BILL NUMBER: Assembly Bill 1584 (Assembly PER&SS Committee) as amended 6/18/09

SUMMARY

AB 1584 expands post-employment restrictions for specified CalSTRS employees or Board members and requires additional disclosures of placement agent fees and activities to prevent "pay-for-play" activities with public pension investments and increases transparency and accountability.

PURPOSE OF THE BILL

Throughout the United Sates, public pension funds have been under scrutiny for their contracting entities' third party placement agent fees and relationships which has resulted in several public pension plans banning contracting entities utilizing placement agents, and a call for increased disclosure of placement agent payments and activities. This bill enhances current law and CalSTRS policy regarding disclosure of placement agent payments and activities, and further limits opportunities for "pay-for-play" practices and conflict of interest activities.

BOARD POSITION

SUPPORT, but note technical amendments to clarify positions subject to post-employment restrictions. This measure augments CalSTRS' current policy on Ethical and Fiduciary Conduct and is in alignment with CalSTRS' Corporate Governance policy.

LEGISLATIVE HISTORY

<u>Chapter 315, Statutes of 2007 (AB 246—Torrico)</u> prohibited anyone who sells investment products to any public retirement system in California from being a member of the board of retirement of a county operating a retirement system under the County Employees' Retirement Law of 1937.

<u>Chapter 856, Statutes of 2003 (SB 269--Soto</u>) allowed the Teachers' Retirement Board and the CalPERS Board of Administration to set salary levels and performance standards for the positions of Chief Executive Officer, System Actuary, Chief Investment Officer and investment managers. It also restricted individuals employed in these positions for less than five years from being paid to influence the actions of the retirement system or decisions of its governing board for two years following the end of their employment with the retirement system.

<u>Statutes of 1990, Chapter 84 (SB 1738, Marks)</u> imposed post-employment restrictions on members of a state administrative agency for one year after leaving employment with the state agency for which he or she worked in the 12 months before leaving office or employment.

PROGRAM BACKGROUND

Placement Agents
A placement agent is a firm hired by an outside investment manager to market its fund to institutional investors, such as public pension funds. Last year, more than half of all private equity firms globally used placement agents to obtain investment funds. A placement agent

typically is paid from 1 to 2 percent of the investment amount that the placement agent helps secure.

Recently, public pension funds throughout the United States have been under heightened scrutiny for their contracting entities' third party placement agent fees and relationships. As a result of ongoing investigations into pension fund corruption and increasing controversy, several public pension plans have actually banned contracting entities from utilizing placement agents. However, some pension systems assert that placement agents do serve a legitimate business purpose.

CalSTRS' Policy on Disclosure of Third Party Relationships and Payment
CalSTRS is committed to protecting assets through the pursuit of good governance and operational accountability, and has robust policies and standards in place to insure transparency and to avoid conflicts of interest. In 2006, as part of its policy governing ethical and fiduciary conduct, the Teachers' Retirement Board (Board) adopted a policy for the disclosure of third party relationships and payments. The policy requires a person or entity involved with any investment transaction or investment management contract to disclose all third party relationships with persons or entities that assisted with the solicitation of CalSTRS as a potential client or the retention of CalSTRS as an existing client. The policy also requires the disclosure of any fees paid or payable to the third party for assisting with the solicitation, which includes placement agent fees.

ANALYSIS:

Existing Law:

Post Employment Restrictions
Existing law prohibits individuals in designated executive, actuarial and investment managerial positions at CalSTRS from acting as an agent, attorney, or any other person to influence the actions of members or officers and employees of the Board. This restriction applies for a period of two years after leaving the position and currently applies only to individuals who hold those positions for less than five years.

Disclosure of Campaign Contributions
Current Board policy and regulations impose requirements on the disclosure of gifts and limit campaign contributions made by people engaged in a business relationship with CalSTRS or seeking to engage in an investment relationship with CalSTRS. Because the relationship with the placement agent is with the investment manager and not CalSTRS, the additional information required by the bill are not included within the current policies and regulations.

This bill:

This measure would not affect the current practice of CalSTRS in a substantive manner, but rather would enhance and strengthen current CalSTRS policy. The measure would augment CalSTRS policies governing placement agents and external investment managers and is consistent with CalSTRS current business practices aimed at mitigating conflict of interest issues when making investment decisions.

Post Employment Restrictions
This measure adds a member of the Board, deputy executive officer, and assistant executive officer to the specified positions subject to the 2-year post-employment restrictions. The measure also deletes the current provision that a person in a specified position subject to the post-employment restrictions, have served in the position for less than five years.

Disclosure of Campaign Contributions
The measure requires the disclosure of all campaign contributions and gifts made by a placement agent to any Board member within specified time frames.

Development and Implementation of Disclosure Policy
CalSTRS does not contract with or make payments to placement agents. Any placement agent fee arising out of a CalSTRS investment is the result of an arrangement between an outside investment manager and the placement agent, and is paid by the investment manager, and not CalSTRS. This measure requires the investment manager to disclose the following additional information:

- A resume for each officer, partner, or principal of the placement agent detailing the person's education, professional designations, regulatory licenses, and investment and work experience;
- A description of any and all compensation of any kind, provided, or agreed to be provided, to a placement agent;
- A description of the services to be performed by the placement agent;
- A statement whether the placement agent or any of its affiliates are registered with the Securities and Exchange Commission or the Financial Industry Regulatory Association, or similar foreign entity, or explanation as to why the registration is not required;
- A statement whether the placement agent or, any of its affiliates, is registered as a lobbyist with any state or national government;

In addition, the measure prohibits:

- CalSTRS from entering into any agreement with an external manager that does not agree in writing to comply with the policy, and
- Any external manager or placement agent who violates the policy from soliciting new investments from CalSTRS for five years after the violation was committed. A majority of the Board could reduce this sanction upon a showing of good cause.

Prohibition on selling or providing investment products
This measure prohibits a member of the Board or CalSTRS employee from participating in the sale or placement of any investment product to any California public retirement fund. This restriction would only apply while the person is serving on the Board or employed by CalSTRS. Subsequent to completion of that service, the person would be subject to the two-year post-employment restriction specified elsewhere in the bill that would apply only to interactions with CalSTRS.

Technical Amendments
The position titles that this measure added to the post-employment restrictions are specific to positions at CalPERS, but not to CalSTRS. CalSTRS does not have "deputy executive officers" or "assistant executive officers." Therefore, CalSTRS recommends adding position titles that reflect titles used at CalSTRS, which are: deputy chief executive officer, chief financial officer and chief technology officer.

OTHER STATES' INFORMATION

The New York state pension fund, among others, has banned the use of placement agents. Other states, including New Mexico are considering legislation related to placement agents.

FISCAL IMPACT

<u>Benefit Program Cost</u> – There are no benefit program costs to revise the existing disclosure policy to include the requirements included in this measure.

<u>Administrative Costs/Savings</u> – Any additional cost due to staff time to revise the disclosure policy by June 30, 2010 can be absorbed.

SUPPORT

John Chiang, California State Controller (Co-sponsor)
Bill Lockyer, California State Treasurer (Co-sponsor)
American Federation of State, County and Municipal Employees
California Public Employees' Retirement System
California School Employees Association
Los Angeles County Employees Retirement Association
Service Employees International Union

OPPOSITION

None known.

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