

CalSTRS Report, February 9, 10, 11, 2011

By Pat Geyer, CalRTA Liaison

Executive Summary

- 1. Steven Kram and Cameron Percy are new CalSTRS Board members replacing Peter Reinke and Roger Kozberg (Governor Brown will make new appointees.)**
- 2. In 2010 there were 15,493 service retirements with an average final compensation of \$81,600. The average benefit for new retirees was \$51,072. The average benefit for all retired members is \$39,624.**
- 3. CalSTRS is implementing a Fiduciary Advisor Program to provide advisory services to California educators. E-Luminary.com will list approved, registered investment advisors for educator selection. The Web site will debut in April 2011.**
- 4. Corporate Governance 2010-11 focus is diversity, governance, and sustainability/risk management.**
- 5. The Home Loan report stated that of the 5470 CalSTRS mortgages, 169 or 3% are delinquent, less than the California average of 9%.**
- 6. Pat Geyer, CalRTA requested that CalSTRS publish a member handbook specifically for retired educators, making it easier for retired members to understand retiree rules and regulations**
- 7. Risks, over the next three years, in level of importance, are (1) GDP growth, (2) interest rates, (3) financing/leverage, (4) inflation, (5) liquidity and (6) Government regulations.**
- 8. Read John Stanton's federal legislative report under Legislative Committee.**
- 9. Penalties and interest charges for late contributions from Districts and County Offices of Education are proposed. A public hearing on the new regulations will be held in June 2011. Penalties and charges will take effect July 1, 2012.**
- 10. Polly Bacich, CalRTA President and Angelique Hill, CalRTA Executive Director presented a "check" illustrating the vast number of volunteer hours that CalRTA retirees contributed to the State of California in 2010**
- 11. An educational session on private equity is scheduled for March 3**
- 12. The CalSTRS fund is \$149 Billion up from a low of \$114 billion in 2009, but still below the 2007 high of \$175 billion. The fund was up 12% in 2010.**

Compensation Committee

The Committee heard a panel discussion on pay incentives in public pension plans.

- Alan MacDougall, Director of PIRC in the United Kingdom, questioned just tying compensation to performance – that is OK for “number of books read” but not for “the great essay”. The public sees executive pay as a “gravy train”; shareholders hate incentives. Many compensation plans are not transparent. There is an interest in returning to salary only. Continue to look at academics for ideas
- Luis Navas, Director at Global Governance, said that incentives must be seen as fair. Emphasize the long term to meet the needs of a long term pension plan..
- Steve Gruppo TIAA-CREF advised a long-term bonus, tied to a 4-5year average; compensation must be seen as fair.
- Edward Rataj, CBIZ of St. Louis stressed that for a professional, compensation is only part of the puzzle; however, money is important. Individual people are each motivated differently.

Benefits and Services Committee

Peggy Plett, Deputy CEO of Benefits and Services reported on the Service Improvement Plan. The goal is to reduce risk (errors) and improve service to members. Noted accomplishments are: a Full Service Sacramento Counseling Center, forms may be submitted to field counseling offices, on line conferencing and web chats are used for employer training in addition to an employer advisory committee web broadcast. A nurse consultant has been hired to assist in interpretation of medical records in disability cases.

CalSTRS is moving toward having all counseling services provided by CalSTRS employees rather than locally controlled, usually County Office, part-time employees.

Pension enhancements (spiking) continue to be a State issue. However, unlike some other plans, CalSTRS has never allowed sick leave or vacation time to be counted for final benefit compensation. In 2010 there were 15,493 service retirements with an average final compensation of \$81,600. The average benefit for new retirees was \$51,072. The average benefit for

all retired members is \$39,624. In 2010 66 districts offered retirement incentives. As of January 2011, only 33 districts are planning to offer retirement incentives this year. CalSTRS will discuss state legislation on pension issues at the April meeting.

CalSTRS is implementing a Fiduciary Advisor Program to provide advisory services to California educators. E-Luminary.com will list approved, registered investment advisors for educator selection. The Web site will debut in April 2011.

Board Governance Committee

The Committee updated the Placement Agent Policy to conform with AB 1584 requirements. Few changes were needed.

The Committee reviewed the insider trading policy. This policy requires a person in possession of material nonpublic information to disclose the information or abstain from trading. The committee adopted the procedures and additional reporting requirements will be added.

The Committee discussed the Steptoe Recommendations, which were presented to CalPERS.

- (1) Risk management and oversight – The CalSTRS Audits and Risk Management Committee is responsible. CalSTRS will evaluate the issue of a separate risk management office.
- (2) Gifts and Travel – CalSTRS has a policy in place. Terry McGuire, representing the Controller, requested that the gift limit be reduced from \$400 to \$50.
- (3) Post employment of Board members – Currently CalSTRS prohibits for one year, former Board members right to represent an outside entity before CalSTRS. AB 1584 extends that ban to two years. Jack Ehnis is concerned about recruitment if the law is too strict.
- (4) Responsiveness to Public Records Act requests – the Ethics and Compliance Officer responds to all requests.
- (5) Internal Audit Program – CalSTRS audit services reports directly to the Audits and Risk Management Committee.

On issues relating to Fees, CalSTRS has a Placement Agent Disclosure Policy in place since 2006, which covers relationships between external managers and placement agents, policies to combat abuses, payment of placement agent fees from investment funds. Most fees are paid in Real

Estate. Since the 1970's there has been a 2 and 20 rule – 2% management fee and 20% of the profit. CalSTRS continues to negotiate for lower fees.

CalSTRS has a clear separation of duties among consultants. Consultants who provide opinions on the prudence of an investment do not opine on the performance of that investment.

In conclusion, the Steptoe recommendations provide a starting point for further discussion and review.

Corporate Governance Committee

The Committee reported on the 2010-11 corporate engagement plan. The Committee is working with 23 companies on issues of:

- Diversity: CalSTRS submitted nine shareholder resolutions to corporations asking that company charters include diversity.
- Corporate governance: CalSTRS has participated in a number of meetings and conferences.
- Sustainability/risk management: CalSTRS has worked with other investors in this area and worked with 31 specific companies in oil and gas extraction.

Staff proposed a revision to the Corporate Governance section of the Board Manual. The Corporate Governance section will remain in the Board Manual and the Corporate Governance Principles will be a separate document. Final vote on the changes will be in April.

Investment Committee

The Committee heard member request to divest in Israel.

The Home Loan report stated that of the 5470 CalSTRS mortgages, 169 or 3% are delinquent, less than the California average of 9%. Most delinquent loans are in the 80/17 program, which has a 17% second mortgage which resets in five years. CalSTRS terminated their reverse mortgage program because of lack of interest. CalPERS suspended their home loan program because of a high rate of defaults.

Staff reviewed CalSTRS history for new Board members. The CalSTRS fund is \$149 Billion up from a low of \$114 billion in 2009, but still below the 2007 high of \$175 billion. The fund was up 12% in 2010, but CalSTRS

will still need to recognize some of the 2009 losses because it uses a 3-year average for actuarial purposes.

The committee approved the Five-year Diversity in Investment Management Business Plan. The committee heard a report on the Infrastructure Policy revision. Staff suggested that investment in Public infrastructure be reduced from 30% to 20%, and that an opportunistic section of 0% to 20% be added to the existing sections of Core and Value Added under Private Infrastructure. The committee also heard a report on Internal/External Asset Management.

Chris Ailman, Chief Investment Officer reported on the financial risk factors. Inflation is the greatest risk over the next six years. Over the next three years, in level of importance, are (1) GDP growth, (2) interest rates, (3) financing/leverage, (4) inflation, (5) liquidity and (6) Government regulations.

Client Advisory Committee

Berman Obladia reported on State legislation.

