 percent increase over the prior year.
We Strive for Quality, Cost-Effective Health Care.

We engage and influence the health care marketplace to provide medical care that optimizes quality, access, and cost.

We are CalPERS
We are CalPERS

We operate our health program in a market where health costs have increased three times higher than the cost of living. Employees of our rate renewal team took a tough stand and it paid off. Members of our HMO plans experienced the lowest average premium increase in six years, and there were no increases in copayments for office visits or prescription drugs.
Health Benefits Program

Overview
The CalPERS Health Program’s mission is to obtain the best possible benefits at the best possible price in the face of ever-rising costs. Short-term, we try to moderate costs, enhance meaningful choice, ensure access to high-quality and effective care, and improve the stability of our Program. Long-term, we collaborate with other major purchasers, plan partners, providers, and government policy-makers to seek fundamental changes and effective solutions to systemic problems afflicting the nation’s health care system.

During the year, we continued to sustain and enhance our activities in pursuit of those objectives. Our CalPERS Board adopted measures at the outset that significantly mitigated premium cost increases. These included the Blue Shield exclusive provider hospital network, regional pricing for contracting public agencies, and incentives to use cost-effective generic and mail-order drugs.

We also introduced new initiatives to improve access to health care in rural counties, adjust the Long-Term Care Program to respond to market pressures, expand efforts to attack the drivers of health care costs, increase reporting by plans and providers, and step up State and national reform efforts.

Runaway Health Care Costs
We operate our Health Program in a marketplace that is dominated by employer-based purchasing systems and large government Medicaid and Medicare subsidies for low-income and age 65 and over consumers. Increasing numbers of private employers are shifting costs to employees and retirees. Many are eliminating retiree coverage altogether. Because of soaring prices, public employers also are under pressure to shift health care costs to consumers.

Overall, annual health care cost increases are three times higher than the cost of living.

There is no single cause of the cost spiral, nor is there a single remedy. Its key contributing factors are: an aging population that is living longer and requiring more care; the increasing incidence of costly chronic conditions such as diabetes, obesity, and heart disease that become more prevalent with age; heavier-than-ever utilization of new technology and prescription drugs to diagnose and treat disease; rising hospital and physician prices; the related consolidation of providers and their networks that limit competition for services in certain areas; the withdrawal of health maintenance organizations (HMOs) from rural areas; irregular pricing, quality, record-keeping and reporting practices by hospitals, physicians, and pharmaceutical providers; and the improper use of emergency rooms.

CalPERS Response: New Strategic Initiatives
In response to such market forces, the Board continued its program to restrain costs and enhance member choice and access to quality care. Our Board has adopted new and expanded initiatives aligned with those strategic imperatives. These initiatives include expansion of disease and high-intensity case management programs, development of new tools to engage members in their own care, pilot wellness...
incentive programs, and a telemedicine option to improve rural health care.

The Legislative Analyst’s Office credited CalPERS with saving up to $168 million since 2002 by consolidating HMOs, excluding high-cost hospitals from the Blue Shield network, aligning premiums for local agencies with regional market costs, and giving members incentives to use generic drugs instead of more expensive brand names, and mail order rather than retail purchases.

Several of those actions stemmed from our Strategic Plan, and they paid off in June 2005 as we adopted the rate package for the 2006 calendar year. Basic HMO premiums increased 8.7 percent, and the average premium increase for members under age 65 HMO members was 2.7 percentage points less than the previous year. There were no increases in copayments for office visits or prescription drugs.

**Collaborative State, National Ventures**

In September 2005, we enlisted some of the nation’s largest public and private health care purchasers in an effort to obtain uniform standards for assessing the quality and efficiency of California hospitals. The Partnership for Change conference focused on action steps aimed at obtaining performance measures that would eventually be written into contracts with hospital providers.

We also established a Purchasers’ Coalition of employers that endorsed the Partnership for Change, representing more than 4.5 million covered lives.

The Partnership will hold hospitals accountable by publicly reporting cost and quality data that will enable everyone to identify the highest value facilities. The goal is a transparent and well-functioning health care marketplace where hospitals compete for business on the basis of the cost and quality of the services they deliver.
The Partnership has two key components: the Hospital Value Initiative, led by CalPERS and the Pacific Business Group on Health, to develop standard measures to calculate the cost efficiency of hospitals; and the California Hospital Assessment and Reporting Taskforce, led by the University of California, San Francisco and the California HealthCare Foundation, to report hospital clinical quality measures.

In November 2005, we collaborated as a national leader of the First Annual Conference and Business Meeting of the Public Sector HealthCare Roundtable, a coalition of public pension systems and others, formed to communicate their health care concerns to federal policy-makers. The Roundtable advocated a national debate on long-term structural reform of the health care system, the increased use of information technology, research on the comparative effectiveness of medical procedures, more access to affordable medications, and federal support of retiree health programs.

During the year, the Roundtable began lobbying Congress to adopt meaningful health information technology legislation that would improve the efficiency of the health care industry, facilitate transparency, reduce costs, and improve the overall quality of patient care.

Positive Developments:

2006 Rate Restraint, PPO Progress

Strategic Plan efforts to stabilize the Health Program also succeeded in 2005-06. At the end of the 2006 Open Enrollment period, completed in Fall 2005, only about 2 percent of CalPERS members made health plan changes — down from 3.7 percent in 2004. The annual Quality Report showed that 66 percent of members expressed satisfaction with their health plans, which included HMOs Kaiser Permanente, Blue Shield of California, and Western Health Advantage, and PPOs PERS Choice and PERSCare. The survey found that 72 percent were satisfied with their doctor and 90 percent would recommend their plan to others.

On the employer side, we continued to stem the loss of contracting public agencies to insurers offering lower premiums, mostly in Southern California. Under our regional pricing plan, we reported an anticipated net loss of 3,124 enrollees as of January 1, 2006 compared with 4,370 in 2005 and 31,894 in 2004, before the plan was adopted. As a result of regional pricing, the Health Program averted an estimated $40 million in premium increases threatened by the potential defection of Southern California agencies. Meanwhile, the System accelerated our marketing plan to sign up new agencies and retain current ones.

The self-funded CalPERS PPOs, PERS Choice and PERSCare, reported continued positive asset levels...

### Total Health Program Membership

<table>
<thead>
<tr>
<th>Year</th>
<th>Membership</th>
</tr>
</thead>
<tbody>
<tr>
<td>'02</td>
<td>1,249,175</td>
</tr>
<tr>
<td>'03</td>
<td>1,240,595</td>
</tr>
<tr>
<td>'04</td>
<td>1,200,668</td>
</tr>
<tr>
<td>'05</td>
<td>1,190,212</td>
</tr>
<tr>
<td>'06</td>
<td>1,205,945</td>
</tr>
</tbody>
</table>
during the fiscal year. In the third quarter of 2005, total program assets exceeded reserve requirements by more than 150 percent. The overall level of the assets in the self-funded health plans remained strong into 2006, when first quarter asset levels met expectations.

In January 2006, Blue Cross of California, the PPO medical administrator, offered almost 90,000 members telemedicine services. The experimental communications program linked participating members in remote rural areas with health care specialists. We were the first employer purchaser in California to include telemedicine as a specific rural benefit. It enabled participants to access designated specialists in dermatology, psychiatry, endocrinology, cardiology, and pediatric neurology through existing local telemedicine programs at more than 50 locations via specialized cameras and computer technology. Physicians used remote live videoconferencing or software to store and forward information.

