

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Bill Number: SB 439 (Simitian) As amended May 23, 2005

SUMMARY

SB 439 specifies which information relating to public retirement systems' alternative investments (AI) is subject to disclosure under the California Public Records Act (CPRA), and which AI information is protected from disclosure under the CPRA, unless that information was previously made public.

PURPOSE OF THE BILL

According to the Sponsor, without the passage of SB 439, public retirement systems in California such as the one administered by the University of California (UC) will lose opportunities to earn significantly better returns on investments, which are in great jeopardy because alternative investment fund managers have begun to reject investments from public institutional investors due to the risk of public disclosure of information they consider confidential and proprietary that they provide to fund investors in the course of doing business.

BOARD POSITION

Support. This measure substantially conforms to the Teachers' Retirement Board's (Board) existing policy on the disclosure of information related to the California State Teachers' Retirement System's (CalSTRS) alternative investments. By specifying which investment information shall be disclosed and which shall become exempt from the CPRA, SB 439 maintains CalSTRS' ability to enjoy higher returns available through alternative investments without jeopardizing our AI partners' ability to compete in the markets.

SUMMARY OF AMENDMENTS

The May 23, 2003 amendments recasts SB 439 to specify which records are exempt from disclosure and which information would be subject to disclosure, thus narrowing the scope of the exemption so that any other record to which the public requests access would be governed by the CPRA, and ensuring that no information or record related to public retirement systems' alternative investments is inadvertently left without a governing statute relating to public access to that information.

ANALYSIS

Senate Bill 439 contains legislative findings pursuant to the California Constitution justifying the need to exclude from public access specified information relating to alternative investments and provides definitions of what constitutes an alternative investment fund or vehicle covered by the bill.

It also exempts the following information from disclosure unless the keeper of the information has previously released the information to the public:

- Due diligence materials that are proprietary to the public investment fund or the alternative investment vehicle.
- Quarterly and annual financial statements of alternative investment vehicles.
- Meeting materials of alternative investment vehicles.
- Information regarding the alternative investment funds' portfolio of investment holdings.
- Capital call and distribution notices.
- Alternative investment agreements and all related documents.

In addition, the bill requires public retirement systems to disclose the following information regarding their alternative investments upon a request made pursuant to the California Public Records Act:

- The name and location of each alternative investment fund, as well as the calendar year in which the fund was formed.
- The dollar amount of the commitment the system has made to each alternative investment fund (fund) over the life of its investment.
- The dollar amount of contributions the system has made to each fund since inception, on a fiscal year-end basis.
- The dollar amount of cash distributions received by the system from each fund since inception, on a fiscal year-end basis.
- The dollar amount of cash contributions received by the system, plus the net asset value of the system's remaining stake in the fund, on a fiscal year-end basis.
- The net IRR of each fund since inception.
- The investment multiple (dollars received vs. dollars returned) of each alternative investment vehicle since inception.
- The dollar amount of the total management fees and costs paid by the system to each fund on a fiscal year-end basis.
- The dollar amount of cash profit received from each fund on a fiscal year-end basis.

According to its sponsors, this bill incorporates the settlement terms of recent lawsuits and represents a balanced response to the public's need to know the actions of its government, and the ability of public pension systems' partners to maintain the confidentiality of their proprietary information.

Since adopting its AI disclosure policy, CalSTRS has not experienced any significant loss of investment opportunities. However, certain members of the private venture capitalist community have expressed displeasure and an unwillingness to enter into investment agreements with other public pension funds out of concern over the extent of disclosure that could occur. The Board has

previously expressed concern that inappropriate disclosure beyond current practice may lead to the system's exclusion from future AI opportunities, thus creating a smaller universe of potential investments. Under such a scenario, some of the top prospective companies could seek capital investment from partnerships that are not subject to disclosure because those partnerships have excluded public pension funds as limited partners. Much of the partnership information CalSTRS refuses to disclose pursuant to its existing policy is exempted from the CPRA by SB 439.

SB 439 substantially codifies CalSTRS existing disclosure policies, minimizes the risk of future court challenges and protects proprietary partnership information. The language of the bill was negotiated with the parties that filed the earlier mentioned lawsuits, and has the support of many venture capital fund managers.

LEGISLATIVE HISTORY

Public Records, Open Meetings. Legislative Constitutional Amendment – Proposition 59 of 2004 amended the State Constitution to clarify the public's right of access to meetings of government bodies and writings of government officials. Among other things, it retains existing exclusions for certain meetings and records and preserves specified constitutional rights to privacy; requires future statutes to include findings demonstrating the interest protected, and the need for that protection; and requires a statute, court rule or other authority to be broadly construed if it furthers the right of access, and narrowly construed if it limits the right of access.

PROGRAM BACKGROUND

CalSTRS is mandated under Education Code §22001 to provide a financially sound plan for retirement with respect to teachers in California's public schools and schools supported by the State of California and other persons employed in connection with these schools. Under Education Code §22203, the Teachers' Retirement Board (Board) is authorized to invest the assets of CalSTRS through the purchase, holding, or sale thereof of any investment, financial instrument, or financial transaction when such action is prudent in the informed opinion of the Board.

Under an Investment Management Plan adopted by the Board, CalSTRS staff has built an AI portfolio of equity and equity related funds consisting of limited partnerships, direct investments, co-investments, and secondary interests in the leveraged buyout, venture capital, distressed debt, mezzanine financing, and natural resource market segments in order to capture higher rates of return than available in the public equity market.

The California Constitution and the CPRA require state and local government agencies to make their records available to the public upon request and allows agencies to charge fees to cover the costs of providing those documents. Existing law contains over twenty exemptions to the CPRA. Where the information is not exempt, and the agency has denied access, it must show that the public interest served by nondisclosure clearly outweighs the public interest served by disclosure

of the records. This balancing test was used by the courts in reviewing a case that forced the University of California in 2003 to disclose returns from its venture capital investments in response to CPRA requests. CalPERS settled a similar challenge in 2002.

In recognition that the access to information concerning the conduct of the people's business is a fundamental and necessary right of every person in California under Government Code §6250, CalSTRS has adopted a disclosure policy for its alternative investment portfolio with respect to private equity partnerships balancing the public's right to know through the disclosure of public records subject to California's Public Records Act, Government Code §§6250 et seq., with not disclosing when the release clearly would outweigh the public interest served by such disclosure as authorized under Government Code §6255(a).

According to Board policy, CalSTRS annually discloses an amount of information with respect to its partnership interests, including: the name of the partnership investment, CalSTRS' capital commitment to the partnership, capital contributed to the partnership, capital distribution to CalSTRS from the partnership, and the internal rate of return (IRR) calculated by CalSTRS pertaining to its investment in the partnership.

FISCAL IMPACT

Benefit Program Cost – None

Administrative Costs/Savings – Minor and absorbable

SUPPORT

University of California, Office of the Treasurer; CalPERS Board of Administration (Co-Sponsors)

OPPOSITION

None

ARGUMENTS

Pro: Provides assurance to AI fund managers that their partnerships and business operations will not be harmed by doing business with CalSTRS and other public retirement systems otherwise subject to broad disclosure requirements.

Allows CalSTRS to continue to achieve superior investment returns through participation in AI fund partnerships that are not available through other asset classes.

Allows the Teachers' Retirement Board to expand CalSTRS' universe of potential investments and reduce overall portfolio risks consistent with its fiduciary duties as specified in the California Constitution.

Con: Limits the public's ability to determine the specific business enterprises that have received indirect investments from public retirement systems.