AB7 (Portantino) prohibits a person employed by the state earning above \$150,000 from receiving a salary increase or bonus.

Ab17 (Davis) requires CalSTRS and CalPERS to report the ethnicity and gender of investment managers and brokerage firms.

AB150 (Perea) and SB67 (Price) directs all state agencies to establish the goal of 25% small business participation.

SB 114 (Yee) requires community college districts to determine compensation of part-time faculty based on full-time salary paid – a CFT sponsored bill.

CalSTRS will take a position on State legislation at the March Board meeting.

Pat Geyer, CalRTA requested that CalSTRS publish a member handbook specifically for retired educators, making it easier for retired members to understand retiree rules and regulations. The Committee also discussed mailing brochures on retiree issues to retired members.

Legislative Committee

Ed Derman, Deputy CEO, recommended that the Board oppose legislation that changes post-retirement employment restrictions effective prior to the date of the legislation. The Committee approved.

Committee voted to oppose unless amended AB7/ABX1 (Portantino), which prohibits state employees with a salary greater than \$150,000 from receiving a salary increase or bonus until 2014.

Committee voted neutral unless amended AB 17 (Davis), which requires that the Board report on the ethnicity and gender of investment professionals who manage the external portfolio.

John Stanton, CalSTRS Washington counsel reported on federal activities.

- (1) Scrutiny of Public Retirement Plans by Congress, SEC, and IRS increases.
- (2) The attack on Government Pensions and Unions increases. Some groups try to keep public pension plans in the news with draconian predictions. Academics are now a partner. They have a two-year window for action. Public plans need to combat the bad news.
- (3) Public Pension Plans need to separate themselves from Labor Union issues.
- (4) California and California issues are not popular in Congress.
- (5) Public plans must advocate retirement security for all.
- (6) GPO/WEP offsets of Social Security will only go away if Social Security is mandatory for all.
- (7) Congress may try to cut funding and starve Health Reform
- (8) Tax reform plans are to consolidate 403b, 457 and 401k plans.
- (9) The Elk Hills final payment is still in the future. (\$20-40 million)

Teachers' Retirement Board

Cheiron reviewed June 2008 Actuarial Valuation of the CalSTRS Defined Benefit Program by Milliman. CalSTRS can rely on the Milliman results; all calculations were reasonable. Market meltdown and inadequate contribution rates specified by the Education code hurt the DP Program's funded status. Staff will evaluate Cheiron's report and Milliman's response and report back to the Board with specific proposals.

Robin Madsen, CalSTRS, reported on proposed penalties and interest charges for late contributions from Districts and County Offices of Education. A public hearing on the new regulations will be held in June 2011. Penalties and charges will take effect July 1, 2012.

Jack Ehnes, CEO, reported that an educational session on private equity is scheduled for March 3. He reported on the BusinessRenew program to update CalSTRS technology and business processes. Ed Derman, Deputy CEO, presented a short report on the actuarial valuation and possible changes in contribution rates. Brian Barow, CalSTRS, presented a draft of proposed regulations for a member's appeal of a determination of a right to a CalSTRS benefit or obligation. Deanna Gay-Tyler, CalSTRS, gave an update of Fiduciary Insurance.

Polly Bacich, CalRTA President and Angelique Hill, CalRTA Executive Director presented a "check" illustrating the vast number of volunteer hours that CalRTA retirees contributed to the State of California in 2010. Jerilyn Harris, CalSTRS Board member representing retirees, accepted the "check" on behalf of the CalSTRS Board.

CalSTRS Report, March 24, 2011

By Pat Geyer, CalRTA Liaison

Legislative Committee

The Committee met to take a position on legislation.

- AB 597 (Eng) & SB 696 (Lieu) – support

This bill establishes the California Financial Literacy Fund and allows the Controller to accept private donations to improve California's financial literacy.

- AB 1101 (Eng) – no position

This bill requires that the CalSTRS Board have a member who is elected by the retired members. After discussion, Pat Geyer, CalRTA representative spoke in favor of AB 1101.

- SB 439 (Negrete McLeod) – support and request amendments to require the law apply to all public pension systems

This bill prohibits a CalSTRS or CalPERS employee or board member from accepting gifts from any single source of more than \$50. value in a calendar year. A vendor or contractor who violates the gift limit twice in 5 years is prohibited from bidding any contract for 2 years.

- SB 689 (Harman) – neutral

This bill requires CalSTRS and all other state public retirement systems to file a report with information about any retired member who receives a pension of \$100,000 or more annually. A discussion followed on giving information to show years of service as well as salary, also to differentiate between classroom teacher salaries and administrator and non-classroom salaries.

The next CalSTRS Board and Committee meetings will be April 6,7, and 8. Client Advisory Committee will meet Thursday, April 7.

With lights going on and off at the CalSTRS building because of the rain and with several members attending by phone because of local flooding, the meeting adjourned.

CalSTRS Report, April 6,7,8, 2011

By Pat Geyer, CalRTA Liaison

Executive Summary

- 1. Rich Zeiger, representing the Department of Education, and Pedro Reyes, representing the Department of Finance, joined the CalSTRS Board.**
- 2. See Legislation Committee report for legislation of interest to CalSTRS.**
- 3. The interest rates for benefit purchases have been lowered to reflect the earnings estimate which has changed from 8% to 7.75%.**
- 4. The SBMA (supplemental benefits maintenance account) as of December 2010 will be paid to those recipients who have retired in 1990 or before.**
- 5. CalSTRS is now on Twitter, Facebook and YouTube.**
- 6. The CalSTRS fund is \$153 billion as of April 7.**
- 7. The unfunded obligation is \$56 billion, an increase of \$15 billion from 2009 because losses and gains are recognized over three years.**
- 8. The State General Fund contribution to the CalSTRS fund will be increased by 0.524%.**
- 9. The Defined Benefit Supplement account has gone from 77.9% funded to 86% funded as of June 30, 2010.**
- 10. CalSTRS members must retire by June 30, 2012 to be eligible to join the Medicare Part A payment program. CalSTRS plans to discuss extending the program at the June Board meeting.**
- 11. CalSTRS is having meetings with Governor Brown over pensions, but there are no drafted proposals**
- 12. The next CalSTRS Board and Committee meetings are May 12, 13. The Legislative Committee will meet on May 20**

Compensation Committee

Rich Zeiger, representing the Department of Education, and Pedro Reyes, representing the Department of Finance, joined the CalSTRS Board.

The Committee reviewed the succession planning (job descriptions) for Chief Executive and Chief Investment Officers. Most important for CEO were strategic orientation, leadership, and risk management. Most important for CIO were market knowledge, strategic orientation, and risk management. Carolyn Widener requested that funding adequacy be emphasized. The CIO, Deputy CIO, and Innovation and Risk team will be evaluated on the average of the five asset classes not his/her specific asset class.

Budget Governance Committee

The Committee reviewed the present gift policy of no gift from one source of more than \$50 and no gift total of more than \$430 in a single year. Representatives from the Treasurer and Controller's office want a no gift policy. The Committee also reviewed the conflict of interest policy. Decisions on changes will be made at a future meeting.

Legislative Committee

The committee acted on the following bills:

AB 738 (Hagman) and SB 523 (Walters) prohibit a person elected to office from becoming a member of a pension system. **Oppose** unless amended to exclude CalSTRS members elected to county superintendent.

AB 873 (Furutani) prohibits a member of CalSTRS or CalPERS from accepting employment within 2 years from an employer with which the individual participated. **Support** if amended to apply only to board members or employees whose compensation is set by the board. The Treasurer want this legislation to apply to all public pension systems in California

AB1151 (Feuer) and SB 903 (Anderson) want CalPERS and CalSTRS to divest in Iran. **Oppose.**

SB 861 (Corbett) on conflict minerals from Congo does not affect CalSTRS. **Neutral.**

H.R. 567 (Nunes) and S 347 (Burr) require the pension plan to file a detailed report to the U.S. Secretary of the Treasury each year. **Oppose** because of cost.

