

Date of Hearing: April 27, 2021

ASSEMBLY COMMITTEE ON JUDICIARY
Mark Stone, Chair
AB 386 (Cooper) – As Amended March 18, 2021

As Proposed to be Amended

SUBJECT: PUBLIC EMPLOYEES' RETIREMENT FUND: INVESTMENTS:
CONFIDENTIALITY

KEY ISSUE: SHOULD SPECIAL RULES LIMITING THE DISCLOSURE OF OTHERWISE PUBLIC RECORDS OF THE CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM RELATED TO ITS PRIVATE DEBT INVESTMENTS (PRIVATE LOANS) BE ESTABLISHED IN THE CALIFORNIA PUBLIC RECORDS ACT (CPRA)?

SYNOPSIS

This bill would exempt from disclosure under the CPRA specified records regarding an internally managed private loan made directly by the CalPERS Retirement Fund. Under the bill, these records would include quarterly and annual financial statements of the borrower or its constituent owners, unless the information has already been publicly released by the keeper of the information. As explained in more detail in the analysis, the bill also requires that specified records and information must be disclosed, in response to a CPRA request, by CalPERS.

The analysis explains what CalPERS is, what it does, and what constitutional duties its Board of Administration has. It also mentions several incidents in the past 15 years in which CalPERS Board members or officers engaged in illegal and/or unethical behavior. The analysis also explains what “internally managed private loans” (a.k.a. private debt) are and why CalPERS wants to make them part of its investment portfolio. The analysis next discusses the California Public Records Act (CPRA) and its strong presumption that records in the possession of public agencies, including CalPERS, are open to the public. In that context, the CPRA was amended in 2006, as a result of SB 439, to exempt many CalPERS records related to “externally managed alternative investment vehicles” (investments in venture capital funds, hedge funds, etc.) were exempted from disclosure in response to a CPRA request because investors did not want their proprietary and personal information disclosed to the public. In response to litigation at the time—which resulted in CalPERS being ordered to release many records related to these investments, CalPERS was excluded from participation by some historically high performing investment funds. CalPERS fears the same outcome for internally managed private loans, so is sponsoring the bill.

In response to some issues raised in the analysis, the author proposes several relatively minor clarifying amendments. The amendments are described and explained in the analysis and incorporated into the bill’s summary, below. The bill, which recently was approved by the Public Employment and Retirement Committee by a vote of 7-0, is sponsored by the California Public Employees' Retirement System and supported by the California Professional Firefighters, California Special Districts Association, and California State Association of Counties. It is opposed by the Peace and Freedom Party of California and the Retired Public Employees Association.

SUMMARY: Establishes a new exemption to the California Public Records Act (CPRA) for records of internally managed private loans made by the Public Employees' Retirement Fund. Specifically, **this bill:**

- 1) Provides that notwithstanding any other law, the following records regarding an internally managed private loan made by a public investment fund are not subject to public disclosure in response to a CPRA request, unless the information has already been publicly released by the keeper of the information:
 - a) Due diligence materials that are possessed by the public investment fund, or proprietary to any participating underwriting syndicate, the borrower, or any of the borrower's constituent owners or guarantors.
 - b) Private loan agreements and all related documents.
 - c) Personal or business identifying information contained in records that would disclose the identities of any constituent owners of the borrower, regardless of whether the constituent owner is a person or legal entity.
 - d) Quarterly and annual financial statements of the borrower or its constituent owners.
 - e) Materials relating to collateral pledged in support of the private loan.
 - f) Meeting materials of creditors' committees.
- 2) Provides that, notwithstanding 1), above, information contained in specified records must be subject to disclosure and not considered to be a trade secret exempt from disclosure:
 - a) The name and address of each borrower.
 - b) The dollar amount of each private loan made to each borrower, and the amount of principal and interest payments made to the PERF by each borrower, since the inception of the loan.
 - c) The annualized time-weighted return of each private loan.
 - d) For each private loan, the aggregate amount of undrawn loan commitments.
 - e) The amount of principal and interest payments made to the public investment fund by each borrower since the inception of the loan.
 - f) For each private loan, whether the loan has been in default for six months or longer and any public records related to the default that are in the possession of the public investment fund and another public agency and that are open to inspection or copying upon request of the public from the other agency.
- 3) Specifies that records related to a public investment fund's indirect funding of a private loan via a fund or other type of externally managed investment vehicle remain subject to certain specified provisions of the CPRA governing those records (Sections 6254.26 and 7514.7 of the Government Code).

