

**BILL NUMBER: [AB 33](#) (Bonta) as introduced December 3, 2018**

**SUMMARY**

AB 33 prohibits the boards of the California State Teachers' Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS) from making additional or new investments or renewing existing investments of public employee retirement funds in a private prison company, as defined, and requires liquidation of such investments on or before July 1, 2020, subject to the fiduciary duty of the boards. The bill also requires the boards to engage with those companies to establish if the company is transitioning its business model to another industry. AB 33 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. The law sets a high standard for the conduct of a fiduciary. As fiduciaries, each board member is required to perform their duties with the utmost care, skill, prudence and diligence in protecting the assets under their care. CalSTRS has well established policies and procedures in place for thoroughly vetting and assessing investment risks.

As such, the [CalSTRS Divestment Policy](#) was invoked in July 2018, and staff initiated a review with respect to investments affected by this bill under the [CalSTRS Investment Policy for Mitigating Environmental, Social and Governance \(ESG\) Risks](#) and [the divestment policy](#). The results of the research and engagement efforts were presented in a detailed [report](#) to the Investment Committee in November 2018. The committee reviewed the report and, acting in good faith and adhering to their fiduciary obligations, ultimately voted to divest CalSTRS' holdings in the private prison companies, CoreCivic and Geo Group.

**REASON FOR THE BILL**

As stated by the findings and declarations of the bill, recent changes in federal immigration policies have resulted in children being separated from their families and thousands of migrant adults and children being detained in for-profit, private prison facilities. These companies are incentivized to maximize their profits and minimize their costs, with a duty to their shareholders. The findings and declarations also state this bill is intended to be a part of the state's broader efforts to redirect the criminal justice system to value and prioritize effective prison rehabilitation programs.

**ANALYSIS**

**Existing Law:**

Under the provisions of Section 17 of Article XVI of the California Constitution, as amended by Proposition 162 of 1992, the 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 also states 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.

**This Bill:**

Specifically, AB 33:

- Defines a “private prison company” as a company that generates the majority of its revenue from operating, managing or contracting as a prison or detention center.
- Prohibits the board from making additional, new or renewed investments in a private prison company, subject to the board’s fiduciary duty.
- Requires the board to liquidate investments in a private prison company on or before July 1, 2020, subject to the board’s fiduciary duty.
- Requires the board, in determining to liquidate investments, to constructively engage with the private prison company in which it is invested to establish if the company is transitioning its business model to another industry.
- Indemnifies present, former and future board members, officers and employees of and investment managers under contract with CalSTRS for actions related to the bill.

Generally, the board opposes legislative efforts to restrict 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. CalSTRS has policies and procedures in place for thoroughly vetting and assessing investment risks, works with its external managers to recognize and manage the risks and, where appropriate, directly engages with portfolio companies.

**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 would have required 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 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. It 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. AB 1597 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.

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.

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.

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 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 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.

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.

## **PROGRAM BACKGROUND**

### ESG Policy

CalSTRS has its own well-established and longstanding process for thoroughly vetting the ESG risks of potential investments set forth in the [Investment Policy for Mitigating ESG Risks](#). As a key component of that process, the board has developed the CalSTRS ESG Risk Factors, which help staff to identify and evaluate investment risks relating to the existence of certain conditions with the potential to hurt long-term profits.

### Divestment Policy

In addition to the CalSTRS ESG policy, the board has adopted the [CalSTRS Divestment Policy](#), focusing on engagement, to respond to external or internal initiatives to divest of specific companies or industries. Divestment bears the risk of adversely affecting an investment portfolio and severs any chance to advance positive change through shareholder advocacy. 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 CalSTRS 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.

### Private Prison Divestment

At the July 20, 2018, CalSTRS Investment Committee meeting, the chief investment officer informed the committee that he was invoking the divestment policy regarding private prisons and that staff would evaluate the risk of investing in private prisons under the ESG and divestment policies. For the purposes of the evaluation, staff defined private prison companies as those companies that derive a majority of their revenue through contracts with governments, or their authorized entities, for the operation or leasing of facilities for the primary purposes of incarceration or detention, which is similar to the definition set forth in the bill.

Staff identified that CalSTRS has holdings in five public companies globally that operate private prisons: CoreCivic, Geo Group, G4S, Serco and Sodexo. Of these five, only two, CoreCivic and Geo Group, were identified as deriving the majority of their revenue from prisons or detention.

CalSTRS heightened its due diligence with both CoreCivic and Geo Group starting in July 2018 in order to engage both companies in productive dialogue surrounding their business practices in accordance with the divestment policy. This included visits to various detention facilities and face-to-face meetings with senior management concerning operational processes and risk management efforts. Additionally, in the course of their research, staff reached out to several non-governmental organizations that focus on immigration and prison issues. Site visits were conducted at the following facilities:

- The South Texas Family Residential Center in Dilley, Texas, operated by CoreCivic.
- The Karnes County Residential Center in Karnes City, Texas, operated by Geo Group.
- The Leavenworth Detention Center in Leavenworth, Kansas, operated by CoreCivic.
- The Adelanto Immigration and Customs Enforcement (ICE) Processing Center in Adelanto, California, operated by Geo Group.
- The Otay Mesa Detention Center in San Diego, California, operated by CoreCivic.

CalSTRS staff analyzed the incarceration and detention practices of the private prison industry in the United States against the CalSTRS ESG and divestment policies. The findings of staff's extensive research and the potential violation of the ESG Risk Factors were summarized in a [report](#) to the Investment Committee in November 2018. The report also included findings related to investment performance and an assessment of whether private prison companies had become "an economic risk to the fund" in accordance with the divestment policy.

The purpose of the report was to present the results of staff's research, engagement efforts and analysis of the private prison industry; to present cases for and against investing in private prisons; and to evaluate the potential impact of divesting of private prison companies and if the result could negatively impact the CalSTRS portfolio.

The Investment Committee reviewed the report and agreed that staff's engagement efforts were thorough. After a comprehensive discussion and based on all the information provided, the committee voted to divest its holdings in CoreCivic and Geo Group.

As of November 6, 2018, CalSTRS had holdings in two companies, CoreCivic and Geo Group, that meet the definition of "private prison company" as set forth in the bill, with a combined market value of \$12,142,211. Since then, the divestment process has been completed, and CalSTRS no longer has holdings in either company.

## **OTHER STATES' INFORMATION**

Other large U.S. public pension funds in Illinois, New Jersey, New York and Pennsylvania have already divested from for-profit, private prison companies.

## **FISCAL IMPACT**

Program Cost – Unknown future costs for lost investment opportunities and for divesting holdings in a company currently in the portfolio that becomes a private prison company, as defined, in the future.

Administrative Costs/Savings – Cost of liquidating CoreCivic and Geo Group from portfolios is approximately \$100,000. Annual costs of approximately \$5,000 associated with monitoring the portfolio to ensure future compliance with the requirements of the bill.

## **SUPPORT**

California Teachers Association

## **OPPOSITION**

CalSTRS

## **ARGUMENTS**

Pro: Could eliminate perception that California supports family detention by investing public pension funds in the for-profit prison industry.

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

May reduce the investable universe and adversely affect portfolio performance.

## **LEGISLATIVE STAFF CONTACT**

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