

# CalSTRS Reports 2016

## CalSTRS Report, February 3,4, 5, 2016

By Patricia K. Geyer, CalRTA Liaison

**CalSTRSreport.com**

### Summary

1. The term of Financial Expert expires June 30, 2016. Dr. Yetman has served as Financial Expert since 2007. Interviews for the Financial Expert will be held in June.
2. Gretchen Zeagler reported that she is the person to contact regarding CalSTRS speakers. Her email is [gzeagler@calstrs.com](mailto:gzeagler@calstrs.com)
3. CalSTRS assets are \$186 billion as of December 31, 2015
4. The Committee adopted the Policy of a Risk Mitigating Strategy Investment Class, and staff will return with details later.
5. The Committee voted for CalSTRS to divest in thermal coal.
6. The Subcommittee of the Investment Committee will meet on March 3 in Sacramento.

### Audits and Risk Management Committee

Staff reported on the External Financial Auditor's Report – Corrective Actions. Recommendation #1 Improve controls over member data received from employers. CalSTRS is working on legislation to receive employer payroll data from EDD. The committee received the financial statement audit plan. Final audit is due in November. The term of Financial Expert expires June 30, 2016. Dr. Yetman has served as Financial Expert since 2007. Interviews for the Financial Expert will be held in June.

The Committee heard a progress report on the 2015-16 Audit plan and results. (final report due in December) As of December 2015 24 employer(school) audits were completed. 13 audits are in progress. Common findings are: (1) unreported post-retirement earnings. (2) reported earnings to the Defined Benefit Program rather than to the Defined Benefit Supplement Program, (3) incorrectly reporting sick leave.

### Client Advisory Committee

Joycelyn Martinez-Wade presented the legislative update. AB736 and AB 1052 by Cooley are CalSTRS bills. Ab736 adds the Chief Operating Officer and Chief Financial Officer to positions which CalSTRS has the authority to establish compensation. AB 1052 Authorizes CalSTRS to contract for investment-related services under the board's terms. There are two new bills which CalSTRS will discuss in April. They are AB 1551 which prohibits CalSTRS from investing in businesses that engage in discriminatory practices in compliance with the boycott of Israel. AB 1552 prohibits entering into a contract with a contractor who is engaging in a boycott of a country that is a member of the World Trade organization.

Andrew Roth gave the Pension Solution Update. The new computer program is nearing completion. CalSTRS will be doing an in service for employers on the new computer program. Gretchen Zeagler reported that she is the person to contact regarding CalSTRS speakers. Her email is [gzeagler@calstrs.com](mailto:gzeagler@calstrs.com)

## **Investment Committee**

Chris Ailman gave the CIO report. CalSTRS assets are \$186 billion as of December 31, 2015. U.S equity and real estate valuations are high. Commodity prices continue their five-year decline. Concerns are low levels of inflation and low levels of economic growth.

The Committee discussed adding a Risk Mitigating Strategy Investment Class. Staff recommended the RMS class containing 35% U.S. Treasuries, 40% Trend Following, 15% Global Macro and 10% Risk Premia. The Committee voted for 40% U.S Treasuries, 45% Trend Following, 10% Global Macro, and 5% Risk Premia. The Committee adopted the Policy of a Risk Mitigating Strategy Investment Class, and staff will return with details later.

The Committee heard a presentation on Divestment Policy and U.S. Coal investments. SB185 requires CalPERS and CalSTRS to divest of certain thermal coal companies, subject to CalPERS and CalSTRS fiduciary duties. Coal is a very cheap source of energy, but CalSTRS fund has continually reduced its thermal coal investments. CalSTRS has already divested of Tobacco, Sudan, Iran, and Firearms illegal in California so its passive index already deviates from the U.S. stock market. The public and teachers support coal divestment. The Committee voted for CalSTRS to divest in thermal coal.

The committee voted to add the Investment Cost Project to the Investment Committee work-plan and direct staff to implement the project. This project will track all investment costs not previously included in the annual cost report.

The Subcommittee of the Investment Committee met for the first time in December and January at the Glendale Office. The next meeting of the Subcommittee of the Investment Committee will be March 3 in Sacramento.

The committee heard the annual Green Team report. Since the last report in the fall of 2014 the Green Initiative Task Force has continued to consider green investments, made new commitments in the Inflation Sensitive asset group, and grown our investments in green bonds held in the Fixed Income Portfolio. The committee also heard a report on private equity.

Finally, the committee heard a report on the new asset allocation targets and the new asset class which will impact the Investment policy and management plan. The changes are: a shift of over \$18 billion because of new long-term asset allocation, inclusion of the new Risk Mitigating Strategies Asset Class, and adjusting benchmarks and index references to exclude U.S. coal companies.

