

CalSTRS Report, February 4,5,6, 2015

By Patricia K. Geyer, CalRTA Liaison

CalSTRSreport.com

Summary

- 1. Common School District reporting errors were: (1) not reporting post-retirement earnings, (2) errors in reporting earnings to Defined Benefit rather than Defined Benefit Supplement, (3) incorrectly reporting member's earnings as non-member earnings, and (4) incorrectly reporting sick leave/excess sick leave. 18 school district audits were completed in 2014.**
- 2. A discussion was held on posting additional earnings to the DBS (Defined Benefit Supplement) and CB (Cash Balance) accounts. Decision will be made later**
- 3. The record keeper for the CalSTRS Pension 2 Program has been changed from TIAA-CREF to Voya. As of December 2014, Pension 2 has 8,412 participants with a total balance of \$492,245,169 in the fund**
- 4. CalSTRS investment in California totals \$19.38 billion. The study estimated that 85,000 to 87,000 jobs are supported in California by CalSTRS investments.**
- 5. President Obama signed the budget with the final Elk Hills payment to CalSTRS.**
- 6. The new CalSTRS Riverside service center will open in July 2015.**
- 7. David Blood and Al Gore founded Generation in 2004; the leading Environmental, Social and Governance (ESG) focused investment fund in the world. The Board heard a presentation by David Blood and Al Gore.**
- 8. Sustainability Committee to begin in fiscal year 2015-16. Sharon Hendricks will be committee chair.**
- 9. CalSTRS assets are \$188.2 billion**

Audits and Risk Management Committee

Paul Rosenstiel, Chair introduced Betty Yee, State Controller who is joining the CalSTRS Board.

The Committee heard a panel discussion on Accounting and Financial Reporting for Investments. Issues discussed were (1) how costs are reported, (2) what are the differences across the industry, (3) GASPE requirements. The issue is how to make costs and investments

comparable across various partnerships. The partners, the investments, and asset class all come with different perspectives. The conclusion is that CalSTRS should move toward one consistent form for transparency and standardization.

Larry Jensen presented a progress report on the 2014-16 Audit Plan. 18 employer audit reports are completed including 5 reporting units within the Los Angeles Unified School District. Common errors were: (1) not reporting post-retirement earnings, (2) errors in reporting earnings to Defined Benefit rather than Defined Benefit Supplement, (3) incorrectly reporting member's earnings as non-member earnings, and incorrectly reporting sick leave/excess sick leave. Audit Services completed three internal audits: Business Continuity Management Program, Implementation of new State and Federal legislation, Survivor Benefits Processes, and Tax Compliance and process. On-going reports will be given as additional audits are completed.

Compensation Committee

Recommendations for revisions to the Section 700B of the Board's Policy Manual were presented. Possible revisions discussed were (1) separation of Administrative Procedures from board level responsibilities, (2) revision to performance benchmarks and quantitative/qualitative weighting. Global Governance Advisors suggested the following changes to the CEO incentive criteria:

Long-Range Strategic Planning remains at 40%.
Total Fund Portfolio reduced from 30% to 25%.
Qualitative (Personal) reduced from 30% to 25%,
and a new category, Qualitative (sustainability) 10% added.

Discussion followed about the definition of sustainability. Global Governance Advisors explained that Sustainability refers to sustaining the organization as well as sustaining the environment. Final action on Policy Manual changes will be taken at the June Board meeting.

The Committee discussed incentive opportunity ranges for the position of Associate Portfolio Manager. One plan was to an incentive opportunity of 40%; a second plan was to gradually increase the incentive from 20% for the first year, 30% for the second year, up to 40% for the third year. Much discussion followed. A final decision will be made at the June meeting.

Benefits and Services Committee

A discussion was held on posting additional earnings to the DBS (Defined Benefit Supplement) and CB (Cash Balance) accounts. The trade-off was between maintaining an adequate level of funding and allocating the earnings back to the members. Under current policy with the funded ratio of the DBS account at 9.62% over, and this exceeded the first threshold of 6% over and exceed the long term rate of return of 7.5%. Thus the full 3.61% was granted. The question is should the additional earnings be granted. A discussion followed. Members who plan to retire

soon would like the full amount granted because they would not benefit from additional earnings which might be added later. However, granting additional returns might leave the fund in deficit if the market has poor returns. Decision will be made later.

