CalSTRS Report for April 2017

By Pat Geyer, CalRTA Liaison with CalSTRS

Summary

1. The ARM Committee voted to select Crowe Horwath as the independent financial statement auditor.
2. The final audit report on the 2016-17 fiscal year is due in November 2017. CalSTRS plans to transfer to a calendar year rather than fiscal year audit plan.
3. The Committee approved Investment belief #6.- Managing short-term drawdown risk can positively impact CalSTRS ability to meet its long-term obligations and belief #7 Responsible corporate governance, including the management of environmental, social and governance (ESGO) factors, can benefit lone-term investors like CalSTRS.
4. The CalSTRS fund has passed $200 billion in assets
5. The plan for the Private Equity Policy is to go away from the 21 risk factors and move toward a more generalized statement.
6. The next Client Advisory Committee meeting will be September, 2017.
7. The Board reviewed the 2017-18 meeting calendar. The scheduled meetings are: July 12,13,14; September 12,13 (in San Diego), November 1,2,3, February 7,8,9; March 14,15 (in Riverside), and May 9,10,11.
8. The funded ratio of CalSTRS has gone from 68.5% funded on June 30, 2015 down to 63.7% funded on June 30, 2016.
9. The reasons for the lower CalSTRS funded status are: lower investment returns and the change in actuarial assumptions. The total employer contribution rate for the defined benefit will increase from 12.5% to 14.3% beginning July 1, 2017.
10. The Board voted to oppose AB 1310 member statement disclosure, oppose unless amended AB 20 Dakota access pipeline divestment, and oppose unless amended AB 1597 Divestiture of Turkish Investment Vehicles.
11. The Committee heard the Outstanding Death Benefits Report. 5630 Death Benefits have not been paid of which 1391 cases are pre-2008.

Audits and Risk Management Committee

The Committee heard a report on the progress of implementing the recommendations of the previous audit of November 2016. The major problem is accuracy of employer data. CalSTRS continues working with employers on this problem and believes that the new CalSTRS computer program will assist in reporting accuracy.

The next item was the selection and approval of the Independent Financial Statement Auditor. The two finalists were Crowe Horwath LLP and Macias Gini & O'Connell LLP.

Crowe Horwath reported that its past performance of 10 years should mean its continued selection as auditor. The firm reported that CalSTRS challenges will be implementation of Pension Solution computer program, and possible GASPE changes. CalSTRS should continue to focus on the evaluation of assets, especially alternative investments, and continue to focus on the accuracy of contributions from employers and accuracy of payments to teacher retirees.

Marcias Gini & O'Connell said that CalSTRS' biggest risk was sustainability. Dr. Yetman (CalSTRS Financial Expert) believed that sustainability was CalSTRS biggest challenge and that investments were CalSTRS biggest risk. Larry Jensen, Chief Auditor believes that the biggest challenge is the new accounting system and accurate transfer of data. The ARM Committee voted to select Crowe Horwath as the independent financial statement auditor.

The Committee heard a progress report on the 2016-17 internal audit plan. Common findings were un-reported post-retirement earnings, errors in reporting earnings, and incorrectly reported sick leave. The number of appeals is down which is a result of CalSTRS training for schools. However, there is a larger number of errors in reporting from Community Colleges. The final audit report on the 2016-17 fiscal year is due in November 2017. CalSTRS plans to transfer to a calendar year rather than fiscal year audit plan.

Investment Committee

The first five investment beliefs were approved in November. The Committee approved Investment belief #6.- Managing short-term drawdown risk can positively impact CalSTRS ability to meet its long-term obligations and belief #7 Responsible corporate governance, including the management of environmental, social and governance (ESGO) factors, can benefit lone-term investors like CalSTRS. Belief #8, Alignment of interests between CalSTRS and its advisors is critical will be voted later by the Committee.

Chris Ailman, CFO gave the investment report. Pat Geyer, retired teacher was asked to announce that the CalSTRS fund has passed $200 billion in assets. Interest rates are low and the stock market is up – good trends. However, expectations of high earnings will be a disappointment. GDP likely will grow at 2%. North Korean missiles and the French election are concerns.

Alan Emkin, PCA reported that over the last ten years the fund has earned 5% well below the goal of 7.5%. The asset allocation is good. However, the cash flow has turned negative – more is going out in pensions than is coming in.

Margot Wirth reported on proposed changes to the Private Equity benchmark. There has been a lack of coordination between the Private Equity benchmark and the actual CalSTRS private equity portfolio. Customizing the Private Equity benchmark is proposed. The plan is to go away from the 21 risk factors and move toward a more generalized statement. The staff will recommend a final Asset Class Policy to the Investment Committee for final adoption at the June meeting. Asset class policy revisions will include the new Associate Portfolio Manager, APM delegation limits, and a new investment reporting cycle.

Client Advisory Committee

Joycelyn Martinez-Wade presented the legislative update. The three divestment bills will be presented to the CalSTRS Board in April. They are AB 20 (Kalra) divest in a company constructing or funding construction of the Dakota Access Pipeline; AB 1597 (Nazarian) divest in any investment owned, controlled or managed by the government of Turkey; SB 560 (Allen) requires CalSTRS boards to consider financial climate risk, as defined, of each investment. CalSTRS is already doing the requirements of AB 1310 (Allen) on disclosure. AB 9450 on the Construction of the Boarder Wall has not been introduced. The WEP and GPO legislation will be considered in June.

