Understanding CalPERS

An Overview of the California
Public Employees' Retirement System

Milestones

1927 Legislation enacted establishing a commission to study and make recommendations regarding the establishment of retirement pensions for State employees. (Chapter 431, Statutes of 1927)

1929 Commission on Pensions of State Employees recommends a State employee retirement system be established and placed on a "sound financial basis, where liabilities are provided for as they are incurred, rather than when they mature."

1930 California voters approve Proposition 5 to amend the California Constitution, authorizing the Legislature to provide for the payment of retirement benefits to State employees. (Former Article IV, Section 22a)

1931 Legislation enacted establishing the State Employees' Retirement System (SERS). (Chapter 700, Statutes of 1931)

1932 The State Employees' Retirement System becomes operational. Investments are limited to U.S. government and municipal bonds.

1935 Legislation establishes the California Highway Patrol Retirement Act, providing enhanced benefits for patrol members.

1939 Political subdivisions authorized to contract with SERS to administer their retirement plans. (Chapter 927, Statutes of 1939)

1943 All public agencies authorized to contract with SERS to administer their retirement plans. (Chapter 640, Statutes of 1943)

1947 The Legislators' Retirement System (LRS) is created. (Chapter 879, Statutes of 1947)

1947 SERS adds public utility bonds to its investment portfolio.

1947 All County Superintendents of Schools required to contract with SERS to include classified employees as members.

1955 SERS adds State of California building certificates to its investment portfolio.

1955 SERS assumes administration of Social Security coverage for California public employees.

1961 The State Employees' Medical and Hospital Act enacted, authorizing SERS to contract for health coverage for State employees. (Chapter 1236, Statutes of 1961)

1966 SERS adds real estate to its investment portfolio.

1967 Local public agencies authorized to contract with SERS to participate in the SERS health care program. (Chapter 1455, Statutes of 1967)

1967 SERS renamed the California Public Employees' Retirement System (CalPERS) to reflect the broader participation of public agencies since 1940.

1967 CalPERS adds private domestic securities to its investment portfolio.

1978 The SERS health plan renamed the Public Employees' Medical and Hospital Care Act (PEMHCA) to reflect the broader participation of public agencies since 1968.

1978 CalPERS given responsibility for the administration of the Judges' Retirement System (JRS), which had been administered by the State Controller since 1937. (Chapter 384, Statutes of 1978)

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Introduction

This publication was developed to provide an understanding of one of the more unique, complex agencies of State government - the California Public Employees' Retirement System (CalPERS).

CalPERS is the largest public pension plan in the nation with more than 1.4 million members. We are much more than a retirement system. In addition to administering retirement benefits for more than 2,500 public agency employers, CalPERS is the third largest public purchaser of employee health benefits in the nation, offers long-term care coverage to California public employees and their families, and invests billions of dollars to help finance the benefits we administer.

CalPERS has a unique governance structure designed to assure broad representation in our decision-making process and a measure of independence to assure that the interests of our customers are placed above all others.

While reading this material, please remember that CalPERS is governed by State and federal law, which is complex and subject to change. There are a number of other sources of information that provide more detailed, targeted information about CalPERS programs. These sources are summarized in the For More Information section on page 28.

Board of Administration

CalPERS is governed by a 13-member Board of Administration designed to be representative of our constituents.

Elected Members
Six members are elected directly by CalPERS members. Two members are elected by the entire membership. State employees elect one member, school employees elect one member, public agency employees (i.e., contracting local agencies) elect one member, and one member is elected by retirees.

Ex Officio Members
By law, three ex officio members serve on the Board during their tenure in office: the State Controller, the State Treasurer, and the Director of the State Department of Personnel Administration.

Appointed Members
The Governor appoints two members to the Board: an elected official of a local public agency and a life insurance official. The State Personnel Board also appoints a representative, and a representative of the public is jointly appointed by the Speaker of the Assembly and the Senate Rules Committee.

The elected and appointed members serve four-year terms. The California Constitution prohibits the Legislature from changing the number of members, their terms, or the method of their selection or removal without a vote of the electorate.

Plenary Authority

The California Constitution was amended in 1992 (see Appendix I on page 23), to provide the board of any California public pension or retirement system with exclusive authority for the investment of moneys and the administration of the system. This provision was enacted in response to concern that retirement funds had been improperly diverted to subsidize expenditures in other areas of government. This constitutional authority vested in retirement boards was designed to protect retirement systems from undue political pressures, and to ensure that funds are used for the exclusive purpose of providing benefits and related services to participants and their beneficiaries.

Board Committees

The Board generally meets monthly, normally over four days, to conduct business. Much of the work is performed in meetings of the Board's standing committees.

Investment - establishes asset allocation and investment policies, oversees investment managers, and is ultimately responsible for investment decisions made by CalPERS. All Board members serve on the Investment Committee.

Benefits & Program Administration - recommends policy on retirement plan administration, actuarial policies, employer rates, and System administration.

Health Benefits - recommends policy on the design and administration of health insurance benefits and the CalPERS Long-Term Care Program.

Finance - provides financial oversight of all budget matters, evaluates funding alternatives, oversees preparation and recommends approval of the CalPERS budget, oversees CalPERS audits, and oversees the CalPERS Strategic Plan.

Performance & Compensation - evaluates compensation mechanisms and criteria, develops compensation policies and procedures, and makes recommendations concerning the compensation of key personnel.

From time to time, the Board also establishes subcommittees or ad hoc committees to address specific issues or projects.

