# CalPERS

## Investment Committee
# Agenda Item 6c

**March 16, 2026**

**Item Name**: Asset Liability Management: First Reading - Affiliate Funds Recommendations

**Program:** Affiliate Investment Program

**Item Type**: Information

## Recommendations

- Adopt the Capital Market Assumptions.

- Adopt the recommended portfolios, as shown in the table below:

| Recommended Portfolio | Affiliate Fund |
|---|---|
| Current | Public Employees' Health Care Fund |
| Option B | Legislators' Retirement System Fund |
| Current | Judges' Retirement System Fund |
| Current | Judges' Retirement System II Fund |
| Current | California Employers' Retiree Benefit Trust Strategy 1 |
| Current | California Employers' Retiree Benefit Trust Strategy 2 |
| Current | California Employers' Retiree Benefit Trust Strategy 3 |
| Current | California Employers' Pension Prefunding Trust Strategy 1 |
| Current | California Employers' Pension Prefunding Trust Strategy 2 |
| Current | Public Employees' Long-Term Care Fund |

- Approve the addition of private equity as an asset class for the Judges' Retirement System II Fund, with an incubation implementation as an opportunistic program with an initial 5% allocation limit.

- Adopt two fixed income benchmarks for the Public Employees' Long-Term Care Fund, as recommended by Wilshire:
    - For US High Yield, adopt Bloomberg US Corp High Yield 2% Issuer Capped Index ex-CCC.
    - For Emerging Markets Bonds (USD denominated), adopt JP Morgan EMBI Global Diversified Index ex-CCC.

**Executive Summary**

This presentation provides the asset liability management (ALM) review and recommendations for seven affiliate trusts:

- Public Employees' Health Care Fund (HCF)
- Legislators' Retirement System Fund (LRS)
- Judges' Retirement System Fund (JRS)
- Judges' Retirement System II Fund (JRS II)
- California Employers' Retiree Benefit Trust Fund (CERBT)
- California Employers' Pension Prefunding Trust Fund (CEPPT)
- Public Employees' Long-Term Care Fund (LTC)

Management recommends maintaining the current strategic asset allocations and policy portfolios for all trusts except LRS, where the recommendation is to adopt a portfolio that reduces expected volatility and risk for this closed and cash flow negative fund.

New to this ALM cycle is the recommended addition of private equity as an asset class for JRS II. Management has engaged with JRS II stakeholders over a number of years on this addition. After exploring and considering various implementation options, we recommend an incubated opportunistic program with an initial 5% allocation limit, but no initial allocation target. This prudent and intentional implementation approach mimics how the private debt asset class was added to the Public Employees' Retirement Fund (PERF) a few years ago.

Lastly, as recommended by Wilshire, management proposes LTC benchmark adjustments for two fixed income sub-asset classes to better align with the external investment manager's approach.

**Strategic Plan**

This agenda item supports the CalPERS Strategic Plan goal of strengthening the long-term sustainability of the Affiliate Funds. The periodic review and evaluation of Candidate Portfolios and selection of the Policy Portfolios are intended to strengthen the sustainability of the funds.

This agenda item additionally supports the Strategic Plan goal of Stakeholder Engagement by promoting collaboration, support, and transparency, as stakeholder input is a critical component to the ALM process.

**Investment Beliefs**

This agenda item supports the following CalPERS Investment Beliefs:

- Investment Belief 1: Liabilities must influence the asset structure;

- Investment Belief 2: A long-term investment horizon is a responsibility and an advantage;

- Investment Belief 7: CalPERS will take risk only where we have a strong belief we will be rewarded for it; and

- Investment Belief 8: Costs matter and need to be effectively managed.

**Background**

ALM is governed by the CalPERS ALM Policy, and the ALM process is a collaborative effort between the Actuarial Office (ACTO), the Financial Office (FINO), and the Investment Office (INVO), with stakeholder engagement as a critical input. ALM operates on a four-year cycle with a mid-cycle review and is the primary process by which investment portfolio and actuarial assumptions evolve to reflect the investment risks and framework, the market opportunity set, demographic assumptions and experience, and plan status. The ALM decision frequency is supported by ACTO's annual actuarial valuation process that determines subsequent employer and employee contribution levels. This process establishes an amortization of each fiscal year's actual experience versus the assumptions underlying the ALM decisions, thus correcting annually for forecast and estimation uncertainty.

**Analyses**

For each trust, this agenda item provides a trust overview with management's recommendation and rationale. With respect to capital market assumptions (CMAs), HCF uses a 5-year time horizon; LRS, JRS, JRS II, and CERBT, use a 20-year time horizon; CEPPT uses a 10-year time horizon, which is a blend of the 5-year and 20-year CMAs, and LTC uses a 30-year time horizon with CMAs provided by BlackRock, the external firm managing the LTC fund.

