

Bill Number: AB 1151 (Feuer) as amended on April 14, 2011.

SUMMARY

AB 1151 requires that any determination made by CalSTRS that an action as specified in the California Public Divest from Iran Act would be a breach of fiduciary duty be made in a properly noticed public hearing of the full board and proposed findings be made public 72 hours before they are considered by the board. This measure also requires similar open session determinations of whether a company has taken substantial action to curtail business operations in Iran, and modifies the definition of business operations in Iran.

PURPOSE OF THE BILL

AB 1151 addresses concerns that public retirement systems in this state invest in publicly traded foreign companies that may be at risk due to business ties with foreign states such as Iran that sponsor terrorism and are involved in the proliferation of weapons of mass destruction.

BOARD POSITION

OPPOSE. This measure would infringe on the investment authority of the Teachers' Retirement Board (board) and potentially compromise its fiduciary responsibility.

LEGISLATIVE HISTORY

Public Law 111-195, 111th Congress, 2010 (HR 2475—Berman) enacted the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, which among other things granted states and local governments the authority to prohibit investment of state or local government assets in persons that engage in investment activities in the energy sector of Iran, as long as Iran is subject to economic sanctions imposed by the United States.

Chapter 671, Statutes of 2007 (AB 221—Anderson) prohibited CalSTRS and CalPERS from investing in companies with business operations in Iran and require each pension system to sell or transfer any investments in a company with business operations in Iran. When the U.S. repeals its sanctions against Iran, the pension Boards shall notify the Secretary of State, and the prohibitions and requirements in this bill will be repealed.

Public Law 104-172, 104th Congress, 1996 (HR 3107--Gilman) enacted the Iran and Libya Sanctions Act of 1996 imposing sanctions on persons making certain investments directly and significantly contributing to the enhancement of the ability of Iran or Libya to develop its petroleum resources, and on persons exporting certain items that enhance

Libya's weapons or aviation capabilities or enhance Libya's ability to develop its petroleum resources, and for other purposes.

ANALYSIS:

Existing Law:

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. Under the provisions, of Section 17 of Article XVI of the California Constitution, as amended by Proposition 162, the board has plenary authority and fiduciary responsibility over the investment of retirement plan assets.

The Constitution 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 and provided the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board.

Chapter 671, Statutes of 2007, (AB 221 - Anderson) enacted the California Public Divest from Iran Act, which requires CalSTRS and CalPERS, when it is consistent with their fiduciary responsibilities, to divest from companies, that are invested in or engaged in business operations with entities in the defense, nuclear petroleum or natural gas sectors of Iran, or that have demonstrated complicity with an Iranian terrorist organization.

This bill:

This measure changes the application of the board's fiduciary duty pursuant to Section 17 of Article XVI of the California Constitution relative to investments in Iran. Under the California Public Divest from Iran Act (Act), the CalPERS and CalSTRS boards are required to take specified actions unless the board determines, in good faith, that such actions would not be consistent with its fiduciary duty. This measure changes that standard so that the board would be exempt from taking actions as specified in the Act if such actions would be a *breach* of the board's fiduciary responsibilities. Although the wording is similar, the standard for exercising the board's fiduciary duty would be set much higher. In addition, this measure would require that any determination that an action would be a breach of fiduciary duty, be made in a public hearing of the full board by a recorded rollcall vote, following a presentation and discussion of findings in open session, during a properly noticed public hearing. Proposed findings of the board would be made public 72 hours before they are considered by the board, and interested parties would be notified of proposed findings. The findings and public comments regarding the adopted findings would be included in the report to the Legislature required under existing law.

Similarly, when the board determines that a company has business operations in Iran, and then makes further determinations at 90-day intervals as to whether the company has taken substantial action, defined as a boycott of Iran, those further determinations would have to be made in an open session. The board would have to make a

determination as to whether a company has taken substantial action following the same public hearing process outlined above.

The public hearing requirements run counter to the Bagley-Keene Open Meeting Act, as the consideration of whether or not a potential decision violated the board's fiduciary duty under current law would be conducted in closed session. Specifically, it is in conflict with Government Code Section 11126 that authorizes a state body that invests retirement, pension, or endowment funds to consider investment decisions in closed sessions.

If the board were to debate the fiduciary responsibility of a specific investment in open session with the required notice period, the investment would be exposed to a potentially negative market impact, which could result in losses for the Teachers' Retirement Fund. This action would not serve to maximize the investment and would run counter to the board's fiduciary responsibility of maximizing the income for the fund.

Chapter 671, Statutes of 2007, required the board to make a one-time determination as to which companies were subject to divestment on or before June 30, 2008. AB 1151 requires the board to review its investment portfolio and determine which companies are subject to divestment on an ongoing annual basis.

AB 1151 also changes the definition of what it means for a company to have business operations in Iran. Under existing law, a company has business operations in Iran if 1) is invested in or engaged in business operations with entities in the defense or nuclear sectors of Iran, or 2) it is invested in or engaged in business operations with entities involved in the development of petroleum or natural gas resources. AB 1151 would change that definition to a company that has an investment of \$20 million or more in the energy sector of Iran, including a company that provides oil or liquefied natural gas tankers, or products used to construct or maintain pipelines used to transport oil or liquefied natural gas for the energy sector of Iran. This revised definition conforms to the definition of investment activities in Iran articulated in federal Public Law 111-195, enacted on July 1, 2010, which grants states the authority to prohibit investment of state or local government assets in any person that engages in investment activities in Iran.

