

CALSTRS REPORT ARCHIVES - 2014

CalSTRS Report, February 5-7, 2014

By Patricia K. Geyer, CalRTA Liaison

CalSTRSreport.com

Summary

1. The Audits and Risk Management Committee approved the Charter Review. The new charter will support a system of enterprise-wide risk management
2. GASB new standards proposal of Fair Value Measurement will begin in 2014. The New Standards will take effect 2015-16
3. The Governor's Budget proposes that work begin on a funding plan, to be enacted as part of the 2015-16 budget, that gradually increases contributions paid by the state, employers, and members to fully fund the DB Program within 30 years.
4. Jack Ehnes, CEO reported that CalSTRS is committed to move forward on increasing CalSTRS funding.
5. Joy Higa has been appointed to the CalSTRS Board by Governor Brown

Audits and Risk Management Committee

The Committee approved the Charter Review. The new charter will support a system of enterprise-wide risk management. The Audits and Risk Management Committee's responsibility is to evaluate the effectiveness of the risk management framework and to review emerging and significant risks specific to the areas of responsibilities of the ARM Committee.

Robin Madsen, CFO and Peggy Plett, Deputy CEO, Benefits and Services reported on corrective action taken in response to the auditor's report. (1) Accurate member data remains a challenge. Management agrees that inaccurate or incomplete member data reported by employers is a primary cause of errors. (2) Five new auditor positions have been added and three more are needed. (3) The goal is to identify errors early because the adjustment to the member's pension will be less. If member paybacks are not sufficient CalSTRS has authority to collect the remaining debt from employers, if the employer caused the error.(Education Code 22008). David Davini, ASCA Retired spoke about his concern about the increase in individual appeals as the result of audits. Ed Foglia, CTA-Retired spoke about his concern that older teachers, long retired could see their pensions reduced because of payment errors. Representatives from CTA, ASCA, Small School Districts and the California Department of Education expressed concerns.

A progress report on audits was presented. GASB new standards proposal of Fair Value Measurement will begin in 2014, with a statement due December 2014. The New Standards

will take effect 2015-16. Kirk Marsten was introduced as the CalSTRS Internal Audit Manager. Many Ann Campbell-Smith present Chief Auditor will retire May 1.

Legislative Committee

The Legislative Committee met to hear the Federal Legislative Report by John Stanton. John Stanton reported that the upcoming elections will influence legislation. The House of Representatives will likely stay Republican because Democrats would have to win 17 seats. The Senate will stay Democrat. There is lack of cooperation. California Democratic delegation is losing influence due to retirement of members.

John Stanton saw the following future challenges: (1) Federal Budget, total spending is capped, (2) Affordable Care Act, (3) Tax Reform. Congress is looking for ways for private capital to help fund infrastructure. This may be an investment opportunity for CalSTRS. There is a crisis coming in retirement because individual savings are inadequate.

Teachers' Retirement Board

The Board heard proposed updates to the Strategic Plan (2012-2017). Some of the changes were to add emerging market managers to provide diversification and add value; to add under Goal 4 object E – Analyze and adopt ways to become more cost-effective while still achieving the board's desired level of service to members and customers.

The Board approved the Risk Management Policy amendments. The Board shall have primary responsibility for CalSTRS enterprise-wide risk oversight, while board committees are chartered with oversight of specific areas of risks.

Ed Derman, Deputy CEO, reported on the impact of further delays in funding. If the funding increase occurred in 2012 14.6% of pay is needed. If funding increase was delayed to 2017, 23.7% increase as a percent of pay is needed. The Governor's Budget proposes that work begin on a funding plan, to be enacted as part of the 2015-16 Budget, that gradually increases contributions paid by the state, employers, and members to fully fund the DB Program within 30 years. CalSTRS is still committed to funding now because waiting is expensive.

Jack Ehnes, CEO reported that CalSTRS is committed to move forward on increasing CalSTRS funding. The options are (1) incorporate funding into trailer legislation as part of the 2014-15 budget, (2) including funding as part of the January 2015 proposed state budget, (3) passage through specific legislation such as AB 6121 (Bonta) which is serving as a placeholder.

The Board heard an update on the BusinessRenew Computer projects.

Joy Higa has been appointed to the CalSTRS Board by Governor Brown. She has held multiple positions at Untied Health Group since 2006. Previously Joy held positions at the California State Controller's Office (2004-06) and at the Office of Governor Gray Davis (2003).

The material below was prepared by Paula Weiss
February 7, 2014

Client Advisory Committee

On February 19, 2014 at 10:30 in room 444 there will be an informational hearing on CalSTRS unfunded actuarial obligation. There will be two additional hearings. Prop 98 issues need to be explored. The shortfall has accumulated over decades. A spot bill is available to carry the language. Legislation may be presented by the end of August, or possibly with budget bills in June.