During the year, we selected Medco Health Solutions, Inc. to administer prescription drug benefits for the PPOs. The three-year contract, which began July 1, 2006, provided unprecedented disclosure of discounts and rebates the pharmacy benefits manager receives from manufacturers. It also required 100 percent pass-through to CalPERS of all manufacturers’ rebates associated with the pension fund’s account and audit rights to verify contract compliance.

**Member Engagement Advances**

The Health Program’s HMO and PPO partners stepped up interventions to arrest or prevent members’ most prevalent chronic conditions, which accounted for more than half of the Program’s estimated spending of $4.3 million in 2006. Health plans reported that 28 percent of all CalPERS members had one of the five most prevalent chronic conditions — including hypertension, 12 percent; diabetes, 5 percent; depression, 5 percent; coronary artery disease, 3 percent; and asthma, 3 percent. Plans offered disease management programs for CalPERS members.

In response to member interest, we adopted the formerly experimental Health Plan Chooser, a Web-based product that enables users to compare and rate plans in terms of cost, quality, and services; and to determine the availability of doctors. The Health Program also made available the CalPERS Health Wallet, a credit card-sized vinyl folder with insert pages allowing members to organize and keep track of important medical information — including contact names and numbers, medications, chronic conditions, and surgery records. This pilot project was offered on CalPERS On-Line and distributed at employee and employer meetings and health fairs.

**2007 Rate Negotiations**

CalPERS extended its contract with Medstat, which built and maintains the System’s Health Care Decision Support System (HCDSS). The HCDSS data warehouse contains health utilization and cost data for all 1.2 million enrollees. CalPERS extracts and analyzes this data to validate health plan reports during annual negotiations for rates in the coming calendar year.

Before the fiscal year closed, we adopted a 2007 package raising Basic HMO premiums by an average of 11.6 percent while maintaining the existing copayment and benefit structures. Basic PPO premiums would increase 12.6 percent.

Key factors affecting the premium increases include rising pricing demands by hospitals and physicians, higher prescription drug costs, the growing number
of people with costly chronic conditions, and an aging population that requires more care.

Our Board deferred action on proposals to raise copayments for selected services, and to start a third PPO plan, “PPO Select,” with a smaller, more efficient network of physicians. The Board approved a plan to expand and promote more PPO urgent care networks, and agreed to require PPO members to obtain prior authorization for expensive imaging procedures such as CT scans.

The Board approved plans for a new three-year contract with Blue Shield of California to administer Network HMO health benefits and develop innovative programs aimed at restraining escalating costs and improving quality.

Long-Term Care Program
Moving into a second decade, we continued to offer the Long-Term Care Program to bolster the retirement security of some 174,000 subscribing public employees, retirees, spouses, parents, parents-in-law, and adult siblings. Enrollees receive financial protection from the high cost of extended care, including nursing home care, which six of 10 Americans over age 65 will need since regular health insurance and Medicare do not cover long-term services. Nursing home care averages $65,000 a year and home care averages $20,000.

### Long-Term Care Program Highlights
- 173,935 participants
- $1,401 average annual premium
- $243.7 million in annual premium income
- $78.0 million paid in benefits

#### LTC Program Membership
- by Member Type
  1. Active Employee Spouse - 14.4%
  2. Parents - 3.6%
  3. Siblings - 0.6%
  4. Active Employees - 45.7%
  5. Retirees & Spouses - 35.7%

#### LTC Membership
- by Plan Type
  1. Facilities Only Plan - 21.4%
  2. Partnership Plan - 4.1%
  3. Comprehensive Plan - 74.5%
When the Program began in 1995, the marketplace for long-term care insurance was relatively new and volatile. Since then, many insurers have left the maturing market, and those that remain or are entering it are more knowledgeable and financially stable than many of their predecessors. Unlike many insurance carriers, CalPERS cannot subsidize its self-funded program with other business lines or financial reserves; it relies exclusively on voluntary subscriber premiums to remain solvent. In recent years, new policy sales for this Program have been low but generally better than in the individual long-term care marketplace. While new policies have balanced departures, total policies in-force have remained flat. Consequently, we faced a projected deficit as the fiscal year closed. The focus going forward is to ensure the program remains fiscally sound.

Through June 2006, the Long-Term Care Program had paid $78 million in benefits for the year.
We are $200 Billion Strong.

We are shareowners and advocate good corporate governance to safeguard our members’ investments and improve investment performance.

We are CalPERS
We are CalPERS

We believe good corporate governance leads to better performance. We seek corporate reform to protect our investments. Our corporate governance team challenges companies and the status quo, they vote our proxies, they work closely with regulatory agencies to strengthen our financial markets, and they invest with partners that use corporate governance investment strategies to earn value for our fund by turning around ailing companies.
CalPERS Passes $200 Billion Milestone
On November 21, 2005, CalPERS assets crossed the $200 billion milestone for the first time. The System reached the major marker 73 years after our birth during the Depression and only nine years after breaking $100 billion. The landmark achievement was the result of our diversified portfolio, an able staff’s nimble response to market opportunities, and the continued trust of contributing public employers and employees.

We achieved an 11.8 percent return on investments, after management fees, for the 12-month period ended June 30, 2006. This was the third straight year of double-digit returns. The average annual return over the previous 10 years was 9 percent.

Our pension fund exceeded industry benchmarks in five of eight major investment portfolios, and staff added approximately $2.8 billion to the fund, mainly by taking advantage of market opportunities.

Our international stocks were the largest percentage gainer, returning 26.7 percent. Real estate generated the second-highest rate of return — at approximately 25.8 percent. Domestic stocks earned 9.6 percent, beating the benchmark of 9.5 percent. Corporate governance funds, which invest in underperforming public companies, posted a 17 percent return compared with a benchmark of 20.3 percent.

U.S. fixed income investments lost 1.3 percent, compared with a benchmark that showed a 3.1 percent loss. International fixed income investments lost less than 1 percent, while the benchmark gained less than two-tenths of 1 percent.

At the end of the fiscal year, 61.2 percent of our portfolio was invested in public equity, 24.5 percent in bonds and other fixed income, 7.2 percent in real estate, 5.7 percent in private equity, and 1.4 percent in cash equivalents.
Investment Policy & Strategy
The starting point and most important element of our successful return on investment is our asset allocation — the percentage of funds we invest in stocks, bonds, real estate, and private equity. We typically implement policy targets over a period of several years on market declines and through dollar cost averaging.

Asset allocation is not an asset-only or liability-only decision. To determine the appropriate asset allocation mix, we take all factors into account — including liabilities, benefit payments, operating expenses, and employer and member contributions. Our goal is to maximize returns at a prudent level of risk — an ever-changing balancing act between market volatility and long-term goals. A well-diversified portfolio will enhance long-term

### Allocation of Investment Portfolio
at Market Value $212.1\textsuperscript{1} Billion
(Dollars in Billions)

1. Alternative Investments & Private Equity - $12.1
2. International Fixed Income - $5.5
3. Domestic Equity - $85.0
4. International Equity - $44.9
5. Cash Equivalents - $2.9
6. Domestic Fixed Income - $46.5
7. Real Estate - $15.2

### CalPERS Asset Allocation
(Dollars in Billions)

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Market Value</th>
<th>Current Allocation</th>
<th>Current Target\textsuperscript{1}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Equivalents</td>
<td>$2.9</td>
<td>1.4%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Global Fixed Income</td>
<td>$52.0</td>
<td>24.5%</td>
<td>26.0%</td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic</td>
<td>$85.0</td>
<td>40.0%</td>
<td>40.0%</td>
</tr>
<tr>
<td>International</td>
<td>44.9</td>
<td>21.2</td>
<td>20.0</td>
</tr>
<tr>
<td>Alternative Investments/Private Equity</td>
<td>12.1</td>
<td>5.7</td>
<td>6.0</td>
</tr>
<tr>
<td>Total Equity</td>
<td>$142.0</td>
<td>66.9%</td>
<td>66.0%</td>
</tr>
<tr>
<td>Total Real Estate</td>
<td>$15.2</td>
<td>7.2%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Total Fund</td>
<td>$212.1\textsuperscript{2}</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Notes:
\textsuperscript{1} Target allocation effective January 1, 2005.
\textsuperscript{2} Differences between investment values above and the values on the Summary of Investments on page 77 of the CAFR are due to differences in reporting methods. The Summary of Investments includes Net Investment Receivables/Payables.
performance, protect the fund, and offset any weaknesses in one area with gains in another.

