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CalPERS CIO unveils major new leverage-backed push into private equity and private credit

The US's biggest public pension is planning to leverage as much as \$80bn of its assets in order to take positions in riskier asset classes.

By **Justin Mitchell** - June 16 2020

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Ben Meng.

California Public Employees' Retirement System chief investment officer Yu (Ben)

Meng outlined a bold new strategy to meet its investment goals within the next 10 years, which could involve leveraging close to \$80 billion of the fund as a way to grow its presence in private equity and private credit as the coronavirus crisis continues to play out across the markets.

“The use of a moderate level of leverage allows CalPERS to take advantage of the low volume cost in today’s low interest rate environment and using those funds to acquire assets with potentially higher returns,” Meng told the investment committee Monday.

This strategy, dubbed “Toward a 7 Percent Solution,” has two major components, which Meng calls “better assets” and “more assets.” “Better assets” refers to the private equity and private credit asset classes. “More assets” refers to our plan to thoughtfully utilize a moderate level of leverage as a tool to increase the base of the asset generating a return in the portfolio,” Meng said.

Meng said that over 2019, CalPERS staff developed this strategy along with ways to create liquidity when the fund required it. He also cited a July 2017

discussion at a CalPERS off-site as when the discussion of liquidity first began.

“This session and other discussions and actions since that time have sought to build a framework by which CalPERS may use a moderate amount of leverage to help offset diminished return expectations,” Meng said.

“Toward a 7 Percent Solution” has been an agenda item during closed session at the last two investment committee meetings as well. Another item titled “The 7 Percent Challenge” was on the closed session agenda for the December investment committee meeting.

Meng’s statement to the committee followed a major media push over the weekend, following months of reticence about the fund’s plans for the future. Meng gave interviews to the *Financial Times* and *Bloomberg* and also wrote an Op-Ed for the *Wall Street Journal* where he announced the strategy to the public.

CalPERS plans to leverage as much as 20 percent of the \$385 billion fund, **according to FT**, or nearly \$80 billion. A recent public presentation gave the pension only a 39 percent chance of doing that based on its current strategy. The fund is only about 71 percent funded. The *FT* story said this push will happen over the next three years.

CalPERS has already made large private fund investments this year. Documents for this week’s meeting reported \$1 billion commitments to funds from **Oaktree Capital Management** and **Oak Hill Advisers**, two private credit shops. The fund also committed \$1 billion to **Blackstone**’s second long-hold fund, Blackstone Core Equity Partners II. Staff can make commitments of up to \$2 billion without board approval.

Meng **told Bloomberg** the strategy also involved raising CalPERS’s 8 percent private equity allocation target “a few percentage points” as well as building out a “small position” in private credit.

The success of this strategy is not guaranteed. “Even if Meng succeeds in allocating more money to private assets and adding leverage, he said CalPERS’s chances of hitting its 7 percent target return over a decade will still be less than 50-50,” *Bloomberg* wrote.

CalPERS confirmed that Meng said this, but to the investment committee Monday, he expressed confidence in the approach.

“We recognize that this approach carries risk. For example, leverage can exacerbate some short term volatility. However, through the use of leverage, [we] can reduce risk over time, thus allowing us to keep more exposure in diversifying assets such as US Treasury bonds while pursuing higher returns in other parts of the portfolio,” Meng told the investment committee.

The plan drew mixed responses from board members and stakeholders.

“I’m encouraged by his work and support his efforts to help us achieve the returns we need to pay benefits our members have earned,” board president and investment committee member Henry Jones told *Buyouts* in an email.

“Leverage is a powerful investment tool. Used prudently, leverage can help CalPERS gain excess returns at a manageable level of risk,” investment committee member Stacie Olivares told *Buyouts* in a statement. “I support the careful implementation of leverage in the CalPERS portfolio.”

“The risky bet of leveraging the fund up to \$80 billion to make private debt and private equity investments is a desperate move that is likely to end badly for CalPERS beneficiaries,” said board member Margaret Brown, who was removed from the committee this year when it was cut down to nine members instead of the entire board.

During public comment, one stakeholder, retired prosecutor David Soares, criticized Meng’s comments to *Bloomberg* about the less than 50-50 chance of success.

“In other words, adding risk of not just missing return targets but adding the risk of actually losing trust assets to creditor failure and bankruptcy during the coming global pandemic downturn, has less likelihood than guessing when a coin flip will turn up heads,” he said. “Mr. Meng’s leverage strategy is speculative in nature and by its very nature is an inappropriate strategy for a fiduciary charged with protecting public trust assets to pursue.”

CalPERS did not respond to a request for comment on this statement.

Action Item: read the July 2017 CalPERS off-site presentations on leverage [here](#).

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