

Report to CRTA Board from Pat Geyer. CRTA Liaison with STRS

I want to list several accomplishments of this last year.

- 1. Reverse Mortgages.** Joe Deluca has posted information on reverse mortgages on the calSTRS web site. www.calSTRS.com/help/faqs.aspx#23. Joe continues to investigate the possibility of STRS offering reverse mortgages and will have results by April 2005. (Pat Geyer asked about reverse mortgages)
- 2. Tax Free Death Benefit.** At the request of Elaine Avak and with the help of Gloria Hom (STRS Board member) this question was raised. Ed Derman, Deputy CEO, said that STRS is planning on a bill with the state legislature to change the death benefit to tax free.
- 3. Article explaining the Monthly Direct Deposit Statement.** At the request of Irene Wetzel who had received requests about the amounts and categories on the deposit statement, Peggy Plett, Benefits & Services Director and Ricardo Pardell, Assistant Director will write an article which will be published in the next Retired Educator Bulletin.
- 4. Possible STRS office in Southern California.** At the last Breakfast meeting with Gloria Hom (STRS Board member representing retired teachers), Gloria asked if there was a need for a STRS office in Southern California. Gloria noted that there were a large number of walk-ins at the Sacramento STRS office and that almost all of them were from the local area. I need a response from the CRTA Board letting me know if there is a need.
- 5. 403bCompare.com website. The new website on investments and funds offered by school districts for member 403b accounts is up and running.** Retired teachers will appreciate looking at the evaluations of the various mutual funds that are listed.

Report on CalSTRS Committee and Board Meetings
February 1-3, 2005
By Pat Geyer, CRTA Liaison with STRS

Executive Summary

The Investment Committee voted to delegate investment decisions to Cal STRS' external equity managers and not restrict the investment in emerging market countries

STRS fund reached \$126 Billion as of December 31, 2004, a new high. As of January 31, the fund is \$123 Billion. The STRS fund earned 13% over the last year.

STRS is investigating making the Death Benefit tax-free. STRS would purchase an insurance policy on each vested STRS member. Then when the member died the insurance would pay the death benefit

. The Richman legislative proposals would require

- Any new employee hired by the state or local government after July 2007 could enroll only in a defined contribution plan, NOT a defined benefit plan such as STRS.
- Present members of a defined benefit plan (STRS) could elect to change to a defined contribution plan.
- Government employers including school districts could hire a private financial company to administer the defined contribution plans.

The CalSTRS Board voted to oppose the Richman legislation

Governor's budget proposal

- All State Contributions to STRS will end. (Presently the State pays about 2%, the amount varies slightly year to year)
- The employer payment would increase from 8.25% to 10.25%. (This increase could be shared by employees if bargained.)
- The \$500 million payment to the SBMA is included in the budget. (payment for purchasing power of 80% of pension)
- Employer and employee would now pay STRS contributions on all earnings including overtime, summer school, and extra duties.

For more details visit CalSTRS website: CalSTRS.com

AD Hoc Board Governance Committee

The committee voted to merge the Subcommittee on Corporate Governance into the Investment Committee. The committee also voted not to create a separate Legislative Committee, but to discuss and develop legislative programs in the appropriate existing committees.

Audits and Risk Management Committee

Randy Cortland, Manager, School District Audits reported that STRS was auditing 27 districts this fiscal year. The major problem found was spiking of final year earnings to increase pensions. Some examples were reporting excessive unused sick leave, making overtime and extra duties part of regular salary, and inconsistent pay for similar jobs. STRS is considering referring instances of fraud to the proper authorities as a deterrent to spiking. STRS also found that some districts were not enrolling part-time members in STRS.

Loretta Toggenberger, UTLA-retired asked about audits of Charter Schools. Randy admitted that Charter Schools were an audit concern. Randy also announced that School District audits will increase from 27 to 66 audits next year.

Subcommittee on Corporate Governance

The meeting with the auto manufacturers and PERS and STRS is off. California has stricter auto emissions standards that the rest of the United States and manufacturers are resisting meeting those standards. State Controller, Steve Westly, and the Treasurer's Office requested that STRS Board ask staff to engage in further discussions. Gary Lynes, Board Chair remarked that it was not the role of the STRS Board to tell corporations how to run their business.

