Report on CalSTRS Meetings, February 5, 6, 2009

By Pat Geyer, CRTA Liaison

Executive Summary

1. **2008 was the worst year since 1931 and the worst decade for stocks in 200 years.**
2. **Even though the fund stands at $120 billion, CalSTRS has ample funds to pay pensions for the next 30 years.**
3. **Inflation may return within 2 years due to the funds put into the economy by the stimulus**
4. **CalSTRS leadership is available to speak to client groups. Please contact CalSTRS about an appointment. Email Communication@CalSTRS.com**
5. **The first and third Fridays of each month are furlough days at CalSTRS. The phone center and CalSTRS office will be closed on those days as long as the State of California is on furlough**
6. **Some school districts are also considering furloughs. Teachers should contact their district or union if subject to a furlough because it may result in not receiving a full year's credit for teaching.**
7. **For the spring and summer of 2009, Congress will be concerned with (1) the stimulus, (2) the bailout, (3) financial regulatory reform, and (4) the budget. Entitlements such as social security and Medicare are unlikely to be considered.**
8. **Late reporting of deaths or overpayment of beneficiaries is the major cause of members owing CalSTRS. (Accounts Receivable)**
9. **The proposal to extend the longevity bonus for six months until June 30, 2011 was postponed until next year.**
10. **CalSTRS Board voted to propose legislation to allow retirees over 60 to return to work, retirees under 60 would have to wait six months before returning to work. Amount allowable would be ½ of final salary or the current earnings limit.**
11. **CalSTRS Board voted for legislation to allow CalSTRS to collect interest and penalties on late contributions from employers.**
12. **New SBMA funding regulations. The sustainability of the SBMA fund will be calculated based on 80 years. The SBMA fund will be evaluated every two years, and ½ % adjustments may be made, but the SBMA may never go below 80% purchasing power**
13. **The Investment Committee will meet on March 5. All of the Committees including Client Advisory will meet Wednesday, April 1 and Thursday, April 2.**

Audits and Risk Management Committee

Dr. Robert Yetman, Committee Financial Expert, reviewed the various financial instruments including the CDO (collateralized debt obligations) and Credit Default Swaps. There securitized bundles of debt are difficult to evaluate and difficult to know who owns the debt in case of default.

Subcommittee on Corporate Governance

Richard Breeden, former chair of the Security and Exchange Commission under President Bush (1), analyzed the financial crisis. What went wrong:

1. Federal Reserve did not take action
2. The SEC was too cautious
3. Boards of Directors did not do their job, paid too much, not accountable to shareholders.
4. Regulators were not accountable
5. Rating agencies were paid by the firms they rated, a conflict of interest
6. Too much emphasis on defined contributions, which increase risk
7. Deregulation went too far
8. Financial innovation was not always good

What should be done:

1. Merge the three banking agencies – FDIC, Federal Reserve, Comptroller
2. Merge the SEC, CFEC (futures), PCOB
3. Board of Directors need more diversity, shareholders need more rights to control Boards
4. Abolish golden parachutes
5. Experiment with a Federal or State chartered rating agency with strict liability
6. Provide more oversight of hedge funds
7. Change the tax code to abolish mortgage interest deduction
8. Provide foreclosure relief
9. Make it a felony to put debt off the balance sheet

Breeden predicted that the Credit Default Swaps would cause the next crisis. Too much leverage and conflicts of interest were the problem in the Great Depression of 1930's and a problem today. Pension Funds must speak for the small investor and must push for accountability and transparency.

Anne Sheehan, Director of Corporate Governance, reposted that STRS was working through shareholder action, with corporations on executive compensation, diversity, and climate risk management. STRS is working to get shareholders more rights and more say on pay. Stock options should be long term, required holding period 3 to 5 years.

Client Advisory Meeting

Chris Ailman, Chief Investment Officer, presented the investment portfolio update.

1. 2008 was the worst year since 1931
2. The financial collapse hurt every asset class
3. This was the worst decade for US stocks in 200 years
4. Inflation will return within 2 years due to the funds put into the economy by the stimulus
5. Due to the decline, CalSTRS is under invested in stocks.

Even though the fund stands at $120 billion, CalSTRS has ample funds to pay pensions for the next 30 years. CalSTRS leadership is available to speak to client groups. Please contact CalSTRS about an appointment. You can email Communication@CALSTRS.com for an appointment.

Ed Derman, Deputy CEO, stated that the first and third Fridays of each month are furlough days at CalSTRS. The phone center and CalSTRS office will be closed on those days as long as the State of California is on furlough. Some school districts are also considering furloughs. Teachers should contact their district or union if subject to a furlough because it may result in not receiving a full year's credit for teaching.

Jennifer Baker, Director Government Affairs, reported that AB53 (Portantino) freezes any employee's salary whose base salary is greater than $150,000 until January 1, 2012 and prohibits them from receiving payment for overtime, a bonus or other compensation in excess of the base salary.

Investment Committee

The Committee heard the first reading of the Divestment Policy. The language reads "Consistent with its fiduciary responsibility . . . the Board does not and will not systemically exclude or include investments, except in cases where: one of the CalSTRS 21 Risk Factors is violated to the extent that it becomes an economic risk to the Fund, and where it weakens the trust of a significant portion of members to the System."

There was renewed educator interest in the CalSTRS Home Loan Program due to the fact that banks were restricting lending. Bank of America has taken over Countrywide and the management of the CalSTRS home loan program.

The Committee discussed creating an Innovation Unit with funds to find and incubate new investment opportunities. The Committee also discussed a "Real Return" class, which would include investments in infrastructure and inflation protected securities.

Legislative Committee

The Committee discussed AB53 (Portantino). CalSTRS voted to oppose unless amended to exempt CalSTRS. Such restrictions would require that CalSTRS contract with outside firms at higher prices.

CalSTRS voted to support the School Lands Leases: Quitclaims proposal. The legislation would require mining lessees to continue to pay rent before and during the reclamation process. This would result in additional funds for the SBMA fund.

Benefits and Services Committee

Peggy Plett, Deputy CEO, reported that 100 new charter schools were established in the last year, putting the total up to 675 active charter schools. Accurate reporting of retirement contributions continues to be a problem.

Two member service challenges are: making a smooth transition to the new STRS building and possible teacher furloughs, which will impact benefits. Late reporting of deaths or overpayment of beneficiaries is the major cause of members owing STRS. (Accounts Receivable) The STRS Board asked that more teachers be employed as retirement counselors, rather than all administrators as in several counseling offices.

Teachers' Retirement Board

Jack Ehnes, Chief Executive Officer reported that the Investment Committee will meet on March 5. All of the Committees including Client Advisory will meet Wednesday, April 1 and Thursday, April 2.

John Stanton gave the Washington Monthly Report. For the spring and summer of 2009, Congress will be concerned with (1) the stimulus, (2) the bail-out, (3) financial regulatory reform, and (4) the budget. For fall 2009 and 2010, Congress will look at (1) health care, (2) tax reform and (3) climate change. Entitlements such as social security and Medicare are unlikely to be considered.

