

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Bill Number: Assembly Bill 221 (Anderson) – As amended 4/17/07

SUMMARY

Assembly Bill 221 prohibits the California State Teachers' Retirement System (CalSTRS) and the California Public Employees Retirement System (CalPERS) from investing in companies with business operations in Iran and requires each pension system to sell or transfer any investments in a company with business operations in Iran. When the U.S. repeals its sanctions, the pension Boards shall notify the Secretary of State, and the prohibitions and requirements in this bill will be repealed.

PURPOSE OF THE BILL

According to the author, the purpose of this bill "is to add stability to California's public retirement fund investments by removing the risk posed to them by the danger and volatility of doing business in Iran. AB 221 will help CalPERS and CalSTRS fulfill their commitment to shield the retirement security of millions of Californians."

BOARD POSITION

Oppose unless amended. The Teachers' Retirement Board (Board) voted on April 7, 2007, to oppose AB 221 unless it is amended to conform to the Board's recently adopted legislative divestment policy. The Board opposes legislation or regulations that restrict or infringe on the investment authority of the Board that is inconsistent with its Statement of Investment Responsibility. The Board should retain its authority to manage the CalSTRS investment portfolios, including difficult geopolitical risk, rather than be restricted or directed how to carry out its fiduciary duty.

SUMMARY OF AMENDMENTS

The Amendments of April 17, 2007, added the following criteria defining those companies in which the Board shall not invest public employee retirement funds:

1. "The company has invested in, or is engaged in, business operations with entities in the defense, oil, nuclear, or natural gas sectors of Iran.
2. "The company is engaged in business operations with an Iranian organization labeled as a terrorist organization by the U.S. Department of State."

The amendments of March 5, 2007:

- Replaced legislative findings and declarations with new findings concerning business activities in foreign terror-sponsoring states where those business activities are subject to U.S. sanctions that may materially harm the share value of foreign companies, particularly those held in portfolios of California public retirement systems;

- Declared that investments in publicly traded foreign companies that have business operations in or with those foreign states that the U.S. Department of State has identified as sponsoring terrorism risks the pensions of California public employees;
- Declared that excluding companies with business activities in foreign states that sponsor terrorism from public portfolios will help protect the public retirement systems in this state from investment losses related to these business activities and may improve the investment performance of the public retirement systems;
- Declared that it is unconscionable for California to invest in foreign companies with business activities benefiting foreign states that commit egregious violations of human rights and that sponsor terrorism;
- Created the California Public Investments Protection Act.

LEGISLATIVE HISTORY

SB 461—Ashburn (2007) prohibits CalSTRS and CalPERS from investing public employee retirement funds in a company with business operations in a foreign terrorist state, as specified. Requires the Board of Administration of each System to sell or transfer any investments in a company with certain business operations. This bill is pending before the Senate PE&R Committee.

Chapter 441, Statutes of 2006, (AB 2179—Leslie) indemnifies from the state General Fund all current or former regents, officers, employees, and contractors of the University of California (UC) from all claims, demands, suits, actions, damages, judgments, etc., and all liability that they may sustain by reason of any decision of the UC Regents not to invest in any company or firm involved in significant business activities that provide revenue to the Sudanese government.

Chapter 442, Statutes of 2006 (AB 2941—Koretz) prohibits CalSTRS and CalPERS from investing in companies with business operations in the Sudan that are complicit in the Darfur genocide or have specified relationships with the Sudanese government or military. Requires the boards of both retirement systems to divest from such companies consistent with their fiduciary obligations. Indemnifies from the General Fund board members, officers, employees and investment managers under contract with the retirement systems from liability for their actions.

Resolution Chapter 98, Statutes of 2005 (ACR 11—Dymally) requests that CalSTRS and CalPERS, wherever feasible and consistent with their fiduciary responsibilities, encourage companies in the funds that are doing business in Sudan to act responsibly and not take actions that promote or otherwise enable human rights violations in the Sudan.

