

## CalSTRS Report – February 7, 8, 9, 2018

### Summary

1. CalSTRS does not currently manage private assets internally. However, CalSTRS continues to look at options for direct investing. However, more staff will be needed
2. Ann Sheehan, Director of Corporate Governance is retiring.
3. The CalSTRS fund is at \$225.3 billion, fueled by a strong return in stocks
4. The recent trend is that a greater proportion of new charter schools are not electing to participate in CalSTRS.
5. It will now take an additional 30 months for this Pension Solution computer project to be complete. The plan is to go live in 2022
6. Tom Unterman, public representative CalSTRS board member has retired. The public representative seat is now vacant and will await the Governor's appointment.
7. The Department of Finance Director has appointed Jacqueline Wong-Hernandez and Erika Li to the CalSTRS Board
8. CalSTRS Chief Financial Officer, Robin Madsen will be leaving CalSTRS.
9. The 2017 Six Month Audit Plan results showed that 18 of 26 audits had systemic findings (2792 members are affected)
10. The next CalSTRS Board meeting will be offsite on March 27, 28. The following CalSTRS Board meeting will be May 8, 9, 10 in Sacramento.

### Board Governance Committee

The Committee approved routine reports and actions of Board policy, the consultant evaluation policy, and charter revisions. An addition to the charter was

to oversee and facilitate educational opportunities for board members. Next the committee heard a presentation on oversight of major system implementations – the Pension Solution technology system implementation. The presentation reported that 68% of all IT projects face significant challenges and

CalSTRS is no exception. A major CalSTRS issue is the transfer of data from the old system to the new. Board member Betty Yee suggested a subcommittee specifically on the Pension Solution technology system implementation challenges.

### **Investment Committee**

The Committee heard a panel discussion on ways to expand direct and co-investment opportunities. Dr. Monk, Stanford University suggested that to get more return CalSTRS should move to private markets (alternative investments and outside managers), but this is costly. CalSTRS should look at what their advantages are and build on them. Mark Wiseman, Blackrock, agreed that CalSTRS should use its comparative advantage. Jon Hausman, Ontario Teachers' Pension Plan remarked that CalSTRS would need more employees if they were to move investments in-house. He is also concerned with governance.

The Committee heard requests from members of the public. Representatives of the hotel workers union asked CalSTRS to help them organize a union at the Pullman Hotel in Redwood City, California. Members of Fossil Free California (Bay Area) asked CalSTRS to divest in companies that produce fossil fuels.

A report on internal versus external asset management was presented by staff. Presently CalSTRS does not currently manage private assets internally. However, CalSTRS continues to look at options for direct investing. However, more staff will be needed. CalSTRS will return in May with next steps and in July with more specifics including in-house staffing needs.

Chris Ailman, Chief Investment Officer presented his report. The CalSTRS fund is at \$225.3 billion, fueled by a strong return in stocks. CalSTRS has averaged a 10% return over the last 10 years. All CalSTRS assets are in normal ranges. The risks are North Korea, Trump's tweets and climate change.

Ann Sheehan, Director of Corporate Governance is retiring.

A review of the 21 risk factor sustainability policy was presented. The present policy is to transition from the current policy, principles-based to a rules-based

policy. Staff will focus on engagement issues which pose the greatest risk to the portfolio. The State Treasurer wants to extend the risk factors to all contracts. CalSTRS will review the request and bring their plan back to the Board.

CalSTRS reviewed the Investment Beliefs. The Committee approved Investment Belief #8: Alignment of financial interests between CalSTRS and its advisors is critical. The Committee reviewed the Green Initiative Report. Of interest is the strategic plan: 1. Continued education, 2. integration of environment risk factors into manager procurement and ongoing efforts, 3. Consider increased allocations to environmental investments, and 4. Integration of environment considerations into asset allocation processes.

