
THIRD READING

Bill No: AB 539
Author: Cooley (D), et al.
Introduced: 2/10/21
Vote: 21

SENATE LABOR, PUB. EMP. & RET. COMMITTEE: 5-0, 6/21/21
AYES: Cortese, Ochoa Bogh, Durazo, Laird, Newman

SENATE APPROPRIATIONS COMMITTEE: Senate Rule 28.8

ASSEMBLY FLOOR: 77-0, 5/6/21 (Consent) - See last page for vote

SUBJECT: State teachers' retirement: investment managers and investment advisers: contracts

SOURCE: California State Teachers' Retirement System

DIGEST: This bill authorizes the California State Teachers' Retirement System (CalSTRS), with the approval of the State Personnel Board (SPB), to establish criteria to bypass the state competitive bidding process and instead develop an internal process or processes to contract with investment managers and investment advisers after a finding that the necessary expertise it seeks is unavailable in the civil service.

ANALYSIS:

Existing law:

- 1) Establishes strict standards for the use of personal services contracts under which a state agency may contract for personal services rather than utilize civil service employees. The standards permit the agency to contract if the services are not available within civil service, civil service employees cannot satisfactorily perform the services, or the services are of such a highly specialized or technical nature that the necessary expert knowledge,

experience, and ability are not available through the civil service system. (Government Code (GC) § 19130 (b)(3))

- 2) Requires state agencies seeking to let personal services contracts pursuant to GC Section 19130(b) provide notice to relevant public employee representatives and, if requested by those representatives, to undergo specified review procedures be the Department of General Services (DGS). (GC § 19132(b))
- 3) Declares the Legislature’s intent that CalSTRS obtain the best possible investment expertise and secure investment advisors¹ with the composite expertise necessary for the investment of the CalSTRS retirement fund portfolio. (Education Code (ED) § 22350 and § 22351)
- 4) Defines “investment manager” and “investment adviser”² to mean any person, firm, or custodian (i.e., bank or trust company), either appointed by or under contract with the board to engage in investment transactions or to manage or advise in the management of the assets of the Teachers’ Retirement Fund with respect to the Defined Benefit and the Cash Balance Benefit Programs. (ED § 22143)
- 5) Prohibits, generally, contracting for state work of a long-term nature that could be done by permanent state employees and creates the state civil service that includes every officer and employee of the State except a limited number of specified, exempted officers and employees. Existing law also requires that the state make “permanent appointment and promotion in the civil service under a general system based on merit ascertained by competitive examination.” (Cal. Const. Art. VII, § 1 and § 4)
- 6) Authorizes the CalSTRS board, upon its finding that necessary investment expertise is not available within existing civil service classifications, and with the approval of the SPB, to contract with qualified investment *managers* having demonstrated expertise in the management of large and diverse investment portfolios to render service in connection with CalSTRS’ investment program. (ED § 22352)

¹ The relevant Education Code sections sometimes use the spelling “advisor” and other times use the term “adviser” without apparent distinction (Cf., ED §22351 and ED § 22353).

² Both of the terms “investment manager” and “investment adviser” are included in one definition which, however, from context appears to distinguish the two positions. Nevertheless, federal securities law and ERISA also blend the terms. (ED §22143, 15 USC § 80b-2 (11), 29 USC § 1002 (38))

- 7) Requires CalSTRS to retain by contract not less than two separate individual investment *advisers*. (ED § 22353)
- 8) Requires CalSTRS, pursuant to the state civil service statutes, to either contract with, or establish and fill full-time positions for, investment managers experienced and knowledgeable in corporate management issues, as specified. (ED § 22354)
- 9) Declares that placing all public contract law in one code will make that law clearer and easier to find and achieve the following state objectives: clarify the law with respect to competitive bidding requirements; ensure full compliance with competitive bidding statutes as a means of protecting the public from misuse of public funds; provide all qualified bidders with a fair opportunity to enter the bidding process, thereby stimulating competition in a manner conducive to sound fiscal practices; and eliminate favoritism, fraud, and corruption in the awarding of public contracts. (Public Contract Code (PCC) § 100)
- 10) States that to encourage competition for public contracts and to aid public officials in the efficient administration of public contracting, to the maximum extent possible, for similar work performed for similar agencies, California's public contract law should be uniform. (PCC § 102)
- 11) Provides that all contracts entered into by any state agency for services are void unless and until the DGS approves the contract. (PCC § 10295)
- 12) Requires state agencies to follow a competitive bidding process for service contracts, as specified, with provisions for minimum number of bids and prohibitions on sole source contracts among other protections. (PCC § 10335 et seq.)
- 13) Authorizes SPB to establish necessary standards and controls over DGS' approval of contracts to assure that the approval is consistent with the merit employment principles and requirements contained in Article VII of the California Constitution. SPB shall have discretion to establish the substantive provisions of the standards. However, SPB and DGS shall establish the specific procedures for contract review pursuant to such standards jointly. (PCC § 10337)

