

**BILL NUMBER: AB 2571 (Gonzalez Fletcher) as introduced February 15, 2018**

**SUMMARY**

AB 2571 requires public retirement systems to make new, additional or renewed investments in alternative investment vehicles only where the investment manager has adopted and committed to comply with a race and gender pay equity policy, as specified, subject to the fiduciary duty of the retirement board. The bill requires the investment manager to submit an annual report to the public retirement system and requires the system to disclose the reported information at a public meeting and to the State Auditor.

**BOARD POSITION**

**Watch.** Although the introduced version of this bill has the effect of limiting the board's investment authority, the author and sponsor of the bill have expressed a willingness to consider amendments to address the concerns noted in this analysis. In light of those circumstances, the board has adopted a "Watch" position in anticipation of amendments and will reconsider this position at its May meeting.

**REASON FOR THE BILL**

According to the author, the purpose of the bill is to ensure public retirement systems require their alternative investment vehicle managers to adopt race and gender pay equity policies and apply such policies to themselves and to their subsidiary entities in the hospitality sector, an area in which pay disparities are well documented.

**ANALYSIS**

**Existing Law:**

Under the provisions of Section 17 of Article XVI of the California Constitution, as amended by Proposition 162 of 1992, the CalSTRS board has plenary authority and fiduciary responsibility over the investment of retirement plan assets and is required to discharge its duties solely in the interests of the members and beneficiaries for the exclusive purpose of providing benefits. The board must invest the assets of the plan with the care, skill and diligence of a prudent person engaged in a similar enterprise so as to maximize the investments and minimize the risk of loss. When considering investments, the preservation of principal and maximization of income is the primary and underlying criteria for the selection and retention of securities. The Constitution states, however, that the Legislature may by statute prohibit certain investments by a retirement board when it is in the public interest to do so and provided the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board.

Existing federal and state law prohibits an employer from paying any of its employees wages that are lower than wages paid to employees of the opposite sex or of another race or ethnicity. California law specifically, allows differences in wages if those differences are based on specified factors, including a bona fide factor other than sex or

race or ethnicity, such as education, training or experience. Employers that violate this law are liable for the wages, plus interest, and an additional equal amount for damages. An employee that is paid wages in violation of the law may file a complaint with the state's Division of Labor Standards Enforcement, which is required to investigate the violation. The Division of Labor Standards Enforcement must take actions necessary to enforce the payment of the amount due to the employee and may initiate a civil lawsuit on the employee's behalf.

Federal law requires private employers with 100 or more employees that are located in the United States to file a confidential annual report with the U.S. Equal Employment Opportunity Commission presenting a snapshot of the racial, ethnic and gender composition of their employees by specified job categories. However, an employer may apply for an exemption if the preparation or filing of the report would create an undue hardship. Under policies of the previous federal administration, employers were going to be required to include employee compensation data in their annual report beginning in 2018. However, last year, the current federal administration reversed the implementation of that additional reporting requirement.

**This Bill:**

Specifically, AB 2571:

- Requires public retirement systems to make new, additional or renewed investments on or after January 1, 2019, in an alternative investment vehicle that is managed by an investment manager only when the investment manager has adopted and committed to comply with a race and gender pay equity policy that requires the investment manager to:
  - With respect to its own employees:
    - Identify and eliminate racial or gender pay differentials that are not explained by bona fide nondiscriminatory factors.
    - Prepare a certified report detailed below.
  - Cause any subsidiary entity of the alternative investment vehicle that is a hospitality employer, and any hospitality employer with which any subsidiary entity contracts to operate a facility owned by the subsidiary entity, to:
    - Identify and eliminate racial or gender pay differentials that are not explained by bona fide nondiscriminatory factors.
    - Prepare a certified report detailed below.
- Requires, beginning September 1, 2019, the investment manager to submit at least annually to the public retirement system a certified report that includes:
  - The steps the investment manager, and any hospitality employers that are subsidiary entities or with which subsidiary entities contract to operate a facility owned by a subsidiary entity, have taken to identify and eliminate racial or gender pay differentials that are not explained by bona fide nondiscriminatory factors.
  - Pay equity information using job categories and ethnic or racial groups used by specified federal agencies that includes:
    - The annual mean compensation of employees, by gender.
    - The annual mean compensation of employees, by ethnic or racial group.

- The number of employees employed in each job category, by gender, for each ethnic or racial group.
- The average annual compensation of employees in each job category, by gender, or each ethnic or racial group.
- Requires a public retirement system to annually disclose the pay equity information provided by investment managers in a report presented at a public meeting and to submit the same information annually to the State Auditor.
- Specifies that this bill does not require a retirement board to take any action that the board determines to be inconsistent with its fiduciary responsibilities under Section 17 of Article XVI of the California Constitution.

This bill could limit the universe of alternative investment vehicles for CalSTRS. If an investment manager, or a subsidiary entity, is not subject the existing federal reporting requirement because it has fewer than 100 employees, received an exemption or is not located in the United States, this bill would impose a new requirement. Even for an investment manager, or subsidiary entity, already subject to the federal reporting requirement, compiling the compensation information required by this bill would be an added requirement, and disclosure of confidential information may not be legally permissible. An investment manager could consider these requirements to be a burden they are unwilling to undertake or to be unnecessary because of the existing federal and state statutes related to pay equity. An investment manager may also be concerned about releasing information that is confidential. Therefore, investment managers may be reluctant to accept CalSTRS as a limited partner. This would put CalSTRS at a disadvantage, resulting in increased opportunity costs by limiting the universe of available alternative investment vehicles.