**Public Employees' Health Care Fund**

Established in 1997, the HCF is a reserve fund for CalPERS' self-funded health programs. As of December 31, 2025, assets under management (AUM) were $79 million, the 20-year investment return was 3.29%, and the 5-year investment return was -0.81%. The HCF fund has a conservative investment strategy to enable paying benefits when claims exceed premiums. The Current Portfolio has an expected return of 3.5% (net of 0.03% expenses), volatility of 0.5%, and an allocation of 100% Liquidity.

Management recommends continuing with a 100% Liquidity allocation (i.e., cash equivalent securities) because it best protects the principal value, provides income, and maintains liquidity for paying obligations when claims exceed premiums.

**Legislators' Retirement System Fund**

Established in 1947 and closed in 2013, the LRS is a defined-benefit retirement system that serves members of the legislature elected prior to November 7, 1990, and elected constitutional and legislative statutory officers elected prior to December 31, 2012. As of June 30, 2025, the LRS had 180 participants, an estimated funded ratio of 96%, and a discount rate of 4.50%. As of December 31, 2025, the AUM was $91 million and the 20-year investment performance was 5.11%. The LRS is mature with a negative cash flow of approximately $8 million per year and has a conservative investment strategy. The Current Portfolio has an expected return of 5.2% (net of 0.35% expenses), volatility of 6.9%, and an allocation of 7% Global Equity, 45% Fixed Income, 35% Treasury Inflation Protected Securities (TIPS), 10% Global Real Estate Investment Trusts (REITs), and 3% Commodities.

Management recommends changing from the current policy portfolio to Option B, with an expected return of 4.8% (net of 0.35% expenses), volatility of 6.3%, and an allocation of 40%

Fixed Income, 49% TIPS, 8% Global REITs, and 3% Commodities. Option B reduces portfolio risk while still achieving expected returns sufficient to support the 4.50% discount rate. The table below presents the differences between the Recommended Portfolio and the Current Portfolio.

| LRS | | | |
|---|---|---|---|
| Asset Class Component | Recommended Portfolio | Current Portfolio | Change |
| Global Equity | 0% | 7% | -7% |
| Fixed Income | 40% | 45% | -5% |
| TIPS | 49% | 35% | 14% |
| Global REITs | 8% | 10% | -2% |
| Commodities | 3% | 3% | 0% |
| Expected Volatility | 6.3% | 6.9% | -0.6% |
| Net Expected Return | 4.8% | 5.2% | -0.4% |
| Discount Rate | 4.50% | 4.50% | No Change |

**Judges' Retirement System Fund**

Established in 1937 and closed in 1994, the JRS is a defined-benefit retirement system that serves eligible judges appointed or elected prior to November 9, 1994. The JRS is an unfunded 'pay-as-you-go' system funded by the state's general fund with two to three months' of benefit payments set aside as a reserve. As of June 30, 2025, the JRS had 1,573 participants, an estimated funded ratio of 3%, and a discount rate of 3.00%. As of December 31, 2025, the AUM was $56 million and the 20-year investment performance was 1.88%. The JRS has a conservative investment strategy and requires liquidity to pay benefits, if needed. The Current Portfolio has an expected return of 3.3% (net of .01% expenses), volatility of 0.8%, and an allocation of 100% Liquidity.

Management recommends continuing with a 100% Liquidity allocation (i.e., cash equivalent securities) because it best protects the principal value, provides income, and maintains liquidity for paying obligations.

**Judges Retirement System II Fund**

Established in 1994, the JRS II is a defined-benefit retirement system that provides pre-funded retirement and ancillary benefits for eligible judges appointed or elected on or after November 9, 1994. As of June 30, 2025, the JRS II had 2,430 participants, an estimated funded ratio of 109%, and a discount rate of 6.00%. As of December 31, 2025, the AUM was $3.2 billion and the 20-year investment performance was 6.65%. The JRS is a young fund with a positive cash flow of approximately $25 million per year and has a moderately aggressive investment strategy. The Current Portfolio has an expected return of 6.4% (net of 0.15% expenses), volatility of 11.7%, and an allocation of 43% Global Equity, 29% Fixed Income, 5% TIPS, 20% Global REITs, and 3% Commodities.

Management recommends keeping the current allocation and policy portfolio, which provides diversified exposure across asset classes, supports the fund's long-term growth objectives and 6.00% discount rate, and helps avoid implementation costs associated with portfolio turnover.