The Reed anti-pension initiative is essentially dead. A lawsuit has been filed to get the title and summary language changed, but that most likely will not leave enough time to gather signatures. Reed may try again in 2016.

The annual fund valuation for fiscal 2012 - 2013 will be presented at the April 2014 meetings. A CAFR (comprehensive annual financial report) will also be prepared. These documents are necessary to prepare the GASB and other financial reports.

A GASB (Governmental Accounting Standards Board) update was presented and discussed. Agencies are still waiting for additional guidance material. CalSTRS is making every effort to reach and train personnel in county offices and school districts. The discussions have been fruitful. We now know the distribution breakdown of the GASB Net Pension Liability on the employers' balance sheets. The NPL has been calculated as \$167 billion. 37% of that number will appear on the State's statement. 63% will be distributed proportionately on the 1700 state school districts. The timeline for posting this information is fluid and there are possible scenarios. The decisions on district numbers will be made in April of next year. It is important to remember the GASB numbers are for GASB only. The actuarial unfunded obligation remains the same and is considered the "real" number by CalSTRS.

There was a long discussion about overpayments to retirees. \$50 million in over payments have been made this year. That money is not available for investments. Mistakes are made by all those involved, from computer errors, CalSTRS errors, district reporting errors, confusion about funds that should go into DBS instead of DB, confusion about what constitutes credible compensation, and unfortunately efforts to spike pensions. IRS requires overpayments to be collected, first from the retiree, and if not paid in full, from the school district. There is a 3 year statute of limitation for collection from the date an audit finds the discrepancy. A pension plan must be administered according to IRS code to retain its IRS tax qualification

Active teachers receive annual retirement reports. Starting next year those reports will only be sent electronically unless there is a written request. This report should be reviewed carefully for potential errors. It is especially important for those nearing retirement because errors that result in overpayment can also result in the member having to repay that amount up to 5% from each

pension check. That can be a real hardship for the member. Pre retirement counseling is also very important for a secure retirement.

CIO (Chief Investment Officer) Chris Ailman dropped in to say hello. Today CalSTRS is valued at almost \$ 176 billion. A market selloff in January has resulted in the drop in value. Longevity for California teachers is the highest in the nation. Those who are 60 can expect to live another 27 years. There are about 500 members over 100. 72% of members are women, nonsmokers, and drink red wine.

Investment Committee

The value of the pension is about \$176 billion, down from \$181 billion at the end of December. There is a negative cash flow of about 1/2 billion a month. Chris Ailman, CIO, reported that the "markets got ahead of themselves" and there was a selloff (-2.5%) in January. US equities were up 33%, but the EU is an "albatross." CalSTRS' portfolio out performed its benchmark in 5 out of 6 classes. Fixed income was "less down." Real corporate earnings declined. Profits were made from cutting, not from growth. Ailman said, "We can't cut our way to growth." Many companies, (tech) are still sitting on large amounts of cash. GDP is predicted to grow slowly, between 2-3% through 2014 - 2016. Risks to the economy include partisan conflict over raising the debt ceiling and fears within the market.

The state has approved the position of deputy chief investment officer. Michelle Cunningham is acting in that capacity. Other positions have opened up, and Mr. Ailman reports that the improved salary structure has been great for recruitment. Top level senior investors from other funds have been applying.

The Board then explored policy revisions for Global Equity, Real Estate, and Infrastructure investments. Staff was requesting more flexibility for external, active management for Global Equity. In real estate, the benchmark should reflect the strategy which emphasizes lower risk investments. The Board will revisit these proposals in April. I believe the changes in the infrastructure policy were approved.

Investment is understaffed. There may be 2 or 3 new hires by the summer.

Brian Bartow, general attorney and legal advisor to the Board, presented a proposal requesting the hiring of an additional attorney specializing in foreign equity. International law and courts operate under different rules. This was the first reading and will be returned to the Board for further review and discussion.

There is a need to review the policy on investment in CA. What goals do we want for CA? What does it mean to be a CA investment when so many companies are global? Since this is an election year, CA investing could be a high profile issue.

The next investment committee meeting will be April 7-9 and will be long.

CalSTRS Report, April 2-4, 2014

By Patricia K. Geyer, CalRTA Liaison
CalSTRSreport.com

Summary

1. The Benefits and Services Committee adopted new interest, credit and contribution rates for 2014-15; the results showed little change.
2. Performance measures for the new Innovation and the Infrastructure Asset Class Managers were discussed.
3. The Board elected Harry Keiley Chair and Sharon Hendricks Vice-Chair of the Teachers' Retirement Board.
4. AB 611 (Bonta), if amended, is the vehicle bill to provide additional funds to address the CalSTRS unfunded liability.
5. GASB requires that CalSTRS unfunded liability must be reported on school district balance sheets for the 14-15 school year.
6. The Investment Committee approved the division of duties for PCA (Pension Consulting Alliance), lead consultant, and for Meketa, co-consultant.
7. CalSTRS has assets of \$180.81 billion
8. The next CalSTRS committee and Board meetings will be on June 4,5,6.

