Affiliate Trust Asset Allocation Review: California Employers' Pension Prefunding Trust (CEPPT)

Trust Level Portfolio Management

Global Equity, Affiliate Investment Program

June 17th, 2019

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Overview of Program Characteristics

Strategic Asset Allocation and Recommendation

CEPPT - Program Overview: Purpose and Establishment

Required pension contributions are on track to rise over the next several years.

As one option to address this challenge, the California Legislature established the California Employers' Pension Prefunding Trust (CEPPT) effective 1/1/2019 to allow state and local public agency employers that provide a defined benefit pension plan to their employees to prefund their required pension contributions and invest those contributions within a trust that is intended to meet the requirements of Section 115 of the Internal Revenue Code.

The CEPPT will be:
- Exempt from taxation
- For a defined governmental purpose (i.e. prefunding pension contributions)
- Irrevocable for contributions and earnings to the trust
- Open to terminations with a transfer to another Section 115 trust with same purpose
- Same trust type used for CERBT

Trust participants do not need to be CalPERS pension participants.

Contributions are voluntary.

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CEPPT - Program Overview: Benefits and Alternatives

Potential Employer Benefits

- Budget stabilization, smoothing of pension payments
- Diversified investments with strategic asset allocation
- Established relationship with CalPERS
- CalPERS is a low cost provider

Potential Employer Alternatives to the CEPPT

- Employer self-managed investments
- Local Agency Investment Fund
- Contribute to the PERF
- Other prefunding trust providers
- Reduce services
- Increase taxes

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CEPPT - Program Overview: Projected Characteristics

Characteristic	Description
Eligible participants	State of CA and CA public agency employers offering a defined benefit plan to their employees
Contributions/ distributions	Voluntary, determined by employer Variable in size and timing
Time horizon	Short to medium-term
Risk tolerance	Low to moderate
Use of funds	Paying pension contributions Transferring to Section 115 trust for same purpose

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Overview of Program Characteristics

Strategic Asset Allocation and Recommendations

CEPPT - Plan Characteristics and Effect on Asset Allocation

Characteristic	Description	If it is…	…Implication
Contributions / Distributions	Voluntary and variable	Uncertain cash in/out, at uncertain times	Requires liquid & less risky portfolios
Investor Time Horizon	Employers may have differing time horizons	Shorter time horizon	Low risk portfolios
		Medium time horizon	Medium risk portfolios
Investor Risk Tolerance	Employers may have differing risk tolerance	Low tolerance	Low risk portfolios
		Medium tolerance	Medium risk portfolios

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CEPPT - 2019 Capital Market Assumptions and Constraints

| 2019 Capital Market Assumptions[1]				Correlation				Constraints (%)	
Asset Class	Arithmetic Return	Geometric Return	Volatility (Std. Dev)	Global Equity	Fixed Income	TIPS	REITs	Floor	Cap
Global Equity	8.03%	6.70%	16.90%	1.00	-0.13	0.12	0.78	0%	100%
Fixed Income	3.46%	3.35%	4.75%	-0.13	1.00	0.75	0.15	0%	100%
TIPS[2]	3.17%	3.00%	6.00%	0.12	0.75	1.00	0.30	5%	100%
REITs[3]	7.20%	5.50%	19.00%	0.78	0.15	0.30	1.00	8%	100%
U.S. Inflation Assumption: 2.10%									

1. Assumptions of 1-10 year forecasted expected returns.
2. Treasury Inflation-Protected Securities (TIPS)
3. Real Estate Investment Trusts (REITs); REITs expected returns are estimated using a Dividend Discount Model.