CalPERS Staff

The CalPERS Board selects a Chief Executive Officer (CEO) who serves at the pleasure of the Board. The CEO is responsible for the selection and management of other CalPERS employees, who number more than 1,800. Most CalPERS employees are directly involved in the administration of retirement and health benefits, the Long-Term Care and Member Home Loan Programs, other programs and services, and the investment of CalPERS assets.

CalPERS administers defined benefit retirement plans for State employees, classified school employees, and employees of local public agencies that contract with CalPERS for retirement plan administration. These plans provide service retirement, disability retirement, and survivor and death benefits to eligible employees and their beneficiaries and survivors.

In a defined benefit retirement plan, a retiree receives a benefit determined by a set formula. The CalPERS defined benefit plans use their years of service, age at retirement, and highest one-year or three-year compensation while employed. This contrasts with a defined contribution plan, in which the benefits are determined not by a formula, but solely by the amount of contributions in an account, plus earnings.

Three sources fund a defined benefit retirement plan. First, employees generally make contributions based on a percentage of their earnings. The percentage is fixed by statute and varies from about 5 to 9 percent, depending on the plan type and whether the employee is covered by Social Security. The second source is earnings from the investment of System assets in stocks, bonds, real estate, and other investment vehicles. The amount contributed from this source fluctuates from year to year. The balance of the funding is provided by employer contributions. Employer contributions are determined through an actuarial valuation process.

CalPERS administers 13 defined benefit retirement formulas for more than 2,500 State, school (classified employees only), and public agency employers.

State & School Statutory Plans

The benefits paid under the State and school plans are determined by statute. Most State employees are in the first tier miscellaneous plan, which is applicable to employees in positions without any special hazards or circumstances.[1] Some State employees continue to be in a second tier noncontributory plan with significantly lower benefits, which was initially required for State employees hired during the

1 *Beginning August 2004, new first-time State miscellaneous and industrial employees are automatically enrolled in an Alternate Retirement Plan, in lieu of the standard CalPERS retirement plan for the first two years of State employment. During those two years, the employee makes retirement contributions into a special retirement savings account managed by the Department of Personnel Administration, instead of making contributions to CalPERS. After two years, the State and the employee begin making retirement contributions into CalPERS, and the employee begins earning CalPERS retirement service credit.*

1990s.[2] There are also additional State plans for employees in various safety occupations; two for judges;[3] and one plan for Legislators (elected prior to 1990), Constitutional Officers, and legislative statutory employees.

Miscellaneous Members

Service Retirement Benefits. The formula for each member generally depends on the classification of the their employment. The basic service retirement formula for State miscellaneous and school members is the 2 percent at 55 formula. This formula provides 2 percent of the member's highest annual compensation for each year of service at age 55. For example, an employee retiring at age 55 with 25 years of service receives 50 percent (2% x 25 = 50%) of their highest annual compensation. Early retirement is permitted between age 55 and 50, at progressively smaller percentages of compensation. The percent paid as a monthly allowance increases above 2 percent if the employee retires after age 55, up to 2.5 percent at 63.

Most members become vested after five years of service. Once a member is vested, they become eligible to receive a retirement benefit when reaching retirement age. Those in the second tier plan must have 10 years of service to be vested.

Disability Retirement Benefits. State miscellaneous and school members who are vested can be retired for disability if they cannot perform their job duties permanently or for a prolonged period, for their current employer and for other CalPERS-covered employers in the State. Generally, the disability retirement payment is 1.8 percent of their compensation for each year of service. If this calculation results in a benefit of less than one-third of the employee's compensation, it is increased to one-third of compensation if they have at least 10 years of service and would qualify for at least this amount if they worked until age 60. State members in the second tier plan are subject to a lesser formula for disability benefits.

2 *Beginning in January 2000, these employees are permitted to move to the first tier and convert their past second tier service.*

3 *One of the judges' plans was closed to new members in 1994.*

Death Benefits. In the event of a member's death, a variety of benefits may be paid. For a State member who was *not* retired, their named beneficiary receives, at a minimum, a lump sum equal to $5,000, the member's retirement contributions, plus interest, and up to six months' salary. Survivors of State members who were eligible to retire or who had 20 or more years of service can receive a lifetime benefit. For members who were eligible to retire, the benefit is calculated as if they had retired for service on the date of death and elected to provide a surviving beneficiary a continuing allowance equal to the member's retirement allowance. For members who had 20 or more years of service but had not reached retirement age, the benefit is calculated as if they had been age 50, the minimum retirement age.

For a school member who was *not* retired, the member's beneficiary receives, at a minimum, a lump sum equal to the member's retirement contributions, plus interest, and up to six months' salary. Survivors of school members who were eligible to retire may receive a lifetime benefit equal to one-half of what the highest service retirement allowance would have been had they retired on the date of death.

When a State or school member dies *after* retirement, a lump sum death benefit of at least $2,000 is paid. (School districts can contract for a higher amount.) In addition, if the member chose to take a reduced monthly pension at retirement in order to provide a payment to a beneficiary after their death, the beneficiary receives that amount for their lifetime.

Safety Members

Service Retirement Benefits. There are several service retirement formulas applicable to various categories of State employees with hazardous duties. California Highway Patrol officers and California State University police are State patrol members. They have a service retirement formula of 3 percent at 50. This means they receive 3 percent of their highest annual pay for each year of service at age 50. This particular formula does not allow for earlier retirement, and the percentage does not increase for service beyond age 50.

The peace officer/firefighter membership category, which includes primarily correctional officers and California Department of Forestry firefighters, has a service retirement formula of 3 percent at 55. These members may opt to retire early at a reduced percentage between ages 50 and 55,

but do not receive a higher percentage of final compensation if they work past age 55. A number of other employee classes are considered safety members, and are subject to a 2.5 percent at 55 formula, with a reduced percentage for early retirement between age 50 and 55.