## **Teachers' Retirement Board**

The Board heard an overview of the budget process used by CalSTRS as well as a brief history of public sector and CalSTRS budgeting.

Next was a presentation of the Research Study: Are California Teachers Better Off with a Pension or a 401(k)? The study concluded that for the vast majority of California teachers, a defined benefit pension provides greater, more secure retirement income.

Jack Ehlnes, CEO reported on a full schedule for the April 6-8 CalSTRS meetings. The schedule includes election of Board Chair and Vice-Chair, actuarial valuations, cybersecurity report, and federal legislative review. Rick Reed, actuary, announced that the 2014 actuarial investigation of experience (Defined Benefit, Defined Benefit Supplement, Cash Balance Benefit and Medicare Premium Payment programs) will be deferred until 2017 and will include the 2015 data.

The Strategic Plan for 2016-19 was presented. The following themes are: (1) achieve the funding plan and investment return goals, (2) implement the Pension Solution Project, (3) enhance information, education, and programs to members, and (4) shape CalSTRS role as a long-term institutional investor.

The Pension Solution and Data Stabilization programs are progressing as expected. The System Risk Management semi-annual report was presented. A second update will be presented at the September Board meeting.

### **CalSTRS Report, April 6,7,8, 2016**

By Patricia K. Geyer, CalRTA Liaison

**CalSTRSreport.com**

## **Summary**

1. Dana Dillon and Sharon Hendricks were elected Chair and Vice-Chair of the Teachers' Retirement Board.
2. The State contribution rate to the CalSTRS Defined Benefit Fund will increase from 2.87% to 4.3%, and the employer's (school districts) contribution rate will increase from 2.4% to 4.3% starting July 1, 2016.
3. Additional earnings credit of 3.9% will be awarded to the Defined Benefit Supplement Program for the fiscal year of 2014-15.
4. The Supplemental Benefit Maintenance Account (SBMA) to bring retired teacher's retirement payments up to 85% purchasing power will remain the same. Death benefits for retired members will remain the same at \$6,163.

5. The next meeting of the CalSTRS Board and Committees will be June 8-10, 2016. The Investment Subcommittee will meet on May 5, 2016 at the Glendale Member Service Center.
6. On the Federal level, H.R. 711 (Brady) would establish a new formula for the treatment of non-covered earnings in determining Social Security benefits for individuals who turn 62 after 2016. A second formula would lessen the effects of the WEP (windfall elimination program) for current beneficiaries. H.R. 711 is presently in the House Ways and Means Committee.
7. The CalSTRS fund is \$185 billion

## **Compensation Committee**

The Committee interviewed representatives from Global Governance Advisors, Grant Thornton, and McLagan Partners for the position of primary consultant to the committee. The Committee voted to retain Global Governance Advisors (GGA) as the primary consultant to the Compensation Committee.

In 2008 the Investment Committee instructed the Real Estate staff to de-risk the real estate portfolio, but the compensation for performance hurdles was not adjusted. Townsend Group advised the Committee to reduce the maximum compensation performance scale from 150 to 70 basis points return. The Committee adopted the new performance scale. Next the Committee heard a presentation on proposed changes to broaden the CEO delegation authority to make changes in certain parts of the compensation program.

Finally, the Committee reviewed the work plan for 2016-17 and heard that the Chief Executive Officer competitive pay analysis showed that the CalSTRS CEO pay was lower than the market average.

## **Board Governance Committee**

The Committee made technical changes to the Board Policy Manual. Aon Hewitt of Investment Consulting discussed the history of the consulting industry. Investment consulting began in the 1970's. Brokers became consultants and generally were paid by commissions on stock trading. Later investment consulting moved into consulting on real estate. And recently investment consulting has become consulting on all parts of the investment programs.

## **Teachers' Retirement Board**

Dana Dillon and Sharon Hendricks were elected Chair and Vice-Chair of the Teachers' Retirement Board. Tom Torlakson is Chair of the Appeals Committee; Paul Rosenstiel is Chair of the Audits & Risk Management Committee; Dana Dillon is Chair of the Benefits and Services Committee; Betty Yee is Chair of the Board Governance Committee; Harry Keiley is Chair of the Compensation Committee; and Sharon Hendricks is Chair of the Investment Committee.

The funded ratio of the Defined Benefit Program remained the same - 68.5% funded. Assets increased, but the actuarial obligation also increased. The Defined Benefit Program is still projected to be fully funded by 2046. The State contribution rate will increase from 2.87% to 4.3%, and the employer's (school districts) contribution rate will increase from 2.4% to 4.3% starting July 1, 2016.