PERS and STRS will be participating in a conference on climate change at San Jose March 29.

Jack Ehnes, CEO, reported on the Council of Institutional Investor (CII) findings.

- The effort to gain more proxy access is not happening.
- Congress may try to change the laws on stock option expensing.
- Sarbanes-Oxley legislation is costly, but should be continued.
- The New York Stock Exchange (NYSE) as a self-regulating organization is a problem.
- Leadership of the Securities and Exchange Commission (SEC) may change and become more business friendly.

Investment Committee

The Committee voted to delegate investment decisions to Cal STRS' external equity managers and not restrict the investment in emerging market countries. However, the Board requested that external equity managers be informed about the STRS Board's concerns with governance, environmental and human rights abuses in specific countries.

Joe DeLuca, manager of the home loan program reported that only 534 new loans were made this last year. Part of the reason for the loan decline was the change to Countrywide Loans as the loan company. Pat Geyer, CRTA, reminded the Committee that there was an interest in STRS providing reverse mortgages.

Chris Ailman, Chief Investment Officer, reported that the STRS fund reached \$126 Billion as of December 31, 2004, a new high. The STRS fund declined to \$123 Billion as of January 31, 2005. The STRS fund earned 13% over the last year.

Benefits and Services Committee

Ed Derman, Deputy CEO, reported that STRS is investigating making the Death Benefit tax-free. STRS would purchase an insurance policy on each vested STRS member. Then when the member died the insurance would pay the death benefit. It is also possible to make the service-related disability tax-free. That would require that disability applications be separated into service related and non-service related. (Under the Internal Revenue Code, benefits paid under a "statute in the nature of a workmen's compensation act" are exempt from federal income taxation and, therefore, California income taxation.)

Teachers' Retirement Board

Jack Ehnes, CEO, reported that STRS is watching both the Richman proposed legislation and the Governor's budget. The first hearing on the Richman legislation is February 16. On February 24 STRS will testify before the Senate Budget Committee. It is early in the session and much can change both with the Richman legislation and the Governor's budget.

Ed Derman, Deputy CEO reported that there are three proposals by Assemblyman Richman including ACA 5 and ACE1x; all will require voter approval to amend the California Constitution. All three proposals will affect members of CalSTRS. The Richman proposals would require

- Any new employee hired by the state or local government after July 2007 could enroll only in a defined contribution plan, NOT a defined benefit plan such as STRS.
- Present members of a defined contribution plan (STRS) could elect to change to a defined contribution plan.
- Government employers including school districts could hire a private financial company to administer the defined contribution plans.

Ed Derman gave some background information on types of plans. As of 2005 50% of the fortune 500 companies offer a defined contribution plan. Regulations by ERISA discourage small companies from offering a defined contribution plan because of the complexity of the requirements. CalSTRS does not offer an excessive pension, except for those who retire after age 60 and receive the bonuses. The average CalSTRS pension at retirement in 2004 is \$3600 a month. The average CalSTRS pension for all present retirees is \$2500 a month. CalSTRS presently earns 8% return on investments or more (in 2004 it earned 13%). No private annuity earns as much. In addition, members in a cash balance plan would need to purchase disability and life insurance since individual plans do not include these.

The CalSTRS Board voted to oppose the Richman legislation with Kathleen Smalley and the representative of the Department of Finance voting no. All of the employee groups present spoke in opposition including CRTA President, Eva Hain.

Ed Derman, Deputy CEO, also presented an analysis of the Governor's budget proposal. The proposal is:

- All State Contributions to STRS will end. (Presently the State pays about 2%, the amount varies slightly year to year)
- The employer payment would increase from 8.25% to 10.25%. (This increase could be shared by employees if bargained.)
- The employee pays 6% and 2% into the DBS (defined benefit supplement) until 2010 when that will change and the employee pays 8% to STRS.
- The \$500 million payment to the SBMA is included in the budget. (payment for purchasing power of 80% of pension)
- Employer and employee would now pay STRS contributions on all earnings including overtime, summer school, and extra duties.

Assemblyman Mullin introduced AB 55, which increases State contributions to the SBMA (purchasing power) from 2005-6 through 20010-11 to pay back the \$500 million not paid in 2003-4. The court case to repay the SBMA \$500 million is continuing.

