CalSTRS Meetings Report, February 3, 4, 5, 2010
By Pat Geyer, CalRTA Liaison

Executive Summary

1. The Compensation Committee approved the compensation policy (see Committee report).
2. The 2009 health benefits survey reported no change from 2006 except that districts providing health coverage support at retirement dropped from 81% to 71%.
3. Governance Committee approved increased dollar amounts delegated to the discretion of the CEO for contracts and matters relating to benefits and personnel.
4. House Resolution 235 to reduce the Medicare Premium payments for non-social security recipients to equal the Medicare payments of social security recipients is not moving.
5. An expansion of 10% in the range for Global Equities investments was approved. The new ranges are 60-80% U.S. Passive; 20%-40% U.S. Active; 40% -60% for Non-U.S. Passive and 40%-60% for Non-U.S. Active.
6. CalSTRS will continue its study of commodity investing.
7. Chris Ailman, CIO reported that CalSTRS assets are up 15% in 2010. 2009 had a 9% return on the portfolio because of the write down in Real Estate investments. The 3-year CalSTRS return was 3.5% and the return for the last 10 years was 2.9%. The 2000's were a lost decade; the U.S. return of 1.2% on investments was the lowest since 1860.
8. The present value of the CalSTRS fund is $131.9 billion.
9. CalSTRS already has a placement agent policy, which follows AB 1564 with the need for some additions such as increased disclosure of information and prohibitions. Discussion followed on the CalPERS proposal to require placement agents to register as lobbyists. The CalSTRS board voted to support the concept of the bill.
10. Health care reform has stalled. There will be no retiree health care other than Medicare.
11. Federal scrutiny of public pension plans continues with an emphasis on plans with unfunded and underfunded liabilities.
12. The $17 million owed to CalSTRS from the Elk Hills sale is still being litigated; no results yet.
13. The governor has reappointed Roger Kozberg to the CalSTRS Board.
14. CalSTRS funds depend on member contributions (25%) and investment returns (75%). Milliman recommends a fund return assumption of 7.5% rather than Milliman's CalSTRS assumption of a return of 8.3%. (Present official CalSTRS return assumption is 8%)
15. Even at 7.5% return the SBMA fund has adequate funds to pay 80% purchasing power, however, the 2% cola which retirees receive each year is not a vested benefit and can be changed.
16. CalSTRS under funding has been caused by the market down turn not the benefit enhancements of 1998-2000.

17. CalSTRS Board and staff agreed that 2010 would be the year to inform Legislators, members, employers, and employer and member organizations about the CalSTRS unfunded liability. In 2011 CalSTRS, with the support of members, will seek legislation to reduce the unfunded liability.
18. Ken Hewitt, CalRTA Legislative Chair, spoke in support of the CalSTRS plan and commended the Board on their efforts. Members representing other client groups also spoke in support of the plan.

Compensation Committee

The Committee approved the compensation policy. The policy is to reward executive management and investment staff for skill, responsibility, and impact on investment performance (investment performance which exceeds the benchmark without excessive risk). This compensation will be in addition to the base salary. (CEO may earn incentives of 0% to 80% of salary, CIO may earn 0% to 100% of salary, Investment Directors – 0% to 75%, Portfolio Managers – 0% to 75%, Head Investment Operations – 0% to 30%). This policy is comparable with other public and private sector firms. The committee discussed adding ethical and reputational to the present criteria, which are skill, responsibility and impact on investment performance. The Committee approved removing the General Counsel from the incentive plan. Compared with other peer groups, CalSTRS' incentive compensation percentage is in the highest quartile for public funds and in the lowest quartile for private groups. The present policy has been in place since 2006.

Benefits and Services Committee

The staff presented the Service Improvement Plan. Staff is working on (1) a program to allow forms and applications to be submitted online, (2) having all publications online, (3) sending an annual retirement status letter to retirees, (4) developing a registered investment advisor program, In addition staff is working on some 20 other programs to improve service to members and employers.

The 2009 Health benefits survey showed little change since 2006. Findings show that nearly all full-time members and 40% of half-time members have district supported health coverage. The percentage of districts providing health coverage support at retirement dropped from 81% to 71%. The percent of districts providing no support for health insurance after age 65 is the same - 61%.

Board Governance Committee

The committee heard a panel discussion on the use of placement agents. Since 2006 CalSTRS has had a policy requiring CalSTRS investment partners to disclose the identity and fees paid to any placement agent. In October 2009, AB 1564 became law. (AB 1584 describes a placement agent as a person hired to raise money from or obtain access to a public retirement system in California) CalSTRS already has a policy, which follows AB 1564 with the need for some additions such as increased disclosure of information and prohibitions. In December 2009, CalPERS voted to sponsor legislation to require placement agents to register as lobbyists. A discussion followed about the restrictions on placement agent compensation in the CalPERS proposal. Generally placement agents work on a commission, a percentage of the amount of the investment. Board members questioned whether small businesses would be able to afford placement agents if the agents had to be hired and paid before completing a transaction. (Large firms already have such expertise on staff) No action was taken on the CalPERS placement agent/lobbyist registration proposal.

The committee approved a code of conduct for CalSTRS Board Members. The code emphasizes (1) collegiality, (2) no financial conflict (Fair Political Practices Act), (3) sharing knowledge and insights with other Board Members.

The committee approved increasing the delegation of authority to the Chief Executive Officer to enter into non-investment contracts from $500,000 to $1,000,000, to increase authority to pay personnel and benefit matters from $100,000 to $200,000 and to increase sole source payments from $100,000 to $150,000.

Corporate Governance Committee

Anne Sheehan, Director Corporate Governance, reported that CalSTRS has worked with some 22 companies on issues of corporate governance, diversity, and climate risk. Anne also reported on the progress of the Congress towards financial reform. The House has passed legislation on proxy access, shareholder rights, regulation of hedge funds and private equity. The Senate still has to act.

Client Advisory

Ed Derman, Deputy CEO, reminded members that the Longevity Bonus ends December 31, 2010. Members must have at least 30 years of service by December 31, 2010 in order to receive the Longevity Bonus at retirement. Peggy Plett, Deputy CEO, announced that CalSTRS has a micro site on Twitter and Facebook, which members can visit.

Berman Obaldia reviewed state and federal legislation. The deadline for the introduction of new State legislation is February 19. Assemblyman Hernandez will be introducing a bill on placement agents. There will also be a bill prohibiting investment in Iran's energy sector. Health legislation (810) in California is not moving. House Resolution 235 to reduce the Medicare Premium payments for non-social security recipients to equal the Medicare payments of social security recipients is not moving. Senate Bill 1074 on SEC authority to grand shareholder proxy access is in Senate Committee. The initiatives on public pension reform are out for signatures. Another initiative is circulating which prohibits investment in Israel.

Investment Committee

The Committee approved an expansion of 10% in the range for Global Equities. The new ranges are 60-80% U.S. Passive; 20%-40% U.S. Active; 40% -^0% for Non-U.S. Passive and 40%-60% for Non-U.S. Active. It is believed that the world has become more volatile and the range needs to expand in order to react to the increased volatility.

Mike DiRe presented information on the Real Estate Policy revision. Real estate over performs in an up market and under performs in a down market. CalSTRS goal of 9.25%

return on core and non-core real estate was successful until 1998. Mike believes that it is possible for CalSTRS to continue to earn 9.25% in real estate if CalSTRS moves into non-core. (The difference between core and non-core real estate is the amount of leverage) The representative from Townsend (CalSTRS real estate advisor) advised an 8% return goal. Chris Ailman, CFO, stated that real estate needs to earn a high return in order for the total fund to earn 8%. Real Estate leverage adds to the cost and also the risk. Ailman suggested to go for a 9.25% return for Real Estate and make up the difference in private equity. Mike DiRe suggested 40% core, 30% value added, and 30% high return. Chris Ailman remarked that if the U.S. is going to be a declining power (China will be #1) real estate in major cities will still hold its value. No action was taken on the Real Estate Policy at this meeting.

