June 11, 2021

The Honorable Jim Cooper
Chair, Assembly Public Employment and Retirement Committee
1020 N Street, Room 153
Sacramento, CA 95814

Senate Bill 457 (Portantino)
Position: Oppose

Dear Chair Cooper:

On behalf of a coalition of public employee organizations, retired teachers, local educational agencies, and local public agencies, we write to respectfully oppose Senate Bill 457 (Portantino), as introduced on February 16, 2021. Though straightforward on its face, SB 457 would fundamentally change the investment and asset allocation structure of California's two pension systems, putting at risk employee retirement benefits and employers.

Public employees, retired public servants, and public employers are opposed to splintering our pension funds, as proposed by SB 457. We urge the Assembly Public Employment and Retirement Committee to refrain from hearing this bill.

SB 457 would provide "an option to elect an investment portfolio that does not contain investment vehicles that are issued or owned by the government of the Republic of Turkey." The option for a no-Turkey pension fund would be offered to nearly every school district, charter school, county office of education, community college district, and city covered by either the California State Teachers' Retirement System (CalSTRS) or California Public Employees' Retirement System (CalPERS).

All public employees are members of either CalSTRS or CalPERS, both of which invest assets and administer pension benefits for millions of active and retired public employees. CalSTRS serves teachers and other certificated educators across 1,788 school employers. CalPERS serve employees in 2,890 public agencies, educational agencies, and the state. Each pension fund conducts a complex and comprehensive asset-liability management process every four years to determine the most strategic path to ensuring retired members will receive their retirement benefits.

In short, we do not support interference with CalPERS' and CalSTRS' ability to fully fund the retirement of educators and public employees. We believe splintering the pension funds will cause irreparable harm to the benefits promised to the lifelong public servants we represent.

For the reasons below, we oppose SB 457.

1. **SB 457 threatens retirement security for public employees.**

Pension benefits are only as secure the assets that support those benefits. SB 457 will result in lower investment returns and greater administrative costs to the two pension systems, both in the Turkey and no-Turkey portfolios.

Investment losses due to divided pension funds. Whether the pension funds can meet their investment return assumption is perhaps the single most important factor for contribution rates for employers, employees hired on or after January 1, 2013, and the state as contributor to CalSTRS and employer within CalPERS. A no-Turkey portfolio may not be large enough to include the level of investment diversity of the current total fund. It could not participate in more profitable opportunities available to larger trust funds, such as real estate and private equity. Dividing the investment portfolios of CalSTRS and CalPERS not only threatens the retirement security of life-long educators and public servants. It also undermines the Legislature and state's incredible investments in fully funding our retirement plans for public employees.

Administrative complexity and costs due to divided pension funds. An overarching strategic goal of both CalPERS and CalSTRS (a goal with which we strongly agree) is to reduce systemic complexity and reduce overhead costs, which in turn contributes positively to the systems' funding statuses. SB 457 is step in the exact opposite direction. CalSTRS has estimated SB 457's administrative costs to range from hundreds of millions of dollars up to $1 billion for significant reprogramming of and associated delays to CalSTRS' new pension administration system. They also cite increased staffing and workload for Investments and Actuarial Resources. CalPERS has likewise estimated its administrative operating costs to develop, implement, and manage a no-Turkey portfolio for the thousands of unique plans they administer to run into the millions of dollars. For perspective, the cost for the state to buy down CalSTRS school and community college employer contributions by 2 percent for the year 2022-23 is approximately $740 million. The administrative costs for this bill alone could swallow up any additional pension contribution rate relief and further erode school funding.

2. SB 457 undermines significant state investments to reduce unfunded pension liabilities.

In the past decade, the Legislature and Governor have made multi-billion-dollar investments in and significantly curbed retirement benefits from our pension systems. Consider the following: $3.15 billion to buy down school employer pension costs over three years; the CalSTRS "Full Funding Plan" (Ch. 47, Stats. 2013); and the California Public Employees' Pension Reform Act (PEPRA) (Ch. 296, Stats. 2012). Presently, the Legislature's response to the May Revision for 2021–22 proposes additional investments to address: school and community college employer unfunded actuarial obligation (UAO); an additional payment to address the State's share of the CalSTRS UAO; and funding to mitigate the effects of rising contribution rates for school and community college employers. This is not the time to undermine those efforts.

The funding statuses of CalSTRS (67.1 percent) and CalPERS (70.4 percent) have been slowly recovering from both the dotcom bust and the Great Recession. We must remain vigilant to address long-term funding gaps as the pension funds emerge from a global pandemic. The Legislature's sole objective should be to ensure we maximize risk-adjusted returns on behalf of the career public servants that rely on pension benefits.

