**BILL NUMBER: AB 736 (Cooley) as amended August 19, 2016**

## SUMMARY

AB 736 adds Chief Operating Officer (COO) and Chief Financial Officer (CFO) to those positions for which the Teachers' Retirement Board has the authority to establish desired competencies, set terms and conditions of employment and fix the compensation levels. This bill also imposes limits on annual salary increases paid to a person who served in either position on January 1, 2016, and who does not separate from service prior to the increase. Finally, the bill limits the number of each of the positions under the board's authority, except for investment officers, to one.

## BOARD POSITION

**Sponsor.** Expanding the board's authority over the COO and CFO positions is CalSTRS highest legislative priority. All amendments requested have been made to address concerns from the Legislature and the Administration. The bill is consistent with the board's commitment to improve the delivery of benefits and services and to provide more effective and efficient administration of the retirement plan by allowing it to recruit and retain high caliber executives.

## REASON FOR THE BILL

This bill seeks to improve CalSTRS ability to attract and retain a COO and CFO, key positions that require specialized expertise to manage the increasingly complex financial and operational components of the largest teacher pension fund in the world. To proactively plan for the succession of these vulnerable top-level executive positions, the board requires the authority to establish desired competencies, set the terms and conditions of employment and set compensation that is consistent with compensation paid for comparable services within selected peer groups, including large financial institutions in the private sector, endowments or other large public pension systems.

## SUMMARY OF AMENDMENTS

The August 19, 2016, amendments:

- Delete "*one*" from before the COO position, replacing it with the article "*a*."
- Add the article "*a*" before other specified positions.

## ANALYSIS:

### Existing Law:

Under current law, salary ranges for Career Executive Assignment (CEA) category are set by the Department of Human Resources at levels significantly lower than what qualified COO and CFO candidates can obtain from other similar financial institutions. These factors constrain CalSTRS' ability to recruit, hire and retain the most qualified COO and CFO.

In the past, in recognition of the difficulty of recruiting experienced senior pension and investment staff, the Legislature provided CalSTRS and the California Public Employees' Retirement System authority over the Chief Executive Officer (CEO), System Actuary, Chief Investment Officer (CIO), General Counsel and designated managerial investment officers and portfolio managers. The Legislature has since expanded CalPERS' authority over its CFO position and granted similar authority to the State Compensation Insurance Fund (SCIF) and the California Health Benefit Exchange over several executives, including COO- and CFO-level positions.

In accordance with current board 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. The minimum and maximum salary range for non-investment positions is based on a peer group weighted with two-thirds public sector funds and one-third private sector firms.

**This Bill:**

AB 736 gives the board authority to establish desired competencies, set the terms and conditions of employment and fix the compensation levels for CalSTRS' COO and CFO. If the bill is enacted, the COO and CFO would be selected from an eligible list based on an open examination and subject to civil service tenure requirements. If the COO or CFO selected served in that position on January 1, 2016, and has not separated from service in that position, the salary increase for that person shall not exceed 10 percent in the first fiscal year following enactment or five percent in any fiscal year thereafter. The board would be allowed to take action to remove these employees according to state civil service discipline standards, for failing to meet specified performance objectives and for causes related to the board's fiduciary responsibility to its members. In setting the compensation, the board would be guided by principles contained in existing civil service law requiring consideration for prevailing compensation rates in public and private business. AB 736 also limits the number of each of the positions under the board's authority, except for investment officers, to one.

## LEGISLATIVE HISTORY

AB 125 (Wieckowski, 2013-14) would have authorized the board to set the compensation for the COO and CFO positions. This bill was amended to delete these provisions.

AB 1394 (Committee on Insurance, Chapter 309, Statutes of 2013) authorized the board of directors of SCIF to set the compensation for a Chief Medical Officer, Chief Actuarial Officer, Chief Claims Operations Officer and Chief of Internal Affairs.