The Client Advisory Committee also watched a video presentation on the Actuarial Valuation and Implications for Contribution Rates. This is to be presented to the CalSTRS Board. The conclusion is that life expectancy is increasing while returns on investments are down. Most of the new liability will go to the State, and State contribution rates will increase. There will be no change in contributions from teachers this year, but increases are expected next year.

The Advisory Committee also watched a video presentation on Charter Schools. The next Client Advisory Committee meeting will be September, 2017.

Compensation Committee

McLagan presented Executive salary recommendations. Chief Operating Officer and Chief Financial Officer have a current base salary plus maximum incentive ranges from $141,000 to

$209,000. McLagan recommends increasing the range from $285,000 to $415,000. The Committee will review in June what part of the incentive is qualitative and quantitative.

The Committee reviewed the salary range for General Counsel. A salary range of $277,000 to $409,000 plus a 20% incentive was recommended. Finally, McLagan recommended increasing the Portfolio Manager's current base salary of $164,000 to 246,000 be increased to $172,000 to $258,000. A final decision on the recommendations will be made in June. Dana Dillon recommended a salary study every two years so the changes would not be so great.

The Risk Mitigation Asset Class will continue to have more emphasis on qualitative rather than quantitative because the class is still in implementation stage.

Board Governance Committee

Grace Crickette presented an overview regarding compliance and board decision making. A review of reports will be completed by June 2017 Board and Committee meetings.   There will be a more comprehensive survey of what other Boards are doing at the June meeting. Jennifer Baker, CTA spoke about the difficulty in trying to contact elected CalSTRS Board members. Loretta Toggenburger, UTLA Retired requested a retired CalSTRS member be appointed to the CalSTRS Board. This appointment is made by the Governor.

Teachers' Retirement Board

The Board reviewed the 2017-18 meeting calendar. The scheduled meetings are: July 12,13,14; September 12,13 (in San Diego), November 1,2,3, February 7,8,9; March 14,15 (in Riverside), and May 9,10,11. Concern was expressed at the number of offsite meetings. Dana Dillon was elected Chair and Sharon Hendricks was elected Vice-Chair of the Teachers' Retirement Board.

The Board heard a report from the state legislative outlook panel. Thad Kousser, Professor from UC San Diego reported that California politics is driven by what happens in Washington. Repeal of Obama Care is very possible. However, while Obama worked to increase Federal power, the present Congress wants more State rights. President Trump is also for more power for the States. Mindy Romero, UC Davis stressed the importance of voter turn-out in California elections. Amy Brown, representing Dimare, Brown, Hicks and Kessler, LLC saw little new legislation in pensions or health care.

Rick Reed, CalSTRS Actuary, reported the actuarial evaluation of the Defined Benefit Program. The funded ratio has gone from 68.5% funded on June 30, 2015 down to 63.7% funded on June 30, 2016. Under the new assumptions of lower investment returns the funded ratio is even lower – 61.8%. The reasons for the lower CalSTRS funded status are: lower investment returns and the change in actuarial assumptions. The total employer contribution rate for the defined benefit will increase from 12.5% to 14.3% beginning July 1, 2017.

The funded ratio of the Defined Benefit Supplement Account decreased from 114.5% funded to 111.6% funded on June 30, 2016. No additional earnings will be credited to the DBS account for the FY 2015-16. The Cash Balance Benefit Program has a funded status of 108.8% which is not sufficient to add additional earnings credit. The Medical Premium Payment program pays Medicare Part A premiums for eligible retired members A reduction in the number of members covered and lower Part A Medicare monthly premiums shows there are sufficient assets to fund the program over the next 30 years.

The CalSTRS Board adopted the Employer contribution rate for elected officials and reduced workload program of 14.43% up from 12.58%. The Death benefits will remain the same: $6,163 for members in Coverage A and $24,652 for members in coverage B. The Defined Benefit investment return assumption will be 7.25% for June 2016 and 7% for June 2017. This will limit the impact on member contribution rates.

The CalSTRS Board voted to oppose, AB 1310 (Allen) Member Statement Disclosure. It is the Board's policy to oppose legislation that appropriates money from CalSTRS funds for purposes that are not in the best interest of members. The Board voted to oppose unless amended AB 20 (Kalra) which prohibits CalSTRS and CalPERS from investing any part of the Dakota Access Pipeline. Finally the Board voted to oppose unless amended AB 1597 (Nazarian) which requires divestment of Turkish Investment Vehicles.

Jack Ehnes, CEO reported on the National Opinions on Retirement. The findings show that (1) we have a retirement crisis, (2) the average worker has not saved enough for retirement, (3) 75% agree the it is getting harder to save for retirement, (4) Support for pensions for teachers. CalSTRS will increase its effort to get members to save with a 403b and 457 savings account.

Benefits and Services Committee

The Committee heard the Outstanding Death Benefits Report. 5630 Death Benefits have not been paid of which 1391 cases are pre-2008. Of the recent cases 2,276 cases have had no response; 1948 cases have missing forms, and 15 cases have not provided a Social Security number. Pat Geyer, retired member asked why more effort had not been made to pay the death benefits.