Other legislation on which CalSTRS has a position is:

AB 7 (Portantino) salary freeze for State employees who earn more than \$150,000 – oppose unless amended.

AB 17 (Davis) report on ethnicity and gender of investment managers – neutral if amended.

Other legislation of CalSTRS interest is:

AB 597 (Eng) authorizes a California Financial Literacy Fund.

AB 758 (Wieckowski) extends the sunset date for post-retirement earnings limit exemptions to 2014.

AB 1101 (Eng) provides for a retired teacher elected to CalSTRS Board.

AB 27 (Simitian) limits types of compensation included in a member's final compensation

SB 114 (Yee) requires community college districts to determine part-time faculty compensation based on full-time compensation.

SB 115 (Strickland) requires a forfeiture of public employee pensions for felony conviction.

SB 439 (Negrete-McLeod) prohibits CalSTRS or CalPERS boards or employee from accepting gifts of more than \$50. from one source in one year.

Corporate Governance Committee

The Committee reviewed the Corporate Governance Policy.

Ann Sheehan reviewed the engagement plan on Corporate Governance (majority vote), Diversity on Boards, and Sustainability/Risk Management. Shareholders proxy voting on pay is increasing. There is concern about adequate Securities & Exchange Committee funding.

The Climate Change Scenarios Report by Mercer were presented:

Climate risk could increase portfolio risk by 10%

Diversify across sources of risk rather than asset class

Infrastructure, private equity, real estate, and some commodities are sensitive to climate change.

Benefits and Services Committee

The interest rates for benefits have been changed to reflect the earnings estimate which has changed from 8% to 7.75%. The following rates have changed – Cash Balance – 4.5% to 4.25%

Defined Benefit Supplement – 4.5% to 4.25%

Employer contribution rate – 9.328% to 9.713% (This is the rate for elected officials and reduced workload program. It reflects the 1990

Elder Full Funding legislation which requires an additional employer contribution if the CalSTRS funding ratio falls below the 1990 full funding level.)

The SBMA (supplemental benefits maintenance account) as of December 2010 will be paid to those recipients who have retired in 1990 or before. The purchasing power of their pensions is below 85%. The SBMA payments will bring the purchasing power up to 85%. If a CalSTRS member has a disability retirement and wants to reinstate and then retire, the member should seek CalSTRS counseling about the value of a disability retirement versus a subsequent service retirement.

The cost of the purchase of service credit has decreased by an average of 0.6% because the average retirement age increased and CalSTRS has more time to invest the money. Service credit cost varies based on the age of the purchaser.

A discussion of pension spiking concluded with a suggestion that staff explore legislation to limit defined benefit compensation to salary and wages. In addition, consider eliminating a class of one or imposing a cap on the amount of compensation or percentage increase that could be used.

CalSTRS presented its use of social media. CalSTRS began using social media in April 2010. Today, there are 436 Twitter followers including California agencies, corporate governance organizations, educators, investors, media, real estate, and retirement/pension organizations. CalSTRS has 470 Facebook fans a 200% increase in the last quarter. On YouTube, CalSTRS has 10 videos on CalSTRS.com or CalSTRSBenefits.Us.

Investment Committee

Chris Ailman, Chief Investment Officer, reported that the CalSTRS fund is \$153 billion as of April 7. The cost to manage the CalSTRS investment portfolio is 22 basis points or \$184 million. Added complexity and specialization have increased costs. Managing investments internally generally costs 1/10 of what external managers charge.

The Committee accepted a report on Infrastructure Investment. An infrastructure portfolio provides diversification, enhanced yield, a hedge against inflation. The Committee also heard a report on credit enhancement.

The 2010 portfolio totaled \$2 billion, a decline of 20%, but earned a net fee of \$12 million a 70% increase over 2009.

Allan Emkin, PCA presented the semi-annual performance report. The last 10 years (2001-10) was the lost decade; investment returns were the lowest since the Civil War and below the Great Depression of the 1930's. As of December 2010 the CalSTRS fund was underweight in US debt (interest rates increased and bond values declined) and real estate (loss of value). The stock market has less risk than bonds because of the risk of inflation. Investors are positive about the US economy, but not positive about the rest of the world. Crises in the Middle East and Japan will have a short-term impact on the market, but will not change market direction.

Mike DiRe and Micolyn Magee (Townsend) presented the Real Estate report ending September 30, 2010. The volume of sales is down because Real Estate depends on the job market. There is a flight to quality. The good news is that banks are loaning again. Home prices will stay depressed through 2013 because of underwater mortgages. No big improvement until 2016.

Mike DiRe reported, in the September 30, 2010 report, no major change in private equity. The return of borrowing is a problem – investors put in money, equity borrows money to repay investors. It is more important to grow the company. Management fees are decreasing. Over the last 10 years, venture capital has not done well.

CalSTRS is increasing internal management of assets because it is cost effective. CalSTRS has 33% of assets internally managed compared to US peers who have 46% and global peers who have 56% internally managed.

Dr Assaud from the University of Minnesota and an expert on Egypt and the Middle East gave an internet presentation. He is optimistic for the long run of 4-7% annual growth, but there are problems of no political model, rise of radical Islam, demand for government giveaways, and demands of the army.

Chris Ailman, Chief Investment Officer reported that the CalSTRS fund was \$153 billion. The US market, EAFE (East Asia, Far East), and Emerging markets are at a 2-year high. Small Caps are at a 3-year high. The tobacco divestment report stated that from July to December 2010 CalSTRS has

underperformed the U.S. equity by .05%; Non-U.S. equity by .17% and private equity by .17%, due to no investment in tobacco.

Teachers' Retirement Board

Jerilyn Harris was honored for her service as Chair of the Teachers' Retirement Board. Dana Dillon was elected Chair by vote of the Board.

Rick Reed, CalSTRS Actuary, presented the actuarial valuation as of June 30, 2010. The unfunded obligation is \$56 billion an increase of \$15 billion from 2009 because losses and gains are recognized over three years. An unfunded obligation of benefits associated with the plan as of 1990 (Elder Full Funding legislation) means that the State General Fund contribution will be increased by 0.524%. As of June 2010 CalSTRS is 71% funded, down from 78%.

The CalSTRS fund would need an additional 14% revenue in order to pay off the unfunded obligation in 30 years – assuming 7.75% returns. In order to grow out of the unfunded position CalSTRS fund would need 19% return for 5 years or a 11.8% return for 15 years.

The Defined Benefit Supplement account has gone from 77.9% funded to 86% funded as of June 30, 2010. The Cash Balance Benefit Program went from 80% funded to 88% funded due to investment returns. The Medical Premium Payment program which funds Medicare part A for those who were not in Medicare is well funded because the costs were less than expected. However, CalSTRS members must retire by June 30, 2012 to be eligible to join the program. CalSTRS plans to discuss extending the program at the June Board meeting.

Jack Ehnes, CEO, reported on a study by the National Institute on Retirement Security. Some findings are: (1) record low confidence about adequate retirement. (Age of New Normal), (2) little or no savings for retirement, (3) more are expecting to work in retirement. The Field Poll reports that 4 out of 7 voters believe government workers' pensions are too generous. 70% want workers to pay more, 60% want to increase the age for retirement, and 56% want a new system (combination of 401k and reduced guaranteed benefits).