Additional earnings credit of 3.9% will be awarded to the Defined Benefit Supplement Program for the fiscal year of 2014-15. The Supplemental Benefit Maintenance Account (SBMA) to bring retired teacher's retirement payments up to 85% purchasing power will remain the same. Death benefits for retired members will remain the same at \$6,163.

The next meeting of the CalSTRS Board and Committees will be June 8-10, 2016. The Investment Subcommittee will meet on May 5, 2016 at the Glendale Member Service Center. As CalSTRS staff has increased, the Board will need to consider how to either acquire additional space or how to use existing space more efficiently.

### **Client Advisory Committee**

The committee heard updates on legislation affecting CalSTRS. Details on legislation will be presented to the Board at the June meeting. Of special interest is H.R. 711 (Brady) which would establish a new formula for the treatment of non-covered earnings in determining Social Security benefits for individuals who turn 62 after 2016. A second formula would lessen the effects of the WEP (windfall elimination program) for current beneficiaries. H.R. 711 is presently in the House Committee on Ways & Means.

The CalSTRS Real Estate Program was presented. Andrew Roth presented an update on the Pension Solution computer project for CalSTRS. The next Client Advisory Committee meeting will be June 8.

### **Investment Committee**

Chris Ailman, Chief Investment Officer reported that the CalSTRS fund is \$185 billion. U.S. public equity, private equity, and real estate remain expensive relative to non-U.S. equity. Commodity prices continue their five-year decline. Inflation remained low indicative of low levels of growth and low inflation worldwide. Risks are price of oil, weak company earnings, and uncertainty about the upcoming Presidential election. The present economy presents a challenge for CalSTRS to meet its earnings goals.

Information was presented on the changes to the Investment Policy and Management Plan. The new asset mix and the risk mitigating strategies asset class will be incorporated in the Plan. The CalSTRS custom benchmark will shift to accommodate the new list. A new Reference Portfolio Benchmark will help the public measure the performance of the Total Portfolio. Final action will be taken at the June meeting.

Alan Emkin, PCA reported that it will be hard for CalSTRS to make its 7.5% investment goal in this investment market. A summary of the CalSTRS Investment Beliefs was presented. The Beliefs are: (1) Diversification Benefits, (2) Global Investment Markets are largely, but not Completely Efficient, (3) Long-term Benefits in Managing Investment Costs, (4) Internal Management is a Critical Capability, and (5) Proactive Corporate Governance is Beneficial. A final list will be presented in September with responses from stakeholders surveyed in October.

Micolyn Magee, Townsend Group presented the semi-annual real estate report. Economic uncertainty has risen. All real estate categories are in compliance. The high return category is slightly over limits and will be reduced.

John Haggerty, Meketa Investment Group gave the Private Equity Report. Private equity had a mixed performance compared to the benchmarks, but it achieved a positive value increase for the year. There were no new commitments in 2015; the market was too expensive.

Five teachers made presentations requesting CalSTRS to divest from fossil fuels especially firms that mine coal. They were all very concerned about the pollution from fossil fuels.

Ann Sheehan(CalSTRS) and Mary Hartman Morris (PERS) presented the Diversity Initiative. CalSTRS continues to lead efforts to diversify corporate boards. The committee heard a presentation on the Infrastructure Investment Policy. There will be a blended benchmark between public and private infrastructure. The single asset limit will be increased to \$250 million to recognize the increased size of the assets available.

The committee approved the Innovation Policy. There were no major changes. The Investment Committee Work Plan for 2016-17 was presented. Projects are (1) Investment Beliefs and review of 21 Risk Factors, (2) Investment Cost Project, (3) Subcommittee-Special Mandates, (4) Risk Mitigation Strategies and Global Equity Implementation. The Committee Work Plan will be presented to the CalSTRS Board at the June meeting.

## **CalSTRS Report**

June 8-9, 2016

By Pat Geyer, CalRTA Liaison

### **Investment Committee**

The Committee discussed the following investment beliefs:

1. Diversification Benefits
2. The Global investment markets are largely, but not completely efficient
3. Long-term benefits of managing investment costs
4. Internal management is a critical capability
5. Proactive corporate governance is beneficial
6. CalSTRS can capture an illiquidity risk premium
7. Managing short-term drawdown risk impacts CalSTRS' long-term health

Final decision on beliefs will be made at a future meeting.