The Committee heard a report on changes in the aging society. The percentage of U.S. population is expected to be older. (13% of the population is over 65 in 2012 and 20.9% of the population will be over 65 in 2050) A greater percentage of the over 65 population will be in the labor force. The average age at retirement for CalSTRS members has increased from 61 years in 2000 to 63 years in 2015-16, while the average years of service in education has decreased from 28 years in 2000 to 24.5 years in 2015-16. One in five teachers continued to work after retirement.

Community College Districts report that 68% of their workforce is temporary, which means that they are not in retirement plans.

10,000 CalSTRS members receive disability. The Average is 55 with 15 years of service credit. The application process is (1) submit application, (2) submit medical documentation and analysis, and (3) a decision is made with 120 days.

Pat Geyer, retired member requested that the Benefits and Service Committee be scheduled to meet earlier in the CalSTRS meeting schedule All the other retired and actives members were not able to attend all the Benefits and Service Committee hearings because the CalSTRS Committee meeting schedule ran some two hours beyond the suggested ending time. The Benefits and Services Committee report is of major interest to members and should be scheduled at an appropriate time.

CalSTRS Report for June 2017

By Pat Geyer, CalRTA Liaison with CalSTRS

Summary

1. Karen Yamamoto is the new CalSTRS Board member representing retired educators.
2. CalSTRS fund is $209 billion. CIO Chris Ailman received an award for his leadership. Areas of risk are U.S. equity, private equity, and real estate which are at high levels
3. The Committee adopted the following long-term changes to the percentage asset allocations: Global Equity 56% to 47%, Private Equity 9% to 14%, Real Estate 13%, Inflation Sensitive 1% to 4%, Innovative Strategies 0%; Risk Mitigating Strategies 3% to 9%; Fixed Income 16% to 12% and Cash 2%.

Compensation Committee

The Committee evaluated and set the quantitative/qualitative weightings for the compensation of the Chief Operating Officer and the Chief Financial Officer. The Chief Executive Officer (CEO) compensation is: 40% - Strategic Planning, 30% Total Fund Portfolio Return, and 30% Qualitative (Personal). The Chief Operating Officer is 35% Long-range Strategic Planning; 15% Total Fund Return, and 50% Personal Performance. The Chief Financial Officer is 30% Long-range Strategic Planning, 20% Total Fund Return, and 50% Personal Performance. Board member Paul Rosenstiel suggested that the Board set the incentives for the CEO and CFO and delegate the rest. Chris Ailman CIO suggested less emphasis on Fund returns since you can't control the economy. The Committee and Board will revisit this again in July.

Audits and Risk Management Committee

The Committee introduced Karen Yamamoto, the new CalSTRS Board member representing retired educators.

The school/employer audits identified 54 out of 73 Community Colleges at high risk; 254 out of 952 K12 Schools at high risk; 1 out of 262 Charter Schools at high risk. Audit Services plans to conduct 26 employer audits during the next six months. Factors that make for high risk are: retirees with increased annual earnings greater than 10%; retirees with monthly compensation greater than $2500; special compensation of $2500 or more; and members with increased compensation more than 10%.

Audit Services will be changing its Audit Plan from a fiscal year to a calendar year.

The Committee heard a separate report on Charter Schools. 60% of charter schools report directly to CalSTRS. 40% are included in a County Office of Education report. Charter schools average 43 members while public schools average 416 members at each school site. Charter school membership increased by an average of 24% a year for the last three years. The most common problem was misreporting creditable compensation. Two of the eight charter schools audited filed for bankruptcy which is a risk for CalSTRS. It is recommended that Audit Services should develop a specific audit program for charter schools and develop training sessions to educate charter schools. Board member, Paul Rosenstiel expressed concerns about Charter School bankruptcy as did retired member Ed Foglia. Board Financial Expert, Dr. Yetman said don't over-emphasize charter schools.

Investment Committee

The Committee heard a report from Frank Blake, former Chairman and CEO of Home Depot. He reported that #! Take care of customers and employees; #2 There is still a place for the big box store; #3 The Board of Directors plays a critical role in capital allocation and executive compensation.

CalSTRS fund is $209 billion, and CIO Chris Ailman received an award for his leadership. Areas of risk are U.S. equity, private equity, and real estate which are at high levels. Interest rates are also high compared to the rest of the economy. Non-U.S. equity is cheap compared to U.S. equity.

The Committee discussed the ESG (Environmental, Social, and Geopolitical) – 21 risk factors. In addition to the 21 risk factors, the Committee heard the ESG policy, principles-based to match our peers. It included the following: The Board has a social and ethical obligation to require that the corporations and entities in which securities are held meet a high standard of conduct and strive for sustainability in their operations.

The Committee adopted the following long-term changes to the percentage asset allocations: Global Equity 56% to 47%, Private Equity 9% to 14%, Real Estate 13%, Inflation Sensitive 1% to 4%, Innovative Strategies 0%; Risk Mitigating Strategies 3% to 9%; Fixed Income 16% to 12% and Cash 2%.

The Committee adopted the following changes to the Private Equity Sub-asset Classes. Buyout, Venture Capital and Debt Related classes will remain. Equity Expansion will be eliminated, Special Mandates and Core Private Equity classes will be added. These changes will be made over several years.

The Committee heard a discussion about adding a "Transitional Core" sub asset category to the Core Portfolio of the Real Estate asset class. The Real Estate Policy and the Inflation Policy will be revisited in July.