Candidates for CalSTRS Board elections to be held next fall are:

Pre K-12 (non administrator)

Dana Dillon
Tyson “Guy” Moore
Chad Posner

Weed Union Elementary
Mt. Diablo USD
San Juan USD

Pre K-12 (inclusive)
Tomas Flores
Harry Keiley
Vince Rosato

Los Angeles USD
Santa Monica Malibu USD
New Haven USD

Community College
Phyllis Hall
Sharon Hendricks

Long Beach CCD
Los Angeles CCD

The next CalSTRS Board and Committee meetings are May 12, 13. The Legislative Committee will meet on May 20

Ed Derman, Deputy CEO reported the funding strategy. Pension reform in Colorado, Ohio, Illinois, and New Jersey will influence California legislators. CalSTRS is having meetings with Governor Brown over pensions, but there are no drafted proposals.

Staff presented an update on fiduciary insurance. CalSTRS has a deductible of \$25 million, high compared to other pension funds. The annual Bagley/Keene review stated that all meetings require notice and are to be open with only narrow exceptions. New issues are telephonic conversations, text messaging and emails that can qualify as meetings when a majority of committee members are involved.

CalSTRS Report, May 12, 2011

By Pat Geyer, CalRTA Liaison

Executive Summary

- **Global Governance Advisors will be CalSTRS compensation consultant**
- **SB 294 (Price) – Emerging Investment Managers has been amended. CalSTRS voted support.**
- **SB 398 (Hernandez) – Placement Agents would augment CalSTRS current policy. CalSTRS voted to support**
- **The next CalSTRS meeting will be June 1,2,3. The CalSTRS meeting for May 20 is cancelled**
- **The CalSTRS fund is \$154 billion as of May 12, 2011.**

Compensation Committee

The committee interviewed three finalists for the compensation consultant. The consultant will have a 3-year contract with a possible 2-year extension. Adam Barnett and Chris Murphy presented for McLagan. The firm has worked with CalSTRS since 2006. Their analysis revealed that Public Funds and government salaries have not changed during this economic downturn. Public funds have taken a “wait and see” position. The pay in Private Funds has varied. Pay for junior employees (\$50-\$60,000) has increased if not fired. Some 10-20% of junior employees were laid off. Mid-level employees had bonus cuts of 1/3 to 1/2. The 2010 pay was back to 2007, again if not fired.

Nanci Hibschman presented for Mercer. Public Sector salaries have increased 4-7% in the last year. When government employees leave only 20% go to the private sector – the remainder retire or remain in government employ. The majority of Mercer clients are in the private sector.

Luis Navas presented for Global Governance Advisors. This firm proposed an education session on risk management and customized to CalSTRS. Mr. Navas believed that the market was not consistent and did not compensate for taking risk. One should look for absolute performance not just to out-perform peers. Also look at where CalSTRS is losing employees and pay competitively.

The Committee chose Global Governance Advisors for compensation consultant.

The next CalSTRS meeting will be June 1,2,3. The CalSTRS meeting for May 20 is cancelled.

The CalSTRS fund is \$154 billion as of May 12, 2011.

Legislative Committee

Berman Obaldia, CalSTRS Director of Government Affairs, reported on State legislation. SB 294 (Price) – Emerging Investment Managers has been amended and CalSTRS voted to support. The bill requires CalSTRS to provide a 5-year plan to expand participation of emerging investment managers. The bill was amended to add a provision that CalSTRS not take any action that is inconsistent with Board fiduciary duties. SB 398 (Hernandez) – Placement Agents would augment CalSTRS current policy. CalSTRS voted to support.

The following bills have been changed to two-year bills and will not be voted upon this session

AB 17 (Davis) Gender and Ethnicity of Pension Fund Managers

AB 738 (Hagman) Prohibits Retirement Benefits for Elected Officers

AB 758 (Wieckowski) extends the earnings limit exemptions.

AB 873 (Furutani) prohibit on employment after separation from Pension system
(is better – exemption for portfolio managers and CEO)

AB 875 (Donnelly) public employees final compensation

AB 961 (Mansoor) prohibits employee organizations from negotiating pension benefits with public employers

SB 115 (Strickland) forfeit public employee pensions for felony convictions

SB 522 (Walters) prohibits purchase of nonqualified service credit

SB 523 (Walters) prohibits retirement benefits for elected officials

SB 524 (Walters) prohibits retroactive pension benefits

SB 526 (Walters) three year final compensation

SB 527 (Walters) prohibits negotiation of retirement benefits

SB 689 (Harman) report on pensions of \$100,000 or more

Teachers' Retirement Board

Pat Geyer was not present at this meeting. However, from the agenda the meeting was a Board Education Workshop on:

Risk Management

Customer Service

Corporate Accounting and Resource Management

Preparing for the Pension Solution

Oversight and Proposed Governance

Sustaining the Effort

CalSTRS Report, June 1, 2, 3, 2011

By Paula Weiss, (substituting for Pat Geyer)

Executive Summary

1. The CalSTRS Board voted to support SB 27, by Simitian if amended to only apply to new hires. The Board believes that as written there would be contract impairment. This is a pension reform bill which seeks to control spiking, but contains many other provisions.
2. The Board discussed the Medicare Part A program. The legislation that authorizes this benefit will expire on July 1, 2012. CALSTRS is working on legislation to protect existing members of the program. Members who would be affected will receive letters from CalSTRS.
3. Audits and Risk discussed the disaster preparedness plans. A business recovery center is planned for McClellan Park. Service should be up in 24 hours. Back-up servers are out of state.
4. There are 915 active Charter Schools in the state. 67% are run by corporations.
5. Corporate Governance heard a presentation on the consequences of the Supreme Court's ruling in Citizens United. Corporate donations add risk to profitability. We seek accountability, responsibility, and disclosure.
6. Benefits and Service voted to maintain the death benefit at \$6163.
7. Mandatory Social Security would be expensive to implement and could result in a much smaller defined benefit pension.
8. The investment committee discussed internal vs. external management. They approved a motion to allow Category 1 and 2 investments to be managed internally. This would save money.
9. The investment committee also heard a presentation on Micro Finance. No action was taken.
10. Client Advisor committee was informed about AB 982 which would solidify land holding to be used for alternate energy and add income to the SBMA account. Charter Schools were also discussed. Ed Derman said we needed to be out there telling our story to counter the anti-pension misinformation that was being spread.
11. John Stanton reported to the legislation committee. Nunes HR 567 would be very harmful to public pensions.

Attending from CalRTA: Joe Dion, Bill Kipp, Polly Bacich, Ken Hewitt, Pat Boyd, Irene Wetzell, Bob Fossgreen, Marcie Launey, and Paula Weiss

June 3, 2011: Regular Board Meeting

1. The Board approved the proposed 2011-2012 calendar. They chose committee members and committee chairs. They made some slight budgetary changes and approved several contracts related to technological improvements that would reduce risk of human error and automate some systems.