AB 2745—Kaloogian (2000) would have encouraged CalSTRS and CalPERS not to invest in foreign companies that pose a threat to national security and would have required the respective boards to investigate and report annually to the Legislature regarding their investments in

international corporations doing business in countries on the U.S. Department of State's list of terrorist-sponsoring nations or the Department of Treasury's list of Foreign Asset Controls. This bill was held in Assembly Appropriations Committee.

SB 1928—Haynes (2000) would have encouraged the CalSTRS and CalPERS, to the extent consistent with their fiduciary duties, not to invest in foreign companies that pose specified threats. Would have created an external "Capital Markets Task Force Board" to review potential investments for national security, human rights, and social concerns and made recommendations to the both retirement system's Boards of Administration. This bill was held in the Assembly Appropriations Committee.

Chapter 341, Statutes of 1999 (SB 105—Burton) requires CalSTRS to report on its investments in companies operating in Northern Ireland.

Chapter 30, Statutes of 1994 (SB 1285—Watson) repeals provisions of Chapter 1254, Statutes of 1986, prohibiting investments in South Africa.

Chapter 1254, Statutes of 1986 (AB 134—M. Waters) prohibits the use of state trust funds or state moneys to make additional or new investments or to renew existing investments in firms doing business with or in South Africa.

PROGRAM BACKGROUND

With a portfolio of approximately \$160 billion, CalSTRS is invested in a wide variety of securities around the globe. As such, CalSTRS assets are invested in many multi-national companies. Some of these companies conduct business in countries where the U.S. government or the United Nations (UN) has expressed concerns about human rights conditions and state-sponsored terrorism. In addition, some portfolio companies are located in countries that have opposing perspectives and judge other countries' treatment of their citizens differently than does the U.S. In circumstances of extreme crisis, such as recently seen in the Darfur region of the Sudan, these different perspectives become divisive and test CalSTRS' confidence in its investment with those corporations.

Iran remains the most active state sponsor of terrorism according to the U.S. State Department. Its Islamic Revolutionary Guard Corps and Ministry of Intelligence and Security were directly involved in the planning and support of terrorist acts and continued to exhort a variety of groups to use terrorism in pursuit of their goals.

UN Sanctions on Iran

The UN Security Council unanimously approved a binding resolution (Resolution 1737) under Chapter 7 on December 23, 2006 sanctioning Iran for refusing to suspend nuclear enrichment programs. That resolution called for freezing the assets of individuals and entities identified as having a key role in Iran's nuclear program, prohibited countries from supplying Iran with dual-use equipment and barred Iran from exporting any nuclear weapons-related equipment or technology to other countries. A second UN resolution (Resolution 1747) cosponsored by

Britain, France and Germany was recently approved on March 25, 2007, by the UN Security Council that allowed for broadening the scope of UN sanctions imposed on Iran in December 2006. These sanctions include the banning of arms exports from Iran and imposing a freeze on the financial assets of 28 individuals and entities.

At the federal level, the U.S. Congress passed the “Iran Freedom Support Act of 2006” (HR 282 and HR 6198) to hold the current Iranian regime accountable for its threatening behavior and support a transition to democracy. While most American companies are barred by law from working with or in countries listed as sponsors of terrorism, most foreign companies are legally allowed to operate in such nations unless their own governments prohibit such activity. This is the reason federal bodies, including the Securities and Exchange Commission (SEC) and the State Department, have repeatedly declined to promote investors, state treasurers and pension fund managers with a comprehensive list of companies operating in those countries.

In 2001, the SEC created an Office of Global Security Risk to provide guidance about such investments. In 2004, Congress directed the new SEC office to list all companies traded on American stock exchanges that do business in terrorist countries. However, according to several state officials as well as correspondence between them and the SEC, the SEC has provided only limited information.

Divestment can be a complex operation because of the companies’ varying degree of involvement and the nature of their activities in the targeted countries. Divestment is further complicated by the fact that many pension funds have money invested in index funds featuring hundreds of stocks.