The Committee heard presentations by employees of the Pullman Hotel in the San Francisco area. The employees want CalSTRS support in their efforts to be able to join a union.

Client Advisory Committee

Joycelyn Martinez-Wade reported on legislation. AB20(Kalra) restricts investments in companies involved in construction of the Dakota Access Pipeline, and requires CalSTRS to consider factors related to tribal sovereignty – CalSTRS position is oppose unless amended. AB 1597 (Nazarian) restricts investments in Turkey – CalSTRS position is oppose. SCA 8 (Moorlach) permits a government employer to reduce retirement benefits that are based on work not yet performed – CalSTRS position is oppose. SCA 10 (Moorlach) Prohibits a government employer from providing public employees any retirement benefit increase until that increase is approved by a 2/3 vote of the electorate – CalSTRS position is oppose.

Sandy Blair presented a video of the Member Education Service Delivery Overview. It highlighted the various CalSTRS member service centers in California.

Grant Boyken presented a video on CalSTRS video highlighting engagement rather than divestment in businesses.

Board Governance Committee

The Committee voted to have the Board Policy Manual reviewed every two years. Barbara Berlin and Terry Ward from PWC Governance Insights Center presented a workshop on overseeing a company's IT (Information Technology) practices.

Benefits and Services Committee

The Committee heard a report on the Benefit Adequacy Study for members who retired before 1999. Key findings were that retirees who retired at age 60 and had more than 20 years of service were above the minimum living expense line. Retirees with savings 11 times greater than final pay were considered to have adequate savings. Approximately 3000 pre-1999 retirees are below the poverty line when only CalSTRS savings are counted.

The conclusions from the Benefit Adequacy Study found that approximately 36% (10,000) pre-1999 retirees were below the poverty line if one counted only the CalSTRS pension. These retirees retired younger, with less years of service credit. They were more likely to leave their career as an educator early, possibly for another career.

Paula Weiss, retiree reported that more women than men were below the poverty line, and adequate health care was a big issue. Karen Yamamoto, retiree CalSTRS Board member wanted information on the number of members whose estate did not receive the CalSTRS death benefit. Board member, Harry Keiley wanted more effort on getting members to invest in Pension 2. Future Committee topics are unpaid death benefits, Charter school education, and education of members on financial planning.

Teachers' Retirement Board

The Board discussed the work plan for 2017-18. The Board will have two educational offsite meetings - September in San Diego and March in Riverside. In addition, the Board will review the funding levels and risks in November followed by the valuation reports and subsequent contribution decisions in May 2018.

Of interest at the Benefits and Services Committee will be the employer audit with an emphasis on charter schools in February; an IT presentation and update on suspended Death Benefit cases in May. The Compensation Committee will review investment policy changes impacting employee compensation in July and a review of employee incentive plans in November. The major project of the Investment Committee will be to study additional direct investment and co-investment opportunities.

Legislation of interest was AB20 (Dakota Access Pipeline Engagement); the position is oppose unless amended to remove the requirement that the Board include factors related to indigenous tribal rights in its investment decisions. ACA 15 (Brough) prohibits a government employer from enhancing new government employee defined benefit pension plan benefits without approval by the voters of the applicable jurisdiction – position oppose. SB 560 (Allen) climate risk of pension investments has been held in suspense file. Federal legislation of interest is H.R. 10 which repeals the Dodd-Frank Wall Street Reform and Consumer Protection Act. Position - oppose. H.R. 985 (Goodlatte) Fairness in Class Action Litigation Act of 2017 restricts the investment authority of CalSTRS Board. Position – oppose. SCA 8 and SCA 10 (Moorlach) restrict public pension actions, Position – oppose.

Jack Ehnes, CEO reported that there were no changes to the CalSTRS budget other than in increase in compensation ($40 million) which requires a higher general fund contribution.

The Board heard a report on Charter Schools. The report stated that Charter Schools have increased their enrollment of students from 1.7% of the student population in 1999-2000 to 7.2% in 2014-15. California Charter Schools have increased from 2.8% in 1999-2000 to 12.2% in 2014-15. CalSTRS provides retirement benefits for 89.4% of charter schools; the remaining schools have different retirement plans. However, the percentage of newly opened charter schools in California offering CalSTRS benefits has decreased from 89% in 2006-7 to 66% in 2015-16. The average earnings of CalSTRS members at K-12 traditional schools is $14,000 more that members of the same gender at Charter Schools. Board member, Harry Keiley does not want charter schools to opt out of CalSTRS. That would be a problem.

Finally, the Board heard a report on the IT Pension Solution and Data Preparation Project. The program is now in roll-out. There are some concerns about data conversion. March 18, 2018 is the date for the complete project to be running.

CalSTRS Report July 2017

Summary

1. The CalSTRS fund stands at $208.7 billion a new record.
2. Chris Ailman, CIO presented the Engagement/ Divestment Policy Revision. (The word engagement has been added to reflect the action of the Committee.)
3. CalSTRS is moving away from a portfolio of international inflation linked bonds to a portfolio of domestically linked bonds in order to better capture the changing inflation in the United States.
4. The CIO and Deputy CIO incentive criteria will include the performance of 7 instead of 5 asset classes. These include the major sections of the fund. The asset classes are Global Equity, Corporate Governance, Income, Private Equity, Real Estate and adding Risk Mitigating and Inflation Sensitive.
5. See the Audit and Risk Management Committee for a report on District Audits.
6. The CalSTRS Board set the funding ratio to 61% to reflect the new assumptions adopted by the Board. The target for new member growth in Pension2, 403b and 457b plans was increased from 5% to 20% a year
7. The Pension Solution CalSTRS computer project is behind schedule. The project rollout, projected for spring of 2018, has been delayed to the fall of 2018 or possible later.
8. The next open session of the CalSTRS Board meeting is September 12, 2017 in San Diego.

