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It's a CalPERS world: Can the investment behemoth pursue social goals, as well as mind the bottom line for its retirees?

By Ralph Brave

The April 16, 2007, meeting of the investment committee of the board of administration of the California Public Employees Retirement System was nothing out of the ordinary. Most of the agenda items were merely for information purposes.

On the topic of global investing, a CalPERS consultant reported that Brazil, Chile, Israel, Malaysia and Taiwan had appealed the scores they received on various factors that determined whether CalPERS could invest in them. China, Pakistan, Russia, Venezuela and Sri Lanka, among others, once again didn't make the grade.

At the end of the meeting, the AIDS Foundation complained that the Abbott Laboratories pharmaceutical company was acting badly toward the people of Thailand, who suffer high HIV rates, by limiting access to new drugs. Investment committee chairman Charles Valdes instructed staff to invite Abbott executives to explain themselves to the board.

The committee then went into closed session.

No big deal here, nothing dramatic to report. The only media present other than local press was from the trade journal *Pensions & Investments*.

But wait a moment. Did we hear this right? Nations from all over the globe are appealing to California's public employees' pension fund to invest in their countries? A multinational drug company is going to be called on the CalPERS carpet for its actions in Thailand? And this is just another day at the office?

That's exactly right.

While most people are familiar with CalPERS as the Sacramento-headquartered pension plan for public employees, and their million-and-a-half members know CalPERS primarily for the formulas that determine their retirement benefits, the underlying reality is that CalPERS has



On November 4, 1930, about 51 percent of California voters favored Proposition 5, allowing retirement pay for state workers. The *Sacramento Bee* opposed it. The next year the state Legislature passed laws creating the system. On January 1, 1932, the State Employees Retirement System opened for business.

become an investment behemoth bestriding the world. With nearly a quarter-of-a-trillion dollars in assets, it is the largest pension fund in North America and one of the largest in the world. Its holdings in the stock market are so great that the recent rise in the market saw the value of the CalPERS fund go from \$226 billion in mid-April to over \$245 billion in mid-May. Last year, CalPERS' administrative costs—salaries, pencils, etc—totaled \$247 million. But if you do the math, that amounts to one-tenth of 1 percent of their funds. And only slightly more than 1 percent of last year's investment income.

There are so many angles from which to understand just how large CalPERS' financial assets actually are. UC Davis professor of finance Brad Barber suggests that CalPERS "holds about 1 percent of the public-equity markets, or close to that." That's one fund—and a public-employee fund at that—holding 1 percent of all the publicly traded stocks! One anecdote that helps communicate the significance of CalPERS in the investment world comes from someone who once served on the CalPERS board. Their daughter began dating a college senior headed to Wall Street. When the college senior found out about the CalPERS position held by his date's parent, he asked if he could meet the parent. CalPERS' board members are among the finance world's celebrities, and everyone wants access.

But the key concept to really grasp the size and influence of CalPERS is "scale." CalPERS is of such a scale—is so large, has so much money to invest—that it cannot depend on making the revenue it needs from simply investing in stocks and bonds. As Russell Read, CalPERS chief investment officer, explained in a recent interview with SN&R, "The bigger the footprint you have in the marketplace ... generally works against you." It's not that they can't or don't make money in the stock market. But their size limits the amount of return. "For example, when we identify some very talented hedge funds, they might be interested in some of our investment money," says Read. "But only to a certain limit. Generally, for the most talented managers, we would want to give them more money than they're willing to accept from us."

The result, says Read, is that CalPERS increasingly has turned to "real estate and private equity, in which we can apply our scale productively—generally to make new projects or buildings possible and profitable." In other words, CalPERS has become a major financier of the emerging economy, participating in the reshaping of companies and countries to generate new economic activity. "Size matters," says Jason Dickerson, an analyst at the Legislative Analyst's Office, "and CalPERS' size allows them to get in on the inside track of cutting-edge business deals all over the world."

What makes all of this even more interesting, and crucial, is that over the past 25 years, and particularly over the past decade, CalPERS has enacted a series of policies to guide its investments to achieve both economic returns and social goals—"the double bottom-line," as former state treasurer Phil Angelides calls it. Whether it's investing in environmentally sustainable technologies or inner cities, divesting from tobacco companies and the Sudan or using its stock holdings to force corporate management to act responsibly, as a regular matter of day-to-day business the public workers' fund is remaking the world in ways Karl Marx would never have dreamed possible.

While there consistently have been questions about whether CalPERS' pursuit of social goals would impede fulfillment of its fiduciary duties to its retirees, there is no doubt that CalPERS' investment record excels, performing better than many traditional investment funds.

The investment calculus may in fact be radically changing on how this equation between economic return and social responsibility is determined. Nothing brings this into view better than global warming. With the future of controls over carbon emissions and the development of carbon markets still uncertain, how will investments in companies with large carbon emissions pan out versus investments in the technologies that will control or replace carbon emissions? With investment stakes on both sides, how aggressive a role should CalPERS play in addressing global warming? "You might imagine these days that we might be tempted to go after companies who are polluting a lot of CO₂ emissions because of concerns about global warming," comments Barber. "But it's much less clear whether doing so would be in the benefit of shareholders, because you might actually be hurting the value of the companies that you engage."

So what is CalPERS doing about global warming? Will it remain officially un-invested in China? How effective have its efforts been to get corporate boards of directors to stop management from ripping off shareholders with illegal ploys, like options back-dating? And how is all this affecting CalPERS investments? The question is of urgent interest to CalPERS members and taxpayers alike, as \$3 out of every \$4 paid to retirees comes from investment income.

For insight into these and related topics, SN&R found time in the busy schedule of CalPERS' Read for an exclusive interview. Read arrived at CalPERS last June, after a tremendously successful career as a private-sector money manager. In person, he's very much the opposite of the stereotypical dour and sour banker. Instead, Read very much carries the bearing of this joyous academic—something that makes sense, as he has a Ph.D. in economics from Stanford University. He also is very attuned to the financial interface with environmental matters. To recruit him, CalPERS had to lure him out of an innovative program in forestry at the University of Maine.

Just like the chairman of the Federal Reserve Board, Read is necessarily cautious in his comments on CalPERS' investment choices and strategy. CalPERS is of such influence in the investment world that an inapt stray comment could potentially affect the market for a company, or even a country. But if you read his answers closely, you'll find Read's conversation with SN&R providing windows on many aspects of the future of the world as being made, and remade, by CalPERS.