

BILL NUMBER: AB 125 (Wieckowski) as amended May 24, 2013, updated July 9, 2013

SUMMARY

AB 125 authorizes the Teachers' Retirement Board (board) to establish the desired competencies, set conditions of employment and performance standards, and establish the compensation for the Chief Operating Officer (COO) and Chief Financial Officer (CFO). These CFO and COO positions encompass facilitating risk mitigation strategies within a new reporting structure, including additional responsibilities and intensified standards of financial and operational accountability, replacing the current COO and CFO positions. This bill allows the board to recruit for these positions from broader sources. The compensation for these new positions would be based on a comprehensive market pay analysis of comparable positions in public and private financial institutions. Under no circumstances could the compensation exceed 110 percent of the maximum salary payable to a CalSTRS investment director. Based on July 9, 2013, board actions concerning other administrative staff over which the board has authority, the COO salary would range between \$168,000 and \$242,000, and the CFO salary would range between \$155,000 and \$225,000. This bill also requires CalSTRS to report on the improvements and cost savings realized because of these new positions.

BOARD POSITION

Sponsor. Expanding the board's authority regarding the COO and CFO positions is consistent with the board's commitment to provide more effective and efficient administration of the retirement plan, especially as the financial and operational risks of large financial institutions continue to intensify with the volatility of economic, political and market conditions. Moreover, the need for management with necessary expertise for overseeing the sizeable financial assets of the nation's second largest pension fund, preventing crisis situations and establishing public confidence cannot be overstated and is widely recognized by the Governor and the current administration. Specific skills with knowledge and expertise requisite for overseeing and mitigating risk and for managing the exceptionally complicated administrative and operational activities are necessary in these positions.

SUMMARY OF AMENDMENTS

The May 24, 2013, amendments:

- Require CalSTRS to report to the fiscal committees of the Legislature on the improvements and cost savings realized because of these new positions, as specified.
- Require the report to be completed 12 months after filling the COO position or CFO position and annually thereafter.

REASON FOR THE BILL

This bill seeks to enhance CalSTRS ability to proactively plan for the succession of vulnerable top level executive positions, particularly those responsible for managing the increasingly complex financial and operational components of the largest teacher pension fund in the nation. This bill also seeks to improve CalSTRS ability to attract and retain employees for key executive positions that require specialized and critical expertise and competencies, as well as set executive compensation that is consistent with compensation paid for comparable services within selected peer groups that include the private financial service sector and other public retirement systems.

ANALYSIS:**Existing Law:**

Under current law, recruitment for most CalSTRS executive level classifications is limited to the state civil service candidate pool. This limitation constrains CalSTRS ability to potentially recruit the most qualified candidates that possess specialized knowledge, skills, abilities and competencies requisite for overseeing and performing vital operational, administrative and financial activities of the organization. Subsequently, the limitation also hinders CalSTRS succession planning efforts.

In the past, recognizing the difficulty of recruiting experienced senior pension and investment staff, the Legislature provided the board authority to establish position specifications and set compensation for certain key positions. Currently, the board has flexibility in recruiting and compensating senior investment and actuarial staff and has authority to establish position specifications and set compensation for the Chief Executive Officer (CEO), System Actuary, Chief Investment Officer (CIO), General Counsel and designated managerial investment officers and portfolio managers. Conversely, as noted previously, recruitment for both the COO and CFO is subject to the state civil service standards and classifications. There are other state agencies (California State Compensation Insurance Fund, California Health Benefit Exchange) that have been granted authority to establish classes of positions and set compensation in order to attract and retain highly qualified employees and meet the needs of the agency.

In accordance with policy, the level of compensation for executive management and investment staff positions for which the board has authority is typically reviewed every two years. A comprehensive market pay analysis using data from third party sources is conducted with pay comparisons targeted towards other employers, based on a blend of private and public sector organizations, with which CalSTRS competes for talented professionals with similar skills. The minimum and maximum salary range for these positions is recommended based on a benchmark identified in the market pay analysis.

This Bill:

AB 125 gives the board authority to establish desired competencies, performance standards and compensation for the vital positions of the COO and CFO, along with the ability to recruit from external sources. This authority allows the board to competitively recruit from a larger and more highly qualified candidate pool. The compensation for these new positions would be based on a comprehensive market pay analysis of

comparable positions in public and private financial institutions. Under no circumstances could the compensation exceed 110 percent of the maximum salary payable to a CalSTRS investment director. Based on July 9, 2013, board actions concerning other administrative staff over which the board has authority, the COO salary would range between \$168,000 and \$242,000, and the CFO salary would range between \$155,000 and \$225,000. This bill also requires CalSTRS to report on the improvements and cost savings realized because of these new positions.

