

Review of Tobacco Investment Restrictions

October 18, 2016

Presenter



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Webinar Overview

- In April 2016 the Investment Committee requested a review
- The purpose of this webinar is to provide an overview of the issues

CalPERS is Committed to Transparency

- The Board wants to hear your thoughts

- Returning to the Investment Committee in December

Please Send Your Feedback

- calpers_stakeholder_relations@calpers.ca.gov
- C/O Office of Stakeholder Relations
CalPERS
400 Q Street
Sacramento, CA 95811

CalPERS Mission

Provide responsible and efficient stewardship of the System to deliver promised retirement and health benefits, while promoting wellness and retirement security for members and beneficiaries

Source: CalPERS 2012-17 Strategic Plan

Fiduciary Duty

- The Board has a fiduciary duty
- The essence of the fiduciary relationship is confidence, reliance, and trust
- Represents a high standard of care

CalPERS Policy & Fiduciary Duty

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.

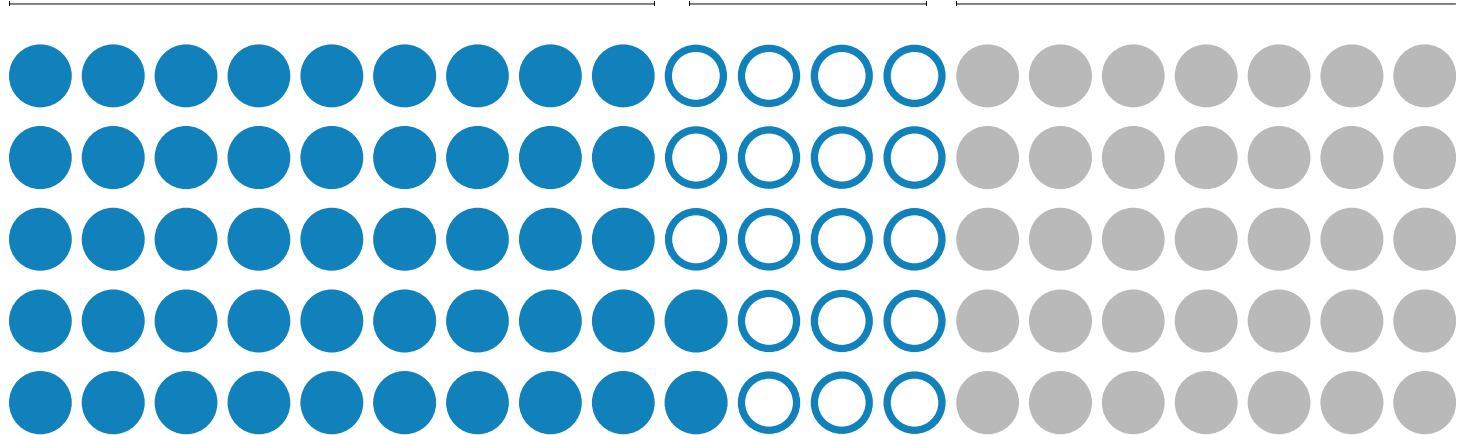
A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.
(CA Const. §17(b).)