The Corporate Governance Policy was reviewed. Treasurer, John Chiang recommended that the corporate Board Policy include the principle of a diverse board: 30 percent women and 30 percent members diverse in terms of sexual orientation and cultural and ethnic composition. No action was taken.

### **Client Advisory Committee**

Three legislative bills of interest were reported: ACA15 prohibits a government employer from enhancing benefits without the approval by the voters, SCA8 permits a government employer to reduce retirement benefits based on work not yet performed, and SCA10 prohibits a government employer from providing benefit increase until that increase is approved by 2/3 vote of the electorate. All are opposed.

Lisa Blatnich presented the CalSTRS long term facilities plan. As of 2016 over 200 new seats were installed, 20% over the original CalSTRS building design. More space will be needed. CalSTRS is planning on extending parking and providing temporary building facilities on the nearby lot that they own.

Tom Buffalo presented the retirement readiness report. In summary: use of CalSTRS.com for retirement planning increased, Paying off student loan debt continues as an obstacle to saving for retirement, and borrowing from retirement plans while working decreased.

Davis Walton discussed the Death Notification Process. Pat Geyer, CalRTA again asked that more be done to see that the information on beneficiaries is complete and up-to-date.

### **Teachers' Retirement Board**

The committee presented more details from the retirement readiness report. Other items of interest are that at every age group women are more likely to be retired compared to men. Younger teachers are more likely to be interested in working longer hours. Also, gradual retirement appeals to younger workers. Generally, good health and secure finances makes every group happy. For pre-1999 retirees 60% have minimum income or more. 25% are living in poverty. For all retirees 7% of retirees married live in poverty and 11% of unmarried retirees live in poverty. For all teachers staying in work longer improves the mind as does volunteering.

The second part of the Charter School Project Report focuses on the choice that Charter schools have regarding retirement benefits and the impact that choice has on the retirement security of California educators. The recent trend is that a greater proportion of new charter schools are not electing to participate in CalSTRS. The CalSTRS funding plan with increased contributions has played a role in the number of charter schools not participating in CalSTRS. CalSTRS will continue its research about charter schools.

Andrew Roth presented an update on the Pension Solution project. More time will be needed to complete the program. There are currently 140 gaps between CalSTRS requirements and Neospin out-of-the-box functionality. It will now take an additional 30 months for this Pension Solution computer project to be complete. The plan is to go live in 2022. CalSTRS position is not unique. For instance the Canada IT project took 10 years to complete. However, if CalSTRS computer project takes 7 years to complete, will the Pension Solution be obsolete when it starts? Staff says no.

Jack Ehnes gave the CEO report. Tom Unterman, public representative CalSTRS board member has retired. The public representative seat is now vacant and will await the Governor's appointment. Joy Higa has been reappointed to the CalSTRS Board. The Department of Finance Director has appointed Jacqueline Wong-Hernandez and Erika Li to the CalSTRS Board to represent the Department.

John Stanton presented an outline of priorities of the Administration and Congress in areas of interest to CalSTRS. The future election and which party will control Congress is a challenge. During this year, Congress will probably not accomplish much. Under tax reform they will drop the corporate tax rate from 35 to 21%. Business will be able to write off capital investments. The 39% tax on investment income which would hurt CalSTRS is out of the tax bill. New rules are proposed for investment advisors. Congress will not repeal Obama Care, and the minor changes in health care are good. The \$1.5 trillion plan for infrastructure is not moving.

The next CalSTRS Board meeting will be offsite on March 27,28. The following CalSTRS Board meeting will be May 8,9,10 in Sacramento.

### **Benefits and Services Committee**

The Committee heard a multimedia presentation where interviewees discussed the role of online education in their careers, the strengths and challenges of distance learning, and how online education might impact the future of teaching.

A discussion was had on employer audit findings. Generally employers were enthusiastic about the CalSTRS support and education. The work plan for the next year will be presented at the next CalSTRS Committee meeting.