CEPPT - Efficient Frontier

Returns %
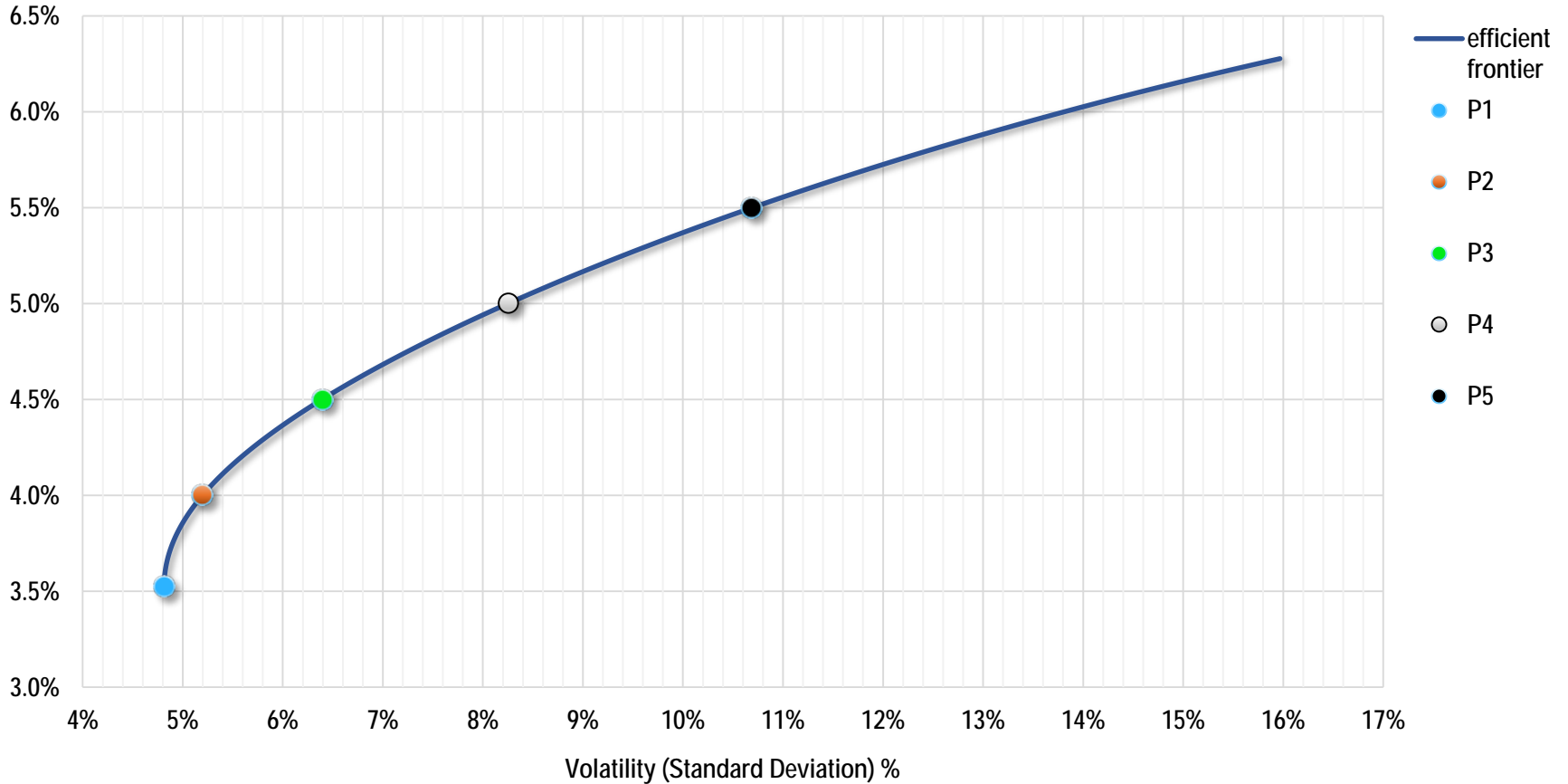
Note: Portfolios shown on the efficient frontier are net of fees of 25 basis points.

CEPPT - Candidate and Recommended Portfolios

	Asset Class Component	Asset Allocation of Candidate Portfolios				
		P1	P2	P3	P4	P5
Components	**Global Equity**	3%	14%	26%	40%	56%
	Fixed Income	84%	73%	61%	47%	31%
	TIPS	5%	5%	5%	5%	5%
	REITs	8%	8%	8%	8%	8%
Statistics	**Expected Volatility (Standard Deviation)**	4.8%	5.2%	6.4%	8.2%	10.7%
	Expected Compound Return (1-10 Years) [1]	3.5%	4.0%	4.5%	5.0%	5.5%
	Expected Tail Risk - Monte Carlo VaR [2]	4.0%	5.3%	7.7%	11.0%	15.3%
Strategy	**Recommendation for Plans**		**CEPPT Strategy 2**		**CEPPT Strategy 1**	

1. Expected Compound Returns shown are net of fees of 25 basis points.
2. Expected Tail Risk - Value at Risk (VaR) calculates the maximum loss expected (or worst case scenario), over a 1 year period given a 95% level of confidence.