Additionally, management recommends the addition of private equity as an eligible investment for JRS II to bring diversification benefits from new exposures and the opportunity to enhance returns through an illiquidity premium. Private equity investments are a strategic fit for JRS II as it is a young and open fund, is cash flow positive, and has a moderately aggressive investment strategy.

Management further recommends implementation of private equity as an incubated opportunistic program with an initial 5% allocation limit and no initial allocation target, a process similar to how the private debt asset class program was recently added to PERF.

**California Employers' Retiree Benefit Trust**
Established in 2007, the CERBT is a section 115 trust for employers to voluntarily pre-fund retiree health and Other Post-Employment Benefits (OPEB). Employers can select from three strategies, depending on risk tolerance. The CERBT is an open and voluntary fund with 603 employer participants as of June 30, 2025.

*CERBT Strategy 1: Moderately Aggressive*
As of December 31, 2025, CERBT Strategy 1 had an AUM of $24 billion and the 10-year investment performance was 8.03%. Strategy 1 has a moderately aggressive investment strategy. The Current Portfolio has an expected return of 6.6% (net of 0.085% expenses), volatility of 12.4%, and an allocation of 49% Global Equity, 23% Fixed Income, 5% TIPS, 20% Global REITs, and 3% Commodities.

Management recommends keeping the current allocation and policy portfolio as it aligns with the strategy's moderately aggressive investment strategy, maintains a diversified and balanced allocation across asset classes, supports long-term growth, and helps avoid portfolio turnover and associated costs.

*CERBT Strategy 2: Moderate*
As of December 31, 2025, CERBT Strategy 2 had an AUM of $2.1 billion and the 10-year investment performance was 6.51%. Strategy 2 has a moderate investment strategy. The Current Portfolio has an expected return of 6.4% (net of 0.085% expenses), volatility of 10.4%, and an allocation of 34% Global Equity, 41% Fixed Income, 5% TIPS, 17% Global REITs, and 3% Commodities.

Management recommends keeping the current allocation and policy portfolio as it aligns with the strategy's moderate growth investment objective, maintains a diversified and balanced allocation across asset classes, and helps avoid portfolio turnover and associated costs.

*CERBT Strategy 3: Moderately Conservative*
As of December 31, 2025, CERBT Strategy 3 had an AUM of $1.2 billion and the 10-year investment performance was 5.28%. Strategy 3 has a moderately conservative investment

strategy. The Current Portfolio has an expected return of 6.2% (net of 0.085% expenses), volatility of 9.0%, and an allocation of 23% Global Equity, 51% Fixed Income, 9% TIPS, 14% Global REITs, and 3% Commodities.

Management recommends keeping the current allocation and policy portfolio as it aligns with the strategy's moderately conservative investment objective, maintains a diversified and balanced allocation across asset classes, and helps avoid portfolio turnover and associated costs.

**California Employers' Pension Prefunding Trust**
Established in 2019, the CEPPT is a Section 115 trust for employers to voluntarily pre-fund required pension contributions. Employers can select from two strategies, depending on risk tolerance. The CEPPT is an open and voluntary fund with 102 employer participants as of June 30, 2025.

*CEPPT Strategy 1: Moderately Conservative*
As of December 31, 2025, CEPPT Strategy 1 had an AUM of $260 million and the 5-year investment performance was 4.37%. Strategy 1 has a moderately conservative investment strategy. The Current Portfolio has an expected return of 5.7% (net of 0.25% expenses), volatility of 9.0%, and an allocation of 37% Global Equity, 44% Fixed Income, 5% TIPS, and 14% Global REITs.

Management recommends keeping the current allocation and policy portfolio as it aligns with the strategy's moderately conservative investment objective, maintains a diversified and balanced allocation across asset classes, and helps avoid portfolio turnover and associated costs.

*CEPPT Strategy 2: Conservative*
As of December 31, 2025, CEPPT Strategy 2 had an AUM of $91 million and the 5-year investment performance was 2.33%. Strategy 2 has a conservative investment strategy. The Current Portfolio has an expected return of 5.3% (net of 0.25% expenses), volatility of 6.4%, and an allocation of 21% Global Equity, 61% Fixed Income, 9% TIPS, and 9% Global REITs.

Management recommends keeping the current allocation and policy portfolio as it aligns with the strategy's conservative investment objective, maintains a diversified and balanced allocation across asset classes, and helps avoid portfolio turnover and associated costs.