CalSTRS Chief Financial Officer, Robin Madsen will be leaving CalSTRS.

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

Andrew Roth presented a report on employer audit findings. In 2016-17 126 school employers were audited and 21 had audit problems. More details will be presented at a future meeting.

Crowe Horwath LLP has been selected to plan and perform an audit of CalSTRS financial statements and other pension information for the year ending June 30, 2018.

The Committee heard the 2017 Six Month Audit Plan results. 18 of 26 audits had systemic findings (2792 members are affected). Member account services is working with the employers. 44 of the findings has been resolved. 33 have been open for less than one year, and 18 have been open more than one year.

The more common findings are: un-reported post-retirement earnings, earnings reported to the Defined Benefit Program rather than to the Defined Benefit Supplement, and incorrectly reported sick leave/excess sick leave. The auditors are concerned about: unresolved prior year deficiencies, the accuracy of the new computer system from an auditor's point-of-view.

The Committee heard a report on the Enterprise Compliance Oversight Program. The program emphasizes (1) Identify Risk Appetite, (2) Determine Risk Tolerance, (3) Determine Course of Action. Dr. Yetman, Committee Financial Expert emphasized how important risk management is and the need to give more resources to internal compliance. There will be a risk assessment report in May.

## **CalSTRS Report – July 18, 19, 20, 2018**

By Pat Geyer, CalRTA Liaison with CalSTRS

### **Summary**

1. In 2019, CalSTRS will be conducting the election of three CalSTRS Board members.
2. Pension Solution (Data and Computer) Project is in the process of data preparation. Project is now projected to be completed by 2022.
3. 2017-18 Board plans are: a funding analysis, oversight of the Pension Solution IT Project, presentations on the Long-Term Facilities Plan, and a 3-year Strategic Plan review
4. A final decision on the leasing or building project will be made by the Board in November.
5. Numerous teachers including representatives from CTA spoke against the use of private prisons.
6. Former employees of Toys R Us reported that Baine Capitol and KKR had not been fair. Employees want severance pay.
7. The Investment Committee voted to keep the 2% California investment as an aspiration not a requirement.
8. The Investment Committee reviewed the 2018-19 Investment Business Plans, and they were accepted.
9. CalSTRS has \$224 Billion in assets as of June 30, 2018. As of June 30 CalSTRS has a 9% return (net); CalSTRS had a 7.8% return (net) over the last 10 years, beating CalPers and other funds.

### **Appeals Committee**

The Committee designated the Bashara decision as a Precedential Decision because it contains significant legal and policy determinations. The decision upholds the use of a plain meaning definition of the term “mental incompetency” which is not defined in the Education Code and has become a recurring issue in disability cases.

The Committee discussed a long-term plan to have a CalSTRS legal team handle appeals cases and not use outside lawyers.

11 hearings are scheduled for the remainder of 2018.

## **Compensation Committee**

The Committee evaluated the Incentive Criteria for Director of Investment Strategy & Risk. The Committee adopted Option 1 which gave a higher rating for personal performance (45% rather than 30%) and a lesser rating for asset class performance (25% rather than 40%).

The Committee heard a presentation on increasing the salaries of Investment Officers III and II because they were below the market rate. Staff will prepare the proposal for change documents for submission to California Department of Human Resources.

## **Teachers' Retirement Board**

The Committee heard an update on the Long-Term Facilities Project. At this meeting the Board explored the possibility of acquiring an existing building in the Sacramento market in FY 2021 and explored the possibility of leasing third-party office space in Sacramento in FY 2021. In September staff will present the financial analysis of these alternatives. A final decision will be made by the Board in November.

In 2019, CalSTRS will be conducting the election of three CalSTRS Board members: (1) a Pre K-12 or County Office of Education employee, not an administrator; (2) a Pre K-12 or Country Office of Education employee, including administrators; and (3) a Community College instructor. The deadline to submit nomination petitions is January 8, 2019. ( Interested candidates should contact CalSTRS and get the Candidate Information packet.) Ballots will be mailed in October and must be received at CalSTRS by November 20. Newly elected Board members will be seated January 1, 2020.

