BILL NUMBER: AB 1320 (Nazarian) as amended March 18, 2019

SUMMARY

AB 1320 prohibits the CalSTRS and CalPERS boards from making additional or new investments or renewing existing investments in any investment vehicle issued, owned, controlled or managed by the government of Turkey, immediately upon passage of a federal law that imposes sanctions on Turkey for failure to acknowledge the Armenian Genocide, and requires divestment from such investments within six months of the passage of such a federal law, subject to the fiduciary duty of the boards. This bill also requires the boards, within one year of the passage of such a federal law, to report to the Legislature any investments in a Turkish investment vehicle and other specified information. It also indemnifies present, former and future board members, officers and employees of and investment managers under contract with those retirement systems for actions related to the bill. AB 1320 also provides for repeal of its provisions upon determination that Turkey has officially acknowledged its responsibility for the Armenian Genocide.

BOARD POSITION

Oppose. The board's policy is to oppose legislation that infringes on the investment authority of the board or is inconsistent with the investment policy adopted by the board as presented in the CalSTRS Investment Policy and Management Plan.

REASON FOR THE BILL

According to the author, Turkey violates the human rights of Armenians by continuing to deny the 1915 genocide of Armenians, and divestment would encourage the Turkish government to acknowledge the Armenian Genocide and to reach a fair and just resolution of reparations to the survivors of the Armenian Genocide.

ANALYSIS

Existing Law:

Under the provisions of Section 17 of Article XVI of the California Constitution, as amended by Proposition 162 of 1992, the CalSTRS board has plenary authority and fiduciary responsibility over the investment of retirement plan assets and is required to discharge its duties solely in the interests of the members and beneficiaries for the exclusive purpose of providing benefits. The board must invest the assets of the plan with the care, skill and diligence of a prudent person engaged in a similar enterprise so as to maximize the investments and minimize the risk of loss. When considering investments, the preservation of principal and maximization of income is the primary and underlying criteria for the selection and retention of securities. The Constitution states, however, that the Legislature may by statute prohibit certain investments by a retirement board when 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.

While there have been numerous bills and resolutions that recognized the Armenian Genocide, there are no existing California laws that require divestment from any investment vehicle issued by, owned, controlled or managed by the government of Turkey.

Under the provisions of the U.S. Constitution, federal laws preempt state laws, and the federal government maintains responsibility over foreign affairs and has the power to regulate commerce with foreign nations. More specifically, the Supremacy Clause (Article VI, Clause 2) establishes that federal laws and treaties made under its authority constitute the supreme law of the land. Also, the Constitution gives the president authority over foreign affairs (Article II, Section 2, Clause 2). Lastly, the Commerce Clause (Article I, Section 8, Clause 3) gives Congress the power to regulate commerce with foreign nations.

This Bill:

Specifically, AB 1320:

- Subject to the board's fiduciary duty:
  - Prohibits the board from making additional, new or renewed investments in any investment vehicle issued, owned, controlled or managed by the government of Turkey immediately upon passage a federal law that imposes sanctions on Turkey for failure to acknowledge the Armenian Genocide, and
  - Requires the board to liquidate prohibited Turkish investment vehicles within six months of the passage of such a federal law.
- Requires the board to report to the Legislature within one year of the passage of such a federal law:
  - A list of Turkish investment vehicles of which the board has liquidated its investments, and
  - A list of Turkish investment vehicles of which the board has not liquidated its investments as a result of a determination that to do so would be inconsistent with the board's fiduciary responsibilities.
- Indemnifies present, former and future board members, officers and employees of and investment managers under contract with CalSTRS for actions related to the bill.
- Repeals the provisions of this bill upon a determination by either the Department of State or the U.S. Congress, or other appropriate federal agency, that the Government of Turkey has officially acknowledged its responsibility for the Armenian Genocide.

The board's policy is to oppose legislation that restricts its ability to invest in specific areas because, as described in its divestment policy, such restrictions could impair the board's ability to exercise its fiduciary obligation to act exclusively for the benefit of the retirement plan members and beneficiaries. Divestment carries the risk of adversely affecting an investment portfolio. This is especially concerning as investment returns affect the CalSTRS Funding Plan (AB 1469–Bonta), which placed CalSTRS on a trajectory toward full funding.

