

BILL NUMBER: [AB 539](#) (Cooley) as introduced February 10, 2021

SUMMARY

AB 539 seeks to expand the CalSTRS Collaborative Model, an investment strategy to reduce costs, control risks and increase expected returns by managing more assets internally and leveraging external partnerships. The bill grants the Teachers' Retirement Board prudent flexibility to contract with investment managers and advisers under policies it adopts. Working closely with external managers and advisers would allow CalSTRS staff to cultivate knowledge of innovative investment strategies and form beneficial, efficient and cost-effective investment partnerships.

BOARD POSITION

Sponsor. The board's policy is to support or sponsor legislation that is consistent with the investment policy adopted by the board as presented in the CalSTRS Investment Policy and Management Plan.

REASON FOR THE BILL

There are two elements that are critical to the successful procurement of contracts with investment managers and advisers—timeliness and access to top asset managers. CalSTRS' ability to quickly secure investment opportunities and replace poor performing managers and advisers is hampered by operating under the umbrella of sometimes inapplicable and restrictive state procurement requirements. With this measure, the board would establish prudent and fiduciarily responsible policies to hire world-class asset managers and advisers.

ANALYSIS

Existing Law:

Most California state agencies, including CalSTRS, must abide by state contracting requirements. Under these requirements, agencies must use the request for proposal (RFP) process to solicit bids for goods and services. Upon identifying a need, staff must develop substantial documentation, including minimum qualifications; advertise and solicit bids through specific channels; address vendor questions through a cumbersome process; and devote significant time to evaluating all candidate proposals, some of which may not be qualified for serious consideration. The length and complexity of these steps make it difficult for CalSTRS to replace underperforming managers timely and to make investment decisions based on objective performance criteria.

The Legislature has recognized the unique nature and mission of certain agencies, such as the California Housing Finance Agency and the California Health Benefits Exchange Board, and has granted exemptions from certain competitive bidding requirements. The challenges CalSTRS faces in the modern investment world are also unique—the most rewarding opportunities require well-timed decisive action, and the top-performing managers have their choice of willing and nimble investors. As such, the RFP process, which strives to encourage competition and fairness, unintentionally inhibits CalSTRS' ability to compete globally.

In addition, as fiduciaries, the board is bound by standards set forth in state and federal law to invest the assets of the plan in a manner that is solely in the interest of members and

beneficiaries. These strict standards require fiduciaries to discharge duties in a timely fashion with care, skill, prudence and diligence at a level that exceeds the goals of California's public contracting requirements.

This Bill:

Consistent with existing authority set forth in the California State Constitution, this bill authorizes the board to seek and secure the highest value contracts for investment-related expertise and services under board-adopted policies, while still meeting the highest fiduciary standards of due diligence. This increased flexibility would allow CalSTRS to move quickly to capture investment opportunities and negotiate reduced fees or better terms when contracts are required.

A potential streamlined investment procurement process could relieve bottlenecks tied to bid solicitation and evaluation by creating a database with simple and open entry criteria in which managers and advisers could identify themselves for consideration. CalSTRS would be able to use this robust and continuously updated universe of potential investment talent to evaluate opportunities in real time using criteria that is investment-specific, objective and competitive to identify the candidates who best fit CalSTRS' needs. Adopting this proactive and innovative process, which recognizes and utilizes current staff practices and expertise, would empower CalSTRS to quickly act upon favorable circumstances.

LEGISLATIVE HISTORY

AB 2510 (Cooley, 2020) would have granted the board authority to contract with investment managers and advisers under policies it adopts. AB 2510 was held in the Assembly Public Employment and Retirement Committee.

AB 1052 (Cooley, 2016) would have authorized CalSTRS to contract for specified investment-related services under the board's terms and conditions and utilizing the processes the board deems necessary and consistent with its fiduciary duties. AB 1052 was held on the Assembly Inactive File.

AB 59 (Elder, Chapter 542, Statutes of 1989), among other things, specified that the incorporation of the board's fiduciary duties into an investment manager contract shall be evidence that the board acted with care, skill, prudence and diligence.

AB 652 (Papan, Chapter 1043, Statutes of 1983) removed the requirement that investments be made under the terms, conditions, limitations and restrictions that are imposed by the state upon savings banks. Repealed requirements for the issuance of bonds as investments and added explicit authority for the board to contract with investment manager firms. Several provisions were operative upon the passage of Proposition 21 on June 5, 1984, which enshrined fiduciary obligations in the California State Constitution and removed the constitutional restrictions limiting the amount of public retirement fund assets that could be invested in equities.

PROGRAM BACKGROUND

Unlike other examples of contracts that utilize the RFP process, CalSTRS' internal investment experts continuously monitor the investment marketplace and are very cognizant of the fees and performance of all potential applicants for investment manager and adviser contracts. Despite this continuous monitoring, the RFP process demands that staff exert a great deal of effort

developing documents, addressing questions and reviewing applications from managers and advisers who may not qualify for work with CalSTRS.

In addition, the complexity of and the time required to participate in the RFP process discourage participation from both top-performing investment managers and advisers with the freedom to choose from abundant potential investors, as well as talented smaller firms without the dedicated resources to complete the bidding process. This process forces CalSTRS to take into consideration a firm's capacity and willingness to engage with state contracting requirements, resulting in a suboptimal universe of potential business partners.

Within the global marketplace, CalSTRS competes with funds that are larger and more agile in terms of their ability to enter into contracts. Top-tier firms with extensive and specific investment-related expertise have numerous choices of investors and often limited capacity for investment, and they may not see the value in competing for a CalSTRS contract. While CalSTRS expends significant time and effort using the RFP process to secure contracts, the landscape may change, costs may increase, and the circumstances driving favorable investments may disappear altogether. Given that a finite number of opportunities exist at any given time, the current process puts CalSTRS at a significant competitive disadvantage in the broader investment world.

OTHER STATES' INFORMATION

At least 20 statewide retirement systems outside of California have varied exemptions to generalized state contracting requirements.

FISCAL IMPACT

Program Costs/Savings – Greater flexibility in procuring new investment managers and advisers could result in significant improvement in CalSTRS' ability to meet performance objectives by taking advantage of favorable market dynamics, maximizing gains and minimizing losses.

Administrative Costs/Savings – Unknown savings in the form of reduced staff work required for the current procurement process.

SUPPORT

CalSTRS (Sponsor)

OPPOSITION

None known.

ARGUMENTS

Pro: Achieves the Collaborative Model's goal of seeking to boost efficacy of guidelines and procedures, increasing responsiveness to investment opportunities as they are presented.

Expands CalSTRS' capacity to partner with peers, form joint ventures, co-invest and develop strong internal investing capabilities, ensuring a well-governed, financially sound trust fund.

Enables the board to create a procurement process that reflects current continuous monitoring of the investment landscape, providing CalSTRS the ability to seize diverse opportunities and potentially generating cost savings for the state.

Con: Creates the potential misperception of an effort to limit a competitive bidding process.

LEGISLATIVE STAFF CONTACT

Peter Elliott
Legislative Analyst,
CalSTRS Governmental Relations,
(916) 414-1183
pellott@calstrs.com

Mary Anne Ashley
Manager,
CalSTRS Governmental Relations,
(916) 414-1981
maashley@calstrs.com

Joycelyn Martinez-Wade
Director,
CalSTRS Governmental Relations,
(916) 414-1980
jmwade@calstrs.com