Safety members receive a higher pension to encourage young, healthy employees to enter these public safety professions, and to enable them to leave these positions before the infirmities of age threaten their ability to adequately protect the public. Also, these public safety employees are not normally covered under Social Security, so their CalPERS pension may be their primary income during retirement.

Disability Retirement Benefits. Like miscellaneous members, safety members may be retired for disability if unable to perform their job duties permanently or for a prolonged period. However, they are entitled to a more generous industrial disability retirement benefit if the disability results from a job-related injury. The industrial disability benefit is 50 percent of the member's highest annual compensation, and it is not subject to federal or State income taxes. (A member who is of minimum retirement age can receive an allowance greater than 50 percent. In this case, the portion of the allowance greater than 50 percent would be subject to federal and State income taxes.) Industrial disability retirement is also available to miscellaneous members if injured as a result of a violent attack by an inmate or parolee.

Death Benefits. The surviving spouse or surviving registered domestic partner of a safety member also receives a more generous benefit if the member suffers a fatal job-related injury. This special death benefit is one-half of the member's highest annual compensation, and up to 75 percent of that amount if there are surviving minor children. This benefit is also payable to certain other members who are fatally injured under specific circumstances, such as misconduct by an inmate or a violent act in connection with their job.

Judges' Retirement Systems

CalPERS administers two Judges' Retirement Systems. One system applies to judges who were appointed or elected prior to November 9, 1994, and one applies to judges appointed or elected after that date.

The first system, the JRS, was closed to new members in 1994 because the statutory contributions were insufficient to pay the accruing liabilities. It continues to be unfunded, requiring an annual State appropriation to pay benefits to the approximately 1,600 retired judges and their beneficiaries and survivors. More than 900 members of the System have yet to retire.

The second system, the Judges' Retirement System II, is fully funded. Currently, there are almost 800 active members and seven retirees, survivors, and beneficiaries.

Legislators' Retirement System

The Legislators' Retirement System once covered all Legislators, Constitutional Officers, and a few key employees of the Legislature. In 1990, a State ballot initiative effectively closed this System to newly elected Legislators. There are more than 260 retirees and beneficiaries currently receiving benefits and approximately 15 active members and 35 inactive members who will be eligible to draw benefits in the future. The number of members in this system will continue to decline.

Local Public Agency Contract Plans

CalPERS also administers retirement plans for local public agencies that choose to contract with CalPERS for this purpose. More than 2,500 public agency employers are covered.

Public agencies can include various contract options in their retirement plan or plans. They may have a miscellaneous plan for employees who are not in a hazardous occupation, and one or more safety plans for police, firefighters, peace officers, and other safety employees. Generally, each plan has only one member classification (i.e., miscellaneous, police, firefighter, peace officer), and the benefits provided to all employees in the plan must be the same.

Statutes require some features of public agency plans; others are optional. For example, an agency must decide which of several possible service retirement formulas to provide; to calculate retirement benefits using the highest one or three years of compensation; to provide service credit for unused sick leave; to permit employees to purchase various military or other forms of service credit; to permit industrial disability retirement for miscellaneous members; the maximum cost-of-living adjustment; the amount of the lump sum death benefit for retired members; and the level of benefits to be provided to survivors of employees not covered by Social Security.

Agencies can amend their contracts to change various features, subject to statutory and procedural requirements. CalPERS provides the estimated cost of amendments that are being considered by a contracting agency or their employees. The law requires that these estimates be made public before the agency amends a contract with CalPERS. A change that impacts employee contribution rates must be submitted to a secret ballot election among the employees. Amendments that impair the vested rights of employees are not permitted.

CalPERS actuaries value each plan annually, reviewing the assets and liabilities to determine if each plan is on schedule to pay the benefits that will become due to their retirees, survivors, and beneficiaries. Through this process, the agency contribution rate is annually established for each plan.

Volunteer Firefighters' Length of Service Award System

The Volunteer Firefighters' Length of Service Award System offers fire departments and districts the opportunity to recognize and financially reward volunteer firefighters for their years of service with payment of a lifetime award to eligible volunteers. Once they have reached age 60, volunteers with 10 to 20 years of service in the program are eligible to receive an award payment of $75 to $150 per month for life. A $3,000 lump sum death benefit is payable to the beneficiary of any award recipient, or to the beneficiary of any member with 10 years of service.

CalPERS currently administers three defined contribution plans: a deferred compensation program for public agency and school employees; a supplemental contributions program available to State employees, members of the Judges' Retirement System, Judges' Retirement System II, and the Legislators' Retirement System; and a money purchase pension plan available only to certain State employees who bargained for this supplemental retirement plan.

CalPERS 457 Deferred Compensation Plan

CalPERS administers a deferred compensation plan for employees of public agencies and schools that contract with CalPERS for this program.[1] Contributions made, as well as earnings on the principal, are not subject to federal or State income taxes until withdrawn.

1 *The Department of Personnel Administration administers the Savings Plus Program, a deferred compensation program for State employees. CalPERS manages some of the funds under contract for that program.*

Members who participate in this program can change their contribution amount, transfer account balances among various investment options, or change the contribution percentages designated to each option on a daily basis.

Supplemental Contributions Program

The Supplemental Contributions Program is a federally tax-qualified defined contribution plan invested by CalPERS that is currently available to State employees.

This program is designed to provide supplemental retirement income. Participants make contributions on an after-tax basis. Earnings are not taxed until withdrawn. Disbursements are permitted only at retirement or upon permanent separation from State employment.