The CalPERS Board of Administration fine-tunes the asset allocation every three years to respond strategically to economic scenarios for global financial markets, while taking into account future liabilities and employer contributions. The Board also establishes investment policies for each portfolio and sets annual performance benchmarks for each asset class. The Board’s Investment Policy Subcommittee reviews policies for final approval by the Investment Committee. We post our investment policies on CalPERS On-Line.

During the fiscal year, our Board approved an updated Strategic Plan that identified goals and principles for the next five to 10 years. In our investment business, the Board committed to managing the risk and volatility of assets and liabilities to ensure sufficient funds are available; first, to pay benefits; second, to minimize and stabilize contributions; and third, to achieve long-term, sustainable, risk-adjusted returns.

Alternative Investment Management (AIM Program)

Our private equity investments earned a 19.8 percent fiscal year return, compared with a benchmark of 19.6 percent. Since its inception in 1990, the AIM Program has committed more than $30 billion for a 17.6 percent return on fully realized investments. At the end of the year, $11.3 billion of those commitments were invested.

Since it began, the AIM Program has invested in private companies primarily through limited partnerships or funds, typically in 10-year legal agreements with professional investment managers. Managers, or general partners, are the intermediaries between investors with capital and businesses seeking the capital. They make investment decisions and provide guidance to portfolio companies.

Mid-year, the Board approved a strategic review designed to enhance the AIM Program’s overall investment capability and maximize long-term performance. The plan included the following elements: reducing the number of AIM relationships; developing a more vertical organizational structure; increasing staff’s delegated authority to expedite decision making; improving evaluation and use of external advisors; exploring potential direct investments in companies — either alone or with general partners; and evaluating benchmarks used to assess the program’s performance.

Specialization of the private equity program will enable us to work more intensively with external managers than we have in the past. Several newly-hired staff brought depth and focus to the realigned

A Closer Look at AIM
Portfolio Diversification by Strategy

<table>
<thead>
<tr>
<th>Portfolio Strategy</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Restructuring</td>
<td>51</td>
</tr>
<tr>
<td>Distressed Securities</td>
<td>7</td>
</tr>
<tr>
<td>Expansion Capital</td>
<td>15</td>
</tr>
<tr>
<td>Mezzanine Debt</td>
<td>2</td>
</tr>
<tr>
<td>Secondary Interests</td>
<td>3</td>
</tr>
<tr>
<td>Special Situation</td>
<td>3</td>
</tr>
<tr>
<td>Venture Capital</td>
<td>19</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>
program in nine sub-asset classes. Three of the new sub-asset classes were geographical — U.S. Middle Market, Europe Middle Market, and Asia. The others were venture capital and included health care; clean energy/technology; information technology; the continuing CalPERS California Initiative; current income; and emerging markets.

In other actions, the AIM Program committed $200 million to the Environmental Technology Program, which has a diversified portfolio of clean technology-focused investments, including alternative and renewable energy; water technologies; advanced materials or nanotechnology; air purification technologies; and transitional infrastructure opportunities.

One of the sub-asset classes of the AIM Program is the California Initiative Program, which began in November 2001 with $475 million in commitments. The Program targets traditionally underserved markets primarily, but not exclusively, in California. The investments are made by 10 private equity funds and one fund-of-funds. Ninety-six percent of the companies directly affected underserved markets, meeting or surpassing at least one of three benchmarks used to identify California Initiative Program companies. Seventy-one percent of California Initiative companies were headquartered in California, and 75 percent employed a significant proportion of their workforce in the State. Approximately 40 percent of California residents employed by California Initiative companies live in economically disadvantaged areas. And most of the companies had at least one female or minority corporate officer or owner.

At the beginning of the fiscal year, we had active investments in 83 companies of the California Initiative Program and the Program showed signs of...
generating healthy returns and economic expansion. Assets gained 16.3 percent in annual returns on investments as of September 30, 2005.

Real Estate
At the end of the fiscal year, real estate had net assets of $16.5 billion invested, of which 56 percent were in core sectors of industrial, apartment, retail, office, REITS, and international core. Forty-four percent of non-core investments were in housing, REIT securities, the CURE (California Urban Real Estate) Program, opportunistic, international, senior housing, and natural resources.

Our real estate portfolio was one of the biggest percentage gainers among asset classes, returning 25.8 percent on investments in office, retail, apartment, industrial, housing, land, and California urban real estate assets. By comparison, the NCREIF industry benchmark earned 18.7 percent.

We continued to implement a shift from “core” to “non-core” investments, moving the portfolio from heavily domestic holdings toward a more globally-diversified composition to capitalize on new investment opportunities and moving to where we see the most attractive risk/return opportunities.

We selected five consultants for real estate consulting assignments to extend through June 30, 2008. The selected firms — Conrad and Associates, LLP; Le Plastier Development Consulting; JRT Realty Group, Inc.; KPM Associates; and Situs Realty Services — offer consulting services in accounting, housing, loan services, and other sectors.

In the international sector, we signed a partnership agreement with Hines in May 2006 for core projects in China. The initial equity commitment was $237.5 million, with the ability to increase the commitment up to $400 million. The initial focus of the Hines CalPERS China Fund is development and redevelopment of high-rise for sale residential, office, retail, hotel, and mixed-use projects starting in Beijing and Shanghai. We also participated with Hines in a $231 million investment in the Spanish residential market through a new fund — HCS Interests LP.

Global Public Equity
The global equity asset class closed the fiscal year with $131.2 billion in the market and an annual return of 15.9 percent. During the year, international equities gained 26.7 percent, U.S. equities 9.6 percent, hedge funds 11.4 percent, and corporate governance funds 16.9 percent.

<table>
<thead>
<tr>
<th></th>
<th>Domestic</th>
<th>International</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Income</td>
<td>$46.5</td>
<td>$5.5</td>
<td>$52.0</td>
</tr>
<tr>
<td>Equities</td>
<td>85.0</td>
<td>44.9</td>
<td>129.9</td>
</tr>
<tr>
<td>Total Global Public Markets</td>
<td>$131.5</td>
<td>$50.4</td>
<td>$181.9</td>
</tr>
</tbody>
</table>
We expanded our program to include AQR Capital Management and Quantitative Management Associates in our pool of managers for international equity enhanced indexing services. We also approved the inclusion of T. Rowe Price Associates in our manager pool for U.S. equity enhanced indexing services. And we chose an additional 11 active international equity managers to manage portfolios in developed and emerging markets.