STRS should work for financial reform and work to stop inappropriate STRS regulation. STRS should support more health coverage for people on Medicare. Stanton continues working to get the last Elk Hills payment.

Jack Ehnes, Chief Executive Officer reported that STRS had asked for 20 additional positions, but STRS may reconsider. The furlough results in a 9.23% pay cut.

The Board passed new SBMA funding regulations. The sustainability of the SBMA fund will be calculated based on 80 years. The SBMA fund will be evaluated every two years, and ½ % adjustments may be made, but the SBMA may never go below 80% purchasing power

The proposal to extend the longevity bonus for six months until June 30, 2011 was postponed until next year. STRS Board voted to propose legislation to allow retirees over 60 to return to work, retirees under 60 would have to wait six months before returning to work. Amount allowable would be ½ of final salary or the current earnings limit. Finally, STRS Board voted for legislation to allow STRS to collect interest and penalties on late contributions from employers.

Investment Committee (continued)

The Investment Committee approved the Global Equities Investment Policy. Both U.S. and non-U.S. equities will be considered as one class – Global Equities. The ratio of 2/3 U.S. and 1/3 non-U.S. equities will remain the same.

Alan Emkin, PCA presented information on the 2009 Asset Allocation study. The history is that CalSTRS had 70% equity and 30% fixed income in the 1980's-90's. Now STRS has a 80% equity and 20% fixed income. STRS is more equity orientated that other pension plans. STRS Board will be discussing asset allocation in future Board meetings.

Report on CalSTRS Meetings, March 5, 2009

By Pat Geyer, CRTA Liaison

Executive Summary

1. **The Committee approved the Divestment Policy.with the 21 risk factors. The Benchmark Modification will become unnecessary.**
2. **The Committee voted to change US and non-US equity to one category – Global Equity**
3. **Chris Ailman, Chief Investment Officer, reported that the STRS fund was $114 billion. The value of the stock market is back to what it was in 1997. He predicts that fall 2009-2010 will see a big increase in the reset of adjustable mortgages, most of which have negative equity.**

Board Education

Ian Lanoff, of the Groom Law Group, provided fiduciary training.
Under the standard of prudence a Board member should

- Act with the same skill as the other trustees
- Make reasoned decisions (an empty head and good heart are not enough)
- Look at the total portfolio not just one part
- Diversify

Under the standard of Loyalty a Board member should

- Act solely in the interest of the Board
- Consider economic factors only (IRS code)
- Act independently of parties of interest
- At times a social or moral bias can be a good investment

Other standards require that a Board member

- Act in accordance with public documents (Constitution, Legislative law)
- Avoid conflicts of interest
- Never use STRS assets personally
- Never act in the interest of an adverse party
- Recuse oneself if there is any question of conflict of interest.

Investment Committee

The Committee approved the Divestment Policy.with the 21 risk factors. The Benchmark Modification will become unnecessary. Future action would be to delete the Benchmark Modification and determine whether tobacco violates the Policy and presents a significant risk to the fund.

The Committee voted to change US and non-US equity to one category – Global Equity. The weighting of US and non-US equity will remain the same. The Committee is considering making investments in distressed debt if the assets are solid.

The Committee heard from a financial market panel. The first speaker, Barton Biggs gave a telephone interview. Mr. Biggs believed that the US was on the verge of a rally in equities and that the market would be better by the end of the year. However, equities are down 60 to 80%, but the bad news has largely been discounted by the market. Growth will be slow (1-2%), and stocks may not be back to new highs for five or six years. Mr Biggs predicts 5-6% inflation.

Jared Carney, Milken Institute, stated that the increase in home prices and the subprime loans were responsible for the recession/depression. Subprime loans were 8% of all loans in 2001, by 2005 subprime was 25%, and all such loans went into securities. The US needs regularity reform and simplification.

Micolyn Yalonis, Townsend Associates, predicted that the reset of real estate values is not over. Real Estate will decline through 2009. The opportunities in the market are in repossessions, distressed funds, and corporations who have to sell assets. Some private equity funds will implode and will be an opportunity for private equity buyers.

Howard Marks, CEO Oak Tree Investments, said that the United States had an advantage over other countries since 1941. Now there is a major correction. We expanded with borrowed money and credit. Now the borrowed money is a problem. Private Equity expanded from 2003-07. Good companies have bad balance sheets, and the old equity will be wiped out and creditors will become owners. There will be a long period of uncertainty. Government will continue to fund AIG Insurance because so many people depend on the insurance. We hope that China will continue to buy US debt.

Alan Emkin, PCA, remarked that three years from now we shall know what are the good companies. We need regulation of derivatives and hedge funds. Emkin predicts that the new generation will buy the distressed debt and will be conservative like the generation of the 1930's.

Chris Ailman, Chief Investment Officer, reported that the STRS fund was $114 billion. The value of the stock market is back to what it was in 1997. He predicts that fall 2009-2010 will see a big increase in the reset of adjustable mortgages, most of which have negative equity. Down periods can last from 10 to 16 years. This recent down period began in 2002.

Alan Emkin, PCA presented an asset/liability study of the Absolute Return Class. Possible components are TIPS and Infrastructure. Other funds include timber, oil, gas, and commodities. Absolute return is designed to diversify equity risk while providing returns greater than bonds and less than equities. PCA will return with a recommendation

Teachers' Retirement Board
The Board heard the committee reports and then moved into closed session.

Report on CalSTRS Meetings, April 1,2, 2009

By Pat Geyer, CRTA Liaison

Executive Summary

1. **STRS fund performance with the exception of fixed income (bonds) was negative**
2. **PCA reported that the world is now in a period of deflation, but the risk of inflation is still there because of the deficit funding. Protectionism may become a problem. In the past diversification has worked, but diversification is no help in a global crisis. The U.S. was the engine of growth in the last 40 years; this will no longer be so.**
3. **STRS buyouts, which represent 75% of private equity had a –12% return (U.S.) compared to the U.S. buyout index which had a –6%. European buyouts had a –18% return compared to the index, which was –7%**
4. **PCA predicts long-term inflation of 2.5% and salary increases of 3%. It will be difficult for CalSTRS to earn an 8% return in the future. It may be necessary to increase employer and employee contributions.**
5. **The CalSTRS fund is $118 billion down from a high of $171 billion in 2007.**
6. **Sandy Jiminez, STRS, reported that CalSTRS now allows forms to be submitted directly to 14 out of the 22 field offices. Such forms take effect immediately.**
7. **School District Audits are improving.**
8. **Interest rate payments to STRS programs have gone down, because interest rates are based on the yields of Treasuries, which have declined.**
9. **SBMA Purchasing Power payments will decline starting with the October 2009 payment. The reason is because the California Consumer Price Index has declined –3.7% in the last six months of 2008. Educators who retired in 1990 and before will receive SBMA payments**
10. **STRS is still working with LA Unified School District and with LA Community College on irregularities in some 17,000 accounts.**
11. **Districts should inform STRS as soon as possible if they are giving a Golden Handshake so that STRS can counsel retirees on benefits**
12. **The next CalSTRS meetings are June 3,4,and 5. No meeting in July. CalSTRS will also meet August 12 and 13**

Investment Committee

The Cash Equitization report was presented. The program minimizes the cash in the global equity program (U.S. and international) by investing the cash in index futures contracts. Because the stock markets were declining, the program lost money and was temporarily discontinued in November 2008. For the fiscal year, the U.S. program lost 9% compared to the S&P Index, which lost 23%. Internationally the Non U.S. program lost 24% compared to the MSCI-EAFE Index, which lost 36%.