Chris Ailman, CIO reported that the CalSTRS fund is \$189 billion compared to last year's \$191 billion. CalSTRS shows a return over 7.5% over the last three years because of a 20% return in the first year. The stock market has been the same since mid 2014. Risks are that: China's economy may slow, Internal computer hacks, Brexit, and the U.S. Presidential election. Rewards are GDP growth and low interest rates. U.S. equity, Private Equity, and Private Real Estate are at high levels. Interest rate change is also a risk.

The Committee reviewed the special mandates – Board ideas for investments. The present special mandates are: Member Home Loan Program, Underserved Urban and Rural California; New & Next Generation Managers, Developing Manager Program, Corporate Government Activists, Energy Star Program and Clean Tech Investments. Should CalSTRS have others? These mandates are to be evaluated over a 3-year cycle. The Special Mandate Policy was adopted. Board member Tom Unterman suggested a mandate on sustainability and a mandate on investing in schools and teaching. Staff will investigate. The Committee heard a review of the Private Equity Program. Buyouts, Venture Capital, and distressed debt contributed to performance. Proactive and Clean Tech programs detracted from value.

The Committee heard proposals for a Global Equity Policy revision. Suggestions were for a transition to global index rates for U.S. and Non-U.S. securities and to revise the Non-U.S. policy benchmark to include small capitalization stocks. The purpose is to move away from a home country bias within global equity.

Next the Committee heard a report on the “Soft Dollar” Program dealing with commissions. Staff feels that a stand-alone soft dollar policy is no longer needed. All investment managers are required to achieve best net execution and act as a fiduciary over CalSTRS assets.

There were two addresses from the public: A request from employees of Palms Casino in Las Vegas for fair labor policies and concerns about a change in policy due to sale of property. (CalSTRS is an investor in Palms Casino.) A request from members was made to divest in fossil fuels.

### **Audits and Risk Management Committee**

The Committee voted to retain Robert Yetman as the Audit Committee Consultant.

Audit Services presented their annual risk assessment. Employer audits showed that the greatest risk factors were: High special compensation, No prior audits in the last five years, Active members nearing retirement with large increases in compensation. Next the Committee heard a presentation on compliance law, which is a new field. It was recommended that CalSTRS implement a compliance program. A discussion followed on the responsibility of the Committee and of the Chief Executive. The Charter of the Audits and Risk Management Committee may need to be changed to reflect the new duties. The Committee approved the motion for a compliance program under the Audits and Risk Management Committee.

The Committee approved the Audit Plan for 2016-17. There will be 55 employer audits, 5 direct reporting audits and 3 limited scope audits. The Committee also approved 11 internal audits, including information security, pension solution program, member data, and operations.

### **Client Advisory Committee**

The Committee heard a report on legislation. AB736 and AB 1052 CalSTRS “housekeeping” bills are moving. AB2833 (Cooley) requires California public pension systems to disclose fees and expenses for each alternative investment vehicle is moving. AB 2833 will be presented to the CalSTRS Board. Federal legislation of concern is H.R. 711 (Brady) which establishes a new formula for the treatment on non-covered earnings in determining Social Security benefits to replace the WEP and GPO. It prescribes a second formula to lessen the effects of the WEP for current beneficiaries. CalSTRS will watch these bills which will affect the current WEP and GPO offsets for retirees and for teachers.

The Committee heard a report on CalSTRS sustainability program. Material issues are: Defined Benefit/Plan Funding, Ethics and Transparency, Information Security and Privacy, Member Services and Engagement, Carbon-Based Investment Risk, Workforce Development, and Water Resources.

### **Compensation Committee**



The Committee approved incentive performance criteria for Risk Mitigating Strategies, Innovation, Risk, Global Equity, Private Equity. The Risk Mitigating Strategies will move from one incentive rating to specific incentive ratings which reflect the evolution of this class and the role of the various managers and director. In the Global Equity class has a move to first assess the regional structure (U.S./non U.S) and second to give active passive consideration. In Private Equity reduces the incentive compensation from 150 basis points to 70 which gives less incentive to risk taking.

The Committee approved a proposal to broaden the delegated authority of the Chief Executive Officer (CEO). New delegation to the CEO is to coordinate review with compensation committee consultants, and to update the committee on results of labor market data, approve changes.

### **Teachers' Retirement Board**

The Committee approved new committee assignments. Dana Dillon will chair the Board and the Compensation Committee. Sharon Hendricks will chair the Benefits and Services Committee. Harry Keiley will chair the Investment Committee. Paul Rosenstiel will chair the Audits and Risk Management Committee, Tom Unterman will chair the Investment Subcommittee. Tom Torlakson will chair the Appeals Committee. Betty Yee will chair the Board Governance Committee.