On the federal level, the President has announced his proposal for Social Security reform, which might include mandatory social security for STRS employees. STRS is working with Congress to finalize the Elk Hills payments. There are a number of proposals on pension reform, but it is too early to know what will be possibly passed.

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Memo to recipients of STRS Report from Pat Geyer

There is an error under the Executive summary on the first page. The second bullet of the Richman Legislative Proposal should read that present members of a defined BENEFIT plan (STRS). The defined benefit plan means that a retiree receives a retirement amount based on age, years of service, and salary. It is not dependent on a return from investments.

A defined contribution plan, which is the Richman proposal, would mean that a retiree would receive a retirement based on what he/she contributed and on any investment returns. The amount is not guaranteed.

Report on CalSTRS Committee and Board Meetings

June 1-2, 2005

By Pat Geyer, CRTA Liaison with STRS

Executive Summary

- 1. Staff plans to ask CRTA to sponsor legislation to allow per diem pay for the retired member of the STRS Board or include such legislation in a present STRS sponsored bill.**
- 2. Chris Ailman, Chief Investment Officer, reported the STRS fund was \$126.6 billion as of May 31**
- 3. The amount of the death benefit remains the same at \$6,163. In December and February STRS will investigate making the death benefit tax-free**
- 4. STRS surveyed a sample of members receiving the SBMA (Supplemental Benefit Maintenance Account) about receiving checks monthly instead of quarterly. There was little interest by members in changing so SBMA checks will continue to be issued quarterly.**
- 5. Governor Schwarzenegger appointed Jerrilyn Harris, retired Ukiah teacher and Roger Kozberg, vice president of Marsh Risk & Insurance to the STRS Board. The STRS Board commended Bill Collins, CTA lobbyist upon his retirement.**
- 6. Jack Ehnes suggested that all members look at MyCalSTRS section on the web to access member personal information and forms, such as 1099R**
- 7. The Department of Labor's new focus is pension boards and consultants for examples of conflict of interest**
- 8. STRS unfunded obligation will cause the fund to go from 83% funded in 2005 to approximately 73% funded in 30 years**
- 9. In September, STRS will investigate what other pension funds are doing to become fully funded. After that STRS will make a decision on how to increase the funding**
- 10. On legislation AB 55 (Mullin) repaying the \$500 million to the SBMA, passed the Assembly. It now goes to the Senate**

Ad Hoc Board Governance Committee

The committee approved the format of the charters of the STRS committees. Individual committees will complete the substance of each of their charters.

The committee will work on a policy regarding adequate compensation for the job absence of the educator members of STRS Board. The concept of compensation for the retired board member was approved. Staff will seek corrective legislation to allow per diem pay for the retired STRS board member. Staff plans to ask CRTA to sponsor legislation.

The committee voted to make the Ad Hoc Board Governance Committee a regular committee.

Audits and Risk Management Committee

The internal audit has taken more time than expected due to loss of staff. Staff will assess the level of risk for each audit category in order to prioritize the audit plan for next year.

There were 27 school district audits in 2004-5 fiscal year. 20 are still being completed. It is hoped that the audits will serve as a deterrent to spiking. (Increasing compensation or counting extra duties as regular compensation in the final year before retirement). Another problem is seeing that school districts notify part-time employees of their right to elect CalSTRS membership.

Investment Committee

The committee heard annual reports on CalSTRS investments. The Ennis Knupp firm advised STRS to do all fixed income investing. Active managers do not add much value to fixed income. Emerging market bonds are not a good investment.

STRS will continue to study whether environmental managers add value as a follow-up to the environmental conference last March. STRS will also look at a small investment in a Developing Manager Program.

In the Credit Enhancement program STRS guarantees the repayment of municipal and school bonds, and STRS earns a percentage of the value guaranteed. Previously STRS invested 95% in California. The new goal is to invest 67% in California and 33% in the rest of the states. This will be accomplished slowly.

McKinsey & Co reported increasing competition in Alternative Investments so opportunities are limited. One solution is to up the amount of money invested in each project. But the probability is that STRS will not reach its alternative investment goal.

STRS reported a need to increase the pool of lenders who lend STRS stock shares. A RFP (Request for Proposal) will be issued. STRS policy is to get the shares back in time to vote proxies. 70% of the STRS securities lent are now with hedge funds.

