CalPERS BRIEFING FOR US TREASURY TRANSITION TEAM

December 18, 2008

- Overview of CalPERS and the Effect of the Financial Markets Crisis – Attachment 1

- Response to Financial Crisis

    - Working with coalition of public pension funds to shape position statement on desired Market Reforms – Attachment 2
    - Basic principles include:
        - Rational Regulation
        - Systemic Risk
        - Global Coordination
        - Transparency
        - Investment Protection – Structured Advisory Group
        - Mark to Market

- Governance Issues
        - SEC must be a strong and independent entity
        - CalPERS governance priorities outlined – Attachment 3
        - TARP - Treasury's position on governance issues, with respect to its interest in companies in which it has taken ownership stakes

- IRC Compliance Issues – Attachment 4

- Credit Rating Agency Standards – Attachment 5

- Special Investment Programs

    - Environmental –$1 billion committed to private equity clean technology investments and $500 million to publicly held companies screened for environmental factors; as energy efficiency goals for our real estate partners.
    - Diversity - Emerging manager programs in public equity, private equity, and real estate, as well as substantial capital committed to traditionally underserved domestic markets
    - Infrastructure – Policy that addresses our approach to public private partnerships, impact on public sector jobs, responsible contracting and sustainable investments with environmental sensitivity.

Attachment 1

CalPERS Investment Office

Overview of Past Six Months

Fund Market Value

As of December 15, 2008 CalPERS fund market value is $182.6 billion. On June 30, the market value was $239.2 billion, a loss of $56.6 million, more than 20% in just under 6 months. The most current 1 year comparison is 10/31/07 $260.4 to 10/31/08 $186.7 which is a one year decline of 28%.

CalPERS Membership/DB Plan

CalPERS manages pension and health benefits for more than 1.6 million California public employees, retirees, and their families. As of June 30, 2008, we provided benefits to 1,126,133 active and inactive members and 476, 252 retirees. CalPERS membership is divided approximately in thirds among current and retired employees of the state, schools, and participating public agencies.

CalPERS is a defined benefit retirement plan. It provides benefits based on a member's years of service, age, and highest compensation.

Funded Status

The funded status of CalPERS, which is determined by comparing market value of assets to the accrued liability on June 30, 2007, was 101.2 percent. However, during the 2007-2008 fiscal year, our investment return was negative 5.1 percent, which is approximately 13 percent less than our assumed annual investment return of 7.75 percent. The difference is expected to reduce our funded status to below 90 percent on June 30, 2008.

Employer Contribution Rates and Concerns

Investment returns for fiscal year 2008-2009 will begin to impact public agency employer contribution rates in fiscal year 2011-2012. If the 2008-2009 fiscal year ends with an investment return of negative 20 percent, we estimate employer rates will increase by 2 percent to 5 percent of payroll in the 2011-2012 fiscal year. Rates will continue to increase by about 0.2 percent to 0.6 percent of payroll in subsequent years if we have investment returns of 7.75 percent in the next few years. Returns in excess of 7.75 percent would be necessary to prevent a steady rise in employer rates.

CalPERS' employer rate stabilization policy reduces the volatility of employer rates by amortizing investment gains and losses over 15 years, greatly reducing the impact of short-term investment return volatility on employer rates.

The current market downturn has not adversely affected CalPERS' ability to pay approximately $11 billion per year in benefits to 476,000 retirees, survivors, and beneficiaries. Last year, employer and member contributions totaled nearly $11 billion, which gave us the cash to pay benefits without selling any assets.

Asset Classes/Returns

All of our asset classes have been affected by the downturn, but CalPERS has a long term strategy of diversification and discipline. In addition, we are exercising leadership in market reform.

In Global Equity, we have underweighted our policy allocation and we are not presently positioned to rebalance.

Due to the unprecedented lock up in the credit markets, CalPERS is carefully managing cash flow and liquidity issues, as are other investors and financial institutions.

