



Agenda Item 5a

December 15, 2014

ITEM NAME: State Legislative Proposal: Elimination or Modification of Investment Reports to the Legislature; and Clarification of Procurement Requirements Applicable to Investment Contracts

PROGRAM: Legislation

ITEM TYPE: Total Fund – Action

RECOMMENDATION

Sponsor legislation to make changes to sections of the Government Code affecting the administration of the CalPERS Investment Program.

EXECUTIVE SUMMARY

This legislative proposal would repeal various California residential real estate investment and annual reporting requirements, the annual Northern Ireland Report, and the World War II Slave Labor Report. It would also modify the frequency and contents of the Quarterly Investment Performance Report. In addition, it would clarify procurement requirements for investment related contracts, consistent with the Board's fiduciary duties. These changes to various provisions of the Government Code have been identified by staff as necessary for the maintenance and good governance of CalPERS.

STRATEGIC PLAN

This proposal supports the CalPERS Strategic Goal to cultivate a high performing, risk-intelligent and innovative organization.

INVESTMENT BELIEFS

This agenda item supports CalPERS' Investment Belief 10 that strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives.

BACKGROUND

CalPERS investments are subject to numerous statutory requirements, several of which are outdated, of diminished use to interested stakeholders, or which otherwise represent an opportunity to realize efficiencies in the administration of the investment program through their modification or elimination. In these cases, legislative amendments are required.

ANALYSIS

Real Estate Investment Requirements and Reporting

Chartered legislation from 1982 requires CalPERS to give “first priority” to investing a quarter of its portfolio in investments designed to support residential real estate mortgages in California and report to the Legislature annually when that requirement is not met. Amendments to the State Constitution approved by voters in 1992 provide public retirement boards plenary authority over investment decisions, and although the Legislature has authority to require divestment or restrict certain investments, it has no authority to mandate that boards undertake particular investments. CalPERS staff recommends seeking a legislative amendment to eliminate the requirements to invest in California real estate and provide a report when that mandate is not met.

Northern Ireland Report

Chartered legislation from 1999 amended the Government Code to require that CalPERS and the California State Teachers’ Retirement System (CalSTRS) report to the Legislature annually any assets invested in companies that operate in Northern Ireland, and to report whether those assets are in compliance with laws applicable in Northern Ireland relating to the principles of nondiscrimination in employment and freedom of workplace opportunity. The CalPERS 2014 Northern Ireland report listed 54 non-US companies and no U.S. based companies with operations in Northern Ireland that may not adhere to the MacBride Principles of Nondiscrimination. As the result of continuing positive developments in Northern Ireland, the additional reporting requirements relating to CalPERS investments in companies doing business in other nations that have been imposed by the Legislature in the interim, and CalPERS’ continued support of human rights and social issues through its global proxy voting program, staff recommends seeking a legislative amendment to eliminate the reporting requirement. This will result in a redirection of staff time and trust fund expenditures to recent legislative divestment mandates.

World War II Slave Labor Report

Chartered legislation from 1999 made findings that World War II slave labor and forced labor victims and their heirs may be entitled to compensation from companies and their successors or affiliates doing business in California who may have benefited from that labor. In order to facilitate such claims, the legislation amended the Code of Civil Procedure to extend the statute of limitations for claims made against such companies until December 31, 2010. Another uncodified section of the legislation required CalPERS, CalSTRS and the State Treasurer’s Office to produce a report on their investments in companies that may owe compensation to such victims. The CalPERS 2014 World War II Slave Labor Report determined that only two portfolio companies continued to meet the identification requirements under the statute. Because the law does not specify how often the report is required to be produced, and the statute of limitations on claims established by the law expired four years ago, staff recommends that CalPERS seek an amendment to the statute to make explicit that the World War II Slave Labor reporting requirement for CalPERS is no longer in effect.

Quarterly Investment Performance Report

Existing law requires CalPERS to submit to the Legislature a quarterly review of the system's assets, which includes the disclosure of the concentration, and current holdings at cost and market value of equities, fixed income instruments, real estate, and mortgages, as well as information on options or forward commitments, and cash or cash equivalents. It also requires disclosure of time and dollar weighted returns by asset type on a five-year, three-year, and one-year basis, as well as a summary of performance of an alternative theoretical portfolio containing all investments and performance of comparable universes and other indexes.

CalPERS fulfills this statutory requirement by submitting to the Investment Committee the CalPERS' Chief Investment Officer's (CIO) Quarterly Report. The report contains asset performance data that substantively meets all of the statutorily required data points. Recently, the Investment Committee directed staff to provide the Committee with the CIO's report on a semi-annual instead of a quarterly basis. In order to harmonize the Committee's action with statute and ensure the resulting administrative cost savings, staff recommends seeking a legislative amendment to change the Quarterly Investment Performance reporting requirement to a semi-annual basis and eliminate the requirement to report portfolio holdings on a cost basis.

Investment Contracting Procedures

State law generally prescribes the process by which state agencies acquire goods and services, and in certain circumstances requires competitive bidding to ensure fair and equal access to government contracts. In some instances, the Legislature has approved blanket exemptions to these requirements, such as those granted to the Health Benefits Exchange and the Housing Finance Agency. In addition, statutory exemptions often exist for agencies attempting to acquire legal, licensing and proficiency testing services. At CalPERS, specific exemptions exist to ensure the prompt delivery of health, vision, and long term care benefits and services. Notwithstanding these exemptions, CalPERS follows the established state contracting processes wherever feasible.

In the area of investments there is a heightened need to be nimble and to make timely decisions regarding potential investment opportunities. As such, staff recommends seeking various legislative amendments to clarify the procurement processes and requirements for investment-related services, consistent with the Board's fiduciary duties. These clarifications are needed to maximize investment returns and to defray reasonable expenses of administering the System. CalPERS would continue to perform extensive due diligence in analyzing the capabilities and qualifications of bidders pursuant to Board policy. In addition, when awarding the investment contracts, CalPERS will continue to require necessary terms and conditions consistent with existing board policies.

BUDGET AND FISCAL IMPACTS

Repealing or modifying investment reports that are obsolete or no longer serve their original purpose provides an estimated annual savings of more than \$50,000.

BENEFITS/RISKS

1. Benefits

- Allows redirection of staff resources currently dedicated to compliance with outdated statutory reporting requirements.
- Harmonizes Board Policy and statute as they relate to CalPERS' investment performance reporting.
- Improves CalPERS' ability to make timely decisions regarding potential investment opportunities when contracting for investment-related services.

2. Risks

- Incurring unnecessary and continuing costs associated with out-of-date reporting requirements and lost investment opportunities are among the consequences if the proposed solutions are not executed.

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