Under legislation the Board voted to support if amended AB 2833 (Cooley) – Private Equity Fee Disclosure and oppose H.R. 4822 (Nunes) Public Employee Pension Transparency Act.

The Board discussed options for the Supplemental Benefit Maintenance Account (SBMA), which has resources in excess of those needed for payments. Option 1 would give a one-time permanent increase in benefits for members retiring before 1999 and increasing progressively the earlier the member retired. Option 2 would increase the purchasing power benefit (various amounts were presented). Option 3 would be to make no changes. No changes were made.

Jack Ehnes, CEO reported that the next meeting will be on July 14 in Sacramento. There will be an offsite CalSTRS meeting in Palo Alto in October. The State Contribution rate of 4.311% will remain the same for the next year. STRS employees Sharon Davis, DJ Sapna, Baishali Dwarka, Andrew Ferko, Kathy Halstead, John Maradik-Symkowitz, Jan Spano, and Michael Wilson received the Virtuoso Award for superior, sustained performance as Cal STRS employees.

The new CalSTRS computer project is nearing completion.

**CalSTRS Report, July 14, 2016**  
By Patricia K. Geyer, CalRTA Liaison  
**CalSTRSreport.com**

## **Summary**

1. The Board discussed the options for CalSTRS building needs.
2. The Investment Committee approved an investment of up to \$2.5 billion in a low carbon equity index strategy.
3. The CalSTRS fund is \$188.7 billion down slightly from June 2015 when it was \$191.4.
4. CalSTRS has a new student intern program in investments.

## **Teachers' Retirement Board**

The Board reviewed the work plans for the 2016-17 fiscal year. Benefits and Services Committee will have an information item on disabilities. There is concern that the public perceives the increased CalSTRS contributions are hurting schools' education programs; actually the State is responsible for the increased contributions. Educational services to members and employers will be expanded with more sites and on line presentations. The Investment Committee will complete the asset allocation study including an evaluation of Risk Mitigating Strategies.

The Board approved the Strategic Plan for 2016-19. The plan is to provide a secure retirement for educators through risk management and sustainability. The goal is to achieve full funding over the next 30 years. The Pension 2 Computer project will be implemented during this period.

The Board discussed the options for CalSTRS building needs. Options are: (1) Develop Tower 11 next to the present building with no 3<sup>rd</sup> party tenants (most expensive estimate ), (2) Develop Tower II and lease space until needed. (second most expensive) (3) Develop Tower II in 2029 and lease space in other buildings as needed (third most expensive), (4) Lease space as needed (cheapest). The cost ranges from \$102 million to \$70 million to \$42 million. Staff believed that services and efficiency would be vastly improved if all staff were in one location. Jennifer Baker, CTA spoke about the possible negative response from the Legislature, schools, retirees, and public if CalSTRS proceeded with a new building.

## **Investment Committee**

The Committee approved the management plan for the fiscal year 2016-17. The speakers requested that CalSTRS divest in fossil fuels. Next the Committee approved an investment of up to \$2.5 billion in a low carbon equity index strategy. There will be an smaller investment in energy utilities. In addition staff will encourage the SEC to require companies to report climate risks.

Chris Ailman, CIO reported that the CalSTRS fund is \$188.7 billion down slightly from June 2015 when it was \$191.4. Returns have been low. U.S. stocks were up 2% but international stocks were down because the dollar value is strong. Interest rates continue to be a risk. U.S. private and public equity high values are also a risk. Future risks are Brexit, US Central Bank moves, Greece bail out, and a possible China slow down.

Anne Sheehan presented information on Corporate Governance Policy Revisions. Revisions of interest are: (1) Boards include expertise and experience in climate change risk management strategies, (2) Board diversity, (3) Hold Directors accountable for unilateral actions that disenfranchise shareholders unless they submit such changes to shareholders for a vote., (4) Move to one share one vote structure. Consultants Mercer agreed that the CalSTRS policy revisions on climate change and review of the risk factors were a good thing.

Chris Ailman and staff presented the 2016-17 business plan. The goal is to continue to earn 7.5%. Costs continue to increase. Plan to increase investments in major markets including Japan and Australia. CalSTRS is looking at new investments in London.

CalSTRS has a new student intern program in investments. The seven student interns were introduced; all majored in finance or economics. Over 170 students applied for the program.

