Asset Allocation Investment Strategy for Terminated Agency Pool

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CalPERS | Investment Office
Asset Allocation

Background

- At the November IC meeting, staff was directed to develop an asset allocation strategy for the Terminated Agency Pool (TAP) with the following two segments:
  1. Immunization:
     - Treasury securities (STRIPS and TIPS)† and cash or cash equivalents would be used for the purpose of immunization against liability.*
  2. Surplus:
     - The remaining surplus after the allocation of current assets for immunization would remain invested with the rest of the Public Employees' Retirement Fund (PERF).

† STRIPS is an acronym for "Separate Trading of Registered Interest and Principal of Securities" and TIPS for "Treasury Inflation Protected Securities."
** Liability is estimated to be about $110 million with a discount rate of 1.2%, which is the nominal yield of the recommended strategy.*

Recommendation

- Staff recommends the assets of the TAP be invested as two independent segments:
  1. Immunization Segment:
     - Allocation: Approximately $110 million would be allocated for immunization. To account for estimation errors, two years worth of expected benefit payments would be reserved as a cushion which will be invested in cash or cash equivalents. The current estimate of the cushion is about $10 million.
     - Objective: To provide sufficient cash flows to pay all the expected benefit payments of the TAP provided that we are able to reinvest at current interest rate levels.
     - Structure: A mixture of STRIPS, TIPS and cash or cash equivalents.

Recommendation (continued)

- Example of a possible asset allocation strategy for the immunization segment under current market conditions:

Asset	Weight in Immunization Segment	Nominal Yield
STRIPS (1-10 year maturities)	35%	1.2%
TIPS (11-30 year maturities)	57%	
Cash or cash equivalents	8%	

Recommendation (continued)

2. Surplus Segment:
   - Allocation: Approximately $64 million would remain after the allocation of assets for immunization.
   - Objective: To seek higher expected returns than Treasury securities and to benefit from the resources allocated to the PERF.
   - Structure: The surplus would remain invested with the rest of the PERF.

Next Steps

The Investment Office would implement the Terminated Agency Pool investment strategy upon approval by the Investment Committee.

The Investment Office and Actuarial Office would continue to collaborate to monitor the funded status of the Terminated Agency Pool and rebalance the recommended portfolio annually.

The standard policy requires a review of the asset allocation of the Terminated Agency Pool at least once every three years, or as needed if there is a material change of funded status.