CalSTRS Investment Policies and Practices

The CalSTRS investment portfolio is managed and governed by a series of comprehensive investment policies. This helps maintain a consistent and thoughtful investment approach, which experts cite as critical for institutional investment success. Investment managers are required to follow the Geopolitical Risk Policy adopted by the Board (See Attachment A). To help identify and evaluate investment risks relating to conditions, such as recognition of the rule of law, shareholder rights, human rights, the environment, acts of terrorism and others, CalSTRS also developed a list of 20 Risk Factors to serve as a guide for its emerging market investment managers to reduce CalSTRS’ exposure to crises around the globe (See attachment B).

The fiduciary standards in the Teachers’ Retirement Law require the Board, CalSTRS officers and employees to discharge their duties with respect to CalSTRS solely in the interests of the members and beneficiaries for the exclusive purpose of providing benefits and to defray reasonable expenses of administering the plan. In addition, under the provisions of Article XVI, Section 17 of the California Constitution, as amended by Proposition 162 (The Pension Protection Act of 1992), the Board has plenary authority and fiduciary responsibility over the investment of retirement plan assets. The authority confers upon the Board the exclusive duty to manage and diversify those assets with the care, skill, and diligence of a prudent person engaged in a similar enterprise so as to maximize investment returns and minimize the risk of loss. The preservation of principal and maximization of income are the primary underlying criteria for the

selection and retention of securities when considering investments. The Constitution also states, however, that the Legislature may, by statute, continue to prohibit certain investments by a retirement board where it is in the public interest to do so provided the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board.

In addition, the Board has adopted a Statement of Investment Responsibility that governs the development of a responsible investment policy (See attachment C). Under the Statement, non-economic factors can be considered secondarily in making investment decisions. These considerations are intended to ensure that CalSTRS does not promote, condone or facilitate social injury. Additionally, under the Statement, social injury is said to exist if it appears that the practices of the company have grave and undesirable side effects for others, such as endangering the environment, suppressing human rights and endangering health. Therefore, within proper fiduciary and prudent investor guidelines, CalSTRS has already adopted policies and guidelines to protect the fund from the very same issues that concern the Legislature and motivate AB 221.

ANALYSIS

Assembly Bill 221:

- Expresses legislative findings and declarations that the SEC has determined that business activities in foreign states sponsoring terrorism and that are subject to sanctions by the U.S. may materially harm the share value of foreign companies. The portfolio of public retirement systems in this state may hold shares in these foreign companies.
- Declares that publicly traded companies in the U.S. are not allowed to do business in or with foreign states that the U.S. Department of State has identified as sponsoring terrorism.
- Declares that public retirement systems in California currently invest on behalf of California citizens in publicly traded foreign companies that may be at risk due to these companies' business ties with foreign states that sponsor terrorism.
- Prohibits the administering boards of both CalSTRS and CalPERS from investing public employee retirement funds in a company that:
 - “has invested in, or is engaged in, business operations with entities in the defense, oil, nuclear, or natural gas sectors of Iran” or that
 - “is engaged in business operations with an Iranian organization labeled as a terrorist organization by the U.S. Department of State.”
- Prohibits the Board from investing public funds in a company that supplies military equipment within the borders of Iran, or equipment that may be readily used for military purposes, including radar systems and military-grade transport vehicles unless the company implements safeguards to prevent the use of such equipment for military purposes.