Board Governance Committee

The Committee heard a presentation on the Board Policy Manual Revisions. Most of the revisions were organizational or reflected Board changes. A final review will be heard at the June 2014 Committee meeting.

Benefits and Services Committee

The Committee adopted new interest, credit and contribution rates for 2014-15; the results showed little change. The regular interest rate for the defined benefit program remained the same at 7.5%. The credited interest rate for the defined benefit program dropped from .5% to .32%. Minimum interest rates for the cash balance and defined benefit supplement programs increased from 3% to 3.55%. Employer contribution rates for elected officials and for reduced workload programs were slightly reduced from 10.276% to 10.259%. Death benefits stayed the same at \$6,163 for retired and \$24,652 for active members if this option is elected. There was discussion regarding increasing the death benefits, which had not changed for a number of years. It was agreed to not increase benefits while CalSTRS was underfunded.

Peggy Plett, Deputy CEO of Benefits & Services reported that sending the retirement progress reports electronically has resulted in approximately \$500,000 in savings.

Compensation Committee

The Committee heard a discussion of the performance measures for the Innovation and the Infrastructure Asset Classes. It is recommended that the benchmark for performance in these classes be a blend of the underlying asset classes. Therefore, the Innovation and Risk Director's performance evaluation would be based on (50%) the average of the five asset classes, (30%) on the total fund, and (20%) on personal performance. The Infrastructure Portfolio Manager's performance evaluation would be based on (50%) total fund and (50%) on personal performance. When these new classes are "built out" the incentive will be based on the performance of the specific assets in the class.

CalSTRS staff will begin preparing a job analysis and class specification for a new Associate Portfolio Manager classification. This position will offer a career path and be a bridge between the Investment Officer and the Portfolio Manager positions.

Teachers' Retirement Board

The Board elected Harry Keiley Chair and Sharon Hendricks Vice-Chair of the Teachers' Retirement Board, both are representatives of active teachers. Dana Dillon was thanked for her service as Chair, and will continue as a member of the Board.

The Board heard an update on the California Teachers Study. The Study began in 1995 with a survey of 133,000 teachers of which 76% remain in the study. The newest part of the study is a project by the National Cancer Institute to study risk factors in the effort to better predict who may be at risk of developing cancer.

Under budget changes an increase of \$2.75 million was approved for the Information Technology Project and funds for an addition of 1 administrative assistant position for Corporate Governance. The Board approved modifications to the creditable compensation regulations for those members of the 2% at 60 retirement regulations. The purpose is to clarify compensation increases which are inconsistent and which should go to Defined Benefit Supplement not Defined Benefit.

The Board adopted the June 30, 2013 Actuarial Valuation of the Defined Benefit Program. As of that date the unfunded obligation was \$73.7 billion an increase of \$2.7 billion from the June 2012 year. The increase in the unfunded obligation was less than predicted because of an investment return of 13.9% above the assumed return of 7.5%. In addition earnings by Defined Benefit members were lower than expected. CalSTRS will continue to need a rate of 16.059% of pay to fully fund the program.

The Board also adopted the June 30, 2013 actuarial valuations of the Defined Benefit Supplement, Cash Balance, and Supplemental Benefit Maintenance Accounts. The SBMA payments will remain the same (bring retirement earnings up to 85% of original purchasing power). There are sufficient funds in the SBMA to increase purchasing power to 90%, but

it was decided not to make any increases until DB unfunded liability problems are resolved.

The Board adopted the actuarial assumptions used by the Defined Benefit and Defined Benefit Supplement Programs as the assumptions for GASB 67 financial reporting except when required otherwise. The Board adopted the 20-year Bond Municipal General obligation Index as the bond index rate to use if GASB requires that.

The Board heard a presentation of the legal framework for adjusting member contributions based on vesting the 2% COLA.

CEO Jack Ehnes reported that the first hearing on funding strategy was held on February 18 by the Assembly Public Employees, Retirement and Social Security Committee. A second hearing was held on March 19 and a third on April 9. AB 611 (Bonta) is the vehicle bill to provide additional funding to address the CalSTRS unfunded liability. The final payment of Elk Hills is in the proposed 2015 Federal Budget.

Client Advisory

Joycelyn Martinez-Wade reported on State and Federal legislation. AB 611 Bonta is the Assembly bill to provide funds to solve the CalSTRS unfunded liability. The legislation is presently being heard in the Senate Retirement Committee.