We selected Legato Capital Management and Strategic Investment Group as joint venture partners in our new Manager Development Program II for emerging money management firms. Legato and Strategic will offer direction to emerging managers selected for the program, which is reviewing potential investments in companies that manage less than $2 billion in public equity or high-yield securities.

Indonesia was added to our list of permissible countries for public equity investment. The addition followed a report by our consultant, which reviewed country and financial market factors — such as political stability, transparency, and labor practices — of 27 emerging markets. Investment was approved for Argentina, Brazil, Chile, the Czech Republic, Hungary, India, Indonesia, Israel, Jordan, Malaysia, Mexico, Peru, the Philippines, Poland, South Africa, South Korea, Taiwan, Thailand, and Turkey. We ruled out public equity investments in China, Colombia, Egypt, Morocco, Pakistan, Russia, and Venezuela. Sri Lanka, which was added in 2005, fell below the qualifying threshold this year. Following our policy, Sri Lanka was granted a one-year “cure” period to improve its score before exclusion from the permissible list.

<table>
<thead>
<tr>
<th>International Equity &amp; Fixed Income Investments Country Diversification</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Up to $25 million</strong></td>
</tr>
<tr>
<td>Argentina</td>
</tr>
<tr>
<td>Bahamas</td>
</tr>
<tr>
<td>Cayman Islands</td>
</tr>
<tr>
<td>Czech Republic</td>
</tr>
<tr>
<td><strong>$25 to $50 million</strong></td>
</tr>
<tr>
<td>New Zealand</td>
</tr>
<tr>
<td><strong>$50 to $100 million</strong></td>
</tr>
<tr>
<td>Chile</td>
</tr>
<tr>
<td>Indonesia</td>
</tr>
<tr>
<td><strong>$100 to $300 million</strong></td>
</tr>
<tr>
<td>Austria</td>
</tr>
<tr>
<td>Denmark</td>
</tr>
<tr>
<td>Greece</td>
</tr>
<tr>
<td>Hungary</td>
</tr>
<tr>
<td>Ireland</td>
</tr>
<tr>
<td><strong>$300 to $500 million</strong></td>
</tr>
<tr>
<td>Belgium</td>
</tr>
<tr>
<td>Finland</td>
</tr>
<tr>
<td>India</td>
</tr>
<tr>
<td>Mexico</td>
</tr>
<tr>
<td><strong>$500 million to $1 billion</strong></td>
</tr>
<tr>
<td>Brazil</td>
</tr>
<tr>
<td>Hong Kong</td>
</tr>
<tr>
<td>South Africa</td>
</tr>
<tr>
<td><strong>More than $1 billion</strong></td>
</tr>
<tr>
<td>Australia</td>
</tr>
<tr>
<td>Canada</td>
</tr>
<tr>
<td>France</td>
</tr>
<tr>
<td>Germany</td>
</tr>
<tr>
<td>Italy</td>
</tr>
<tr>
<td>South Korea</td>
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</tbody>
</table>
Global Fixed Income
The fixed income program had a market value of $49.9 billion on June 30, 2006, down 1.1 percent from a year earlier. Twenty-four percent of the CalPERS portfolio was committed to investment in this asset class, with the goal of producing the highest total rate of return possible, consistent with a prudent level of risk and our liabilities.

Cash equivalent investments gave us adequate liquidity to meet projected cash flow needs while keeping cash balances fully invested to maximize returns. More than 3 percent of our portfolio was committed to international fixed income with external managers to gain exposure to non-U.S. dollar fixed income securities. Our in-house fixed income unit administered the internal currency overlap program.

At the end of the fiscal year, we had more than $3 billion in fixed income investments in California. Such investments provide jobs and services to California and contribute to the State’s economy.

During the year, we issued a request for proposal for prospective international fixed income managers. The new pool of advisors will help us build strategic relationships with a broad set of managers who have expertise in the global bond market.

Corporate Governance
In the fallout of the WorldCom scandal, we recovered more than $257.4 million from a non-class action lawsuit filed against former company executives and investment banks after the financial collapse.

In another area, we urged PacifiCare of California and the Department of Managed Health Care to unwind $345 million in executive bonuses proposed as part of the pending merger of PacifiCare with United Health. We asked the company to remove the payouts tied to the merger, arguing that they were unrelated to the ongoing performance of the future combined entity. The newly granted equity vesting requirements also were not linked to performance.

In a letter to fellow Home Depot shareowners, we urged support of a proposal that would allow shareowners to cast advisory votes on the company’s executive compensation practices. Giving shareowners a non-binding vote on total compensation and pay policies for the company’s top five executives, would strengthen transparency in setting executive pay, improve accountability to shareowners, and help link pay to performance.

We also addressed how directors are elected to corporate governing boards. In many corporate elections, unopposed candidates can win board seats with only one vote from shareowners. We strongly endorsed California Senate legislation that would require candidates in uncontested elections to receive more than 50 percent support from participating shareowners. The bill does not affect contested elections, where the candidate needs only a plurality

2006 Focus List

- Brocade Communication System
- Cardinal Health, Inc.
- Clear Channel Communication, Inc.
- Mellon Financial
- OfficeMax, Inc.
- Sovereign Bancorp, Inc.
not a majority — to win. (The bill was signed into law in September 2006.)

We asked 40 companies to respond to questions about published media allegations of stock option backdating by top executives. By the Summer of 2006, we received 18 responses to our request that companies independently investigate reports of employees backdating options to maximize compensation not tied to performance. We also asked the companies to develop and publicly disclose financial and proxy statements of any new board of directors’ policies for determining option grant dates.

In the global corporate governance arena, we signed the United Nations Principles for Responsible Investment, a menu of possible global actions on environmental, social, and corporate issues. CalPERS participated in the drafting of the six guidelines along with representatives of as many as 20 investment organizations from 12 countries. The guidelines proposed possible actions related to investment analysis and decision-making; shareowners’ policies and practices; reporting standards; and promotional, collaborative and reporting ventures by participating institutional investors.

In response to continuing human rights abuses, we barred CalPERS investments in nine companies that do business in Sudan until the government of that country halts the genocide. We adopted a nine-point position statement that urges the federal government to publish a definitive list of companies with ties to Sudan; asks already identified companies to work with international human rights groups such as the United Nations Global Compact to fully declare their business operations in Sudan; and encourages engagement with companies to effect change.

Our annual Focus List called attention to six U.S. companies for poor financial and corporate governance performance. This year’s list included Brocade Communications of San Jose, California; Cardinal Health of Dublin, Ohio; Clear Channel Communications of San Antonio, Texas; Mellon Financial of Pittsburgh, Pennsylvania; OfficeMax of Itasca, Illinois; and Sovereign Bancorp of Philadelphia, Pennsylvania.

**Diversity**

Investing in ethnically and culturally diverse emerging markets was a key driver of our investment strategy during the year. In Fall 2005, our Board held a workshop on diversity investment that concluded that broad diversification of the base of investment managers and brokers offers economic opportunities for investors.

Our leadership in this area continued in Spring 2006, when more than 600 people attended a two-day Diversity Investment Conference sponsored by CalPERS and the California State Teachers’ Retirement System. The event helped pension funds, endowments, and foundations learn how to attract and develop a broad range of diverse money managers, brokers, consultants, and investment partners.

Later, we approved an investment action plan to expand opportunities through investments in emerging markets and emerging managers. The plan included establishing a pool of consultants specializing in diversity in the investment industry and compiling a database of emerging investment managers and brokers. The database will target money managers, private equity funds, private equity fund of funds, private real estate investments firms, REITs, hedge funds, hedge fund of funds, consultants, emerging manager program managers, broker dealers, and
research firms. The goal is to capture a wide universe of untapped talent in the investment industry to broaden diversity investment opportunities for public and private pension funds, promote transparency and access to capital, and develop a better understanding of emerging investment firms.