The Cash Equitization Program buys stock futures with the cash that equity managers have while they are waiting to make an investment. This year the program had a 5% return. The cash was earning additional interest.

Chris Ailman, Chief Investment Officer, reported the STRS fund was \$126.6 billion as of May 31. In remarks on the economy, Ailman noted that long term interest rates were down while short term interest rates increased. If the interest rate curve inverts it is bad for the economy. Investments in the United Kingdom and Europe were a best buy in 04-05. Emerging markets were up 25% for 04-05. There is no consensus on what the stock market will do next year.

In response to 9-11 STRS is developing an emergency off-site location and an emergency line of succession for management.

Benefits and Services Committee

The amount of the death benefit remains the same at \$6,163. In December and February STRS will investigate making the death benefit tax-free.

STRS surveyed a sample of members receiving the SBMA (Supplemental Benefit Maintenance Account) about receiving checks monthly instead of quarterly. There was little interest by members in changing so SBMA checks will continue to be issued quarterly.

Rick Reed, STRS Actuary, reported the projected number of STRS retirees for 04-05 will be about 12,000. That number will increase gradually over the next 10 years. The big increase in number of retirees because of the bonuses is over. The Baby Boomers have already reached retirement so the numbers should not change drastically. The projected numbers of new teachers for 04-05 is about 35,000 down from 40,000 in 03-04. This is because of an increase in class size and a less than expected student enrollment. It is projected that the need for new teachers in California will gradually increase from 35,000 to 45,000 a year in 08-09. The average age of teachers in the STRS system and the average age at retirement has remained the same since 1982. However, 40% of teachers leave the system in the first 5 years, after that most stay until retirement. Reed will research whether the 40% dropout is a new phenomenon.

Teachers' Retirement Board

Governor Schwarzenegger appointed Jerrilyn Harris, retired Ukiah teacher and Roger Kozberg, vice president of Marsh Risk & Insurance to the STRS Board. The STRS Board commended Bill Collins, CTA lobbyist upon his retirement.

Jack Ehnes suggested that all members look at MyCalSTRS section on the web to access member personal information and forms, such as 1099R. The Department of Labor's new focus is pension boards and consultants for examples of conflict of interest. CalSTRS will again investigate soft dollar arrangements with consultants to be sure there are no conflicts.

Rick Reed, STRS Actuary reported the STRS fund is better off in relative terms. Both the Defined Benefit Supplement and the Cash Balance Accounts have small surpluses, but not enough to credit the extra to the accounts. The STRS fund is \$1 Billion better off in 2004 than was expected; however, it is not enough to improve the actuarial valuation. STRS has gone from 82 to 83% funded. On the cost side STRS obligations did not increase because salaries went up 1 and ½% in 2004 compared to 3-4% in 2003. STRS unfunded obligation will cause the fund to go from 83% funded in 2005 to approximately 73% funded in 30 years. (The dollar amounts are \$24Billion in 2004 to \$217 Billion in 2034). STRS has had an unfunded obligation before; in 1975 STRS was only 29% funded. STRS will need a 4.5% increase in contributions or a similar decrease in benefits in order to balance the fund.

In September, STRS will investigate what other pension funds are doing to become fully funded. After that STRS will make a decision on how to increase the funding.

On legislation AB 55 (Mullin), repaying the \$500 million to the SBMA, passed the Assembly. It now goes to the Senate. The trial court found that the State must pay the \$500 million, but the State may appeal the finding. STRS is considering amending AB224 (STRS bill) to include per diem pay for the STRS retired Board member. STRS Board voted to support ACR 11, which encourages STRS to persuade companies doing business in Sudan to avoid taking actions that promote human rights violations in that country.

Client Advisory Committee Meeting

The Client Advisory Committee continued to discuss State legislation and the STRS unfunded liability.

The next CalSTRS meeting is July 14, 2005.

Report on CalSTRS Committee and Board Meetings July 14, 2005

By Pat Geyer, CRTA Liaison with STRS

Executive Summary

1. **The CalSTRS fund has grown from \$126 billion to \$131 billion as of July 14, 2005**
2. **AB 55 (Mullin) has been amended to extend the payback from 3 years to 10 years, beginning in 2008.** CalSTRS board instructed staff to work with the co-sponsors to change the bill back to the shorter payback. If there is no change in the Mullin bill, CalSTRS will call a special board meeting to vote on changing their position on the AB 55 (Mullin).