CalPERS Pension Beneficiaries

Active
873,026

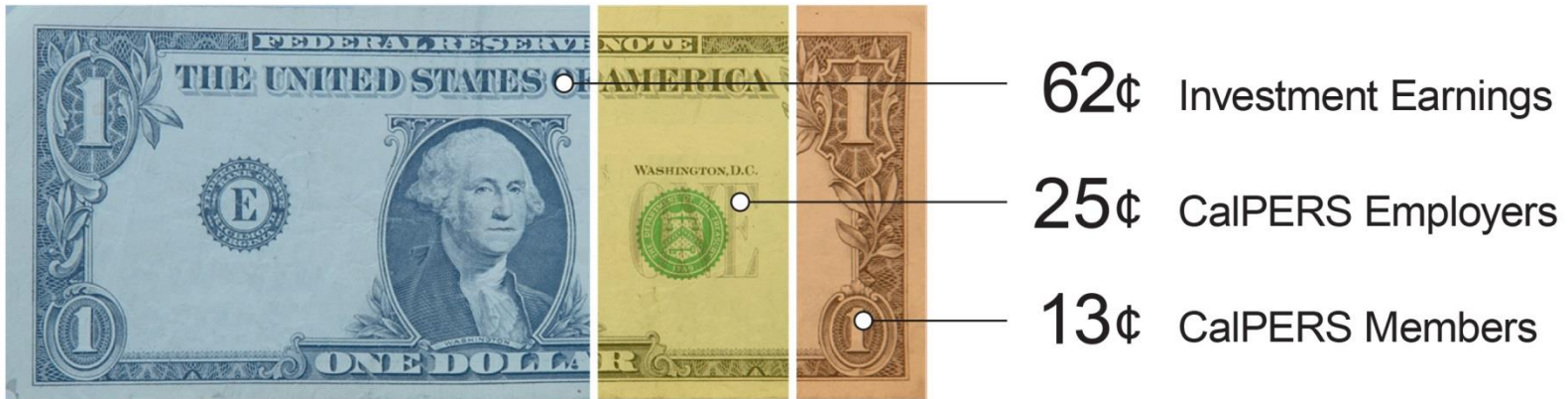
Inactive
337,883

Retirees & Beneficiaries
648,645



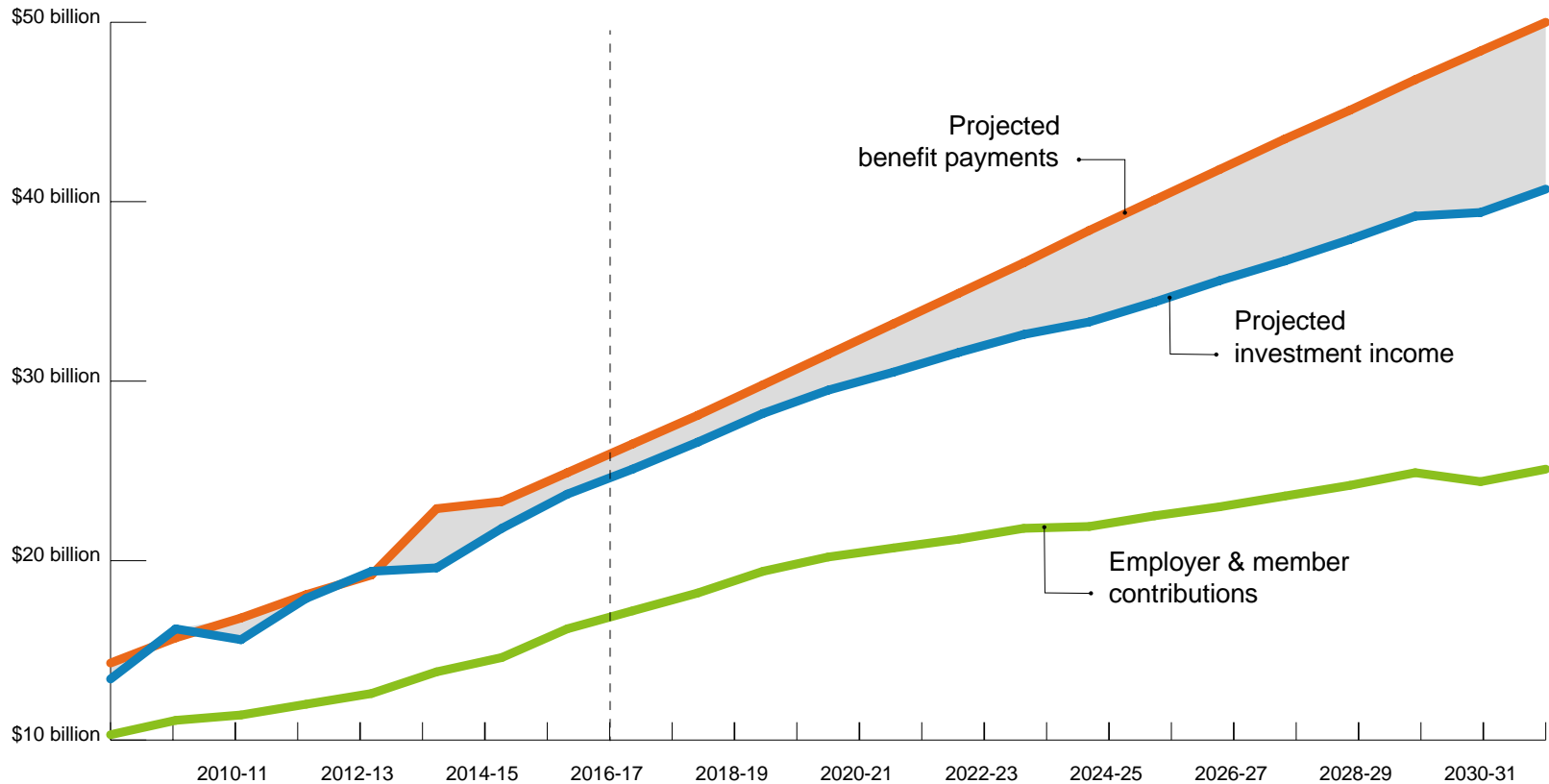
1,859,554 members

Investments Are CalPERS Primary Source of Income



Source: CalPERS income over the last 20 years as of June 2016.

Benefit Payments Projected to Outpace Investment Income and Contributions



How CalPERS Invests

The members of the retirement board of public pension or retirement system shall diversify the investments of the system so as to minimize risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so. (CA Const. §17(d).)

How CalPERS Invests – Investment Beliefs

- 10 Investment Beliefs
 - Guide strategic management
 - Inform priorities
 - Ensure alignment

How CalPERS Invests – Investment Beliefs

- 10 Investment Beliefs
 - Not a checklist
 - Guide decisions requiring balancing multiple, inter-related factors

Investment Belief 3

“CalPERS investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries”

