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California Pension Fund Hopes Riskier Bets Will Restore Its Health

By [LESLIE WAYNE](#)

SACRAMENTO — Big as California's budget woes are today, so are the problems lurking in its biggest pension fund.

The fund, known as Calpers, lost nearly \$60 billion in the financial markets last year. Though it has more than enough money to make its payments to retirees for many years, it has a serious long-term shortfall. Meanwhile, local governments in the state are pleading poverty and saying they cannot make the contributions that would be needed to shore it up.

Those problems now rest largely on the slim shoulders of Joseph A. Dear, the fund's new head of investments. He is not an investment seer by training, but he thinks he has the cure for what ails Calpers, or the [California Public Employees' Retirement System](#), the largest in the nation with \$180 billion in assets.

Mr. Dear wants to embrace some potentially high-risk investments in hopes of higher returns. He aims to pour billions more into beaten-down [private equity](#) and hedge funds. Junk bonds and California real estate also ride high on his list. And then there are timber, commodities and infrastructure.

That's right, he wants to load up on many of the very assets that have been responsible for the fund's recent plunge. Calpers's real estate portfolio has tumbled 35 percent, and its private equity holdings are down 31 percent. What is more, under Mr. Dear's predecessor, Calpers had to sell [stocks](#) in a falling market last year to fulfill calls for cash from its private equity and real estate partnerships. That led to bigger losses in its stock portfolio.

Mr. Dear remains a believer. Private investments, he asserts, will over the long haul outperform stocks by three

percentage points a year, and that is necessary to keep Calpers on track to returning its goal of 7.75 percent annual returns.

“Three percent on a portfolio as large as ours makes a material difference,” he said.

If he can inch Calpers’s investment performance up, many problems will disappear. If not, Calpers may end up in an even bigger financial squeeze than it is today.

The scope of his task elicits sympathy from one of Calpers’s harshest critics, Marcia Fritz, a Sacramento lawyer and vice president of the California Foundation for Fiscal Responsibility, which has led a loud campaign over the rich benefits received by some Calpers retirees.

“Joe Dear has got a tough job,” Ms. Fritz said. “I wouldn’t wish it on anyone. There’s so much pressure. It’s horrible.”

A somewhat unorthodox choice for the job, Mr. Dear sounds a little like Captain Kirk surveying the Starship Enterprise when he explains why he leaped at the opportunity earlier this year: “Calpers is the flagship command of the public pension fund world.”

He was hired in large part for his management skills and political savvy — honed in Washington, where he headed the [Occupational Safety and Health Administration](#) in the Clinton years. He does not have an M.B.A. or any other advanced degree in finance. [Harvard](#), Yale or Wharton is not on his résumé. Instead, his lone degree, in political economy, is from Evergreen State College in Olympia, Wash.

Most recently, Mr. Dear headed the Washington State public pension fund, which gained a reputation as a daring investor under his oversight. It risked more of its portfolio — 25 percent — on private equity than any other public fund. The bet pushed the Washington State Investment Board, which now has \$67 billion in assets, into the top 1 percent of its peer group in performance during the boom years, according to Wilshire Associates. But in the fiscal year that ended last month, the fund lost 27 percent of its value, or \$18 billion.

Calpers has a lot riding on Mr. Dear’s effort to achieve above-market performance. The fund just posted a loss of 23 percent, the worst in its history. That leaves it 66 percent funded, the lowest level in two decades,

meaning it has only \$66 on hand for every \$100 in benefits promised to 1.6 million California public employees and their families.

Gov. [Arnold Schwarzenegger](#), who is on the Calpers board, has called the fund “unsustainable.” He has specifically criticized a decision by Calpers last month to give California municipalities a break on their required contributions. Rather than stepping up contribution rates to 5 percent to cover investment losses, Calpers set a maximum increase of 1.1 percent — saving municipalities hundreds of millions of dollars.

Mr. Schwarzenegger called it a “pass the buck to our kids idea.” Calpers says municipalities, which pay 15 percent of their payroll — or about \$11 billion a year — into the fund, needed the help.

Steering through the political cross currents would seem to be one of Mr. Dear’s strengths.

“My career sort of culminates in this job, where this combination of investment and political management and organization management come together because that’s what Calpers needs,” he said in his expansive corner office decorated with a photo of himself and Bono. (Bono was a general partner in an equity fund in which the Washington State fund invested.)

“The fun part is the investment part,” Mr. Dear added, speaking in fast, yet measured tones. “The necessary part is the organization, the management and the work in the political environment. The common element in my career is that I’m extremely focused on improving the performance of the organizations I work for.”

Mr. Dear, 57, is also chairman of the Council of Institutional Investors, a Washington nonprofit group that promotes shareholder activism — an effort close to the heart of the Calpers’s board and one reason he was hired.

“The board felt that we had extremely good depth on the investment staff,” said George Diehr, chairman of the board’s investment committee. “We were looking for someone to knock down silos and get various asset managers talking to each other. We felt Joe would have those skills. He’s well known in the public pension field, and he’s a strong advocate for corporate governance.”

In the end, Mr. Dear, who will get \$408,000 to \$612,000 in salary and can qualify for a performance bonus of

up to 75 percent of that salary, will be judged by portfolio returns.

Already, Calpers has raised its target for private equity and related investments by 40 percent to about 14 percent of the total portfolio. To cover any calls by private equity firms for additional money, the fund has also raised its target for cash on hand to 2 percent of assets.

It is ratcheting back on public domestic stocks, which account for less than 25 percent of the portfolio, while another 25 percent of the portfolio is in international equities.

Critics say that Mr. Dear and Calpers — which has a staff of 200 investment professionals — are taking on too much risk.

“Calpers is significantly underfunded, and they have decided that they will roll the dice,” said Edward A. H. Siedle, president of Benchmark Financial Services, which audits pension plans. “Is that appropriate if you have just lost 25 percent of your portfolio? These are high-risk, illiquid, unregistered products where there is tremendous valuation uncertainty. I would bet you any amount that five years from now, this plan will not have outperformed the market.”

Mr. Dear says he can improve performance in other ways as well. He has pressed the private equity and hedge funds in Calpers’s portfolio to reduce their fees, provide more transparency and segregate Calpers’s money from that of other investors. While not ready to announce any agreements, Mr. Dear said he was making “good progress.”

Last week, he testified before Congress that private equity and hedge funds should register with the Securities and Exchange Commission and be subject to the agency’s oversight. On the activist front, Calpers has voted against management in a number of recent proxy battles, including management of [Bank of America](#). And Mr. Dear or his staff meet regularly with members of Congress and the Obama administration.

Saying he spends a third of his time as investment chief, a third on board matters and a third on outside issues, Mr. Dear remains passionate that this is the moment when shareholders can prevail.

As he sees it, “You have public awareness, outrage over the consequences of a failed regulatory system and an

administration and Congress prepared to respond.”

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