The record keeper for the CalSTRS Pension 2 Program has been changed from TIAA-CREF to Voya. The LAUSD 457b program has been under the Pension 2 plan. LAUSD decided to stay with TIAA-CREF so CalSTRS has agreed. As of December 2014, Pension 2 has 8,412 participants with a total balance of \$492,245.169 in the fund.

Teachers' Retirement Board

Data preparation is essential for the success of the new computer program. A data cleansing program has been approved, and SoftSol will be helping with the data preparation.

The Board heard a presentation on the Actuarial Valuation Policy. Milliman will determine employer and state contribution amounts for three areas of the defined benefit program (1) 1990 benefits, (2) Pre-2014 benefits, and (3) the total DB program. Milliman will determine the amortization structure which will meet the requirements of AB1469 (Bonta). AB 1469 does not cover any funding obligation for new benefits earned after June 30, 2014.

Mary Anne Ashley reported that legislation so far included Senate Joint Resolution 1 (Beall) to repeal the WEP/GPO. This resolution will be sent to Congress with the hope that Congress will act.

Ed Derman reported on the Study of Impact of CalSTRS Investments on California economy. CalSTRS investments in California total \$19.38 billion. The study estimated that 85,000 to 87,000 jobs are supported in California by CalSTRS investments.

Robin Madsen gave the System Risk Management Report. Top risks are pension funding, pension administration, information security.

Jack Ehnes presented the CEO Report. President Obama signed the budget with the final Elk Hills payment to CalSTRS. Senate Bill 1234 authorized the establishment of the Secure Choice Retirement Savings Program. The goal is to provide a retirement savings vehicle for California workers who have no access to retirement savings plans through their employers. California is in the process of completing a market analysis, feasibility study and program design. CalSTRS has signed the lease on the new member service center in Riverside. The Riverside service center will open in July 2015.

Client Advisory Committee

Lucy Arbuckle reported that 97 employer audits are to be completed by June. CalSTRS has sent letters to Superintendents and has a Webinar on the GASB update. Committee adjourned to hear a presentation by Al Gore.

Teachers' Retirement Board

Climate change and sustainable investing are addressed in the CalSTRS Investment Policy and more specifically in the Environmental, Social and Governance, 21 Risk Factors. CalSTRS was Generation Investment Management's first U.S. institutional client in June 2007. CalSTRS now has \$542 million in Generation. David Blood and Al Gore founded Generation in 2004. The fund has become one of the leading Environmental, Social and Governance (ESG) focused investment managers in the world. The Board heard a presentation by David Blood and Al Gore.

The Board approved moving the Asset Liability study from the fall of 2015 to the start of 2015. The ESG (Environmental, Social, and Governance) study project will be moved to the Sustainability Committee to begin in fiscal year 2015-16. Sharon Hendricks will be committee chair.

The Board approved the Responsible Contractor Policy. Not all of the unions suggestions were placed in the policy because it could limit the competitiveness of CalSTRS investments and negatively impact investment returns.

The Board received the Diversity in the Management of Investments 2015 Annual Report. CalSTRS received good reports on its diversity. Its staff is diverse – 43% are from ethnic groups.

Chris Ailman, CIO reported that CalSTRS assets are \$188.2 billion. Risks are in U.S. equity, private equity and the possibility of inflation. The market has been flat for the last 6 months, but the long-term trend is up.

Information on the Asset Allocation Study was presented.

PCA suggested four major asset classes: Global Equity, Private Equity, Real Estate, and Fixed Income.

Meketa suggested expanding:

- Global Equity to U.S. Equity, Developed Equity (non-U.S.) Emerging Markets Equity.
- Fixed Income to Investment Grade Bonds, High Yield/Bank Loans
- Real Estate to Real Estate-Core, Real Estate-Value Added.
- Private Equity to Private Equity, Private Debt
- Inflation Sensitive to Core Private Infrastructure
- Cash to Cash

Staff and PGA recommended not to hedge the minimum rate of the Defined Benefit Supplement and Cash Balance Benefit Programs.

A presentation was made on changing the benchmark for the Inflation Sensitive asset class from CPI plus 5% to CPI plus 4%. This would put the Inflation Sensitive class in alignment with the Infrastructure Program benchmark. Item will be brought back for a second reading in April.

The committee heard a presentation on Corporate Governance Proxy Voting Guidelines. The Committee also heard an update on the Pension2 Policy Revision. The record-keeper for the program has been changed from TIAA-CREF to VOYA.

