

Bill Number: **Assembly Bill 2570 (Arambula) – As amended 5/26/06**

SUMMARY:

Among other things, AB 2570 requires the California State Teachers' Retirement System (CalSTRS) and the California Public Employees Retirement System (CalPERS) and public retirement systems in California with assets over \$4 billion to report in their annual financial reports to the State Controller information on their investments in California, and information on their investments in areas identified as having limited access to capital markets by the California Economic Strategy Panel, in consultation with the retirement systems, by asset class, fair market value, and percentage of total portfolio. AB 2570 also establishes an Advisory Committee on Private Investment in California's Future, which would include an unspecified number of representatives from public and private pension funds to assist in the development of a Private Investment Strategy as part of the California Economic Development Strategic Plan required under existing law.

PURPOSE OF THE BILL:

According to the author, California lacks a comprehensive strategy for attracting private investment. As the eighth largest economy in the world, the author maintains that the state has the ability to encourage private investment that could result in increased financial opportunities for the state's historically underserved capital markets, also known as emerging domestic markets (EDM).

BOARD POSITION:

Oppose, unless amended to remove CalSTRS from the reporting provisions of this bill. The Teachers' Retirement Board (Board) reviews on a semi-annual basis, staff reports on CalSTRS' Investments In California, in general, and Investments In Underserved California Markets, in particular. The Board has expressed a willingness to provide copies of these reports to the Legislature, however, it does not wish to allocate additional resources and incur additional expense to track and report information on which of its investments are allocated to specific capital markets identified and developed by another agency.

LEGISLATIVE HISTORY:

Chapter 1338, Statutes of 1989, (SB 1093-Presley) requires CalSTRS/CalPERS to join with the Department of Housing and Community Development (HCD), Treasurer's Office and the California Housing Authority (CHA) to determine what can be done to produce affordable housing in rural communities with prisons. CalSTRS/CalPERS would be required to jointly participate in preparing a report with recommendations to the Governor and Legislature by January 15, 1990.

Chapter 928, Statutes of 1977 (AB 727-McAllister) requires all state and local public retirement systems to annually submit audited financial statements to the State Controller and to triennially secure the services of an enrolled actuary, require the State Controller to annually compile and publish a report on the condition of all state and local public retirement systems.

PROGRAM BACKGROUND:

According to the Assembly Committee on Jobs, Economic Development, and the Economy, there are 132 public pension funds in California with total estimated assets over \$460 billion. Some of these pension funds have already prioritized making investments in California including historically underserved areas such as inner cities and some rural areas; however, many other pension funds have not.

In 2001, the Teachers' Retirement Board (Board) and CalPERS' Board of Administration each established a goal of investing two percent of their systems' assets in emerging portions of the state. As the pension fund serving California's public school educators, CalSTRS represents one of the largest pools of investment capital in the state. While the primary purpose for all CalSTRS investments is to achieve the desired rate of return necessary to fund members' benefits many investment activities have multiple ancillary benefits, creating economic value and activity that benefits the State and its citizens. Every six months CalSTRS' staff report on the estimated amount of California investments as well as investments in underserved portions of the State. These underserved areas include: "urban and rural communities undergoing, or in need of, revitalization where there are assets (e.g., an available labor pool, underutilized infrastructure) conducive to business development."

As of December 31, 2005, CalSTRS has invested more than \$17 billion, or 13 percent, of its total CalSTRS' portfolio in California with the largest portion of assets invested through the public equity and fixed income portfolios. Specifically, CalSTRS' holdings in a number of large companies have significant business exposure and often comprise an integral part of the fabric of California communities, however, it is not possible to obtain the information to measure the actual exposure of these large firms in California's emerging domestic markets in a systematic, reliable and cost-effective manner.

The CalSTRS' Policy on California Investments sets forth the general plan to achieve the two percent goal in the underserved/emerging market space. CalSTRS' has invested \$1,941.7 million as of December 31, 2005, in the underserved and emerging markets of California which represents an increase of \$116.5 million over the December 31, 2004 figure. The Plan is divided between the public and private market portions of the portfolio. The public markets are comprised of assets that are daily valued and regularly traded on open exchanges.