- Requires the Board, without competitive bidding, to contract with a research firm to determine those companies that have business operations in Iran and to report to the board on or before March 30, 2008 their findings including whether there has been a change of circumstances in Iran.
- Requires the Board to take all of the following actions no later than March 30, 2008: (1) review publicly-available information regarding companies with business operations in Iran; (2) contact other institutional investors that invest in companies with business operations in Iran; and (3) send written notice to a company with business operations in Iran that the company may be subject to this section of law.
- Requires the Board to determine by the next applicable board meeting, based on the information and reports already submitted, whether a company meets the criteria for prohibiting the investment of public funds. If the board plans to invest or has investments in a company that meets such a criteria, such planned or existing investments shall be subject to review to determine whether the board, in its capacity as shareholder or investor, shall notify any company meeting the criteria banning such investment of public funds that no additional or new investments will be permitted.
- Requires the Board to liquidate its investments in that company no later than 18 months after this section of law applies to that company. The Board shall liquidate those investments in a manner to address the need for companies to take substantial action in Iran and consistent with the Board's fiduciary responsibilities as described in Section 17 of Article XVI of the California Constitution.
- Requires the Board to file a report with the Legislature on or before January 1, 2009, and every year thereafter describing a list of investments the Board has in companies with business operations in Iran. The report must include the name of the issuer of the stock, bonds or securities and other evidence of indebtedness as well as a detailed summary of the business operations of these companies in Iran.
- Requires the Board to also include in their annual report whether they have reduced their investments in companies that meet the investment prohibition criteria as prescribed by this bill and, in cases where the Board has not completely reduced such investments, to disclose when the Board anticipates full divestment of such investments or the reasons why a sale or transfer of investments is inconsistent with the fiduciary responsibilities of the Board as described in Section. 17 Article XVI of the California Constitution.
- Discloses that nothing in this section of law shall require the Board to take action in this section unless the Board determines, in good faith, that the action described in this section is inconsistent with the fiduciary responsibilities of the Board.
- Exempts from the prohibition of investments: (1) companies that are primarily engaged in supplying goods or services intended to relieve human suffering in Iran, (2) companies

that promote health, education, journalistic, religious, or welfare activities in Iran, and (3) U.S. companies that are authorized by the federal government to have business operations in Iran.

- Sunsets the provisions of this bill when the U.S. revokes its current sanctions against Iran, thereby requiring the Board to notify the Secretary of State of this fact.
- Requires the State General Fund to indemnify the Board and CalSTRS and CalPERS staff and investment managers for any personal liability associated with divesting stock pursuant to this bill.

Chapter 442, Statutes of 2006 (AB 2941-Koretz) deals with the divestment of public funds from businesses with operations in Sudan. Since 2006, the movement to divest public pension funds from foreign, publicly traded companies that have business ties of any kind to U.S. State Department-designated terrorist-sponsoring states has grown with efforts that are patterned after a successful one in Missouri and others in more than six statehouses across the nation.

The impact on real estate investments would likely be minimal. However, a section in the bill refers to “personal property located in Iran” as a triggering event for the provisions of the bill. This means that even if the company itself were not subject to the restrictions, the employees’ private holdings could taint the firm’s ability to do business.

Given that this bill would not expire until January 1st of the year following the U.S. Government’s decision to end current sanctions, the law would remain in effect for up to a year after its objective had been achieved. During that year, the Teachers’ Retirement Fund (Fund) would continue to have increased risk and CalSTRS would have to continue the monitoring process.

AB 2941 contained a provision that stated that nothing in the Koretz legislation “shall require the Board to take action as described in the bill unless the Board determines, in good faith, that the action described is consistent with the fiduciary responsibilities of the Board as described in Section 17, Article XVI of the California Constitution.” As a result, if the Board determined, in good faith, that implementing the provisions pertaining to investments in the Sudan was inconsistent with its fiduciary obligation, the Board could elect not to implement the provisions of the bill. Identical language is included in AB 221.

What differentiates AB 2941 regarding Sudan from AB 221 is that AB 221 imposes broad restrictions with narrow exceptions; they indiscriminately prohibit the investment of CalSTRS funds in a company with business operations in Iran or a foreign terrorist state, respectively, unless the company is primarily engaged in supplying goods or services intended to relieve human suffering, promoting health, education, journalistic or religious activities or welfare in Iran or the foreign terrorist state or unless the company is a U.S. company authorized by the federal government to have business operations in Iran or the terrorist state.

The restrictions in these two bills are so vague that it may be difficult, if not impossible, to assure compliance. Unlike the narrow restriction in Chapter 442, the two bills impose a broad restriction, subject to three exceptions. Each step in applying these restrictions – identifying the broad universe of potentially prohibited companies and then identifying the subset of permitted companies within the broad group – is subject to uncertainty and interpretation. This increases the risk of violating the restrictions as well as the cost of complying with the restrictions.