**Public Employees' Long-Term Care Fund**
Established in 1992 and currently paused for new enrollments, the LTC fund provides participants with coverage for long-term care expenses. As of June 30, 2025, the LTC had 75,769 participants, an estimated funded ratio of 97%, and a discount rate of 4.75%. As of December 31, 2025, the AUM was $4.9 billion and the 20-year investment performance was 4.73%. The LTC fund has negative cash flow of approximately $115 million per year and has a conservative investment strategy. The Current Portfolio has an expected return of 5.6% (gross of expenses, which are accounted for in the liabilities and discount rate), volatility of 6.4% and an allocation of 28% Global Equity, 69% Fixed Income, and 3% Global REITs.

The ALM mid-cycle review in 2024 brought investment strategy and actuarial changes to better sustain the fund. Management recommends that the LTC retain the current policy asset allocation, which provides diversified exposure across asset classes, supports the fund's 4.75% discount rate, and helps avoid implementation costs associated with portfolio turnover.

Additionally, to better align with the external manager's approach and to reduce benchmark misfit, Wilshire is recommending an update to two LTC Fixed Income benchmarks, as detailed in the table below:

| Current Benchmark | New Benchmark | Impact |
|---|---|---|
| Bloomberg US Corp High Yield 2% Issuer Capped Index | Bloomberg US Corp High Yield 2% Issuer Capped Index ex-CCC | Removes lower credit quality bonds (CCC and below) from the benchmark, which aligns with the portfolio implementation. |
| JP Morgan EMBI Global Diversified Index | JP Morgan EMBI Global Diversified Index ex-CCC | |

**Other Supporting Analyses**

Asset class component weights for the Policy Portfolios are rounded to the nearest whole percentage value, and the expected return and risk characteristics have been calculated based on rounded weights. Assigning target weights using fractional percentages is believed to convey more precision than is warranted by the modeling process. For all recommended Policy Portfolios, the table below shows allocations, expected returns, expected volatility, expenses, and CMA time horizons utilized.

| Asset Allocation of Policy Portfolio Recommendations | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Asset Class Component | HCF | LRS | JRS | JRS II | CERBT 1 | CERBT 2 | CERBT 3 | CEPPT 1 | CEPPT 2 | LTC |
| Global Equity | - | - | - | 43% | 49% | 34% | 23% | 37% | 21% | 28% |
| Fixed Income | - | 40% | - | 29% | 23% | 41% | 51% | 44% | 61% | 69% |
| TIPS | - | 49% | - | 5% | 5% | 5% | 9% | 5% | 9% | - |
| Global REITs | - | 8% | - | 20% | 20% | 17% | 14% | 14% | 9% | 3% |
| Commodities | - | 3% | - | 3% | 3% | 3% | 3% | - | - | - |
| Liquidity | 100% | - | 100% | - | - | - | - | - | - | - |
| Expected Gross Return: | 3.5% | 5.2% | 3.3% | 6.6% | 6.7% | 6.5% | 6.3% | 6.0% | 5.6% | 5.6% |
| Expected Volatility: | 0.5% | 6.3% | 0.8% | 11.7% | 12.4% | 10.4% | 9.0% | 9.0% | 6.4% | 6.4% |
| Expenses: | 0.03% | 0.35% | 0.01% | 0.15% | 0.085% | 0.085% | 0.085% | 0.25% | 0.25% | 0.0% |
| Net Expected Return: | 3.5% | 4.8% | 3.3% | 6.4% | 6.6% | 6.4% | 6.2% | 5.7% | 5.3% | 5.6% |
| CMA's Utilized: | 5-Year | 20-Year | | | | | | 10-Year | | 30-Year |

**Budget and Fiscal Impacts**

Modifying portfolios brings transaction and other associated costs that may increase the investment expenses and impact both expected and realized investment returns. Recommendations reflect this potential impact.

**Benefits and Risks**

The benefits of reviewing candidate portfolios and selecting a policy portfolio for adoption are:

1. Reviewing candidate portfolios and proposed Discount Rates (where applicable) provides support for selecting a Policy Portfolio for each trust that has an appropriate risk/return profile.

2. Reviewing candidate portfolios for the defined-benefit trusts that have been developed with updated demographic assumptions and aligned with a new strategic asset allocation may improve the asset liability profile for the funds.

3. Selecting a policy portfolio that has been designed with updated market information may improve the portfolio return/risk profile.

The risks of reviewing candidate portfolios to select a policy portfolio for adoption are:

1. Reviewing candidate portfolios and proposed discount rates requires evaluating and balancing a variety of risks to different stakeholders.

2. Selecting a policy portfolio requires reliance on investment and actuarial assumptions, which are inherently uncertain.

3. Dramatic shifts or frequent allocation changes may undermine the long-term, strategic nature of the ALM's purpose.

**Attachments**

Attachment 1: Asset Liability Management: First Reading - Affiliate Funds Recommendations

Attachment 2 – Wilshire Opinion Letter

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