Client Advisory Committee

Joycelyn Martinez-Wade presented the legislative report. AB20 (Kalra) requires CalSTRS to report to the Legislature and Governor regarding investments in companies engaged in the Dakota Access Pipeline – position neutral. AB1597 (Nazanian) requires divestment in Turkey – position oppose. Other state legislation of interest was either pulled or dead for this session. Federal legislation of interest is H.R. 10 which repeals provisions of the Dodd-Frank Act – position oppose. H.R. 985 makes changes to the laws governing class action lawsuits – position oppose. H.R. 1205 and S. 915 repeal the Government Pension Offset and Windfall Elimination Provisions – position support.

The Charter School Update was presented. There are presently 1243 active charter schools of which 87% are in the CalSTRS retirement system. (1878 charter schools have been in existence of which 1/3 are no longer active.) In terms of reporting, 12% of the charter schools report through the County Office of Education. 86% report through the school district. The remainder report through the State Board of Education. Charter schools represent approximately 4% of CalSTRS revenue.

Melyssa Adams presented a Survivor Benefits Overview. About 5% of the death benefits are not paid. Of that number 3% are situations where the beneficiary can't be located. CalSTRS sent an email blast and newsletter article (Winter 2017), and will continue to encourage members to check their death benefit beneficiary. Pat Geyer also suggested that a letter be sent to those members over 70 who might not be computer literate.

The next Client Advisory meeting will be in February 2018.

Investment Committee

Jonathon Gray, Blackstone and Jared Carney, Lightdale presented the Investment Insight Program report. Their findings are: Low interest rates and new technology makes this time a difficult investment period. Infrastructure investment is needed. Emerging markets are good because they are growing faster. Other trends are a shift to online purchases causing an increase in demand for warehouse space; continued demand for population growth in cities because of demand for the highly educated, and a decline in demand for retail stores. They see a lower rate of return for the next five years.

Workers for the Pullman Hotel in the San Francisco Bay Area requested that CalSTRS continue to urge the hotel to allow a union.

Chris Ailman presented the CIO Report. The CalSTRS fund stands at $208.7 billion a new record. Private Equity and Real Estate growth were outstanding – up 18% in the last fiscal year. The Stock Market is up. Concerns are that the U.S. economy is at the late stage of the growth cycle and asset valuation is high. The eight summer student interns were introduced. CalSTRS had 140 applicants for the positions.

Anne Sheehan gave the 2017 Corporate Governance update. The environmental issue was to reduce methane gas. The emphasis was on oil and gas companies. In the future Anne sees an emphasis on climate change and also on water management. CalSTRS continues to work toward more diversity on corporate boards. CalSTRS has engaged with Wells Fargo on governance as well as Mylan (Epipens). Alan Emkin, PCI reported that there are clear links between good corporate governance and performance.

Chris Ailman, CIO presented the Engagement/ Divestment Policy Revision. (The word engagement has been added to reflect the action of the Committee.) If engagement fails to cause satisfactory change, only then should divestment be considered. Chris Ailman also reported that there has been an increase in number of divestment proposals. One of the problems with divestment is if the investment is part of an index.

The ESG (Environmental, Social, Governance) Risks policy was discussed. The changes suggested at the June Committee meeting have been incorporated in the policy. The Board approved the ESG policy. The Real Estate Policy had only one major change which was to add "Transitional Core" sub asset category definition to the Core Portfolio.

The Inflation Sensitive policy revision will delete the Barclays Inflation Linked Global Series and make way for the Bloomberg Barclays U.S. Government Inflation Linked Bond Index. CalSTRS is moving away from a portfolio of international inflation linked bonds to a portfolio of domestically linked bonds in order to better capture the changing inflation in the United States.

With the retirement of Ed Derman, The Pension 2 Investment Program, under the direction of Andrew Roth has been moved to the Benefits and Services Branch; more specifically to the newly created Retirement Readiness unit under the leadership of Sandy Blair. The Pension 2 program includes the 403(b) and the 457 (b) investment programs.

Margot Wirth presented the Private Equity Policy revisions. The suggested revisions are (1) increase the investment limits in recognition of the increased size of the fund, (2) change the secondary market transactions section to reflect developments, (3) refine the co-investment section to increase CalSTRS' competitiveness, and (4) add sub-asset allocation targets.

Compensation Committee

Staff presented changes to private equity to accurate reflect the actual portfolio, innovative strategies to include private assets, and inflation sensitive benchmark to reflect the move to U.S. tips. These accomodate the changes that the Investment Committee made at their meeting.

The CIO and Deputy CIO incentive criteria will include the performance of 7 instead of 5 asset classes. These include the major sections of the fund. The asset classes are Global Equity, Corporate Governance, Income, Private Equity, Real Estate and adding Risk Mitigating and Inflation Sensitive classes. No action was taken on the policy of investment performance's impact on investments. No change was made to the CEO and CIO personal performance targets. Finally, the Committee discussed allowing the Board to adjust the formulaic results +25% based on the CIO overall performance for the previous year. The Board will review the +25% option again in November.