CalSTRS Investment Portfolio: Total California Content	
Asset Class <i>(As of December 31, 2005)</i>	Market Value <i>(Millions)</i>
Publicly Traded Equity (estimated)	\$8,744
Corporate Fixed Income (estimated)	414
Cash Investments (estimated)	1,121
Fixed Income – Securitized Product California Exposure:	2,072
Individual Home Loans	49
Real Estate	2,309
Private Equity	805
Credit Enhancement	1,645
Estimated California Exposure	\$17,159
California as a percent of the CalSTRS total portfolio <i>(Portfolio total \$137,559 million)</i>	

CalSTRS Investment Portfolio: Investments in California Underserved/Emerging Markets	
Asset Class	Market Value <i>(Millions)</i>
Fixed Income – Securitized Product California Exposure	\$ 337.7
Individual Home Loans	5.0
Real Estate	742.2
Private Equity	61.8
Credit Enhancement	795.0
Estimated Exposure to Underserved California	\$ 1,941.7
Percentage of CalSTRS portfolio	1.41%

Historical Data on CalSTRS Investments in California			
Reporting Date:	Market Value (Millions)	Reporting Date:	Market Value (Millions)
June 30, 2001	\$ 1,093.7	December 31, 2003	\$ 1,841.0
December 31, 2001	\$ 1,173.0	June 30, 2004	\$ 1,617.0
June 30, 2002	\$ 1,860.6	December 31, 2004	\$ 1,825.2
December 31, 2002	\$ 1,777.5	June 30, 2005	\$ 1,787.8
June 30, 2003	\$ 2,044.0	December 31, 2005	\$ 1,941.7
		Total Sum:	\$ 31,531.5

ANALYSIS:

Specifically, Assembly Bill 2570:

- Requires public retirement systems with pension assets over \$4 billion to include in their annual financial report to the State Controller, by asset class, fair market value, and percentage of total portfolio, information on investments each holds in California, as well as the emerging domestic markets of California, as defined by the California Economic Strategy Panel;
- Requires the Secretary of Business, Transportation and Housing Agency to establish a statewide cooperative partnership with business and industry sectors to develop a strategy to attract new private investment into the state, including an Advisory Committee on Private Investments in California's Future to assist in the development and implementation of the strategy. The advisory committee would consist of an unspecified number of foreign and domestic representatives from the banking and insurance industries, foundations, corporate and public pension funds, venture capital funds, community development financial institutions and community development corporations.
- Codifies legislative findings recognizing CalSTRS' and CalPERS' existing goals to invest two percent of their portfolio assets in emerging domestic markets, and legislative intent that other public retirement systems with assets over \$4 billion in invested in sufficiently diversified portfolios to adopt emerging domestic market investment policies that meet their own unique investment objectives;
- Requires the California Economic Strategy Panel (ESP) to develop, in consultation with public pension funds with assets over \$4 billion, a definition for emerging domestic markets by October 1, 2007, and update the definition every five years.

Reporting Requirements

Under existing law, each state and local retirement system in California is required to submit audited financial statements annually, which includes data on the value and type of assets each is holding in its portfolio. Retirement systems are required to report this information to the State Controller's Office within six months of the close of each fiscal year. However, the investment portfolio information is classified by the type of financial instrument, not the physical location of the investment or the intended recipients of the ancillary benefits which may be generated.

CalSTRS staff has not been able to estimate the amount of additional staff work needed to meet the EDM reporting requirement of AB 2570 due to the differences in the quality of available data amongst different asset classes that will be necessary to identify their impacts on EDMs. For example, there is no method to easily ascertain the underserved population affected as it relates to investments in Public Equity, where the California content and specifically the content in underserved areas must be measured. Any definition of an EDM developed by the Economic Strategy Panel should account for the differences in the quality of identifying information and the relative ease or difficulty retirement systems have in gathering this information.