**CalSTRS Report**, September 14-15, 2016  
By Patricia K. Geyer, CalRTA Liaison  
**CalSTRSreport.com**

By Patricia K. Geyer, CalRTA Liaison - CalSTRSreport.com

**Summary:**

1. Jocelyn Martinez-Wade will be replacing Ed Derman as Director of Government Relations. Ed Derman has announced his retirement
2. The next Client Advisory Committee meeting will be November 16, 2016.
3. Future CalSTRS Board meetings: October offsite-Santa Clara, November-Sacramento, February (2017)-San Diego, March and April(2017)-Sacramento, and June (2017)-Sacramento.
4. CalSTRS assets are \$193 billion as of August 1, up from \$188 billion in June.

**Client Advisory Committee**

Andrew Roth, Benefits and Services Executive Officer opened the meeting. He announced that Jocelyn Martinez-Wade will be replacing Ed Derman as Director of Government Relations. Ed Derman has announced his retirement.

Chris Ailman, CIO made a presentation on Risk Mitigation Strategy. This program used to be called Absolute Return. It is only 1.8% of the total CalSTRS portfolio, but it does well during poor economic times. Risk Mitigation Strategy includes trend following and global macro. Ailman then reviewed stock market performance over the last 150 years. Generally the stock market has done well. Stock recessions are not common, but are remembered. The longest was during the depression of the 1930's. CalSTRS has had two periods of negative performance since 2000. One was from 2000-2003, and another severe one was in 2008 lasting 58 days.

Margot Wirth, Director of Private Equity reviewed that asset class. Private Equity is about growth and long-term value. The returns over the last 10 years have been from 8-9%. Examples of CalSTRS private equity investments are Ancestry.com, Astra Zeneca, Netflix, Pet'Smart and Waze.

Joyelyn Martinez-Wade, the new Director of Government Relations presented the legislative update. Legislation passed and awaiting the Governor's signature are:

AB 736 (Cooley) which adds the Chief Operating Officer and Chief Financial Officer to the positions that the Board has authority to set compensation.

AB 2833 (Cooley) CalSTRS to require that alternative investment fund managers make disclosures regarding fees and expenses.

SB1353 (Pan) makes a technical clarification to the 2014 Full Funding Plan.

Andrew Roth presented the Pension Solution computer program update. Enrollment and Contributions, Calculations and Payments, and Customer Service are all in roll-out (implemented).

The following is the schedule for future CalSTRS Board meetings: October offsite-Santa Clara, November-Sacramento, February (2017)-San Diego, March and April (2017)-Sacramento, and June (2017)-Sacramento.

The next Client Advisory Committee meeting will be November 16, 2016.

**Benefits and Services Committee**

Andrew Roth discussed the member benefits planning services. The Service Center initiative which has provided service centers in local population areas concludes with the opening of the San Diego Center in November 2016. Now the staff is working on ways to deliver service to less urban parts of the state, for example Central Valley, Northern California. In addition there is growing member awareness of the importance of additional savings. Pension2 savings program has grown 13.8%.

Andrew Roth gave an update on employer outreach. Member Account Services provides training to employers delivered in person and via webinar. Since February 2015, staff conducted training for 45 report sources (County Offices of Education as well as independent sources) and 135 report units (school districts and community colleges).

The member satisfaction survey was e-mailed in 2016 - the response rate was only 6%. Of those who responded 57% were engaged with CalSTRS similar to previous years. 44% of the responders were aware of the Pension2 savings program a significant increase from the 25% of 2015.

The next Benefits and Services meeting will be in March. A discussion of possible increases in the Death Benefit and Benefits for those who retired before 1999 will be discussed at the June meeting.

### **Investment Committee**

The Committee heard a presentation by members of Fossil Free California, who asked CalSTRS to divest in fossil fuels (coal, oil, and gas) that are a major cause of global warming.

Chris Ailman presented the Chief Investment Officer's Report. CalSTRS assets are \$193 billion as of August 1, up from \$188 billion in June. Risks are: the upcoming Presidential election, interest rate change, internet hacking, challenges of Brexit, and climate change. The market has had generally good results over the last 10 years, but has underperformed its benchmark.

PCA presented its Semi-Annual Performance Report. Townsend presented the Real Estate Semi-Annual Performance Report. The general portfolio is doing well except for the high return section. Meketa Investment Group presented the Private Equity Semi-Annual Report. The value is \$17 billion and has had mixed performance.

PCA gave an update on the Investment Beliefs Project. Beliefs accepted are: #1. Diversification Benefits, #3 Long-term benefits of managing costs, #4 Internal management is a critical capability. Beliefs still under discussion are: #2 Global Public Investment Markets are Largely, but Not Completely Efficient, #5 Proactive corporate governance is beneficial, #6 CalSTRS can potentially capture an illiquidity risk premium, #7 Managing short-term drawdown risk impacts CalSTRS' long-term health. PCA recommends accepting #2, #5, and #6. Final changes are expected to be completed this fall.