While the requirements of this bill would be conditional on the passage of a federal law that imposes sanctions on Turkey for failure to acknowledge the Armenian Genocide, this bill might not align with the specific provisions of potential federal sanctions. For example, sanctions under federal law could be narrowly crafted to impact individuals or companies with specified ties to the Turkish government, while the provisions of AB 1320 would be broader. Under the provisions of the U.S. Constitution, the federal government maintains authority over foreign affairs and commerce with foreign countries. Prior legislation prohibiting investments in Sudan and Iran did not come into constitutional conflict with federal authority because Congress granted authorization to the states to enact such legislation in accordance with specific parameters. In contrast, a much broader law in Illinois called the Illinois Sudan Act, which contained provisions that were not authorized by Congress, was ruled unconstitutional because it interfered impermissibly with the federal government's power over foreign affairs and commerce with foreign countries.

In addition, CalSTRS follows an investment strategy, adopted by the board, of diversification and passive index management that does not systematically exclude or include any investments in companies, industries or geographic areas. However, AB 1320 would require CalSTRS to actively exclude new, additional or renewed investments in Turkish investment vehicles, reducing the diversification of the portfolio, increasing risk, and creating opportunity costs as well as costs to customize benchmark indices.

LEGISLATIVE HISTORY

AB 1597 (Nazarian, 2018) would have prohibited the CalSTRS and CalPERS boards from making additional or new investments or renewing existing investments in any investment vehicle issued, owned, controlled or managed by the government of Turkey, immediately upon passage of a federal law imposing sanctions on Turkey for failure to acknowledge the Armenian Genocide, and requires divestment from such investments within six months of the passage of such a federal law, subject to the fiduciary duty of the boards. Would have required the boards, within one year of the passage of such a federal law, to report to the Legislature any investments in a Turkish investment vehicle and other specified information. Also, would have indemnified present, former and future board members, officers and employees of and investment managers under contract with those retirement systems for actions related to the bill. Also, would have provided for repeal of its provisions upon determination that Turkey has officially acknowledged its responsibility for the Armenian Genocide. This bill was vetoed.

AJR 3 (Nazarian, Resolution Chapter 56, Statutes of 2017) designated 2017 as "State of California Year of Commemoration of the Anniversary of the Armenian Genocide of 1915-1923" and April 24, 2017, as the "State of California Day of Commemoration of the 102nd Anniversary of the Armenian Genocide of 1915-1923" and called upon the U.S. President and Congress to formally and consistently reaffirm the Armenian Genocide.

AB 1410 (Nazarian, 2015) would have sought to encourage the government of Turkey to acknowledge, and to reach resolution on reparations for survivors of, the Armenian Genocide by requiring CalSTRS and CalPERS to divest of any investment vehicle issued by, owned, controlled or managed by the government of Turkey; would have required these boards, on or before January 1, 2017, and annually thereafter, to report to the Legislature any investments in a Turkish investment vehicle and the sale or transfer of those investments, subject to the fiduciary duty of these boards; and would have indemnified from the General Fund and hold harmless the present, former and future board members, officers and employees of and investment managers under contract with those retirement systems. This bill was held in the Assembly Appropriations Committee.

H.Res.154 (Dold, 2015) would call on the U.S. President to work toward equitable, constructive, stable and durable Armenian-Turkish relations based upon Turkey's full acknowledgment of the facts and ongoing consequences of the Armenian Genocide and a fair, just and comprehensive international resolution of this crime against humanity. This resolution was held in the House Committee on Foreign Affairs.

S.Res. 410 (Menendez, 2014) would have expressed the sense of the U.S. Senate: (1) in remembrance of the anniversary of the Armenian Genocide on April 24, 2014, and (2) that the U.S. President should ensure that U.S. foreign policy reflects appropriate understanding and sensitivity concerning issues related to human rights, crimes against humanity, ethnic cleansing and genocide documented in the U.S. record relating to the Armenian Genocide. This resolution was held on the Senate Floor.

SB 424 (Poochigian, Chapter 9, Statutes of 2005) established April 24 of each year as the "California Day of Remembrance of the Armenian Genocide" and the period beginning on the Sunday before that day through the following Sunday as the days of remembrance of the Armenian Genocide.