CalSTRS also invests cash from private equity in short-term bonds for credit enhancement. The limit is 3% of the CalSTRS investment portfolio. In 2008, CalSTRS earned $5.2 million in interest.

The General Consultant firm (PCA) presented the STRS performance report for the second half of 2008. STRS fund performance with the exception of fixed income (bonds) was negative. In the U.S. market, financial stocks were the worst performing, consumer staples and health care were the best. Asia is the only area of the world, which is growing. The world is now in a period of deflation, but the risk of inflation is still there because of the deficit funding. Protectionism may become a problem. In the past diversification has worked, but diversification is no help in a global crisis. The U.S. was the engine of growth in the last 40 years; this will no longer be so.

Micolyn Yalonis of Townsend Group reported that the Real Estate portfolio was $19.7 billion. Not all real estate is marked to market because there are no comparable sales. 2007 was the peak of the real estate market. Apartments will be the first to recover and offices are still in decline. It will be a long time before real estate generates the returns of 2005-08.

The U.S. government will be selling CMBS (commercial mortgage backed securities). The first sales will be April 10. CMBS will likely sell for 20 to 25% of the mortgage value. However, banks are reluctant to offer their mortgages for sale because banks don't want to acknowledge the loss.

Mike Moy of PCA reported on Private Equity returns. Buyouts, which represent 75% of private equity had a –12% return (U.S.) compared to the U.S. buyout index which had a –6%. European buyouts had a –18% return compared to the index, which was –7%. Part of the reason was unfavorable exchange rates. (buyouts – the purchase of the assets of a company.)

Graham Schmidt, PCA gave an update on the Asset Liability study. CalSTRS Board will make a final decision on asset class targets in July. PCA predicts long-term inflation of 2.5% and salary increases of 3%. It will be difficult for CalSTRS to earn an 8% return in the future. It may be necessary to increase employer and employee contributions.

The CalSTRS Board will make a decision on divestment and the decision factors at the June meeting. The committee continued its discussion of combining U.S. and non-U.S. stocks into one Global Equity class.

The CalSTRS fund is $118 billion down from a high of $171 billion in 2007.

Compensation Committee

The Committee approved compensation policy for the new director of Innovation and Risk, the Corporate Governance Division, the new Global Equity division. The committee also approved the selection of a compensation consultant who will help determine the components of compensation and oversee the preparation of a succession plan.

Client Advisory Committee Meeting

Jennifer Baker, STRS staff, reported on State legislation.
AB53 (Portantino) freezes the salary of state employees in excess of $150,000. The bill no longer impacts STRS.
AB 360 (Ma) sponsored by CFT, allows community college instructors to use number of hours as an alternative to qualify for full-time teaching.
AB368 (Skinner) increases the income from leases on state lands (STRS gets a percentage of such income.)
AB506 (Furutani) prohibits retirees under age 60 from working in CalSTRS related service for the first six months after they retire. Extends post-retirement earnings limit exemptions to June 2012. (CalSTRS sponsored bill)
AB654 (Mendoza) is a CalSTRS bil, which allows regular interest to be charged for service credit purchase. It also lets the Board to assess interest and penalties for late reports of employers.
AJR10 (Torlakson) requests the repeal of the GPO and WEP
SB280 (Calderon) retroactively eliminates the fortfeiture of retirement incentive for re-employment. STRS opposes this unless amended
AB 1267 (Eng) Deletes the January 1, 2010 sunset date for the Longevity Bonus. STRS is opposed

Sandy Jiminez, STRS, reported that CalSTRS now allows forms to be submitted directly to 14 out of the 22 field offices. Such forms take effect immediately. The remaining 8 field offices will accept submitted forms beginning in June.

Audits and Risk Management Committee

The Committee approved the extension of Dr. Yetman's financial expert contract and added a financial education component.

School District Audits are improving. Problems remain with incorrect reporting of earnings to the Defined Benefit Program rather than to the Defined Benefit Supplement Program; incorrectly reporting members' earnings as non-member earnings; and errors in reporting sick leave. Dr. Yetman wants to expand the number of School District Audits. 40 Audits were completed this year.

The Future State Architecture Project, which is to update or replace the STRS database (START), is on hold.

Board Governance Committee

The Committee approved 40% released time for Board Chair, 35% released time for Committee Chairs, and 30% released time for members. This applies only to teacher STRS Board members. Board members Reinke asked whether other Board members should be compensated. Board member Widener reported that two of the teacher Board members are compensated by their unions.

Board member Jerilyn Harris questioned whether a Legislation Committee was necessary since so much legislation came out of other committees not the Legislation Committee.

Benefits and Services Committee

Interest rate payments to STRS programs have gone down. The regular interest rate was 5.25% now is 4.75%; the Defined Benefit Program interest rate was 4% now is 2%; the Cash Balance Program interest rate was 5% now is 4.25%; the Defined Benefit Supplement Program interest rate was 5% now is 4.25%. Interest rates are based on U.S. Treasury bill interest payments, which have declined.

SBMA Purchasing Power payments will decline starting with the October 2009 payment. The reason is because the California Consumer Price Index has declined –3.7% in the last six months of 2008. Educators who retired in 1990 and before will receive SBMA payments starting October 2009.

Retiree health care coverage was reviewed. There are no STRS funds available for health care at this time. The death benefit amounts will remain the same.

Ed Derman, Deputy CEO, reported that STRS is working with two Charter Schools in Gilroy, which have retirement contribution irregularities. STRS is still working with LA Unified School District and with LA Community College on irregularities in some 17,000 accounts.

Districts should inform STRS as soon as possible if they are giving a Golden Handshake so that STRS can counsel retirees on benefits. Furlough days may reduce years earned for retirement since teachers will not be teaching a full year.

Carolyn Widener asked whether STRS would consider giving a pregnancy leave like PERS.

Teachers' Retirement Board

Legislation is covered in the Client Advisory Committee Report. STRS voted to continue the PCA advisory contract. The Medicare Premium Payment Program (part A) is being redesigned to meet GASPE regulations. There is no change to the program. STRS will move into the new headquarters building during the month of June. The next CalSTRS meetings are June 3,4,and 5. They will include a report on the actuarial evaluation. No meeting in July. CalSTRS will also meet August 12 and 13.