Unlike Chapter 442 restrictions, which the Board was advised would require the divestment of only a few companies that were replaceable in CalSTRS' portfolio, the broader restrictions in the two bills could require the Board to consider the divestment and replacement of a much greater number of companies. Moreover, to the extent that the Legislature begins to add additional countries in which CalSTRS investments are restricted, the more difficult it becomes to identify the suitable alternative investments required by the Board's policy prior to selling the asset.

In addition, to the extent that the companies subject to sale under the proposals are a part of CalSTRS' passive portfolio, restructuring and any future trading of the benchmarks and portfolios to exclude these investments would be particularly expensive to CalSTRS. Even under the current proposed legislation, the fund is not indemnified for any costs or losses associated with implementing the bill. Finally, the current proposal requires the establishment and maintenance of special separate accounts that exclude such investments from commingled funds. Establishing and maintaining such special accounts would incur additional investment costs.

CalSTRS opposes this measure unless it is amended to conform to the Board's recently adopted legislative divestment policy. Divesting will reduce its investable universe thereby exposing the fund to more volatility and potentially negative performance. The employees and Trustees of CalSTRS have a fiduciary duty to run the fund in the best interest of the plan participants. Reducing the investable universe and incurring the cost of compliance with the law would increase risk and decrease performance, which may increase to the unfunded liability.

In the past, the Board has opposed legislative efforts to restrict its ability to invest in specific areas, because such a restriction could impair the Board's ability to exercise its fiduciary obligation to act exclusively for the benefit of the retirement plan members and beneficiaries. The Board's legislative policy explicitly provides for the Board to oppose proposals that are inconsistent with the investment policy adopted by the Board as presented in the Statement of Investment Responsibility. CalSTRS estimates the cost of this bill could exceed \$500 million and in future opportunity costs could exceed \$1 billion.

The current bill would also place an ill-suited burden on the current practices of CalSTRS. AB 221 would require the Board to contract with a research firm, not to define the criteria that make a company terrorism-related, but to identify those companies that meet the criteria, as specified, that define those terrorism-related companies. When CalSTRS divests itself of such companies, staff would then be required to monitor them continuously for a change in behavior.

CalSTRS considers the process of determining whether a company's equipment is or could be used for military purposes and whether there are adequate safeguards to prevent such use to be

well outside its expertise and its mission. Likewise, requiring CalSTRS to contract with an independent researcher for this service makes CalSTRS unreasonably accountable for ensuring that a private entity produces an outcome in which CalSTRS has no expertise. This monitoring role seems more appropriate for a Federal government entity than a state pension system. In other words, in matters of foreign policy AB 221 makes a private researcher responsible but CalSTRS accountable and assigns international military intelligence objectives to a state pension fund.

Potentially, CalSTRS staff would need to go through this process before investing in any new company or issuer thereby increasing its workload considerably. Finally, the 20 risk factor model for evaluating investments in emerging markets would need to be modified to cover the exclusion of investments doing business in Iran.

The legislation is too broad and onerous on staff resources, the time frame for implementation is unfeasibly short, and the legislation does not indemnify or allocate any funds for the losses it may sustain by divesting.

FISCAL IMPACT

Benefit Program Cost – While the performance of the investment portfolio affects the ability to fund the benefits CalSTRS may offer its membership, AB 221 does not directly impact CalSTRS' benefit programs. The actual cost of engagement and divestment will depend on variable such as: (1) companies identified for divestment, (2) criteria for divestment, (3) CalSTRS' holdings in those companies, and (4) timing for such divestment not to mention the opportunity cost associated with the loss of that company to the investment portfolio.

