



Investment Committee

Agenda Item 7b

March 14, 2022

Item Name: Asset Liability Management: Affiliate Funds – Health, Defined Benefit, and Pre-Funding Trusts

Program: Trust Level Portfolio Management and Implementation

Item Type: Action

Recommendation

Adopt the updated Fixed Income Long Liability benchmark weights for the Affiliate Funds.
Adopt the recommended Candidate Portfolio A for each Affiliate Trust as its Policy Portfolio.

Executive Summary

This agenda item presents Candidate Portfolios and Policy Portfolio recommendations for the Health Care Fund, Legislators' Retirement Fund, Judges' Retirement System Fund, Judges' Retirement System Fund II, California Employers' Retiree Benefit Trust Fund, and the California Employers' Pension Prefunding Trust Fund.

The Candidate Portfolios for each Affiliate trust have been designed with the same methods used for the Public Employees' Retirement Fund and in alignment with CalPERS objectives of minimizing potential losses, maximizing projected returns, maintaining sufficient liquidity, and minimizing costs. For each portfolio, both current and candidates, this item includes information about asset allocation, projected risk and projected return, and asset class diversification. For the prefunded defined benefit programs information is presented on funded ratios, estimated employer and employee contribution rates and discount rates that align with the portfolios.

As part of the review, the following analyses were also conducted:

- An analysis to determine if Private Equity could be added as an asset class. The findings show that the implementation would require fund-of-funds at a significantly increased cost. Adopting Private Equity as an asset class is not being recommended.
- An analysis to determine if the Fixed Income Long Liability benchmark weights that were modified for the PERF are appropriate for the Affiliate Funds. The findings show that the modified weights are reasonable and improve the risk/return profile. Adopting the new weights is being recommended.

Strategic Plan

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

Investment Beliefs

This agenda item supports the following CalPERS Investment Beliefs:

- Investment Belief 2: A long term investment horizon is a responsibility and an advantage;
- Investment Belief 6: Strategic asset allocation is the dominant determinant of portfolio risk and return;
- 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

Governed by CalPERS Asset Liability Management Policy, the ALM process is a collaborative effort between the Actuarial Office (ACTO), the Financial Office (FINO), and the Investment Office (INVO) and currently occurs every four years with a mid-point review. This ALM cycle is the primary process by which investment portfolios and actuarial assumptions evolve to reflect 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.

The review of Candidate Portfolios and the selection of the Policy Portfolio and Discount Rate is the culmination of a significant body of work that has been undertaken by the ALM team during the past year and is a progression in the ALM process from the following presentations made earlier in the year to the Investment Committee:

- February 2021 – Asset Liability Management: Timeline, Concepts, and Framework
- March 2021 - Asset Liability Management: Risk Concepts and Examples
- June 2021 – Current Market Environment
- July 2021- Capital Market Assumption Education, Capital Market Assumptions: Survey & Methodology, and Creating and Assessing Candidate Portfolios
- November 2021 – Asset Liability Management: Adoption of Affiliate Funds' Capital Market Assumptions

This agenda item, Asset Liability Management: Affiliate Funds – Health, Defined Benefit, and Pre-Funding Trusts, is intended to provide comprehensive information and analysis to support the Investment Committee in selecting the Policy Portfolios for adoption.

Analysis

Not applicable.

Budget and Fiscal Impacts

Not Applicable.

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, as compared to the current portfolio strategic asset allocation, which was set in 2018/19.

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. Extreme volatility in the short-term may lower confidence in the selected Policy Portfolio.

Attachments

Attachment 1 – Asset Liability Management: Affiliate Funds – Health, Defined Benefit, and Pre-Funding Trusts

Attachment 2 – Wilshire Opinion Letter

James Sterling Gunn
Managing Investment Director
Trust Level Portfolio Management

Scott Terando
Chief Actuary

Dan Bienvenue
Interim Chief Investment Officer