Report on CalSTRS Meetings, June 3, 4, 5, 2009

By Pat Geyer, CRTA Liaison

Executive Summary

1. **CalSTRS will begin moving to 100 Waterfront Place, West Sacramento on June 12. The customer service office will open in the new building on June 22.**
2. **AB 506 (Furutani) prohibits retires under age 60 from working in any CalSTRS related service for the first six calendar months after they retire and extends sunset dates for post-retirement earnings limit exemptions to 2012. The bill is moving**.
3. **CalSTRS voted to support AJR 10, which requests Congress to repeal the GPO and WEP from Social Security**.
4. **The CalSTRS Defined Benefit Fund is 87% funded as of June 30, 2008 (The most recent year for actuarial evaluation) This is a reduction of 1% and is the result of STRS 3-year smoothing. The fiscal year of 2007-08 had an investment return of –3.7%, which is much less than the assumed return of +8%**.
5. **CalSTRS will need a contribution rate of 21.5% over the next 30 years in order to become fully funded. Therefore, the contribution rate from employees, school districts, and the state would have to increase by a total of 3.71%.**
6. **Ed Derman, Deputy Chief Executive Officer, reported that there was no plan to request increased contributions to CalSTRS at this time.**
7. **The Investment Committee agreed to the following asset allocations: 40% Global Equity, 12% Private Equity, 15% Real Estate, 5% Absolute return, and 20% Fixed Income**
8. **The Securities Lending Program lost $84 million or 6.68% in 2008, mostly resulting from the bankruptcy of Lehman Brothers**
9. **The CalSTRS Board voted to divest in tobacco due to increased pending litigation**
10. **Jack Ehnes, CEO, reported that the CalSTRS fund is now $123 Billion**
11. **There will be a phone meeting of the Investment Committee on July 7. The audience may come to the new CalSTRS building to participate.**
12. **The next full CalSTRS Board and Committee meetings will be Wednesday and Thursday, August 12 and 13.**

Legislative Committee

Jennifer Baker, Director of Government Affiars, reported on federal legislation. HR 1327, Iran Sanctions Enabling Act is approved by committee and sent to the House of Representatives. This act will provide for divestment in companies that invest in Iran’s energy sector. The bill has no financial loss to CalSTRS fund.

Senator Feinstein and Representative Berman have introduced legislation to repeal the GPO and WEP, Social Security offsets. However, President Obama's 2010 budget has a proposal aimed at more stringent enforcement of the GPO and WEP offsets. It proposes a mandatory system rather than the present self-reporting.

Health Care Reform is a federal priority. The primary focus is expanding health care coverage and curtailing costs. The Baucus plan would allow individuals aged 55 to 64 the right to buy into the Medicare program.

(State legislation will be reported on in the Client Advisory Committee meeting.)

Subcommittee on Corporate Governance

Anne Sheehan, Director of Corporate Governance, reported on project activities.

- CalStrs is interested in working with European countries on corporate governance.
- CalSTRS also plans to communicate with smaller government entities, which may not have corporate governance resources.
- The Climate risk survey found that 75% of fund managers do not include climate risk in fund evaluation because customers do not want it.
- CalSTRS is considering including water as a sustainability risk
- CalSTRS will post proxy votes on the CalSTRS website. It will also publicize CalSTRS vote positions on the website before proxy elections.

There is no push in Washington to consolidate regulatory agencies which CalSTRS wants. Congress appears to be waiting for the Obama administration to act on business regulation.

Investment Committee

The Committee heard a report on directed brokerage (soft dollars if used by investment managers). These are credits earned by dealing with certain brokers or firms similar to airline mileage programs. CalSTRS earned $2.75 million directed brokerage dollars in the last year. The money has been credited to the CalSTRS fund. However, CalSTRS does allow some managers to use these credits to purchase research needed for investment. A decision on future use of brokerage credits will be made at a future meeting.

Staff discussed the Asset Liability Study. Change is happening. The trends of the last 25 years have changed. In a recession all assets behave alike. There is no diversity. Equity and debt are the same when a firm goes bankrupt like GM. Chris Ailman reported that this has been his most challenging year.

The Committee weighted the five Key Investment Decision factors

1. Seek to Achieve Lowest Average Actuarial Cost – 43%
2. Attempt to Avoid Actuarial Cost Spikes – 28%
3. Seek to Achieve Highest Average Funded Status – 17%

4. Attempt to Avoid Deterioration in Funding – 0%
5. Attempt to Minimize the likelihood of Pay-As-You-Go – 12%

The Investment Committee agreed to the following asset allocations: 40% Global Equity, 12% Private Equity, 15% Real Estate, 5% Absolute return, and 20% Fixed Income. Final asset allocation decisions will be made at the August CalSTRS meeting.

Chris Ailman, Chief Investment Officer, reported on the use of Placement Agents. Placement Agents are necessary for foreign and small investors who do not have the staff to research investment opportunities. Placement Agents are also necessary for small companies who can not afford staff to market their product. The agents usually earn a 2% fee which can be large. Placement Agents are similar to a real estate agent who assists buyers and sellers. Since 2006 CalSTRS Board policy has required the disclosure of any placement agent and fees prior to an investment transaction.

The Securities Lending Program lost $84 million or 6.68% in 2008, mostly resulting from the bankruptcy of Lehman Brothers. CalSTRS expects additional securities lending loss from Lehman Brothers in 2009. Since inception in 1988 Securities Lending Program earned $849 million and had average earnings of 4.49%. At the close of 2008, CalSTRS had $22 billion on loan out of $76 billion lendable assets.

Chris Ailman, Chief Investment Officer, reported that the present assets of CalSTRS are $123 billion. Goldman Saks predicts a positive Gross Domestic Product of 1% in the fall, anxiety and volatility is less. However, are these increases "green shoots" or "weeds"? Who knows? The reset of mortgages will increase in summer. Pure subprime mortgages have gone. However, mortgages with low interest rates now readjust to market interest rates. Most of these mortgages are "upside down" meaning that the amount owed is more that the house is worth. In 2009, $20 billion worth of mortgages will reset each month. In 2010, $40 billion of mortgages will reset each month.

Chris Ailman predicts that the CalSTRS 5 and 10 year average earnings will be about 3.7% whereas CalSTRS needs an 8% return. Asset allocation predictions range from +/- 3% for fixed and +/- 6% for equity.

Client Advisory Committee

CalSTRS will begin moving to 100 Waterfront Place, West Sacramento on June 12. The customer service office will open in the new building on June 22.

Jennifer Baker, Director of Government Affairs reported on State legislation.

- AB 53 and 224 (Portantino) freezes the base salary of state employees in excess of $150,000 and prohibits them from receiving bonus or overtime payment. STRS is excepted.
- AB368 (Skinner) the state lands bill increases STRS income. The bill is moving.
- AB 506 (Furutani) prohibits retires under age 60 from working in any CalSTRS related service for the first six calendar months after they retire and extends sunset dates for post-retirement earnings limit exemptions to 2012. The bill is moving.
- AB 1267 (Eng), which extends the longevity bonus for retirees who retire with more than 30 years of service, is dead for this year.
- CalSTRS voted to support AJR 10, which requests Congress to repeal the GPO and WEP from Social Security.
- SB 280 (Calderon), which eliminates the golden handshake for teachers who return to work for the school district when they had agreed not to, is dead for this year.
- AB 1584 requires disclosure of Placement Agents by government entities. (A Placement Agent is a person hired by a vendor who receives a commission if the vendor gets the business) This is a new bill. CalSTRS already discloses placement agents and their fees.

