CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 2745	**Assembly Member Kaloogian (As introduced 2/25/00)**
Position:	**Oppose**
Proponents:	**None known**
Opponents:	**CalSTRS**

SUMMARY

AB 2745 requires the internal and external fund managers of the California State Teachers' Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS) to perform and disclose due diligence on potential investments in foreign companies that pose a threat to national security. The bill also requires both systems to hire an independent auditor to (1) evaluate present and proposed investments in foreign companies and (2) report quarterly to their respective boards and the Legislature on such investments. The auditor may, when warranted, recommend divestment of companies posing a threat to national security. The reports would be available to the public.

HISTORY

Chapter 341, Statutes of 1999 (SB 105—Burton) required CalSTRS to report on investments in companies operating in Northern Ireland. The Board supported this bill.

Chapter 216, Statutes of 1999 (Hayden—SB 1245) required CalSTRS to report on investments in companies that owed compensation for victims of WW II era slave labor. The Board supported this bill.

CURRENT PRACTICE

CalSTRS does not currently require their internal and external fund managers to disclose their due diligence efforts with respect to current and proposed investments in any domestic or foreign companies. In these matters, fund managers have complete discretion. In return for that discretion, the fund managers have fiduciary responsibility for their investment decisions.

DISCUSSION

Under AB 2745, CalSTRS and the CalPERS must require all internal and external fund managers to perform and disclose due diligence on potential investments in foreign companies and any threats to national security that those companies may pose. Both systems are required to hire an independent auditor to study, evaluate and report, publicly, on the present and proposed investments in foreign companies, specifically those believed to be involved in terrorism or the proliferation of weapons of mass destruction. The auditor may also recommend the divestment of investments in specific companies that pose a threat to national security.

The bill appears to include both public and private international equities within its provisions. About 50 percent of CalSTRS' international investments are passively managed. Recommending divestment of specific investments, however, results in an active investment strategy. An active management strategy for much of the system's investments would be expensive and would likely result in investments being concentrated in certain countries and companies that may or may not offer the best investment returns. This could result in potentially higher investment costs and increase risks to the Teachers' Retirement Fund. In addition, if implementation of this bill results in a reduction in the outside manager's discretion over investment decisions, CalSTRS would no longer have the fiduciary protection provided by the use of outside managers, and CalSTRS would assume fiduciary responsibility for the investment decisions.

Proposition 162 of 1992 amended the California Constitution to grant public employees' retirement systems sole and exclusive constitutional authority over their respective investment and administrative decisions. Under the Constitution, the duty of a public retirement system board to its participants and beneficiaries takes precedence over any other duty set forth by the Legislature. The bill requires the auditor to evaluate present and proposed investments in foreign companies. Requiring the manager to have proposed investments subjected to an auditor review will result in significant opportunity costs to CalSTRS because of the amount of time spent evaluating the proposed investment. In addition, because the auditor's recommendation would not apparently be based on any investment performance criteria, any actions by CalSTRS that resulted in a cost to the retirement fund would be inconsistent with the Board's fiduciary duty to operate on behalf of its members and beneficiaries.

FISCAL IMPACT

Benefit Program Costs – No net actuarial impact on the Teachers' Retirement Fund is expected.

Administrative Costs – The bill requires the Board to hire an independent auditor to study and evaluate present and proposed investments in foreign companies identified as threats.

CalSTRS has never employed a firm for the type of services required under the bill and is not aware of a firm that performs the duties required to develop the quarterly investment reports the bill requires. As a result, it is difficult to estimate the cost of these types of services, assuming they can be obtained. Large accounting firms that employ certified public accountants, for example, do not work with intelligence or national security related data in the normal course of things. Instead, these firms are in the business of computing and verifying only the accuracy of historical financial data.

POSITION

Oppose. The Board has plenary authority over investment matters and owes a fiduciary duty to CalSTRS' membership. Subjecting foreign investments to the type of review that is proposed in this bill would be inconsistent with that duty.