### **CALSTRS REPORT: September 15, 2016 Meeting Highlights**

This section prepared by Paula H. Weiss, Area 3, GRC

#### **Executive Summary:**

1. An external audit did not find any serious issues. Issues that do require attention will be addressed based on priority and resources.
2. The Board decided to postpone any decision on the General Counsel's salary until April. At that time the salaries of the CFO and the COO will also be discussed.
3. The Board received its fiduciary training. There was discussion of a Marin County court decision that could have implication for defined benefit pensions such as CalSTRS.

#### **Audits, Risk and Management (ARM) Committee:**

Both internal and external audits were completed. External audits are performed every 5 years. The external audit is a Quality Assessment Review (QAR).

"Overall Assessment: Significant improvements have been made to address areas of deficiency noted in the 2011 QAR. There are several areas for improvement noted, however, items noted do not rise to the level of "non-conformance" as defined by the IIA standards."

Findings: Audits did not disclose any serious issues. Issues that do require attention will be addressed by priority and the availability of resources.

#### **Compensation (COMP):**

Despite difference in salary when compared to the competitive market for general counsel, the board voted to postpone a decision on the salary adjustment of the general counsel until the April Board meeting. At that time legislation may have passed that would allow the board to address salaries of the employees who are presently not under the salary setting authority of the CalSTRS Board. They are the Chief Operating Officer, and the Chief Financial Officer. In order to recruit and retain highly skilled staff, salaries, incentives, and benefits must be competitive.

**Regular Meeting, Teachers Retirement Board (TRB):**

Deputy CEO, Ed Derman, who is retiring shortly, presented amendments to creditable compensation designed to adjust rules to accommodate, correct language, and close loopholes related to LCAP and other positions.

Joycelyn Martinez-Wade updated the board on legislation including HR 711, the WEP proposal, for which CalSTRS took a watch position. It has been held in committee. AB 736 places the Chief Operating Officer and Chief Financial Officer positions under the authority of CalSTRS Board to establish terms and conditions of employment and is on the Governor's desk. This bill is sponsored by CalSTRS, CTA, and CalRTA.

CEO, Jack Ehnes reported CalSTRS social media platforms continue to show strong results and growth. Fiduciary attorney, Harvey Leiderman, presented his power point training module for the Board . General Counsel, Brian Bartow reported on a recent court decision in Marin on pension and vested rights related to defined benefits plans. Mr. Bartow and Mr. Leiderman discussed the issues, and the board followed up the discussion in closed session.

CFO, Robin Madsen presented the budget proposed operational budget.

Pension Solution, the project to switch CalSTRS to a new software program, is progressing with checks and balances in place. It is scheduled to be completed by 2020.

## CalSTRS Board and Committee Meetings, November 16,17 2016

### Executive Summary

1. Dave Davini, Division 53 CalRTA make a presentation asking for increases in the Death Benefit and Pension Equity for CalSTRS members retiring prior to the 1999-2000 school year.
2. CalSTRS fund is \$193.7 billion. Asset allocation is stable and global growth is good.
3. Investment costs were reduced from 51 basis points in 2011 to 42 basis points in 2015. This is compared to the U.S. average cost which increased from 58 basis points to 63 basis points
4. CalSTRS Board approved \$8 million for further study of CalSTRS long-term facilities needs and options
5. When the Client Advisory Committee asked about increasing the SBMA (supplemental benefits maintenance account) the reply was that the CalSTRS Board had decided to do nothing at this time.
6. Grant Boyken formerly with the State Treasurer's office is now CalSTRS' Deputy Chief Executive Officer replacing Ed Derman who has retired.
7. The CalSTRS Investment Sub-Committee meetings are scheduled for December 8 and January 12 in Glendale. Full Board and Committee meetings are scheduled for February 1,2 in San Diego.

### CalSTRS Audits and Risk Management Committee, November 16

The Committee heard the annual report of benefit payment modification. The modifications of \$16 million are less than 1% of the \$13 billion of payments. The Pension Solution Project (computer program) accounted for about 10% of the modification. The remainder was overpayments and underpayments due to errors in reporting. CalSTRS is considering legislation to improve member data reporting.

Next Crowe Horwath gave the independent auditor's report. Concerns were that CalSTRS may not be able to make the 7.6% investment income and that some investments were difficult to accurately value because a market value was not readily available.

Ethics training to the CalSTRS Board will begin in April.