Participants in this program can also contribute to a deferred compensation plan.

State Peace Officers' & Firefighters' Plan

The State Peace Officers' and Firefighters' Defined Contribution Plan is a qualified money purchase pension plan under federal law. It is available, pursuant to a Memorandum of Understanding, to State peace officer/firefighter members in Bargaining Units 6 and 8 and, with the approval of the Department of Personnel Administration, to supervisors of these members.

The contributions to participant accounts are established in the Memorandum of Understanding. A participant is entitled to a distribution of funds when terminating employment or retiring. The participant's designated beneficiary receives the balance of the funds in the account, if any, upon their death.

CalPERS is the third largest public purchaser of health benefits in the nation, behind General Motors and the federal government. CalPERS health plans cover more than 1.2 million active and retired State, school, and public agency employees and their families. About 62 percent are State employees and their dependents, and the balance are employees and dependents of other public agencies that contract with CalPERS for health coverage. Public agencies can contract with CalPERS for health coverage whether or not they contract for a retirement plan. Annual premiums exceed $4.3 billion.

The Public Employees' Medical and Hospital Care Act authorizes the CalPERS Board to enter into contracts with health care plans and also authorizes the Board to operate self-funded health plans. CalPERS offers health maintenance organizations (HMOs) in most parts of the State and two self-funded preferred provider organizations (PPOs) Statewide.

CalPERS also administers enrollment for three plans that are available only to members of the California Association of Highway Patrolmen, California Correctional Peace Officers Association, and the Peace Officers Research Association of California.

Nearly three-quarters of enrollees are in HMOs, which generally provide lower cost options. The PPOs are more costly, but provide patients more freedom to direct their course of care.

CalPERS has established two standard benefit packages for health plans. The Basic plan is designed for employees and retirees who are not eligible for Medicare. The Supplement to Medicare plan is designed for retirees who are eligible for Medicare. As the name implies, this plan supplements the benefits available under Medicare.

CalPERS negotiates with each HMO and sets premiums for which the HMO will provide the Basic and Supplement plan services. During an annual open enrollment period, members have the option of selecting any HMO in their service area at the premium CalPERS has negotiated. If the employee or retiree is a member of an employee association with an approved plan, they can enroll in that association's plan.

Employees and retirees can also select one of the self-funded PPOs, PERSCare or PERS Choice. These plans provide the same basic medical coverage as HMOs, but the premiums are generally higher, and enrollees pay a percentage of the cost in return for greater control over the direction of their medical care.

Who Pays the Cost?

CalPERS negotiates with health care plans on behalf of those eligible to participate in the CalPERS Health Program. Employers, employees, and retirees pay the cost of the health care.

State Employees. State employees generally are entitled to an employer contribution that is established in the collective bargaining process. An employee who selects a plan with monthly premiums higher than the employer contribution must pay the difference.

State Retirees. State retirees receive a contribution from the State that is determined by a statutory formula. The retiree receives 100 percent of the weighted average of the cost of the four health plans with the largest enrollment. For dependents, the formula pays 90 percent of the weighted average of the additional cost for family member enrollments. A retiree who selects a plan with monthly premiums higher than the State contribution pays the difference.

Public Agency Employees & Retirees. The employer contribution for public agency employees is established locally, normally through the collective bargaining process. Employees of public agencies must be provided a minimum monthly contribution from the employer. The minimum contribution amount is prescribed in Government Code Section 22825. Retirees of these agencies generally must be provided the same contribution as active employees, although agencies are permitted to scale up to an equal contribution for retirees over a 20-year period. Any premium portion not paid by the employer must be paid by the employee or retiree.

Since 1995, CalPERS has offered long-term care insurance to California public employees and retirees, spouses, parents, parents-in-law, and siblings.

Long-term care is the extended care sometimes needed for assistance with basic activities of daily living - like bathing, dressing, or eating - because of a chronic illness, an injury, or the frailties of old age. It is care typically received either at home from a nurse or home health aide, or in a facility such as a nursing home, assisted living facility, or adult day care center. Six out of 10 Americans over 65 years of age will need this type of care.

Medicare, Medi-Gap policies, health plans, and disability insurance typically provide little or no long-term care coverage. Medi-Cal does provide long-term care coverage, but only after a person has exhausted virtually all personal assets. The cost of most long-term care is paid directly by individuals or their families. Protection against the cost of long-term care must be purchased separately.

The CalPERS Long-Term Care Program is a self-funded not-for-profit plan. New enrollees are added during the annual application period.

Enrollees pay premiums that vary based on the person's age and the level of coverage purchased. CalPERS invests the funds in the same manner as pension funds are invested, and the earnings are used to offset the cost to those enrolled in the program. The cost of the CalPERS plans is often less than comparable insurance products, primarily because CalPERS enjoys higher investment earnings and lower expenses.

CalPERS offers three basic long-term care plans. The Comprehensive Plan, selected by about 75 percent of enrollees, offers a broad range of services, including personal care, respite care, homemaker services, home health care, adult day care, assisted living/residential facility care, and nursing home care. The Nursing Home/Assisted Living Facility Plan, selected by about 20 percent of enrollees, covers only nursing home or assisted living care. The Partnership Plan, selected by about 5 percent of enrollees, also provides comprehensive coverage, but contains a Medi-Cal asset protection feature.

Enrollees can select from a variety of long-term care coverage options. The vast majority of enrollees select an unlimited lifetime benefit option with inflation protection. More limited plans are available as well.

The CalPERS Strategic Investment Focus & Board Role

CalPERS invests billions of dollars to help pay pensions to members and beneficiaries. More than 75 cents of every dollar in the CalPERS investment portfolio comes from investment earnings.