The total fund returns (net) over the past five years as of 10/31/2008:

Fiscal year to date ended 10/31/08	-21.47%
3 years for period ended 10/31/08	-.54%
5 years for period ended 10/31/08	4.40%

Attachment 2

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December 15, 2008

AGENDA ITEM 10b(1)

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: Institutional Investor Response to Market Conditions

II. PROGRAM: Global Equity – Corporate Governance

III. RECOMMENDATION: Information

IV. ANALYSIS:

Executive Summary

Background

The recent conditions in the global markets have demonstrated the need for significant changes to the existing structures of regulation, market operation, information availability and accountability. As this situation has evolved, it has become apparent that institutional investors in general, and public pension funds in particular, need to be involved in shaping the changes that will surely be forthcoming. To this end, CalPERS and CalSTRS have partnered together, along with many other public pension plans, to begin the construction of a coherent position statement that outlines our concerns and ideas. A meeting was held in Washington D.C. on December 11th to discuss the situation and form the base outline of the document that will present a shared position for the participating funds. This meeting constituted a continuation of the work being done by CalSTRS and CalPERS to collect thoughts and perspectives from other public plans.

Participation

The participants in the meeting were: Eric Baggesen, CalPERS; Anne Sheehan, CalSTRS; Meredith Williams and Greg Smith, Colorado; Melissa Moye, Maryland STO; Maureen Madden, New York Common; Mike McCauley, Florida; Michael Musuraca, NYCERS; Meredith Miller, Connecticut STO; Shelley Smith and Sally Choi, LACERS; Gail Hanson, Wisconsin; Carol Drake, Ohio; George Wong and Luke Bierman, New York Common; Michael Perez and Erika Tiedge, LA Fire and Police. The meeting also included prior SEC Commissioner Roel Campos, Senior Counsel of the House Financial Services Committee Lawranne Stewart and Damon Silver, Member of the Congressional Oversight Panel established by the Emergency Economic Stabilization Act. Also participating were staff members from the Council of Institutional Investors, John Stanton from Hogan & Hartson, Tom Lussier and Leigh Snell from LGVA.

Meeting Topics

A significant portion of the meeting was allocated to discussion with Stewart, Campos and Silver to identify the current regulatory and legislative environment. The main insights are:

- There is great support for the concept of creating a “systemic risk regulator”. Systemic risk appears to be defined as the threat to the overall financial system from the failure of an intermediary. There is no clarity regarding how this new regulatory capability would be organized, endowed with authority or resourced.

- The SEC is viewed as having been significantly weakened by the lack of the agency’s “presence” in the events taking place over the past year or more. The Federal Reserve and Treasury appear to have been much more engaged in attempting to work through the issues.

- There are high levels of disagreement on the relative merits of “principles” versus “rules” based regulation.

- Significant questions are being raised about the potential behavior of the Government as a shareowner in the companies accessing public capital. It is very unsure how the different aspects of corporate governance may be impacted.

- The attachment of traditional corporate governance items (executive compensation, golden parachutes, etc) to the various rescue programs is not seen as weakening the concept that these items should apply to all public equity issuers.

- A long term perspective needs to be reattached to both investment and corporate management. There are differences of opinion regarding topics such as mark to market accounting's impact on the time perspective.

- Reform needs to be done on a global basis to be really meaningful as the issues underlying the market problems in the U.S. extend to the global capital markets.

Next Steps

The group was able to agree on a variety of next steps to be taken. There is a shared belief that institutional investors need to have a unified posture going into the supercharged environment for change and reform that presently exists.