CalSTRS Report, April 1, 2, 3, 2015

By Patricia K. Geyer, CalRTA Liaison

CalSTRSreport.com

- 1. Interest rates for the 2015-16 fiscal year were adopted. There was little change.**
- 2. Peggy Plett, Deputy Chief Executive Officer, Benefits and Services is retiring. Her great organizational skills and pleasant manner will be missed.**
- 3. Interest rates for the 2015-16 fiscal year were adopted. See Benefits and Services Committee Report.**
- 4. CalSTRS presently has four member service centers: Sacramento, Glendale, Santa Clara and Irvine. Riverside service center is scheduled to open in the summer of 2015**
- 5. The final Elk Hills payment of \$15 million has been received.**
- 6. The Teachers' Retirement Board elected Harry Keiley Chair and Sharon Hendricks Vice-Chair**
- 7. The Board selected the firm of Harvey Leiderman, Reed Smith as Fiduciary Counsel..**
- 8. The Defined Benefit Supplemental Account (DBS) has additional earnings. The Board voted to allocate an additional 4.5% earnings credit to each account.**
- 9. The California Federation of Teachers (CFT) asked CalSTRS to divest in Freedom Group (gun manufacturers) as stated in the CalSTRS policy.**
- 10. A group of CalSTRS teachers asked CalSTRS to divest in thermal coal. The Board will not take a position until amendments for SB 185 are agreed upon. Chris Ailman stated that CalSTRS will look at the risk, the cost, and the thermal coal securities to be considered in divesting.**
- 11. Harry Keiley and Sharon Hendricks are running for their CalSTRS Board seats unopposed,so they are re-elected to their positions on the CalSTRS Board.**

Dana Dillon and Maggie Ellis are running for the third Board seat so an election for that position will be held in the fall.

12. Meketa Investment Group recommended modeling 13 asset classes because it gave more precision and helped to identify risk. PCA recommended 7 asset classes because each allocation would be more meaningful.

13. The CalSTRS fund is \$192 billion as of April 9, 2015.

14. The next CalSTRS Board meetings are June 10,11,12.

Compensation Committee

The Committee heard a presentation on the compensation policy for executive management and investment staff. The Head of Investment Operations has been renamed Director of Investment Operations in order to be consistent with the other staff. Generally executive management and investment staff are evaluated on:

1. (1) Asset class or specific area of responsibility. For example, the Chief Executive Offices is evaluated on Long-Range planning while the Investment Director –Fixed Income is evaluated on the Asset Class (fixed income portfolio). The weighting ranges from 40-50%
2. (2) Total portfolio return. The weighting is 30% (an exception is for Deputy Chief Investment Officer where the weighting is 50%)
3. (3) Qualitative- personal performance. The weighting ranges from 20-30%.

Global Governance Advisors presented a 10-Year Summary of compensation, and their observations, and recommended that the Board review the analysis and determine whether it is comfortable with any differences. Global Governance Advisors found that rankings for U.S. Equity-Active and Global Equity-

Active (a blend between Active U.S. Equity and Active non-U.S. Equity portfolios) would have been different. The final reading and action on compensation policy will be at the June meeting.

Board Governance Committee

The Committee reviewed the Board Education Policy. Two components of board education were added as a result of AB 1163:

1. Establishes a minimum of 24 hours of education every two years for Board members.
2. Identifies specific topics including fiduciary responsibilities, ethics, pension fund investments, pension fund governance and various other related topics.

Dana Dillon suggested education on benefits, a report on the progress on the unfunded liability, and information technology progress. Harry Keiley suggested a template to help with recording hours.

Information was presented on the organization of reports to the Board. The following are Reports to the Board:

Governance - 10 reports
Funding – 3 reports
Investments - 23 reports
Benefits – 5 reports
Operations – audit and finance - 17 reports Ethics – 3 reports
Legal – 2 reports
State mandates – 9 reports.

Discussion followed. Paul Rosenstiel wanted a list of where the reports are on the web. Harry Keiley wants a special emphasis on Corporate Governance since there is no longer a Governance Committee. Sharon Hendricks wants consolidation, and Tom Unterman wants fewer reports and more broad policy. Further discussion will follow.

CalSTRS member, Ed Foglia made a plea for the appointment of a retired member and a School Board member to the CalSTRS Board.

Benefits and Services Committee

Peggy Plett, Deputy Chief Executive Officer, Benefits and Services is retiring. Her great organizational skills and pleasant manner will be missed.