The California Constitution provides the framework for making investment decisions. It gives the CalPERS Board plenary authority and fiduciary responsibility for investment of moneys and administration of the System. It also gives the Board sole and exclusive fiduciary responsibility over the assets, and directs the members of the Board to discharge their duties with respect to the System solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions, and defraying reasonable expenses of administering the System. It directs that the Board's duty to participants and beneficiaries takes precedence over any other duty.

The California Constitution specifically directs the Board to diversify investments to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.

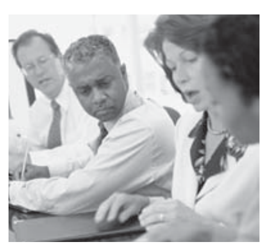
The Constitution permits the Legislature to prohibit certain investments "... where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board."

Asset Allocation

The CalPERS Board carries out its fiduciary responsibility by annually setting an asset allocation strategy and overseeing the implementation of that strategy by CalPERS Investment staff, consultants, and fund managers.

Asset allocation is one of the most important sets of decisions made by the Board. In the long run, it is the way in which the Board diversifies stocks, bonds, real estate, private equity, and other investments that determines long-term performance of the System. The asset allocation plan is the working framework for the selection and weighting of asset classes.

The CalPERS asset allocation mix is decided following an extensive review of a variety of factors. Economic scenarios of the global financial markets are simulated, and future liabilities and expected future contributions by employers are considered.



Asset Allocation

CalPERS Target Asset Allocation (Adopted in January 2005)

Asset Class	Target
Cash Equivalents	**0%**
Global Fixed Income	**26.0%**
Equities	
Domestic	**40.0%**
International	**20.0%**
Alt. Invest./Private Equity	**6.0%**
Total Equities	**66.0%**
Real Estate	**8.0%**
Total Fund	**100.0%**

Most CalPERS assets are invested passively in broad index funds that are designed to replicate the market. CalPERS attempts to diversify investments, both to minimize risk and to ensure that the System benefits from broad market trends. The focus is on the long term. The objective is to acquire sufficient assets to pay pension benefits as they become due.

This passive approach, coupled with heavy reliance on internal staff, reduces investment expenses and increases net returns. A study issued by Cost Effectiveness Measures, Inc. (CEM) concluded that the System added more value at less cost than any other large public pension fund, over a five-year period ending December 31, 2004. The cost of CalPERS internal staff is far less than the cost of compensating external fund managers. CEM, which tracks 134 pension funds, found that the CalPERS Investment staff took advantage of market opportunities to earn $18 billion more than CalPERS would have gained over the last 10 years by just following our asset allocation policy.

California Investments

CalPERS is one of the largest investors in California, providing jobs, goods, and services that help to power the State's economy.

California investments are part of each asset class at CalPERS and are expected to deliver a return commensurate with similar investments of comparable risk. The CalPERS Board considers California investments and all other investments on the sole basis of investment merit. They must be financially comparable to other available investment alternatives. The CalPERS Board judges comparability on a risk-adjusted basis. **Under existing policy, CalPERS will accept no less in return and may incur no additional risk or cost for a California-oriented investment.**

Investments in California may have the ancillary benefit of creating jobs, housing, and improvements to the general infrastructure, but their primary purpose is to serve the broad interests of CalPERS beneficiaries.

By strengthening the State's economy and the well being of employers, California investments help promote the continued ability of employers to make contributions to the System. The Board considers the secondary objective of promoting economic growth and well being of the State and its localities **when it is not in conflict with the Board's trust duties of loyalty, care, skill, prudence, diligence, and diversification.** The emphasis is on promoting long-term sustainable economic, industry, and business growth, as well as the creation of jobs and affordable housing.

While cognizant of the Constitutional mandate and fiduciary responsibility to diversify our investment portfolio, CalPERS recognizes the significant investment opportunities that exist in California. As of December 31, 2005, the System had invested approximately $22.5 billion, about 11.2 percent of our investment portfolio, in California.

CalPERS California investments are diversified among many types of investments. The System is a shareholder in corporations that make their home in California; is one of the largest real estate developers in single family homes; invests in venture capital; develops underserved rural and urban California communities; and helps its members achieve the dream of home ownership through our Member Home Loan Program. These are just a few examples of programs designed to provide superior risk-adjusted returns for CalPERS members while invigorating the California economy.

Member Home Loan Program

The CalPERS investment of most interest to many members is their home loan. Legislation enacted in 1980 authorized CalPERS to establish a program to assist CalPERS members to purchase homes in California. In 1998 the program was made available nationwide. CalPERS offers our members a variety of options for financing or refinancing homes. A member can obtain up to 100 percent financing for a home purchase.

CalPERS home loans are originated and serviced by private lenders. CalPERS provides the funds and establishes the governing guidelines.

CalPERS Historical Rates of Return

For the Fiscal Year Ended June 30	Percent Rate of Return
1966	4.40%
1967	4.70
1968	4.70
1969	4.87
1971	5.37
1972	5.52
1973	5.59
1974	5.74
1975	5.90
1976	6.08
1977	6.36
1978	6.69
1979	7.23
1980	7.91
1981	8.72
1982	9.58
1983	10.56
1984	-3.10
1985	35.40
1986	24.60
1987	13.80
1988	3.90
1989	15.70
1990	9.70
1991	6.50
1992	12.50
1993	14.50
1994	2.00
1995	16.30
1996	15.30
1997	20.10
1998	19.50
1999	12.50
2000	10.50
2001	-7.23
2002	-5.97
2003	3.90
2004	16.60
2005	12.30

Corporate Governance

As a long-term investor, CalPERS has an interest in assuring that the corporations we invest in are paying attention to the long term. The interests of management and investors with a short-time horizon are not necessarily the same as the interests of long-term investors. The latest quarterly earnings may temporarily boost stock prices and executive compensation, but if this is accomplished by neglecting the need to build the human and capital infrastructure required for sustained growth, the long-term value of the company may be compromised.