This bill:

- 1) Authorizes CalSTRS to create a board policy (with the approval of SPB) to establish competitive bidding processes that CalSTRS would use (in lieu of the

state's contract bidding process) to let contracts with investment managers and investment advisers that have demonstrated expertise in managing, or advising the management of, large and diverse investment portfolios to render service in connection with CalSTRS' investment program.

- 2) Permits CalSTRS to specify the contract terms and conditions it solely deems necessary and prudent to contract for investment managers and investment advisers.

Background

CalSTRS manages retirement, disability and survivor benefits for full-time and part-time California public school educators. Like most state agencies, CalSTRS must follow state contracting requirements that require agencies to use the request for proposal process to solicit bids for goods and services. Under state contracting laws, agency staff must develop certain documentation; advertise and solicit bids through certain channels; address vendor questions through a certain process; and evaluate all candidate proposals. The state makes some exceptions to these requirements for certain agencies, such as the California Housing Finance Agency and the California Health Benefits Exchange Board.

According to CalSTRS, the length and complexity of the typical state contracting process slows CalSTRS' ability to replace contracted investment managers who are underperforming and makes it more difficult for CalSTRS to compete for top talent and therefore maximize CalSTRS investment performance.

Rather than soliciting bids via traditional means, CalSTRS intends to create an open and easy-to-use database in which investment managers and advisers would register themselves for CalSTRS' consideration with specified information. When CalSTRS determines it needs to contract for a service it could filter the database for qualified candidates. This process could reduce the time to contract from what currently takes 14-16 months to as little as three months.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

SUPPORT: (Verified 8/5/21)

California State Teachers' Retirement System (source)

OPPOSITION: (Verified 8/5/21)

None received

ARGUMENTS IN SUPPORT: According to the sponsor, California State Teachers' Retirement System:

This measure seeks to expand CalSTRS Collaborative Model, an investment strategy to reduce costs, control risks and increase expected returns by managing more assets internally and leverage external partners. It grants the Teachers' Retirement Board prudent flexibility to contract with investment managers and advisers under policies it adopts.

The investment world is increasingly fast paced and competitive, with top-performing managers and advisers often having both their pick of partners and limited capacity. Conversely, CalSTRS operates under the umbrella of sometimes inapplicable and restrictive state procurement requirements when contracting for investment expertise. While CalSTRS expends significant time on this process, the landscape may change, costs may increase, and the circumstances driving favorable investments may disappear altogether.

ASSEMBLY FLOOR: 77-0, 5/6/21

AYES: Aguiar-Curry, Arambula, Bauer-Kahan, Bennett, Berman, Bigelow, Bloom, Boerner Horvath, Burke, Calderon, Carrillo, Cervantes, Chau, Chen, Chiu, Choi, Cooley, Cooper, Cunningham, Megan Dahle, Daly, Davies, Flora, Fong, Frazier, Friedman, Gabriel, Gallagher, Cristina Garcia, Eduardo Garcia, Gipson, Lorena Gonzalez, Gray, Grayson, Holden, Irwin, Jones-Sawyer, Kalra, Kiley, Lackey, Lee, Levine, Low, Maienschein, Mathis, Mayes, McCarty, Medina, Muratsuchi, Nazarian, Nguyen, O'Donnell, Patterson, Petrie-Norris, Quirk, Quirk-Silva, Ramos, Reyes, Luz Rivas, Robert Rivas, Rodriguez, Blanca Rubio, Salas, Santiago, Seyarto, Smith, Stone, Ting, Valladares, Villapudua, Voepel, Waldron, Ward, Akilah Weber, Wicks, Wood, Rendon

NO VOTE RECORDED: Mullin

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