In recent years, we have increased our investments in emerging markets, including more than $4.5 billion invested or committed for investment in underserved California areas.

Environmental Investment Initiatives
We began the year by calling the G-8 Summit’s attention to the need for strategies to address climate change, which has the potential to threaten worldwide financial markets.

CalPERS approved a plan aimed at improving the reporting of greenhouse gas emissions by the electric power utilities industry. The Greenhouse Gas Reporting Project is a joint effort by CalPERS, the California State Teachers’ Retirement System, and the Carbon Disclosure Project (CDP) to engage electric power utilities in reporting emissions of carbon dioxide and greenhouse gases that may contribute to potentially costly global warming. The CDP is a coalition of institutional investors with more than $21 trillion in assets. It developed a process for informing publicly-traded companies of shareowner concerns about the impact of carbon emissions on long-term company value. We also asked utility companies in our investment portfolio to respond to the CDP survey, and to consider other forms of disclosure made available by the California Climate Action Registry, the Chicago Climate Exchange, or the Global Reporting Initiative Sustainability Report.

We joined other major institutional investors in requesting that insurance companies report to shareowners about their exposure to climate risk and their strategies for responding. Letters to major insurers by CalPERS and other members of the Investor Network on Climate Risk cited findings of a 15-fold increase in insured losses from catastrophic weather events like Hurricane Katrina in the past three decades. The losses have far out-stripped premium increases, inflation, and population growth.

We selected six U.S. and international managers to invest up to $500 million in environmental public equity funds. Approval of the pool was the latest step in an ongoing effort to utilize managers who have a superior track record of investing assets using environmental strategies.

In carrying out such actions, we were following a new corporate governance guideline to act on shareowner proposals for the timely, accurate reporting of environmental risks — especially those associated with climate change. The new initiatives were part of an Environmental Strategic Plan adopted in the previous fiscal year.

Supplemental Savings Program
Through this voluntary program, local public agency and school members can make contributions that will enhance their retirement security. In 2005, the CalPERS Public Agency 457 Deferred Compensation Program celebrated 10 years of providing dependability, value, and retirement security to public agency and school district employees throughout California. During the past 10 years, we have made many enhancements to the program to respond to the needs of public employees. We want to thank those who have played a part in the program’s success.
The Program, which is available to local public agency and school members, welcomed an additional 2,086 new participants and 43 new agencies this past fiscal year. The program now has 21,542 members and 567 participating employers. Assets totaled $540.3 million at year end, a 22.1 percent increase from the previous year. Contributions and transfers amounted to $97 million; investment gains realized were $36 million. More than $35 million was paid to participating plan members for distributions and withdrawals.

The State Peace Officers’ and Firefighters’ Defined Contribution Program is available to Correctional Peace Officers. During 2005-06 fiscal year, the employer contributions were suspended for rank and file employees. Net assets increased by 7.9 percent to $259.5 million at June 30, 2006. Benefits paid out during the year were $6.6 million and contributions decreased 78.4 percent to $8.9 million. A total of 34,485 participants take advantage of the program.

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 2005-06, there were 879 participants and assets were valued at $20.8 million. Contributions were $634,000 for the year, and $2.1 million was paid in participant withdrawals.

**Member Home Loan Program**

The CalPERS Member Home Loan Program marked a high point too. It celebrated 25 years of helping California public employees realize the dream of home ownership. Since its inception in 1981, the program has made more than 126,520 real estate loans — resulting in a total real estate loan volume of more than $20.1 billion.

The Member Home Loan Program is available nationwide and offers 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 2,062 real estate loans totaling more than $462 million during the fiscal year.

**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, 2006, approximately $26 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 $14.4 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 total approximately $3.3 billion. We have earmarked more than $8.3 billion for housing, real estate development, and redevelopment in urban areas of California.
We are CalPERS

We believe a diverse workforce provides our organization with a variety of perspectives and enables us to effectively serve our diverse customer base. Our new Strategic Plan, developed under the leadership of our Strategic Management Services Division, highlights the importance of diversity as a fundamental business philosophy.

To promote diversity among our employees, Diversity Staff and Committee coordinated the first-ever Cultural Diversity celebration during the year. It featured the music, clothing, and food of many cultures and gave employees an opportunity to learn about the traditions of their fellow employees.
We Live our Core Values.

We foster a work environment that values quality, respect, diversity, integrity, openness, communication, and accountability.

We are CalPERS
Strengthening Enterprise-Wide Operations

The 2005-06 fiscal year brought with it many successes. In addition to the significant strides in improving our member and employer services, we continued a process to overhaul our information technology platform, took steps to develop new leaders and maintain the intellectual capital of our organization, launched several initiatives in response to an employee survey, and led the way in expanding our investment opportunities through diversity.

We began the fiscal year with a revised Strategic Plan that identifies the goals and principles that will guide our fund for the next five to 10 years. The plan calls for providing sustainable pension and health benefit programs that are responsive to and valued by CalPERS members, employers, and stakeholders.

Our Strategic Plan guided us in developing a Business Plan that included specific objectives and outcomes to achieve our goals in four major business categories. First, “The Enterprise” addresses our global leadership in pension and health benefits, our work culture, and our education and communication to members and stakeholders. Second, the area of pensions addresses the sustainability of our benefits and the cost-effective administration of those benefits. The third area focuses on our asset and liability management and achieving long-term returns. And the fourth area is health benefits, where our goal is to continue tackling the drivers of health care costs and seeking ways to moderate those costs.

Organizational Effectiveness
One of the keys to our success is the close interaction of employees in the various divisions of our organization. That interaction was demonstrated in the steps we took this past year to enhance our organizational effectiveness.

We continued to advance our plan to create a state-of-the-art integrated pension information database. Staff from throughout the organization have been involved in the project, which will harness the power of the Internet as the primary channel for conducting CalPERS business. Seven of the 10 database projects have been completed, with the remaining three scheduled for completion by 2009.

To enhance the protection of our members’ privacy, this year we mailed 500,000 tax statements in pressure-sealed envelopes. Our team of computer system security experts continued to seek other ways to protect member data. As a result of their efforts, our information systems were protected from thousands of viruses.

As a world leader in promoting corporate responsibility, we want to fully comply with rules, laws, and regulations. In 2005, we established an Office of Enterprise Compliance. During its first full year of operation, the office began planning an enterprise-wide compliance program in the areas of investment, health, and retirement. The office also launched an employee Web site and conducted compliance awareness training for staff.

Our Office of Audit Services conducts internal and field audits to ensure that our programs operate within prescribed laws and regulations. During the year, the office completed 47 public agency audits, provided consultation on 16 special projects, and completed 34 internal audits. The office also completed 26 health, real estate, and other contracted audits.

Our capacity to serve members was tested early in the fiscal year when Hurricane Katrina devastated parts of Louisiana and Mississippi. Our Benefits Services Division’s Program Support Unit quickly identified
more than 300 CalPERS members who lived in the affected areas. We took steps to locate these members to ensure that they received their retirement checks in a timely manner. Our Health Program staff also intervened to ensure that members who relocated continued to receive necessary care.

Following Hurricane Katrina and the subsequent Winter flooding in the greater Sacramento area, we reviewed our business recovery system to ensure that we are prepared to continue operating if a disaster strikes. We relocated our Business Recovery Center to a new site located outside the 500-year flood plain. It is equipped with computers and emergency power. It will enable us to restart our critical business processes within four days if a crisis makes Lincoln Plaza unusable.

