

California State Teachers' Retirement System Investment Reports

December 31, 2010

Introduction

The California State Teachers' Retirement System (CalSTRS) is required to report to the Legislature on specific areas regarding the fund's investments and CalSTRS actions as they relate to specific investments and holdings. This report is submitted in compliance with the direction of the following statutes:

- Chapter 442, Statutes of 2006 (AB 2941-Koretz) - Sudan.
- Chapter 671, Statutes of 2007 (AB 221-Anderson) - Iran.
- Chapter 341, Statutes of 1999 (SB 105-Burton) - Northern Ireland.
- Chapter 216, Statutes of 1999 (SB 1245-Hayden) - World War II Slave Labor.

Background on CalSTRS

With over 97 years of experience, CalSTRS is one of the nation's oldest teacher pension systems. CalSTRS' members include California public school employees, pre-kindergarten through community college, who teach, are involved in the selection and preparation of instructional materials, or are supervising persons engaged in those activities. CalSTRS members are employed by approximately 1,400 school districts, community college districts, county offices of education, and regional occupational programs. CalSTRS is administered by a 12-member Teachers' Retirement Board (Board). The Board sets the policies and is responsible for ensuring benefits are paid by the system in accordance with the law. The Board is comprised of:

- Three member-elected positions representing current educators;
- A retired CalSTRS member appointed by the Governor and confirmed by the Senate;
- Three public representatives appointed by the Governor and confirmed by the Senate;
- A school board representative appointed by the Governor and confirmed by the Senate;
- and
- Four board members who serve in an ex-officio capacity by virtue of their office.

One of the Board's 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. A copy of the policy is included as [Attachment A](#).

Teachers' Retirement Fund

The Teachers' Retirement Fund (Fund), from which CalSTRS benefit payments are made, is valued at about \$140 billion as of November 30, 2010. Historically, investment returns have contributed roughly two-thirds of the costs of the educators' defined benefit retirement plan. The Board's investment actions reflect a policy of investing on a long-term basis. This is done in a comprehensive, measured manner. In August 2009, the CalSTRS Board adopted its long-term target investment asset allocation:

Global Equity	47 percent
Fixed Income	20 percent
Real Estate	15 percent
Private Equity	12 percent
Absolute Return	5 percent
Liquidity	1 percent

At that time, the CalSTRS Board also reviewed and updated its 10-year financial plan. Although future events may arise that would require adjustment to the plan, having a plan insures easier management of unexpected shifts. The development of a long-term plan is relatively new ground for public pension plans; most of CalSTRS' peers only plan year-to-year through the traditional budget process. The specific components of the plan will be incorporated as needed into the discussion within this paper, and the plan in its entirety is included as [Attachment B](#).

Strategic Response: Policy Review

CalSTRS has contracted with ISS, a division of MSCI (formerly known as RiskMetrics) to provide data on World War II Forced Labor and companies with operations in Northern Ireland. CalSTRS had contracted with two external service providers (KLD and RiskMetrics) to provide it with monthly research on companies with possible ties or exposure to Iran and Sudan specific investments and holdings. However, in late 2009, RiskMetrics purchased KLD, and subsequently RiskMetrics was purchased by MSCI. MSCI is currently rebranding the service back to ISS. Since the KLD-RiskMetrics merger, the two groups have continued to provide independent research on Iran and Sudan. ISS plans to complete the combination of the research groups in 2011 at which time CalSTRS would have only one research provider. CalSTRS is currently reviewing research providers to replace KLD.

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, staff 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: The Chief Investment Officer, Deputy Chief Investment Officer, two staff members from Global Equities, two staff members from Fixed Income, two staff members from Corporate Governance, and one

staff member from the Innovation and Risk Group. The Committee 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.

Additionally, CalSTRS engages with all of the companies on the Sudan and 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 (Attachments C & D). 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 (Attachments E & F).

In addition to the companies in its portfolio, CalSTRS continually monitors its portfolio for the companies it does not hold that have been designated as possibly problematic. If securities of these companies enter the portfolio, the GIRC is notified and the engagement process is started. Additionally, the Private Equity and Real Estate groups are updated with the lists of restricted securities, and they review their portfolios to monitor for possible related securities.

Additionally, CalSTRS will continue to work with groups such as the Conflict Risk Network, United Nations Principles for Responsible Investment (UNPRI), and Global Compact to improve transparency and encourage corporations to act responsibly when dealing with conflict prone areas.

Planned Actions

CalSTRS intends to maintain its relationships with independent research providers and to continue to review publicly available information regarding investments with ties to the restricted areas. Additionally, CalSTRS is reviewing potential providers to replace KLD, which through a series of mergers has been acquired by ISS. CalSTRS also plans to continue the research and engagement process indefinitely. If there are investments in the portfolio that fall within the terms of the statutes and the Board finds that it is consistent with its fiduciary duty, those investments will be eliminated.