- 4) Finds that the bill imposes a limitation on the public's right of access to the meetings of public bodies or the writings of public officials and agencies within the meaning of Section 3 of Article I of the California Constitution, and finds the following to demonstrate the interest protected by this limitation and the need for protecting that interest:

"This act strikes a balance between preserving the right of the public to access information about how public funds are invested and protecting the privacy of loan recipients and proprietary information provided to public investment funds."

- 5) Defines the following terms:
 - a) "Business identifying information" to mean any information about a legal entity that reveals a trade secret, commercial information, or financial data that is proprietary or confidential, including, but not limited to, information that may be used to distinguish or trace the identity of a person or other legal entity maintaining a constituent ownership interest in the borrower.
 - b) "Constituent owner" to mean a person or legal entity that maintains a direct or indirect ownership interest in the borrower or one of its guarantors or sources of collateral for the loan, including, among others, a stockholder, member, or partner.
 - c) "Personal identifying information" as the same meaning as defined in Section 530.55 of the Penal Code (see below).
 - d) "Private loan" to mean a loan made to or evidenced by a loan agreement, debt instrument, other evidence of indebtedness, if that lending arrangement is exempt from registration as a security under federal securities laws.
 - e) "Public investment fund" to mean the Public Employees' Retirement Fund (PERF).

EXISTING LAW:

- 1) Provides, in the California Constitution, that "The people have the right of access to information concerning the conduct of the people's business, and therefore . . . the writings of public officials and agencies shall be open to public scrutiny." (Cal. Const., art. 1, sec. 3, subd. (b), par. (1).)
- 2) Requires, pursuant to the California Constitution, that "A state, court rule, or other authority . . . that limits the right of access shall be adopted with findings demonstrating the interest protected by the limitation and the need for protecting that interest." (Cal. Const., art. 1, sec. 3, subd. (b), par. (2).)
- 3) Provides, under the CPRA, that all public agency records are open to public inspection upon request, unless the records are otherwise exempt from public disclosure. (Government Code Section 6250 *et seq.* All further statutory references are to this code, unless otherwise indicated.)
- 4) Requires, except with respect to public records exempt from disclosure by express provisions of law, each state or local agency, upon a request for a copy of records that reasonably describes an identifiable record or records, shall make the records promptly available to any person upon payment of fees covering direct costs of duplication, or a statutory fee if applicable. (Section 6253 (b).)

- 5) Requires each agency, upon a request for a copy of records, to, within 10 days from receipt of the request, determine whether the request, in whole or in part, seeks copies of disclosable public records in the possession of the agency and shall promptly notify the person making the request of the determination and the reasons therefor. (Section 6253 (c).)
- 6) Exempts certain records regarding “alternative investments” (means an investment in a private equity fund, venture fund, hedge fund, or absolute return fund) unless the information has already been publicly released by the keeper of the information, from public disclosure. (Section 6254.26.)
- 7) Requires every public investment fund to require each alternative investment vehicle in which it invests to make specified disclosures at least annually. (Section 7514.7.)

FISCAL EFFECT: As currently in print this bill is keyed fiscal.

COMMENTS: This bill would exempt from disclosure under CPRA specified records regarding an internally managed private loan made directly by the CalPERS Retirement Fund. Under the bill, these records would include quarterly and annual financial statements of the borrower or its constituent owners, unless the information has already been publicly released by the keeper of the information. As explained in more detail below, the bill also requires that specified records and information must be disclosed, in response to a CPRA request, by CalPERS.

Author’s Statement. According to the author, the bill is necessary to allow CalPERS to invest in internally managed private loans and thereby diversify its investment portfolio while also allowing public disclosure of records that provide transparency to its operations:

While private debt investments are not new, existing PRA laws do not explicitly address private debt investments[.] . . . Prospective borrowers need a disclosure structure that is clear in statute and consistent with existing law for internally managed private debt investments.