Teachers' Retirement Board

The Board was presented with the CalSTRS Balanced Scorecard. The scorecard has four parts:

1. **One and Done** (quality)
2. **No Surprises** (customer service)
3. **Rock Solid** (organizational and financial strength)
4. **Trusted Guide** (informed decisions)

The following are the committee work plans for the 2005-6 fiscal year. Items of importance to retired teachers are noted.

1. **Teachers' Retirement Board** will discuss the relationship between Social Security and CalSTRS in September. In December they will review options for addressing the unfunded liability.
2. **Benefits and Services Committee** will discuss eliminating taxation of survivor and disability benefits in February. In April they will explore expanding the role of counseling offices in other cities so they can act as mini-service centers.
3. **Audits and Risk Management Committee** will discuss opportunities to clarify laws regarding school district audit issues. In February they will explore improving the school district audit process.
4. **Investment Committee** will perform an asset allocation study from December to July meetings. They are planning a CalSTRS Institutional Investor Conference in the Bay Area in February or April, topic to be decided.

A number of ideas suggested by city and/or country governments and adopted by CalPERS were discussed. In summary the changes proposed are generally

- Inapplicable to CalSTRS
- Would be difficult to administer, or
- Would only affect future conditions, not the current deficiency.

Some of the suggestions were to increase the smoothing period from 3 years to 15 years (makes no real change), stabilize contributions (STRS already does this), increase contributions (would need a law change for this), restrict enhancements for future service

(too complicated and not of great value), restrict employment for disabled members (CalSTRS already does this).

CalSTRS discussed **AB310 (Umbert)**. This bill would impose fees and requirements on vendors who perform investment services for defined contribution plans. The purpose of the plan was to include mandatory 401(k), 403 (b) and 457 plans for state and local public employees. CalSTRS wants to exempt the CalSTRS fund, but the Board took no action on the bill.

AB 5X (Torrico) will impose criminal penalties on CalSTRS members, beneficiaries, participants and those who assist them in making false statements in order to receive CalSTRS benefits. CalSTRS will support the bill if it is amended to include a definition of prior knowledge and intent to conform to the False Claims Act.

AB 55 (Mullin) increases contributions to CalSTRS in future years to offset the \$500 million not paid in 2003-4. The bill has been amended to extend the payback from 3 years to 10 years, beginning in 2008. CalSTRS board instructed staff to work with the co-sponsors to change the bill back to the shorter payback. If there is no change in the Mullin bill, CalSTRS will call a special board meeting to vote on changing their position on the AB 55 (Mullin).

Investment Committee

The Committee voted to continue the Consulting Contract with McKinsey. Minor changes were made in the Alternative Investments and Corporate Governance Policies. The Fixed Income Study was postponed until September.

Jack Ehnes, CEO, reported that the STRS fund had grown from \$126 Billion on June 1, 2005 to \$131 Billion as of July 14, 2005. Most of the change was due to increased valuation of the Real Estate portfolio.

Report on CalSTRS Committee and Board Meetings September 7, 8, 2005

By Pat Geyer, CRTA Liaison with STRS

Executive Summary

1. There were 27 school district audits this last year, an increase from 12 the year before. That is still a small number of the 1200 districts. Over 50% of the districts audited had errors in reporting
2. The firm of Ennis Knupp suggested an increase in fixed income risk from 1/4% to 1/2% in order to earn a higher return. STRS Board will consider the recommendation.
3. Disability applications increased by 6.8% this last fiscal year. 70% of the applications were from members with only 5 to 10 years of service credit and who are of retirement age.
4. STRS Board voted to support SJR 15, which requests that the President and Congress enact legislation removing the Government Pension Offset and the Windfall Elimination Provisions from the Social Security Act.
5. AB 55 passed the legislature. It provides for repayment of the \$500 million over 5 years.
6. November 2-3 STRS Board meeting will be at the Arco Towers in Los Angeles. Beginning in 2006, STRS will meet on Wednesday, Thursday, and Friday.
7. The STRS fund is \$133.7 billion as of September 7.