3. SB 457 sets a precedent that invites further splitting of our pension systems.

This measure establishes a slippery slope, starting with Turkish investments, that will potentially extend in the future to other political issues. We agree with the bill's author that Turkey has violated the human rights of Armenians by continuing to deny the 1915 genocide of Armenians. This is unacceptable.

The problem with manipulating public pension funds to solve present-day political problems or seek historical redress is that the issues change constantly. From year to year, and from week to week, the issues change. In recent years, investment and divestment mandates have been introduced to address climate change, foreign policy, "obscenities," and ammunition sales, and many other issues along the way. Our state and country must confront these issues through policy. But divestiture and (now) splitting up pension funds are entirely inappropriate means to do so. We do not support interference with the funds' investment authorities or their ability to fully fund the retirement of educators and public employees, particularly as these discussions have not included comprehensive conversations on how the measures be paid for or how the effectiveness of these plans would be evaluated.

In contrast, we strongly support CalSTRS' and CalPERS' world-class investment strategies for mitigating environmental, social, and governance (ESG) risks. CalSTRS' risk factors for engagement, for example, include respect of human rights, respect for civil liberties, respect for cultural and ethnic identities, and respect for political rights, among others. ESG policies allow California's pension funds to ***engage*** with political and other risks to the system, as opposed to ***divest*** from those risks. Engagement is to have a seat at the table. Divestment is to lose all leverage. Both CalSTRS and CalPERS have recently illustrated the effectiveness of engagement through their corporate leverage with Exxon to replace members of their Board of Directors to shift the existing corporate direction away from its overreliance on fossil fuels and its impacts on the environment.

Public employees and teachers should not bear the financial cost of divestment created by the Legislature. Priorities at this level should be borne by the state without burdening the middle-class public employees who have suffered from the recent pandemic. Crippling the long-term financial security of a population that has already suffered from job loss and abrupt early retirements will only serve to stifle an economic recovery for California's middle-class families.

4. **SB 457 threatens to increase the contribution rates of public employees, public employers, and the State.**

Dividing the pension funds will drive-up administrative costs and investment losses, for the reasons described above. Here are how these costs will be borne by employees, employers, and the State: The contribution rates for all three parties are determined through a mix of statutory rules and board actions. Perhaps the most important factor for all three is the overall financial health of the pension funds. If the funds are unable to maximize risk-adjusted returns due to legislative constraints like SB 457, these losses are amortized over decades on the backs of employees, employers, and the state.

Any public employee hired on or after January 1, 2013, is required to contribute 50 percent of the total annual normal cost of their pension benefit. In practice, this means PEPRA employee contribution rates fluctuate with the overall health of the employee's pension fund. The same factors affect public employer contribution rates, though the calculations differ as between CalPERS and CalSTRS.

Even though the state is eligible for the no-Turkey investment portfolio, its required contribution rates are impacted by fund losses as a participant in the overall CalPERS fund. Similarly, pursuant to the CalSTRS Full Funding Plan, the Education Code requires the CalSTRS Teachers' Retirement Board to increase the state's contributions to ensure the state makes progress toward eliminating its share of the unfunded actuarial obligation by 2046. For the state in particular, investment losses directly correlate with the required annual increases in the state's contribution rate. Investment losses can cause extreme fluctuations in the state's future contribution rates, which, in this case, would likely occur after the projected additional state revenues subside. Since the creation of the CalSTRS Full Funding Plan, there has yet to be a year in which the maximum increase was not required.

We must also underscore the Proposition 98 (1988) implications of any bill, like SB 457, that creates new cost mandates for local educational agencies. Every dollar lost to increased administrative costs or investment losses will directly affect the state's general fund and Proposition 98, the constitutional formula for determining K-14 school funding.

5. **School districts and cities are not in the best position to make sound financial judgments on pension asset-liability management.**

Asset-liability management requires sophisticated training and expertise. Major pension funds, like CalPERS and CalSTRS, are fiduciarily obligated to act in the best financial interests of the plans and their members. To achieve this requirement, they are supported by teams of actuaries, legal counsel, investment experts, and financial consultants to guide sound financial decisions and include consistent evaluation at the board and staff levels to ensure fiduciary and investment policies are followed. School districts and cities have no investment and legal training to ensure the asset selection is in the best interest of the employee. Moreover, public employers are not fiduciaries to pension system members. The political pressures this would place on the state's thousands of school districts and cities is antithetical to pension security and fully funding the CalSTRS and CalPERS pension funds.

For the reasons above, this coalition of public employees, retirees, and employers are opposed to SB 457 and urge your committee to not hear this bill.

Should you have any questions about our letter, please feel free to contact Jennifer Baker, representing the California Retired Teachers Association (jbaker@m-w-h.com), and Derick Lennox, representing the California County Superintendents Educational Services Association (dlennox@ccsesa.org).

Sincerely,

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cc: The Honorable Senator Anthony Portantino
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