There was a discussion of the Longevity Bonus, which sunsets December 31, 2010. More details on the requirements will be published as that date approaches.

Benefits and Services Committee

The Medicare Premium Payment Program, which pays Medicare Part A Premiums for retirees who did not qualify for Medicare, was evaluated. The only change was that participation rates by retirees were lower than expected.

The Defined Benefit Supplement Program (2% of the 8% retirement deduction of active member pay goes to DBS) and the Cash Balance (an alternate plan for part time employees who don't belong to the regular CalSTRS benefit program) still have surpluses. No additional STRS contributions are needed.

The CalSTRS Defined Benefit Fund is 87% funded as of June 30, 2008 (The most recent year for actuarial evaluation) This is a reduction of 1% and is the result of STRS 3-year smoothing. The fiscal year of 2007-08 had an investment return of –3.7%, which is much less than the assumed return of +8%. These findings do not include the current fiscal crisis of 2008-09.

CalSTRS will need a contribution rate of 21.5% over the next 30 years in order to become fully funded. The present contribution rate is 17.845% of member salaries. Therefore, the contribution rate from employees, school districts, and the state would have to increase by a total of 3.71%

Ed Derman, Deputy Chief Executive Officer, reported that there was no plan to request increased contributions to CalSTRS at this time. However, contributions must be increased soon or the unfunded liability will increase. Unlike CalPERS which can set contribution rates, CalSTRS must seek legislative approval. CalSTRS is considering asking for permission to increase member contributions by ½%, increase state contributions by 1.25% and increase employer (school) contributions by 4.75% in ½% intervals as needed. Schools presently pay almost 8% more for each classified employee because they contribute to Social Security.

State funds of 1.5% from the Elder Full Funding Legislation will begin in June 2010 because there will be a big increase in CalSTRS unfunded liability. (Elder Full Funding requires State increased contribution if CalSTRS funds fall below 1990 benefit levels.)

Ed Derman reported on CalSTRS Benefits and Adequacy study. The study recommends assistance for CalSTRS members' retirement planning through financial education and advice. He also discussed opportunities to expand the Defined Benefit Supplement Program.

Polly Bacich, CalRTA President, announced that CalSTRS Board member, Jerilyn Harris had received the Friend of CalRTA Award at the CalRTA May Convention in Los Angeles

Teachers' Retirement Board

The CalSTRS Board voted to divest in tobacco due to increased legal risks. CalSTRS already has a tobacco divestment policy. This new policy would affect outside CalSTRS managers who now can not purchase tobacco stocks for the CalSTRS portfolio.

Jack Ehnes, CEO, reported that the CalSTRS fund is now $123 Billion. He also reported that the attack on defined benefits is shifting to an attack on early retirement and pension spiking. Expect to see new legislation.

There will be a phone meeting of the Investment Committee on July 7. The audience may come to the new CalSTRS building to participate. The next full CalSTRS Board and Committee meetings will be Wednesday and Thursday, August 12 and 13.

The National Institute on Retirement Security issued a report on the retirement needs of women. The report stated that women need to accumulate more than men for retirement because they live longer. Women especially benefit from a defined benefit plan because women tend to have smaller savings.

Jennifer Baker, Director of Government Affairs, discussed a CalSTRS proposal to require school districts to make benefit contributions for staff furlough days so that teachers did not lose service credit. The proposal was not accepted.

CalSTRS purchased fiduciary insurance for Board members from AIG. Cost of insurance had increased.

The CalSTRS headquarters building will be reclassified from an investment to a capital asset by November 1, 1009.

Report on CalSTRS Meetings, August 12, 13, 2009

By Pat Geyer, CRTA Liaison

Executive Summary

1. **STRS will be closed the first three Fridays of the month. The Governor has ordered furloughs of three days a month until June 2010**
2. **2008 was the second worst year ever for investments. The CalSTRS funding ratio will be worse in 2009-10 and in 2010-11 because of smoothing (not all losses are recognized in one year).**
3. **Asset allocation changes are (1) Global Equity reduced by 13%, (2) Private Equity increased by 3%, (3) Real Estate increased by 4%, (4) Absolute Return of 5% added.**
4. **The new CalSTRS Building is located at 100 Waterfront Place, West Sacramento 95851. The new phone number is (916) 414-2200.**
5. **SB506 (Furutani) prohibits retirees under age 60 from working in CalSTRS related service for six months. (This conforms to a present IRS ruling.) It also extends post-retirement earnings limit exemptions to June 30, 2012. The bill is on the Senate floor.**
6. **Community Colleges had the most audit problems because of increased pay at retirement and because of unreported sick leave. 20 high-risk Charter Schools were identified and will be audited. Dr. Yetman, CalSTRS Financial Expert, recommended emphasis on school audits. Let the other audits wait**.
7. **School District audits have been successful. The appeal rate of School District audits has declined from 27% to 7%.**
8. **The CalSTRS fund stands at $125 billion. The next CalSTRS meeting will be September 2,3,4.**

Benefits and Services Committee

The Committee discussed future CalSTRS benefit strategy. The Board objectives are:

- Reward teaching longevity
- Improve health care in retirement
- Help members to accumulate retirement assets
- Expand the use of the Defined Benefit Supplement Program.

The Committee found the following proposals most possible due to funding and administrative considerations.

- Increase member financial literacy through CalSTRS bulletins and website
- Facilitate member access to registered investment advisor services
- Allow members to purchase service credit with Defined Benefit Supplement (DBS) funds

- Allow members to rollover funds to DBS from qualified plans
- Allow members to postpone distribution of DBS after retirement.

(The last three items would require legislation)
Other benefit proposals would have to wait until there was an improvement in CalSTRS benefit funding.

Teachers' Retirement Board

Jack Ehnes presented the Chief Executive Officer Report. STRS will be closed the first three Fridays of the month. The Governor has ordered furloughs of three days a month until June 2010. The Controller and Treasurer's offices have not been subject to furloughs so some STRS employees have been considering a transfer. Morale is down. Nationally, STRS is no longer the attractive place to work.

CalSTRS investment staff has to work on Fridays so they will need to take comp time off later. CalSTRS projects will take longer to complete because of furloughs. The only good news is that CalSTRS yearly expenses will be less.

Approximately 29,000 California teachers have been laid off this year. Districts have taken pay cuts. Community colleges took a 10% cut and the UC system took a 8% cut in budget.

The CalSTRS Board reviewed the committee work plans for 2009-10. Of interest was the Investment Committee plan which included a review of active vs passive management, possible commodity investments and liability driven investments.

CEO Jack Ehnes presented the CalSTRS business plan for 2009-10. The major challenge is to begin to resolve the issue of the CalSTRS funding. Other concerns are that Board elections and appointments may mean a majority of new Board members over the next two years. The major accomplishment was the completion of the new CalSTRS building.

