Pension fund probe into possible bribery of former Los Angeles deputy mayor

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The California Public Employees' System (CalPERS) is investigating allegations that over $50 million in fees were paid to agents who directed the pension fund's investments. A former deputy mayor of Los Angeles who also served on the board of CalPERS has been implicated in the scandal.

The investor in question, Alfred Villalobos, served on the CalPERS board for three years and now heads a private equity firm called Arvco Financial Ventures.

Estimated at $200 billion, CalPERS is the largest pension fund in the United States, and has an asset value the size of the gross domestic product of Israel. In addition to managing the pensions of over 1.6 million state workers, retirees, and their families, it offers health benefits for 1.3 million members. Currently 492,500 state workers are collecting their pension benefits from the fund.

CalPERS members are 31 percent state employees, 38 percent school employees, and 31 percent local and municipal public workers. This includes everyone from judges and fire fighters to teachers and custodians.

CalPERS faces a fiscal crisis after losing nearly 23 percent of its value last year to June 30, 2009, from $237 billion one year ago to $180.9 billion. The fund plunged to $160 billion by March and is worth around $200 billion today, thanks to a rebound in the stock market.

In recent years many of CalPERS' investments became increasingly risky; the fund borrowed money to boost returns and bought collateralized debt obligations, land for residential real estate, and various commodities. After losing almost a third of its value because of the Wall Street collapse, CalPERS' investors turned even more sharply toward speculative investments. They increased their target for high-risk venture capital and private equity firms from 4 percent of total investments to 14 percent.

CalPERS once had a reputation as the gold standard in pension investing, largely because of its enormous size. In 1984, state voters passed a law that allowed the fund to invest 25 percent of its portfolio in stocks, and over the next decades, CalPERS would become known for its so-called shareholder activism.

As CalPERS investment returns began to deteriorate, its economic forecasts remained overly optimistic at a target of 7.7 percent. Each percentage point that the fund loses equals $2 billion that taxpayers and pensioners have to make up, either in the form of reduced benefits or further injections from municipalities where state workers are employed. However, most municipalities are already facing a huge budget crunch and cannot make up the losses.

In other words, because of the sheer size of CalPERS, many reckless investments were made because, it was assumed, taxpayer money could always be relied upon to bail out bad gambles.

CalPERS would contract private firms, known as placement agents, to direct these investments. The placement agent would usually receive a 1 or 2 percent fee on the value of the deal. CalPERS announced last week it was reviewing the $50 million in fees paid to Arvco over a five-year period. Arvco was headed at the time by Villalobos, who also served on the CalPERS board from 1993 to 1995.

As a placement agent, Villalobos served as a middleman between the pension funds and "private investment funds with vast holdings," according to the *Los Angeles Times*. He has denied any wrongdoing and stated his willingness to cooperate with CalPERS' investigation.

Villalobos told the *Times*, that Arvco "doesn't make

recommendations to CalPERS or any other investor," but presents "investment opportunities to them."

CalPERS is not the only pension fund investigating claims that kickbacks were being awarded to placement agents who transferred pension money to certain private firms. New York State Attorney General Andrew Cuomo and the Securities and Exchange Commission (SEC) have begun a separate investigation into similar placement agents.

A fraud inquiry began last May in California at the time CalPERS announced it would demonstrate more transparency when it came to large investment decisions. Significantly, last week Governor Arnold Schwarzenegger also signed a law that would mandate all pension funds in the state to disclose fees paid to placement agents.

Arvco Financial Ventures is a politically well-connected private equity firm. In August, the company hired Fred Buenrostro, a chief executive of CalPERS for six years. From 1993 to 1995 he served on the same CalPERS board as Villalobos. Villalobos's daughter, Carissa M. Villalobos, has also worked as Arvco's general counsel.

Arvco also assisted in managing the pension funds of Los Angeles Fire and Police Pensions, the California State Teachers' Retirement System (CalSTRS), the New York State Common Retirement Fund, the Washington State Investment Board and 13 more.

Before serving five months in 1993 as Los Angeles deputy mayor under Richard Riordan, Villalobos was an independent financial consultant who specialized in helping minority-owned businesses land government contracts and investments, and was active in state and local Republican politics.

In 1993, the *Times* discovered that Villalobos had been sued 18 times in Los Angeles and Orange County courts, had written off $350,000 in debts in bankruptcy, and sustained huge gambling losses.

The inquiry is ongoing. Whether Villalobos's actions were legal or not, and, given the present state of affairs in the US, it is entirely possible they were, that his firm made $50 million out of such parasitic operations is a commentary in itself.

Moreover, there is the fact that in present-day America the funds designated for workers' retirements can be gambled with (and away!), meanwhile becoming the source of massive profits for a handful of individuals.

In a related development, California Attorney General Jerry Brown announced last week the he was suing State Street Corporation for defrauding CalPERS and CalSTRS of at least $56.6 million by overcharging them for foreign exchange trades beginning in 2001.

Brown is seeking at least $200 million in overcharges and penalties from the bank, which was one of the 19 banks considered "too big to fail" in the federal "stress tests." The bank is accused of covering up practices such as adding secret charges to the price of currency trades.

According to Brown, State Street executed $35.2 billion in currency trades for CalPERS and CalSTRS, beginning in 2001. State Street allegedly covered up their fraud by entering false exchange rates in electronic databases and reporting false prices in their accounting statements to CalPERS and CalSTRS. At some point, according to Brown, the bank realized it could steal millions of dollars from the pension funds this way.