

BILL NUMBER: AB 1597 (Nazarian) as amended June 11, 2018

SUMMARY

AB 1597 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, and requires divestment from those investments within six months of the passage of a federal law imposing sanctions on Turkey, subject to the fiduciary duty of the boards. This bill 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 the sale or transfer of those investments, subject to the fiduciary duty of the boards. 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.

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 bill's 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.

SUMMARY OF AMENDMENTS

The June 22, 2017, and June 11, 2018, amendments change the coauthors of the bill.

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 1597:

- Prohibits the board from making additional, new or renewed investments in any investment vehicle issued, owned, controlled or managed by the government of Turkey;
- Requires the board to liquidate prohibited Turkish investment vehicles within six months of the passage of a federal law imposing sanctions on Turkey, subject to the board's fiduciary duty;
- 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; and
- Indemnifies present, former and future board members, officers and employees of and investment managers under contract with CalSTRS for actions related to the bill.

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 2014 funding plan (AB 1469–Bonta), which placed CalSTRS on a trajectory toward full funding.

While the requirement to divest from prohibited Turkish investment vehicles would be conditional on the passage of a federal law imposing sanctions on Turkey, AB 1597 also unconditionally prohibits additional or new investments or renewing existing investments in Turkish investment vehicles. Under the provisions of the U.S. Constitution, the federal government maintains authority over foreign affairs and commerce with foreign countries. In fact, there have been a number of court cases related to divestment legislation enacted by states in which the legislation was found unconstitutional. 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. Congress has not granted similar authority to the states to restrict investments in Turkish investment vehicles.

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 1597 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

AJR 3 (Nazarian, 2017) would designate 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 also would call upon the United States President and Congress to formally and consistently reaffirm the Armenian Genocide.

SB 185 (De León, Chapter 605, Statutes of 2015) required the CalSTRS and CalPERS boards to engage with thermal coal companies, as defined, and to divest the public employee retirement funds of any investments in thermal coal companies and prohibited additional or new investments or the renewal of existing investments in thermal coal companies.

H.Res.154 (Dold, 2015) would call on the United States President to work toward equitable, constructive, stable and durable Armenian-Turkish relations based upon the Republic of 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 United States Senate: (1) in remembrance of the anniversary of the Armenian Genocide on April 24, 2014, and (2) that the United States 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.

AB 761 (Dickinson, 2013) would have prohibited CalSTRS and CalPERS from investing in companies that manufacture firearms or ammunition for a recipient other than the U.S. military, subject to a process specified in the bill and consistent with previous divestment legislation, but subject to the board’s fiduciary duties. This bill was held in the Assembly Appropriations Committee.

SR 18 (Leno, Adopted, 2013), in response to the Russian government taking an aggressive course of action to pass laws targeting the lesbian, gay, bisexual and

transgender (LGBT) community, strongly encouraged CalSTRS and CalPERS, whenever feasible and consistent with their fiduciary responsibilities, to cease making direct investments in Russia and to encourage companies in which employee retirement funds are invested and that are doing business in Russia not to take actions that promote or otherwise enable human rights violations in Russia.

AB 1151 (Feuer, Chapter 441, Statutes of 2011) required that any determination by CalSTRS that an action, as specified in the California Public Divest from Iran Act, fails to satisfy the fiduciary duty of the board be made in a properly noticed public hearing of the full board and that proposed findings be made public 72 hours before they are considered by the board.

AB 221 (Anderson, Chapter 671, Statutes of 2007) enacted the California Public Divest from Iran Act prohibiting CalSTRS and CalPERS from investing in companies with business operations in Iran and requiring each pension system to sell or transfer any investments in a company with business operations in Iran. Required, when the U.S. repeals its sanctions against Iran, the pension boards notify the Secretary of State and the prohibitions and requirements in this bill be repealed.

AB 2941 (Koretz, Chapter 442 Statutes of 2006) prohibited CalSTRS and CalPERS from investing in companies with business operations in Sudan that are complicit in the Darfur genocide or have specified relationships with the Sudanese government or military and required the boards of both retirement systems to divest from such companies, consistent with their fiduciary obligations.

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.

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. In its latest incarnation, the board developed a list of 21 Risk Factors as part of its [Investment Policy for Mitigating ESG Risks](#). The 21 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 21 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 long exposure to debt securities issued by the government of Turkey is approximately \$911,000. Global equities and currency investments subject to possible divestment have a potential combined market value of up to \$54.1 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 \$405,100 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

Armenian Nation Committee of America, Western Region

OPPOSITION

CalSTRS
California Special Districts Association
California Teachers Association (Opposed, unless amended)
School Employers Association of California

ARGUMENTS

- Pro: Could eliminate the perception that CalSTRS is contributing to a continuing denial of 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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