Ellen Maurizio discussed the Power Point on Creditable Compensation Regulations. The Power Point is available through the CalSTRS website. Krista Noonan reported that CalSTRS is on Facebook and Twitter. CalSTRS is also on Pintrist (a virtual bulletin board). All CalSTRS programs direct visitors to the CalSTRS website. Phillip Burkhold gave a GASB update. The CalSTRS unfunded liability must be reported on school districts balance sheets for the 14-15 school year. The amount for each district will be based on the number of CalSTRS members who are district employees.

Investment Committee

Allan Emkin, PCA gave the CalSTRS Semi-annual Performance Report. As of December 2013, CalSTRS had a value of \$181.2 billion. It was a good year for CalSTRS, but one can't expect such returns every year. Presently, no investment classes look cheap, and low interest rates will likely increase in the future.

Micolyn Magee, Townsend Group gave the Semi-annual Performance Report on Real Estate. It has been a good year of growth in Real Estate. Private equity has outperformed its benchmark, due to many recent acquisitions. Concerns are about possible future interest rate increases.

Chris Ailman gave the CIO report. CalSTRS has assets of \$180.81 billion. Concerns are about the Federal Reserve tapering bond purchases and rising interest rates. Interest rates could increase about 1% a year and return to the long-term average of 3-4% with

the 30 year bond paying 7-8% interest. Michelle Cunningham presented the revision of the Investment Committee's Charter to include responsibility for Pension2 as well as Defined Benefit Plans. The Global Equity Policy was revised to allow more internally managed strategies in accordance with Board policy. The Real Estate Policy benchmark was adjusted to match the benchmark approved in the CalSTRS Investment Policy and Management Plan. Global Equity Policy was updated to give staff additional internally managed strategies also.

At the December Investment Committee meeting, the committee chose PCA (Pension Consulting Alliance) and Meketa Investment Group, to serve as lead and co-consultant. The division of duties is agreed upon as follows: PCA duties include: (1) Full service comprehensive general investment consulting. (2) Participation in the tri-annual asset allocation study (due 2015). Meketa duties include: (1) Research and analysis on two major Investment Committee projects each year. (2) Monitor and comment on the fund's strategic asset allocation, (3) Participation in the tri-annual asset allocation study (due 2015). The Committee approved the division of duties.

CALSTRS REPORT: July 11, 2014

Prepared by Paula H. Weiss

Teachers Regular Board Meeting

1. Approved new creditable compensation regulations with 15 days for public comments
2. Accepted the work plans for the appeals, audits and risk management, benefits and services, board governance, compensation, legislative, and investment committees
3. Approved the 2014-15 operating budget of \$247.3 million an increase of \$70 million

Increased costs:

- a. salaries, \$3.9 million
 - b. start up costs for new service centers in Irvine, followed by one in the Inland Empire; already up and running Santa Clara, and Glendale centers
 - c. \$61.6 million for technology projects
 - d. added costs of implementing GASB requirements including assistance to school districts
 - e. For fiscal year 2014-15, CalSTRS estimates cash inflows of + \$32.790 B; cash outflows of \$12.880 B for an estimated net inflow: \$19.910 billion. Prior to increasing contributions we were losing \$15 M a day. However, until new contribution rates are fully implemented, a negative cash flow will exist. Board will monitor.
4. Reviewed the annual Business Plan which provides a strategic plan, vision, mission and core values, and goals
 - a. The plan provides analysis of strengths and weakness, opportunities and threats
 - b. It provides activities to accomplish goals and objectives
 5. CEO Jack Ehnes presented his report

Discussed components of the newly enacted CalSTRS full funding plan (see links below)

<http://www.calstrs.com/calstrs-2014-funding-plan>

http://www.calstrs.com/sites/main/files/file-attachments/ab_1469_factsheet2014.pdf

6. Update on Business Renew (technology improvement plan)

Things are going as planned, but there are delays in data preparation

Investment Committee

- Chief Investment Officer's Report, Christopher Ailman
 - As of June 30, 2014 CalSTRS was valued at \$189.1 billion
 - With an asset breakdown as of 3/31/2014:
 - Global Equities; \$103 B
 - Fixed income; \$28.7 B
 - Real Estate; \$22.6 B
 - Private equity; \$21.8 B
 - Corporate Governance \$4.6 B
 - Infrastructure \$1.25 B
 - Innovation and Risk \$1.063 M

To see the CalSTRS news release of July 14, 2014, visit this website:

<http://www.calstrs.com/news-release/calstrs-reports-second-year-healthy-investment-returns-2013-14>

- The investment committee voted to approve the use of the State Street Private Equity Index (SSPEI) for determining the benchmark for private equity investments because it will provide a more appropriate measure (less than 10 years). It will be used in conjunction with the Russell 3000 Index plus 3% (300 basis points).
- The Board voted to approve the investment committee's business plans.