Administrative Costs/Savings – The exact fiscal impact is unknown, but it is certain to be significant. CalSTRS anticipates considerable costs associated with litigation over breaches of fiduciary duty. Estimates of the impact of this bill could exceed \$500 million in investment losses and more than \$1 billion in future opportunity costs. Additional costs of maintaining special separate accounts and increased trading costs from the loss of common stock. Costs to comply with reporting processes of up to \$100,000 annually.

OTHER STATES:

In October, 2006, the Missouri State Treasurer adopted a proactive stance concerning a terrorism-free divestment policy and convinced the Missouri State Employees Retirement System, which has \$6 billion in assets, to unanimously adopt a policy to divest from companies with links to sponsors of terrorism.

Louisiana enacted legislation in 2005 authorizing the state's 13 pension funds to divest from companies doing business in and with terrorist-sponsoring nations. The Louisiana sheriff's pension fund was the first to put into place a "terror-free" investment policy. Pennsylvania recently pushed through a new statute to toughen a 2003 law requiring state authorities to report on state holdings in companies operating in terror-sponsoring countries. Similar bills have been introduced in Alaska, Arizona and Tennessee requiring those state's pension funds to report on

all of their holdings in American companies active in terrorism-sponsoring countries.

SUPPORT

American Jewish Congress, Brotherhood Organization of a New Destiny, California Conference of Machinists, Children of Jewish Holocaust Survivors of Los Angeles, Congregation Mogen David, Jewish Community Forum of Orange County, Jewish Federation of Greater Los Angeles, Jewish Federation of Greater Santa Barbara, Jewish Labor Committee, Simon Wiesenthal Center, Stand With Us, UNITE HERE, United Food & Commercial Workers Western States Council

OPPOSITION

CFT, CSEA, SEIU

ARGUMENTS

Pro:

Could eliminate any perception that CalSTRS funds being invested in companies that do business in countries that support or allow inappropriate activities.

Con:

- Interferes with the Board's constitutional duty to manage investments.
- To the extent that restriction is overly broad, utilizing provisions to exercise fiduciary duty could lead to unfounded criticism of the Board.

CalSTRS Board Investment Policy Regarding Geopolitical and Social Risks

CalSTRS Investment Portfolio operates in a unique and complex social-economic milieu, and the Board expects corporations in which securities are held to meet a high ethical and social standard of conduct in their operations which, in the long-term, will result in superior investment performance. Importantly, CalSTRS ownership of securities in a corporation does not signify approval of all of a company's policies, products, or actions. This Policy is intended to address the financial and administrative risks associated with corporate decisions that support Government endorsed genocide, as identified by the U.S. government, or that violate the CalSTRS 20 Risk Factors adopted by the Board (see Attachment A).

It is important to state that investments shall not be selected or rejected based solely on the basis of geopolitical and social risk factors. In fact, geopolitical and social risk factors can only be taken into consideration to the extent that such factors bear on the financial advisability of the investment; e.g., not investing in a corporation whose conduct demonstrates a negative effect on the corporation's financial viability. The extent of the responsibility of the System to engage in activity to address these issues will be determined by: 1) the number of shares held in the corporation, and 2) the gravity of the violation of CalSTRS policies.

When faced with a corporate decision that violates CalSTRS policies, at the direction of the Investment Committee or at the discretion of the CIO, the Investment Staff will directly engage corporate management to seek a change in corporate behavior that supports government endorsed genocide and/or that violates the CalSTRS 20 Risk Factors, a subset of the Investment Policy and Management Plan, in the following manner. First, CalSTRS will actively engage, in a constructive manner, corporate management whose actions are inconsistent with this Policy. All forms of engagement will be utilized (letter writing, meetings, participation in advocacy groups, media campaigns, proxy voting etc.) Second, after all reasonable efforts have been made to constructively engage management and there is a clear nexus between the corporate behavior and the CalSTRS Policy violation, and in the CIO's opinion, the corporate remedies are insufficient or non-responsive, CalSTRS will inform its active investment managers that, to the extent that suitable alternative investments are available and that their inclusion in the Portfolio would result in no diminution in portfolio return or increase in risk, the managers shall invest in said alternative(s) until such time as the violations of this policy cease. Notice of this action will be reported to the Investment Committee in writing. Passive portfolios will cease to acquire shares of companies in violation of this Policy until such time as the violations of this Policy cease. Third, upon remedy of the policy violation, CalSTRS will inform the active investment managers and passive managers that the securities can be purchased and report such action in writing to the Investment Committee.