Under legislation, CalSTRS Board voted to support AJR 41 (Thurmond) Social Security Offset Repeal; CalSTRS Board remained neutral on SB 783 (Pan) Pension Divestment Review Program.

The Board heard the Pension Solution (Data and Computer) Project report. The Project is in the process of data preparation. Project is now projected to be completed by 2022.

The Board approved the Board/Committee work plans for 2017-18.

1. Board plans are: a funding analysis, oversight of the Pension Solution IT Project, presentations on the Long-Term Facilities Plan, and a 3-year Strategic Plan review.
2. The Audits and Risk Management Committee plans presentations on governance, audit/risk reporting and oversight, compliance reporting, and audit reporting.
3. Benefits and Services Committee plans are: Research presentations on Health Care and Retirement Security and the Member Satisfaction Survey.
4. Board Governance Committee plans include a Board Education Forum and the Board Policy Manual Revisions
5. Compensation Committee plans include an evaluation of the incentive criteria and the evaluation of risk mitigating strategies
6. Investment Committee plans include the adoption of a statement of investment beliefs, review of ESG policy/21 risk factors, and implementation of risk mitigating strategies.

The Board heard a presentation by Elizabeth Laderman, Senior Outreach Economist from the San Francisco Federal Reserve Bank. Ms Laderman reported that the Federal Reserve goals are maximum employment (natural rate of unemployment is 4.6% meaning those who want a job can get it.) and stable prices (2% inflation). Presently inflation is 2.4% and the labor market is tight. The present U.S. expansion (2010-18) is the second longest in history. The Federal Reserve sees long-run growth of 1.8% slower than the 2.4% growth of the 1960—90. There is a decline in labor force growth as well as in productivity. However, every state is growing: incomes up, wages up, consumer confidence up, stocks up, and interest rates still low.

Chris Ailman, Chief Investment Officer announced that Julie Underwood is the new Chief Financial Officer.

Jack Ehnes, Chief Executive Officer announced that the CalSTRS workforce is younger than the general state workforce and has a higher percentage of females in leadership. He then announced the Virtuoso Award recipients. Work plans for all the Committees were reviewed.

The Teachers' Retirement Board then heard statements from the Public:

Employees from the Pullman Hotel reported that they now had a recognized union but hope to get more concessions.

Former employees of Toys R Us reported that Baine Capitol and KKR had not been fair to the employees. Employees want severance pay.

Numerous teachers including representatives from CTA spoke against the use of private prisons. They asked for CalSTRS support. CalSTRS is investigating and may divest. The discussion included concern about the incarceration of children of immigrants.

### **Investment Committee**

The Committee reviewed the California Investment Policy. The goal of the policy was to encourage investment into the underserved urban and rural portfolio of the State (in-state emerging markets). The policy had a requirement that 2% of the CalSTRS portfolio be invested in California. Presently CalSTRS has 10% invested in California. The Committee voted to keep the 2% California investment as an aspiration not a requirement.

The Committee reviewed the Home Loan Program and made minor changes regarding reducing the number of reports. The Committee included a reference to the Investment Beliefs as a part of the Investment Policy. The Investment Beliefs and Policy will be reviewed at the September meeting. The Investments Branch Business Plans will also be revisited at the September CalSTRS Committee and Board meetings.

Chris Ailman introduced the Investment Team – 18 members. All members have at least 10 years of experience; they are lean, mean, and very efficient. Debra Smith is the Chief Operating investment officer.

The Committee reviewed the 2018-19 Investment Business Plans. Issues are: the ability to recruit good staff, thinking long term, and minimizing cost. Meketa approved CalSTRS increase in internal managers. Emkin stressed that in 10 years there will be new technology, but human staff and critical thinking will still be needed. Chris Ailman suggested a study of the cost of acquiring more staff; government regulations could be a problem. The Investment Business Plans were accepted.