Interest rates for the 2015-16 fiscal year were adopted. The regular interest rate of 7.5% remains unchanged. The interest rate for the Cash Balance and Defined Benefit Supplement programs decreased from 3.55% to 3.15%. Death Benefits remained the same at \$6,163 for retired members and \$24,652 for active members. The cost for the purchase of service credit has been slightly decreased.

The Medicare Premium Payment Program pays Medicare part A and the surcharge on B for members who retired prior to July 1, 2012 and from an employer who held a Medicare division election prior to January 1, 2001. CalSTRS pays Medicare Part A for 6715 members and Party B for 650 members, a slight decrease from previous years.

CalSTRS presently has four service centers: Sacramento, Glendale, Santa Clara and Irvine. Riverside service center is scheduled to open in the summer of 2015. One additional service center is scheduled

for the San Diego area. Members are encouraged to go to a service center for information as well as to go to the CalSTRS website. Members in northern and eastern rural areas will receive visiting counselors as needed.

Teachers' Retirement Board

John Stanton, Federal Lobbyist for CalSTRS presented his report. The final Elk Hills payment of \$15 million has been appropriated. This is money from the school lands sections of federal lands that were sold for their oil reserves, and the Federal Government did not initially make the payments to CalSTRS. It took some 25 years of legislation. There has been a dramatic shift away from Defined Benefit to Defined Contribution Retirement Plans. (1978 – Defined Benefit Plans 70% and Defined Contribution and IRA's 22%. 2013- Defined Benefit Plans 35% and Defined Contribution and IRA's -60%). The federal administration is proposing a number of plans for infrastructure investment.

There is a new WEP (Windfall Elimination Proposal) for Social Security (House Resolution 711). The Social Security benefits would be computed using all earnings, then multiplied by a percentage of all earnings that were covered by Social Security. Example: if a worker earned 40% of her lifetime earnings from Social Security covered employment, she would get 40% of her Social Security benefit.

The Teachers' Retirement Board elected Harry Keiley Chair and Sharon Hendricks Vice-Chair. The Board approved eight forms of trustee education and travel: (1) attend conferences, (2) university training, (3) deliver speech and attend conference for education, (4) deliver speech only at conference, (5) presentations to stakeholders, (6) meetings with investment managers, (7) board/committee meetings, legislative meetings, (8) meetings associated with management of board/committee meetings.

The Board heard a presentation by Aon Risk Insurance Services West for fiduciary insurance. \$50 to \$75 billion was the suggested coverage. Paul Rosenstiel stated that CalSTRS wanted protection against catastrophic events. A final decision will be made in June.

The Board heard a report on Federal Legislation.

AB 1410 (Nazarian) Public Divestment of Turkish Investment Vehicles – Oppose, CalSTRS will follow its present divestment policy.

SB 185 (DeLeon) Public Divestment of Thermal Coal Companies Act –no position. A group of CalSTRS teachers asked CalSTRS to divest in thermal coal. The Board will not take a position until amendments are agreed upon.

SJR 1 Repeal of the WEP /GPO. CalSTRS voted to support.

A discussion was held on the standards for a district to report directly to CalSTRS rather than to their county office of education. Staff will initiate the rulemaking process. The Chief Executive Officer will schedule and hold related hearings.

The California Federation of Teachers (CFT) asked CalSTRS to divest in Freedom Group (gun manufacturers) as stated in the CalSTRS policy.

The Board heard presentations by three firms for the position of Fiduciary Counsel replacing Ian Lanoff and associates. The firms are (1) Chris Waddell, Olson Hagel ;& Fishburn; (2) Harvey Leiderman, Reed Smith; (3) Marcus Wu, Pillsbury Winthrop Shaw Pittman. The Board selected the firm of Harvey Leiderman, Reed Smith as Fiduciary Counsel.

The Defined Benefit Supplemental Account (DBS) has additional earnings. The Board voted to allocate an additional 4.5% earnings credit to each account.

The Board adopted the actuarial valuation for the Defined Benefit Program as of June 30, 2014. The Board expects additional improvement in the funded ratio for the June 30, 2015 report.

The Board adopted the Actuarial Valuation for the Medicare Premium Payment Program and the Defined Benefit Program. The Technology Project is on track. The Board approved an increase of \$601,000 for the 2015-16 year.

Jack Ehnes, CEO reported that Harry Keiley and Sharon Hendricks are running for their CalSTRS Board seats unopposed, so they are re-elected to their positions on the CalSTRS Board. Dana Dillon and Maggie Ellis are running for the third Board seat so an election for that position will be held in the fall. Jack Ehnes reported that the average U.S. savings are \$12,000 per person. The average American supports pensions and is opposed to social security cuts. The next CalSTRS Board meetings are June 10,11,12.