To look at the documentation supporting today's meetings go to:

<https://trb.calstrs.com/publicdocs/Page/CalSTRSComWrapper.aspx?PageName=PublicBoardAgenda>

You can access archived video and power point presentations as well.

CalSTRS Report, September 4, 5, 2014

By Patricia K. Geyer, CalRTA Liaison

CalSTRSreport.com

Summary

1. Elections to CalSTRS Board are coming up. The election information packet is on the CalSTRS web site. Deadline for receipt of nomination petitions is March 2, 2015. Elections are held in the fall of 2015
2. Governor Brown signed AB 1469 (Bonta) which increases contributions paid by members, employers, and the state in order to fully fund the Defined Benefit Program by 2046.
3. Jack Ehnes, CEO reported that with the passage of AB 1469 the defined benefit fund has met the GASB funding requirements. Under GASB the Defined Benefit Program will not have to use the lower municipal bond rate to calculate pension liabilities so it and school districts can use the investment return assumption of 7.5%.
4. The CalSTRS fund has outperformed the average of its peers consistently for the last 10 years. One major reason is that CalSTRS has invested more in the United States compared to global equities
5. The CalSTRS fund is \$188 billion.

Audits and Risk Management Committee

The committee heard a progress report on the status of corrective action in response to the June 2013 External Financial Auditor's Report. The two unresolved audit findings are: (1) internal control over member data and (2) internal control over financial reporting. CalSTRS continues to work with employers and county offices of education to increase accuracy of data. An additional emphasis is on improving accuracy of data from community colleges, especially data for part-time instructors.

The annual report of benefit underpayments and overpayments noted that CalSTRS underpaid 16,659 benefits with a value of \$19.2 million. This amount is less than ¼ of 1% of all benefits paid. This amount is similar to the prior fiscal year. CalSTRS overpaid 18,152 benefits with a value of \$48.5 million. The number of payments decreased by 44% and the value decreased by 3.6%. (The previous higher number of payments was due to data cleansing and the amounts were small.) The typical reasons for underpayments and overpayments are employee benefit applications which don't coincide with the employer reporting, and a report of death after the benefit was paid.

An overview of cybersecurity was presented. Hackers want to get member information and sell it, and they want to get investment information. CalSTRS will test its system regularly and have a plan for when it is attacked. Finally, the committee received the summary of the final

internal audit reports for Corporate Accounting and Resource Management project, Service Retirement Benefits Processes, and Valuation of Data Processing.

Benefits and Services Committee

Peggy Plett, Deputy CEO Benefits and Services, reported that the volume of the service credit purchases and the volume of the refund applications are trending down so staff is able to complete 95% in 25 days compared to the former goal of 95% completed in 30 days. Staff turnover is lower so training requirements are fewer and the service is better. Phone calls are all answered in 30 seconds or less. Members can receive full time service credit for up to 10 years even if they only work part time. 13,763 members are presently receiving full time benefit for part time work. Presently 29 members who are elected officials of employee organizations are receiving service credit also.

The Retirement Progress Report will be e-mailed to active members. CalSTRS sends less than 5% by mail which is done only if a member requests it.

Compensation Committee

Incentive criteria were approved for the Chief Operating Investment Officer (formerly Deputy Chief Investment Officer) and for the Director of Inflation Sensitive portfolio. The Chief Operating Investment Officer's incentive compensation will be weighted on 20% performance of total fund, 60% project management and customer service, and 20% on personal performance. The Director of Inflation Sensitive portfolio incentive compensation will be weighted on 50% inflation sensitive portfolio performance, 30% total fund performance, and 20% personal performance.

The committee adopted incentive criteria for the Private Equity Investment Director (50% asset class returns, 30% total fund returns, and 20% personal performance). It also adopted the incentive criteria for Private Equity Portfolio Manager (50% asset class returns, 30% total fund returns, and 20% personal performance).

Teachers' Retirement Board

Elections to CalSTRS Board are coming up. The election information packet is on the CalSTRS web site. Deadline for receipt of nomination petitions is March 2, 2015. Elections are held in the fall of 2015. The three CalSTRS elected Board members are: (1) a pre K-12 or County Office of Education employee, (2) a pre K-12 or County office of Education employee, including administrators, and (3) a community college instructor.

An estimate of 2015-16 STRS income is \$37 billion, an increase of \$5.3 billion. Increases are predicted from investments (\$4 billion), employer contributions (\$.5 billion), state general fund (\$.5 billion), and members (\$.2 billion). Outflows are estimated at \$12.8 billion, an increase of \$.6 billion. The major outflow increase is in benefit payments to members. The final 2015-16 CalSTRS budget will be approved in November.