Audits and Risk Management Committee

Committee heard a report on the internal audit of STRS. It was noted that a number of consultants were used in investments because of lack of investment expertise among state employees and an unfavorable state salary compared with private industry.

There were 27 school district audits this last year, an increase from 12 the year before. That is still a small number of the 1200 districts. Over 50% of the districts audited had errors in reporting, which is a problem. However, the districts were selected because they had irregularities in their reporting; districts without irregularities might not have as many errors.

The major audit issues were: (1) What was creditable compensation and (2) final year compensation. Examples are counting extra duties, overtime, sick

leave as part of the regular yearly salary, failing to notify part-time employees of right to elect CalSTRS as their pension system, post retirement earnings exceeding the limit.

Another audit issue is the reporting of the independent Charter Schools. (Those schools not a part of a school district) Irregularities include electing STRS as their retirement option and then not making any payments to STRS. Some of these charter schools are now closed and teachers who worked there do not get their retirement credit.

Ed Derman, Deputy CEO, reported that STRS will work toward legislative change to clarify the law. Carolyn Widener, STRS Board member, suggested a study on ways to improve the reporting problem. David Crane, new board member appointed by the Governor, remarked that STRS needs a system where there is an incentive to do things correctly. Presently the system has the opposite incentive.

Investment Committee

The committee heard a number of semi-annual performance reports.

1. Allan Emkin, General Consultant reported that STRS has earned 8.6%, which is more than the policy benchmark of 8%. Don't count on 8.6% returns going forward.
2. Nori Lietz, Real Estate Consultant, reported that the real estate returns were unusually high. The June 1 returns were 18%; the benchmark was 9%
3. The firm of Ennis Knupp, reported on the fixed income study. They suggested an increase in risk from 1/4% to 1/2%. This would require investments in additional high yield and emerging market bonds. The STRS Board will consider the suggestions.
4. Under Corporate Governance STRS will continue to closely scrutinize corporations where the top 5 employees receive payments of more than 5% of the equity.
5. Chris Ailman, Chief Investment Officer, reported that STRS would have earned \$600 million more over the last 4-5 years if STRS had invested in tobacco. Major court cases against the tobacco companies may be resolved in the next six months. STRS will re-evaluate the Benchmark Modification Policy in six months.

The Committee heard a report from the State Lands Commission. The proceeds of the income from State Lands goes to the Supplemental Benefit

Maintenance Fund. Originally 2 sections out of every township were set aside for education. The State sold 90% of the 5 million acres set aside. The State Lands presently earn about \$5 million a year. Most of the income comes from the Geysers electric generation (\$3.6 million). State Lands Commission expenses for the last year, were \$1.1 million. Gary Lynes, Board member, asked the STRS staff to work with the State Lands Commission to lower expenses.

Chris Ailman, CIO, reported that the STRS fund is \$133.7 billion as of September 7. It is up 3.5% for this fiscal year.

Benefits and Services Committee

Peggy Plett, Deputy CEO, reported that response time for phone, e-mail, and written requests continued to decline. STRS is emphasizing employer training. In a survey of retirement applications there was a 9% error rate. Of that 9%, 55% came from employer errors, 40% from problems with the START computer system, and 5% from a STRS employee error.

Ed Derman, Deputy CEO, reported that disability applications increased by 6.8% this last fiscal year. 70% of the applications were from members with only 5 to 10 years of service credit and who are of retirement age. The monthly benefit is significantly higher for disability (50% of final compensation) compared to service retirement (20% of final compensation if age 60 with 10 years of service), so there is an increased incentive for disability benefits.

Board member, Widener, asked about extending survivor benefits to children in absence of a spouse. There are only about 10 such children and the cost over the life of the fund would be \$1/2 to \$3/4 million.

Ed Derman, Deputy CEO, reported that the Voluntary Investment Program (403b) was growing. STRS charges 90 basis points (.9%), but that will be reduced to 76 basis points (.76%) when the fund reaches \$125 million. Members may invest in 12 different stock and bond funds.

Teachers' Retirement Board

Jack Ehnes, CEO, reported that the November 2-3 STRS Board meeting will be at the Arco Towers in Los Angeles. The Board will do an evaluation of STRS officers and consultants. It also will do a self-evaluation and discuss

conflicts of interest. There will be a presentation by Agewave on the future of retirement systems and financial planning.