Investment Committee

Chris Ailman, Chief Investment Officer presented the 10-year financial plan. Mr. Ailman introduced the plan by stating that 2008 was the second worst year ever for investments. The last decade has been the worst for stocks in US history. The CalSTRS funding ratio will be worse in 2009-10 and in 2010-11 because of smoothing (not all losses are recognized in one year). CalSTRS plans to reduce active manager fees as well as Real Estate and Private Equity fees.

CalSTRS approved the following fund asset allocations. Global Equity 41-54% (target 47%); Private Equity 9-15% (target 12%); Real Estate 12-18% (target 15%); Absolute Return 0-8% (target 5%); Fixed Income 17-23% (target 20%); Cash –2-4% (target 1%). Changes are (1) Global Equity reduced by 13%, (2) Private Equity increased by 3%, (3) Real Estate increased by 4%, (4)Absolute

Return of 5% added. (Absolute return is a blend of Global Inflation Protected or Linked securities and infrastructure.)

Client Advisory Committee
Ed Derman, Deputy CEO, welcomed the committee to the new CalSTRS Building, 100 Waterfront Place, West Sacramento 95851. The new phone number is (916) 414-2200. At the conclusion of the meeting the Committee took a tour of the building, a leader in Energy and Environmental Design (LEED).

Mary Ann Ashley reported on legislation. AB232 (Hill), a STRS bill for technology improvements was Chaptered (passed). SB506 (Furutani) prohibits retirees under age 60 from working in CalSTRS related service for six months. (This conforms to a present IRS ruling.) It also extends post-retirement earnings limit exemptions to June 30, 2012. The bill is on the Senate floor. AB654 (Mendoza) requires STRS to assess employers' interest at the regular interest rate for any delinquent contributions because of late reports. AB654 is in Senate Appropriations.

Audits and Risk Management Committee
Peggy Plett, Deputy CEO, reported that the Data Integrity Project has completed the corrections to the CalSTRS corporate database, START.

Karen Scott, Director, Audit Services and KPMG reported the CalSTRS Investment Risk Assessment results. Real Estate is the most at risk at this time. The Director of Private Equity position is vacant. That is a problem. Global Equities and Securities Lending are looking less risky.

Karen Scott also gave the internal risk assessment report. With the move to the new building and with furloughs, the level of member services is at risk. Dr. Yetman, CalSTRS Financial Expert, stated that member services were satisfactory.

School audits focused on school employers. Community Colleges had the most audit problems because of increased pay at retirement and because of unreported sick leave. 20 high-risk Charter Schools were identified and will be audited. Dr. Yetman, CalSTRS Financial Expert, recommended emphasis on school audits. Let the other audits wait. Chris Ailman, CFO, reported that CalSTRS was moving more slowly with audits because of employee furlough days.

Karen Scott, Director, Audit Services reported that School District audits have been successful. The appeal rate after School District audits has declined from 27% to 7%.

Report on CalSTRS Meetings, August 12, 13, 2009

By Pat Geyer, CRTA Liaison

(Part of the Investment Committee and part of the Audits and Risk Management Committee were held during the Client Advisory. Here a few highlights that I got when I listened to the CD which CalSTRS sent.)

Investment Committee

Chris Ailman, Chief Investment Officer, reported that CalSTRS has already marked down its Real Estate portfolio, which makes STRS assets smaller. Most other companies have not taken this step. This recession is most like the 1973-4 recession. But remember that the 73-74 recession was followed by inflation. That is one reason why CalSTRS has a new Absolute Return Asset Class (5% of assets) Most of the absolute return funds will be invested in TIPS (Treasury Inflation Protected Securities) and a small amount will be invested in infrastructure such as pipelines, power lines, power plants.

Alan Emkin, PCA, and Chris Ailman predict that CalSTRS will have a lower rate of return on investments. The 8% assumed return may be too high. Presently 2/3 of CalSTRS money comes from investments and 1/3 from teachers. This ratio may have to be revised in the future. However, CalSTRS has sufficient funds to make all payments in the foreseeable future.

Audits and Risk Management Committee

Karen Scott, Director, Audit Services reported that the Fixed Income Program needs a management review to make sure that there is no illegal access to the Program. Investment accounting needs updating because the types of data have changed.

CalSTRS Meetings Report, September 3, 4, 2009

By Pat Geyer, CRTA Liaison

Executive Summary

1. **AB 506 (Furutani) prohibits retirees under age 60 from working in any CalSTRS related service for the first six months after they retire.(IRS requirement) AB 506 passed**
2. **Medicare Premiums for those members who do not receive Social Security will have an increase four times greater than those who do receive Social Security (see article at end of report)**
3. **Alan Emkin, PCA, in his semi-annual report said that Real Estate was the biggest reason for CalSTRS loss in the last six months because of leverage**
4. **Three-fourths of private equity funds are invested in buyouts, 11% is distressed debt. CalSTRS has had two failed co-investments, and has under performed the market in buyouts**
5. **The CalSTRS fund is $124 billion**.
6. **CalSTRS defined benefit fund is 87% funded as of June 30, 2008**, **The CalSTRS deficit cannot be amortized over 30 years so it will need a contribution increase of at least 3.7%.**
7. **SBMA, supplemental benefits for those retirees whose pension purchasing power has dropped below 85% will be slightly lower beginning with the October 2009 payment because inflation was below 1% and the 2% retirement pay increase was larger than inflation**
8. **Based on present assumptions of low inflation and lower salaries, the SBMA fund can pay 85% indefinitely**.
9. **Future CalSTRS meetings are: November 4-6, February 3-5, April 7-9, and June 2-4.**
10. **Polly Bacich, President of CalRTA, presented a video highlighting the accomplishments of CalRTA and its 80th year celebration.**

Client Advisory Meeting

Mary Anne Ashley reported on CalSTRS legislation. AB 506 (Furutani) prohibits retirees under age 60 from working in any CalSTRS related service for the first six months after they retire.(IRS requirement) AB 506 passed and is sent to the Governor. AB 1594 (Hernandez) restricting placement agents will be passed. AJR 10 requesting repeal of the GPO and WEP from Social Security has passed.

Ed Derman, Deputy Chief Executive Officer, reported that Medicare Premiums for those members who do not receive Social Security will have an increase four times greater than those who do receive Social Security. (Social Security recipients have a "hold harmless" requirement that their Medicare premiums do no exceed their increases in Social Security) Monthly Medicare premiums for those without Social Security will be $119 in 2010, $123 in 2011, and $128 in 2012. Those with Social Security will be $103 in 2010 and grow to $109 in 2012. (See article at end of report)

Investment Committee
Alan Emkin, PCA, in his semi-annual report said that Real Estate was the biggest reason for CalSTRS loss in the last six months because of leverage. Some purchases by CalSTRS are "under water" (the value is less than the amount that CalSTRS invested). Because CalSTRS is a long-term investor some of the value may come back. Also CalSTRS is negotiating with banks about writing down loans. CalSTRS may need to hold some Real Estate assets longer than the 3-5 years. CalSTRS will put money into Real Estate in order to meet the asset allocation target. (Money will be taken out of equities which are over target)

Alan Emkin reported that inflation is the biggest risk even though inflation presently is only 2.7%. CalSTRS has already taken the asset write-downs. Other firms have not yet taken complete write-downs.