## Client Advisory Committee

Joycelyn Martinez-Wade reported on State legislation. AB 736 (Cooley) adding the Chief Operating Officer and Chief Financial Officer to positions which the CalSTRS Board has authority to establish compensation levels was passed. AB 1875 (Chavez) allowing “special needs trusts” for disabled individuals to be an option for CalSTRS Benefits Programs, and AB 2833 (Cooley) requiring alternative investment fund managers to make specified disclosures regarding fees and expenses were passed. When the Committee asked about increasing the SBMA (supplemental benefits maintenance account) the reply was that the CalSTRS Board had decided to do nothing at this time.

Steven Tong, Director of Innovation and Risk Team made a presentation on that class of investments. The 403b Compare website was reviewed.

Dave Davini, Division 53 CalRTA make a presentation asking for increases in the Death Benefit and Pension Equity for CalSTRS members retiring prior to the 1999-2000 school year.

## Investment Committee

Presentations were made by members of CalSTRS asking the Board to divest in companies producing fossil fuels.

The Committee heard a presentation about the Investment Insight Program. The discussion centered on emerging markets. Such investments make it difficult to meet the CalSTRS ESG goals. In 2000 CalSTRS was opened to global trade. In 2014 Cal STRS was generally out of the emerging markets because of the commodity downturn. In 2016 such investments are turning position.

Chris Ailman. CIO presented the Investment Policy and Management Plan revision. Real Estate is to be reduced by 1% and Risk Mitigating Strategies are increased by 1%.

The Committee adopted the Corporate Governance Engagement Plan. Executive compensation, proxy access, and majority voting are issues as well as Board diversity and concerns about the effects of climate change.

Chris Ailman gave the Chief Investment Officer’s report. CalSTRS fund is \$193.7 billion. Asset allocation is stable and global growth is good. Risks are internet hacks, Brexit, climate change, China slowdown, and the possibility of a natural disaster. Italy is possibly the next bankruptcy, and North Korea aggression is a risk.



Investment costs were reduced from 51 basis points in 2011 to 42 basis points in 2015. This is compared to the U.S. average cost which increased from 58 basis points to 63 basis points during the same time. While there has been some increased cost of bringing investments “in house”, there has been significant savings.

The committee heard a presentation on investment beliefs. All beliefs except #5-Proactive corporate governance is beneficial, #7-Managing short-term drawdown risk impacts CalSTRS’ long term health, and #8-Alignment of interests between CalSTRS and its advisors is critical were adopted. Adopted beliefs are:

#1-Diversification benefits, #2-Global Public Investment Markets are Largely, but not Completely Efficient, #3-Long-term Benefits of Managing Investment costs, #4-Internal Management is a Critical Capability, #6-CalSTRS can potentially capture an illiquidity risk premium.

A representative from UTLA (United Teachers of Los Angeles) expressed her concern about Alliance Educators (Charter schools) which are anti-union and would leave CalSTRS.

## Board Governance Committee

The Committee heard a report on trends in Board Education Programs. Boards tend to have 1/3 elected by members, 1/3 elected by employers, and 1/3 investment experts. Trustees are required to learn about their role in an on-line course. Trustees are evaluated by their expertise, competence, and professionalism.

## Teachers’ Retirement Board

Staff presented the plans for an additional building next to the present CalSTRS facility. It would require two years for planning and 3 years for construction. It would consist of a 10 floor tower (2 floors for mechanical) and parking below. The cost is estimated at \$180 million. CalSTRS staff is out of space. Both the State Controller and the State Treasurer on the CalSTRS Board spoke against adding a new building at this time. The alternative would be to lease office space off Folsom Blvd in the Rancho Cordova area. CalSTRS Board approved \$8 million for further study of CalSTRS long-term facilities needs and options.

Rick Reed, Actuary reviewed CalSTRS funding levels and risks. Key results are: (1) Today, CalSTRS is a financially stronger system. (2) Significant risk remains in CalSTRS ability to achieve full funding by 2046. (3) As CalSTRS continues to mature over time, small investment losses will have a greater impact on contribution requirements.

Next Rick Reed, Actuary reported on Mortality improvement trends. The largest increase in life expectancy was from 1900 to 1950 when life expectancy increased by 20 years. From 1950 to 2000 life expectancy increased by 10 years.

Jocelyn Martinez-Wade , Director of Government Relations presented a legislative update. (See Client Advisory Committee) The Pension Solution new computer software Project is in the final phase of completion. The emphasis is not on data preparation.

Grant Boyken formerly with the State Treasurer's office is now CalSTRS' Deputy Chief Executive Officer replacing Ed Derman who has retired.

The CalSTRS Investment Sub-Committee meetings are scheduled for December 8 and January 12 in Glendale. Full Board and Committee meetings are scheduled for February 1,2, in San Diego.