To ensure consistency, this bill is modeled after existing law. It identifies investment information that is subject to disclosure or not subject to disclosure under the PRA and draws on existing law to ensure that items of disclosure are substantively consistent.

This bill maintains the balance established in existing law between the necessary public disclosure of CalPERS investments and the necessity of protecting borrowers’ financial information.

Background – The California Public Employees’ Retirement System (CalPERS). CalPERS is the largest public employee pension fund in the nation. It holds assets for 2 million California public employees and retirees that exceed \$440 billion. According to information posted on the CalPERS website, CalPERS is governed by a 13-member Board of Administration who are elected, appointed, or hold office *ex officio* (because of their elected role, such as the California State Treasurer and California State Controller, or because they represent an organization—such as the State Personnel Board and the California Department of Human Resources—that is required to be represented on the Board of Administration). The Board’s authority that has been established by the California State Constitution. (Cal. Const., art. XVI, Section 17.) Among other things, this section of Article XVI provides the following:

- Notwithstanding any other provisions of law or the California Constitution to the contrary, the retirement board of a public pension or retirement system has plenary authority and fiduciary responsibility for investment of moneys and administration of the system, subject to specified limitations. (Cal. Const., art. XVI, Section 17.)
- The retirement board of a public pension or retirement system shall have the **sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system**. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are trust funds and shall be **held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system**. (Cal. Const., art. XVI, Section 17, subd. (a) [emphasis added].)
- The members of the retirement board of a public pension or retirement system shall **discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system**. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty. (Cal. Const., art. XVI, Section 17, subd. (b) [emphasis added].)
- The members of the retirement board of a public pension or retirement system shall **diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so**. (Cal. Const., art. XVI, Section 17, subd. (d) [emphasis added].)
- The Legislature may by statute continue to **prohibit certain investments** by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section. (Cal. Const., art. XVI, Section 17, subd. (g) [emphasis added].)

The CalPERS Board of Administration reviews and approves portfolio performance, asset allocation, investment transactions, and investment management performance. The Board also establishes investment strategies and policies, and under the Board's direction, the Investment Office carries out the daily activities of the Investment Program.

While the public (especially those who are public employees and retirees) would like to think that the CalPERS Board abides by its fiduciary obligations, recent scandals have unfortunately shown that it has not always done so. Just last year, former CIO Yu Ben Meng suddenly departed after an anonymous ethics complaint to the Fair Political Practices Commission alleged he approved a \$1 billion deal with the New York financial firm Blackstone Group while personally holding as much as \$100,000 in the company's stock. (Finch, "CalPERS ahead of earnings goal with absence at top. When will investment chief vacancy hurt?," Sacramento Bee (April 19, 2021), available at <https://www.sacbee.com/news/politics-government/the-state-worker/article250732564.html>.) It was another embarrassing chapter for the agency. In 2018, a blogger revealed exaggerated claims on the resume of newly-hired chief financial officer Charles

Asubonten, prompting him to resign. (*Ibid.*) Two years prior, former CEO Fred Buenrostro was sent to prison for taking bribes from former CalPERS board member Alfred Villalobos. (*Ibid.*)

What are internally managed private loans, the subject of the bill? Internally managed private loans (also known as “private debt”) are loans that would be made by CalPERS directly to private individuals and businesses. The loans generally would be made for relatively short periods of time and at higher rates than loans made on the ordinary commercial market. The fact that these loans are “internally managed” rather than externally managed, means that CalPERS makes its own decisions whether to underwrite the loans and services them, but does not pay management fees to a third party for those responsibilities.

According to notes from a recent meeting of the CalPERS Board of Administration:

[A] private debt investment strategy involves direct lending to a public or private issuer seeking funds for operations, growth, or other purposes. Private debt strategies include, but are not limited to, direct lending to a borrower, fund investments made through an external manager, and asset-based lending. Unlike fixed income investments, private debt is typically not traded on an exchange. The CalPERS investment portfolio benefits from private debt investments because they provide the opportunity to earn a higher yield and return in many cases, combined with the ability to achieve additional diversification. (CalPERS Board of Administration, Agenda Item 9c1, November 18, 2020.)