**Diversity**

Our updated Strategic Plan highlights the importance of diversity as a fundamental business philosophy. To promote diversity among our business partners, the CalPERS Business Connection Program and Diversity Outreach Program participated in numerous conferences and business expos where diversity was the dominant theme. To educate staff about the value of diversity, we held our first Cultural Diversity Celebration, which featured the music, clothing, and food of many cultures and gave employees an opportunity to learn about the traditions of their fellow employees. A diverse workforce provides our organization with a variety of perspectives and enhances our ability to effectively serve our diverse customer base.

To ensure that our organization has the expert staff necessary to provide services into the future, three years ago we initiated a Succession Planning and Workforce Management Plan. The plan is designed to sustain current leadership, develop new leaders, and maintain the intellectual capital of our organization. To facilitate the development of new leaders, we implemented a Leadership Skills Assessment (LSA), which evaluates current employees who are candidates for succession. The LSA provides an understanding of the strengths, gaps, and developmental priorities for candidates and considers their potential to assume new roles.

We also made important progress in creating a system for maintaining our intellectual capital. This year, each division identified and prioritized key business areas in which documentation of policies and procedures is needed. To facilitate the process, we adopted Information Mapping (IM) — a technique that helps simplify and manage complex information. More than 100 staff members received training and certification in IM. The use of IM will ensure that future staff succession takes place without loss of organizational effectiveness.

As indicated in the profiles throughout this book, our employees are our most valuable asset. Based on employee feedback, we developed four broad initiatives and corresponding action plans designed to enhance employee satisfaction. The initiatives address open communication and employee engagement; growth and development; managing workload; and accountability for performance. Many activities related to the initiatives have been completed, and the remaining activities are targeted for completion by June 2007.

A new department-wide program expanded our current recycling of mixed paper and cardboard to include glass, plastic, and cans. All employees now have desk-side recycling containers. Our Café and all coffee stations, kitchenettes, and break rooms also
have containers for glass, plastic, and cans. The expanded program reflects our commitment to preserving our environment.

Our employees recognize that in addition to the vital role they play at CalPERS, they are also part of a larger community. Employees demonstrated their commitment to the community through participation in a variety of charitable activities. In 2005, our staff contributed more than $293,000 to the California State Employees Charitable Campaign, an increase of 15 percent over last year. For the fourth consecutive year, we donated more than 100,000 pounds of food to the annual holiday food drive. Throughout the year, 385 pints of blood were collected at several blood drives. At the Susan G. Komen Foundation Race for the Cure, our team of 124 employees doubled last year’s contributions, raising more than $20,000. And 65 employees participated in the March of Dimes WalkAmerica, raising more than $12,000.

Headquarters Expansion
In August 2005, a five-year expansion of our Lincoln Plaza headquarters complex was completed. As a result of the outstanding teamwork of hundreds of people, our headquarters complex now comprises three buildings. The newest buildings — Lincoln Plaza East and West — include a variety of state-of-the-art environmental and energy efficient designs. The expansion allows all our headquarters staff to be together, which will enhance internal communication and facilitate effective service to our customers. The Sacramento Regional Office is now easily accessible to members in the Lincoln Plaza East building.

Feedback & Recognition
We are pleased that our environmentally responsible business practices continued to be recognized. Our new headquarters received a gold LEED (Leadership in Energy and Environmental Design) certification for excellence in design, construction, and operation of green buildings. Lincoln Plaza also received an Environmental Recognition Award from the Sacramento Environmental Commission. This award honors individuals and organizations in the Sacramento area that have voluntarily exceeded environmental requirements or provided leadership in protecting and enhancing the environment. Additionally, a partnership of California utilities and other entities granted us a 2005 Flex Your Power Award. We were one of three winners in the category of “Best Overall” achievement for energy saving practices. Those practices include reducing overhead lighting during summer months and automatically powering down lights in offices that are not being used.

For the ninth consecutive year, we were awarded the “Certificate of Achievement for Excellence in Financial Reporting” from the Government Finance Officers Association. We were also recognized for “Outstanding Achievement in Popular Financial Accounting” for our Operations Summary. This award recognizes annual reports that are easily readable and organized, and satisfy both generally accepted accounting principles and legal requirements.

Plexus Group, a division of J.P. Morgan Chase Bank N.A., placed us in the top performance quartile of the Plexus Plan Sponsor Universe of more than 50 funds that oversee more than 600 equity asset managers. We were honored to receive the Plexus Group Gold Iceberg Award for the achievement.
We are Leaders.

We exercise state and national leadership to ensure the sustainability of CalPERS pension and health benefit systems.

We are CalPERS
We maintain an active State and federal legislative program designed to serve the best interests of our members and employers. Our Government Affairs staff analyze and monitor hundreds of bills and established positions based on our Board’s legislative standards.
State & Federal Legislative Update

The CalPERS Board of Administration maintains an active legislative program for the benefit of all members and employers, and works with staff and other stakeholders to develop legislative positions and proposals. During the fiscal year, our staff analyzed and monitored hundreds of bills and established positions based on our Board’s legislative policy standards that were designed to serve the best interests of our members and employers.

State Legislative Update

Listed below is a summary of CalPERS-related legislation last year. The new laws will become effective on January 1, 2007, unless otherwise noted in the summary.

A.B. 1643, Chapter 724 (Jones)
Requires the California Institute on Human Services at Sonoma State University, with assistance from the CalPERS Board, to contract with an organization experienced in disability policy and demographic research to conduct a study to determine the feasibility of expanding long-term care coverage to persons excluded from the program because of underwriting criteria, and to report the results of the study to the Legislature by December 31, 2008.

A.B. 2242, Chapter 611 (Committee on Public Employees, Retirement & Social Security)
Creates the Vision Care Program for State Annuitants Fund and establishes, under the administration of the Department of Personnel Administration, a voluntary vision care program for state retirees and their dependents. This vision care program would be a self-funded program with the participating enrollees paying a monthly contribution to sustain the program.

A.B. 2244, Chapter 355 (Maze)
Prohibits a governing body of a city or county from granting or paying for contributions for service credit for an elected officer or member of a board of supervisors for time that they did not serve in the elected office. It does not preclude an elected officer from purchasing service credit.

A.B. 2351, Chapter 121 (Chu)
Makes a clarifying amendment in the definition of “compensation” under the retirement law to allow a member employed at a school district or at a community college district to have their Workers’ Compensation temporary disability payments reported to CalPERS for purposes of receiving service credit.

A.B. 2544, Chapter 862 (Pavley)
Current law allows public agencies to provide retirees with an unequal employer contribution according to a specified formula for the health program. This bill revises that formula to require an employer contribution for retirees amounting to no less than the number of years that the contracting agency has been subject to PEMHCA, multiplied by 5 percent of the current monthly contribution for employees. The annual adjustment to the minimum monthly employer contribution for an annuitant shall not exceed $100.
A.B. 2667, Chapter 758 (Baca)
Gives express authority to the CalPERS Board to consider specified factors with respect to any individual or entity that seeks to contract with the System for the provision of health benefits. These factors would include whether the applicant is of reputable and responsible character, and whether the applicant has the ability to provide health care benefits or services based on their history of providing health care services. This bill also applies to the Department of Managed Health Care, the Department of Insurance, and the Department of Health Services.