Client Advisory Committee

The Committee discussed the topics covered in the other committee meetings. However, the following slide presentations are available on the CalSTRS website.

State and Federal Legislative Update GASB Update
Charter School Overview
Medicare Premium Payment Program Pension Solution Replacement Process, Update on VOYA/Pension2

CalSTRS Funding Status

On the web, go to CalSTRS.com. In the upper right box, type in Client Advisory. Click on Meeting Agenda and Materials. All items in red are available, just click on the item of interest.

The CalSTRS fund is \$192 billion as of April 9, 2015.

Investment Committee

The Committee held a discussion on SB 185 DeLeon, Public Divestiture of Thermal Coal Companies Act. Chris Ailman stated that CalSTRS will look at the risk, the cost, and the securities to be considered in divesting. At a future date CalSTRS will come back with a list of companies. If the legislation directs, CalSTRS will begin divesting. Next was a presentation by teachers asking that CalSTRS divest its coal investments and possibly divest other fossil fuel investments. Chris Ailman stated that CalSTRS is talking to other funds about how to address climate and environmental issues.

The Committee heard a detailed discussion of the Asset Classes. Meketa Investment Group recommended modeling 13 asset classes because it gave more precision and helped to identify risk. PCA recommended 7 asset classes because each allocation would be more meaningful. The big issue is the amount of equity. PCA stated that U.S. equity has performed better in the last 4 years, but PCA believes that non-U.S. equity will do better in the future. CalSTRS investments have done better than their peers, but CalSTRS investments have not performed as well as the benchmark because of Private Equity. It is believed that Private Equity will do well in the long run.

The Semi-annual Performance Report on Real Estate stated that CalSTRS is underfunded in real estate, but CalSTRS has out-performed the market, helped by new investments.

Long term Private Equity returns have been satisfactory, and non-U.S. private equity returns have been outstanding. Over the 2014 calendar year CalSTRS made 33 new commitments totaling \$2.8 billion. It is predicted that Private Equity will move to more transparency in the future.

Ann Sheehan, Director of Corporate Governance presented the Corporate Governance Policy Revisions. This is an update to reflect current market conditions and developments in corporate governance. These reflect Board changes approved in February 2015.

In June the Committee will vote on a list of suggested topics for the 2015-16 work plan. The asset allocation study will be a big committee commitment over the next two meetings.

CALSTRS REPORT: June 10, 11, 12, 2015

Meeting Highlights

Prepared by Paula H. Weiss, Area 3, GRC

Summary:

1. The Board continues its efforts to define Sustainability. It voted to form a subcommittee of the investment committee to study and discuss the topic.
2. The Board voted to support HR 973 (full repeal of the WEP/GPO) and to watch HR 711 (adjusts WEP formulas).
3. The Investment committee heard a presentation from environmental advocate, Tom Steyer who spoke of the risk of keeping fossil fuel investments in the portfolio.
4. The fund was valued at \$191 billion on June 12.
5. In a discussion of the proposed pension initiative, it was speculated that should it pass, and the CalSTRS fund become unstable, the unvested cola for retirees, could be at risk. The state would remain the guarantor of the pensions.

Regular Meeting, Teachers Retirement Board:

The Board received training on SUSTAINABILITY from consultants from Mercer Investing. There were many questions and lots of discussion. The components include operational, governance, and investment. There was no clear consensus, many questions, and lots of discussion. Keeping in mind that their constitutional fiduciary responsibility is to prudently satisfy the obligation owed to the CalSTRS membership by assuring their ability to pay benefits, the Board focused on investment and voted to form a subcommittee of the Investment Committee to refine understanding and concepts. The sustainability subcommittee will meet off site and off cycle.

CalSTRS incorporates principles of ESG, (Environmental, Social, and Governance), PRI, (Principals of Responsible Investment, supported by the UN) and the 21 Risk Factors, to guide investment decisions. CIO, Chris Ailman is on the PRI association board.

The CalSTRS Board has been cognizant of Climate Change, and the effects of using fossil fuels. They are actively seeking education on sustainable investments that will produce revenue at or greater than investing in thermal coal and fossil fuel commodities. There is much pressure from the legislature and the public to divest from those investments. However, there doesn't appear to be any rush to do so. Staying engaged with the Board of Directors of these companies, seems to be the strategy for now.