(The report on the Home Loan Program will be sent at a later date.)

The Committee heard a presentation on commodities investing. Steven Tong, Investment Director presented a report. Over the last 20 years commodities have earned less than equities; however, they are a source of diversification since they have a low correlation with equities. Commodities are driven by supply and demand. CalSTRS will continue its study of commodity investing.

Ronald Layard-Liesching, chairman of Mountain/Pacific Group, presented an analysis. In the 20th Century industrialization and urbanization have increased the demand for goods. Commodities continue to go up because of increased demand from emerging markets. In China 7 million people migrate to cities each year and 400 million people still remain in the countryside. China will continue to increase demand for commodities, unless there is some breakdown. Commodities may become the new medium of exchange as the dollar loses value because of increase in supply. The U.S. money supply has increased by 144% in the last two years. However, the money multiplier has slowed because banks are not lending. With the downturn in commercial real estate and small business, many regional banks could fail and the Federal government might have to bail them out.

Trish Tamiguchi, Investment Director presented the Global Equity Policy revision. The trading ranges for investment officers have been changed from dollar amounts to percentages of the portfolios because of the growth of the portfolios. Basically, Global Equity is passively managed and the trades are to track the indexes. No action was taken.

Chris Ailman, CIO reported that CalSTRS assets are up 15% in 2010. 2009 had a 9% return on the portfolio because of the write down in Real Estate investments. The 3-year CalSTRS return was 3.5% and the return for the last 10 years was 2.9%. The 2000's were a lost decade, the U.S. investment return of 1.2% was the lowest since 1860. Risks for CalSTRS are: (1) stock market decline, (2) China backs away from US investing, (3) a California earthquake, (4) U.S. economy tanks, (5) an internet collapse, and (6) a terrorist attack. Finally, the financial system is healthy but the US economy is not healthy. There continue to be problems in Real Estate. The value of the CalSTRS fund is $131.5 billion.

Legislation Committee

Berman Obaldia, CalSTRS state legislative representative, reported on State legislation. Berman presented the CalPERS bill by Hernandez, which requires placement agents to register as lobbyists. Members of the Board expressed concern that small businesses would not be able to afford the up-front costs if placement agents had to register as lobbyists and would be required to charge a salary rather than a commission or percentage of the investment. The CalSTRS board voted to support the concept of the bill.

DeLaTorres proposes a bill to require that furloughs not affect retirement. However, this could be a cost to the school districts. CalSTRS will present an analysis of the legislation after it is introduced.

John Stanton, Hogan and Hartson, presented a report updating Federal activities. Health care reform has stalled. There will be no retiree health care other than Medicare. There will be no premium relief for those Medicare recipients who do not have Social Security, because it would cost the US government $2.8 billion. However, retirees will get a $250 tax credit.

Federal legislation on proxy access, climate risk, and shareholder say on pay appear to be succeeding. The Administration has proposed providing money to community banks for small business loans. Federal scrutiny of public pension plans continues with an emphasis on plans with unfunded and underfunded liabilities. The $17 million owed to CalSTRS from the Elk Hills sale is still being litigated; no results yet.

Teachers' Retirement Board

Jack Ehnes, CEO, reported that the governor has reappointed Roger Kozberg to the CalSTRS Board. The National Conference on Retirement Security expressed the need for all Americans to have adequate pensions. Housing, health care, and taxes have driven up consumer debt in the U.S.

Nick Collier and Mark Olleman (Milliman) presented an analysis of CalSTRS actuarial assumptions. CalSTRS funds depend on member contributions (25%) and investment returns (75%). Presently, the Milliman assumption for CalSTRS assumes a real investment return of 5.3%, an inflation return of 3.2% minus expenses of .2% for a total return of 8.3%. (Official CalSTRS return assumption is 8%) Milliman recommends a assumed return of 4.5%, inflation 3.2% minus expense of .2% for a total return of 7.5%. Discussion followed. Most other pension funds presently have an expected return of 8%. Even at 7.5% return the SBMA fund has adequate funds to pay 80% purchasing power; however, the 2% cola which retirees receive each year is not a vested benefit and can be changed.

Funding strategy discussion followed. STRS employees have contributed 8% of salary since 1972. Districts have contributed 8% since 1990. The State contributed 4.3% until 1998 when it was reduced to 2%. The State contribution rate for state employees has To:

been going up. CalSTRS under funding has been caused by the market down turn not the benefit enhancements of 1998-2000.

All pension funds are dealing with unfunded liabilities. Milliman reported some examples from other funds: (1) Orange County now has a 2-tier pension plan, (2) Colorado has increased employer contributions as has New York, (3) Ohio lets departments change contribution rates for existing employees without any increase in benefits. (California has laws against increasing contribution rates without an increase in benefits.)

A discussion about strategies for reducing the CalSTRS unfunded liability followed. The CalSTRS Board and staff agreed that 2010 would be the year to inform Legislators, members, employers, and employer and member organizations about the CalSTRS unfunded liability. After that CalSTRS and members would work toward a solution. Members present spoke in support. Ken Hewitt, CalRTA Legislative Chair, spoke in support of the CalSTRS plan and commended the Board on their efforts.

Sent: Mon, Feb 15, 2010 7:38 pm
Subject: Re: CalSTRS Report

CalSTRS has an unfunded liability, which means that the fund will not have enough money from investments or contributions to pay the pension obligations forever. However, CalSTRS has more than enough money to pay all pension obligations for the next 30 years. The fund presently stands at $131.9 billion up from a low of $120 billion last year. That said, CalSTRS will be seeking increased contributions from districts and/or from the State to reduce the unfunded liability.We need to be concerned, but there is no need to panic. CalSTRS has planned to make 2010 a year of educating the legislature, client groups, employers, and employees (teachers) on the need to increase contributions.

The question about contributing 25% of wages to retirement probably comes from #14 in my February report. 25% of the CalSTRS assets have come from member and employer contributions over the years. (members contribute 8% of salary, employers contribute 8% and the State contributes 2%) 75% of the CalSTRS assets come from the income earned from investing member, employer, and state contributions.

I hope this helps. Carolyn, please share this with your friends. I have cc'd teampowell. Pat Geyer

February 15, 2010

CalSTRS Meetings Report, April 7,8,9, 2010

By Pat Geyer, CalRTA Liaison

Executive Summary

1. **The school employer audits status is improving. Errors are decreasing and there are fewer appeals**
2. **CalSTRS investments have under performed its peers because of CalSTRS real estate allocation. During the last six months equities, particularly emerging markets have improved**.
3. **In uncertain times commodities outperform. Energy and industrial metals will be the most volatile. Agriculture will be a long-term scarcity due to urbanization and increased income.**
4. **The CalSTRS fund was $138.5 billion as of April 6 – a high for the year. Concerns to watch for are (1) austerity budgets and (2) unemployment.**
5. **The interest paid to the Cash Balance Program and to the Defined Benefit Supplement program was increased from 4.25% to 4.5% for the 2010-11 year. The CalSTRS regular interest rate charged for installment payments to CalSTRS has been increased from 4.75% to 8%. .**
6. **Medicare premium payments for those members who do not receive Social Security (most teachers) increased; premiums for those who do receive Social Security did not increase. H.R. 3631 to correct this increase passed the House of Representatives, but is blocked in the Senate because of objections to the cost.**
7. **The report on Purchasing Power Protection (SBMA) stated that members who retired in 1990 and before will receive SBMA payments during the 2010-11 year**
8. **AB 1862 (Eng) provides for the CalSTRS Board member retiree representative to be elected by retirees. Sponsor is CFT, and the bill is moving, but faces a probable veto**
9. **The CalSTRS Board elected Jerilyn Harris, Chair and Harry Keiley, Vice Chair.**
10. **The next CalSTRS meeting is Thursday, May 6 topics include investments and legislation**.

Audits & Risk Management Committee

The Enterprise Program Investment Council (EPIC) project is continuing. The cost has increased because the data programs were more complex than expected. The EPIC projects include improvement of customer service, and improved efficiency of operations.

