CalSTRS Report for November 2018

By Pat Geyer, CalRTA Liaison with 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 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.

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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.