The pension risk management report showed that the three most important risks were funding, pension administration, and financial reporting.

Ed Derman, Deputy CEO reported that Governor Brown signed AB 1469 (Bonta) which increases contributions paid by members, employers, and the state in order to fully fund the Defined Benefit Program by 2046. The largest increase in contributions will be the employer (school district, etc.) contribution which will increase from 8.8% of payroll in 2014 to a total of 19.1% of payroll by 2020. Jack Ehnes, CEO reported that with the passage of AB 1469 the defined benefit fund has met the GASB funding requirements. Under GASB the Defined Benefit Program will not have to use the lower municipal bond rate to calculate pension liabilities so it and school districts can use the investment return assumption of 7.5%.

Client Advisory Committee

The Committee heard a presentation on the AB 1469 (Bonta) which was also discussed at the meeting of the Teachers' Retirement Board meeting. David Walrath brought up the issue of the Long Term Care Insurance Program (PERS) and the program's increasing costs. There was a discussion about whether CalSTRS had any responsibility for its implied support of the PERS Long Term Care Insurance Program.

Investment Committee

Chris Ailman, Chief Investment Officer reported that the fund was \$188 billion. This has been a good year for equities; however, we may be coming to the end of the present Bull Market. The average Bull Market is five years and this Bull Market has lasted for 66 months. Concerns are: interest rate increases, internet hacking, climate change, and the Middle East crisis.

Alan Emkin, PCA gave the semi-annual performance report. The CalSTRS fund has outperformed the average of its peers consistently for the last 10 years. One major reason is that CalSTRS has invested more in the United States compared to global equities. CalSTRS real estate has outperformed because the U.S. real estate market has been stronger than predicted.

The committee heard a review of the responsible contractor policy. The policy supports and encourages fair wages and fair benefits for workers employed in the construction, maintenance, and operations of CalSTRS properties. This year CalSTRS staff will be holding sessions between August and September 2014. The policy may be expanded to include other real assets such as infrastructure and future farmland investments. The policy revision will be submitted at the November 2014 board meeting.

CalSTRS Report, November 5,6,7, 2014

By Patricia K. Geyer, CalRTA Liaison and Paula Weiss, CalRTA Legislation Committee
CalSTRSreport.com

Summary

1. As of June 30, 2014 CalSTRS total funding was 77% compared to 70% for June 30,2013. Since employer, member, and state contributions were increased beginning July 2014, CalSTRS does not project a depletion of assets. Therefore CalSTRS does not have to report a blended rate using the Bond rate for some assets. (GASB standards require that the pension liability will also be reported in the employers' (school district's) financial statements.)
2. Since 2008 active CalSTRS members have decreased from 459,009 to 416,643. Retired members have increased from 203,649 to 236,487. This probably reflects reduced staffing due to recent school budget problems.
3. The current average age of teachers is older; teachers are starting teaching later compared to ten years ago.
4. John Stanton, by video, presented the emerging priorities of Congress and the Administration. Possible issues are (1) reopening the Dodd/Frank legislation, (2) Legislation to allow the States to get out of funding benefits, (3) possible agreement on Infrastructure, (4) trade agreements, (5) Debt ceiling renewal in 2015.
5. The total CalSTRS budget for 2015-16 is \$272,296,000. There are 1005 CalSTRS employees.
6. The Board plans to sponsor the following legislation in 2015: (1) Modifications to the Penalties and Interest Regulation (2) add the Chief Operating Officer and Chief Financial Officer to the positions for which the Teachers Retirement Board has authority to set conditions of employment and compensation. (3) Clarify the definition of "creditable service". (4) Exempt CalSTRS from State Contracting Requirement when procuring investment related services.

Audits and Risk Management Committee

The independent Auditor's Report by Crowe Horwath on CalSTRS financial statements for the year ended in June 30, 2014 was presented. The following are highlights from the CalSTRS management response. Since 1984-85 investment returns have financed 62% of the retirement benefit. CalSTRS earned approximately 18.7% return for the fiscal year 2013-14; its net after expenses was 14.5%. As of June 30, 2014 CalSTRS total funding was 77% compared to 70% for June 30,2013. Since employer, member, and state contributions were increased beginning July 2014, CalSTRS does not project a depletion of assets. Therefore CalSTRS does not have to

report a blended rate using the Bond rate for some assets. (GASB standards require that the pension liability will also be reported in the employers' (school district's) financial statements.)

Crowe Horwath, auditors, reported a material weakness in control of member data. It suggested annual submission of payroll records by employers and increased compliance audits. CalSTRS responded that technology changes will improve records, but CalSTRS needs legislation in order to have ability to compel employers to provide data corrections when requested.