Beginning in 2006, STRS will meet on Wednesday, Thursday, and Friday. There will be two off-site meetings.

Ed Derman, Deputy CEO, reported that AB 55 passed the legislature. It provides for repayment of the \$500 million over 5 years. The State begins payment in 2008 and completes payment in 2012.

STRS Board voted to support SJR 15 which requests that the President and Congress enact legislation removing the Government Pension Offset and the Windfall Elimination Provisions from the Social Security Act.

Client Advisory Committee

It was announced that there would be an update on the unfounded liability and proposed changes to the fund at the December STRS meeting. A Retirement Lifestyle Survey Report will be made in February.

There was no consensus on the best time for future CAG meetings. The next Client Advisory meeting will be December 8.

For a copy of future STRS Reports please e-mail Pat Geyer with your e-mail address.

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**Report on CalSTRS Committee and Board Meetings
December 6, 7, 8, 2005
By Pat Geyer, CRTA Liaison with STRS**

Executive Summary

1. The Board voted to have 20% of the fixed income portfolio invested by outside managers in order to increase returns.
2. CalSTRS will issue a RFP for a survey to gain additional information on Sustainable (Green) Investments.
3. CalSTRS will be seeking possible legislation on disability issues in the 2007 legislative session.
4. The CalSTRS fund is \$135 billion.
5. There are the 12 options for reducing the unfunded obligation of the CalSTRS pension system.
6. A new option was to add the Supplemental Benefit Maintenance Account to the general STRS fund and guarantee 80% purchasing power for retirees' pensions.
7. CalSTRS will be seeking input from client groups: teachers, retirees, districts, the state, as well as from members of the CalSTRS Board on options for reducing the unfunded obligation.
8. Under state legislation CalSTRS voted to oppose ACA 23 (Richman).

Board Education

Chris Ailman, Chief Investment Officer, stated that research shows that 91.5% of investment returns comes from asset allocation. 5.1% comes from style or portion of the market (large stocks, etc). 3.4% comes from individual stocks or bonds selected. Presently CalSTRS asset allocations is 27% debt and 73% equity. In July the Board will decide if they want to make any small changes to the asset allocation.

Audits and Risk Management Committee

The independent audit firm of Macias, Gini, & Company reported that the audit report was completed. There were no major errors and all minor corrections were being completed. School Districts are having problems with correct reporting lines, but actual accounting errors are stable or declining. CalSTRS continues to need to increase school district audits to correct errors.

Investment Committee

A discussion was held on whether CalSTRS should be investing in companies who have business in Sudan. Should CalSTRS try to get companies to cease operations in Sudan or try to change the government. Board member Crane wondered if such actions were effective. Gary Lynes spoke for giving active managers the right to decide about investments. Presently the STRS policy gives direction but does not require specific action.

Eileenn Okada, Investment Director, and Allen Emkin, Pension Consulting Alliance, reported that there are no clear definitions of sustainable or green investments. There is no clear evidence that active sustainable investment managers have been able to outperform their benchmarks. Europe is further ahead compared to the U.S. Emkin suggested that investments could be made in such large companies as General Electric and British Petroleum which presently have a program of sustainable investments. These companies review the innovations and go with the ones that will make money. (see Economist article on General Electric, December 8 issue) CalSTRS will issue a RFP for a survey to gain additional information on Sustainable (Green) Investments.

Presently, the fixed income portfolio is all invested by CalSTRS staff. The Board voted to have 20% of the fixed income portfolio invested by outside managers in order to increase returns. They hope to earn at least an additional 25 basis points (1/4%).

Chris Ailman, CalSTRS CIO, reported under corporate governance that Sarbanes-Oxley issues are fading. The only important issue is executive compensation. CalSTRS and other institutional investors are working to get corporate board members elected by shareholders. It is the Corporate Board that makes executive compensation decisions.

