Investment Committee

California Public Employees' Retirement System

Agenda Item 5a

May 14, 2012

ITEM NAME: Adoption of Asset Allocation Investment Strategy for Terminated Agency Pool

PROGRAM: Affiliate Investment Programs

ITEM TYPE: Asset Allocation Performance & Risk – Action

RECOMMENDATION

Approve the recommended asset allocation investment strategy as shown in Attachment 1 for the Terminated Agency Pool (the Pool). Wilshire Associates' opinion letter is included as Attachment 2.

EXECUTIVE SUMMARY

This agenda item provides the analysis and recommendation for the Terminated Agency Pool's investment strategy to reduce the investment risk based on the Board's decision in August 2011 to adopt a more conservative asset allocation.

BACKGROUND

Currently the Terminated Agency Pool exists within the Public Employees' Retirement Fund (PERF) to provide for the payment of benefits to members who are employees of agencies who have terminated their contract with CalPERS. When a contracting agency terminates its CalPERS contract, the assets and liabilities of the agency are merged into the Pool.

The estimated market value of assets attributable to the Terminated Agency Pool as of June 30, 2011 is $172 million and the actuarial liabilities attributable to the Pool are $91 million. This results in a funded status of 189%. Expected benefit payments attributable to the Pool approximate $4.2 million annually.

As with all pension plans there is a risk that the Pool could become underfunded at some point in the future. Currently the Pool is invested in the same asset allocation as the rest of the PERF. Although the Pool is very well funded at this time, the funded status could change with the termination of one large employer, or a number of smaller employers, which could significantly dilute the funded status of the Pool and substantially increase the risk of underfunding. Additionally, the Pool's funded status is affected by investment returns and actuarial experience (e.g., mortality rates, salary increases) being different than expected.

Should the Pool become underfunded, CalPERS has limited recourse against terminated agencies, and member benefits may be impacted. Since the Pool is currently very well-funded, an opportunity exists to mitigate investment risks by creating a different asset allocation for the Pool than the rest of the PERF. On August 17, 2011, the Board approved:

- The concept of adopting a more conservative asset allocation strategy for the Pool to match its investment cash flows with future expected benefit payments.

- Initiating the Rulemaking process for the California Code of Regulations to credit income to the Pool based on this investment strategy. These rules were approved in December 2011.

- Adopting a revised method to determine the discount rate and the setting of the actuarial assumptions when calculating the actuarial liabilities of a public agency at the time it terminates its contract with CalPERS and for the annual actuarial valuation of the Pool.

ANALYSIS
The Investment Office and the Actuarial Office collaborated on the analysis to recommend an investment strategy limiting the investment risk of the Pool. Attachment 1 provides this analysis and a recommended asset allocation strategy.

BENEFITS/RISKS
Should the Pool become underfunded, member benefits may be negatively impacted. The recommended investment strategy mitigates investment risks and will help maintain the current funded status. However, other risks remain such as actuarial risks and the risk of a large employer entering the Pool and diluting the funded status. These risks are more difficult to mitigate. Should the funded status change materially in the future, staff will revisit the asset allocation strategy and return to the Investment Committee with recommended changes as needed.

ATTACHMENTS
Attachment 1 – Terminated Agency Pool Asset Allocation
Attachment 2 – Wilshire Associates Opinion Letter

____

GERALDINE JIMENEZ
Division Chief
Affiliate Investment Programs

____

BEN MENG
Senior Portfolio Manager
Asset Allocation

____

JANINE GUILLOT
Chief Operating Investment Officer

____

JOSEPH A. DEAR
Chief Investment Officer