



## Agenda Item 6b

June 15, 2015

**ITEM NAME:** Long-Term Care Fund Asset Allocation Review and Proposed Policy Revisions

**PROGRAM:** Long-Term Care Program

**ITEM TYPE:** Asset Allocation, Performance & Risk – Action

### **RECOMMENDATION**

Approve the following recommendations regarding the Long-Term Care (LTC) Fund:

- Maintain the current asset allocation for the LTC Fund,
- Approve the proposed revisions to the Statement of Investment Policy for the LTC Fund provided as Attachment 1, and
- Approve the proposed revisions to CalPERS Total Fund Investment Policy provided as Attachment 2.

### **EXECUTIVE SUMMARY**

CalPERS Board of Administration (Board) is responsible for the administration and investment of the LTC Fund, which is independent of the Public Employees' Retirement Fund (PERF).

At the May 18, 2015 Investment Committee (IC) meeting, Agenda Item 7a presented recommendations for the LTC Fund in which staff sought feedback and guidance from the IC on the following:

- The recommendation to maintain the current asset allocation for the LTC Fund,
- The proposed revisions to the Statement of Investment Policy for the LTC Fund provided as Attachment 1, and
- The proposed revisions to CalPERS Total Fund Investment Policy provided as Attachment 2.

Based on the direction provided at the May 18, 2015 IC meeting, staff is modifying the policy language that was proposed, as follows:

- Added language to the Statement of Investment Policy for the LTC Fund, in Section V. B., Strategic Asset Allocation Process, outlining the conditions for altering the strategic asset allocation schedule, by referencing the CalPERS Total Fund Investment Policy, in Section II, Asset Allocation Strategy, Investment Approaches & Parameters, Implementation, Item B.
- Adding "liabilities" to CalPERS Total Fund Investment Policy, in Section II.B., Asset Allocation Strategy, Implementation.

## **STRATEGIC PLAN**

This agenda item supports the CalPERS Strategic Plan goal of improving long-term pension and health benefit sustainability by evaluating the current strategic asset allocation of the LTC Fund and relevant policy guidelines, and recommending a course of action given the current status of the LTC Program. This agenda item supports the following CalPERS Investment Beliefs:

- Investment Belief # 1 – (Liabilities must influence the asset structure): This agenda item recommends maintaining the current asset allocation, given the uncertainty in the future benefits, premiums, and liabilities.
- Investment Belief #10 – (Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives): This agenda item improves the policies and processes governing the management of the LTC Fund.

## **BACKGROUND**

The current Statement of Investment Policy for LTC mandates a comprehensive asset allocation review be presented to the IC at least every three years, with the last comprehensive asset allocation review presented to the IC in May 2012.

In 2012, the Board approved the Stabilization and Open Application Period Project (SOAPP) to stabilize and enhance the long-term sustainability of the LTC Program. Key components of SOAPP included a restructuring of the premiums and benefit packages. SOAPP is still active whereby enrolled members are choosing amongst various premium payments and benefit packages through 2016. The outcome of these decisions will materially affect the future benefits and premium estimates.

At the May 18, 2015 IC meeting, staff sought feedback on postponing the strategic asset allocation review of the LTC Fund until the SOAPP is fully implemented, and to align the strategic asset allocation schedule for the LTC Fund to be consistent with the revised Asset Liability Management (ALM) schedule for the PERF and the other Affiliate Programs. Moreover, the asset classes were reclassified to be consistent with the other Affiliate Funds and Liquidity was made an asset class with a 0% target and a +2% range.

## **ANALYSIS**

### **Recommendation**

A summary of the recommended strategic asset allocation and investment policy changes and rationale are as follows:

1. Staff recommends maintaining the current strategic asset allocation, including an explicit recognition of Liquidity as an asset class, as follows in Table 1:

**Table 1: Strategic Asset Allocation Weights and Ranges**

Asset Class	LTC Fund	
	Policy Target	Policy Range Relative to Target
Global Equity	15%	+/- 4%
U.S. Fixed Income	61%	+/- 5%
Treasury-Inflation Protected Securities (TIPS)	6%	+/- 2%
Commodities	6%	+/- 2%
Real Estate Investment Trusts (REITs)	12%	+/- 4%
Liquidity	0%	+ 2%
Total	100%	

Staff believes it is advisable to avoid transaction costs which would result from any asset allocation repositioning, given the uncertainty in the future benefits, premiums, and liability estimates as a result of the LTC Program stabilization efforts. Instead, staff recommends postponing the strategic asset allocation review until there is more clarity, and this work may be integrated into the ALM schedule being used for the PERF and the other Affiliate Programs.

- Staff recommends modifying CalPERS Total Fund Investment Policy and the LTC Fund Statement of Investment Policy in order to align the strategic asset allocation process of the LTC Fund with the PERF, strengthen the operational processes of the Investment Office, and avoid administrative or other expenses associated with a scheduled review of the strategic asset allocation process while the program is undergoing significant changes. Please see proposed black-lined changes in Attachments 1 and 2. Changes from the black-lined version presented to the IC on May 18, 2015 have been highlighted.

**BUDGET AND FISCAL IMPACTS**

Not Applicable

### **BENEFITS/RISKS**

The proposed recommendations provide the following benefits:

- Maintains the same target asset allocations which results in the maintenance of approximately the same risk and return profile established in 2012.
- Avoids transaction costs by not re-allocating the LTC assets while the underlying program is undergoing a restructuring and while the choices of the member's premium and benefit packages are unknown.
- Aligns the strategic asset allocation process of the LTC Fund with the PERF.
- Recognizes the need to potentially postpone scheduled asset allocation activities during periods of restructuring or assessment as directed by the Board.

The proposed recommendation carries with it the following risk:

- A risk to maintaining the existing asset allocation is that the current portfolio may be suboptimal given the latest capital market assumptions.

### **ATTACHMENTS**

- Attachment 1 – LTC Statement of Investment Policy with Proposed Revisions
- Attachment 2 – CalPERS Total Fund Investment Policy with Proposed Revisions
- Attachment 3 – Wilshire Associates Opinion Letter
- Attachment 4 – PCA Opinion Letter

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