AB 2251 (Margolin, Chapter 1351, Statutes of 1992) prohibited state trust funds from making new or additional investments in business firms or financial institutions that engage in discriminatory business practices after January 1, 1994, relating to the Arab League's economic boycott of Israel. The California Attorney General concluded that this bill was pre-empted by federal law and, therefore, not subject to implementation by CalSTRS.

PROGRAM BACKGROUND

ESG Policy

CalSTRS has its own well-established and longstanding process for thoroughly vetting the environmental, social and governance risks of potential investments. The board adopted its Statement of Investment Responsibility in 1978, making CalSTRS an industry leader as one of the first pension funds to adopt a written policy to navigate these complex issues. As a key component of that process, the board has developed a list of risk factors as part of its Investment Policy for Mitigating ESG Risks. The ESG Risk Factors help the board to identify and evaluate investment risks relating to the existence of certain conditions, such as recognition of the rule of law, shareholder rights, human rights, the environment, acts of terrorism and other unsustainable practices and governance crises with the potential to hurt long-term profits.

Divestment Policy

In addition to the CalSTRS ESG policy, the board has adopted a divestment policy, focusing on engagement, to respond to external or internal initiatives to divest of specific companies or industries. In accordance with this policy, CalSTRS has historically taken the position that active and direct engagement is the best way to resolve issues. Divestment bears the risk of adversely affecting an investment portfolio and severs any chance to advance positive change through shareholder advocacy. Face-to-face meetings with shareowners and senior management, or the board of directors, are generally more effective in bringing about change in a corporation. Under the policy, the board will only consider divestment after all efforts at engagement have failed, and only then in cases where at least one of the ESG Risk Factors is violated over a sustained timeframe to the extent that it becomes an economic risk to the fund, creates a potential for material loss of revenue and weakens the trust of a significant portion of CalSTRS members. Finally, the divestment policy sets forth that the board will only instruct staff to divest of a security when it determines that continuing to hold a security is imprudent and inconsistent with its fiduciary duty.

Armenian Genocide

The Armenian Genocide is largely believed to have begun on April 24, 1915, when hundreds of Armenian intellectual, political, religious and business leaders were arrested and deported from Constantinople. In acknowledgment of its 100th anniversary, California enacted Resolution Chapter 30, Statutes of 2015 (AJR 2–Nazarian), to recognize the Armenian Genocide as a series of events occurring between 1915 and 1923 in which the rulers of the Ottoman Turkish Empire and its successor state, the Republic of Turkey, subjected its Armenian citizens to torture, starvation and murder. The rulers conducted massacres of able-bodied Armenian men and forced Armenian women, children, elderly and infirm to march from their homeland to the Syrian Desert. Approximately 75 percent of those Armenian people on these marches died. Between 1 million and 1.5 million Armenian people were killed during the three-year period from 1915 to 1918. Other groups of Turkey's minority Christian population were killed during this period along with the Armenians, including Greeks and Syrians. Successive Turkish governments have failed to acknowledge the Armenian Genocide and have even lobbied other governments, organizations and institutions to prevent the genocide from being discussed or included in educational curricula.

FISCAL IMPACT

Program Cost – CalSTRS holdings of debt securities issued by the government of Turkey is approximately $3.2 million. Global equities and currency investments subject to possible divestment have a potential combined market value of up to $8.3 million. CalSTRS may incur opportunity costs if suitable alternative investments are unavailable or if such alternative investments do not provide an investment return that meets or exceeds those of the divested securities. Any resulting costs would increase the unfunded liability and also may result in an increase in the state's contribution to the Defined Benefit Program.

Administrative Costs/Savings – Minor costs to monitor whether federal sanctions have been enacted. If federal sanctions are enacted, approximately $100,000 initial costs and $43,200 annual ongoing costs resulting from transaction costs for liquidating securities and additional costs related to external research services. Implementation and ongoing compliance will also require reallocation of staff resources.

SUPPORT

None known.

OPPOSITION

CalSTRS
Association of California School Administrators
School Employers Association of California

ARGUMENTS

Pro: Could eliminate the perception that CalSTRS is contributing to a continuing denial of the Armenian Genocide by Turkey.

Con: May infringe upon the investment authority of the board.

May reduce the investable universe and adversely affect portfolio performance.

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