- A background statement will be formed that speaks to the reasons why the investor group is engaged on these topics. This statement will reflect some of the impacts that are being experienced by the group along with statement regarding the importance of these institutional investors to overall economy. Among these impacts are:

    - A decline in the funded ratios
    - Liquidity constraints
    - Great uncertainty regarding asset allocation assumptions
    - Serious concern for the ability of sponsoring entities to meet their retirement and healthcare funding contributions

- Listing of the principle topics of concern where reform appears to be needed. This listing needs to be at a high level and distilled to the primary considerations. In asking for ideas from a number of informed parties, CalPERS collected literally dozens of items. To create a coherent message, the final listing needs to be constrained to a small number of the most important concepts. Tentative topics are:

    - Transparency – All financial instruments and their attendant attributes need to be visible to the regulators and the market. Transparency should also extend to trading activity and all accounting information.
    - Systemic Risk – In addition to the concept that systemic risk derives from an entity whose failure could compromise market function, another source of systemic risk is a market

without any balance of buyers and sellers. When homogenous behavior takes hold of the market, prices can move wildly and result in extreme valuations with great implications.

- Investor Protection & Corporate Governance – Investors need a strong, uncompromised voice with a mandate to create the most equitable environment based on responsible behavior and accountability. For U.S. investors, the SEC has held this role.
- Rational regulation – The current regulatory model is highly complex and based on the type of entity (bank, broker, insurance, etc). A problem with this model is that many entities participate in the same financial instruments but have very different regulatory requirements.
- Mark to Market – This accounting treatment has been at the heart of many debates and is linked to the investment time horizon issue.
- Global Coordination – For any reform to be effective there needs to be a degree of cooperation and coordination. This concept needs to urge convergence at the highest standard.

The listing of topics and perspective statement will be compiled and sent to the investor group for their input. Upon final determination of this information set, a dissemination and engagement process will be formulated to carry the messages to the appropriate regulatory and political audiences. The dissemination activity should start early in 2009.

V. STRATEGIC PLAN:

This item will further the following goals of CalPERS' Strategic Plan:

- Goal VIII. Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

- Goal IX. Achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

Costs associated with implementing strategies to address market reform as a result of the current financial market crisis are contained within the Investment Office budget.

<u>Attachment 3</u>

12/5/08 email transmission to Gary Gensler and Daniel Brundage:

Good Morning Mr. Gensler,

The California Public Employees' Retirement System (CalPERS) greatly appreciates the opportunity to respond to your request of what we believe to be the most relevant issues that should be addressed by the Securities and Exchange Commission within the first year of President Elect Obama's term. As a significant long-term institutional investor, CalPERS has a vested interest in an efficient capital market system founded on integrity, transparency, and accountability. The SEC's oversight, enforcement, and regulatory authority to protect investors should not be weakened going forward. We look forward to discussing the following seven key issues with you later today and are prepared to provide your team with continued support that address relevant issues from the perspective of CalPERS as an institutional investor and long-term shareowner:

Key Issue #1 (SEC Protection of Investors): In March 2008, the Department of the Treasury issued its "Blueprint for a Modernized Financial Regulatory Structure." The comprehensive financial regulatory reform laid out identifies a series of "short-term" and "intermediate-term" recommendations that directly affects the regulatory structure in the United States today. CalPERS believes SEC oversight, enforcement, and regulatory authority should not be weakened; rather, strengthened so that the implications of the evolving regulatory reform adequately address investor protections, efficient capital markets, facilitate capital formation, and ensure investors' interests are put first by financial intermediaries who sell and trade securities. The SEC must be adequately staffed, funded, and free from conflict.

Key Issue #2 (Proxy Access): Today in the United States, shareowners do not have effective access to the proxy. Shareowner access to the proxy for the purpose of nominating director candidates is important to investors to ensure a sustainable system of corporate governance that fosters democracy, director accountability and long-term value creation. CalPERS strongly supports shareowner access to the proxy.