CalSTRS Response to Sudan Risk

Process

Though AB 2941 was not signed until September of 2006, CalSTRS had already identified a list of 24 companies with some level of business operations in Sudan. The legislation defined "active business operations" to mean a company engaged in business operations that provide revenue to the government of Sudan or a company engaged in oil-related operations. Those distinctions provided assessment framework and supported the qualitative aspect of CalSTRS process. The initial list was divided into four sections of various levels of involvement and

holding levels. The list is fluid, and at any time, there will be companies that are in the “being monitored” or second tier, and companies in the “being reviewed” or third tier. The initial list was based on the list contained in the April 2006 Investment Committee agenda item published by the University of California Regents. The initial list has been updated based on data provided by CalSTRS independent research contractors, NGOs, and engagement work.

Tactical Response: Investments Identified

At the June 2006 Teachers’ Retirement Board, meeting staff presented a list of 24 investments that could have ties to Sudan. Companies were placed on the Sudan related securities list in one of four Sections: Restricted Companies, Companies Being Monitored, Companies Being Reviewed, or Non Holdings that Possibly Meet the Divestment Criteria. The list critically focused on 10 companies that fell within the definition of the statute. Since that time, three companies have been removed from the list, and two companies have been added. Currently, nine companies are subject to the most severe restrictions under the law. As of October 4, 2008, the CalSTRS portfolio has been free of PetroChina, Petronas, Sinopec, and MISC Bhd, all of which were restricted under the Sudan Divestment law.

In addition to the nine restricted companies, CalSTRS has identified seven companies in its portfolio that have ties to Sudan but do not meet the requirements for divestment. CalSTRS maintains these companies on its list in a monitored status (second tier category) and continues to engage them to confirm they keep with their commitments and their status does not change. Currently, there are two companies in the third tier or “being reviewed” category (determining if criteria for divestment is met) ([Attachment G, which includes these three tiers](#)).

Lastly, CalSTRS has identified 19 companies that are not CalSTRS holdings but could be subject to the statute if purchased. Staff continually monitors the portfolio for these securities, and if purchased, staff will immediately begin the engagement process.

All asset classes were reviewed for any investments that could have ties to Sudan. Only the Global Equities Asset Class was found to have investments potentially affected by the legislation.

Actions Taken

CalSTRS staff has continued to engage with the companies on the Sudan related securities list. In addition to engaging with individual companies, CalSTRS is a founding member and serves on the advisory board of the Conflict Risk Network. The Conflict Risk Network is the successor to the Sudan Divestment Task Force. The network is intended to increase responsible foreign investment and leverage the influence of members in areas afflicted by genocide and other atrocities.

CalSTRS was a member of the expert group working on responsible investment in conflict-affected countries. The project was a collaborative effort between the UNPRI and Global Compact to develop a set of best practices regarding stakeholder and corporate engagement when companies operate in conflict prone areas such as Sudan. The UNPRI and Global compact released their guidance document at the Global Compact Leaders Summit in June 2010

(Attachment H). Additionally, CalSTRS participated in the GAO's report on Sudan Divestment by providing holdings information and responding to their questionnaire (Attachment I).

CalSTRS Response to Iran Risk

Process

As directed by legislation, CalSTRS identified and created a list of companies noted as having some level of or possible business ties to Iran, such as operations in the oil, nuclear, or defense industries. These distinctions provided the assessment framework and supported the qualitative aspect of CalSTRS' process. The initial CalSTRS list was divided into three sections of various levels of involvement and holding levels. The list was based on the information provided by independent research providers, NGOs, and engagement work.

The initial list has been updated, and currently, companies that are determined to meet the requirements of the law are placed on the list in one of five sections: Restricted Companies, Extended Review, Companies Being Monitored, Companies Being Reviewed, or Non Holdings that Possibly Meet the Divestment Criteria.

Tactical Response: Investments Identified

The initial list comprised the names of 23 companies identified as having some level of business ties to Iran. The list was presented to the Board in June 2008 and included three companies that were already restricted under the Sudan Divestment law, 18 companies that were under review, and two companies that were being monitored but were not CalSTRS holdings. One additional company identified as having ties to Iran was subsequently added to the list.

As of October 4, 2008, CalSTRS' portfolio was free of PetroChina, Petronas, Sinopec, and MISC Bhd, all of which were restricted under Chapter 442, Statutes 2006 (AB 2941-Koretz), the Sudan Divestment law.