Harvey Leiderman, fiduciary counsel to the CalSTRS board, made a presentation concerning Board liability insurance. He also conducted a training session on fiduciary responsibility.

There was a discussion of the two WEP/GPO bills in the congress, HR 973, and HR 711. The CalSTRS Board took a support position on HR 973 (full repeal) and a watch position on HR 711 (changes the formulas in the WEP). Note: CalRTA supported both bills on Lobby Day in DC.

Investment Committee

The investment committee interviewed the two finalists for the position of Private Equity Counsel to the Board. After much discussion a one year contract was awarded to the Meketa investment group with specifications for negotiations.

Renowned environmental advocate, Tom Steyer posed questions and considerations to the Board as he shared his thinking. He stated that he had divested from all coal and fossil fuel investments. As the global economy transition from fossil fuel energy into the use of renewables such as solar and wind the value of fossil fuels is going down while the value of investments in renewable energy is increasing. The cost of renewables is going down making it more accessible to ordinary people. It is possible fossil fuel commodities will be "stranded" or undeveloped. There are 500,000 new clean energy jobs. Another consideration is the harm the use of fossil fuels is doing to people and the environment. Mr. Steyer said CalSTRS must determine if they can produce investment returns equal to or better than their present energy investments. They need to compare the options of divestment or engagement. CalSTRS must determine the correct balance for our pension.

CIO, Chris Ailman gave his report. Today the balance in the fund is \$191 billion down from the \$193 billion on 4/30. The market has been volatile.

The Board received asset allocation studies from their consultants, Meketa and PCA.

Please Note: Because of CalSTRS scheduling overlap, and other CalRTA meetings, I was unable to stay for the entire sessions of the regular board and investment committee. You can view the agendas and the presentation slides at:

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

The videos of these board meetings should be released in a week or two. Check this website if you are interested in seeing them: <http://www.calstrs.com/board-meeting-video-archive>

Other sources of video material on YouTube: CalSTRS YouTube website:

<https://www.youtube.com/user/myCalSTRS>

De-Carbonize portfolio: <https://www.youtube.com/watch?v=HsfEn0GJuDk>

The Board welcomed its new member, Nora Vargas, school board appointment by Governor Brown.

Client Advisory Committee:

Ed Derman introduced Andrew Roth, the new Executive Officer of Benefits & Services. Andrew replaces Peggy Plett who has retired. He will co-lead the Client Advisory Committee.

Mary Anne Ashley reviewed legislation with us including HR 973 and HR 711.

Chris Caietti provided us with an update and status of the Pension Solution Project. Things are going well. Andrew Roth is a new project co-sponsor. Randy Doyle was hired to be the project

manager. Pension solution is the new technology project to update CalSTRS infrastructure. The project has a 5 year rollout.

Robin Masden, chief financial officer, discussed excess contributions caused by AB 1469. This only affects actives. DB contributions and DBS contributions are computed at different rates. DBS remains at 8%, but has been charged at the DB rate which is higher and which will increase. The excess funds are sent to the districts and are supposed to be refunded to the employee. Teachers should be sure to check their annual statements which are online.

Glenn Hosokawa and his team of fixed income portfolio managers educated us on the importance of fixed income assets in a diversified portfolio. They provide liquid assets to pay benefits. It is composed of bonds, treasuries, and other securities. Purchasing these equities on foreign markets requires currency hedging.

We had a discussion on the new proposed pension initiative. Hypothetically, if our pension fund were to become underfunded, the retiree's cola which is not vested could be at risk.

Audits, Risk and Management (ARM) Committee

In the next year CalSTRS will conduct both internal and external Quality Assurance Reviews (QAR). The external review will be performed by one of the companies in the "vender pool."

The annual risk assessment of K-14 including county offices and charter school will focus primarily on 27 of the high risk districts. Attention will be paid to high income situations to avoid spiking. There are over 1800 district in total. The number of audits that can be done is limited by budget and time. Some of the auditors are called away to testify in court.

The Board would like to see more audits done.

Compensation:

The Board is committed to have a fair and consistent incentive plan. It constantly strives to clarify and define the compensation policy. There is a very competitive market for pension and investment staff. The Board voted to approve the recommendation by staff to revise the policy.

Board of Governance:

The Board is trying to make its functioning more efficient. There are many reports to read and the Board has expressed the desire to have them prioritize. A table listing all reports and when to expect them has been compiled. The Board is planning to do a self assessment.