The Risk Assessment and Internal Controls Report, required by the FISMA Act, is complete. There has been some loss of equipment including laptops, but no loss of information. The Committee noted that there is a need for an alternate site in the case of disaster. (The present site can be taken by other agencies) Committee noted that audit costs were low and STRS may expect increased audit costs in the future.

The school employer audits status is improving. The three most common problems are (1) Reporting earnings to the Defined Benefit Program rather than the Defined Benefit Supplement Program as required; (2) Reporting STRS member earnings as non-member earnings, (3) Incorrect reporting of unused sick leave. The good news is that errors are decreasing and there are fewer appeals. The new employer site and no new regulations have helped to reduce errors. Los Angeles Unified District is still working to convert to their new payroll system and make the necessary corrections to STRS.

Dr. Robert Yetman's Financial Expert Contract was extended for one additional year. The Audit Committee's self assessment will be completed in September.

Compensation Committee

The Committee discussed salaries and incentives (bonuses) for Chief Investment Officer, Investment Director, and Portfolio Manager positions. Such salaries and incentives are in line with other public funds.
The Chief Investment Officer earned $360,000 in salary and $360,00 in incentive (bonus) - the bonus was larger than peer group.
The Directors earned $240,000 salary and $180,000 in incentive.
Portfolio Managers earned an average of $169,000 salary and $127,000 incentive (bonus) - Director and portfolio manager earnings were similar to the peer group.

Committee discussed a policy of reducing or eliminating bonuses when there was poor investment performance, ethic violation. Bonuses are phased in over a three-year period for new hires. Committee discussed the types and amounts of the phase in. No action was taken on these issues.

The Committee passed a motion to defer the limitation on bonuses because of ethic violation until the ethic investigation was completed.

Board Governance Committee

The Committee approved additions to Board policy on Placement Agents in line with the implementation of AB 1584. In summary, placement agents will be required to disclose (1) if the agent was a former Board member or close relative, or Board consultant. (2) if the agent is used for all clients, a subset of clients, or a single client, and (3) if any current or former Board member, employee or consultant suggested retention of the placement agent.

The Committee approved incorporating the Code of Conduct signed by the CalSTRS Board into section 500 of the Board Policy Manual.

Investment Committee

The Credit Enhancement Program reported an income of $7.1 million, a 36% increase. (CalSTRS underwrites low risk credit (i.e. lines of credit) on municipal debt)

The cost to manage the CalSTRS portfolio has increased 22 basis points (.22%) due to the addition of Private Equity and Real Estate management fees and to the increase in active management of both global equity and fixed income.

Allan Emkin, PCA gave the semi-annual performance report. CalSTRS investments have under performed its peers because of CalSTRS real estate allocation. During the last six months equities, particularly emerging markets have improved. Emerging markets will continue to outperform because of low debt, young workers, natural resources, and low wages. Developed markets have high debt and an aging workforce. The investing future will be more challenging because of the amount of debt and the risk of inflation in order to pay debt cheaply. Both Real Estate debt and Bond debt are "under water" and will need to be repaid in the next 2-5 years.

Micolyn Yalonis, Townsend Group gave the semi-annual report on Real Estate, ending Sept 2009. Micolyn sees 2-3 more quarters of real estate decline. $1.5 billion in securitized debt will come on the market in the next five years. Prices will come down, which is a buying opportunity. Micolyn sees 7-10% return from Real Estate over the next 10 years.

Mike Moi, PCA, gave the semi-annual performance report on private equity, as of September 2009. The 1 to 3 year private equity returns are negative, and this can continue for another 3 years. Manufacturing is not expanding and unemployment is increasing. CalSTRS portfolio is tilted towards buyouts and will under perform the market. CalSTRS private equity has made no new commitments. However, there may be opportunities, other groups have left the buyout market because of lack of funds; CalSTRS is one of the remaining players and that may be a buying opportunity.

The committee approved increasing the Global Equity investment range from +/- 5% to +/- 10%.
Steven Tong, CalSTRS, reported that in uncertain times commodities outperform. Energy and industrial metals will be the most volatile. Agriculture will be a long-term scarcity due to urbanization and increased income. Steven Tong also presented a report on Microfinance. Microfinance risks are high, but it is an opportunity to assist the economically-active poor in developing countries. No action was taken.

The committee discussed Real Estate Policy revisions. They propose return rates be lowered from 9.25% to 8.25% - 9%. Final action will be taken in June.

Chris Ailman, Chief Investment Officer, reported that the CalSTRS fund was $138.5 billion as of April 6 – a high for the year. Concerns to watch for are (1) austerity budgets and (2) unemployment. Possible bubbles are government debt, algorithmic trading, and commercial real estate debt.

Benefits and Services Committee
Interest rates for the 2010-11 year were adopted. The interest paid to the Cash Balance Program and to the Defined Benefit Supplement program was increased from 4.25% to

4.5%. These rates are tied to the two-year Treasury notes, which interest rates have increased. The CalSTRS regular interest rate charged for installment payments has been increased from 4.75% to 8%. The law has been changed to require that CalSTRS charge the interest based on the CalSTRS assumed rate-of-return rather than the fixed income rate.

Medicare premium payments for those members who do not receive Social Security (most teachers) increased to $110.50 in 2010 and $120.20 a month in 2011. H.R. 3631 to correct this increase passed the House of Representatives, but is blocked in the Senate because of objections to the cost. Medicare premiums for members who receive Social Security do not increase.

The report on Purchasing Power Protection (SBMA) stated that members who retired in 1990 and before will receive SBMA payments during the 2010-11 year.

Ed Derman, Deputy CEO, reported that STRS will be opening STRS counseling offices in addition to the regular County-operated counseling centers. Offices are planned for the Bay Area, Central California, and three offices in Southern California in addition to the office in Sacramento.

Ed Derman reported that 27 school districts are offering early retirement incentives for 2009-10. There were approximately 15,000 layoffs last year and 22,000 layoff notices have been sent out in March 2010. CalSTRS is working with school districts to be sure that they do not reduce the school year below 175 days which is the minimum number required for a full-year credit. California ranks the second lowest in per pupil spending and ranks the second highest in teacher salaries in the United States. (New York is the highest in teacher salaries.)

Teachers' Retirement Board

The CalSTRS Board elected Jerilyn Harris, Chair and Harry Keiley, Vice Chair.
The next CalSTRS meeting is Thursday, May 6 topics include investments and legislation. CalSTRS received awards for its Pension 2 program, which offers 403(b), Roth 403(b), and 457 pension plans for CalSTRS members.

Client Advisory Committee

Berman Obaldia, CalSTRS government affairs, discussed legislation. The following bills of interest have been introduced. AB 1743 (Hernandez) restricting placement agents is moving. CalSTRS supports the legislation. AB 1862 (Eng) provides that the CalSTRS Board member retiree representative be elected by retirees. Sponsor is CFT and the bill is moving, but faces a probable veto. AB 2337 (Ammiano) prohibits CalPERS and CalSTRS from investing in a company engaged in practices that result in displacement of residents of rent-regulated housing.
SB 1271 (Simitian) states that any change in final compensation for the purpose of enhancing a member's benefits will not be counted for retirement benefits.
House Resolution 235 (Berman) and S484 (Feinstein), which repeal the GPO and WEP of Social Security, have been introduced. June is the next Client Advisory meeting.

CalSTRS Meeting Report, May 6, 2010
By Pat Geyer, CalRTA Liaison

Legislative Committee
The Legislative Committee was the only CalSTRS committee to meet in May. The Committee discussed the following legislation:

AB 1650 (Feuer) prohibits a scrutinized person, as defined, that invests in the energy sector in Iran from entering into a contract with a public agency. CalSTRS is neutral if amended to exclude an investment firm that does not invest California pension funds in the energy sector in Iran, and that the legislation include the provision that CalSTRS take action consistent with its fiduciary responsibilities.