Key Issue #3 (Discretionary Broker Votes): Inaction by the SEC to protect investors runs contrary to the primary mission of the Commission. The Council of Institutional Investors (CII) and many others have been lobbying for reform relating to broker discretionary voting for over a decade arguing that "allowing brokers to continue to cast votes for uninstructed shares – votes that always are cast in favor of management's proposals and candidates for board seats – skews voting results and is akin to stuffing the ballot box." (CII letter to the NYSE dated June 29, 2006.) More recently, a bipartisan NYSE working group, and the NYSE itself, has asked the SEC to eliminate director elections from the list of "routine" maters on which discretionary voting by brokers is permitted. Yet, the SEC has failed to take action. CalPERS strongly supports this important reform.

Key Issue #4 (SOX 404): In addition to protecting investors, it is paramount that the SEC maintains the integrity of the securities markets. A January 15, 2008 report published by Glass Lewis & Co. indicates that the requirement for companies to comply with Sarbanes Oxley Section 404 is working, particularly for smaller companies. This is demonstrated by the following facts: 1) The number of companies with a market capitalization between $75 million and $749 million that restated prior year financial reports, declined to 337 in 2007 from 408 in 2005; and 2) the number of companies with a market capital capitalization between $75 million and $749 million that disclosed a material weakness, declined to 357 in 2007 from 712 in 2005. CalPERS does not believe small companies should be exempt from complying with SOX 404. Given these two facts and reports suggesting audit fees paid by US publicly traded companies have declined for the last two years, CalPERS believes the SEC should not exempt small companies from complying with SOX 404?

Key Issue #5 (Global Accounting Standards): As a global investor and member of the International Corporate Governance Network (ICGN), CalPERS supports a move toward a more consistent and comparable global standard for accounting practices. High-quality, fully transparent global financial reporting standards should continue to be an ultimate goal for the purpose of ensuring the integrity of, and investor confidence in, the global capital markets. CalPERS understands that the timing for achievement of this goal is very imprecise and subject to many considerations; however, supports the SEC's long advocated stance in reducing disparity between accounting and disclosure practices of the U.S. and other countries as a means to facilitate cross-border capital formation while ensuring adequate disclosure for the protection of investors and the promotion of fair, orderly and efficient markets. While CalPERS generally supports the objective of moving toward consistent and comparable global accounting standards, this goal should not be to the detriment or dilution of US GAAP and other US accounting standards.

Key Issue #6 (Environmental Disclosure): CalPERS believes that to ensure sustainable long-term returns, companies should provide accurate and timely disclosure of environmental risks and opportunities through adoption of policies or objectives, such as those associated with climate change. As a signatory to the Investor Network on Climate Risk (INCR), CalPERS agrees that enhanced guidance from the SEC to businesses and investors on what material issues related to climate change companies should disclose in financial reporting is recommended, so that investors can assess more accurately the effects of climate risk and opportunity in their portfolios.

Key Issue #7 (Executive Compensation): Executive compensation programs are one of the most powerful tools available to attract, retain, and motivate, as well as align executive interests with the long-term interests of shareowners. In 2008, investors are increasingly requesting that companies submit non-binding shareowner advisory vote proposals on executive compensation to enhance constructive investor-board communication, improve transparency in setting executive pay, and better align executive performance with the creation of shareowner value. U.S. companies such as Aflac and Verizon, international countries such as Australia and the United Kingdom, and the Council of Institutional Investors (CII) embrace this important investor right. CalPERS strongly supports a non-binding shareowner advisory vote on executive compensation programs.

Thank you again for this opportunity to provide input on behalf of CalPERS.

Kind Regards,
Bill

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Attachment 4

GOVERNMENTAL PLANS BRIEFING

Governmental Retirement Plans Differ from Private Sector Plans

- Broad coverage
  The political process and historic plan structures ensure governmental plans offer broad coverage and include many non-highly compensated workers, without need for Federally imposed rules.

