

Bill Number: AB 1913 (Davis) as amended April 22, 2010

SUMMARY

AB 1913 requires the Board, through 2015, to:

- Beginning on or before January 1, 2012, annually report comprehensively and aggregately on the ethnicity and gender of the emerging investment managers as defined, who participate in managing its portfolio of fund management contracts, including all asset classes; and
- Develop and include in its annual report to the Legislature plans and strategies aimed to increase the participation of emerging investment managers until such managers manage at least 10 percent of the Board's actively managed portfolio.

BOARD POSITION

Neutral, if amended to make the goal apply only to the externally managed portfolio and to add a provision noting that nothing in this bill would require CalSTRS to take any action that is inconsistent with the fiduciary duties of the Board pursuant to Article 16, section 17 of the California Constitution. Staff notes, however, that provisions of the bill may violate other provisions of the California Constitution.

PURPOSE OF THE BILL

AB 1913 is intended to encourage equal opportunity and to increase participation of women and minority-owned business in the management of pension fund assets. AB 1913 aims to support economic growth and prosperity in California through inclusion and requires California's pension systems to establish a policy and goals for using emerging managers in the management of pension fund assets that are consistent with the system's fiduciary duties and responsibilities.

SUMMARY OF AMENDMENTS

On April 22, 2010 the bill was amended to require the CalSTRS Board to:

- Beginning January 1, 2012 report annually to the Legislature the ethnicity and gender of emerging investment managers who participate in managing its investment portfolio; and
- Develop and include in the report plans and strategies to increase the participation of emerging managers until they manage at least 10 percent of the Board's actively managed portfolio.

LEGISLATIVE HISTORY

Chapter 320, Statutes of 2000 (SB 2122—Ortiz) authorized and encouraged CalSTRS and CalPERS to cooperate and share information that may assist them in developing and implementing appropriate investment strategies, with the advice of investment experts, as specified. Specified that confidential information or documents relating to investments in the possession of either system would not lose their confidential status due to the fact that the information or documents are shared with the other system or with investment advisors.

Chapter 9, Statutes of 2000 (AB 869—Keeley) established a Community Reinvestment Act for California insurers by creating an affirmative obligation for insurers to invest in low-income communities. Makes legislative findings that California Organized Investment Network (COIN) in the Department of Insurance (DOI) efforts to encourage insurer commitment to safe investments that benefit low-income communities have resulted in insufficient economically targeted investments; that IMPACT Community Capital, a for-profit insurance industry investment intermediary designed to make economically targeted investments, has also resulted in insufficient investments in comparison to the amount of premiums collected in the state. Established an affirmative and continuing obligation for California insurers to make economically targeted investments in low-income communities.

PROGRAM BACKGROUND

CalSTRS has a rich history of inclusion from its creation by the California Legislature. The CalSTRS Board and staff have been actively pursuing expanding the diversity of investment management, both internally and externally. In 2003, the Board adopted “Strength from Diversity” as one of CalSTRS Core Values and set forth an objective to increase the diversity of investment managers. As a direct result of this effort, more than \$3 billion of assets are now managed for CalSTRS by women and minorities. Since 2003, CalSTRS has received several national awards and recognition for its efforts and actions to expand diversity within the investment portfolio and is seen in the investment industry as a leader and best practice model for the use of minority and women owned investment firms.

The philosophy of inclusion and diversity is interwoven in the business and investment goals of CalSTRS and the direction given by the Board with regard to issues around diversity of ideas and people has proven to be invaluable. CalSTRS continues efforts to ensure that a wide variety of talent and investment ideas continues to be incorporated in CalSTRS investment strategies, as a smart and responsible way to execute its duties as fiduciaries.

ANALYSIS:

Existing Law:

Proposition 209 amended the state constitution in 1996 and provides that the state shall not discriminate against, or grant preferential treatment to, any individual or group on the basis of race, sex, color, ethnicity or national origin in the operation of public employment, public education, or public contracting.