AB 1862 (Eng) provides for the retiree representative on the CalSTRS Board to be elected by the retired CalSTRS members. CalSTRS takes no position since that is CalSTRS Board policy.

AB 2337 (Ammiano) prohibits CalSTRS and CalPERS from investing in companies that engage in predatory investment practices in rent-regulated housing. This legislation is in response to a problem with East Palo Alto rent-regulated housing. CalSTRS is support if amended. CalSTRS policies are consistent with the intent of this legislation, but CalSTRS does not want to have the unintended consequences of limiting investment in rent-regulated housing.

SB 1007 (Hancock) requires candidates for the elected Board positions to be subject to the Political Reform Act and the same rules governing campaign finance as other candidates for state office. CalSTRS is support.

CalSTRS also has a support position on AB 1743 (Hernandez), which regulates placement agents. SB 919 only applies to CalPERS not CalSTRS.

The committee heard a report on the El Dorado County audit, which identified an unusual employment relationship between the CalSTRS member, the county office, and the nonprofit organization, which suggested that the member might have been an employee of the nonprofit organization and not the county office. If this was correct such employment would not be credited to CalSTRS retirement benefits. The Board will seek a legal opinion and more information before taking action.

CalSTRS Meetings Report, June 2,3,4, 2010
By Pat Geyer, CalRTA Liaison

Executive Summary

1. Core Real Estate investments will go from 30% to 50% while Opportunistic Investments change from 50% to 30%. Value Added Investments remain at 20%. The intent is to lower Real Estate leverage and risk.
2. The Investment Committee approved the concept of investing in Commodities in the 2010-11 year
3. CalSTRS is implementing the Global Inflation Protected Strategy by investing 5% of the Absolute Return Class in infrastructure and global inflation linked bonds.
4. The CalSTRS fund was $130 billion down from $132 billion on May 31.
5. The US Health Care Legislation has little effect on seniors on Medicare. There will be an early retiree temporary reinsurance program for seniors aged 55 to 64 beginning July 1, 2010. It pays claims above $15,000
6. SB 1425 (Simitian) limits final compensation increases to not more than 10% or twice the percentage increase in the average salary rate of active members and requires all members have 180 days separation from service. SB 1425 is presently on the Senate floor.
7. The additional State contribution of $150 million will not be required in 2010-11. However an additional State contribution will be required in 2011-12 whether the return assumption is 8% or 7.5%. (see last page of CalSTRS report)
8. The next CalSTRS Board meeting is July 8-9.

Compensation Committee

Incentives for newly hired staff were approved. Newly hired Investment Directors and Portfolio Managers get incentives above salary of 40% of total possible the first year and 60% the second year. After that they are eligible for the total amount offered.

	salary range	incentive opportunity
Chief Executive Officer	$240,00 to $315,000	0% to 80% of salary
Chief Investment Officer	$275,000 to $320,000	0% to 100%
Investment Directors	$170,000 to $205,000	0% to 75%
Portfolio Managers	$145,000 to $170,000	0% to 75%
Head Invest Operations	$120,000 to $140,000	0% to 30%

Incentives generally are based on fund performance, which is above the benchmarks. Salaries and incentives are consistent with the peer group of other leading public funds.

Client Advisory Committee

Berman Obaldia, Government Affairs, reviewed legislation.

AB 2743 (Hernandez) on requiring placement agents, who seek investment from a Public Retirement system, to register as lobbyists. Bill is on the Assembly floor. CalSTRS supports.

AB 1862 (Eng) provides for the election of the CalSTRS Board member who represents retirees is in the Senate PERS Committee. CalSTRS has no position.

SB 1425 (Simitian) prohibits a change in salary compensation for the purpose of increasing benefits (anti-spiking). Legislation Committee will discuss this bill later.

Congressional legislation to change the WEP and GPO of Social Security is not advancing. Congress has not made the last Elk Hills payments.

Ginny Johnson, Health Benefits Analyst, reported that the US Health Care Legislation has little effect on seniors on Medicare. There will be an early retiree temporary reinsurance program for seniors aged 55 to 64 beginning July 1, 2010. It pays claims above $15,000. However, most retired teachers receive health care from their districts until 65. Ginny also announced that she will retire this summer.

Corporate Governance Committee

Risk Metrics reported on corporate governance in Europe. Glass Lewis & Co. reported on Latin America and the Pacific Rim. Governance standards vary greatly from country to country.

Anne Sheehan, Director Corporate Governance reported that CalSTRS had a successful proxy season regarding shareholder right to vote for Board members and Board diversity. Climate risk is a major emphasis. Brian Rice, CalSTRS, reported that CalSTRS participated in the Global Warming Shareholder Campaign, The Carbon Disclosure project, and Investor Network on Climate Risk.

Investment Committee

The annual report on Brokerage Credits reported the amount was $1.8 million in 2009 down from a high of $4.5 million in the 1990's. Brokerage Credits are generated by trading securities with certain brokers. While CalSTRS has discouraged the use of credits, they continue to be generated and are added to the fund.

The Securities Lending Program suffered a loss of $19 million in 2009 due to the Lehman Brothers collapse. Securities lending earnings have recovered; in the first quarter of 2010 earnings were $20.6 million.

The Committee and staff discussed proposed changes to the Real Estate Policy. Core Investments would go from 30% to 50% while Opportunistic Investments change from 50% to 30%. Value Added Investments remain at 20%. The intent is to lower Real Estate leverage. Both the Townsend Report and Chris Ailman, CIO, stated that Real Estate should be viewed as a diversification. Expected earnings should be 7 to 8% for Core and 8 to 10% for Opportunistic.

The Committee approved the concept of investing in Commodities with implementation in the 2010-11 year. Commodities are viewed as a hedge against inflation. Based on data from 1950-2009 a 1% inflation results in a 6% increase in commodity prices and a 2% decrease in stocks and bonds.

The Committee heard the semi-annual report that diversity in management was increasing slowly. The Committee also heard the report of a change to the Fixed Income Policy. Michelle Cunningham, Director reported that they are implementing the Global Inflation Protected Strategy by investing 5% of the fixed income in the Absolute Return Class in infrastructure and global inflation linked bonds.

Staff presented the Chief Investment Officer report. The stock market is declining due to continuing unemployment and the threat of financial regulation. European deficits and risk have caused international stock decline. As of June 7 the CalSTRS fund was $130 billion down from $132 billion on May 31.

Benefits and Services Committee

A survey of other states shows reform legislation aimed at (1) calculating final compensation on last three years, (2) increasing age and years of service required, (3) changing early retirement qualification, (4) reducing the COLA, and (5) increasing employee and employer contributions.

Peggy Plett, Deputy CEO, reported that the Call Center was helping with questions on furloughs. The CalSTRS offices in three different locations, who were open on Saturday, were successful. CalSTRS employees will staff pension offices in Folsom and Dublin.

Legislative Committee

Legislation to prevent CalSTRS retirees from increases in Medicare Part B premiums and legislation to abolish the WEP and GPO are not moving in Congress.

SB 1271 (Romero) requires state and local government agencies to adopt a conflict of interest code. CalSTRS already has a code and supports the legislation.

SB 1425 (Simitian) limits final compensation increases to not more than 10% or twice the percentage increase in the average salary rate of active members and requires all members have 180 days separation from service. Staff recommends support with minor amendments and more time for implementation.

Teachers' Retirement Board

Jack Ehnes, Chief Executive Officer, reported that State employees had 46 furlough days over the last 17 months. NIRS (National Institute on Retirement Security) reported that state and local government workers are disproportionately female, married, black, unionized, older, and more educated. Salaries are lower and benefits higher than private sector. Total compensation is 6.8% lower for state employees and 7.4% lower for local employees compared to the private sector.

Ed Derman, Deputy CEO, reported on the actuarial impact of a change in the investment rate of return. If the rate of return is 8%, the fund is 77% funded, 14% additional contributions will be needed. If the rate of return is reduced to 7.5% the fund is 72%

funded, 20% additional contributions will be needed. This is based on the June 2008 valuation.