- No Employer Tax Advantage
  Federal private plans rules mandate coverage of the non-highly compensated in return for the tax advantage of a current employer deduction and employee income deferral. State and local governments do not benefit from the early deduction since they are not subject to tax; they can generally provide the same benefits outside of qualified plans without adverse tax consequences to the employer, but providing the benefits as part of a qualified plan is more efficient and is better for employees. The policy reasons to impose limits on private plans do not apply to governmental plans.

- Transparency
  Governmental plans are highly transparent and accountable to the legislative and executive branches of the state; independent boards of trustees that include elected employee representatives and/or ex-officio elected public officials.

- State Law Employee Protections
  Governmental plans must comply with state constitutional, statutory, case law, and state and local requirements, as well as governmental accounting standards, that protect employees' rights to benefits. Federal rules, and their changes, sometimes conflict with these state laws.

- Most Private Plan Rules Promoting Coverage, Non-Discrimination, and Limits Are Unnecessary in Governmental Plan Context
  Most rules for private sector plans are not needed for governmental plans. Many rules have been made inapplicable over time. To improve administration and conserve resources, only rules on the timing of, and limitations on, plan distributions and on portability should be retained.

Communications Between IRS and Governmental Plans and Improved Targeted Guidance Should be Encouraged

With a goal of increasing the IRS' understanding of the nature of and differences between governmental plans and private plans, as well as the administrative and political structure of governmental plans, and of state constitutional and other legal constraints on governmental plans, we suggest the following steps:

- Set Up Advisory Counsel or Working Group and Seek Input From the Governmental Plans Community In Advance of Taking Action
  We request that the IRS seek input and suggestions from governmental plans in important areas where we understand changes are under consideration, such as the definition of a governmental plan and the reasonable good faith interpretation of 401(a)(9) minimum distribution rules.

- Focus Regulation of Governmental Plans on Areas Requiring Regulation Rather than Attempting to Cover Governmental Plans Under the Private Plan Structure
  Current IRS efforts put governmental plans into the structure for private plans, rather than tailoring rules to their unique governmental plans characteristics. Public agency resources should be devoted to ensuring compliance with rules regarding governmental plan distributions, rollovers, and transfers, rather than focusing on governmental plans' adherence to requirements that should apply only to private plans.

Improvements Through Regulatory or Legislative Changes

We suggest that changes in the areas listed below would be helpful to administration of governmental plans. Such changes may be achieved through legislative, regulatory or administrative action.. We suggest that IRS compliance and enforcement efforts should focus on assisting governmental plans to implement rules relating to distributions, rollovers, and transfers from governmental plans and on clearly defining governmental plans and the employees these plans cover, with reasonable grandfather provisions.

- Make Sections 415, 401(a)(16) and (17) Inapplicable to Governmental Plans
  A large amount of resources are expended in applying Section 401(a)(16) and 415 limits on benefits and contributions to governmental plans even though the limits impact only a small number of participants to a modest degree. Federal regulations have not adequately addressed governmental cost-of-living adjustments and phased retirement plans. Moreover, the same benefits subject to 415 limits may be provided outside the plan under a section 415(m) excess benefit arrangement with no different impact on income tax revenue or participant income taxes. Similarly, given that governmental plans are not subject to non-discrimination rules, benefits can remain the same notwithstanding the 401(a)(17) compensation limits simply by changing the benefit formula for certain employees. These provisions add to complexity and plan administrative costs without advancing federal policy goals.

- Facilitate Asset Pooling Through Group Trusts
  To provide economies of scale and improve provision of health benefits, the group trust option permitted under Rev. Rul. 81-100 should be expanded to permit pooling of a qualified plan trust and an exempt trust under Section 115 providing health care benefits to employees and retirees.

- Clarify Rules on What Constitutes a Governmental Plan and Who Can Be Covered
  We understand that an interagency group is working on guidance on what constitutes a governmental plan. Input from governmental plans should be sought on this issue before guidance is released and grandfather provisions and/or transition mechanisms should be included (such as permitting preservation of employee benefits via a spin off to a non-governmental plan).