LEGISLATIVE HISTORY

AB 1735 (Wieckowski, 2012) would have authorized the board to establish the desired competencies, set conditions of employment and performance standards, and establish the compensation, as specified, for the COO and CFO, and allowed the board to recruit for these positions from broader sources. This bill was held in the Senate Appropriations Committee.

AB 2260 (Committee on Public Employees, Retirement and Social Security, Chapter 207, Statutes of 2010) clarified which executive level staff are restricted from performing post-employment activities that influence various actions and proceedings of the board.

AB 1584 (Hernandez, Chapter 301, Statutes of 2009) expanded the prohibition on high level officers and investment staff, who had been in those positions for less than five years, from acting as agents before the board or staff for a period of two years after leaving the retirement system, by removing the five year limitation and including board members, deputy executive officers and assistant officers as staff subject to these provisions.

AB 1317 (Mullin, Chapter 333, Statutes of 2007) authorized the board to determine compensation for the general counsel position.

AB 224 (Negrete McLeod, Chapter 351, Statutes of 2005), among other provisions, specified that the CEO, System Actuary, CIO and investment managers do not receive annual Merit Salary Adjustments.

SB 269 (Soto, Chapter 856, Statutes of 2003) allowed the board to determine the compensation of certain actuarial and investment positions and provided these determinations must be guided by the principles contained in statutes governing the creation of salary ranges for each class or position.

PROGRAM BACKGROUND

Of significant concern for the board are the financial and operational risks that continue to intensify with the volatility of economic, political and market conditions. The most recent independent audit of CalSTRS financial statements identified significant risk surrounding internal controls and material weaknesses in financial reporting. The current CFO and COO are the senior management most responsible for managing these areas of risk. In response to the audit, CalSTRS completed an organizational assessment that benchmarked organizational structures and positions with the essential competencies needed to manage the increasingly complex fiscal and risk management issues related to public pension funds. The assessment identified the need to create

new CFO and COO positions that would facilitate risk mitigation strategies in a new reporting structure with additional responsibilities and intensified standards of financial and operational accountability, replacing the current CFO and COO positions.

One of the board's top strategic objectives is to address and proactively plan for the succession of the CEO and other key senior executive staff. The board recognizes the value of retaining institutional knowledge by developing potential successors internally. Internal succession of the CEO, as desired by the board, would likely come from the COO, CFO and/or the CIO, and therefore, the skills of the incumbents must be on par with those of the CEO. Additionally, in leading all of the operational and administrative functions of CalSTRS, the COO has immense accountability for the management of risk. Moreover, the CFO is responsible for leading all financial activities, which include pension financial accounting and analysis, investment analysis and all financial system activities. Both positions require specialized knowledge, skills and competencies in order to effectively carry out the complex duties of the positions.

Proper business operations require that the increased needs of the organization be reflected as CalSTRS develops its succession strategy. When recruiting for these positions, it is very likely that the most highly qualified candidates would come from large financial institutions in the private sector, endowments or other large public pension systems. However, under existing state civil service laws, CalSTRS is limited to recruitment for these positions from the state civil service candidate pool where required competencies are much less likely to exist.

With authority to establish desired competencies, performance standards and compensation for the positions of the COO and CFO, along with the ability to recruit from external sources, the board would be able to competitively recruit from a larger and more highly qualified candidate pool. CalSTRS would be able to attract and retain employees for key executive positions that require specialized and critical expertise and competencies, as well as, set compensation that is consistent with compensation paid for comparable services within selected peer groups that include the private financial service sector and other public retirement systems. Additionally, providing the board such authority would enhance CalSTRS' ability to proactively plan for the succession of vulnerable top level executive positions, particularly those responsible for managing the increasingly complex financial and operational components of the largest teacher pension fund in the nation.

FISCAL IMPACT

Program Cost – No impact on benefit costs.

Administrative Costs/Savings – The exact cost of establishing the new positions will be dependent on the compensation package developed. Any anticipated increased compensation costs would be offset by savings based on future financial and operational risk avoidance due to board's increased ability to attract, recruit and retain the most highly qualified employees, proactively plan for succession and ensure that staff with skills requisite for managing risk and overseeing vital operational, administrative and financial functions are in place in order to secure the financial future of CalSTRS.

SUPPORT

California Federation of Teachers
CalSTRS

OPPOSITION

None known.

ARGUMENTS

Pro: Increases CalSTRS ability to attract, recruit and retain staff with highly specialized knowledge, skills and competencies requisite to the vital leadership positions of the COO and CFO.

Enables CalSTRS to recruit from a larger candidate pool for the critical expertise needed for these positions.

Supports CalSTRS succession planning efforts.

Provides more effective and efficient administration of the retirement plan and assures the prompt delivery of benefits and related services.

Assists the board in meeting its fiduciary obligation in retaining employees in key senior executive and management positions and in securing the financial future of CalSTRS.

Con: May be viewed as a compensation issue and, therefore, be politically problematic at this time given the heightened attention to state budgetary pressures.

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