The present State contribution to CalSTRS is equal to 2.017% of compensation credited to the CalSTRS Defined Benefit Program two years ago. Elder Full Funding legislation of 1990 requires that if there is an unfunded liability of benefits as of 1990, then the State contribution would need to increase. The increased State contribution would be an additional .524% or about $150 million. And the State contribution would increase by ¼% annually up to a total of 1.505% as long as there was an unfunded liability as defined by Elder Full Funding legislation.

As a result, reducing the investment assumption from 8% to 7.5% makes it a virtual certainty that the increased General Fund contribution of $150 million will be paid in 2010-11. (Teachers Retirement Board page 61)

There will be very minor changed to the DBS (Defined Benefit Supplement) and Cash Balance programs. The SBMA is still projected to pay 85% purchasing power benefit in the future. There will be increases in the amount of money needed to purchase service credit due to lower earnings.

CalSTRS staff recommended that the return assumption be reduced from 8% to 7.5%. Earlier Milliman reports had recommended a 7.5% return, but Carolyn Widener pointed out that this Milliman report did not make a specific recommendation in its conclusion. Board member Roger Kozberg and Cynthia Bryant representing Finance spoke in favor of lowering the assumption to 7.5%. However, the CalSTRS Board decided to postpone the decision to lower the return assumption until the November Board meeting.

Therefore, the additional State contribution of $150 million will not be required in 2010-11. However an additional State contribution will be required in 2011-12 whether the return assumption is 8% or 7.5%.

Polly Bacich, CalRTA President, reported that CalSTRS Board member, Carolyn Widener had been awarded the Friend of CalRTA award.

CalSTRS Meetings Report, July 7, 8, 2010
By Pat Geyer, CalRTA Liaison

Executive Summary

1. **GASB preliminary report is out. (see Retirement Board)**
2. **The Board work plan for September, November, and April will focus on valuation reports and funding strategy. The February meeting will focus on Federal issues.**
3. **The Investment Committee will discuss allocation management and asset class range in the fall, Private Equity in March, and internal VS external asset management in spring.**
4. **Beverly Carlson, was honored for her many years of representing CTA at CalSTRS Board meetings.**
5. **CalSTRS' core investment objective remains an 8% return. The relative return goal is to make 60 basis points over the benchmark, which means to take some risks. STRS plans to increase internal management as well as seek fee reductions from external managers.**
6. **Investments will create a new position of Deputy Chief Investment Officer.**
7. **CalSTRS fund is $130 billion as of June 30. However, the unfunded liability will be larger because CalSTRS uses a 3-year average**
8. **CalSTRS is planning a telephone CalSTRS Board meeting on July 20**
9. **The next CalSTRS meetings are September 1,2,3**.

Audits and Risk Management Committee

It was reported that CalSTRS was looking at Fresno as an additional "out-of-region" counseling center in conjunction with the Fresno data site.

The committee heard a presentation on Enterprise-Wide Risk Management. This provides a "bottom-up" and "top-down" assessment of risk. Eleven risk categories are identified: (1) Project Risk, (2) Investment/Market Risk, (3) Technology Risk, (4) Operational Risk, (5) Legal Risk, (6) Human Resources Risk, (7) Actuarial Risk, (8) Financial Reporting Risk, (9) Credit Risk, (10) Regulatory Risk, and (11) Sustainability Risk.

Investment/Market Risk was the highest category. CalSTRS will audit Credit Enhancement Activities, Currency Portfolio Activities, and Global Equity Investments in that order. Under internal business area risks CalSTRS will be assessing operational and technology risks. The START Data program used by CalSTRS is now ten years old. CalSTRS plans to gradually replace START.

Increased pay (greater that 15%) during the final pay period; excessive sick leave reports; and members reported as non-members were the most common problems in School Employer Reports. Charter Schools are a separate category. CalSTRS continues to work with those Charters who report to CalSTRS. (Some Charters do not participate in CalSTRS pensions.)

The Committee approved the Audit Plan.

Teachers' Retirement Board

Jack Ehnes, Chief Executive Officer announced that the next CalSTRS meetings are September 1,2,3. Items of importance are funding strategy, adoption of actuarial evaluations, audit results, investment portfolio performance report, and the commodities investment plan.

GASB has released the initial document; a final report and implementation will be several years out. The proposed changes are (1) liabilities that a pension plan has or will have in the future will continue to be discounted at the assumed rate of return of plan assets (CalSTRS currently is 8%). Liabilities that will be paid after assets are depleted will be discounted at the municipal bond rate (currently 5%). This reporting requirement when adopted would increase the CalSTRS unfunded liability. However, GASB requirements will apply to accounting and financial reporting not how government pension plans are funded.

Furloughs have hurt CalSTRS. 900 employees have had furloughs; only 15 employees are exempt. July 22 is the critical date for the governor's minimum wage proposal. (Payroll run begins July 22.) Schools and Golden State Credit Unions will provide budget impasse loans.

CalSTRS is planning a telephonic CalSTRS Board meeting on July 20.

Jack Ehnes reported that the Board focus for September, November, and April is on valuation reports and funding strategy. The September meeting will include a formal actuarial evaluation, an update on stakeholder meetings, and an overview of the legal framework. The November meeting will include the Actuarial Audit Report, the GASB accounting overview, and investment assumption decision. The February meeting will focus on Federal issues.

The Investment Committee will discuss allocation management and asset class range in the fall, Private Equity in March, and internal VS external asset management in spring.

Ehnes noted three changes: (1) negative market returns have affected the whole system, (2) Pensions now have national attention, and (3) there is new legislative action across the country. However, CalSTRS has a good reputation. CalSTRS weakness is that the Board does not have the power to adjust contributions and the State budget crisis has a negative impact on funding and staff. The economic recovery may take many years.

Peggy Plett, Deputy CEO, Benefits and Services, reported that CalSTRS needs a new technology system, which is more flexible and adaptable. The current START system is 10 years old and has little additional capacity. Plans will be developed in the fall of

2010. Implementation will occur over the next 5 to 10 years, with accounting the first priority. Funding strategy will be sought in 2011-12.

Beverly Carlson, was honored for her many years of representing CTA at CalSTRS Board meetings and for her commitment and dedication in working to improve retirement benefits.

Investment Committee

The fixed income policy was approved. Fixed income staff will be responsible for implementing strategies that do not fit in any other investment class as directed by the Chief Investment Officer. In the 1980's and 90's fixed income earned 8%; in the 2000's it earned 3%.

Chris Ailman, Chief Investment Officer, reported that the core investment objective remained an 8% return. The relative return goal is to make 60 basis points (0.6%) over the benchmark, which means there is a need to take greater risks. STRS plans to increase internal management as well as seek fee reductions from external managers. CalSTRS has investments costs of $187 million of which $142 million is investment manager fees. Investments will create a new position of Deputy Chief Investment Officer who will oversee the Absolute Return Asset Class, investment operations, and Investment Branch management.

Climate change will present investment opportunities, possible infrastructure investment in solar, wind, and geothermal facilities. CalSTRS may also help to finance PACE bonds, which will finance solar panels for homes to be paid off through an increased tax bill.

Allan Emkin, PCA reported that interest rates have gone from 12% in the 1980's to 3% today. Equities were priced at 8 times earnings; today equities are 16 times earnings. Nothing is cheap today. The near term risk is deflation; inflation is the long-term risk. The most important statistic is jobless claims, which have not dropped, but corporate earnings are up. This recession will last for a while.

Chris Ailman, CIO reported that the CalSTRS fund is $130 billion as of June 30, including a 12% return for the fiscal year. However, the unfunded liability will be larger because CalSTRS uses a 3-year average and now must recognize the losses of '08-09 and '07-08 as well as the gain in '09-10. The predictions for the economy are 3.5% growth, 2% dividends and 3% inflation, which equal a return of 8%

The Committee concluded with a panel on Liability Driven Investing with M. Barton Waring, retired CIO Barclays Global Investors and Dimitry Mindlin, President CDI Advisors. Liability Driven Investing is a focus on the liabilities of a pension system rather that a focus on income or returns. In order to minimize risk a pension system should invest more in bonds, which have a guaranteed return.