Proposition 162, The California Pension Protection Act (Act), amended the state constitution in 1992 and grants the board of the state’s public employee retirement systems sole and exclusive fiduciary authority and responsibility over the assets of the public pension system. The Act provides that the retirement board shall have sole and exclusive responsibility to administer the system in a manner that is consistent with those exclusive fiduciary responsibilities and duties.

The Act also grants that the Legislature, by statute, to continue to prohibit certain investments by a retirement system when it is in the public interest to do so, provided that the prohibition satisfies the standards of fiduciary care required of the retirement system.

This bill:

AB 1913 requires the Board, beginning January 1, 2012 to report annually to the Legislature the ethnicity and gender of emerging investment managers, as specified, who participate in managing CalSTRS investment portfolio. Additionally, the measure requires the Board to develop and include in the report plans and strategies to increase the participation of emerging managers until they manage at least 10 percent of the Board's actively managed portfolio.

CalSTRS has been working diligently to increase participation of women and minorities in the management of its investments in accordance with its fiduciary responsibility. CalSTRS plans to continue its practice of increasing diversity through the normal course of business in conjunction with the Investments goals aimed to achieve the maximum return at a prudent level of risk and in accordance with its fiduciary responsibilities.

CalSTRS already makes significant efforts to encourage a broad range of investment managers to participate in managing CalSTRS funds. This has been done in a neutral way that affords opportunities without making distinctions based upon race or gender. It is unclear whether AB 1913 violates Article 1, section 31 of the California Constitution, which provides, in pertinent part:

(a) The state shall not discriminate against, or grant preferential treatment to, any individual or group on the basis of race, sex, color, ethnicity, or national origin in the operation of public employment, public education, or public contracting.

The measure may be facially unconstitutional because of the racial and gender lines it tries to draw, or because of the 10 percent baseline of emerging investment managers that it seeks to establish. Additionally, AB 1913 delegates the truly difficult task of devising a constitutional strategy to increase emerging investment managers to CalSTRS. Staff will need to determine what strategies (if any) would be permissible to move the percentage of emerging investment managers from its present level to 10 percent. As a result of existing law, developing such a strategy may impede upon the Board's ability to administer the system and to carry out its fiduciary responsibility. Therefore a provision should be added noting that nothing in this bill would require CalSTRS to take any action that is inconsistent with the fiduciary duties of the Board pursuant to Article 16, section 17 of the California Constitution.

In addition, there appears to be a drafting error requiring CalSTRS to report annually on the percentage of the Board's actively managed portfolio. Within each asset class, portfolios are either actively or passively managed; and are managed either by internal CalSTRS staff or external investment managers. Staff presumes the bill is intended to establish a goal that 10 percent of the externally managed portfolio, whether actively or passively managed, be managed by emerging managers. As drafted, however, this bill would only apply to actively managed assets, even if managed internally, and exclude the passively managed portfolios, even if managed externally. The bill should be amended to reflect the author's presumed intent.

AB 1913 will not help to further this goal of increasing the overall diversity of CalSTRS investment managers, and could jeopardize those efforts by encouraging staff to engage in strategies that would violate Article 1, section 31 of the California Constitution. There would be minor absorbable costs associated with reporting to the Legislature on an annual basis as specified in the measure as well.

OTHER STATES' INFORMATION

Many states are increasing the number of emerging managers who are managing their pension funds and have found that the smaller funds perform just as well as the larger firms.

FISCAL IMPACT

Benefit Program Cost – Unknown.

Administrative Costs/Savings –Ongoing costs associated with annual reporting are minor and absorbable.

SUPPORT

California State NAACP
California Teachers Association

OPPOSITION

N/A

SUPPORTING ARGUMENTS

PROS:

- Increase participation of women and minorities in the management of CalSTRS investments

CONS:

- May violate Article 1, section 31 of the California Constitution (unless amended)
- Increasing emerging investment managers participation to at least 10 percent by January 1, 2016, may not be realistic and could negatively impact the Teacher Retirement Fund
- Requires CalSTRS to devise a constitutional strategy to increase emerging investment managers

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