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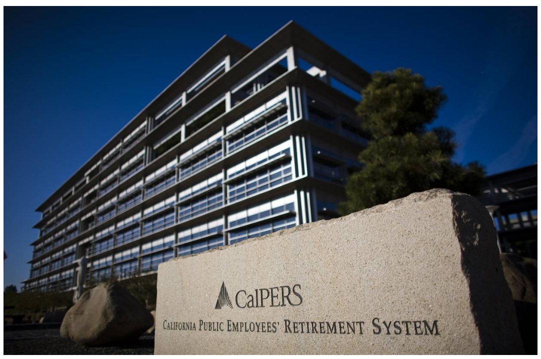
MARKETS

Largest U.S. Pension Fund Eyes Drop in Investment Target to 7%

Calpers seeks more realistic annual return, but drop would mean higher pension bills for cities, counties and school districts



Officers at Calpers, the largest pension fund in the U.S., are recommending that investment targets drop to 7%. *PHOTO: MAX WHITTAKER/REUTERS*

By **HEATHER GILLERS**
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Officers of the largest U.S. pension fund recommended Tuesday that their investment targets drop to 7% because of a cash crunch and changing market conditions, a move that would set a more cautious tone for those who manage retirement assets around the country.

The proposal to abandon a long-held goal of 7.5% over three years came during a board committee meeting of the California Public Employees' Retirement System in Sacramento. The rate would drop to 7.375% in fiscal 2017-18, 7.25% in fiscal 2018-19, and 7% in fiscal 2019-20.

The Board's Finance and Administration Committee approved the recommendation Tuesday evening and it will move to the full board for consideration Wednesday.

The last time the fund, known commonly as Calpers, lowered its investment expectation was in 2012, when the target dropped to 7.5% from 7.75%.

A reduction would have real-life consequences for taxpayers and cities. It would likely trigger an increase in yearly pension bills for the towns, counties and school districts that participate in California's state pension plan. Any loss in expected investment earnings must be made up with significantly-higher annual contributions from public employers as well as the state.

A drop in Calpers's return assumptions could also put pressure on other pension funds to be more aggressive about their reductions and concede that investment gains alone won't be enough to fund hundreds of billions in liabilities.

Because of its size, Calpers typically acts as a bellwether for the rest of the pension world. It manages nearly $300 billion in assets for 1.8 million workers and retirees. Calpers—like many pension funds—doesn't have enough assets on hand to pay for all future obligations.

The Calpers recommendation of 7% followed a weekend of negotiations between Calpers staff, California Gov. Jerry Brown's office and organized labor, according to people familiar with the matter.

Calpers staff wanted the return assumption down to 7% as quickly as possible, these people said. They offered a two-step process, with a drop to 7.25% taking effect in the first year. Unions wanted more than three steps, while avoiding a significant drop in the first year so workers and local governments had time to adjust to higher pension contributions. Calpers eventually offered its three-tiered proposal: 7.375% in year one, 7.25% in year two, and 7% in year three.

The costs are expected to be steep for all Calpers participants. If the rate drops to 7%, the state and school districts participating in Calpers would have to pay at least $15 billion more over the next 20 years, said spokeswoman Amy Morgan. That number doesn't include cities and local agencies.

The more cautious stance from Calpers' investment staff comes just 13 months after the fund agreed to a plan that would slowly scale back its target by as much as a quarter percentage point annually—but only in years of positive investment performance.

Now Calpers officials are concerned that plan may not be fast enough because of a mounting cash needs and declining estimates of future earnings from stocks and bonds. The fund is paying out more in retirement benefits than it receives in contributions, and outside adviser Wilshire Associates is predicting the fund's 10-year return will drop to 6.21%.

"Conditions have in fact changed," said Calpers Chief Executive Officer Marcie Frost.

Pensions have long been criticized for using unrealistic investment assumptions, which proved costly during the last financial crisis. But more than two thirds of state retirement systems have trimmed their assumptions since 2008, according to an analysis of 127 plans by the National Association of State Retirement Administrators, and some are now dropping to 7% and lower.

Earlier this month, Connecticut's state employee fund dropped its assumption to 6.9% from 8%. The Hawaii Employees' Retirement System had been scheduled to drop its rate only slightly, to 7.5% in 2017, from 7.55%, but the board this month voted to instead drop the rate to 7%.

The average target among 127 plans surveyed by the National Association of State Retirement Administrators is currently 7.56%. That is the lowest since at least 1989.

Write to Heather Gillers at heather.gillers@wsj.com