CalSTRS Meetings Report, September 1,2,3, 2010
By Pat Geyer, CalRTA Liaison

Executive Summary

1. Dr. Yetman, ARM Committee Financial Expert recommended a new technology system which would reduce or eliminate manual records, be designed for a larger organization, and allow members to access more information.
2. The Committee selected Crowe Horwath for the CalSTRS financial statement audit firm for fiscal years 2010-11 through 2017-18.
3. The move to the new headquarters in July 2009 and the furloughs caused decline in services and decline in member satisfaction. In addition, 2009-10 saw a 20% increase in service retirement.
4. The CalSTRS death benefit payment remains at $6,163 for retirees and active coverage A members. It remains at $24,652 for active coverage B members.
5. $31,020 is the amount that retirees can earn in 2010-11 without losing benefits
6. Readers interested in Cash Balance retiree regulations read Benefits and Services report.
7. The Folsom Counseling Office is closed; members will go to the CalSTRS headquarters. Members going to the Dublin office will go to Hayward. There will be a new counseling office in Sonoma.
8. Curt Custard, UBS, predicts a 7% return for CalSTRS. Stuart Schweitzer, J.P. Morgan predicts a 7-8% future return for CalSTRS. Allan Emkin, PCA predicts a 7.5% future return for CalSTRS.
9. See Client Advisory Committee report for update on legislation passed and sent to the Governor for signing.
10. CalSTRS fund was $129 billion as of June 30, 2010
11. The Legislature is responsible for making CalSTRS system financially sound through increased State and employer contributions or increased new member contributions or a decrease in non-vested benefits
12. The next CalSTRS meetings will be on November 3-5.

Audits and Risk Management Committee

The committee heard the Enterprise Program Investment Council (EPIC) report. EPIC provides governance and assessment of CalSTRS large projects. Several projects including the Headquarter facility, the Contact Center were completed. Most projects are on going. No projects were issued a "warning"

The Internal Audit presented an update. Generally the audit recommended that (1) CalSTRS move away from manual updates and changes and towards electronic changes where possible.(2) counseling services standardize websites, listing office hours and services available, (3) CalSTRS have a comprehensive ethics or fraud policy and a Code of Conduct.

The School Employer Audit issued 45 final reports and 5 draft reports in 2009-10, up from 44 in 2007-8 and 47 in 2008-9. The 2009-10 Audit recovered $4,301,000 for CalSTRS. The most common errors were (1) incorrectly reporting earnings to the DB (defined benefit) rather than to the DBS (defined benefit supplement) programs. (2) reporting member earnings as non-member earnings, (3) incorrect reporting of unused or excess sick leave data. The Los Angeles Unified School District audit is to be completed in November 2010.

The State Board of Education reports 1,210 numbers have been assigned to Charter Schools in 2009-10. Most charter schools are in Los Angeles County(215), followed by San Diego(81) and Bay Area Counties (113). Common Charter problems are spiking and not reporting member contributions. CalSTRS staff will investigate whether CalSTRS is at risk when Charter schools don't report contributions.

Like other departments, CalSTRS Real Estate needs to automate record keeping and make reports user friendly. (Manual record keeping has a potential for more errors) The audit of Private Equity showed a need for a process to track investments, which were not recommended for investment.

Dr. Yetman, ARM Committee Financial Expert recommended a new technology system which would reduce or eliminate manual records, be designed for a larger organization, and allow members to access more information. Staff responded that a new technology system is part of an 8-year plan, which will begin with review of investment technology. The estimated cost is $300 to $500 million.

The committee heard presentations by Crowe Horwath and MGO audit firms. The Committee selected Crowe Horwath for the CalSTRS financial statement audit firm for fiscal years 2010-11 through 2017-18.

Compensation Committee

The committee directed CalSTRS staff to get information on compensation consultant firms. Committee reviewed succession planning and position profiles for the Chief Executive Officer and the Chief Investment Officer.

Benefits and Services Committee

Peggy Plett, Deputy CEO for Benefits and Services, presented the service accomplishments and member satisfaction for 2009-10. The move to the new headquarters in July 2009 and the furloughs caused decline in services and decline in member satisfaction. In addition, 2009-10 saw a 20% increase in service retirement. Member benefits payments were made on the benefit date, except when the request for payment was made in the same month as retirement. Phone waiting times increased resulting in member frustration, response time for emails also increased.

The CalSTRS death benefit payment remains at $6,163 for retirees and active coverage A members. It remains at $24,652 for active coverage B members. Until 2001 the death benefits were adjusted for inflation. If they had continued to be adjusted for inflation the benefits would be 23% higher. Board member Harry Keiley requested that death benefits be increased, but the committee voted to keep death benefits the same.

Peggy Plett, Deputy CEO reported that there was a great improvement in the accuracy of employer data. She anticipated fewer errors in future district audits. A course on CalSTRS benefits is planned for newly vested members. Carolyn Widener suggested sending information by email. It was also suggested that CalSTRS give callers a call back time rather than requiring callers to wait on the phone.

Ed Derman, Deputy CEO reported that $31,020 is the amount that retirees can earn in 2010-11 with losing benefits. Members who retire before the age of 60 face additional earnings limitations. Cash Balance recipients (usually community college teachers) have no limit in teacher earnings if they take a lump sum benefit, otherwise they are restricted from service for 12 months after retirement. SB1425 will change certain earnings limitation/restriction if enacted.

The committee voted to seek legislation to (1) reduce the time CB retirees are restricted from service to 180 days or their 60th birthday, (2) allow retirees over age 60 to perform creditable service without restriction except as required by SB 1425. (3) require no contributions for compensation paid to retired CB participants, (4) require employer to submit documentation of the eligibility for a retired DB member's post-retirement earnings limit exemption with 30 days of commencement of service. Jennifer Baker, CTA explained that some emergency administrative positions required several employee job changes. The committee requested additional study of administrative exemptions including those for employees on approved emergency leave.

Ed Derman, Deputy CEO, presented three possible plan designs for community college instructors: (1) Determine DB program service credit for all community college members based on assigned teaching load, (2) Determine DB program service credit for all community college members based on their earning a minimum level of salary with a specific period. Or (3) exclude part-time and adult education community college instructors from the DB program and credit all contributions to the DBS program. A task force will study the proposals and present a report to the committee in 2011.

Ed Derman, Deputy CEO, reported that the Folsom Counseling Office is closed; members will go to the CalSTRS headquarters. Members going to the Dublin office will go to Hayward. There will be a new counseling office in Sonoma.

The next meeting of the Benefits and Services Committee will be in February 2011.

Board Education

Allan Emkin, PCA, introduced the panel. Alan began by stating that the next ten years will be more challenging and more volatile. Bonds will earn less than 3% and it will be difficult for CalSTRS to get an 8% return.

Curt Custard, UBS Global Asset Management began. Since 1982 the U.S. has beat inflation, seen a decline in bond yields, a decline in savings, and an increase in consumption. Going forward the U.S. will see savings increase, consumption decrease, stock dividends increase at least for the next 10 years, unless there is an inflation shock.

The U.S. will see 2-3% growth in the future not the 3-4% growth of the past. This will impact the labor market because the smaller firms (under $500 million) are domestic and are the biggest employers. However, the U.S. is a leader in entrepreneurship. In the long term manufacturing will increase because the rest of the world will become more middle class and want U.S. goods. Curt Custard, UBS, predicts a 7% return for CalSTRS.

Stuart Schweitzer, J.P.Morgan, reported that future investment returns will be smaller. Bond yields will increase; equities will have moderate but volatile returns. U.S. corporate profits cannot grow unless U.S. GDP grows. There are no good future choices. Pension funds will have to increase contributions to meet future obligations. Stuart Schweitzer, J.P. Morgan predicts a 7-8% future return for CalSTRS.

