Wilshire

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Managing Director & Principal

May 2, 2012

Mr. Henry Jones
Chair, Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Adoption of Asset Allocation Investment Strategy for Terminated Agency Pool

You requested our opinion regarding the asset allocation for the Terminated Agency Pool proposed by Staff.

Recommendation

Wilshire recommends that the Investment Committee approve the asset allocation as presented by Staff, with the caveat that the addition of any significant amount of new assets and liabilities should trigger an immediate review and, if needed, revisions to these asset allocation targets.

Background

Wilshire has not conducted an independent calculation of the funded status or alternative asset allocation mixes. However, given the apparent significant level of overfunding of the terminated agency pools, we see no reason that a parallel calculation is necessary at this time.

The asset allocation targets presented by Staff are extremely conservative and, as Staff has modeled, should protect the assets through the vast majority of possible scenarios, including significant longevity risk or a high inflation environment. It should be noted that the proposed allocation forgoes an opportunity to participate in global economic growth through equity exposure, which is a dominant driver of expected return in the PERF portfolio. However, the difference in funding levels between the Terminated Agency Pool and the PERF is significant and the recourse against the employers in the Terminated Agency Pool is limited. Therefore, such a conservative allocation is deemed prudent.

As noted above, however, new assets will likely enter this pool at a far lower level of funding. If new assets significantly impact the overall funded status of the total plan, these asset allocation targets may no longer be appropriate. We commonly advise clients that they should review their asset allocation every three years or when there is a significant change in the structure of the plan. The addition of significant new assets and liabilities would constitute such an exception to the three year rule.

In short, an asset allocation target that works for a plan that is 190% funded may not work equally well for a plan that is 110% funded in all of the economic scenarios reviewed and therefore should be revised as events warrant.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

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