CalPERS began our corporate governance program in the early 1980s, as a direct response to greenmail and the takeover frenzy in corporate America. It began simply as objections by a few shareowners to certain company actions that were considered to be self-serving. Companies created anti-takeover devices and procedural obstacles that were viewed more as protecting the corporate status quo than serving the long-term interests of shareowners.

A debate quickly ensued over whether shareowners - particularly institutional investors who were accused of being transitory and only interested in short-term profits - had a right to participate in decisions concerning the long-term viability of a corporation.

In late 1989, CalPERS began working closely with the U.S. Securities & Exchange Commission (SEC). This relationship led to the 1992 reform of executive compensation disclosure and proxy solicitations. These reforms paved the way to elicit support from other shareowners through communication and to work together to bring about change.

As the CalPERS corporate governance program evolved, the System moved away from a specific issues approach to focus on company performance.

Today, CalPERS reviews the performance of the U.S. companies in our portfolio, and identifies those that are among the lowest long-term performers relative to their industry peers. The review results in a "long list" of companies that may potentially be publicly identified as a CalPERS Focus Company. We meet with the directors of each of these companies to discuss performance and governance issues. The CalPERS Focus List contains those companies that, at the end of the process, continue to merit public and market attention.

A Wilshire Associates' study in 1999 (and later updated), demonstrated the "CalPERS Effect" on identified companies. The study showed that the stock performance of 113 companies targeted by CalPERS between 1987 and 2003 underperformed the Standard & Poor's 500 Index by an average of 97.7 percent in the five years prior to being targeted and performed 8.1 percent better than this index the following five years.

In 1996, CalPERS launched our International Corporate Governance Program. It has adopted corporate governance principles for the United Kingdom, France, Germany, and Japan. In 1998, the CalPERS Board reaffirmed their commitment to corporate governance and adopted a set of U.S. Corporate Governance Core Principles and Guidelines. (The Corporate Governance Principles and accompanying Guidelines are available on our online Shareowners' Forum. A link to the Forum can be found on the main page of the CalPERS On-Line Investments area at **www.calpers.ca.gov**.)

CalPERS believes the criteria contained in our U.S. Corporate Governance Principles and Guidelines are important considerations for all companies within the U.S. market. They represent the foundation for accountability between a corporation's management and its owners, and serve as a tool to further enhance this relationship. CalPERS also believes the accountability reflected in these Principles is needed for American corporations to compete globally.

Following a string of corporate scandals in 2002, CalPERS adopted a financial market reform plan in an effort to improve integrity, transparency, and accountability in the financial markets.

A number of important steps were taken. We helped craft a federal law intended to curb corporate abuse, the Sarbanes-Oxley Act. It requires corporate directors be more independent, provides greater oversight of company operations, and requires chief executives to certify the accuracy of financial statements. CalPERS also adopted a set of Investment Protection Principles, which require investment banks and money managers to meet strict standards of disclosure and eliminate conflicts of interest.

In 2003, CalPERS adopted a set of mutual fund protection principles that call for a wide range of reforms related to shareholder disclosures and reporting, business practices, and board structure.

In 2004, CalPERS led a campaign to reform the New York Stock Exchange, promote greater auditor independence, and improve governance and performance at several corporations, including the Walt Disney Company.

In recent years, we launched two major corporate governance initiatives aimed at reigning in abusive compensation practices in corporate America and shining light on corporate environmental liabilities.

We have a three-year strategic plan to advocate for executive compensation reforms on a national level by addressing issues of transparency and design with the SEC, the financial exchanges, and the compensation consulting industry. As part of the plan, we are working with the SEC on proposed regulations to ensure that publicly-traded companies provide investors with greater transparency about compensation packages. We also plan to engage the self-regulatory organizations and exchanges to advocate for national executive compensation reform.

On the environmental front, we are taking actions to improve transparency and timely disclosure of environmental impacts. We signed on to the Global Carbon Disclosure Project, an international effort to improve the transparency of business risks associated with climate change due to rising levels of greenhouse gases (GHG). We are exploring ways to develop a model GHG reporting project that ensures timely and standardized disclosure of environmental data in the utilities industry. We expect environmental corporate stewardship to play a greater role in corporate governance over the next 10 years as data on corporate environmental impact will be one of the best sources for investors to measure related investment risks.

Finally, we increased our commitment to investment partners that have a common strategy to improve corporate governance in our capital markets. We committed $500 million to three funds that will target underperforming companies in the U.S. and Great Britain.

Appendix I

Amendments of 1992 to Article XVI, Section 17

The State shall not in any manner loan its credit, nor shall it subscribe to, or be interested in the stock of any company, association, or corporation, except that the State and each political subdivision, district, municipality, and public agency thereof is hereby authorized to acquire and hold shares of the capital stock of any mutual water company or corporation when the stock is so acquired or held for the purpose of furnishing a supply of water for public, municipal or governmental purposes; and the holding of the stock shall entitle the holder thereof to all of the rights, powers and privileges, and shall subject the holder to the obligations and liabilities conferred or imposed by law upon other holders of stock in the mutual water company or corporation in which the stock is so held.

Notwithstanding any other provisions of law or this Constitution to the contrary, the retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system, subject to all of the following:

(a) The retirement board of a public pension or retirement system shall have the **sole and exclusive fiduciary responsibility over the assets** of the public pension or retirement system. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are **trust funds** and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.