Margot Wirth presented the Private Equity Policy revisions. Size limits of commitments under Delegation of authority were increased by about 50% roughly in line with the increase in size of the portfolio. Traditional Private Equity (87% of the class) includes buyouts (69%), Venture Capital (7%) and Debt Related (11%). Opportunistic Private Equity includes Longer-Term Strategies( 5%), Multi-Strategy (4%) and Special Mandates (4%).

Chris Ailman, CIO presented the Performance Report. As of June 30 CalSTRS has a 9% return (net); CalSTRS had a 7.8% return (net) over the last 10 years, beating CalPers and other funds. CalSTRS has \$224 Billion in assets as of June 30, 2018. The risks are trade wars (China), Presidential Tweets, US export uncertainty, anti-made in US sentiment. Positives are US steady growth. Under asset class valuations – US Equity and Real Estate are over-valued.

Mike DiRe presented information on the collaborative business model for real estate. 95% of core assets are under CalSTRS management. 59% of value added assets are under CalSTRS management, and 22% of opportunistic investments are under CalSTRS management. (The amount of value added and opportunistic investments are less than 50% of value added assets.)

### **Benefits and Services Committee**

The Committee heard a report on business transformation and change management. The Business Transformation (computer program) has assigned “change agents” to each business area to help staff. In addition Pension Solution project is getting members involved. If staff and members don’t know or want to use the new system it will not succeed. 2021 will be the big change in benefits and services department.

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

The Committee heard the 2018 Internal Audit Progress Report. The employer common audit findings are (1) Un-reported post-retirement earnings (found in 37% of the audits); (2) errors in reporting earnings to the Defined Benefit (BD) Program rather than to the Defined Benefit Supplement Program (64% of the audits); (3) misreported unused sick leave/excess sick leave (33% of the audits). There is no change to the reporting of the CalSTRS unfunded obligation.

Robert Yetman (Committee Financial Expert) commented that the goal #1 is to help the districts to do better. Goal #2 is to look at current employers to prevent big and continuous mistakes. Goal #3 is to identify a problem early and fix it.

## **CalSTRS Reports – September 19, 20, 21, 2018**

By Pat Geyer, CalRTA Liaison with CalSTRS

### **Executive Summary**

1. Long-Term Facilities. The budget has increased from the \$226,675,746 estimate to \$300,000,000
2. CalSTRS members who retired in 1999 or earlier will receive a payment from the SBMA
3. Pension 2 (a 403b program) now has \$1 billion in assets
4. The CalSTRS Board off site meetings will be held on October 3,4. Full Board meetings will be on November 7, 8, 9, 2018
5. The CalSTRS fund has reached \$226 billion.

### **Appeals Committee**

The Appeals Committee heard a presentation on quality control, quality assurance, and training needs. CalSTRS has less county offices each year due to the increase in the number of area CalSTRS centers so teachers are getting better and more accurate services.

### **Benefits and Services Committee**

The Committee heard a presentation on the policy related to interest rates. The Defined Benefit interest rate is the same as the 2-Year U.S. Treasury notes. The Defined Benefit Supplement and the Cash Balance interest rates are linked to the 30-year Treasury notes because these are long term.

Staff reported that over the last 10 years CalSTRS has paid refunds of contributions to about 5,000 members per year. 4,000 of these members have had less than five years of service. About 100 retired members seek refunds each year. Regarding interest rates, CalSTRS uses the interest rate for the two-year treasury notes which presently are about 3%. Two notes were added to the Credit Interest Rate section - (1) The credited interest rate cannot exceed the investment return rate of the DB program, and (2) the credited interest rate cannot be lower than what a person could earn in a savings account.