A.B. 2863, Chapter 846 (Karnette)
Members with previous service with any of the Riverside agencies specified in the bill are allowed to have that service covered under the 3% at 60 retirement formula. This bill applies to persons employed by any of these agencies at the present time, as well as to those with such service in the past who are returning to work with any of the Riverside agencies or at any time in the future. Urgency legislation, effective 9/30/06.

A.B. 2941, Chapter 442 (Koretz)
Prohibits CalPERS and CalSTRS from investing public employee retirement funds, as defined, in a company with business operations in the Sudan, that meet specified criteria, and requires the Boards of these retirement systems to sell or transfer any investments in these companies within specific time frames. This bill also requires each Board to submit a specified annual report to the Legislature on or before January 1, 2008.

A.B. 3033, Chapter 834 (Lieber)
Authorizes local firefighter members of CalPERS to elect to receive service credit for public service as permanent career firefighters, if the service was terminated as a result of closure, downsizing, or realignment of a federal military institution. These provisions must be adopted by their contracting agencies.

A.B. 3041, Chapter 326 (Pavely)
Provides that employees, retirees, and family members enrolled in a Board-approved or offered health benefit plan that provides a PDP or qualified prescription drug coverage would not be prohibited from enrolling in a Board-approved health benefit plan.

S.B. 739, Chapter 526 (Speier)
Establishes the Hospital Infectious Disease Control Program requiring the Department of Health Services and general acute care hospitals to implement measures relating to disease surveillance and the prevention of health care associated infection. The bill also requires that hospitals take measures to prevent the spread of influenza in hospitals. Hospitals are required to report to DHS their implementation of infection prevention measures and develop procedures to prevent secondary surgical site infections.

S.B. 1168, Chapter 642 (Chesbro)
Extends the operation of the Rural Health Care Equity Program from January 1, 2008 to January 1, 2012, or until the Board determines that health maintenance organization plans are no longer the most cost-effective health benefit plans offered by the Board. The program is contingent upon funding in the Annual Budget Act.

S.B. 1207, Chapter 871 (Alarcon)
Allows California incorporated public corporations, without cumulative voting, to adopt a majority vote requirement for uncontested board of director elections, and specifies procedures to be followed if an incumbent director fails to be elected at such an election. Maintains the plurality vote as the default
standard for uncontested board of director elections of these corporations.

S.B. 1273, Chapter 307 (Soto)
Authorizes a private nonprofit area agency on aging to enter into a contract with CalPERS for participation of the agency’s employees as members of the System, if the agency obtains a ruling from the U.S. Department of Labor defining it as a public agency.

Federal Legislative Update
Lawmakers passed a pension reform bill that President Bush signed into law in August 2005. Congress approved legislation that, among other things, makes permanent the pension provisions of the 2001 tax cut bill; revises rules regarding the purchase of service credits; waives certain early withdrawal penalties for public safety employees who are at least 50 years old; and provides some relief from minimum distribution rules and permits retired or disabled public safety employees to pay for health or long-term care insurance with pre-tax money.

Defined benefit pension plans continued to be scrutinized and criticized during the past year. Deloitte Research released a study in July examining a “public pension crisis” that it said “stems from years of bad planning and poor decisions,” and Standard & Poor’s reported that public pension funding in the United States’ 20 largest cities fell from 99.8 percent to 84 percent in the past five years. The chairman and ranking Democrat of the Senate Finance Committee, meanwhile, wrote to the Government Accountability Office in July requesting a study of public plan funding, and the House Education and Workforce Committee held a field hearing in August to examine public pensions.

Social Security reform faded further into the background. Congress also shied away from health care reform, failing to pass even small, relatively noncontroversial proposals, such as one that would enhance the use of information technology (IT) in the health care system. Although both the House and Senate passed their own versions of health IT legislation, and there is general agreement that digitizing medical records would save lives and money, the bills stalled and, as of mid-October, it did not appear that a Conference Committee would be appointed to write a compromise bill.

The Public Sector HealthCare Roundtable, a group that CalPERS helped to form in 2005 to advocate for the interests of public plans in the health care debate, wrote to key lawmakers to urge them to move this legislation. The Roundtable also sent letters to members of Congress to ask that they pass a bill related to the availability of generic prescription drugs. Congress once appeared likely to pass legislation this year on association health plans, but opponents, including CalPERS, blocked that effort, arguing that the plans would do more harm than good by drawing younger, healthier people out of traditional plans, thus raising the costs for older and less healthy individuals.

On the investment front, discussions continued about revising the four-year-old Sarbanes-Oxley Act, which implemented accounting and corporate governance reforms, but no action was taken. CalPERS Chief Investment Officer Russell Read testified before the Senate Banking Committee in September outlining his concerns with stock options backdating and asking the panel to urge the Securities and Exchange Commission to crack down on the practice. CalPERS Senior Investment Officer for Global Public Equity

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Christiana Wood, meanwhile, told members of the House Financial Services Committee in May that companies should be required to make their executive compensation policies more transparent. The Securities and Exchange Commission in July adopted a rule intended to enhance disclosure of such policies.
We are Focused on the Future.

We remain committed to fulfilling our mission of providing retirement and health security to California’s public employees.

We are CalPERS
The Year Ahead

We are CalPERS

As our membership grows, we are empowering members to serve themselves. A dedicated team of employees is creating a new personalized member portal called myCalPERS. It will provide members seamless and fast access to personal information — all in a format that they create. Our myCalPERS team is employing the most sophisticated security methods to provide members the assurance that their personal information is fully protected.
The Year Ahead

This Operations Summary has described many of our key accomplishments for the 2005-06 fiscal year. As we enter our 75th year of serving public employees, we are more committed than ever to meeting and exceeding our members and employers expectations.

Our revised Strategic Plan and three-year business plan guide our course in the new fiscal year. We will pursue Plan goals that address our primary lines of business: pension benefits, health benefits, and investments, as well as our enterprise-wide operations. In each of these areas, we will engage in responsible and creative activities to respond to both the changing business environment and the changing needs of our customers. All of our actions will support our ongoing commitment to providing the value and security our customers expect.

As we look to the future, we can envision a time when the number of retirees we serve grows from its present 450,000 to more than one million. One way we are preparing for the future is by creating more opportunities for members to serve themselves, when they require basic information about their account or have general questions about our services. This greater reliance on self service will enable our Customer Contact Center and Regional Office employees to provide one-on-one assistance to members with more complex needs. Recent focus groups demonstrated members’ willingness to serve themselves, when the self-service tools are secure and easy to understand. Members want self service to be an expansion of their service options, rather than a substitute for personal contact. As we transform our service delivery processes, we will remain mindful of the expectations of our members, and we will not lose sight of the value of direct member contact.

The need for easy-to-use self-service options is driving our creation of a new personalized member Web site called myCalPERS. Members will be able to build a Home Page where they can view information such as their total service credit, years of service, total contributions, retirement formula, current health plan and premium, enrolled family members, and other personal data. The myCalPERS site will provide members seamless and fast access to the personal information they want — all in a format they create. The new site will incorporate the most sophisticated security methods available to provide members the assurance that their personal information is fully protected. A concept similar to myCalPERS could be beneficial to employers, and we will be analyzing the efficacy of such a service, while recognizing that employers require ongoing dialogue with our staff.

Another way we will empower members to serve themselves is through expanded online educational offerings that provide 24/7 financial planning courses for members at all stages of life. We will also be creating an online system through which members and employers can register for online or instructor-led classes and schedule an appointment at a Regional Office.