The Real Estate Investment Audit Report had no high risk findings. Some data management processes were suggested which management has implemented.

II GASB's new accounting rules present challenges to accountants and auditors. Staff at CalSTRS has risen to the occasion producing 2 reports, one reflecting prior criteria and one reflecting the new GASB requirements. Additionally, the proportionate amount of the unfunded liability (cost sharing) needed to be calculated for county, district, individual schools, charters, and community colleges. That information is available in the committee documentation (ARM 76-107, item 2). All open session documentation for November 2014 meetings is available at: <https://trb.calstrs.com/publicdocs/Page/CalSTRSWrapper.aspx?Page Name-PublicBoardAgenda>

CalSTRS is responsible for determining the net pension liability of the State Teachers Retirement Plan. CalSTRS views itself as four separate plans: DB, DBS, CB, and SBMA. GASB views CalSTRS as one plan. General Counsel, Brian Bartow will research this and report back to the Board.

The unfunded liability is now about \$58 billion as of June 2014 (unaudited).

There remains a material weakness in internal controls over member data. This does not pose any threat to members, but seems to be related to audits, data analysis, and computer systems.

Board Governance Committee

The Committee approved the Self-Evaluation Policy for the CalSTRS Board. Board member Sharon Hendricks asked for Board Education to be flexible and allow specific education for specific Board members. Jack Ehnes CEO replied that there might be a cost factor. The Board discussed the amount of training needed for new and existing Board members. Finally the Committee heard the first reading of the Compensation Policy and Procedure.

Compensation Committee

The last review of asset class performance benchmarks including performance relative to peer group was in 2009. The staff will consult with Pension Consulting Alliance (PCA) and return with recommendations for a new review of asset class performance benchmarks.

The Committee heard the proposal for Incentive opportunity for the new position of Associate Portfolio Manager. The recommended maximum incentive is 40% and a salary range of \$108 – \$162 thousand. This position is between the Portfolio Manager whose compensation ranges from \$164-246 thousand and has a maximum incentive from 40% to 75%, and above the Investment Officer III with a compensation of \$95-113 thousand and a maximum incentive of 15%.

Benefits and Services Committee

The Retirement Incentive Program (Education Code 22714) allows districts to offer two additional years of service credit to participating employees who retire and do not return to work for the same employer for five years. However, if the employee does return to work for the same employer within the five years the benefit will be lost or forfeited. During the 2014 calendar year 80 incentives were revoked. CalSTRS is looking for ways to strengthen the language around forfeiture.

Peggy Plett, Deputy CEO Benefits and Services, reported on the 2013-14 Service Objectives Accomplishment Report. Benefits and Services will continue to look at ways to coordinate with the new Pensions Solutions Program. It will be a challenge to implement the new Program and keep service up. Presently they are working to answer all calls in 1-3 minutes.

Ed Derman, Deputy CEO, reported on the demographic characteristics of CalSTRS members. Since 2008 active CalSTRS members have decreased from 459,009 to 416,643. Retired members have increased from 203,649 to 236,487. This probably reflects reduced staffing due to recent school budget problems. 84% of active members work for a K-12 employer and 9% work in Community College. The number of participants in the Cash Balance Benefit Program has decreased due to changes in the incentive program; however, Community College faculty continues to participate. The current average age of teachers is older; teachers are starting teaching later compared to ten years ago.

Ed Derman, Deputy CEO presented policies for determining the credited interest rates and including them in the Board Policy Manual. Generally, the minimum interest rate will be equal to the average amount paid on 30-year U.S. Treasury notes. The Lump Sum Death Benefit for active coverage A members and retired members remains at \$6,163. Loretta Toggenburger, UTLA Retired asked that the lump Sum Death Benefit be increased since costs have increased.

The Committee heard a review of the additional earnings and annuity credits policy. The Defined Benefit Supplement and Cash Balance Programs are overfunded. When should the extra income be credited to member accounts? The concern is if there are low returns in the future then the funds will not be able to meet their promised returns. This is an information item; a decision will be made later.

Teachers' Retirement Board

John Stanton, by video, presented the emerging priorities of Congress and the Administration. Possible issues are (1) reopening the Dodd/Frank legislation, (2) Legislation to allow the States to get out of funding benefits, (3) possible agreement on Infrastructure, (4) trade agreements, (5) Debt ceiling renewal in 2015 (6) Consumer protection is in danger. This will be the first Republican spending program. The remaining Elk Hills payment of \$15 million owed to California needs to be part of a budget bill. The California delegation has lost senior members, but Feinstein and Pelosi are still in Congress. In summary, it is a divided government. Congress recognizes that people have not saved enough for retirement, but they have no government program.