(b) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system **solely** in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.

(c) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.

(d) The members of the retirement board of a public pension or retirement system shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.

(e) The retirement board of a public pension or retirement system, consistent with the exclusive fiduciary responsibilities vested in it, shall have the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system.

(f) With regard to the retirement board of a public pension or retirement system which includes in its composition elected employee members, the number, terms, and method of selection or removal of members of the retirement board which were required by law or otherwise in effect on July 1, 1991, shall not be changed, amended, or modified by the Legislature unless the change, amendment, or modification enacted by the Legislature is ratified by a majority vote of the electors of the jurisdiction in which the participants of the system are or were, prior to retirement, employed.

(g) The Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section.

(h) As used in this section, the term "retirement board" shall mean the board of administration, board of trustees, board of directors, or other governing body or board of a public employees' pension or retirement system; provided, however that the term "retirement board" shall not be interpreted to mean or include a governing body or board created after July 1, 1991 which does not administer pension or retirement benefits, or the elected legislative body of a jurisdiction which employs participants in a public employees' pension or retirement system.

Appendix II

California Public Employees' Retirement System Board of Administration Legislative Policy Standards

Approved by the CalPERS Board of Administration, June 19, 1996.
Revised December 16, 1998 and December 19, 2001

CalPERS Mission

Our Mission is to advance the financial and health security for all who participate in the System. We will fulfill this Mission by creating and maintaining an environment that produces responsiveness to all those we serve.

To fulfill its Mission and to provide consistency in its policies, the CalPERS Board of Administration shall adopt Legislative Policy Standards. In adopting these standards, the Board shall perform its duties for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer retirement contributions, and defraying reasonable expenses of administering the System. The Board's duty to its participants and beneficiaries shall take precedence over any other duty.

Advocate/Activist:

Lobby for changes; actively seek to shape the external environment.

Sponsor/Support:

- Proposals which give the Board increased flexibility in its administration
- Proposals which provide remedies for inequitable, unfair or discriminatory benefits
- Proposals which correct structural or deficiencies in program design
- Retirement and health program changes developed through a collaborative effort where the opinions of all relevant stakeholders are considered
- Proposals which add protection to the trust
- New retirement contract benefit options when they include a proposal to consolidate contract options or promote the concept of Board-approved "pooling"
- Proposals which provide benefit improvements to excluded* employees which are consistent with those provided to represented employees
- Proposals which provide benefit improvements to excluded* employees and retirees to recognize the unique needs of those groups.

* **Note:** For purposes of these Policy Standards; excluded employees are identified as those employees excluded from collective bargaining and not subject to a Memorandum of Understanding (MOU).

Innovator/Advisor:

Design and recommend changes in benefits and new products, give the cost implications of proposed changes with alternatives when appropriate, and provide an unbiased analysis including the pros and cons of each proposal.

Neutral or No Position:

- Proposals to change retirement benefits which are appropriately subject to collective bargaining and are consistent with other Board policies
- Proposals which do not significantly affect the benefit interests of our stakeholders and which do NOT significantly impact CalPERS benefits or the administration of the System

- Proposals to reclassify members from miscellaneous to safety, whether mandated or optional
- Proposals which have conflicting policy implications
- Health care industry mandates which add benefits or coverages which are already included in the PEMHCA standardized health benefit package or are not detrimental to the program
- Health benefit proposals which mandate the health care industry to Offer (rather than require) to the purchaser (CalPERS) benefit packages or design changes.

Protector:

Act when CalPERS is threatened, when mandates are proposed, or limitations arise to the Board's authority.

Oppose:

- Proposals which threaten the Trust
- Proposals which deprive members of vested benefits and do not provide an equivalent, compensating benefit
- Any change which would endanger the tax-exempt status of CalPERS programs and the deferred treatment of income tax on employer contributions and related earnings
- Any investment mandate or restriction on the Board's investment authority
- Any benefit change which results in an unfunded liability and does not provide for proper actuarial funding
- Proposals which create a benefit change for a subcategory within a member classification, unless the proposal promotes the concept of Board-approved pooling
- Proposals which create unreasonable cost or complexity for the administration of the system
- Proposals which reduce or limit the Board's administrative authority
- Proposals which threaten the integrity of the PEMHCA purchasing pool concept or would result in adverse selection between plans
- Proposals which mandate benefits that would be detrimental to the CalPERS PEMHCA program.

Note: "Stakeholders" means those people or entities who have an interest in the performance of the System, i.e., customers (members, beneficiaries, and employers), representative organizations, the Legislature, health providers, taxpayers.

These Legislative Policy Standards are designed to give general policy principles to guide staff in formulating positions on legislative proposals and in no way binds the CalPERS Board of Administration from adopting a differing policy position on any specific legislative proposal, as such proposals are presented to the Board.

Appendix III

California Public Employees' Retirement System Board of Administration California State Ballot Initiative Policy Standards

Approved by the CalPERS Board of Administration
October 22, 1997

CalPERS Mission

> *Our Mission is to advance the financial and health security for all who participate in the System. We will fulfill this Mission by creating and maintaining an environment that produces responsiveness to all those we serve.*

To fulfill its Mission and to provide consistency in its policies, the CalPERS Board of Administration shall adopt California State Ballot Initiative Policy Standards. In adopting these standards, the Board shall perform its duties for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer retirement contributions, and defraying reasonable expenses of administering the System. The Board's duty to its participants and beneficiaries shall take precedence over any other duty.

