CalSTRS Report for February 2018

By Pat Geyer, CalRTA Liaison with CalSTRS

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 held 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.