In addition to changing the way we serve our members, we will also be considering new products. As part of our vision to be a full-service provider of financial products, we will be exploring innovative ways to expand the investment options available to members.

We recognize that our employers’ needs are changing too, and we remain committed to responding to those needs. We will take the first steps to set up investment accounts that will help our CalPERS public employers pre-fund retiree health care costs, and comply with the new Governmental Accounting
Standards Board requirements. The pre-funding approach will offer a lower cost option for local governments, as earnings on those assets could reduce employer contributions significantly. Returns on employer investments might cover many of those long-term health care bills, as investment earnings do now for pensions. By drawing on the same expertise and asset allocations that have given us double-digit returns on our investment fund for the past three fiscal years, we can help fund retiree health benefits.

Just as more of our members are retiring, so too, many of our own employees are approaching retirement age. Our Succession Planning and Workforce Management Program will continue to develop and prepare leaders to fill future vacancies. In the year ahead, we will expand the succession planning program to address all leadership levels and take proactive steps to maintain a skilled workforce. We will move forward with the vital task of documenting our key business processes to ensure the preservation of organizational knowledge. Completion of a series of employee-driven internal initiatives will enhance our working environment. And we will explore ways to improve cross-divisional communication to provide employees greater insight into activities occurring throughout the organization.

With the selection of a contractor to develop our consolidated pension information system, the new fiscal year will be vital in preparing us for the future. Our sophisticated new data system will address all the fundamental business requirements necessary to ensure the highest level of member and employer service. The new modernized database system is expected to harness the power of the Internet, and will ultimately provide for faster, more reliable and more cost-effective service, while increasing capacity and simplifying the pension fund’s technology infrastructure.

In the coming year, our Health Program will take a three-pronged approach to moderating future cost trends by analyzing utilization and cost data, identifying initiatives to attack cost drivers, and actively negotiating for the best possible rates with CalPERS health plans. A new three-year contract with Medco Health Solutions to administer our prescription drug benefits program requires unprecedented disclosure of Medco’s discounts and rebates from manufacturers. Similarly, our multi-year contract with Blue Shield — which begins in 2007 — calls for greater transparency of costs and services. Transparency will also be a vital consideration as we select the next medical administrator for our self-funded PPO plans — PERS Choice and PERSCare. The new contract will require greater transparency in clinical outcomes and more disclosure of costs for provider reimbursement and program administration.

Early in the next fiscal year, our Partnership for Change will release data from two key studies: the California Hospital Assessment and Reporting Taskforce — which will address hospital clinical quality measures — and the Hospital Value Initiative — which will provide standard measures to calculate the cost efficiency of hospitals. Both studies will include cost and quality information that will enable identification of the highest value hospitals. In the national arena, the Public Sector HealthCare Roundtable will focus on reducing barriers that delay the availability of lower-cost generic drugs in the marketplace.

In our investment operations, we will continue to seek long-term, sustainable, risk-adjusted returns. In the coming year, the Board will explore the possibility of adding commodities as an asset class. Market trends point to significant capital growth in the commodities
sector and in projects that produce and distribute commodities. We are looking beyond short-term developments in these markets for long-term investments to further diversify our portfolio, add value, and reduce risks.

Our activism in corporate governance has evolved over the last 20 years. We have helped bring about a greater understanding of the benefits of strong independence, accountability, and transparency. We will continue to play a key leadership role in the drive to make boards more accountable to shareowners. We anticipate that increasing numbers of boards will respond to proposals to secure the majority vote in corporate elections, end super-majority vote requirements to pass company by-laws, and give shareowners a stronger voice in executive compensation decisions. We also will advocate and support action by market regulators against abuses related to the backdating and spring-loading of stock options that benefit executives regardless of their performance.

We believe our environmental initiatives will gain momentum as we receive information from companies about climate risks, including emissions of greenhouse gases. The next step entails potential increases in commitments to clean technologies to reduce such risks and in new ventures to develop new energy-producing resources.

Going forward, we will retain and draw upon our excellent investment staff, our diversified portfolio, and our commitment to making every dollar count in returns that will secure defined pension benefits, as we have done for more than seven decades.

Our 75th year will be a time to remember our accomplishments and celebrate our strengths. Those strengths are rooted in the strong bonds we have with our members and employers, as well as the dedication of our employees and the vision of our leadership. As we prepare for the challenges and opportunities of the future, we will remain committed to fulfilling our mission of providing retirement and health security to California’s public employees.
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Photo, bottom right: Bret Grosso

Introduction, Page 5
Carlous Johnson and Hillary Sunada

Introduction, Page 6
Pension System Resumption (PSR) Team


Pension Plan Services for Members & Employers, Page 15
Account Manager Team
Seated, from left to right: Sharon Sanderson, Roger Santiago, and Lilia Kirlis.
Standing, from left to right: Mohini Singh-Ram, Joseph Caffrey, Serena Crisologo, Bonnie Smith, and Lydia Perez.

Pension Plan Services for Members & Employers, Page 16
Retirement Applications for Disability Accelerated Response (RADAR) Team
From left to right: Ken (Yat) Ng, Valvita Davis, Kris Hilliker, Tamara Nguyen, Emma Shaw, Shayne Day-Bolar, Ralph Smith, and Martha Favila-Vazquez.
Not pictured: Lea Landry, Connie Meister, and Michelle Boyer.

Health Benefits Program, Page 23
From left to right: Densie Clemens, Jamila Ponnley, Don Jarrell, and Julie Okimura.
Health Benefits Program, Page 24
Health Benefits Rate Renewal Team
*Seated, from left to right:* Kathy Donneson, Stacie Sormano, Marc Leonard, Jim Loftin, and Bill Alameda.
*Standing from left to right:* Debbie Bennett, James DeBenedetti, Richard Waters, and Kim Maness.
*Not pictured:* Carla Corbett and Beverly Craig.

Investment & Corporate Governance Programs, Page 31
*From left to right:* Christopher L. Gray, Marina Kong, and Kevin Winter.

Investment & Corporate Governance Programs, Page 32
Corporate Governance Team
*Front row, from left to right:* Mary Morris, Aeisha Mastagni, and Bill McGrew.
*Back row, from left to right:* Kelly Forrest, Simiso Nzima, Craig Rhines, and Bridgette Butler.

Strengthening Enterprise-Wide Operations, Page 45
Strategic Management Services Team
*First photo (left)*
*Seated, left to right:* Kristin Sawchuk, and Kami Niebank.
*Standing, left to right:* Angela D’Ambrosio, Deann Gee, and Karen Van Amerongen.

*Second photo (right)*
*Seated:* Kimberly Mayhugh
*Standing, from left to right:* Christina Forakis, and Milly Romero-Salas.
*Not pictured:* Brian Gould

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Diversity Staff & Committee
*From left to right:* Sandy Santiago, Carol Gale, Joseph Jackson, Lindy Plaza, Gina Crawford, Michael Dennis, and Lindy Lingren.

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*In foreground:* LaTrenia Minnifield

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Governmental Affairs Team
*From left to right:* Linda Clifford, Jennifer Watson, Danny Brown, Dagmar Wheeler, and Evelyn Stacey.
*Not pictured:* Kathleen Padilla and David Rubio.

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*From left to right:* Judy Allen, Jasbeen Singh, Jamila Ponnley, and Derek Chan.

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myCalPERS Team
*From left to right:* Paul Lewis, Sean Crutcher, Darryl Watson, Marilyn Clark, Ladonna Green, and Sean Randell.
*Not pictured:* Tim Taylor and Virginia Kayoda.