In accordance with our Mission, we approve the following positions as they relate to California State ballot initiatives:

Support:

- Initiatives which give the Board flexibility in its administration
- Initiatives which provide remedies for inequitable, unfair, or discriminatory benefits provided by CalPERS
- Initiatives which add protection to trust funds administered by CalPERS.

Neutral or No Position:

- Initiatives which do not directly affect the benefit interests of our stakeholders and which do not directly impact CalPERS benefits or the administration of the System
- Health care initiative mandates which add benefits or coverages which are already included in the PEMHCA standardized health benefit package or are not detrimental to the program
- Health benefit initiatives which mandate the health care industry to offer (rather than require) to the purchaser (CalPERS) benefit packages or design changes.

Oppose:

- Initiatives which threaten the trust funds administered by CalPERS
- Initiatives which deprive CalPERS members of vested benefits and do not provide an equivalent, compensating benefit
- Any initiative which would endanger the tax-exempt status of CalPERS programs and the deferred treatment of income tax on employer contributions and related earnings
- Any investment mandate or restriction on the Board's investment authority
- Initiatives which reduce or directly limit the Board's administrative authority
- Initiatives which threaten the integrity of the PEMHCA purchasing pool concept
- Initiatives which mandate benefits to be included in CalPERS PEMHCA program.

Note: These California State Ballot Initiative Policy Standards are designed to give general policy principles to guide staff in formulating positions on ballot initiatives and in no way bind the CalPERS Board of Administration from adopting a differing policy position on any specific type risk/cost analysis here.

CalPERS On-Line Web Site

For additional information about the CalPERS Board, benefits, investment policies, and member publications, visit CalPERS On-Line.
www.calpers.ca.gov

Customer Contact Center

For members and employers with benefit questions.

888 CalPERS (or **888**-225-7377)
Hours: Monday thru Friday, 8 a.m. to 5 p.m.
TTY: For Speech & Hearing Impaired
(916) 795-3240

Additional Contact Information

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Legislative Issues
CalPERS Office of Governmental Affairs
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Sacramento, CA 94229-2720
(916) 795-3689

Public Affairs Issues
CalPERS Office of Public Affairs
P.O. Box 1802
Sacramento, CA 94229-1802
(916) 795-3991

Regional Offices
Fresno Regional Office
10 River Park Place East, Suite 230
Fresno, CA 93720

Glendale Regional Office
Glendale Plaza
655 North Central Avenue, Suite 1400
Glendale, CA 91203

Orange Regional Office
500 North State College Blvd., Suite 750
Orange, CA 92868

Sacramento Regional Office
Lincoln Plaza West
400 Q Street, Room 1820E
Sacramento, CA 95814

San Bernardino Regional Office
650 East Hospitality Lane, Suite 330
San Bernardino, CA 92408

San Diego Regional Office
7676 Hazard Center Drive, Suite 350
San Diego, CA 92108

San Francisco Regional Office
301 Howard Street, Suite 2020
San Francisco, CA 94105

San Jose Regional Office
181 Metro Drive, Suite 520
San Jose, CA 95110

Milestones

1979 CalPERS given responsibility to administer the Volunteer Firefighters' Length of Service Award Program. (Chapter 1145, Statutes of 1979)

1980 Member Home Loan Program created, permitting CalPERS to use retirement funds to assist members to purchase homes in California. (Chapter 410, Statutes of 1980)

1984 CalPERS initiates its Corporate Governance Program.

1988 CalPERS adds international securities to its investment portfolio.

1989 CalPERS consolidates its fee-for-service health plans into one self-funded PPO plan, PERSCare.

1990 California Constitution amended to close the LRS to new legislators. (Proposition 140)

1991 Legislation enacted directing CalPERS to establish a program to provide long-term care coverage to public employees and certain family members. (Chapter 9, Statutes of 1991)

1991 Legislation enacted directing funds in certain CalPERS accounts to be used for the State employer contribution, transferring basic actuarial functions to an appointee of the Governor, and requiring new State employees be placed in an inferior Second Tier retirement plan. (Chapter 83, Statutes of 1991)

1992 California Constitution amended to provide public pension systems "plenary authority" over the administration of the System, including the investment and actuarial functions, and to make other changes generally designed to protect public pension plans from undue interference. (Proposition 162; Article XVI, Section 17)

1993 CalPERS offers an additional, lower cost, self-funded PPO health care plan, PERS Choice.

1994 The Judges' Retirement System (JRS) closed to new members first appointed or elected after November 8, 1994 due to growing liabilities and inadequate funding. A new plan for judges, the JRS II, enacted to apply to newly appointed and elected judges.

1995 The new CalPERS Long-Term Care Program becomes operational, offering coverage to California public employees and their families.

1995 The CalPERS 457 Deferred Compensation program for local agency employees is implemented.

1996 CalPERS investment assets exceed $100 billion.

1998 State Peace Officers' and Firefighters' Defined Contribution Plan Fund (SPOFF) created.

1999 Significant increase in service retirement formulas for State and school employees. Employees in the State Second Tier plan permitted to convert their service to First Tier. (Chapter 555, Statutes of 1999)

2002 Siblings of CalPERS members become eligible for Long-Term Care insurance.

2002 Three new local agency miscellaneous formulas become available by contract option: 2.5% at 55, 2.7% at 55, and 3% at 60.

2003 CalPERS launches financial market reform plan to prevent Enron-type accounting scandals.

2004 CalPERS adopts reduced hospital network and regional health plan pricing to reign in escalating health insurance costs.

2005 CalPERS investment assets reach all-time high of $200 billion.

California Public Employees' Retirement System
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Sacramento, California 95814

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www.calpers.ca.gov

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