Next was a report on the SBMA (Supplemental Benefits Maintenance Account). CalSTRS members who retired in 1999 or earlier will receive a payment from the SBMA. SBMA is critical for the oldest retirees even though there has been low inflation in the last few years. The SBMA is paid quarterly, and has \$10 Billion in excess reserves. However, this excess could be depleted if inflation returns.

Staff reported that health care costs, especially nursing home care are the largest risk for retirees. Mercer-Vanguard research predicted an annual health care expense for the average 65-year-old woman to be \$5280 in 2018. Findings suggest the members' expectation of health care expenses is less than the reality.

### **Teachers' Retirement Board**

The Board heard a report on the Long-Term Facilities. The budget has increased from the \$226,675,746 estimate to a \$300,000,000 budget. The increase is due to increases in the cost of construction (\$53 million), infrastructure (\$12 million), Contingency (\$15 million) and Impact fees (\$3 million). CalSTRS plans to lease up to 80% of the extra space until needed. The CalSTRS Headquarters expansion is the lowest cost compared to acquisition of a building or a lease.

David Walrath, CalRTA and Jennifer Baker, CTA both urged CalSTRS to provide a comprehensive plan. Walrath wanted CalSTRS to inform and work with the Department of Finance and the Legislature.

Aaron Laurel, City Manager West Sacramento gave a report. West Sacramento is predicted to have \$80 million in riverfront development over the next 10 years – new apartments as well as additional office and retail buildings. They are planning street cars to run down Front Street and connect with Raley Field and the Tower Bridge. A new bridge over the Sacramento River is planned and will be located between the I Street and Tower Bridges.

The preliminary 2019-20 Operating Budget is \$285 million and represents a \$7.4 million increase for the fiscal year of 2018-19. The increase is due to wage increases, state mandates, growth and the Pension Solution computer project. CalSTRS is committed to 100% funded. Several groups have suggested an 80% funded target, but this would cause funded levels to decline over time.

The Board heard an update on the Pension Solution computer project. Prashant Mittal has been selected as the project director. CalSTRS has been working closely with employers. Eight webinars were conducted in May and June. The challenges to the computer project remain the same: a successful launch, employer readiness, budget for demonstrations and testing.

Chief Executive Officer, Jack Ehnes gave his report. An off-site meeting of the CalSTRS Board will be held on October 3-4 at the San Diego Service Center. Pension 2 (a 403b program) now has \$1 billion in assets. In 2017 the Actuarial Standards Board adopted new standards (ASOP 51) regarding assessment and disclosure of risks for pension plans. This new plan will not impact CalSTRS.

### **The Board heard an update on State and Federal legislation:**

#### State Legislation:

AB 1297 (Nazarian) prohibits CalSTRS and CalPERS from making new investments in Turkey. Bill is on Governor's desk. CalSTRS opposes.

AB 2571 (Gonzalez) requires annual report on radce, gender, pay equity and sexual harassment. Bill not heard. CalSTRS watch.

AJR 41 requests the repeal of the Government Pension Offset and Windfall Elimination Provision from Social Security. Bill passed

SB 964 (Allen) requires boards to report on the analysis of climate related financial risks. Position neutral. On Governor's desk.

SCA 8 (Moorlach) permits a government employer the right to reduce retirement benefits based on work not yet performed. Position oppose. Held in Committee

SCA 10 (Moorlach) requires any retirement benefit increase be approved by a 2/3 vote of the electorate. Position oppose. Held in Committee

#### Federal Legislation:

Cal STRS opposes the following legislation: 1. H.R. 10 repeals provisions of the Dodd-Frank Reform and Consumer Protection Act. 2. H.R. 1205 repeals the Government Pension Offset and Windfall Elimination Provisions.

The CalSTRS Board off site meetings will be held on October 3,4. Full Board meetings will be on November 7, 8, 9. The CalSTRS fund has reached \$226 billion.