Benefits and Services Committee

The Committee heard the results of the Customer Service Performance for the 2016-17 year. As usual customer service had the lowest ratings, especially for quarter 3 which was the end of the school year. Calls answered within 120 seconds or 2 minutes was not achieved. In fact, during the spring quarter the average wait time was four minutes. Only 18% of the on-line messages were answered within one day, and only 62% of the service credit purchase requests were processed within 25 days. Pat Geyer asked if there was some way of increasing the Customer Service staff for the end of school year period.

Audits and Risk Management Committee

The 2016-17 audit plan called for a goal of 58 audits which was accomplished. The common audit findings were (1) un-reported post-retirement earnings found in 47% of the audits, (2) Earnings reported to the Defined Benefit Program rather than the Defined Benefit Supplement Program (59% of the audits), and (3) Incorrectly reported sick leave/ excess sick leave found in 38% of the audits. CalSTRS continues to focus on the larger and high/risk districts. A full report will be presented at the November meeting.

Teachers' Retirement Board

Grant Boyken and Jocelyn Martinez-Wade presented the report on State and Federal legislation. (Please see the report under the Client Advisory Committee) Additional legislation presented was SCA 10 (Moorlach) which prohibits a government employer from providing public employees a benefit increase until that increase is approved by 2/3 vote of the electorate of the jurisdiction. The CalSTRS Board took an oppose position.

Jack Ehnes, CEO introduced the 11 CalSTRS employees who have received the Virtuoso Award, CalSTRS highest honor for their outstanding service to the organization. They are Lucy Arbuckle, Patrick Bivins, Jesse Darden, Lisa Kashiwamura, Lamont King, Lew Levy, Tom O'Hair, David oshima, Pam Simmons, Heather Totten, and Shaun White.

Minor changes were made to the CalSTRS Annual Business Plan for 2017-18. Of interest was setting the funding ratio to 61% to reflect the new assumptions adopted by the Board. The target for new member growth in Pension2, 403b and 457b plans was increased from 5% to 20% a year. The Board also heard an overview of the Communications Division, the Media Relations Unit, the Marketing, Publications and Design Unit, the Internal Communications Unit, and the Multimedia Unit.

Brian Bartow presented information on the Bagley-Keene Open/Closed Meeting principles. Items presented were: (1) Open sessions for all meetings, (2) Advance notice of meetings so public can attend, (3) Anyone can attend meetings, (4) Meetings can be closed for investments or litigation.

Jack Ehnes, CEO reported these new actions: (1) Strategic plan to look at alternative ways to manage investments, (2) Expand member services with new service centers and research on ways to serve rural areas, (3) Emphasis on new employee orientations and new teacher orientation, (4)Complete the computer projects, (4) Plan for CEO and CIO succession, and (5) leadership development at STRS. Harry Keiley suggested that CalSTRS engage with colleges of education. Dana Dillon suggested a district website for 403b and other investments from CalSTRS.

The CalSTRS Annual Business Plan for 2917-18 was presented. Changes made were (1) setting the funding ratio to 61% to align with the new assumptions adopted by the board, (2) ratio of internal/external asset management should include the total fund, (3) target for member growth in Pension2 was increased from 5% to 20% a year, (4) Pension2 assets under management increased from 5% to 15% per year.

The Pension Solution CalSTRS computer project is behind schedule. The project rollout, projected for spring of 2018, has been delayed to the fall of 2018 or possible later. However, data preparation for the Pension Solution Project is going well.

The Board received fiduciary training. Members of the CalSTRS Board are (1) responsible for other persons' money, (2) to act in the best interests of the system, (3) be the prudent expert , and (4) follow CalSTRS policy and rules.

Jack Ehnes, CEO presented the Charter School Project for 2017-18. The following issues will be analyzed and presented for discussion: (1) actuarial and funding issues, (2) financial and bankruptcy issues, (3) audit issues, (4) election, outreach and membership issues, and (5) legal issues. The Board expressed an interest in taking a more active role in Charter school issues.

CalSTRS Report - November 1, 2, 3, 2017

Executive Summary

1. The Annual Investment Cost Report for 2016 was presented. Compared to peers CalSTRS is a low cost fund. CalSTRS saved $211 million compared to peers
2. The CalSTRS fund is $215.2 billion, an all-time high.
3. CalSTRS Board is different because 6 members are appointed by the Governor or represent elected officials. There will be a big change at the next election
4. CalSTRS base salary plus annual incentives are below the median for several positions. The CEO, CIO, and DCIO are 10% below the market for such positions.
5. An active discussion was held be members of the Client Advisory Committee on the need for an increase in benefits for older retirees.
6. A letter from client groups asked if it was prudent for CalSTRS to consider an additional CalSTRS building given the increases in contributions facing both school and community college districts.
7. Charter schools have been increasing; they now represent 12% of K-12 enrollment. The present Charter School impact on CalSTRS is currently minimal.
8. . At this time the Pension Solution IT project is expected to take 2 or more years more than originally planned.
9. Representatives from California Retired Teachers Association (CalRTA), California Teachers Association (CTA), California Federation of Teachers (AFT), Faculty Association of California, and Association of California School Administrators presented a letter questioning whether it was prudent for CalSTRS to consider such a costly building project at this time.
10. CalSTRS sponsored legislation for Board approval is: (1) Align Contribution and Reporting Due Dates, (2) Annual Billing of Excess Sick Leave, (3) Requiring Employers to Use Electronic Payments, and (4) Postretirement Option Change to New Spouse Following Divorce.
11. The next CalSTRS meetings will be February 7-9, 2018 in Sacramento.