2. Thirteen staff members were awarded the "Virtuosity" awards and honored by staff and audience. Their pictures also will be displayed throughout the building. This was very touching to all of us because it showed the CalSTRS really valued their employees.
3. Jack Ehnes, CEO gave his report.
 - There was a discussion of the members' satisfaction survey. The numbers have improved, as service has gotten better with the ending of furloughs. 66% of CalSTRS members reported being highly satisfied with the services they were receiving. Retired members were more satisfied than active members.
 - It was suggested that the survey instrument be updated.
4. There was extensive discussion of SB 27 by Simitian. This legislation is designed to end pension spiking and double dipping.
 - The legislation requires a 180 day clean separation from service. That means that retiring teachers would not be able to substitute or take any contract without losing dollar for dollar from their pension. This provision is already in effect for retirees who are not yet 60.
 - There was a discussion of the "class of 1," which might disappear because of this legislation. This would mostly affect superintendents.
 - The legislation, in its present form, would create an administrative nightmare for CalSTRS as it presents a pension cap in terms of a percentage. CalSTRS prefers a hard cap based on the IRS figure which presently caps pensions at \$245,000. The number CalSTRS would like to use is \$147,000, and would be adjusted for inflation. Another issue is the impairment of contract, if it were applied, as written in the legislation, to present employees.
 - There was extensive discussion of what constitutes credible salary. Some members are given car allowances, and other enhancements. Presently some of these items may be deemed part of credible salary, and increase retirement benefits. The legislation also challenges these extras. This too would be an impairment of contract if it was applied to present employees.
 - Most CalSTRS members who receive extra pay for extra services (coaching, summer school, retirement bonuses, etc.) have those extras credited to their defined benefit supplemental account. Those extras do not count towards their defined benefit. CalSTRS does this to control pension spiking.
 - The Board plans to revisit the question of what should be included as creditable service.
 - There was much discussion with CalSTRS lawyer, Brian Bartow provided counsel to the Board.
 - The Board voted to support the legislation, if amended to apply only to new hires, and the technical issues were corrected.
5. There are challenges to what is considered vested rights. Ed code 2219 deals with some of these issues. We can expect court challenges.
6. Extension of Medicare Premium Payment Program
 - The legislation that allows CalSTRS to pay the premium for Part A Medicare for those members who are not otherwise eligible is set to expire on July 1, 2012.

- Legislation states Medicare payment cannot be extended unless there is a plan in place to fully fund (at 100%) the pension. That is not likely to happen in our state's present political and financial situation.
 - Members who are close to retirement could retire before July 1, 2012 and enroll in the program. Some members would not be able to do that and therefore become ineligible. They also may not have any district insurance, as 62% of present members do not, and that could leave them in a difficult economic situation.
 - While funds have been set aside to pay the premiums for present enrollees, and there would no impact on the unfunded liability, there was some question if CalSTRS could even continue to pay their premiums.
 - CalSTRS is working on legislation to protect members who are covered by this Medicare program. It's also possible that those members who qualify and do not retire by July 1, 2012, may be covered by the program at a future date.
7. The Board approved committee recommendations.
 8. Jerilyn Harris announced to the Board that Chair, Dana Dillon had received the Friends of CalRTA award. We are so pleased that Dana has received the recognition she rightfully deserved.

June 3, 2011: Legislation Committee

1. John Stanton gave his Federal Legislative update from Washington, DC via telecommunication.
 - HR 567 - Nunes; S 347 - Burr: Public Employee Pension Transparency Act
 - This proposed legislation would require pension information be reported using an unrealistic assumption rate based on Treasury Bills. This would make the unfunded liabilities look much larger. Failure to report using this rate would result in a state's inability to sell tax free bonds. It would also ban federal bailouts.
 - John referred to Nunes' website as the "chimp" show. I've gone to Nunes' website and copied the photo into this report (below), as a picture is worth a thousand words.
 - Hearings are taking place in the Ways and Means Committee, and they are very partisan. This legislation is opposed by unions, and state and local governments. John said, "This is a solution in search of a problem. Nobody testifying knows anything about pensions. They are presenting inaccurate information and distorted results." We have a long and difficult battle as our opponents are well financed by destructive groups. There's a lot to overcome.
 - We have to use PR to change public perception and beat back misinformation. "Finally, the other side of the story is beginning to come out on the Hill, but also in the press."



Taken from Congressman Nunes website: <http://nunes.house.gov/>

- There are pension disclosure rules and municipal bond rules. The National Association of Bond Lawyers knows bonds. They don't know pensions. The SEC has a special unit on municipal securities and bonds.
 - Pension disclosure may become an issue in its own right.
 - Proxy access is tied up in court. Dodd - Frank (legislation to regulate Wall Street) may suffer death by a thousand cuts. Public plans may be required to post margins.
 - We all know that mandatory social security would increase employer costs, but what's also resonating is mandatory social security as the "new pot of gold." Fortunately mandatory social security is not on the table yet.
 - Elk Hills has been settled, but now they are discussing how to split the take. Senator Feinstein is part of this bipartisan effort.
2. Berman Obaldia discussed state legislation proposals. He presented information on AB 982 (see Client Advisory). The committee voted to support the legislation.

June 2, 2011: Client Advisory Committee

1. Berman Obaldia presented the legislation report. 2300 bills have been introduced by legislators. CalSTRS has analyzed 29 bills, 29 (1%). Of these 2 were removed, 3 failed, 10 have become two year bills, 2 remain in committee, and 12 bills are still moving. Mr. Obaldia and members of CalSTRS staff are making frequent visits to the Capitol in support/opposition/amending of legislation. They also explain and defend the CalSTRS pension system.
- AB 982: This legislation would facilitate land exchanges and consolidate school owned parcels into 300 acres of contiguous holding for renewable energy (solar projects) in the Mojave Desert. The income generated by this energy project would go towards the SBMA fund. CalSTRS' position is to support if amended, probably to ease some of the administrative issues.
 - There has been a settlement of the Elk Hills lawsuit. It is yet to be determined what portion of the funds will go to SBMA. We will also receive funding from geyser generated energy.
2. Charter Schools: There was an excellent handout on Charters. The information has been included in the Audits and Risk Committee Report.

3. There was a discussion of the penalties & interest proposals. A public hearing is scheduled for tomorrow.
4. Ed Derman led a discussion on defending our pensions. CEO, Jack Ehnes has posted video clips on YouTube. We are asked to "spread the story." CalSTRS is preparing a response to the CFFR (Marcia Fritz) proposals.
5. The Medicare part A benefit is scheduled to sunset on July 1, 2012. Some members may need to retire before that date to receive that benefit. Please read the discussion included in the Regular Board Section.
6. Online services are improving. As of June 17, members can file for their retirement online.
7. You can follow discussions at www.calstrsbenefits.us

June 2, 2011: Investment Committee

1. Securities and Lending Program:
 - CalSTRS participates in a lending securities program. In 2010 they earned approximately \$93 million or \$ 1.6 billion compounded from inception. The securities lending program continues to recoup losses taken during the financial crisis and has recovered nearly 60% of those losses. Currently 65% of total plan assets are lendable
 - Risk is mitigated through borrower diversification.
2. The overall Directed Brokerage Program continues to run efficiently and effectively. Staff deposits rebates to provide additional income for the portfolio. This is a very limited investment strategy.
3. John Petzold, Deputy Chief Investment Officer, guided the Board through a discussion on internal and external management. Allan Emkin, consultant from PCA, also provided input. Internal management results in lower fees and greater cost savings. However, internal staff must have the prerequisite skills and equipment to be successful.
 - Various categories of investments can be increasingly complex.
 - Both passive and active management strategies are involved, with active being more costly and time consuming.
 - Presently CalSTRS is 67% external and 33% internal. Global peers are 42% external and 54% internal.
 - Category 1 assets requiring passive management, and can easily be managed internally. Category 2 assets, also passive, are a bit more complex and with some additional infrastructure, resources, and staff development, can be managed internally as well. Category 3 investments need to continue to be managed externally.
 - The committee passed a motion to proceed with internal management for Category 1 and 2 investments with the exception of a small portion of the Russell 3000 and the RAFI/US REIT.
4. Micro Finance
 - The committee heard a presentation by Scott Buddy of TIAA-CREF. The presentation discussed ways to manage challenges and risks of investing in micro finance. Staff and PCA have determined that micro finance is a viable investment

strategy. \$30 million is being considered for the initial investment. These investments are viewed to have positive social impact and to reduce third world poverty.