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Teachers' Retirement Board

The Board reviewed the agenda for the 2015-16 fiscal year. Agenda items of interest are:

1. A presentation of research on retirement readiness in September followed by a presentation on the retirement savings crisis in November.
2. A special presentation on Cybersecurity scheduled for the April meeting.
3. During the June Board meeting a discussion is planned on increasing the SBMA payments. Presently the SBMA (Supplemental Benefits Maintenance Account) increases benefits to provide 85% purchasing power. If additional funds are available there may be a discussion about extending some of the 2000 benefits to members who retired before 2000.
4. The June Board meeting will look at increasing the lump sum death benefit which has not been increased for 13 years.

Jack Ehnes, CEO introduced David Lamoureux who is the new Deputy Chief Actuary. David comes from PERS and has 15 years of actuary experience. Jack Ehnes presented the SWOT Analysis (Strengths, Weaknesses, Opportunities, and Threats).

Goal 1 (ensure a financially sound retirement system) has been achieved.

Goal 2 (responsibly manage risk) needs continuing work.

Goal 3 (enhance services to members) has been achieved.

Goal 4 (improve the work environment and efficiency) is continuing.

An additional challenge is if the Pension Reform Initiative qualifies for the ballot.

Investment Committee

Christopher Ailman, CIO reported that the '14-'15 fiscal year has been flat. Assets increased slightly from \$189 billion to \$193 billion as of May 29. Small stocks slightly outperformed the market while foreign stocks lost 3% because of the increased value of the dollar. U.S. real estate in coastal cities did well: however, developed markets, emerging markets and Canada did poorly. Greece and China pose economic risks. The stock market will be flat for the next six months though foreigners continue to purchase U.S. stocks. Chris Ailman believes that bonds and equities are moving together. The model will favor investing in emerging markets, but this is difficult and will take longer to implement.

The Committee approved the minimum and maximum constraints that PCA and Meketa advised.

The challenge will be for CalSTRS to make 7.5% or \$15 billion in the next fiscal year. CalSTRS will seek candidates for a new position of consultant for public relations in order to free Chris Ailman to focus on investments.

As of June 30, 2015 the CalSTRS fund stands at \$191.4 billion.

CalSTRS Report, November 4,5, 2015
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Summary

1. CalSTRS assets are \$187.8 billion
2. The Committee adopted Asset Allocation Policy Option 1 (with Risk Mitigating Strategies)
3. SB185 (De Leon), which requires CalSTRS and CalPERS to divest in thermal coal, has passed. (The divestment is not to affect investment returns.)
4. Ed Foglia, CTA/NEA Retired, spoke emphatically about the need for a retired member on the CalSTRS Board. He asked that the CalSTRS Board write a letter to Governor Brown requesting that he make the appointment. Board and staff agreed to pursue the matter.
5. The Board approved the item to sponsor two legislative proposals in 2016. (1) Legislation authorizing CalSTRS to obtain payroll data from the Employment Development Department in order to comply with GASB's new reporting requirements. (2) Employer monthly reports will be delinquent one calendar day after they are due to CalSTRS.

Audits and Risk Management Committee

The Committee accepted the Independent Auditor's Report. The financial highlights noted that there was very little change in the net position of \$191,822,236 for the 2014-15 fiscal year compared to \$190,474,016 for the fiscal year of 2013-14. Other information of interest is that CalSTRS unfunded liability will be required to be put on individual school district balance sheets. CalSTRS has improved controls over member data, but it is still a problem.

Larry Jensen, Chief Auditor gave the following oral update. Fourteen audits have been completed along with the audit of private equity. Reports will be available in February. CalSTRS is continuing to work with school districts on accounting issues.

Investment Committee

Chris Ailman, CIO gave the CalSTRS investment report. CalSTRS assets are \$187.8 billion. U.S. equity and private equity are at risk with high price levels. Other risks are possible change in interest rates and what happens in global growth or lack thereof. Commodity prices have continued their five-year decline, and international equity valuations are cheap relative to U.S. equity.

The Committee heard part 6 of the Asset Allocation Study (Adopt new asset allocation targets). The Committee heard and adopted Policy Option 1 (with Risk Mitigating Strategies). The policy

reduces global equity from 51% to 47%; reduces inflation sensitive from 6% to 4%; reduces fixed income from 15% to 12% and adds Risk Mitigating Strategies of 9%. The components of RMS are (1) trend following, (2) long-term (Treasuries), (4) Global Macro, and (4) Systematic Risk Premia (computer models get returns from value, momentum across asset classes). Risk mitigating strategies can reduce negative returns, although they have modestly higher management fees. "A dollar not lost is worth more than a dollar gained."

