



OFFICE OF THE CITY MANAGER

August 3, 2020

Marcie Frost
Chief Executive Officer
California Public Employees' Retirement System
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Subject: Concerns Regarding CalPERS Efforts to Meet Seven Percent Discount Rate

Dear CEO Marcie Frost:

As you and your team at CalPERS work to provide a sustainable pension system for members and member agencies, I want to thank you for the opportunity to meet with key senior staff from your team to discuss our concerns on July 28, 2020. The meeting was a valuable opportunity for both CalPERS and the City of Pasadena (City) to share information, and we look forward to future opportunities based on your team's commitment to greater engagement.

The City has serious concerns regarding CalPERS' "Better and More Assets" plan to achieve long term investment returns to meet the seven percent discount rate. The City recognizes the importance of a funded and sustainable pension plan for our employees and understands the challenges CalPERS faces to achieve the seven percent goal in the current economic and investment market.

CalPERS has an obligation to its members and agencies to not only provide a sustainable pension system, but to do so as a public agency that is transparent and accessible. Pursuing an investment strategy that increases investments in private assets and equity is concerning due to both the added risk and the inability to publicly value the investment. The challenge or inability to accurately value such investments garnered international attention in 2019 when it became public that both WeWork and Uber were significantly overvalued, resulting in tens of billions of dollars in losses to private equity investors. If similar losses were incurred due to over-inflated valuations followed by dramatic reduced valuations by the pension plan, it could create unfunded accrued liabilities to member agencies crippling their financial position.

Additionally, the strategy of marketing this move to increase private equity and credit as Better Assets is concerning. The average CalPERS member does not have investment expertise nor understands the

risk involved with the undertaken investments. As acknowledged by Wilshire, a CalPERS Advisor, and CalPERS' own staff at recent Board meetings and webinars, private equity and credit investments increase the risk to the overall portfolio, but do so in an effort to meet the seven percent objective. Furthermore, Wilshire's most recent analysis of CalPERS investment plan outlined the reality that CalPERS would likely earn 5.9% over a ten-year timeframe without changes to seek greater returns. Glossing over the increased risk to the plan and marketing this change as Better Assets, a term that has never been used to describe risky investments such as private equity and credit, is irresponsible and not transparent to the average member who does not have the time to watch Board meetings.

The pursuit of More Assets by issuing debt, as much as twenty-percent of the total plan's portfolio, which does not include existing internal leverage included in certain investments or the billions of dollars of leverage from pension obligation bonds by local agencies, is also of great concern. The City recognizes the need for leverage in the investment plan, the fact that it can provide positive results, and the fact that certain investments such as real estate or mortgage investments are leveraged. However, the pursuit of More Assets of up to \$80 billion based on CalPERS' current plan assets of almost \$400 billion is risky and overly aggressive. Public investment funds have used leverage for decades with great rewards and failures. Unfortunately, local government agencies can no longer absorb failures from large pension system losses as the current unfunded accrued liabilities from prior losses are already crippling many agencies. The Orange County Bankruptcy twenty-five years ago is an example of a public investment fund that used leverage to chase investment returns with catastrophic results to the County and local government participants. Additionally, there are cities across California that have used Pension Obligation Bond leverage to pay off or down unfunded pension liabilities with crippling results. Stockton is one such example, where issuing debt to pay off unfunded pension liabilities in 2007, just prior to the market collapse of the Great Recession and record investment losses by CalPERS, highlights the risks of leveraging. For CalPERS to mask this risk by simply referring to it as More Assets is irresponsible and the opposite of the transparency CalPERS should provide.

During the webinar hosted by CalPERS on July 21, 2020, CalPERS staff made reference to the State of Wisconsin pension plan in the fact that they have used leverage and have been fully funded at 100% or more for a long time. The State of Wisconsin's pension plan is dissimilar in many ways to CalPERS in the fact that when it faced funding issues years ago the plan benefits were reduced, guaranteed COLAs were eliminated, the creation of a split program of defined contribution and benefits was executed, and greater burden was placed on both employers and employees to provide contributions to the plan in a more timely manner. All of these changes have had a far greater impact on Wisconsin's pension plan being fully funded in comparison to their use of leverage. It is troublesome that CalPERS would again reach to substantiate the change and be far less than transparent to the members and local agencies when trying to publicize their leverage plans as simply More Assets making unequal comparisons to other plans and retirement systems.

Lastly, in August 2019 the CalPERS Board approved the reduction in board meeting frequency to a minimum of six per year and board committees to four per year. At a time when public entities are seeking to be more transparent in conducting business, CalPERS has elected to reduce the opportunity for public participation and involvement. While CalPERS is taking on more risk and struggling to meet the seven percent discount rate objective, it is withdrawing from the public eye. This was never more evident than when on June 15, 2020, the Investment Committee emerged from a more than

five-and-a-half hour closed session to hear a brief report from Chief Investment Officer Meng outlining the More and Better Assets concept with not one question asked by a committee member. It was obvious the committee was briefed on this item and conducted all discussion in Closed Session. This is even more alarming with the fact that CalPERS has had its own legal problem in the past with a bribery scandal. The combination of disguising risk as Better and More Assets, conducting all discussions about it in Closed Session, and reducing public meetings is concerning for the City as a member that must be responsive to its community.

For the reasons stated above, the City of Pasadena respectfully requests that CalPERS begin to have regular and ongoing meetings with local agency members, including methods beyond public comment at Board meetings; conduct critical conversations regarding risk and investment plans in open session; and reconsider the decisions to reduce the number of Open Session public meetings of the board and committees. Additionally, as CalPERS begins the Asset Liability Management Study, the City requests that CalPERS actively engage member agencies throughout the process to have earnest dialog regarding decisions to take on increased risks to obtain a potentially unrealistic discount rate.

If you have any questions regarding our concerns and position, please contact me at (626) 744-6936 or smermell@cityofpasadena.net.

Sincerely,



Steve Mermell
City Manager

cc: The Honorable Mayor and City Council, City of Pasadena
The Honorable Chris Holden, California State Assembly
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