New Investment Strategies

AB 2570 requires the Secretary of the Business, Transportation and Housing Agency to establish a statewide cooperative partnership with business and industry to develop a strategy to attract new private investment, including an Advisory Committee composed of an unspecified number of industry representatives, including representatives of public pension systems. While this may be helpful in promoting ideas to improve investment in emerging domestic markets, the Secretary would also be responsible for carrying out an implementation strategy to develop the partnership and carry out Advisory Committee actions, including:

- Assessment of the current trends and opportunities in investment practices;
- Identification of major asset managers by investment type;
- Develop strategies to improve foreign and domestic investments key businesses and industries and emerging domestic markets;
- Consideration of sponsoring conferences and marketing campaigns;
- Make recommendations for statutory and regulatory changes.

It is unclear whether Agency staff dedicated to the Advisory Committee would have the resources and expertise necessary to accomplish all these tasks, or whether an additional call on public retirement system resources would be necessary.

Identifying California's Emerging Domestic Markets

In addition to having responsibility for developing a definition of emerging domestic markets which the Legislature requests public pension funds direct their portfolio investments under this bill, the California Economic Strategy Panel established by Chapter 864, Statutes of 1993 (AB 761—Vasconcellos), composed of 15 legislative or Governor-appointed members, is also

responsible for developing a standard definition of economic development and measuring the performance of state policies intended to stimulate the California economy. Existing law requires the Panel to be representative of state government, business, labor, finance, and academic institutions, and be broadly reflective of the state's population as to gender, ethnicity, and geographic residence within California. Existing law also specifies that at least half of the panel shall be from the private sector, with at least two appointments from small businesses and two appointments from rural areas.

Finding opportunities in the underserved portions of the state is integrated in CalSTRS day-today investment operations. It is part of the total analysis of the portfolio as reflected in Board policy. The Teachers' Retirement Board has already defined what is an undeserved area for purposes of directing its investments in California. CalSTRS staff determines in each asset class, if a specific investment falls in the category of the underserved space. In some asset classes, for example, real estate and private equity, funds have a specific strategy in targeting this space, although not all their investments might be in this category. Requiring the Board to report on the allocation of CalSTRS assets according to a definition that may differ from the Board's current definition would force the system to incur additional expense to collect, calculate and report data whose utility has yet to be determined.

It is possible that the efforts of the Panel and the Business, Transportation and Housing Agency may be better served by collecting data on all public and private investments in underserved areas as part of its regular course of business. For example, if the Panel accepted the Board's existing definition as the basis for reporting, BT&H Agency staff would be able to access both current and historical data on investments in underserved areas on the CalSTRS Web site, which would eliminate the need to incorporate such data into the System's annual financial statements. This is likely to be the process by which the Agency would collect data on other public and private investment in underserved areas of the state.

It is Board policy to oppose legislation or regulations which restrict its investment authority or are inconsistent with its investment policy as presented in the State Teachers' Retirement System of Investment Responsibility. Although AB 2570 requires the Panel to develop an EDM definition in consultation with the public retirement systems, there is a possibility that the Panel will create a definition inconsistent with existing policies of the Board and other retirement systems already participating in this space, whose boards have ultimate fiduciary responsibility for the investment of portfolio assets. To require that CalSTRS report investments defined by one set of criteria that are likely to be different than those adopted by the Board to implement its existing policy objectives would require additional effort, without any apparent positive impact on the goals of the legislation.

FISCAL IMPACT:

Benefit Program Cost – None.

Administrative Costs/Savings – Nominal. Generally, there is a cost impact to CalSTRS when existing policy of the Teachers' Retirement Board (Board) is codified. AB 2570 would impose some additional cost in the form of staff work in reporting the information required in the bill to the State Controller's Office. Moderate additional administrative costs could arise, however, if the definition created by the ESP grossly differs from CalSTRS' definition.

SUPPORT/OPPOSITION

Support:

California Association for Local Economic Development (Sponsor)

Opposition:

CalSTRS