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CEPPT - Recommended Benchmarks

Asset Class	Benchmark
Global Equity	MSCI ACWI IMI (Net)
Fixed Income	Bloomberg Barclays U.S. Aggregate Bond Index
TIPS	Bloomberg Barclays U.S. TIPs Index, Series L
REITs	FTSE EPRA/NAREIT Developed Liquid (Net)
Liquidity	91-day Treasury Bill (asset class utilized for operating cash)

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CEPPT - Recommended Asset Class Ranges

Asset Class	Range
Global Equity	+/- 5%
Fixed Income	+/- 5%
TIPS	+/- 3%
REITs	+/- 5%
Liquidity	+ 2%

Objectives:

- Provide flexibility for changing market conditions between portfolio rebalances

- Reduce rebalancing frequency and costs

- Facilitate contribution & distribution activity

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CEPPT – Recommendation & Next Steps

Recommendation

- Approve Portfolio P2 for CEPPT Strategy 2 (more conservative)
- Approve Portfolio P4 for CEPPT Strategy 1 (less conservative)
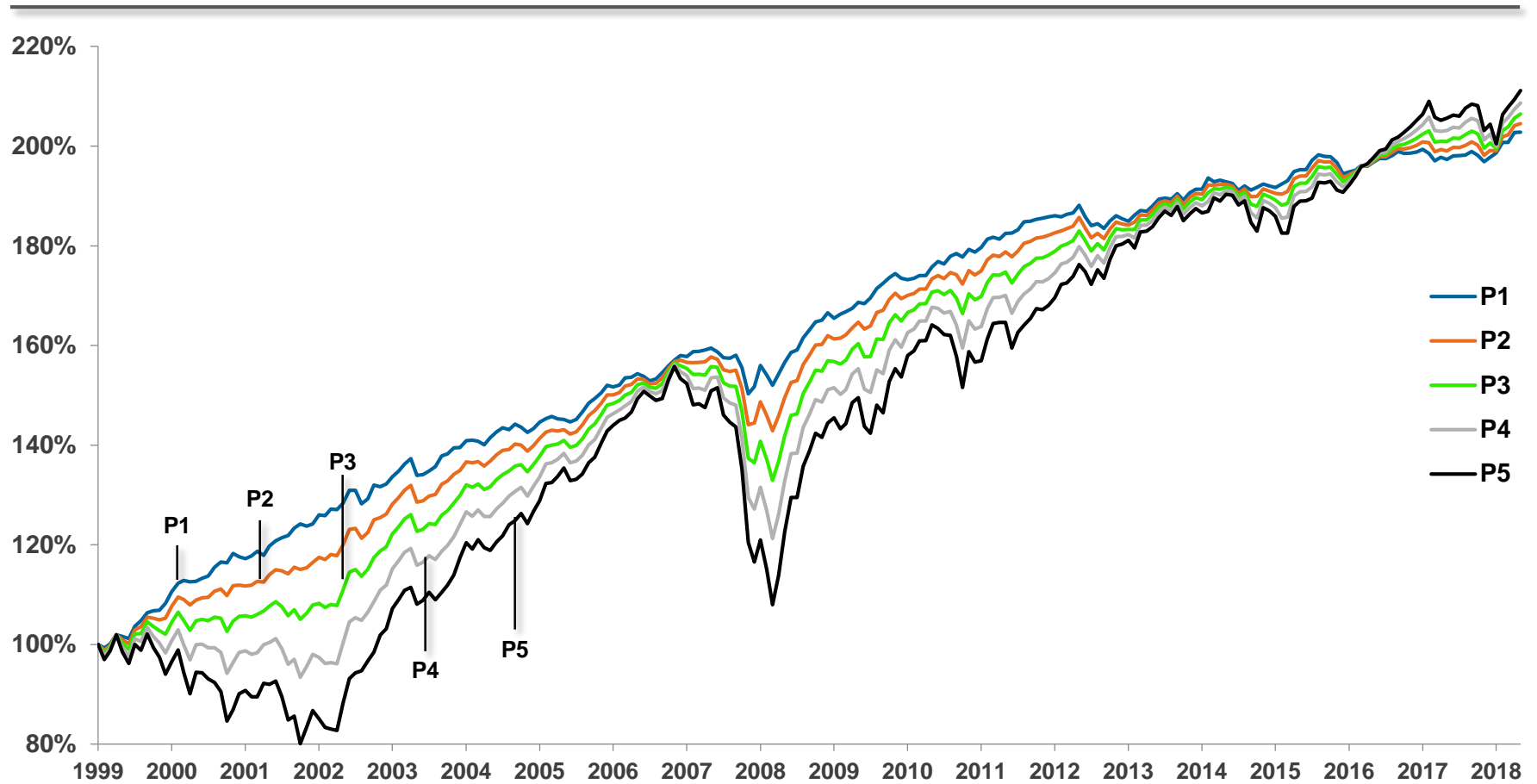- Approve Recommended Benchmarks and Ranges
- Approve Investment Policy

Next Steps

- Complete setup work for the CEPPT
- Open CEPPT by 7/1/19
- Update Board in future Program reviews

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Appendix

Cumulative Returns Through Various Economic Conditions

Cumulative Return %

Cumulative Returns (Drawdown) Under Historic Market Distress

Cumulative Return %