Investment Committee

Education Code #22362 mandates that CalSTRS give priority to investing 25% of funds in California, including 2% in underserved markets. As of June 2010 CalSTRS has 15% of funds in California including nearly 4% of funds in underserved markets.

Fixed income outperformed its benchmark by nearly 2% in 2009-10.

Allan Emkin, PCA, presented the semi-annual performance report. In the six months ending June 30, 2010 the CalSTRS portfolio decreased by $4.7 billion. CalSTRS lagged benchmarks due to an underweight in strong performing public equity and poor private equity performance.

Micolyn Yalonis, Townsend Group, reported that CalSTRS real estate outperformed the NCREIF Property Index for the quarter but under performed the benchmark for the last 1,3,and 5-year periods due to the recent downturn. Mike Moy, PCA, reported that Private Equity, like Real Estate, outperformed the benchmark for the latest year, but under performed the benchmark for the last 3 and 5-year periods.

The CEM Benchmarking reported that the costs to manage CalSTRS portfolio for calendar years 2007, 2008, and 2009 were 22, 48, and 47 basis points. Compared to peers, CalSTRS costs are lower due to more investments by CalSTRS staff rather than outside managers. In fact, CalSTRS costs for 2009 were 10% less than estimate resulting in a savings of $139 million.

Allan Emkin, PCA presented an introduction to risk oriented strategic asset allocation. This would be a move away from traditional asset allocation to a risk allocation matrix.

Steven Tong, CalSTRS, presented a report on implementation of Commodities Strategy. The choice would be to put commodities under Absolute Return asset class or put commodities in the Innovation Portfolio. Staff recommends placing commodities under the Absolute Return asset class with an allocation of approximately $1 to $2 billion, phased in. Staff will follow up with a draft of a commodities investment policy.

Chris Ailman, Chief Investment Officer reported that the CalSTRS fund was $129 billion as of June 30, 2010. Gross Domestic Product has remained steady at 2.8% and the unemployment rate remains at 9.5%. CPI, consumer prices have dropped by .2% as has consumer confidence and retail sales.

Client Advisory Committee

Berman Obaldia, CalSTRS, reported on state legislation. The following bills have been passed by the legislature and need to be signed by the Governor in order to become law.
AB 194 (Torrico) limits the retirement benefit of any member of a public retirement system to 125% of the California Governor's salary.
AB 1650 (Feuer) prohibits a person engaged in the energy sector in Iran from entering into a contract with a public entity for goods or services of $1 million or more.
AB 1743 (Hernandez) Prohibits a person from acting as a placement agent for public entities unless that person is registered as a lobbyist.
AB 1862 (Eng) provides for a member of CalSTRS Board elected by retired defined benefit and retired cash balance members.
AB 1899 (Eng) requires state agencies (including CalSTRS) to post audits and data on contracts on the Government Internet Web site.
SB 1007 (Hancock) requires candidates for CalSTRS Board be subject to reporting requirements of the Political Reform Act.
SB 1271 (Romero) requires public retirement systems to attach to conflict of interest code an appendix, listing officials who manage public investments and to post appendix on their Web site.
SB 1425 (Simitian) limits the types of and increases in compensation that count towards final compensation and reduces the benefit for compensation earned during the first 180 days after retirement. Shall only become operative if AB 1987 (Ma) county employees' retirement is enacted. (see SB 1425 table at end of report)

Brian Young, CalSTRS, gave a Charter School update. There has been steady growth in number of Charters and in number of students in Charter schools. 30 Charter schools closed and 60 Charter schools opened in the last year.

The next meeting of the Client Advisory will be in November.

Teachers' Retirement Board

Brian Bartow and Harvey Leiderman presented the legal framework for CalSTRS funding. Based on <u>market value</u> of the fund as of June 30, 2009 – the unfunded liability will increase to $73 billion and the funding ratio will be 58%. An unfunded obligation will influence investment policy and asset allocation as funds for benefits take a larger share of assets. CalSTRS cannot reduce vested member benefits for existing members or retirees. The Legislature is responsible for making CalSTRS system financially sound through increased State and employer contributions or increased new member contributions or a decrease in non-vested benefits.

The State is responsible for a funding plan and design. Ian Lanoff, Fiduciary Counsel stated that CalSTRS has the option of designing a solution. Barstow stated that all actions have the potential for litigation. The CalSTRS Board should be a catalyst, educate but not propose changes.

The CalSTRS Board adopted the June 30, 2009 actuarial evaluation for the defined benefit program, the defined benefit supplement program, and the cash balance program. The SBMA will continue to pay 85% purchasing power since there are adequate funds in the account.

Robin Madsen, Interim CFO, presented the first reading of the 2011-12 operating budget. Increases for new technology and for improved benefits counseling were outlined.

Jack Ehnes, CEO reported that the next CalSTRS meetings are November 3-5. Anticipated items are Adoption of Actuarial Investment Return Assumption, Board Election Procedures, Approval of the 2011-12 Proposed Budget, and GASB Pension Hearing Overview.

The following table shows the comparative results of the staff-recommended changes, with the recommended changes to conform to SB 1425, if it is enacted in its current form, *indicated in italics*.

	DB Member	CB Participant	
		Current	Recommended
Lump Sum Benefit Recipient	Not applicable, lump sum payments not made after 2010	No limitation. *No payment for 180 days, then no limitation*	No payment for 180 days or age 60, whichever occurs first, then no limit. *No payment for 180 days, then no limitation*
Under Age 60	No creditable service for 6 months or age 60, whichever occurs first. *No creditable service for 180 days, then earnings limitation, unless exempted*	No creditable service until age 60 then no limitation	No creditable service for 180 days or age 60, whichever occurs first then no limit. *No creditable service for 180 days, then no limitation*
Age 60 and Older	Earnings limit, unless exempted. *No creditable service for 180 days then earnings limitation, unless exempted*	No creditable service for 12 months then no limitation	No limitation. *No creditable service for 180 days then no limitation*
Impact of Exceeding Limitation	Monthly benefit offset by amount of compensation	Annuity benefit terminated	Monthly benefit offset by amount of compensation
Contributions Paid on Post-retirement Compensation	No	Yes	No
Exemptions from Limitations	Various	None	None

Vacant Administrative Positions

Under current law, a retired DB member who is hired to perform creditable service in an emergency situation to fill a vacant administrative position requiring highly specialized skills, can be exempted from the earnings limitation up to an additional one-half of the full-time salary for the position, for a period of up to 24 months, if the following conditions are met:

- The vacancy occurred due to circumstances beyond the control of the employer;
- The recruitment to fill the vacant position on a permanent basis is expected to take several months;
- The employment is reported in a public meeting of the employer's governing body; and

CalSTRS Meetings Report, November 3, 4, 5, 2010
By Pat Geyer, CalRTA Liaison

Executive Summary

1. **All GASB standards have been met by CalSTRS.**
2. **Dr Yetman recommended and the Committee concurred that a new financial computer system was needed to replace the present need for manual adjustments to the system.**
3. **See Legislative Committee for Federal legislation.**
4. **The CalSTRS fund is $142 billion, the highest since 2007.**
5. **The currency management program under performed by 14 basis points because of market volatility**
6. **CalSTRS will gradually invest $150 million in commodities under the Innovation Portfolio. Commodities are seen as a hedge against inflation.**
7. **Risk Based Asset Allocation looks at investments that are not influenced by equities. CalSTRS will take action on Risk Based Asset Allocation in February.**
8. **In order to receive the Longevity Bonus teachers must qualify by December 31, 2010.**
9. **CalSTRS is proposing to charge penalties and interest on late reporting of member compensation by school districts**
10. **Nominating petitions for the three (active educator) elected seats on the CalSTRS Board are due March 4, 2011.**
11. **The adoption of the investment return actuarial assumption is postponed until the Thursday, December 2 Board meeting.**
12. **The Board approved video broadcasting of CalSTRS meetings.**

Audits and Risk Management Committee

The committee heard a report on the GASB (Government Accounting Standards Board) required changes to the financial statements. All GASB standards have been met. There was a question about STRS derivatives – the program is for the purpose of currency hedging not speculation. The committee accepted the external auditor's report (Macias). As of June 30, 2010 the STRS fund increased by 9.6%; benefit payments increased by 8.8% to a total of $753 million. The Pension 2, supplemental retirement plan, and the 403b programs are increasing as more employers have joined the program.

