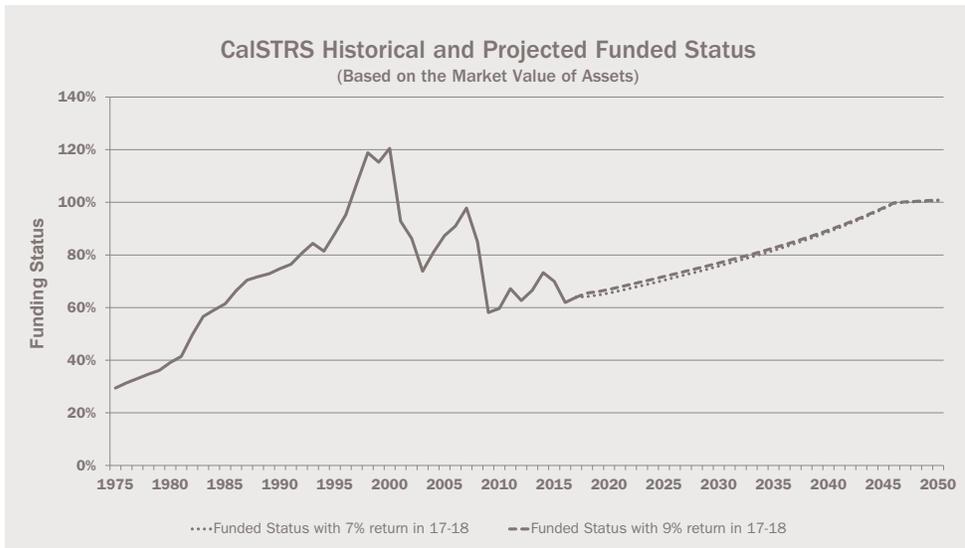


## Annual Risk Report Shows Funding Plan on Target

The board was presented with an annual review of [CalSTRS funding levels and risks](#). This report is intended to assist the board and CalSTRS stakeholders in assessing the trajectory and long-term sustainability of the system. The report also provides better understanding of how well the funding plan is expected to achieve its goal in light of uncertainties related to potential risks in investments, lifespan longevity and declines in membership.

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## CalSTRS to Divest from Private Prisons

The Teachers' Retirement Board voted to remove the fund's holdings in two U.S. companies that operate private prisons: [CoreCivic and GEO Group](#). CalSTRS initiated [CalSTRS Divestment Policy](#) in July related to private prison holdings after the Trump administration's zero tolerance policy for border crossing led to the separation of children from their parents.

CalSTRS engaged both companies surrounding their business practices, including visits to various detention facilities and meetings with senior management.

"The board conducted a review of the staff research; we agreed that the engagement efforts were thorough and listened to our expert investment consultants. Based on all the information and advice we were provided, the board decided to divest according to the policy criteria," said Teachers' Retirement Board Investment Committee Chair Harry Keiley.

The process of divestment will begin immediately and is expected to be completed within six months. As of 11/6/18, CalSTRS' holdings in CoreCivic and GEO Group were \$12,142,211.

## Board Member Profiles:



### Dana Dillon

#### K-12 Classroom Teacher

Dana Dillon has been a K-8 elementary school teacher for 36 years in the Weed Union Elementary School District. She has served on the board since her election in 2003, including stints as chair and vice chair, as well as serving on several board committees. Ms. Dillon has been active in the California Teachers Association for all 36 years, serving as state council representative, chair of CTA's Retirement Committee, and as a member of the CTA board of directors. Ms. Dillon also served as a director on the National Education Association board of directors. She holds a bachelor's degree in liberal studies from California State University, Chico, where she earned her multiple-subject and library media teaching credentials.



### Karen Yamamoto

#### Retiree Representative

Karen Yamamoto is a retired elementary school teacher from West Sacramento. Ms. Yamamoto taught second grade for 15 years and retired in 2007. She was a member of the California Department of Education's Curriculum Development and Supplemental Materials Commission from 1999-2003, acting as Chair in 2003. Prior to beginning her career as an educator, Ms. Yamamoto also served as a legislative assistant to several assembly members in the California State Legislature from 1978-1991. She is currently active in the Asian Pacific Youth Leadership Program and the Japanese American Citizens League, Florin Chapter.

Dana Dillon

Board Chair

Sharon Hendricks

Vice Chair

Keely Bosler

Ex-Officio Member, Director of Finance

John Chiang

Ex-Officio Member, State Treasurer

Joy Higa

Public Representative

Harry M. Keiley

K-12 Classroom Teacher

Paul Rosenstiel

Public Representative

Tom Torlakson

Ex-Officio Member, State Superintendent of Public Instruction

Nora E. Vargas

School Board Representative

Karen Yamamoto

Retiree Representative

Betty Yee

Ex-Officio Member, State Controller



The board approved the construction of an expansion of the CalSTRS West Sacramento headquarters.

## CalSTRS Invests in Headquarters Expansion

The Teachers' Retirement Board voted unanimously to approve the construction of an expansion of its West Sacramento Headquarters. The additional space will allow the organization to grow in order to meet the needs of a changing business model for its investment operations and address the increasing complexities of the ongoing administration of the pension plan while maximizing investment assets and capital returns for the fund over the long term.

In addition, CalSTRS plans to make 200,000 square feet of Class A office space available for lease. Because of the current lack of premium office space in downtown Sacramento, the expansion has great potential to generate lease revenue in the early years.

"This board as a whole will not be better or more informed on this—ever. We can make our decision today and believe it's important that we do so," said Board Chair Dana Dillon. "Good governance requires a focus on prudent process," she continued, adding that the planning leading up to the decision was a "good prudent overall process."