<i>CALSTRS 20 RISK FACTORS</i>	
Monetary Transparency	Free and open monetary and financial data, and observance of codes
Data Dissemination	Whether or not a country is a member of the IMF (or similar organization) and satisfies the conditions for access, integrity, and quality for most data categories
Accounting	Whether or not the accounting standards are formulated in accordance with International Accounting Standards or the U.S. Generally Accepted Accounting Principles
Payment System: Central Bank	Whether the activities of the central bank encompass implementing and ensuring compliance with principles and standards which are established to promote safe, sound, and efficient payment and settlement systems
Securities Regulation	Compliance with IOSCO objectives, which provide investor protection against manipulation and fraudulent practices
Auditing	Whether or not the country uses International Standards on Auditing in setting national standards
Fiscal Transparency	Publication of financial statistics. Sound standards for budgeting, accounting, and reporting
Corporate Governance	Whether or not the government recognizes and supports good corporate governance practices. Whether they generally adhere to OECD principles
Banking Supervision	Endorsement/compliance with the Basle Core Principles. An endorsement includes an agreement to review supervisory arrangements against the principles and bring legislation in line with the principles where necessary.
Payment System: Principles	Whether country complies with the 10 Core Principles for Systemically Important Payment Systems. Operational reliability, efficiency, real time settlement, final settlement in central bank money. Whether rules and procedures are clear and permit participants to understand the financial risks resulting from participation in the system
Insolvency Framework	Bankruptcy reform. Insolvency legislation
Money Laundering	Whether or not a country has implemented an anti-money laundering regime in line with international standards. Compliance with the 40 recommendations in the Financial Action Task Force (FATF) on Money Laundering. Member of FATF
Insurance Supervision	Regulatory framework in line with International Association of Insurance Supervisors (IAIS) Principles

<p>Respect for Human Rights</p> <ul style="list-style-type: none"> • Judicial System • Arbitrary or Unlawful Deprivation of Life • Disappearance • Torture and Other Cruel, Inhuman, or Degrading Treatment or Punishment • Arbitrary Arrest, Detention, or Exile • Arbitrary Interference with Privacy, Family, Home, or Correspondence • Use of Excessive Force and Violations of Humanitarian Law in Internal Conflicts • Governmental Attitude Regarding International and Non-Governmental Investigation of Alleged Violations of Human Rights
<p>Respect for Civil Liberties</p> <ul style="list-style-type: none"> • Freedom of Speech and Press • Freedom of Peaceful Assembly and Association • Freedom of Religion • Freedom of Movement Within the Country, Foreign Travel, Emigration, and Repatriation
<p>Respect for Political Rights</p> <ul style="list-style-type: none"> • The Right of Citizens to Change Their Government
<p>Discrimination Based on Race, Sex, Disability, Language, or Social Status</p> <ul style="list-style-type: none"> • Women • Children • Persons With Disabilities • National/Racial/Ethnic Minorities • Indigenous People
<p>Worker Rights</p> <ul style="list-style-type: none"> • The Right of Association • The Right to Organize and Bargain Collectively • Prohibition of Forced or Bonded Labor • Status of Child Labor Practices and Minimum Age for Employment • Acceptable Conditions of Work • Trafficking in Persons
<p>Environmental</p> <ul style="list-style-type: none"> • Air Quality • Water Quality • Climate Change • Land Protection
<p>War/Conflicts/Acts of Terrorism</p> <ul style="list-style-type: none"> • Internal/External Conflict • War • Acts of Terrorism • Party to International Conventions and Protocols

STATE TEACHERS' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT RESPONSIBILITY

I. **Philosophy**

The Teachers' Retirement Board finds that:

It is the fiduciary responsibility of the Board of the State Teachers' Retirement System to discharge its responsibility in the interest of the participants and beneficiaries and for the primary purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administrating the System; the investment policy of the System should reflect and reinforce this purpose.