While private loans result in higher rates of return for CalPERS than investments in bond market, they also carry more risk. Regardless of due diligence, it is always possible that even well-qualified borrowers could default on their payments. Nevertheless, private debt—whether internally or externally managed--is an investment strategy that presents an opportunity for CalPERS to earn a higher yield and achieve additional diversification of its investments in line with its constitutional mission.

The California Public Records Act and its existing exemption for records of CalPERS investments. The California Public Records Act (CPRA) was enacted in 1968 (Chapter 1473, Statutes of 1968) and codified as Sections 6250 through 6276.48 of the Government Code. Similar to the federal Freedom of Information Act, the CPRA requires that the documents and “writings” of a public agency be open and available for public inspection, unless they are exempt from disclosure. (Sections 6250-6270.) The CPRA is premised on the principle that “access to information concerning the conduct of the people’s business is a fundamental and necessary right of every person in this state.” It defines a “public record” to mean “any writing containing information relating to the conduct of the public’s business prepared, owned, used, or retained by any state or local agency regardless of physical form or characteristics.” (Section 6252 (e).) In enacting the CPRA, the Legislature was “mindful of the right of individuals to privacy,” but also found and declared that “access to information concerning the conduct of the people’s business is a fundamental and necessary right of every person in this state.”

Since 2006, pursuant to Senate Bill 439 (Simitian, Chap. 258, Stats. 2005 [upon which this bill is modeled]), the CPRA has included an exemption for many CalPERS records regarding its “externally managed alternative investment vehicles.” Alternative investment vehicles are investments in venture capital funds, hedge funds, etc. The exemption is codified in Section 6254.26. According to information provided by CalPERS, “At the time SB 439 was introduced, many alternative investment firms were hesitant to accept capital from California-based public pension systems without adequate protections from public disclosure of sensitive and proprietary

information about underlying investments, putting California public pension funds at a competitive disadvantage.” Furthermore, according to the analysis of SB 439 by the Assembly Banking and Finance Committee, a series of lawsuits pursuant to the CPRA forced CalPERS to disclose records of its alternative investment vehicles and hurt the ability of CalPERS to invest in those highly profitable funds:

Recent litigation against the public pension funds to compel the disclosure of information related to these highly profitable investments in venture capital funds, hedge funds, and other alternative investments, provides the impetus for this bill. The separate court actions, brought by the California First Amendment Coalition against CalPERS and by the Coalition of University Employees, Charles Schwartz and the San Jose Mercury News against the Regents of the University of California, invoked the CPRA and the public's right to information about the defendants' private equity investments. The lawsuits requested disclosure of, among others, the amount of the investments, management fees paid to private equity funds, capital gains paid by the funds to the pension funds, internal rates of return, and other specified information. The settlement of the lawsuits resulted in some requested information being designated as confidential and not disclosable, and others as fully disclosable upon request pursuant to the CPRA.

Since the lawsuits were filed and continue to date, the state's public pension funds have been excluded from participation by some historically high performing investment funds. The rationale the pension funds were given was that the CPRA makes the alternative investment funds vulnerable to disclosure of highly confidential information. (Assembly Committee on Banking and Finance, SB 439 as amended May 23, 2005 (July 6, 2005).)

As a result of SB 439, disclosure of certain investment data retained by CalPERS in its records, particularly company-level information, is generally considered to be proprietary or trade secret and therefore exempt from public disclosure pursuant to Section 6254.26.

This bill – seeking to exclude certain information within CalPERS records related to private loans/debt, like its records of externally managed alternative investment vehicles, from public disclosure. According to CalPERS, the underwriting of private debt investments requires significant due diligence, including a comprehensive review of the borrower's financial condition, credit history, and collateral. Public disclosure of certain documents, such as these, would impair CalPERS' ability to participate fully in future private debt investment opportunities. Borrowers may be reluctant to take loans from CalPERS if personal and financial information about their personal and business finances were likely to be disclosed to the public upon request.

At the same time, given the strong presumption towards public disclosure in the CPRA and the California Constitution, the need that CalPERS expresses for investor privacy must be balanced against that presumption so that any exemption from public disclosure is as limited as necessary to assist CalPERS carry out its constitutional duties. This is especially true given the history of numerous instances of illegal and/or unethical conduct by CalPERS Board members and officers in the past 15 years.