- This was an informational presentation and the committee took no action.
5. Chris Ailman provided an updated financial report.
 - The economy remains slightly positive, with slow growth at best. However, there are uncertainties on the horizon. We'll take the good year we've had, but clearly we cannot invest our way out of the unfunded liability.
 - There are many risks: core inflation, the price of crude oil, rising interest rates, sovereign debt in Europe, instability in the housing market, mother nature, and the situation with Chinese real estate (empty cities). Other risks include global risks, internet attack, and hostilities. There are near and long term risks.
 - The fund is now valued at \$152.2 billion. DBS reported assets around \$8 billion. The guaranteed interest rate based on a 30 year US Treasury rate through June 2011, compounded daily is 4.5%.
 6. Chris Ailman, CIO, and CalSTRS were honored as Large Public Fund Investment Manager of the Year by Institutional Investor Magazine.
 7. The next Investment Committee meeting will be held in July, TBA.

June 2, 2011: Benefits and Services Committee

1. A comparison of CalSTRS pensions was made to 11 other non social security teacher pension funds. CalSTRS ranked about midway in the study. It provides a 61% replacement rate at (\$4,162) at age 62 after 27 years of service. This is a modest pension and not "overly generous" as claimed in the Little Hoover Commission report.
2. Mandating social security would be very expensive, costing employer/employee and additional 12.4% of payroll. To keep costs level, members would receive a significantly lower Defined Benefit. DB is a vested lifetime benefit. Social Security is not vested and can be changed by Congress.
3. Because of the unfunded actuarial liability, the death benefit will remain at \$6163.
4. We have a hybrid plan. Compensation that is not defined as creditable does not count towards the calculation of the defined benefit allowance. It is credited to the defined benefit supplementary account which functions like an annuity.
5. There was much discussion on what should be included as creditable compensation. Changes should only apply to new members.
6. CalSTRS is planning to open an additional 5 member service centers. One is planned for Burbank/Pasadena/Glendale and is scheduled to open in January 2012. Evening appointments would be available.

June 2, 2011: Corporate Governance Committee

1. The successful management of corporations and firms CalSTRS invests in is a key concern of this committee as it directly affects profitability. Staff continues to focus their engagement efforts on three major areas:
 - Corporate governance, (boards and management)
 - Diversity and Sustainability
 - Risk Management

- "CalSTRS Investment Office is part of the Mercer asset allocation study that considered the potential effects of climate change on pension fund portfolios."
- 2. CalSTRS participates in coalitions of partners, stakeholders, and professional organizations to promote:
 - best practices; the impact of corporate governance activities
 - engagement with companies by attending a variety of meetings; maintaining communications
 - voting its proxies:
 - public policy; regulations that affect the operations of corporations and CalSTRS and the ability of CalSTRS to protect its investment interests (SEC, Capitol Hill activities, Professional Advocate)
- 3. A telecommunication seminar on Corporate Political Spending was presented by Valentina Judge, Associate Director of the Center of Political Accountability. Corporate political spending has become more complex since the Supreme Court ruled for unlimited contributions in the Citizens United case.
 - Political spending inherently carries risk:
 - criticism from stakeholders, the public and the media, affecting
 - brand reputation or business opportunities, and profitability;
 - and/or possibility of enforcement action
 - Citizens United opened an additional pathway to spending, allowing companies to directly and indirectly run ads supporting, or opposing federal candidates.
 - Spending indirectly carries higher risks because of the lack of control companies have in overseeing the spending.
 - The 2010 midterm elections signaled the beginning of a dramatic shift in influence away from national party committees to outside groups not required to disclose their source of funding, and are not held accountable for the content of their ads.
 - CalSTRS and the CPA seek accountability, responsibility, and the right to know. "In summary, CalSTRS supports shareholder proposals calling for disclosure of company policy on campaign contributions and Board oversight on political spending when neither appears to exist."

June 1, 2011: Audits and Risks Management Committee

Items Discussed:

- Working to improve incidents of under and overpayments
 - In 2009-2010 there were over \$43 million in benefit overpayments and \$11 million in underpayments. This can be the result of poor or delayed reporting by school districts. Methods to collect overpayments are being explored. As of June 30, 2010 9,197 accounts remain open and subject to active collection efforts.

During the fiscal year 2009 - 2010 \$9.4 billion was paid to recipients.
- The results of the independent external audit performed by Sjoberg Evashenk Consulting were presented. Some areas received a rating of partially conforms. Areas of concern included changes in the charter, skill improvement of internal auditors, controls against potential fraud, and improvement of internal audits. The

ARM committee voted to follow up and implement the external auditor's recommendations.

- Disaster Preparedness was discussed.
 - In the event of a disaster contingency plans for the resumption of services must be in place. A business resumption center (BRC) is planned for McClellan Business Park which is considered safe. Within 24 hours basic services to members could be resumed. Members would still receive their checks.
 - A disaster recovery site is located out of state with back up servers to protect data.
 - Staff is constantly testing and evaluating different scenarios in order to make sure all systems and data are safe.
- Charter Schools
 - 915 Active Charters; 836 have elected to remain in CalSTRS; 496 are independent charters with unique ID's; 340 have no unique ID's and their data is merged within their districts' reports.
 - The cap increases by 100 each school year and is presently 1,450.
 - 67% of all charter schools are established by corporations.
 - CalSTRS works to insure it receives accurate and timely reports and payments.
- There was a discussion of the "To Do" list as it relates to evaluating risks of various investments.
- There was a discussion of redefining the scope of the committee. ARM would like directive from the full CalSTRS Board and would then proceed in reviewing and refining the committee charter.

CalSTRS Report, July 11, 2011

By Pat Geyer, CalRTA Liaison

Executive Summary

- 1. New benefit counseling district offices and a new accounting computer system resulted in an approximately 8% increase in the CalSTRS operating budget**
- 2. The name of the Absolute Return asset class was changed to Inflation Sensitive asset class.**
- 3. Chris Ailman, CIO reported that the CalSTRS fund is \$154 billion, a 22% return for the 2010-11 fiscal year**

Teachers' Retirement Board

The CalSTRS operating budget for 2011-12 fiscal year increased to \$170.4 million, a 10% increase. Of the approximately \$17 million increase only \$2 million is permanent. One time costs are for new benefit counseling district offices and for a new accounting & resource management computer system. (It seems that business computer program/systems need to be redone at least every 10 years.)

CalSTRS reimburses the employer cost for lost time for those CalSTRS Board members who are members of the Defined Benefit Program. Compensation was increased, due to increased meetings and workload for Board Chairperson (from 40 to 50% of yearly work load), for Investment Committee Chair (45%), for other committee chairs (from 35 to 40%), and for other board members from 30 to 35%. (These employer reimbursements are for the three elected active teacher members.)

The Board reviewed the work plans for the 2011-12 fiscal years. Of interest are an anti-spiking discussion set for September and an unfunded liability discussion in November. GASB is suggesting new rules for amortizing pension liabilities. In April and June the Investment Committee will evaluate having CalSTRS manage the global equity portfolio rather than an outside consultant.

The Board voted to change their position from oppose to neutral if amended for AB 1151 Feuer. This bill would require divestment in companies doing business with Iran. The amendment would allow CalSTRS to divest only if there was no breach of CalSTRS fiduciary duty.

Pat Geyer, CalRTA liaison with STRS, urged the Board continue anti-spiking efforts. Marcia Fritz announced that there would be a new initiative on pension reform. No details were given.

Investment Committee

The Committee changed the name of the Absolute Return asset class to Inflation Sensitive asset class. The fiscal year asset changes were made to Global Equity (54% to 53%), Real Estate (13% to 12%), and Inflation Sensitive (3% to 2%). Long-term targets are Global Equity 47%, Private Equity 12%, Real Estate 15%, Inflation Sensitive 5%, fixed Income 20%, and Cash 1%. The Inflation Sensitive class consists of commodities, TIPS (inflation protected returns), and infrastructure.

