

Date of Hearing: April 3, 2018

ASSEMBLY COMMITTEE ON HIGHER EDUCATION

Jose Medina, Chair

AB 2041 (Caballero) – As Amended March 22, 2018

**SUBJECT:** University of California: Office of the Chief Investment Officer

**SUMMARY:** Urges the Regents of the University of California (UC) to require the Office of the Chief Investment Advisor (OCIO) to take specific actions to enhance diversity both within the office and among companies with which the office partners and invests. Specifically, **this bill:**

- 1) Requires the OCIO, at the Regents urging, to:
  - a) Encourage diversity and to implement a hiring strategy that requires candidates from underrepresented groups be given full consideration whenever an OCIO position is to be filled.
  - b) Require the OCIO's partner firms to implement similar efforts and similar hiring strategies.
  - c) Encompass, as a part of efforts made pursuant to (a) and (b), the Stewardship Pledge for the Innovation Investor announced by the Kauffman Fellows Program in 2017, or something similar.
  - d) Encourage start-up firms to develop diverse executive teams and to maximize efforts to recruit diverse managerial talent.
  - e) Send staff, as appropriate, to the Kauffman Fellows Program at the Center for Venture Education in Palo Alto.
  - f) Create an advisory committee to provide guidance on diversifying the firms included in the OCIO's investment strategy.
- 2) Requires the OCIO to report, by January 2020, to the chairs of the appropriate policy committees of the Assembly and Senate on the actions and plans for addressing the above, including pertinent statistics setting forth the diversity metrics of the OCIO's current investments and those of its partner firms.

**EXISTING LAW:**

- 1) Establishes UC, to be administered by the Board of Regents, with full powers of organization and government, subject only to such legislative control as may be necessary to insure the security of its funds and compliance with the terms of the endowments of the university and such competitive bidding procedures as may be made applicable to the university by statute for the letting of construction contracts, sales of real property, and purchasing of materials, goods, and services. (California Constitution Article IX, Section 9)
- 2) Prohibits the State from discriminating against, or granting preferential treatment to, any individual or group on the basis of race, sex, color, ethnicity, or national origin in the

operation of public employment, public education, or public contracting. This applies to the State itself, any city, county, city and county, public university system, including the UC, community college district, school district, special district, or any other political subdivision or governmental instrumentality of or within the State. (California Constitution, Article 1, Section 31, as added by Proposition 209 (1996).)

- 3) Requires each state agency to be responsible for an effective equal employment opportunity program, including statewide advocacy, coordination, enforcement, and monitoring. (Government Code Sect. 19790 et al.)

**FISCAL EFFECT:** Unknown

**COMMENTS:** *Purpose.* According to the author, "Diversity is important for investment performance, both for better financial outcomes and for ameliorating risks. The trend has been to encourage more diverse governance bodies, in investment managers or corporate boards, from early stage startups to public company boards." The author cites a 2015 report, "Diversity Matters," by the management consulting firm McKinsey and Company, which examined data for 366 public companies across a range of industries in Canada, Latin America, the United Kingdom, and the United States and found, in part, that:

- 1) Companies in the top quartile for racial and ethnic diversity were 35% more likely to have financial returns above their respective national industry medians,
- 2) Companies in the top quartile for gender diversity were 15% more likely to have financial returns above their respective national industry medians.
- 3) In the United States, there is a linear relationship between racial and ethnic diversity and better financial performance: for every 10% increase in racial and ethnic diversity on the senior-executive team, earnings before interest and taxes rise 0.8 percent.

The venture capital (VC) industry, which includes many firms that partner with UC's investment office, has in recent years self-identified a profound lack of women and minorities in management/partner positions within these firms. Many in the industry are making efforts to improve this situation. In 2015, 48 VC firms (23 from California), with more than \$100 billion in managed investments, publicly committed to take concrete steps to develop a more diverse and inclusive industry, including in leadership positions.