As explained above, this bill is modeled on Section 6254.26. It would exempt from disclosure under CPRA specified records regarding an internally managed private loan made directly by the CalPERS Retirement Fund. Under the bill, these records would include quarterly and annual financial statements of the borrower or its constituent owners, unless the information has already

been publicly released by the keeper of the information. The bill in print also requires that the following information is disclosed, in response to a CPRA request, by CalPERS:

- 1) The name and address of each borrower.
- 2) The dollar amount of each private loan made to each borrower by the public investment fund since inception.
- 3) The annualized time-weighted return of each private loan.
- 4) For each private loan, the aggregate amount of undrawn loan commitments.
- 5) The amount of principal and interest payments made to the public investment fund by each borrower since the inception of the loan.
- 6) For each private loan, whether the loan has been in default for six months or longer.

However, some provisions of the bill in print may be somewhat more broad than necessary. For example, the bill in print requires that certain items of information about private loans must be disclosed, such as the name and address of each borrower, and the dollar amount of each private loan. For loans in default, however, which arguably are of greater public interest to the public than loans which are not in default, the bill in print only requires that CalPERS disclose “whether the loan has been in default for six months or longer.” This may not be adequate. If CalPERS has records about loans in default, such as court filings, which could be obtained from other public agencies or entities, such as courts, CalPERS should also certainly be required to disclose such records without fear of disclosing proprietary or other nonpublic information about the borrower.

Author’s amendments. In order to address the issue above, and to clarify other minor provisions of the bill in print, the author proposes to amend the bill as follows:

- 1) On Page 2, at line 28, strike out “proprietary to” and insert: “possessed by”
- 2) On Page 2, at line 29, after “fund,” insert: “or proprietary to”
- 3) On Page 3, at line 11, after “trade secret” insert: “or otherwise”
- 4) On Page 3, at line 22, at the end of the current sentence, insert: **and any public records related to the default that are in the possession of the public investment fund and another public agency and that are open to inspection or copying upon request of the public from the other agency**

ARGUMENTS IN SUPPORT: According to CalPERS, this bill would “...mitigate the competitive disadvantage to the state’s public pension funds under existing state law in accessing private-debt investment opportunities, while ensuring full and complete public access to the data needed to evaluate investment performance. This bill parallels existing disclosure requirements for public pension investments in alternative investment vehicles.”

The California Professional Firefighters state in part that, “Private debt is an investment strategy that presents an opportunity for CalPERS to earn a higher yield and achieve additional diversification. The strength and health of the retirement fund is of paramount priority for firefighters.”

ARGUMENTS IN OPPOSITION: The Retired Public Employees Association states that, “Because it is necessary for the public to understand whether the terms of the proposed private loans are prudent risks, the loan agreements and documents, the personal or business identifying information disclosing the identities and the constituent owners of the borrower, and materials relating to collateral pledged must not be exempt from the Public Records Act — once negotiations are concluded and the agreement is executed. Only then may the public, and the members and beneficiaries, independently determine whether CalPERS staff have negotiated a good deal and whether the CalPERS Board are acting as sound fiduciaries.”

The Peace and Freedom Party, similarly observes that, “Denying transparency of public funds may be extremely dangerous for taxpayers and in this case public agencies retirees. A public agency that would make loans to entities that banks would not loan to is irresponsible and fails in its fiduciary responsibility to its stakeholders. . . . Our opposition is based on our concern that this could provide a cover for unforeseen corruption. Secrecy and money do not belong together.”

Prior Similar Legislation: AB 2473 (Cooper, 2020) was virtually identical to this bill. Although it was referred to this Committee, due to disruption and constraints to the legislative calendar following the COVID-19 pandemic, AB 2473 was withdrawn from the Committee. Status: Died in the Senate Labor, Public Employment and Retirement Committee without a hearing.

REGISTERED SUPPORT / OPPOSITION:

Support

California Public Employees' Retirement System (sponsor)
California Professional Firefighters
California Special Districts Association
California State Association of Counties

Opposition

Peace and Freedom Party of California
Retired Public Employees Association

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