Investment Committee

Board member John Chiang, State Treasurer requested that CalSTRS divest in retail and wholesale sellers of assault weapons. He mentioned the latest incidence of gun violence, the Las Vegas massacre as an example of what should be prevented.

A presentation was made by staff of the Pullman Hotel, Redwood City (CVRE) which still has not allowed its workers the right to organize. Staff was instructed to engage with CVRE about the issue. State Treasurer Chiang requested that CalSTRS (1) review the Responsible Contractors Policy, consider applying it to all contracts and including it in all CalSTRS legal contracts.

The Annual Investment Cost Report for 2016 was presented. Compared to peers CalSTRS is a low cost fund. CalSTRS saved $211 million compared to peers; however, the new contracts have had higher fees. CalSTRS is close to a double digit return for 2017. The Committee voted to select RCL as the real estate consultant.

Revisions to the Private Equity Policy were approved. The overall nature of the policy has not changed. Delegation of authority limits is being raised to reflect the growth in size of the portfolio. Changes to policies regarding co-investments and secondary transactions reflect the growing complexity of these marketplaces.

Anne Sheehan presented the Corporate Governance Engagement Plan. The issues include executive compensation; water, energy and climate change; the opioids crisis; Board diversity, and gender pay.

Chris Ailman gave the CIO report. The CalSTRS fund is $215.2 billion, an all-time high. Equities have done well, up 25% for the year. It has been a long bull run. Stocks are up and low interest rates help the economy. Holiday shopping is predicted to be good. Risks are actions by North Korea and the U.S. President. Michelle Cunningham, Deputy Chief Investment Officer is retiring after 27 years of service at CalSTRS.

The Committee heard about small revisions to the Asset Allocation. Global Equity was reduced 1% to 54%. Fixed Income was reduced 2% to 13%. Risk Mitigating Strategies was increased 3% to 9%. The Committee also made minor changes to the Infrastructure Policy. The language pertaining to Corporate Governance Investment Program will be moved from the Global Equity Policy to the Corporate Governance Policy. The Committee heard revisions to the Corporate Governance Proxy Voting Principles. In summary they move to (1) more Board independence, (2) periodically review the tenure of directors, (3) improve Board diversity, and (4) change and rotate the external auditor periodically.

Alan Emkin, PCA gave the semi-annual performance report. In summary, the CalSTRS portfolio generated good results – a 13.4% return during the most recent fiscal year. Each strategic class is in-line with the policy targets.

Townsend Group gave the Semi-Annual Real Estate Performance Report. As of March, 2017 $1.6 billion is available for investments; however, staff is appropriately cautious in today's market. Leverage and portfolio risk are reduced.

The Committee heard a discussion of the Co-Investments and Direct Investment opportunities work plan. Part 1 explains how various strategies across the portfolio have been implemented (internal vs external management); Part 2, due in February 2018 outlines various forms of direct investing by asset class and investment options. In May or June of 2018 staff will outline a detailed action plan to implement the strategies by asset class.

Audits and Risk Management Committee

Robin Madsen reported the modifications to benefit payments amounted to ¼ of 1%. CalSTRS assessed $3.4 million penalties and interest on employers. While this seems a large amount, it was a decrease of 5%. The problem is reporting accurately and on time. Crowe Horwath gave the independent auditor's report. There were no deficiencies and no significance weaknesses.

Crowe Horwath reported that there were 60 audits completed in the 2016-17 fiscal year. The number of audits has increased each year from a low of 15 in 2012-13. Of the audits 48% had at least one systemic finding. Common findings were un-reported post-retirement earnings (50%), member earnings reported as non-member earnings (8%), reporting to the Defined Benefit Program rather than to the Defined Benefit Supplement (68%), and incorrectly reported sick leave/excess sick leave (38%).

Crowe Horwath gave the Independent Auditor's Report on CalSTRS Financial Statement. There were no material deficiencies or significant weaknesses in the CalSTRS Financial Statement. However, there may be differences between GASBE and CalSTRS reports, but there are no errors. There were no significant concerns over member data, but CalSTRS needs to make sure that original data from employers is accurate.

Grant Thornton gave the audit plan year-end report. CalSTRS needs to formalize the process for back-up operations. They need to restrict access to backup. Monitoring over investment compliance is good. However, the Investment policy in real estate needs control over compliance in reporting. The decrease in the Medicare Premium Payment Program was small and insignificant.

Audit services' resource allocation for 2018 in number of hours are employer audits (23,255 hours), internal audits (7225 hours), consulting (2,000 hours), other audit activities (3170 hours), management and supervision of audits and administration (12,450 hours).

The Committee approved the Code of Ethics and Business Conduct document.

Board Governance Committee

Beverly Brehan, Board Advisor LLC presented on Board Culture. Board Culture can be an asset – high ethics, integrity, service, accountability. CalSTRS should showcase their culture – a Board Culture dashboard. CalSTRS should revise their culture periodically and have explicit definitions. CalSTRS presently has a good culture.