- Clarify Rules On Pick Up Contributions
  IRS issuance of Revenue Ruling 2006-43 created confusion and complications regarding long-standing government plan operations with respect to governmental entity “pick-up” of employee contributions. Formal action by adopting employers regarding “pick-ups” should not be required as long as employers treating contributions as pre-tax for payroll purposes.

- Clarify Application of Section 401(a)(1) Requirements
  Because governmental plans are often established through state statutes, which are more difficult to amend frequently, more flexibility is needed to satisfy the written plan requirement -- including incorporation by reference and reliance on combinations of statutes, rules and plan administrator materials. The IRS should also provide model provisions that can be used

to meet requirements through administrative adoption rather than state law legislative changes.

- Remove Compliance Fee for Governmental Plan Corrections
  Governmental plans should be permitted to receive IRS approval of Voluntary Correction Program corrections without imposition of a fee, because governmental plans may be limited in their authority procure additional employer funds to pay the fee and some governmental plans may have concerns about relying on self-correction.

- Modify Final Regulation on Normal Retirement Age For Governmental Plans
  The IRS issued a final regulation defining "normal retirement age" for the purpose of permitting commencement of benefit payments that provides that the normal retirement age must be reasonably representative of the typical retirement age for the industry and includes numerical safe and unsafe harbors. In response to concerns expressed by the governmental plans community, in Notice 2008-98, the IRS recently pushed back the effective date of these regulations for governmental plans. The IRS should consider excluding governmental plans from these regulations, as state rules adequately govern these benefits.

- Clarify Limited Scope of Section 401(a)(9)
  Since passage of the Pension Protection Act of 2006, a governmental plan is deemed to comply with the Section 401(a)(9) minimum distribution rules if it complies with a "reasonable good faith interpretation" of the statutory requirements. Before issuing final regulations regarding the good faith interpretation of this provision, if any detailed rules will be included, we request that the IRS seek input from governmental plans on typical provisions so as not to inadvertently create difficulties for governmental plans, and also to ensure that typical governmental plan options such as survivor benefits and death cash outs based on employee contributions and attributable interest are permitted under the rules, (given that legislative change was implemented to allow flexibility for various historic distribution options.).

- Make Section 105(h) Health Non-Discrimination Rules Inapplicable to Self-Funded Governmental Health Plans
  Governmental health plans are generally broad based offering coverage to many nonhighly compensated employees and often are collectively bargained. For example, some health plans may provide higher levels of coverage for retirees having longer service or for those covered under collective bargaining agreements. As with retirement plans, nondiscrimination testing should not be imposed on these plans, as it would be an unnecessary and inefficient use of resources.

- Clarify Tax Treatment Under Health Plans Covering Domestic Partners
  The IRS should clarify that if a health plan (including a retiree health plan) covers domestic partners, such coverage will not result in taxation for everyone in the health plan.

- Issue Model Notice and Updates On Plan Distributions and Rollovers
  It would be helpful if the IRS would issue timely model 402(f) distribution notices and updates, to facilitate plan administration and communication with participants on rollover options and taxation of distributions.

Attachment 5

Credit Rating Agency Standards – CalPERS Board Resolution

The Board of Administration of the California Public Employees' Retirement System endorses the principle that major rating agencies should rate municipal bonds on a scale based on new standards which are uniform, fair, and consistent, and which will provide all investors with an accurate and credible basis for comparing the relative default risk of municipal and corporate bonds and other investment vehicles. The Board supports voluntary action by the major ratings agencies to achieve these objectives, and failing that, will support appropriate and effective legislative or regulatory efforts to achieve them. The Board directs staff to communicate the Board's position to ratings agencies, Congress and relevant regulatory agencies, and to provide leadership on this issue to other public and private pension funds, and coalitions of investors such as the Council of Institutional Investors, subject to the normal review and approval procedures of the Investment Committee and the Board.