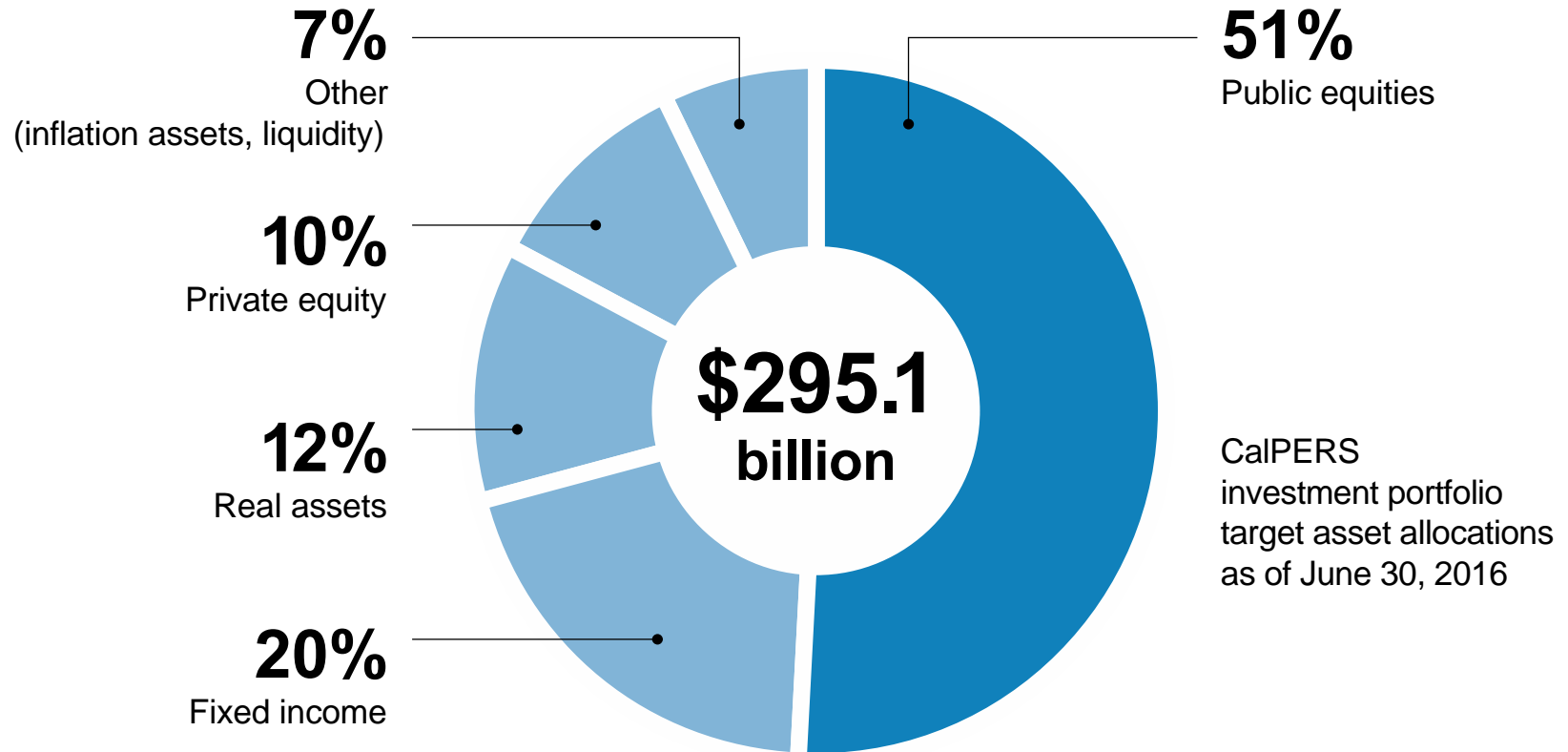
Investment Belief 7

“CalPERS will take risk only where we have a strong belief we will be rewarded for it”

Investment Belief 9

“Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error”

CalPERS is the Largest Public Defined Benefit Pension Fund in the US



How CalPERS Invests

- CalPERS uses both active and passive strategies
- Our overall portfolio has a low level of active risk

Divestment and the Investment Decision Making Process

- Reduces the universe of available investments
- Impacts performance and risk management

CalPERS Experience

- Divesting almost invariably harms investment performance
- At this time tobacco has proved no exception

Why Did CalPERS Divest?

What Action CalPERS Took Regarding Tobacco

On October 16, 2000, the Investment Committee directed staff:

- Divest tobacco stocks and bonds from CalPERS internal and external passive public equity portfolios and internal public debt portfolios
- Implement tobacco-free benchmarks for its public equity and debt portfolios

What Action CalPERS Took Regarding Tobacco

- External active investment managers were not required to divest of tobacco stocks
- They were required to adopt tobacco-free benchmarks

Why Did CalPERS Take Action?

Why Did CalPERS Take Action?

- Ongoing pressures presented ongoing risk
 - Litigation
 - Regulation

What Happened?

- Tobacco outperformed the broad market

What Was the Outcome?

- An estimated \$2 to \$3 billion in potential performance was lost

Source: Wilshire Associates Analysis, Sept 2015

The Future is Uncertain

- Going forward, tobacco-related securities may under perform or over perform

Investment Outlook

- Positive characteristics include
 - Strong performance
 - High dividend yield
 - Durability
 - Consistent cash flows

Investment Outlook

- Reasons to be cautious
 - Falling sales
 - Ongoing litigation
 - Increasing regulatory pressure around the world

Investment Belief 9

“CalPERS must consider risk factors... that emerge slowly over long time periods, but could have a material impact...”

Investment Belief 7

“...take risk only where we have a strong belief we will be rewarded for it...”

Social Considerations

- The health and social concerns associated with tobacco are well documented
- Estimated 40,000 adult deaths in California each year
- Institutional investor impact

Investment Committee Review

- Options for consideration
 1. Affirm existing policy
 2. Extend divestment
 3. Remove restriction

Summary

- Divestment is an active decision
- Limiting the opportunity set can hurt performance
- CalPERS-specific mission and governing principles

Summary

- Tobacco has negative health effects
- The future is unclear
- These issues require careful consideration
- Regular review supports fiduciary duty and Investment Beliefs

Next Steps

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