AB 1735 (Wieckowski, 2012) would have authorized the board to set the compensation for the COO and CFO positions. This bill was held in the Senate Appropriations Committee.

SB 1406 (Emmerson, 2011-12) would have authorized the board of directors of SCIF to appoint and set the compensation of up to 20 unspecified positions exempted from the civil service appointment system. This bill was held in the Senate Appropriations Committee.

AB 1042 (Allen, Chapter 688, Statutes of 2011) authorized the CalPERS Board of Administration to set the compensation for the CFO position.

SB 1145 (Machado, Chapter 344, Statutes of 2008) authorized the board of directors of SCIF to set the compensation for a CFO, COO, Chief Information Technology Officer, CIO, Chief Risk Officer, and General Counsel.

AB 1317 (Mullin, Chapter 333, Statutes of 2007) authorized the boards of administration of CalSTRS and CalPERS to set the compensation for the General Counsel position.

SB 269 (Soto, Chapter 856, Statutes of 2003) authorized the boards of administration of CalSTRS and CalPERS to set the compensationfor the CEO, CIO, systems' actuaries and investment manager positions.

**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. An independent audit of CalSTRS' financial statements identified significant risk surrounding internal controls and material weaknesses in financial reporting. The COO and CFO are the senior management most responsible for managing these areas of risk and facilitating risk mitigation strategies in a reporting structure providing heightened standards of financial and operational accountability.

Among other benefits, recruiting and retaining high caliber individuals in the COO and CFO positions would ensure that CalSTRS can successfully achieve:

- High levels of transparency and internal controls of financial operations.
- Prudent management of cash flow, liquidity, banking and reconciliation activities.
- Increased oversight, risk management and organizational efficiencies.
- Coordination of financial and investment accounting and reporting.
- Compliance with accounting standards and regulatory requirements.
- Innovative and cost-effective hiring, contracting and procurement strategies.

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. Recruiting and retaining high caliber individuals further ensures CalSTRS future success as the COO and CFO shoulder many of the responsibilities associated with the following large-scale efforts currently underway:

- Implementation of the landmark funding plan under Chapter 47, Statutes of 2014 (AB 1469–Bonta).

- New demanding financial reporting requirements for public pension funds mandated by the Governmental Accounting Standards Board (GASB).
- Large-scale overhauls of CalSTRS' financial reporting and pension benefit information technology systems.
- Expansion of the amount of cost-saving, in-house investment expertise.

Although CalSTRS has been fortunate to develop a strong executive management team, prudent business practices and fiduciary obligations dictate that the board position the organization to attract and recruit from among the best and the brightest in the industry. With authority to establish desired competencies, terms and conditions of employment and compensation for the COO and CFO positions, the board would be able to competitively recruit from a larger and more highly qualified candidate pool. 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 world.

**FISCAL IMPACT**

Program Cost – No impact on benefit costs.

Administrative Costs/Savings – The exact cost will be dependent on the compensation package necessary to retain the most well-qualified candidate in the position. Based on CalSTRS' third-party market analysis, the salary would be within the range of $187,900 to $268,500 for the CFO and $201,200 to $266,600 for the COO. However, if either the current CFO or the current COO is selected, the maximum salary in the first fiscal year would be limited to a 10 percent increase from the current $172,900 salary. Any anticipated increased compensation costs would be offset by savings based on future financial and operational risk avoidance and increased organizational efficiencies.

**SUPPORT**

CalSTRS (Sponsor)
California Teachers Association
California Retired Teachers Association

**OPPOSITION**

Department of Finance

**ARGUMENTS**

Pro: Increases CalSTRS' ability to attract and retain staff with highly specialized knowledge, skills and competencies required to identify and mitigate financial and operational risks, improve organizational efficiencies and oversee vital operational and financial functions.

Con: Sensitivity toward the compensation practices of the public and private sector alike has been appropriately increasing, and CalSTRS efforts toward more flexibility could be perceived negatively.

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