Micolyn Yalonis, Townsend Group, gave the Real Estate semi-annual report for the period ending June 30, 2009. There will be an increase in bank failures in 2011-2013 due to commercial real estate losses. Banks are waiting for TARP to "bail them out". In the past five years CalSTRS has had a 20% return in real estate while the average return is 7% plus 2% cash flow. CalSTRS has been a net seller of real estate during the last four years and will be a buyer of real estate next year.

Mike Moy, PCA, gave the semi-annual report on private equity. Private equity is valued as of December 2008. Three-fourths of private equity funds are invested in buyouts, 11% is distressed debt. Since 2007 the private equity portfolio has been positioned to benefit from an economic downturn. However, CalSTRS has had two failed co-investments, and has under performed the market in buyouts.

The RFP for the CalSTRS general consultant is out and the finalist interviews will be in November. Presently, Alan Emkin, PCA, is general consultant.

The fixed income policy was approved with minor changes.

Chris Ailman, Chief Investment Officer, reported that the CalSTRS fund is $124 billion. The equity markets (U.S. and others) are up over 50% in the last six months. U.S. gross domestic product lost 6% in the last six months, but is predicted to increase by 1% in the 3rd and 4th quarters. It won't feel like the end of recession. The S&P 500 has gone up over the last 30 years, but broke that trend the last 2 years. The concerns are: (1) U.S. deficit resulting in higher interest rates, (2) a run on the U.S. dollar, (3) problem of toxic assets still held by banks and no mortgage relief.

Compensation Committee

The Committee discussed salaries and bonuses. The discussion will be continued in November and December.

Subcommittee on Corporate Governance.
Ann Sheehan, Director of Corporate Governance, reported that

- CalSTRS held conference calls with companies on climate risk
- A Conference at Stanford will be held on Corporate Board diversity
- CalSTRS voted on 62,000 proxy proposals including:
  - Election of directors
  - Independent auditors
  - Responsible compensation plans

The Securities & Exchange Commission is now very responsive to investor concerns, but it will take time for the SEC to re-establish credibility. Congress has lost interest in corporate governance and is concentrating on health care. The Federal Reserve is led by economists not regulators, which is a problem.

The CalSTRS Corporate Governance Policy was approved.

Benefits and Services Committee
The Medicare Premium Payment Program has sufficient funds. This fund pays Medicare A premiums for those older teachers who did not participate in Medicare A program.

Rick Reed, CalSTRS Actuary, reported that the unfunded liability was $22.5 billion a $1,8 billion increase this year. CalSTRS defined benefit fund is 87% funded. This was as of June 30, 2008, the latest valuation period. However, no General Fund supplement is required because the value has not dropped below the cost of the 1990 evaluation (Elder Full Funding Legislation). The CalSTRS deficit cannot be amortized over 30 years so it will need a contribution increase of at least 3.7%. These computations do not include the losses of 2008-09.

SBMA, supplemental benefits for those retirees whose pension purchasing power has dropped below 85% will be slightly lower beginning with the October 2009 payment because inflation was below 1% and the 2% retirement pay increase was larger than inflation. A written explanation will be sent to each SBMA recipient including those from approximately 1991-93 who will not receive a SBMA payment this year.

The good news is that, based on present assumptions of low inflation and lower salaries, the SBMA fund can pay 85% indefinitely.
The Benefits Committee approved increasing member access to investment advisors and improving financial literacy. Proposed changes to the use of DBS (defined benefit supplement) would require future legislation. Health benefit proposals were put "on hold" until after the Federal government acts on health benefits.

Teachers' Retirement Board
The schedule of future CalSTRS meetings is:

- November 4,5,6
- February 3,4,5
- April 7,8,9
- June 2,3,4

Christine Ford, Chief Financial Officer, reported that the CalSTRS budget for 2008-09 had a surplus of $31 million. The CalSTRS building was less than budgeted and furloughs and vacancies have reduced salaries. The National Institute on Retirement Security reported that households <u>withou</u>t a Defined Benefit pension had six times the rate of poverty.

Polly Bacich, President of CalRTA, presented a video highlighting the accomplishments of CalRTA and its 80th year celebration.

CalSTRS Meetings Report, November 4,5,6, 2009

By Pat Geyer, CalRTA Liaison

Executive Summary

1. **June 30, 2009 CalSTRS assets decreased by 27% to $118 billion. Benefit payments increased 10% or $8.6 billion.**
2. **As of November 6, the CalSTRS fund is $129 billion.**
3. **Benefits and Services Committee agreed to implement the first three proposals, which require minimal funding and no legislative action. They are: (1) Facilitate automatic enrollment in 403b and 457 plans. (Districts and employee groups would need to do this.) (2) Increase financial literacy (CalSTRS will present a plan) and (3) Facilitate access to registered investment advisors (CalSTRS plans to have this in place by the end of the year)**
4. **The Longevity Bonus and the Defined Benefit Supplement payments will end December 31, 2010.**
5. **A reduction in SBMA payments because of low inflation and the increase in income tax withholding has resulted in smaller SBMA retirement checks.**
6. **The SBMA is guaranteed an 8% return on investments and with negative inflation, the current funding is sufficient to pay 85% purchasing power through 2089**
7. **John Stanton, CalSTRS advocate in Washington, gave an update on financial market reform. Now is the time for corporate governance reform legislation. Later, Congress will have other concerns. The Securities and Exchange Commission (SEC) should be strengthened**
8. **The Investment Committee chose Pension Consulting Alliance (PCA) as general consultant for the next three years.**
9. **The proposed initiative to reduce government pensions has been filed with the Attorney General by the California Foundation for Fiscal Responsibility. CalSTRS will have a detailed analysis of the initiative in December.**
10. **Polly Bacich, CRTA President, reported that 15% of the CRTA members had contributed some 2.7 million hours of volunteer work. Polly thanked the CalSTRS Board and staff for all their work**
11. **The next CalSTRS meeting will be Thursday, December 3, only the Compensation Committee will meet.**

Audits and Risk Management Committee

Chris Ford, Chief Financial Officer, gave an overview of some of the accounting changes required by the GASB (Government Accounting Standards Board). The changes only deal with the organization not the content of the CalSTRS financial statements.

Karen Scott presented the Marcias Gini & O'Connell, Independent Auditor's report. As of June 30, 2009 CalSTRS assets decreased by 27% to $118 billion.

Investments decreased by $30 billion. The primary contributor to the loss was the depreciation of U.S. and international equities (stocks), which represent 43% of assets. Private equity, real estate decreased $8.2 billion or 21%. Growth in number of retirees, salary increases, and SBMA (purchasing power) increases contributed to the benefit payment increase of 10% or $8.6 billion.

The CalSTRS headquarters building is now complete and is listed as a capital asset of $159 million.