The committee approved the Investment Policy and Management Plan and the Investment Business Plan for 2011-12.

Chris Ailman, CIO reported that the CalSTRS fund is \$154 billion, a 22% return for the 2010-11 fiscal year. This is the best yearly return since 1986, but the unfunded liability will increase because not all losses were realized due to a three-year smoothing. The decade from 2000-2010 was a lost decade – worst decade for investment return in 140 years. Present financial concerns are US debt, lack of job growth, residential real estate, inflation, interest rate increase, European debt crisis, and slow Chinese growth.

The next CalSTRS meetings will be September 7, 8, 9, 2011.

CalSTRS Report, September 7,8, 2011

By Pat Geyer, CalRTA Liaison

Audits & Risk Management Committee

Committee heard a report on GASB (Government Accounting Standards Board) proposed rules. (1) GASB wants more accurate values of public equity and hedging. CalSTRS already does this. (2) GASB wants a more conservative accounting of risk assessment and funding status. GASB wants the unfunded liability to be evaluated as earning at the bonds rate, which presently is 4% or less. This would greatly increase the unfunded liability, since presently CalSTRS estimates funding at 7.75% return.

A report was presented on the audits of school districts. 30 school districts are audited in one year out of 1,120 employers. Districts are prioritized by their risk assessment. There was discussion about addition partial audits of problem areas only.

Investment Committee

Alan Emkin, PCA, reported on the economy. Investments will no longer fund pension plans like the 1980's and 90's. There is talk about the bell curve having fat tails. There is a greater possibility of very bad return years. Perhaps the asset allocation should be adjusted for such years of poor returns. Less investments in stocks and bonds. More investment in private equity and real estate. More study is needed. CIO Chris Ailman reported that he would present more information on a Risk-Based Asset Strategy model in the November meeting

The CalSTRS reverse mortgage program is discontinued. It was rarely used. The home loan program for educators has had a 3% delinquency rate. However, payments on the second mortgages issued from 2008-10 are all not due for five years – their may be some losses in the years ahead. The new Home Loan Connection offers an 80-% first mortgage, a 15% second mortgage and 5% down payment.

The CalSTRS fund stands at \$147 billion, down 5% since the July 1 high.

Benefits and Services Committee

Peggy Plett, Deputy Ceo, reported on 2010 statistics: disability applicatants up 15%, deaths up 6%, retirements down 14%. Ed Derman reported that

CalSTRS still struggled to get retirement information read by active teachers. From the survey 77% of the actives were concerned that CalSTRS would not have enough money to pay their retirement.

The new Glendale CalSTRS Service Center will open in 2012.

Client Advisory Committee

Berman Obladia, CalSTRS, reported on legislation. AB 27 Simitian which limits the types of earnings included in final compensation and requires separation from teaching service for 180 days after retirement, has become a 2-year bill. Other bills of interest are included in the handout and will be presented separately.

The meeting adjourned for a reception honoring Peter Reinke, who has left the CalSTRS Board, and Jerilyn Harris, who has completed her term as CalSTRS Board Chair.

Teachers' Retirement Board

The Committee heard a report on the technology infrastructure oversight project. It will oversee the computer program, which will replace the CalSTRS START computer program which is over 10 years old.

SEGAL reviewed the Millimans June 30, 2008 actuarial valuation of the Defined Benefit Supplement, Cash Balance, and Medicare Premium Payment programs. The Defined Benefit program will be reviewed in February. Small changes were suggested: (1) reducing the inflation rate from 3% to 2.75%, (2) Lowering the interest credited to the DBS and CB programs, (3) increasing the longevity predictions, and (4) decreasing disability rates by .25%, same as inflation decrease.

Pension spiking was discussed. In the last 5 years 5-10% of educators had a increase of over 15% in final year compensation. This has an impact on the viability of the fund.

Further discussion of GASB proposal about valuing the earnings of the unfunded liability at the government bonds rate. In addition GASB proposes that the unfunded liability be reflected on employer (school district) balance sheets. Legal Counsel still believes that the State of California continues to be legally responsible for the unfunded liability of CalSTRS. Organizations have only one month to respond to the GASB proposal. Jennifer Baker,

CTA, and other organizations expressed their concerns with the GASB proposal.

The next meetings will be November 2,3,4 at the CalSTRS building.
October 5,6 will be an offsite Board education meeting in the Los Angeles area

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CalSTRS Report, November 2,3,4, 2011

By Pat Geyer, CalRTA Liaison

Executive Summary

- 1. The Glendale Member Service Center, for Los Angeles area members, at 505 North Brand Blvd. is planned to open January 2012.**
- 2. Individual retirement progress reports, including information on Social Security offsets, are available on line. Paper copies will be mailed December 5, 2011**
- 3. CalSTRS voted on 66,572 proxy proposals, a 9% increase. In addition, CalSTRS voted on all foreign proxies, previously, some foreign proxies were voted by the fund managers.**
- 4. The Medicare Premium Payment Program for Medicare, Part A will no longer accept new payees after July 2012**
- 5. The Penalties and Interest Project is a computerized program to help school districts make correct and timely reports to CalSTRS. Implementation is scheduled for spring/summer 2012.**
- 6. Board Oversight of Political Contributions has been added to the Roles and Responsibilities section of the CalSTRS Corporate Governance Program Policies.**
- 7. The California Pension Reform has submitted two initiatives, titled Government Employee Pension Reform Act. Signatures must be submitted by April 20 to make the November election.**
- 8. Joe Dion, CalRTA President, presented a “check” for almost 50 million, representing the value of the volunteer hours donated by CalRTA members**
- 9. A reception was held, honoring CalSTRS Board Members (Jerilyn Harris, Kathy Brugger, and Beth Rogers) with terms ending December 31, 2011.**
- 10. The next CalSTRS meetings will be February 1,2,3, 2012.**
- 11. The CalSTRS fund is \$147.5 billion, up \$9.1 billion in October.**

Audits and Risk Management Committee

The Committee heard the Crowe Horwath, independent auditor's report on the CalSTRS financial statements of June 30, 2011. No problems were detected; however, Crowe Horwath did express some concerns.

- (1) Real Estate does not have a ready market so it is difficult to value the holdings.
- (2) School District audits still contain errors, which require correction.
- (3) CalSTRS still uses manual procedures, which can cause errors. Some manual procedures will continue during 2011-12, until the new computer system is installed.
- (4) There needs to be more sharing of information between the different CalSTRS departments.
- (5) A quarterly report on audit progress is suggested.

The Committee heard the progress report on School Employer Audits. CalSTRS completed 30 final school audit reports in 2010-11. Common findings were incorrectly reporting earnings to the Defined Benefit Program rather than the Defined Benefit Supplement Program; reporting members' earnings as non-member earnings and not paying the CalSTRS employer contribution; sick leave incorrectly reported. Chris Ford, Chief of Staff reported that much progress has been made on perfecting the employer reporting website. Chris believes that the website will improve employer reporting in the future.

Benefits and Services Committee

CalSTRS plans to add information related to community property, helpful to CalSTRS members who are divorcing. The Glendale Member Service Center at 505 North Brand Blvd. is planned to open January 2012. The Glendale Member Service Center will serve members in the Los Angeles area.

Online retirement application forms are available as of June 2011. Individual retirement progress reports are available on line. Paper copies will be mailed December 5, 2011. Information on the Social Security offsets will be added to the reports.

Board Governance Committee

The Committee approved the Strategic Plan Policy.