Robin Madsen, CFO presented the proposed 2015-16 CalSTRS operational budget. Salaries and benefits have increased by 51% because of the Pension Solution (technology) funding. In addition there is the expense of opening the San Diego Member Service Center, and the expense of bringing the Investment Portfolio in house rather than hiring outside managers. The total CalSTRS budget for 2015-16 is \$272,296,000. There are 1005 CalSTRS employees. The operational budget was approved.

Mary Anne Ashley, Legislation asked for Board approval that it sponsor the following legislation in 2015. (1) Modifications to the Penalties and Interest Regulation (increase the 5% penalty rate for very late contributions to the same percentage rate as the new state contribution rate). (2) Add the Chief Operating Officer and Chief Financial Officer to the positions for which the Teachers Retirement Board has authority to set conditions of employment and compensation. (3) Clarify the definition of "creditable service". (4) Exempt CalSTRS from State Contracting Requirement when procuring investment related services.

Jack Ehnes, CEO reported that the legislative committee's responsibilities will be absorbed by the full board. The report on the economic impact of CalSTRS investments will be postponed until February.

Client Advisory Committee Meeting

Teresa Gonzales, Sustainability Consultant presented the 2014 Sustainability Report. The 2014 topics are (1) Water Resources/Drought, (2) Climate Change Impact, (3) Carbon-based Risk Strategy, (4) Defined Benefit funding impact, (5) Ethics and transparency, (6) Information Security & Privacy, (7) Diversity & Inclusion, (8) Supply Chain Responsibility, (9) Responsible Contractor Policy, (10) Member Services, (11) Workforce Development, (12) Indirect Economic Impact of CalSTRS Benefits & Investments.

There will be a valuation of the Medicare payment program in April. The funding of the MPP comes from the surplus funds in the DB plan. The present cost of Medicare is \$407 per month. To qualify for the payment you must have retired prior to July 1, 2012, although you did not need to be 65 at that time. If you think you might qualify you should apply

Paula Weiss, CalRTA asked if there was a possibility of extending the Medicare Part A CalSTRS payments to members who did not contribute to Medicare. She mentioned that Sacramento City USD was reducing their payments for medical services for retired members, and some members were not qualified for Medicare. Ed Derman, Deputy CEO replied that the decision of extending Medicare Part A payments would have to be made by the CalSTRS Board.

The material below is prepared by Paula Weiss

Audits and Risk; November 5, 2014:

GASB's new accounting rules present challenges to accountants and auditors. Staff at CalSTRS has risen to the occasion producing 2 reports, one reflecting prior criteria and one reflecting the new GASB requirements. Additionally, the proportionate amount of the unfunded liability (cost sharing) needed to be calculated for county, district, individual schools, charters, and community colleges. That information is available in the committee documentation (ARM 76 - 107; item 2). All open session documentation for November 2014 meetings is available at:

<https://trb.calstrs.com/publicdocs/Page/CalSTRSComWrapper.aspx?PageName=PublicBoardAgenda>

CalSTRS is responsible for determining the net pension liability of the "STRP" (State Teachers Retirement Plan). CalSTRS views itself as four separate plans, DB, DBS, CB, and SBMA. GASB views us as one plan. General Counsel, Brian Bartow will research this and report back to the Board.

The unfunded liability is now around \$ 58 billion as of June 2014 (unaudited).

There remains a material weakness in internal controls over member data. This does not pose any threat to members, but seems to be related to audits, data analysis, and computer systems.

Investments: November 7, 2014

The Board listened to a presentation by Amy Borrus from CII and Michelle Edkins from Blackrock investments. They spoke about the need to pass share holders rights, transparency, diversity on corporate boards, and the need to have majority rather than plurality voting. Ms. Borrus reported that a \$14 Trillion was lost during the Great Recession. Anne Sheenan, CalSTRS Director of the Corporate Governance, votes proxies on CalSTRS investments in support of these goals.

Chris Ailman today's value of CalSTRS was \$187 billion. While we have a "hiccupping" market, it is up 10% since the October decline, equity markets are not over priced and the S&P is above 2030. Fund cash flow has improved. Overall the economy has made steady growth.

The investment committee discussed Responsible Contractor Policy. AS CalSTRS is investing more in infrastructure, it has worked with labor to meet goals. Members of SEIU addressed the Board.

CEM, cost effectiveness measurement, is used to compare CalSTRS with 15 other large institutional investors. CalSTRS costs are \$247 million lower than our peers.

Because of time limitations, discussions of the Green Initiative Task force and ESG report were postponed until February.

Finally, a member of the public addressed the Board about the continued use of fossil fuels. Unless there is change, it is possible that the planet temperature would increase 6 degrees Celsius and our planet would become uninhabitable.