CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 107	**Assembly Member Knox (As amended 2/29/00)**
Position:	**No Position**
Proponents:	**CFT, CTA, UTLA**
Opponents:	**None known**

SUMMARY

AB 107 prohibits new or additional investments in tobacco companies by the California State Teachers' Retirement System (CalSTRS) and the California Public Employees Retirement System (CalPERS), on and after January 1, 2001 and requires a divestment of existing investments by July 1, 2002.

HISTORY

In 1997, two tobacco divestment bills, AB 1744 (Knox) and SB 1433 (Hayden), were introduced but failed passage.

CURRENT PRACTICE

CalSTRS passively and actively invests a portfolio valued at over $100 billion. The portfolio is broadly diversified and ranges from publicly traded bonds to privately held partnerships. At the end of last fiscal year, CalSTRS' portfolio allocation across asset classes was 70 percent domestic and international equity, 25 percent domestic fixed income, and 5 percent private equity. Currently, CalSTRS does not adhere to any investment policy restricting the holding of equities in any particular industry or sector in its portfolio, such as tobacco.

DISCUSSION

As of December 31, 1999, CalSTRS held domestic and international equities in 22 companies that manufacture and distribute tobacco products, at a market value of $319,270,861, or less than one half of one percent of equity holdings. The bill (1) prohibits *new* or *additional* investments by CalSTRS and CalPERS in tobacco companies on and after January 1, 2001 and (2) requires the divestment of existing investments by July 1, 2002.

AB 107 defines a tobacco company broadly as " … a business entity that makes more than 10 percent of their gross revenue from tobacco products or have more than 10 percent of their personnel or has more than 10 percent of its business activity in tobacco products." Such a definition could encompass the business activities of retailers, transportation companies, chemical companies, flavoring companies, and advertisers resulting in a very long list of companies in the CalSTRS portfolio that would be targeted for divestment, with a market value exceeding the $319 million for the 22 companies cited earlier.

As an investment sector, tobacco stocks have had mixed results during the past six years. At the April 2000 Investment Committee meeting, the Teachers' Retirement Board (Board) was informed by various consultants, including Pension Consulting Alliance, Inc., that tobacco divestment would not increase the overall risk of CalSTRS aggregate portfolio. However, the consultants could not determine what impact, if any, tobacco divestment would have on the future investment returns of CalSTRS' aggregate portfolio. As a result, the Board chose to address investments in tobacco in the context of larger investment policy issues: the benchmark the system uses to determine specific investments and the extent to which CalSTRS delegates investment portfolio decisions to external portfolio managers.

At the May 2000 Investment Committee meeting, the committee adopted a policy to modify the benchmark against which investments are measured. Under the policy, the benchmark will be modified when it is in the economic interest of the System do so, when a more cost efficient alternative is available or when an industry is exposed to economic risk. The indicators of significant economic risk would include product liability judgements, industry-wide bankruptcy filings and regulatory and/or legislative actions. At the June 2000 meeting, the committee adopted a modification to its existing benchmark that excludes tobacco manufacturers. As a result, the system will not be holding such investments in its passive portfolio.

FISCAL IMPACT

<u>Benefit Program Costs</u> – While the performance of the investment portfolio impacts the benefits CalSTRS may offer its membership, AB 107 does not directly impact the benefit programs.

<u>Administrative Costs</u> –

POSITION

No position. The Board has modified its benchmark to exclude tobacco manufacturers from its passive investment portfolio. The Board is concerned, however, that the scope of companies included in this bill goes well beyond tobacco manufacturers and that, should tobacco industry economic conditions change, the Board would be precluded from resuming such investments, despite any economic benefits of doing so.