The Committee heard a presentation on the Corporate Governance Engagement Program. Items of interest were: (1) Proxy access – the right to nominate directors. CalSTRS plans to coordinate with the New York pensions fund and CalPERS on this issue. (2) CalSTRS staff is working to prepare for divestment of thermal coal. (3) CalSTRS continues to promote diversity on corporate boards.

The Committee received the Annual Investment Cost Report. The Committee heard a presentation on two suggested changes to the Real Estate Policy. (1) Increase core real estate from 50% to 60% and (2) reduce opportunistic from 30% to 20%. The purpose is to reduce risk.

Finally, the committee heard a presentation by Jan Vosburg of Fossil Free California urging CalSTRS to divest from companies such as Exxon that produce fossil fuel.

Client Advisory Committee

Joycelyn Martinez-Wade gave the Legislative update. CalSTRS sponsored bills have passed the state legislature. AB 736 (Cooley) adding Chief Operating Officer and Chief Financial Officer to positions for which the CalSTRS Board has authority to establish pay is in Committee. SB185 (De Leon), which requires CalSTRS and CalPERS to divest in thermal coal, has passed. (The divestment is not to affect investment returns.)

The Committee heard a report on Corporate Governance by Brian Rice and Aeisha Mastagni.

Compensation Committee

During the 2014-15 fiscal year the portfolio return did not exceed the benchmark. No incentives were added for that component, but incentives can be added for qualitative components that include personal evaluation. The committee authorized a Request for Proposal (RFP) for compensation consulting services. The salary range for General Counsel was increased by a modest amount. The Committee approved incentive criteria for the Engagement and Compliance positions.

Board Governance Committee

The Committee reviewed the list of reports sent to the CalSTRS Board and Committees. Each Committee is instructed to review its reports and delete unnecessary reports. Next the

Committee reviewed the compliance functions and compliance related polities and legal requirements. Action will be taken at future meetings.

Ed Foglia CTA/NEA Retired spoke emphatically about the need for a retired member on the CalSTRS Board. He asked that the CalSTRS Board write a letter to Governor Brown requesting that he make the appointment. Dana Dillon agreed, but formal action could not be taken because the item was not on the agenda. Board and staff agreed to pursue the matter.

Teachers' Retirement Board Regular Meeting

The Board adopted the 2016-17 fiscal year Operational Budget. The Budget decreased from \$272,604,000 to \$255,000,000 at decrease of \$17,604,000. A major reason for the decrease is that the Enterprise Tech Project is being completed. Investments requested 11 new positions to address the following: (1) a net increase in assets under management, (2) an increase in the complexity of the portfolios, (3) an increase in internal management (offset by decreased amounts paid to external manages).

The Board approved the item to sponsor two legislative proposals in 2016. (1) Legislation authorizes CalSTRS to obtain payroll date from the Employment Development Department in order to comply with GASB's new reporting requirements. (2) Employer monthly reports are delinquent one calendar day after they are due to CalSTRS. (Presently they are allowed 14 days.) Other CalSTRS sponsored legislation of interest is AB 736 (Cooley) which adds the Chief Operating Officer and Chief Financial Officer to those positions for which the Board has authority to establish compensation. AB 963 (Bonilla) clarifies definition of service that can be reported to CalSTRS.

The Board adopted regulations that specify the penalty rate employers are subject to when contributions are sent after March 1 in the year following the fiscal year in which they were due ("extra late contributions"). In addition, the Board adopted minor revisions to the existing Defined Benefit Program.

Jack Ehnes, CEO reported that the next Board meeting is February 3, 4, 2016. Two new pension initiatives have been submitted: (1) the Voter Empowerment Act of 2016 that will require voter approval for new public employees to be enrolled in a defined benefit plan. (2) Government Pension Cap Act of 2016 allows new employees to be able to participate in a defined benefit plan with limitations. Both proposals would undermine CalSTRS funding. Neither pension initiative has qualified yet. CalSTRS has a new Urban Garden outside the CalSTRS building – a place for employees, students, and community to learn and grow together.

The Board heard a report on the National Retirement Savings Study. The results show that on average, household retirement savings have declined over the past two decades and millions are at risk of not having resources necessary to maintain their standard of living in retirement.

John Stanton, Federal Lobbyist for CalSTRS orally presented his report. Generally speaking, other than passing the budget, not much has been done in Congress because the leadership is so divided.