## **CalSTRS Report November 2018**

By Pat Geyer, CalRTA liaison to CalSTRS

### **Executive Summary**

1. In this latest legislative session the following bills were passed: AB2052 requires employers to submit their contribution payments by an electronic funds transfer method. SB964(Allen) requires boards to publicly report on the analysis of the climate related financial risks of their public market portfolios.
2. Given the divisive nature of private prisons and the likelihood that many members are against private prisons, it is possible that the threshold to divest has been met. No action was taken.
3. The CalSTRS fund has \$229.2 billion as of October 30, 2018. The next CalSTRS meetings will be January 30, 31 and February 1, 2019.
4. After discussion the CalSTRS Board approved the construction of an expansion structure at a cost not to exceed \$300 million utilizing tax-exempt lease revenue bond financing.
5. The next CalSTRS meeting will be by January 30 – February 1, 2019.

### **Compensation Committee**

The Committee heard a report on the Incentives for statutory positions. Incentives are based on quantitative and qualitative measures. The quantitative is based on the three-year returns of the total portfolio and asset classes. This year the portfolio exceeded the target and quantitative incentives were awarded. Qualitative measures were also awarded, which include personal evaluation components. The Committee also delegated to the CEO decisions for setting performance weightings and benchmarks for asset class levels. These recommendations reflect current practice. The committee will maintain its approval authority.

### **Client Advisory Committee**

Jocelyn Martinez-Wade presented the legislative update. In this latest legislative session the following bills were passed: AB2052 requires employers to submit their contribution payments by an electronic funds transfer method. SB964(Allen) requires boards to publicly report on the analysis of the climate related financial risks of their public market portfolios. CalSTRS is proposing a bill on Annual Billing of Excess Sick Leave. The bill would require employers to report and prefund the cost of a member's excess sick leave annually when it is granted. Mike DiRe and Paul Shantic reported on the Inflation Sensitive Program and Real Estate. \$8.8 billion out of the CalSTRS total assets of \$225 billion are committed to Inflation Sensitive. They include U.S. TIPS, Infrastructure, and other asset types such as Agriculture, Commodities and Timber.

Next was an update on the outstanding Death Benefits. CalSTRS continues to make an effort to locate recipients. CalSTRS now requires the beneficiary's social security number which will be a help in locating beneficiaries. Also, coming soon, is the CalSTRS' Unclaimed Property page. Beginning in January, CalSTRS will hold employer readiness meetings with information and training on the requirements of the new CalSTRS computer system.

## **Investment Committee**

Items #3-9, I was unable to hear because the Investment Committee was held at the same time as the Client Advisory Committee. You can access CalSTRS committee meeting recordings by going to the CalSTRS website.

During the next fiscal year CalSTRS will focus on: (1) **Executive Compensation**. Pay for performance alignment policy remains the core of this analysis. (2) **Sustainability Risk Management** with an emphasis on managing environmental risks. (3) **Opioids**. CalSTRS will continue their engagement with companies in the U.S. drug supply chain in collaboration with the Investors for Opioid Accountability. (4) **Diversity of Corporate Boards** and Human Capital Management Development. CalSTRS continues to promote diversity and will continue to monitor pay ratio changes. (5) **21 Risk Factors Policy**. CalSTRS has initiated a review of the private prison industry. CalSTRS will engage both U.S. and non U.S. companies that operate prisons. Chris Ailman, CIO wants the committee to focus on items #3 and #4.

Chris Ailman, CIO discussed the divestment policy and private prisons. The purpose of the item is to (1) Present research, 2. Present the cases for and against investing in private prisons, and 3. Evaluate the impact of divestment. Two U.S. companies operate private prisons, CoreCivic and Geo-Group. Numerous groups have spoken at CalSTRS against investment in private prisons. The recommendation of the CalSTRS staff is that the exposure private prisons have to ESG risks do not appear to pose a threat to the long-term profitability of CalSTRS. However, given the divisive nature of private prisons and the likelihood that many members are against private prisons, it is possible that the threshold to divest has been met.