Staff growth is essential to support the CalSTRS mission and core business functions of responsibly investing contributions in the Teachers' Retirement Fund and paying benefits to retirees and beneficiaries. By building the capacity to manage more investment assets with in-house staff, CalSTRS will save millions of dollars in investment fees annually.

"If you hire just 25 (in-house investment) managers, that comes down to \$30 million a year," said Doug Orr of the California Federation of Teachers. "That means if they work here 10 years, you've paid for the building, just in the cost of savings on the managers."

When CalSTRS approved its current 409,000 square foot headquarters in 2006, future expansion was factored into the planning, and in November the board voted to utilize existing land entitlements from the 2009 move to West Sacramento. Office space optimization efforts extended the usage of the existing headquarters three years beyond what was originally intended, which allowed CalSTRS time to plan and analyze several options to meet its long-term needs.

"Our retirement committee is very happy to have an investment in the new building," said Denise Bradford of the California Teachers Association.

After more than two years of planning work, the board decided that expansion through bond financing is the best investment for the system. Additionally, it is less costly than acquiring an existing building and provides greater flexibility, control and operational efficiencies than leasing existing office space. Construction is due to begin in late 2019 with completion expected sometime in late 2021.

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## Annual Risk Report Shows Funding Plan on Target

In May, the board exercised its authority for the second year in a row to increase the state's contribution rate by the maximum allowed, 0.5 percent of payroll. The employer contribution rate continues to increase based on the schedule laid out in the CalSTRS Funding Plan. Furthermore, the investment portfolio once again performed above expectations, with returns above the assumed rate of 7.0 percent. All of these factors have moved CalSTRS to a stronger fiscal position.

The 2018 CalSTRS Funding Levels and Risks report illustrates that the rate setting authority granted in the funding plan has considerably improved CalSTRS funding trajectory; however, significant risks remain in funding the system.

Key results and report findings include:

- The CalSTRS Defined Benefit Program continues to mature, which increases the system's sensitivity to investment volatility, especially for the state contribution rate.
- A better than expected investment return of 9.0 percent in FY 2017-18 improved projected funding levels and lessened some of the expected increases to the state's contribution rates.
- The largest risk facing CalSTRS' ability to reach full funding is risk from investment volatility.
- A recession resulting in both a decline in active membership and a period of lower investment returns would put significant strain on CalSTRS ability to achieve full funding.
- While small in comparison to the overall size of CalSTRS, the trend of new charter schools electing not to participate in CalSTRS continues to increase.

## Diversity Within Investment Managers Discussed

At November's meeting, trustees heard from a panel of investment managers on their views on diversity within the investment management industry. The panelists, Thurman White, CEO of Progress Investment Management; Stephanie Ivy, Managing Director of Goldman Sachs; Edward Powers, Managing Director, HarbourVest Partners LLC; and Debbie Harmon, CEO of Artemis Real Estate Partners, covered the current state of the industry, discussing how CalSTRS might measure diversity and how to define the term within an investment firm.

While CalSTRS has been involved in diversity efforts for decades, the program is being refreshed to reframe its objectives and parameters. Panelists noted several factors have changed the current landscape.

For example, in the last few years as more of the investment portfolio is managed by internal CalSTRS staff,

less is managed by small privately held U.S.-based firms. And, the definition of diversity is expanding to include more groups, such as Pacific Islanders and sexual orientation groups. Overall, the concept for diversity has grown to cover inclusion, now known as "Diversity & Inclusion."

Using the axiom, "What gets measured gets managed," the first step in the process will be to redefine what diversity means to CalSTRS within investment managers. Once defined, staff will survey the managers to build a baseline measure. From there, the Investment Committee will develop a new long-term strategic plan.

After the meeting, the board joined CalSTRS staff at the third annual CalSTRS Emerging and Diverse Manager Reception. There, CalSTRS investment staff met with more than 100 emerging and diverse managers in an informal setting. The panel and reception together proved a prime opportunity for the Investment Committee and CalSTRS to begin to develop the foundation for a new long-term plan for expanding the diversity of CalSTRS investment management.



CalSTRS Chief Investment Officer Chris Ailman meets with prospective emerging managers.



CalSTRS Chief Executive Officer Jack Ehnes at the 3rd Annual Emerging & Diverse Manager Reception.

## Reporting Updates Coming for Employers

The Pension Solution project, a multi-year effort to update CalSTRS' pension administration system, is currently underway. The system is used to track members' service credit and compensation throughout their careers. Employers need to know about these upcoming changes to ensure that their systems will be compatible with the new pension administration system and to make sure payroll vendors are aware and can make the necessary updates. Employer and stakeholder outreach is under way via multiple channels.

Existing law requires employers to submit regular reports to CalSTRS containing key information to administer the plan.

These reports must be submitted electronically through encrypted formats to ensure the security of member data.

The new system will replace several existing employer reporting files. The new file formats will contain new fields and new values that will enhance the accuracy of employer reporting and member data.

Regulations are needed to implement the new file formats. The board is expected to initiate the rulemaking process early next year. If you have questions, please email [Regulations@CalSTRS.com](mailto:Regulations@CalSTRS.com). The Pension Solution project is currently scheduled to be complete in FY 2022-23.

# CALSTRS

California State Teachers' Retirement System | P.O. Box 15275 | Sacramento, CA 95851-0275

For more information on board meeting items and video archives, visit [www.CalSTRS.com/teachers-retirement-board](http://www.CalSTRS.com/teachers-retirement-board)

Next board meeting dates:

- January 30–February 1, 2019, West Sacramento
- March 27–29, 2019, West Sacramento

For board [minutes](#), [full items](#) and [video archives](#) of past meetings, go [here](#).