CalSTRS Report for July 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, oversite 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, oversite 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/2 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.