The CalSTRS fund has \$229.2 billion as of October 30, 2018. The next CalSTRS meetings will be January 30,31, and February 1, 2019.

The Committee heard a presentation by employees of the Pullman Hotel and the Irvine Marriott Hotel and Restaurant. They talked about worker abuse and unfair wages and asked for CalSTRS help.

## **Audits and Risk Management Committee**

The Committee heard a report on benefit payments changes. CalSTRS made payment increases on 33,964 accounts, and modifications decreasing 23,508 payments. Reasons for accounts being modified were death of member (58%), change in standard business processes (25%), Inaccurate benefit payment amounts (13%), and earnings in excess of postretirement earnings limits. (3%)

The Independent Auditor's Report (Crowe) found no significant deficiencies or material weaknesses. Excellent! The Committee also heard plans for the 2019 Internal Audit and for the 2019 Internal Audit Risk Assessment.

## **Teachers' Retirement Board**

The Board heard a presentation on the Long-Term Facilities Plan Alternatives. An additional alternative was presented (lease for 10 years and then build). An evaluation of the long term facilities plan was: use bond financing, individual space of 6X6, first three floors for parking, solar panels on roof. CTA, AXT, UTLA Retired spoke in support of the Plan. After discussion the CalSTRS Board approved the construction of an expansion structure at a cost not to exceed \$300 million utilizing tax-exempt lease revenue bond financing.

The Board adopted the 2019-20 Operational Budget. Total revenues increased by 9% (investment income, member and employer contributions, state contributions). Total expenses increased by 4% (pension and general administration, capital projects, internal and external administration). Reasons for the budget changes were wage escalation, state mandates, organizational growth, and Pension Solution computer project.

The Board approved the incentive awards for CIO and CEO. CEO, Jack Ehnes received \$253,860, 57% of base salary. CIO, Chris Ailman received \$352,233, 65% of base salary. The Board heard a review of CalSTRS funding level. Key findings are: (1) a better than expected investment return in 2017-18 improved funding, (2) the largest risk is investment volatility, (3) a recession and decline in memberships could put the fund at risk, (4) a small risk is new charter schools not electing to participate in CalSTRS.

The next CalSTRS meeting will be by January 30 – February 1, 2019.

John Stanton of Hogan Lowells reported on the emerging priorities of the Administration and Congress which may be of interest to CalSTRS.

First, John commented on the election results. In the Senate, Democrats have lost seats as have Republican moderates. In the House, the question is who will be speaker. Stanton likes Nancy Pelosi. Two issues are the Family Savings Act (403b and 457) and possibly pension reform. There are no big issues.

Government leadership will not hurt public employees. WEP relief is a work in progress. Not much help – changes put off. Probably Congress will make changes to Obama Care (Affordable Care Act). Congress is in favor of infrastructure but has a conflict over who pays. There may be more changes in the Supreme Court because of the age of some of the judges.

## **Benefits and Services Committee**

(Pat Geyer was unable to attend the Benefits and Services Committee meeting. The following are notes from the Committee agenda and materials.)

A report on the 2018 Annual Member Survey was given. Members reported high levels of satisfaction. Reasons were good information, timely issuing of checks and automatic deposits.

82 percent of respondents reported a high level satisfaction with staff performance and service performance. In general, most retired members feel well prepared for retirement. 63 percent of newly retired members and 67 percent of members enjoying retirement reported they are confident they will have enough money to live comfortably throughout retirement.

Member awareness of Pension2 (retirement savings accounts) increased in 2018 to 48 percent, but remains an opportunity for improvement, especially with younger members.

Diane Alsup and Andrew Roth presented an overview of the Medicare Premium Payment Program. This program was established in 2001 to help with Medicare Part A premiums for CalSTRS members who did not get premium-free Part A. The last extension of this program allowed members who retired before July 1, 2012 and did not get premium-free Part A to be eligible for the program.