AB 1151 changes the conditions under which the provisions of the Act would cease to be operative. Currently, the provisions of the Act cease to be operative if:

- Iran is removed from the United States Department of State's list of countries that have been determined to repeatedly provide support for the acts of international terrorism, and
- The President of the United State determines and certifies to the appropriate committee of the United States Congress that Iran has ceased its efforts to design, develop, manufacture, or acquire a nuclear explosive device or related materials and technology.

Instead, the provisions of the Act would cease to be operative if the President of the United States makes a certification relating to Iran, as specified in a provision of Public Law 111-195.

Finally, AB 1151 removes the existing exemption from divestiture for humanitarian, educational, journalistic, religious, or welfare companies and U.S. companies authorized by the federal government to have business operations in Iran.

PROGRAM BACKGROUND

One of CalSTRS' key core values is to ensure the strength of the retirement system by proactively addressing the risks of investing. The value permeates the investment portfolio, where the board has adopted the Investment Policy for Mitigating Environmental, Social, and Geopolitical Risks (ESG). The policy requires managers to consider 21 separate risk factors when investing for CalSTRS.

Additionally, in compliance with Chapter 671, CalSTRS has identified and maintains a list of companies noted as having some level of or possible ties to Iran. CalSTRS contracts with external service providers to provide it with monthly research on companies with possible ties or exposure to Iran specific investments and holdings. In addition to the service providers, CalSTRS also receives information from non-governmental organizations (NGOs), such as the Conflict Risk Network (formerly the Sudan Divestment Task Force), Amnesty International, Human Rights Watch, and the American Israel Public Affairs Committee (AIPAC). The information from these sources is compiled, vetted, and compared to the CalSTRS portfolio. After reviewing the information, CalSTRS determines which companies potentially meet the criteria of the statutes.

The companies identified are then presented to the Geopolitical Investments Review Committee (GIRC). The GIRC is a committee consisting of nine senior staff members, which reviews the companies identified to determine if they meet the requirements of the law. Companies that are determined to meet the requirements of the law are placed on restricted or related securities lists as noted in this report. After placing the companies on the respective lists, the list of restricted securities is sent out to all of CalSTRS' managers.

CalSTRS engages with all of the companies on the Iran related securities lists in which it has holdings. When a company is added to the list, they receive a letter requesting information on their ties to the respective investments and holdings. In addition to the letter requesting information, CalSTRS makes every attempt to have senior investment staff meet with senior executives of the company. All the companies are sent a letter requesting an update of the company's operations in those restricted areas specified in statute.

The initial list of companies with some level of business ties to Iran that was presented to the board in June 2008 was comprised of 23 companies. Three of those companies were already restricted by Chapter 442, Statutes of 2006 (Sudan Divestment), while 18 companies were under review to determine if they met the requirements for divestment and were later determined to not meet the restriction criteria. The remaining two companies were being monitored but were not CalSTRS holdings. Subsequently, one additional company was identified as having ties to Iran was added to the list. By October 2008 CalSTRS' portfolio was free of PetroChina, Petronas, Sinopec, and MISC Bhd, which were restricted under Chapter 442.

More recently, CalSTRS had 29 investments identified as having ties to Iran. Only seven of those companies were subject to the restrictions under the Act, and CalSTRS has divested all seven from its portfolio. CalSTRS identified 19 companies having ties to Iran that do not meet the requirements for divestment. The remaining three companies were reviewed to determine if they met the criteria for divestment, and two were determined to have not met the criteria, while one continued to be undetermined. CalSTRS continues its engagement activities with the remaining undetermined company and plans to meet with the company's management this year. While the status of this company is being determined, CalSTRS has restricted any further investment.

CalSTRS continues to monitor and engage companies identified as having ties to Iran and report annually to the Legislature as mandated by the California Public Divest from Iran Act. To date, CalSTRS has not made a determination that taking action as specified in Chapter 671 would be in conflict or be a breach of its fiduciary duty.

FISCAL IMPACT

Benefit Program Cost – The potential costs of the measure are unknown but could be significant. While CalSTRS staff has not come across an investment that the board felt should be exempt from divestment for fiduciary reasons, it remains a possibility. If the board were to debate the fiduciary responsibilities in relation to a specific investment in open session with the required notice period, the investment would be exposed to potentially negative market impact which could result in significant losses for the Teachers' Retirement Fund.

Administrative Costs/Savings – None.

SUPPORT

Jewish Public Affairs Committee
Simon Wiesenthal Center
American Jewish Committee
Center for the Promotion of Democracy & Human Rights
City of Beverly Hills
30 Years After
Jewish Labor Committee
United Against Nuclear Iran
Anti-Defamation League

OPPOSITION

CalSTRS

ARGUMENTS

Pro: Ensures that CalPERS and CalSTRS are in compliance with the provisions of the California Public Divest from Iran Act.

Con: Imposes a higher standard for the board's fiduciary responsibility than what is set forth in the California Constitution,

Restricts and infringes on the investment authority of the board,

Conflicts with the authority granted under the Bagley-Keene Act, which allows the board to make investment decisions in closed session.

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