Public retirement systems operate in a unique and complex social-economic milieu, providing for substantial disclosure of their operations and investment activity and placing them in a position where they should be above that of the private sector in social responsibility activities.

The System's responsibility extends to its participants and beneficiaries and to the general public. In addition to its fiduciary responsibilities to its members, the Board has the social and ethical obligation to require that corporations in which securities are held meet a high standard of conduct in their operations.

The act of investment in the securities of a corporation predominantly reflects a judgment that the ownership will produce a rate of return which will make it an attractive investment. While not outwardly signifying approval of all of a company's policies and products, it is possible however that such investment may be interpreted as an indication of the shareholders approval or support of all of a company's policies and products.

The System is a large investor and as such, is in a position to exert influence on the corporations in which it has invested.

II. **Principles**

Consistent with these findings, the System establishes the following principles to govern the development of a responsible investment policy:

A. **Preservation of Principal and Maximization of Income**

The preservation of principal and maximization of income will clearly be the primary and underlying criteria for the selection and retention of securities.

B. Non-Economic Factors

Non-economic factors will supplement profit factors in making investment decisions. Non-economic factors are defined as those considerations not directly related to the maximization of income and the preservation of principal. The consideration of non-economic factors is for the purpose of ensuring that the Retirement System, either through its action or inaction, does not promote, condone or facilitate social injury.

C. Social Injuries Defined

Social injury will be said to exist when the activities of a corporation serve to undermine basic human rights or dignities. Basic human rights and dignities include, but are not limited to:

1. Equal Employment

Equal employment opportunity, including: fair and equitable recruitment and hiring, equal wages and benefits for equal and comparable worth, fair and equitable promotional and training opportunities, and the right to organize and join representative trade unions and associations if a majority of the employees so elect.

2. Housing

Equal access to safe and decent housing.

3. Basic Services

Equal access to basic services including medical care, transportation, recreation and education.

D. Corporate Practices

Social injury may also be said to exist when the Board, having followed the procedure set forth in Section IV.C.2, perceives that it is the prevailing belief of the members of the Retirement System that the practices of a corporation result in undesirable side effects for others, and that the side effects are grave in nature. Side effects which may be deemed grave in nature shall include, but not be limited to:

1. Environmental

Practices which are known to endanger the environment, subject to current federal, state and local law, including:

- a) Unsafe nuclear waste disposal;
- b) Ineffective or inadequate pollution control; or
- c) Improper use of chemicals and contaminants; or
- d) Any practice which directly or indirectly endangers human health or the environment.

2. Suppression of Human Rights

Practices which result in the suppression of human rights including:

- a) The sale of weapons and technology to governments known to engage in the systematic suppression of human rights; and
- b) The sale or purchase of goods from countries known to employ forced labor.
- c) The rendering of services that are used in a manner that denies or suppresses human rights in violation of international law or the Geneva Conventions where the company has failed to take reasonable steps to ensure that the services would not be used in that manner.

3. Human Health

Practices which endanger human health including:

- a) Sale and distribution of known contaminated products;
- b) Sale and distribution of therapeutically ineffective or dangerous drugs; and
- c) Purchasing goods from or selling goods to companies known to disregard worker safety.
- d) A company should not be held responsible for the infliction of social injury merely by virtue of its agreements or relationships with other (independent) entities engaged in socially injurious activities.

E. STRS Involvement

The extent of the responsibility of the System to engage in activity for the prevention, reduction, and elimination of social injury should be determined by:

- The number of shares held in the corporation;
- The gravity of the social injury.

In support of the aforementioned principles, the System sets forth the following guidelines for social responsibility in investments.

III. Selecting New Investments

In selecting new investments for the System, the Board adopts the following guidelines for both domestic and international investments.

- A. Investments shall not be selected or rejected based solely on social responsibilities.