The Committee heard a panel discussion on the Composition of Public Pension Boards. Nancy Williams (Hewitt Ennis Knupp) presented the following concerns: number of active vs. retired members, appointed vs. elected members, ex-officio members, and the need for investment experts. Professor Weber, Boston University expressed the need for beneficiary members. This is usually coordinated with better fund performance. David Kelly, Chairman of Teacher Retirement System of Texas Board, spoke in favor of retirement system members and the need for outside investment experts. Professor Grundfest, Stanford University, School of Law, spoke in favor of index funds. Board members stated that the CalSTRS Board has a tradition of working together for the benefit of its members.

Corporate Governance Committee

Anne Sheehan, Director of Corporate Governance presented the activity report. CalSTRS was present and presented at a number of conferences. It promoted majority voting with a number of companies including Coca Cola, Shiseido, BP, Pfizer, General Mills, and Wal-Mart.

CalSTRS voted on 66,572 proxy proposals, a 9% increase. In addition, CalSTRS voted on all foreign proxies, previously, some foreign proxies were voted by the fund managers. There has been an increase in the number of social and environmental proposals. Work is continuing on the ratio of CEO pay to the average worker pay, but most company and shareholder concern is to link pay to performance. CalSTRS also promotes diversity on corporate boards and sustainability (climate risk management).

CalSTRS continues to monitor the Security and Exchange Commission meetings.

Client Advisory Committee

Ed Derman, Deputy CEO, reported that the Medicare Premium Payment Program for Medicare, Part A will no longer accept new payees after July 2012. Only a few districts have not held elections for Medicare, and there are few members who do not already have Medicare coverage.

Mary Ann Ashley, CalSTRS, reported on legislation. Chaptered (passed) legislation affecting CalSTRS is:

AB 597 (Eng) establishes the Financial Literacy Fund.

AB 873 (Furutani) prohibits specified CalSTRS employees from engaging in certain activities with CalSTRS for a period of up to 4 years. It

also prohibits acting as a placement agent, in connection with CalSTRS for 10 years.

AB 982 (Skinner) requires the State Lands Commission to consolidate school land parcels for renewable energy-related projects.

SB 294 (Price) requires CalPERS and CalSTRS to provide a plan for emerging investment manager participation.

SB 398 (Hernandez) revises the definitions of placement agent.

An update on the Penalties and Interest Project was presented. This is a computerized program to help school districts make correct and timely reports to CalSTRS. The formal public comment period has ended. Next draft regulations will be presented to the Teacher's Retirement Board and to the Office of Administrative Law. Implementation is scheduled for spring/summer 2012.

Investment Committee

Chris Ailman, Chief Investment Officer presented his report. This has been the era of the great de-leveraging: companies-2009, banks-2010, consumers and government-2011. Economic growth slowed. The forecast is for 2.2% GDP growth in the 4th quarter and 2.5% growth through 2012. In the housing market, both new and existing home prices are falling as housing supply continues to be high. Unemployment is still high.

Ailman reports that this is a balance sheet recession not an income recession. The rules are changing. Stocks have seen a huge increase in volatility. All attention is on Europe and who owns the Greek debt. The best U.S. investment in 2011 was U.S. government bonds, up 22%. GDP will likely be low for at least two years. But printing money will result in inflation eventually.

CalSTRS asset allocation is down in global equity and up in private equity and real estate. The revised CalSTRS Long-term Policy Target and Ranges report stated that the variation or range in the asset classes has been increased in order to give more flexibility. In addition, a new asset class (Alpha) allows for up to 3% of the portfolio to be flexible. Alpha can include an "Innovation" portfolio to test different investment ideas, a "Overlay" portfolio spread across the entire asset classes such as currency, and a stable return portfolio which includes the member Home Loan program and the Credit Enhancement. The CalSTRS fund is \$147.5 billion, up \$9.1 billion in October.

The Investment Committee approved a RFP (Request for Proposal) for a private equity consultant. This contract is re-bid every five years; presently PCA (Pension Consulting Alliance) is the consultant.

The fixed income policy is revised to reflect the increase in the asset ranges. The Real Estate Investment Policy benchmark is changed from the NCFEIF/Townsend Fund indices for value added and Opportunistic fund indices to the NCREIF Open End Diversified Core Equity Index, an aggregation of open-end core funds.

The committee approved the addition of Board Oversight of Political Contributions to the Roles and Responsibilities section of the CalSTRS Corporate Governance Program Policies. The committee heard the annual report on currency management and the Currency Program Policy Revision.

The State Lands continue to generate income, but the income from the geothermal Geysers is down. The Cost Effectiveness Benchmarking Report (Global Peers) showed that CalSTRS was low cost (saving \$174 million) because so much of the fund is managed “in house”.

There will be no open Investment Committee meeting in December. The next CalSTRS meetings will be in February

A reception was held, honoring CalSTRS Board Members (Jerilyn Harris, Kathy Brugger, and Beth Rogers) with terms ending December 31, 2011.

Legislative Committee

John Stanton, Washington D.C. reviewed federal legislation for the 2011-12 fiscal year at a Teleconference. The final Elk Hills payment of \$15 million to CalSTRS is going through Congress. Call Diane Feinstein to voice your support.

Mandatory Social Security is “off the table” for now. But there is a need to put Medicare and Medicaid on a more sustainable basis. The Super Committee needs to reach an agreement; otherwise there will be automatic cuts to defense, to health spending, and to education. The “middle road” is gone in Congress so it is difficult to find a compromise.

Teachers' Retirement Board

The CalSTRS operational budget for 2012-13 was approved. There was a small increase in expenses. The information technology contract with the State is higher because CalSTRS is one of fewer users and has to absorb more of the costs.

Jack Ehnes, CEO reported that the Actuary Study on investment assumptions and wage growth will be presented in February and the formal actuary report will be made in April.

At the Berkeley Symposium on Retirement, a UC study was released. The following were some key findings: (1) nearly half of California workers will retire in or near poverty; (2) the situation is worse in California because there are less employee retirement plans; (3) 2/3 of retirees in poverty are women; (4) Social Security served as the retirement income foundation; (5) 54% of workers, age 24-44 are at risk for economic hardship in retirement.

Governor Brown's 12 Point Pension Reform was out October 27, 2011. Points emphasized were (1) Equal sharing of pension costs between employers and employees; (2) Hybrid Plan of 1/3 defined benefit, 1/3 defined contribution, 1/3 social security; (3) Increase the retirement age to 67; (4) Require 3-year final compensation for new employees; (5) Calculate benefits on regular pay for new employees; (6) limit post retirement employment; (7) felons forfeit pension benefits; (8) prohibit retroactive pension benefits; (9) prohibit pension holidays; (10) Prohibit purchase of service credit; (11) Increase pension board independence and expertise; (12) Reduce retiree health costs.

Ed Derman, Deputy CEO, reported that two initiatives titled Government Employee Pension Reform Act of 2012 are filed. The first version proposes to give government employees the same type of retirement as private sector employees, mainly defined contribution plans. The second version is similar to Governor Brown's pension reform proposal. The initiatives, with approved signatures, must be submitted by April 20, 2012 in order to be on the November election ballot. California Pension Reform has submitted the initiatives.

Joe Dion, CalRTA President, presented a "check for almost \$50 million" representing the value of the volunteer hours donated by CalRTA members. Sees candy was given to Board members and attendees.

Rick Reed and Robin Madsen presented a GASB update, including the hearing in San Francisco. CalSTRS suggested establishing a special project to evaluate a cost-sharing plan (school districts, State, employee). A cost-sharing plan would add 10% to the administrative budget since there are approximately 1800 different school districts with different costs. CalSTRS asked that GASB use the municipal bond rate rather than the tax-free rate for evaluating the unfunded liability. GASB statements will be out June 2012.

Brian Bartow, CalSTRS presented the CalSTRS Board annual ethics training.