Dr. Yetman, Committee Financial Expert, reported that the major challenge was that the financial reporting relies on a manual process, which could result in errors. Dr Yetman recommended and the Committee concurred that a new financial computer system was needed to replace the manual system. The Committee passed a revision of the self-assessment guide and recognized the need for a revised Committee Charter to reflect what the Committee actually does. Dr. Yetman's contract was extended to June 2013.

Compensation Committee

The private equity performance measure is now the ZYI-STRS Private Equity Investment Index. The Committee reviewed the succession plan and the competencies for the Chief Executive Officer (CEO) and the Chief Investment Officer (CIO). The Committee discussed the hiring of a compensation consultant.

Benefits and Services Committee

The committee reviewed the four option changes available to a retired DB member. They are: (1) Unmarried retired member marries, (2) married retired member changes option beneficiary to spouse, (3) retired member's beneficiary predeceases member, and (4) retired member cancels an option due to divorce. There is a waiting period of six month for all except option 4. Few retired members elect to change an option, possibly due to the change in the amount of monthly benefit that results from the option change.

The committee discussed allowing members to borrow from their Defined Benefit Supplement (DBS) account. Ed Derman, Deputy CEO, reported that CalSTRS is considering using more State employees in the regional counseling offices. Peggy Plett, Deputy CEO, reported that more forms are available on line. Members can purchase service credit, complete death beneficiary form, and verify benefits. Death notification forms on line will be available in January.

Legislative Committee

John Stanton, CalSTRS Washington Counsel, gave a teleconference report. With the new election, the middle is gone in Congress and members are already preparing for the 2012 election. The issues are: 1. Extending the Bush tax cuts – dividend tax, death tax, teacher's expense deduction. Some may be extended. 2. Spending – the Republicans want $100 billion cut which would require a 20% cut in non-military spending. 3. Health Reform will see no major change because the individual elements are popular. 4. Other issues are consumer finance, derivatives, credit rating agencies, and proxy access.

Social Security possibilities – raise the retirement age to 70, mandatory social security. The problem with repeal of the WEP and GPO is the cost. If social security is mandatory there may be some adjustment of WEP and GPO.

Corporate Governance Committee

The committee heard a report on proxy voting. There were no big issues. Compensation is still an issue. 8 out of 9 CalSTRS shareholder proposals on Board diversity were accepted. CalSTRS plans to team up with a west-coast university to train students of diversity for corporate boards. 4 out of 6 CalSTRS shareholder proposals on the environment were accepted. CalSTRS is working with other organizations on environment issues. Generally, mergers are not financially beneficial, but buy-outs can be a financial benefit to the corporation.

Investment Committee

The committee heard a presentation by the Hotel Workers Union #2 which was striking against the Hilton Hotels of San Francisco, Chicago, and Honolulu. The Union asked that CalSTRS, as an investor, work with the Hilton to resolve the dispute.

Michelle Cunningham, Director Fixed Income, reported that the currency management program under performed by 14 basis points because of market volatility. Chris Ailman, CFO, reported that income from the State Lands was down due to a decrease in land values and a decrease in energy prices. 85% of the State Lands income comes from the Geysers geothermal project. State Lands are investigating consolidating land holdings as well as solar and wind leases.

The committee heard a presentation on the five-year plan for diversity in management. The priority is on ethnic and gender diversity in private equity. CalSTRS has a student intern program and a mentoring program for minority business students.

Carrie Lo, Investment Officer, reported that CalSTRS will gradually invest $150 million in commodities under the Innovation Portfolio. Commodities are seen as a hedge against inflation. Allan Emkin, PCA, asked that CalSTRS monitor their commodity investment influence. There will be a final report in 2012.

The committee heard a presentation on Risk Based Asset Allocation by Neil Rue, PCA. Some 90% of the CalSTRS portfolio is influenced by the equity market. Risk Based Asset Allocation looks at investments that are not influenced by equities such as TIPS, commodities, infrastructure, and absolute return strategies. CalSTRS will take action on Risk Based Asset Allocation in February.

Chris Aliman, CIO reported that the markets are up but still under their 2008 highs. CalSTRS is #16 internationally in terms of growth. Canada, Norway, and Holland are the best performing funds.

Client Advisory Committee

Berman Obaldia reported on legislation. AB 1650 (Feuer) limits investment in companies doing business with Iran in energy; AB 1743 (Hernandez) requires that placement agents register as lobbyists. Both passed and were signed by the governor. AB 1862 (Eng) provides for an elected CalSTRS Board retired teacher member. AB 1862 was vetoed.

In order to receive the Longevity Bonus teachers must qualify by December 31, 2010.

CalSTRS is proposing to charge penalties and interest on late reporting of member compensation by school districts. Hearings will be held and the earliest possible effective date is November 2011.

Nominating petitions for the three (active educator) elected seats on the CalSTRS Board are due March 4, 2011.

Teachers' Retirement Board

The adoption of the investment return actuarial assumption is postponed until the Thursday, December 2 Board meeting.

The Board approved the adoption of the 2011-12 CalSTRS operating budget. The Board approved video broadcasting of CalSTRS meetings.

Jack Ehnes, CEO, reported that the CalSTRS February 9-11 meeting has a full agenda. Brian Bartow, CalSTRS, presented an ethics training.

CalSTRS Meeting Report, December 2, 2010

By Pat Geyer, CalRTA Liaison

Executive Summary

1. **The Board voted to reduce the investment return assumption from 8% to 7.75%.**
2. **The Board reduced the price inflation assumption from 3.25% to 3%.**
3. **The assumption for wage increases was changed from 4.25% to 4% (wage increases include inflation plus a 1% real wage growth).**

Teachers' Retirement Board

The sole agenda item was the evaluation and adoption of the actuarial assumptions for investment returns, price inflation, and wage inflation. Milliman and PCA had both recommended that the projected investment return be reduced from 8% to 7.5%. Changing these actuarial assumptions will affect the following:

- The cost of purchasing service credit will increase since less interest will be earned on the funds.
- The interest rate charged for installment payments would decrease.
- The payments for members who retire and opt to have their retirement pay go to a beneficiary after their death would have their payments reduced. (For example: a member who selects a 100% beneficiary option would have his/her retirement reduced by 0.4% at the 7.75% earnings and reduced by 0.82% at 7.50% CalSTRS earnings.)
- Members who convert their CB (cash balance) and DBS (defined benefit supplement) programs into an annuity would see their annuity payments slightly reduced because of the reduced investment return.

After a discussion, the Board voted to reduce the investment return assumption from 8% to 7.75%. The Board also reduced the price inflation from 3.25% to 3%. The assumption for wage increases was changed from 4.25% to 4% (wage increases include inflation plus a 1% real wage growth). The Board voted to have the changes take place on September 1, 2011 in order to give CalSTRS and members adequate time to make the adjustments.

For currently retired teachers, these changes will not change their retirement payments. In addition, the SBMA fund, which pays for purchasing power protection for those members who retired before 1990, is adequately funded. There is ample money in the SBMA fund.

The decreased assumption return on CalSTRS investments will result in an additional increase in the unfunded liability assumption. However, the Elder Full Funding law of 1990 requires that the State increase its contribution rate by 0.524% equal to about $150 million; increasing annually at a rate of .24% up to a total contribution rate increase of 1.505% annually.

CalSTRS Changes Assumptions

By Pat Geyer, CalRTA Liaison

CalSTRS Board voted to reduce investment return assumption from 8% to 7.75%. It also reduced the price inflation assumption from 3.25% to 3%