The trend is to hire CEO from within. However, the CalSTRS Board is different because 6 members are appointed by the Governor or represent elected officials. There will be a big change at the next election. Tom Unterman, a Governor appointee announced that he will be leaving the CalSTRS Board after the present meetings.

Finally, the Committee reviewed the draft of the Board Consultant Policy.

Compensation Committee

The Committee reviewed incentive amounts for selected CalSTRS staff. CalSTRS base salary plus annual incentives are below the median for several positions. The CEO, CIO, and DCIO are 10% below the market for such positions. The CalSTRS total rewards market position (base salary + annual incentive + long term incentives + retirement and health benefits) are well below the competitive market. The committee expressed a desire to include long-term incentive considerations in the incentive plan review. Staff recommended a delay in the comprehensive incentive plan evaluation to give time to come up with a model.

Benefits and Services Committee

The Committee heard a report on the activities of the six Member Service Centers (Glendale, Irvine, Riverside, Santa Clara, San Diego, and West Sacramento). West Sacramento has the most satellites (6), because it must service members from Sacramento to the Oregon Border. Most satellites are located in the County Offices of Education. CalSTRS is considering satellites for Humboldt, Santa Cruz, Santa Barbara, Fresno, and Kern Counties. It is also considering a Central Valley service center. The next generation of teachers does not want to go to meetings in person they prefer electronic. Webinars are increasing in popularity. Future events are Financial Awareness Day (spring) and New Member Day Workshops.

The recent teacher survey showed more retirement awareness is needed. Especially the fact that the Defined Benefit payments will not meet all member financial needs.

Client Advisory Committee

The Committee heard a presentation on Private Equity. A Private Equity fund has a General Partner and Limited Partners such as CalSTRS. Private Equity has outperformed Global Equity over the last 10 years. During the last 3 years it outperformed by 6.3%.

Legislation of interest is AB20 (Kalra) which requires that CalSTRS consider factors related to tribal sovereignty and indigenous tribal rights when considering investments in construction or funding of the Dakota Access Pipeline. AB20 was Chaptered (passed). Other legislation was either not heard or held as a two-year bill.

Andrew Roth discussed the Pension Solution computer update. The program is in testing phase to see how it functions with CalSTRS data. The Project is now a 6 year effort which is not unusual for such projects.

David Davini, retired member presented a letter recommending that the CalSTRS (1) increase the lump sum death benefit and (2) Give a one-time permanent increase in SBMA benefits for CalSTRS members and beneficiaries who retired before 1999. An active discussion was held be members of the Committee on the need for an increase in benefits for older retirees.

A letter from California Retired Teachers Association, California Teachers Associations, California Federation of Teachers, Faculty Association of California, and Association of California School Administrators. The letter asked if it was prudent for CalSTRS to consider the project of building an additional CalSTRS building given the increases in contributions facing both school and community college districts.

The next Client Advisory Meeting will be on Wednesday, February 7, 2018.

Teachers' Retirement Board

The Board heard a review of CalSTRS funding levels and risks. Key findings are (1) recent changes have put CalSTRS on more sustainable funding (2) Strong investment performance for 2016-17 has helped (13.5% return, (3) Significant risk remains. A significant risk is the increase in percentage of retirees vs actives. In 1971 there were 6 active teachers vs 1 retiree. In 2011 there were 2 actives vs 1 retiree. In 2016 there was 1 ½ actives vs 1 retiree. (Life expectancy has increased 2% a year over the last century.) Finally, investment volatility has a great impact on the funding of the plan. For example, a 1% change in return costs $7 billion for STRS. Board member Rosenstiel wants ways that CalSTRS can respond without going to the State. Dana Dillon wants ways to protect funding.

The Board heard a report on Charter Schools. Charter schools have been increasing; they now represent 12% of K-12 enrollment. However, at this time only 1% of the school employees are not in CalSTRS. The present Charter School impact is currently minimal. Next the Board heard a report on late School Employer reporting. 96% are received on time; 3% are late but received before the end of the fiscal year. 1% was reported after the end of the fiscal year.

The Pension Solution Project (IT) timeline was reviewed. In the spring of 2018 is enrollment of members and employer reporting; fall of 2018 calculations and payments are done by the Project; spring/summer of 2020 sees Service Centers and Employer Account management; Late 2020 is the final stage with the Project completed in 2022. At this time the project is expected to take 2 or more years more than originally planned as reported by the MAXIMUS consultant.

CalSTRS continues to evaluate the process to design a headquarters expansion and to explore additional long-term alternatives. CalSTRS believes that they can provide a building design not to exceed budget, as well as being competitive with other alternatives. Representatives from California Retired Teachers Association (CalRTA), California Teachers Association (CTA), California Federation of Teachers (AFT), Faculty Association of California, and Association of California School Administrators presented a letter questioning whether it was prudent for CalSTRS to consider such a costly building project at this time.

CalSTRS presented a proposed operating budget of $277,481,192. Grant Boyken presented proposed CalSTRS sponsored legislation for Board approval. The proposals are: (1) Align Contribution and Reporting Due Dates, (2) Annual Billing of Excess Sick Leave, (3) Require Employers to Use Electronic Payments, and (4) Postretirement Option Change to New Spouse Following Divorce.

The next CalSTRS committee and board meetings will be February 7-9, 2018 in Sacramento.