CalSTRS is often a limited partner in an investment, and as a limited partner in alternative investment vehicles, CalSTRS does not perform management functions in order to maintain limited liability. However, by requiring a policy for the identification and elimination of race and gender pay inequity, CalSTRS would be executing a management function of the investment manager. If CalSTRS begins to perform what are deemed to be management functions, there is risk that it could lose its limited liability protections.

In relation to the board's fiduciary duty, AB 2571 allows that nothing in the bill would require CalSTRS to take any action that the board determines to be inconsistent with its fiduciary duty. However, this language has the effect of adding to the board's fiduciary responsibility by obligating the board to require its alternative investment managers to adopt race and gender pay equity policies.

## LEGISLATIVE HISTORY

AB 2833 (Cooley, Chapter 361, Statutes of 2016) required California public investment funds to require their alternative fund managers and related parties to make specified disclosures regarding fees and expenses for each alternative investment vehicle. It also required this information to be disclosed at least once annually in a report presented at a meeting open to the public.

SR 18 (Leno, Adopted, 2013), in response to the Russian government taking an aggressive course of action to pass laws targeting the lesbian, gay, bisexual and transgender (LGBT) community, strongly encouraged CalSTRS and CalPERS, whenever feasible and consistent with their fiduciary responsibilities, to cease making direct investments in Russia and to encourage companies in which employee retirement funds are invested and that are doing business in Russia not to take actions that promote or otherwise enable human rights violations in Russia.

AB 1151 (Feuer, Chapter 441, Statutes of 2011) required that any determination by CalSTRS that an action, as specified in the California Public Divest from Iran Act, fails to satisfy the fiduciary duty of the board be made in a properly noticed public hearing of the full board and that proposed findings be made public 72 hours before they are considered by the board.

## PROGRAM BACKGROUND

### ESG Policy

CalSTRS has its own well-established and longstanding process for thoroughly vetting the environmental, social and governance risks of potential investments. The board adopted its Statement of Investment Responsibility in 1978, making CalSTRS an industry leader as one of the first pension funds to adopt a written policy to navigate these complex issues. In its latest incarnation, the board developed a list of 21 Risk Factors as part of its [Investment Policy for Mitigating ESG Risks](#). The 21 Risk Factors help the board to identify and evaluate investment risks relating to the existence of certain conditions, such as recognition of the rule of law, shareholder rights, human rights, the environment, acts of terrorism and other unsustainable practices and governance crises with the potential to hurt long-term profits. More specifically, one risk factor requires CalSTRS staff and external investment managers to include in their financial analysis of any investment decision, “the investment’s long-term profitability from business practices and activities on discrimination, such as discrimination against women, children, and persons with disabilities, nation/racial/ethnic minorities, or indigenous people.”

### Divestment Policy

In addition to the CalSTRS ESG policy, the board has adopted a [divestment policy](#), focusing on engagement, to respond to external or internal initiatives to divest of specific companies or industries. In accordance with this policy, CalSTRS has historically taken the position that active and direct engagement is the best way to resolve issues. Face-to-face meetings with shareowners and senior management, or the board of directors, are generally more effective in bringing about change in a corporation than divestment.

### Diversity

CalSTRS supports board and staff diversity as an important business goal that can be properly addressed in the marketplace and, more specifically, at the company level within CalSTRS’ portfolio company investments. The [CalSTRS Corporate Governance Principles](#) state that “board diversity should be considered by the board or the nominating committee. The director nomination process and policy should consider a diverse mix of skills, background, experience, age, gender, sexual orientation and

identification, and cultural and ethnic composition that are most appropriate to the company's long-term business needs." CalSTRS takes a multifaceted approach to improving diversity in the management of its investments. For example, CalSTRS, along with 24 other large institutional investors, through the Thirty Percent Coalition, engaged 81 companies in 2017, with 24 companies appointing a woman to their board. In addition, one of its external managers that was founded in 2008 and now has \$3.3 billion of assets under management is majority women-owned.

CalSTRS is also working with other pension funds to look at human capital management issues, including pay equity issues, at companies within its portfolio. The Corporate Governance team is finding that while companies are attempting to gather pay equity information, the data is not always accurate or easily obtainable.

## **FISCAL IMPACT**

Program Cost – Private equity and real estate asset classes, which comprise approximately \$40 billion of CalSTRS' investment portfolio, could potentially be affected by this bill. However, the actual impact to these asset classes caused by the loss of investment opportunities cannot be quantified at this time.

Administrative Costs/Savings – Personnel costs exceed \$50,000 for staff time required to collect information from investment managers and produce the required report.

## **SUPPORT**

Unite Here, Local 11 (Sponsor)

## **OPPOSITION**

None known.

## **ARGUMENTS**

Pro: May support pay equity in the private equity and hospitality industries.

Con: May infringe upon the investment authority of the board.

May reduce the investable universe and adversely affect portfolio performance.

## **LEGISLATIVE STAFF CONTACT**

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