

November 11, 2018

TO: Governor Edmund G. Brown  
Governor Elect Gavin Newsom  
Attorney General Xavier Becerra  
Assembly Member Freddie Rodriguez  
Assembly Member Travis Allen  
Senator Richard Pan  
Senator Mike Morrell

RE: CalPERS CEO Marcie Frost

We are writing to recommend that an investigation into the hiring of CalPERS CEO Marcie Frost be conducted. Because the CalPERS Board has a significant vested interest in her hiring and strongly defends her as CEO, it is essential that the investigation be conducted by an independent, external organization. Furthermore, since it seems unlikely that the Board will take any steps to implement an investigation, other agencies of the state government should initiate and/or conduct an investigation.

An investigation is appropriate because there is compelling evidence that the CalPERS Board made its decision to offer Frost the position of CEO based on the mistaken belief that she was enrolled in a program at The Evergreen State (of Washington) College that would lead to both baccalaureate and master's degrees. That misinformation originated with Frost and it appears she made no attempt to correct this misconception until more than a year after she was hired.

Since Ms. Frost does not have a college degree, or, for that matter, any formal education beyond high school, the belief that she was pursuing university degrees could not help but embellish her resume. Evidence that the Board believed she was well on track to graduate is provided by one Board member who reportedly told constituents that Frost expected to complete this program within a year. It is of further relevance that the dual-degree program she claimed to be pursuing does not even exist at The Evergreen State College.

The truth behind Frost's alleged pursuit of university degrees and the discovery that she had not completed a single post-secondary education course was not revealed until almost two years after she was installed as CalPERS CEO. This delay might be immaterial if it were not for the clear relevance and importance of post-secondary education in the decision to hire her.

Members of the CalPERS Board have attempted to divert focus from these facts by repeatedly asserting that Frost explicitly stated more than once that she did not possess a college degree and that all Board members knew this. We have no qualms with these assertions. At the same time Board members have ducked the critical issue that demands investigation: did Ms. Marcie Frost purposely misrepresent her post-secondary education and not only create but perpetuate the myth that she was pursuing a (non-existent) BS/MS degree at TESC? We find it hard to believe that this misinformation did not influence Board members' decision to hire her.

There are other questions surrounding the search and hiring process that should be investigated. Why were applicants not required to provide information on their education and meet specific education requirements such as, at a minimum, a baccalaureate degree? Did prior CalPERS searches for CEO and other senior management positions specify minimum or desired education requirements? If so, why were they excluded from this CEO search?

Since CalPERS Board members were led to believe that Frost was pursuing a post-secondary, dual-degree program, why were no specific questions asked about courses she had taken, their content, courses remaining to complete the degrees, etc.? The answer may lie in the very restrictive evaluation process CalPERS employed—a process that discourages if not virtually prevents evaluators from developing an accurate and extensive understanding of each candidates' qualifications. Because not all evaluators interview each applicant, a set of recommended questions was established. We expect this discouraged evaluators from pursuing areas of knowledge, experience, and other factors that are clearly important for a CEO of a \$350 billion pension system and of critical importance for a fund that has an unacceptably low funded status.

Most Board members argue that Ms. Frost is doing a very good job, citing the fund's FY 2017/18 returns and the resultant modest increase in its funded status. But anyone at all familiar with financial markets and the historical performance of the Public Employees' Retirement Fund (PERF) know that there are substantial variations in its year-to-year returns and the CEO has very little impact on performance.

Nobel Laureate in Economics, William F. Sharpe, asserts that on the order of 95% of investment returns depend on asset allocation. There has been no material revision, if any, in CalPERS asset allocation since Frost's arrival. Any claim that her leadership somehow contributed to the fund outperforming its market benchmarks is refuted by the fact that in both fiscal years returns were *below* their market benchmarks: 15 bps short in FY 2017 and 6 bps shy in FY 2018.

Further assertions of Ms. Frost's exemplary performance are in a letter signed by a number of managers at the Chief level. Given that the signers work for Ms. Frost and that the identities of those in support is known by Frost and the public, is it any surprise that most signed? What was their choice? Despite protections offered by civil service laws any government manager knows the potential damage to their career of getting "crossways" with their agency's CEO. A proper evaluation tool would have been an anonymous survey where respondents score the CEO on a number of factors and are provided opportunity to comment.

There is one glaring example of Ms. Frost making a particularly bad decision that eventually resulted in a termination of a high-level CalPERS manager. In 2016, Ms. Frost hired a new Chief Financial Officer, a position that reports directly to her. Some nine months later it was revealed by an individual external to CalPERS that the CFO had misrepresented his work experience. Based on that misrepresentation, his employment was terminated. Today we have an almost identical situation: a CEO who falsified her resume was hired by the CalPERS Board. This falsehood was subsequently discovered, but no action has been taken. One would expect that the same rules, regulations, and standards that apparently applied to her deputy (an African-American male) would also apply to her.

Early in Ms. Frost's tenure two documents were created and made public: her bio was posted and a press release distributed. Both contained her claim that she was pursuing a post-secondary dual-degree program. It is difficult to believe that she was not aware of both, and more than likely approved them for distribution. From our experience on the CalPERS Board, we believe that the Board President or Vice President would also have signed off on the press release.

Events that took place before and during the hiring process must also be investigated. It will be more difficult to obtain a clear picture of this period because some activity was conducted in closed sessions and other events occurred outside of CalPERS offices.

What led Frost to even consider applying for the CalPERS CEO position? It is probable that Ms. Frost was strongly encouraged to apply by top-level CalPERS management and/or Board leadership. She faced little risk that her Washington State employer would find out due to the confidential nature of the process. Offsetting any risk, the upside was tremendous if she were hired. Opportunities to develop relationships with CalPERS leaders were readily available by attending various investment and ESG conferences in 2013 and 2015; however, for Ms. Frost to be eligible for the position, qualifications such as holding a baccalaureate degree (common to virtually all CEO jobs in public pension systems) had to be excluded—and they were. The CalPERS application went even further, requiring no information whatsoever regarding education from an applicant.


As the process progressed, relationships and contacts created the opportunity to provide Ms. Frost insight into the review and evaluation process such as probable interview questions. If any such actions occurred, whether they violated regulations or not, they would have undermined the integrity of the process. These are issues that warrant investigation. Board members should appreciate the answers to these questions.

Most CalPERS Board members seem to believe that we and others are quibbling over CEO Frost's creation of the myth and possible coverup. They insist this matter can be ignored and will simply "go away." Recently, Ms. Frost has tried to trivialize the issue by equating "pursuit of a college degree" with simply her long-term "goal." This is absurd. If it were truly just a goal, it would be unlikely to appear in a bio or be quoted in a press release. While the goal is a good one, it would carry little weight in evaluations of her suitability for the top-job at CalPERS.

We conclude that there is substantial evidence that the Board was scammed by Ms. Frost and the Board is loath to admit it.

We concur with State Treasurer John Chiang who also called for an independent review by a neutral third party. He concluded: "An organization with the strong reputation of CalPERS needs to have a leader with unimpeachable integrity. If we do nothing, we will be perpetuating a double standard. Worse yet, a cloud of controversy will continue to hang over the head of the nation's largest public pension fund. Until that cloud is removed, pundits will continue to question the decisions made by its leadership."

Sincerely,

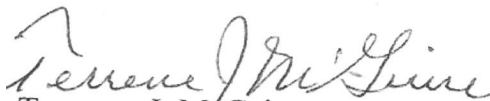


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cc: Members, CalPERS Board of Administration