Wilshire

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April 24, 2015

Mr. Henry Jones
Chairman of the Investment Committee
California Public Employees' Retirement System
400 P Street, Suite 3492
Sacramento, CA 95814

Re: Long Term Care Program Asset Allocations Review and Policy Revision

Dear Mr. Jones:

The Board of Administration approved a three-year plan to improve the sustainability of the Long Term Care Program (LTC) in 2012. The goal of this project (the Stabilization and Open Application Period Project (SOAPP)) was to stabilize and enhance the long-term stability of the LTC by restructuring premiums and benefit packages and shifting the fund to a more conservative asset allocation strategy. Since the implementation of SOAPP is still in progress, Staff recommends, and Wilshire agrees, that the Investment Committee should approve the current asset allocation, as the final outcome of the project will materially change future liabilities of the fund.

Wilshire also agrees that staff needs a mechanism to halt the progression of a scheduled asset liability study in order to receive better clarification of how liabilities will be impacted when significant changes are being made.

Recommendation

Wilshire has reviewed staff's recommendation to remain at the current asset allocation until the SOAPP is completed and the new characterization of the liabilities of the LTC Fund is calculated. This recommendation is consistent with the CalPERS Investment Belief #1 – Liabilities must influence asset structure.

Additionally, staff is proposing that modifications be made to the Total Fund Investment Policy Statement and the Statement of Investment Policy for the Long Term Care fund.

The proposed change to the Total Fund Investment Policy Statement permits staff to reassess the timing of a scheduled asset liability study for ALL funds (i.e. PERF, Affiliates and LTC) if the Board of Retirement approves a change to any of the funds that would impact projected liability values. Following an approved change by the Board, staff would return to the IC with an assessment and recommendation as to whether the asset allocation study should be postponed pending an analysis on the impact to liabilities

The proposed changes to the Statement of Investment Policy for the LTC Fund include a reflection of the change cited above for the Total Fund Investment Policy Statement and an acknowledgement that the LTC is managed entirely by external managers. Additionally, a section on Target Tracking Error is added to mirror the tracking error forecasts described in the Total Fund Investment Policy.

Wilshire agrees with the proposed changes to both the policy statements and agrees that staying with the current asset allocation is prudent given the uncertainty of the liability calculation. However, we also recommend that the Investment Committee propose specific guidelines with respect to timing and subsequent review of the progress of any project when approving a postponement in the process of a currently authorized asset liability study. The asset allocation for the LTC was approved in 2012 and has lingered for three years as the SOAPP completes its mandate.

Discussion

Asset liability studies are conducted every four years and involve multiple offices within the CalPERS organization. These studies require the copious use of resources at great expense to CalPERS. A meaningful change in the required data inputs for an asset liability study will compromise the analysis and require a restart of the process. The ability to pause and reassess the impact of changes approved by the Board will mitigate the potential of being in a perpetual asset-liability cycle and free up time for staff that could be used for more valuable endeavors. The effect of this change is consistent with Investment Belief #4 – Long-term value creation requires effective management of three forms of capital: financial, physical and human.

If you have any questions or comments, please contact us.

Sincerely,