Board Governance Committee
The Board approved the following reimbursement of employers of Board members whose employers are part of CalSTRS. 40% of employment contract for Board Chair, 35% of employment contract for Committee Chairs, and 30% of employment contract for Board members are paid by CalSTRS to employers for Board member absence.

The Corporate Governance Charter was approved. The Corporate Governance Committee will be a subcommittee of the Investment Committee.

Client Advisory Committee
Mary Anne Ashley reviewed the CalSTRS legislation passed this last session. AB 232 (Hill) specified technology improvements; AB 506 (Furutani) prohibits retirees under age 60 from working in any CalSTRS-related service for the first six months after they retire, extends post-retirement earnings limit exemptions to June 30, 1012. AB 654 (Mendoza) requires regular interest to be charged for refunds or service credit purchases.

Chris Ailman, CIO, reported that the California Attorney General has filed a lawsuit stating that State Street Corporation cheated CalPERS and CalSTRS out of $57 million. The issue has to do with currency exchange. Since there is no one market: banks, individuals, corporations all exchange currency. The cost varies between institutions. The allegation is that State Street exchanged money at a lower rate and charged CalPERS and CalSTRS a higher rate.

Ed Derman, Deputy CEO, reported that there were 108 new charter school groups registered in 2008-09. 92% of these are members of CalSTRS. Presently, about 50% of the Charters are under school districts or counties. The two largest independents are Green Dot (27) and Aspire (28). There are about 800 charters total in California.

The CalSTRS benefits discussion will be covered under the Benefits and Services Committee report.

Benefits and Services Committee
Tom Barrett, Ombudsman reported that 2008-08 showed a decline in complaints. Concerns were delays in processing payments or in resolving disputes.

Because of the unfunded liability, the Committee voted to keep the death benefit the same even though it has not been increased since 2001. The death benefit, payable to the surviving beneficiary, remains at $6,163 for retired members and $24,652 for active members.

The 2009 Annual Member Satisfaction Survey was presented. Members are satisfied with CalSTRS service. The main complaints were the slow response to phone calls and emails because of the Friday furlough days.

Ed Derman, Deputy CEO, presented the Benefits Strategy Report. The Committee agreed to implement the first three proposals, which require minimal funding and no legislative action. They are: (1) Facilitate automatic enrollment in 403b and 457 plans. (Districts and employee groups would need to do this.) (2) Increase financial literacy (STRS will present a plan) (3) Facilitate access to registered investment advisors (STRS plans to have this in place by the end of the year). Other benefits, mostly concerning the DBS (Defined Benefit Supplement), were postponed until 2011 because they needed additional funding and/or legislative approval.

Ed Derman reminded the Board that the Longevity Bonus and the Defined Benefit Supplement payments of 2% end December 31, 2010. To qualify for the Longevity Bonus active teachers must have 30 years credit by December 31, 2010.

Peggy Plett, Deputy CEO, reported that the reduction in SBMA payments because of low inflation and the increase in income tax withholding have resulted in a recent 33% increase in calls. Retirees are receiving less money in their retirement checks.

Subcommittee on Corporate Governance
The Committee discussed CalSTRS Board ethics in light of the PERS problems. A motion was made to update the ethics guidelines. Harry Keiley suggested mentors for new board members.

John Stanton, CalSTRS advocate in Washington, gave an update on financial market reform. Now is the time for corporate governance reform legislation. Later, Congress will have other concerns. The Securities and Exchange Commission (SEC) should be strengthened. Other issues concern: (1) Proxy access, (2) exempting businesses under $75 million from some legislative requirements, (3) requiring hedge fund and private equity advisors to register with the SEC, (4) reforming credit rating agencies, (5) increasing transparency of derivatives, (6) providing a Consumer Financial Protection Agency.

Ann Sheehan, Director of Corporate Governance, reported that CalSTRS continues to promote diversity on corporate boards, fair executive compensation, and efforts to prevent climate change.

Investment Committee
Michelle Cunningham, Director Fixed Income reported that the currency management program broke even this last year. The year was volatile and STRS maintained a neutral risk portfolio. The team expects the dollar to decline in value next year because of the federal deficit and monetary stimulus.

The State Lands portfolio continues to provide income to CalSTRS. 80% of the income comes from the Geysers Project in the Napa/Sonoma area.

Seven firms responded to the RFP for general consultant: Meketa Investment Group, Pension Consulting Alliance, and Mercer Consulting were selected to be interviewed by the CalSTRS Board. Meketa saw opportunities in investment in infrastructure projects and private equity. Public equity will not be as lucrative as in the past; the equity opportunities will be in emerging markets. The big change is that the U.S. economy will not grow as fast because of the increase in debt. The potential for inflation will come from commodities not wages.

Pension Consulting Alliance saw the need for a conservative, risk-management approach. Equities are volatile; they predict another crisis in 5-10 years. Today, Treasuries, TIPS, and developing markets will give the highest returns. An 8% return on investments will be more difficult in the future because of the level of debt, the increased regulation and social restraints.

Mercer Consulting liked a deterministic model. The level of interest rates determines the return. There is a need for a diversified portfolio with 5 to 10% in the opportunity category for new ideas.

The Investment Committee chose Pension Consulting Alliance (PCA) as general consultant for the next three years.

Trish Taniguchi and Michelle Cunningham presented the Active/Passive Management Review. STRS needs a return of 20 to 22% above average in order to justify active managers' costs. Active managers invest in foreign equities; otherwise equity investment is in index funds – inexpensive and follows the market. New data shows that this may be a good time for active managers because of uncertainty in the markets.

Mike DiRe, Director, reported on the Real Estate Policy. The types of real estate are more precisely defined. There is a need to define the amount and type of leverage.

Chris Ailman, CIO reported that the Investment staff has implemented a position of “devil’s advocate” or “questioner” for all internal investment committee meetings. The position will help the discussion process and expand the consideration of risk.

Teachers’ Retirement Board

Jack Ehnes, Chief Executive Officer, reported that the proposed initiative to reduce government pensions has been filed with the Attorney General by the California Foundation for Fiscal Responsibility. The title will be The New Public Employee Benefits Reform Act. It is anticipated that the initiative will by out for circulation sometime in December, and could be on the June or November 2010 ballot. The initiative limits the pensions of new government employees to 1.25 multiplied by the number of years of employment. The base wage shall be based on the highest average over a period of three consecutive years. CalSTRS will have a detailed analysis after the initiative is in circulation.

Jack Ehnes announced that Berman Obaldia is the Director of Government Affairs. Chris Ford is the Chief Financial Officer.

The SBMA, purchasing power protection, will continue to pay 85% purchasing power. The SBMA is guaranteed an 8% return on investments and with negative inflation the current funding is sufficient to pay 85% purchasing power through 2089.

The CalSTRS total operating budget for 2010-11 is $153 million, which includes salaries for 894 employees.

Polly Bacich, CRTA President, reported that 15% of the CRTA members had contributed some 2.7 million hours of volunteer work. Polly thanked the CalSTRS Board and staff for all their work and passed out Sees chocolates to the Board and staff.

The next CalSTRS meeting will be Thursday, December 3 when the Compensation Committee will meet.