According to the author, UC's OCIO "has not yet adopted an investment strategy that embraces diversity, internally, nor works to encourage its investment partners to do so, either. This is markedly different from the investment strategy of UC's sister entities with decades of investment management experience, [the California Public Employees Retirement System] CalPERS and [the State Teachers' Retirement System] CalSTRS, which have been in the vanguard in sponsoring corporate diversity through their own hiring processes, and through their investment selection process."

AB 2041 urges the Regents to require the OCIO to make and carry out a similar commitment to diversity, not only within the office itself, but with the investment firms with which it partners and the companies in which it directly invests.

*OCIO.* The OCIO manages UC's retirement, endowment, working capital, and cash assets under the policies, guidelines, and performance benchmarks established by the Regents. The mission of the Office is to implement those policies and guidelines by selecting, executing, and monitoring investment strategies designed to add value over the benchmarks within a risk-controlled framework. The Office currently manages a portfolio totaling approximately \$100 billion.

*CalPERS and CalSTRS.* As mentioned by the author, the state's two other large pension funds have long made significant commitments to diversity, both in their internal investment staffs and their direct and indirect investments. CalSTRS states, "Diversity is built into the very fabric of CalSTRS' culture. It is explicitly set forth in our core values, which state that 'we ensure the strength of our system by embracing diversity of ideas and people.'"

In January 2007, both CalPERS and CalSTRS unveiled an online Emerging Managers and other Financial Service Provider (EMFSP) database of more than 700 emerging managers and financial service providers towards exposing public and private pension funds and other institutional investors to a new universe of emerging investment firms, and in an effort to boost investment returns by building investment portfolios that tap into the changing demographics and talent emerging in California and across the country. In 2011-12, both entities adopted five-year strategic plans to expand outreach to and participation of emerging managers.

It should be noted that emerging managers are generally defined as newly-formed or relatively small investment firms. Each CalPERS and CalSTRS asset class – global equity fund of funds, private equity funds, real estate partnerships, etc. - has emerging manager definitions based on assets under management and/or length of track record. For example, at CalPERS, an emerging manager global equity fund of funds would have less than \$2 billion in assets under management. Proposition 209 prohibits state agencies from discriminating against or granting preferential treatment to any individual or group on the basis of race, sex, color, ethnicity or national origin in the operation of public contracting. Therefore, CalPERS and CalSTRS may not grant preferential treatment to emerging managers based on these characteristics. Data shows, however, that women and minority managers make up a higher proportion of emerging managers than of all external managers; therefore, emerging manager strategies can result in greater ethnic and gender diversity among CalPERS and CalSTRS external investment managers.

CalPERS and CalSTRS have also pushed for diversity on corporate boards. They, along with leading corporate governance experts have developed a digital resource to assist companies in finding diverse candidates for their boards. Since 2001, CalSTRS and 24 other institutional investors have also engaged 250 companies with the intent to have their board consist of at least 30% women. CalSTRS indicates that it is also partnering with the UC Regents on an initiative to engage 50 companies headquartered in California that have not women on their boards.

*The Kauffman Fellows Program* was created by the Kauffman Foundation in partnership with leaders in the venture capital industry. While working full-time at an investment organization, Fellows receive a structured curriculum with an individual development plan, facilitated mentoring, peer learning, executive coaching and networking—all with a focus on giving back and on each Fellow's responsibility as an emerging leader in the industry. There are nine structured learning opportunities during the two-year program: seven modules and two international summits. Each constantly evolving module explores an essential theme of innovation investing, with a special emphasis on leadership and self-awareness.

*Prior Legislation.* AB 856 (Levine) of 2017, which required the Trustees of the California State University (CSU) and the governing board of each community college district, and requested the UC Regents, when filling faculty or athletic coaching positions, to give consideration to candidates with socioeconomic backgrounds that are underrepresented among existing faculty or coaching staff on the campus where the position is to be filled, was held on Suspense in Assembly Appropriations.

SB 294 (Price), Chapter 701, Statutes of 2011, required the CalPERS and CalSTRS to provide a five-year strategic plan for emerging investment manager participation and to provide a progress report annually to the Legislature.

**REGISTERED SUPPORT / OPPOSITION:****Support**

Fairview Capital

**Opposition**

None on file.

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