Benefits and Services Committee

Ed Derman, CalSTRS Deputy Chief Executive Officer, reported on the adequacy of the CalSTRS Disability and Survivor Benefits. There are two disability programs: Coverage A pays 50% of final compensation plus 10% for each dependent child, at 60 member gets service retirement. Coverage B (after 1992) is the same as A except member gets compensation for life as long as he/she is disabled. Overall, CalSTRS pays the same or 15% more

than the other systems surveyed. Two issues warrant attention: (1) members can withdraw STRS contributions, if they become disabled they only need to redeposit the minimum (5 years) to be eligible for complete disability. (2) CalSTRS members who begin teaching later in life and get the minimum CalSTRS years of service get a disability pension much higher than if they retired for service credit. CalSTRS will be seeking possible legislation on disability issues in the 2007 legislative session.

CalSTRS is recommending that legislation be proposed in 2006 to make it possible for teachers to purchase service credit for teaching in a private school in another state.

Teachers' Retirement Board

On Federal legislation the final House-Senate budget includes \$48 million payment to CalSTRS for Elk Hills. Social Security reform efforts are postponed for an indefinite period.

Jack Ehnes, CalSTRS CEO, reported that the CalSTRS fund is \$135 billion. CalSTRS is 83% funded as of July 2005. In order to become fully funded CalSTRS would need to earn or receive through payments another 4.5% for the next 30 years. Not all of the changes need to be made at once; however, a plan must be made. Most changes can only be made to future not present teachers.

In terms of adequacy, teachers need to replace 80% to their salary to have a similar standard of living (adequate) as well as to have health coverage. Before the benefit enhancements of 1998 and 2000 very few teacher's pensions were adequate. With the benefits enhancements 40% of today's teachers with at least 20 years of service retire with 80% or more income replacement.

Here are the 12 options for reducing the unfunded obligation of the CalSTRS pension system.

1. Issue pension obligation bonds. (Borrow money at 5.25% and earn 8%) It is questionable whether the state can sell the bonds without voter approval. Local school districts could issue bonds to cover an increase in pension obligations.
2. Amortize the unfunded obligation over 40 years. Changing the amortization period from 30 to 40 years only extends the problem. It does not solve it.

3. Base final compensation on highest 3 years rather than highest year. This could only apply to new teachers so the proposal would have a small impact.
4. Eliminate the career factor for new teachers. This increases the 2% factor up to 2.4% for teachers over 60 who have more than 30 years of service.
5. Reduce the age factor for new teachers. This increases the 2% factor up to 2.4% for teachers over 60 and up to 63. (Note that #4 and #5 total cannot be more than 2.4%)
6. Do not convert unused sick leave to service credit for new teachers.
7. Drop the 2% contribution to the Defined Benefit Supplemental Account (DBS). Presently 2% of the 8% teacher's contribution goes not into the STRS pension account, but into a personal supplemental savings account, which a teacher may take when he/she retires or leaves the system. This program will end in January 2011.
8. Eliminate employer contributions to the DBS account for extra service and credit the amounts to the STRS pension account for new teachers.
9. Eliminate the 2% benefit (COLA) to the pension benefit checks. This would affect all retired and future retirees. This benefit is one, which can be changed for present retirees.
10. Do not extend the Medicare Part A payment program for new retirees.
11. Impose employer contributions for teachers who work for a school district after they retire.
12. Increase the contribution rate for teachers or for the school districts or for the state.

An additional consideration was to add the Supplemental Benefit Maintenance Account to the general STRS fund and guarantee 80% purchasing power for retirees' pensions. Because the SBMA has more money than is needed at the present inflation rate to pay the 80% purchasing power this would help the unfunded obligation.

CalSTRS will be seeking input from client groups: teachers, retirees, districts, the state, as well as from members of the CalSTRS Board on options for reducing the unfunded obligation.

Under state legislation CalSTRS voted 6 yes with 5 abstaining and one absent to oppose ACA 23 (Richman) ACA 23 proposes either a new defined benefit plan or a combined benefit and defined contribution "hybrid plan" for all new teachers. Four of the five governor's appointees as well as the

Department of Finance abstained. One of the governor's appointees was absent.

CalSTRS Board also approved two legislative proposals: 6-01 Survivor Benefits for Coverage B Dependent Children in the Absence of a Surviving Spouse and 6-02 Permissive Service Credit Purchases. Under 6-02 members would be able to purchase service credit for service in public education that was not credited to a public retirement system. This would enable teachers who did not work long enough to qualify for an out-of-state pension or who worked part time to purchase service credit from CalSTRS.

The next CalSTRS Board meetings will be on February 1,2,3, 2006.