BILL NUMBER: AB 946 (Ting) as amended March 28, 2017

SUMMARY

AB 946 prohibits the CalSTRS and CalPERS boards from making additional or new investments or renewing existing investments in any company that contracts or subcontracts to build, maintain or provide material for President Trump's Border Wall. It requires the CalSTRS and CalPERS boards to engage with, and to liquidate their investments in, such a company within 12 months of the company contracting or subcontracting to provide work or material for a border wall. The bill also requires the boards, by January 1, 2019, to report to the Legislature any investment actions related such companies, subject to the fiduciary duty of these boards and indemnifies board members, officers, employees and contracting investment managers 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 findings and declarations in the bill, the U.S. was founded on the principles of freedom and opportunity, a refuge for the oppressed, the persecuted and those looking for a better life.

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.

This Bill:

Specifically, AB 946:

- Prohibits the board, subject to fiduciary duty, from making additional, new or renewed investments in a company the contracts or subcontracts to build, maintain or provide material for President Trump's Border Wall.
- Requires the board, subject to fiduciary duty, to liquidate its investments in a border wall construction company within 12 months of the company contracting or subcontracting to provide work or material.
- Requires the board to constructively engage with a company subject to divestment to establish whether the company is transitioning its business model away from building, maintaining or providing material for President Trump's Border Wall.
- Requires the board, on or before January 1, 2019, to report to the Legislature, with information on any investment actions related to companies subject to the provisions of this bill, including:
    - A list of companies from which the board has liquidated its investments.
    - A list of companies with which the board engaged and supporting documentation to substantiate the board's determination whether to liquidate investments.
    - A list of companies from which the board has not liquidated its investments as a result of a determination that a sale or transfer of investments is inconsistent with the board's fiduciary responsibilities and the board's findings adopted in support of that determination.
- 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 has generally opposed 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. This legislation presents a unique situation because the proposed restriction is based on one specific construction project, which is unlike previous divestment measures that have tended to apply to a sector of business or to business activity in a specified country.

The provisions of AB 946 suggest that CalSTRS would be prohibited from investing in restricted companies in perpetuity, even after construction of the wall is completed or when a company is no longer a contractor or subcontractor. Also, as the bill is currently drafted, it is not clear whether raw material or construction equipment providers, who would not be directly building, maintaining or providing material for the wall, would be restricted companies. Lastly, it is not clear whether companies involved in repairing, improving or replacing any portion of the existing 700 miles of physical barrier along the southern border would be deemed to be restricted companies since the provisions of this bill do not clearly distinguish between the existing physical barrier and a new wall. These circumstances present uncertainties as to how CalSTRS would comply with the requirements and restrictions.

LEGISLATIVE HISTORY

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.

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, Statues 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, Statues 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 Statues 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 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.

President Trump’s Border Wall

Leading up to the 2016 election, presidential candidate Donald Trump campaigned on the promise that he would have a wall built along the entire length of United States’ southern border and require the government of Mexico to pay for its construction. On January 25, 2017, President Trump signed an executive order directing the Secretary of Homeland Security to “immediately plan, design, and construct a physical wall along the southern border, using appropriate materials and technology to most effectively complete operational control of the southern border.” On March 17, 2017, U.S. Customs and Border Protection, a law enforcement agency of the U.S. Department of Homeland Security, opened the process to accept bids to design and build a wall along the southern border and closed the process on April 4, 2017. At least 200 companies expressed interest in this construction project, although the number and names of companies that actually submitted bids have not been made public.

OTHER STATES' INFORMATION

To date, no other state has enacted legislation related to divestment from a company that contracts or subcontracts to build, maintain or provide material for President Trump’s Border Wall.

FISCAL IMPACT

Program Cost – At this time it is not possible to determine the costs due to the fact that the companies subject to this legislation have not been determined. Staff will continue to monitor the situation and can provide additional analysis once the companies have been named. 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 any divested securities. Any resulting costs would increase the unfunded liability and also may consequently result in an increase in the contribution rates required to fund the Defined Benefit Program.

Administrative Costs/Savings – Total impact is undeterminable at this time.

SUPPORT

None known.

OPPOSITION

CalSTRS

ARGUMENTS

Pro: Could reduce the perception that CalSTRS is contributing to companies involved in the construction of a border wall.

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

May reduce the investable universe and adversely affect portfolio performance.

Establishes an indefinite limitation on the investable universe while the project is finite.

Creates uncertainty as to whether divestment is still required once construction is completed or otherwise changed.

Lacks clarity regarding which companies are subject to the bill.

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