In addition to the restricted companies, CalSTRS has identified 23 companies in its portfolio that had possible ties to Iran. Staff has been engaging with those companies to determine if they fall within the terms of the statute to restrict, if the Board determines it would be consistent with its fiduciary responsibility.

Through the year there have been modest changes made to the list of companies included in last year's report. At this time, CalSTRS has 29 investments identified as having ties to Iran. Currently, seven companies are subject to the most severe restrictions under the law. Additionally, through the year, CalSTRS also divested shares of Daelim Industrial Co., PTT, and GS Engineering & Construction. However, GS Engineering & Construction was later taken off the restriction list after they announced the cancellation of their most recent Iranian contracts (\$1.3 billion).

In addition to the seven restricted companies, CalSTRS has identified 19 companies in its portfolio that have ties to Iran but do not meet the requirements for divestment. CalSTRS maintains these companies on its list in a monitored status (second tier category) and continues to engage them to confirm they keep their commitments and their status does not change. Currently, there are three companies in the third tier or “being reviewed” category (determining if criteria for divestment is met) (Attachment J, which includes these three tiers).

Lastly, CalSTRS has identified 17 companies that are not CalSTRS holdings but could be subject to the statute if purchased. Staff continually monitors the portfolio for these securities, and if purchased, staff will immediately begin the engagement process.

All asset classes were reviewed for any investments that could have ties to Iran. Only the Global Equities Asset Class was found to have investments potentially affected by the legislation.

Actions Taken

CalSTRS has continued to monitor the situation with regards to Iran and engage companies identified as having ties to the country. Over the past year, CalSTRS staff has met with identified companies at CalPERS’ offices in Sacramento as well as has held meetings with companies in New York and Munich. Additionally, staff plans to go to China in 2011 to continue engagement activities.

CalSTRS Report on Northern Ireland Related Securities

Process

CalSTRS contracted with the ISS, a division of MSCI, to provide a list of companies with business operations in Northern Ireland and those companies’ efforts towards substantial action relating to affirmative action in Northern Ireland. In addition, CalSTRS has consistently voted in favor of shareholder proposals relating to companies’ operations in Northern Ireland.

Companies with Exposure to Northern Ireland

The following list is comprised of companies that have been identified as having ties to Northern Ireland. CalSTRS has determined that it holds \$2,487,457,377 worth of equity with exposure to Northern Ireland, which represents 3.25 percent of CalSTRS’ equity holdings. Additionally, CalSTRS holds \$1,148,182,731 worth of bonds with exposure to Northern Ireland, which represents 4.21 percent of its fixed income portfolio. In total, CalSTRS holds \$3,635,640,108 worth of securities with exposure to Northern Ireland, which represents 2.59 percent of the total Fund.

CalSTRS has identified 32 holdings representing 29 companies that it believes have not made substantial action towards the goals of inclusiveness in Northern Ireland. CalSTRS has sent a

letter to each of the companies requesting they take actions towards inclusiveness in Northern Ireland ([Attachment K](#)).

<u>Company Name</u>	<u>Security Type</u>	<u>Shares/Par Value</u>	<u>Market Value</u>
Abertis Infraestructuras S.A.	Stock	245,030	\$ 3,912,138
Adecco	Stock	134,990	\$ 7,740,221
Allied Irish Banks	Stock	682,542	\$ 306,476
C & C Group PLC	Stock	230,671	\$ 935,660
Cemex SA de CV	Stock	432,431	\$ 391,580
Cemex SA de CV	ADR	2,050,580	\$ 18,537,243
Fraport Group	Stock	30,798	\$ 1,813,930
Fred Olsen Energy	Stock	25,322	\$ 939,876
Glanbia	Stock	255,777	\$ 1,048,816
HCL Technologies	Stock	596,268	\$ 5,262,908
Hutchison Whampoa	Stock	2,380,300	\$ 23,770,356
John Menzies PLC	Stock	21,277	\$ 154,081
Kerry Group	Stock	107,026	\$ 3,448,721
Kone	Stock	138,538	\$ 7,265,970
Lafarge	Stock	180,581	\$ 9,884,744
Lafarge	Bonds	5,000,000	\$ 5,349,114
Lloyds TSB Group	Stock	75,989,733	\$ 71,490,817
Michelin (CGDE)	Stock	299,508	\$ 20,320,773
Mitchells & Butlers	Stock	176,688	\$ 941,065
Mouchel Group plc	Stock	18,373	\$ 22,747
Next PLC	Stock	219,467	\$ 6,869,922
Provident Financial	Stock	97,028	\$ 1,226,231
Randstad Holdings	Stock	87,566	\$ 4,019,252
Saipem	Stock	1,040,269	\$ 43,414,676
Teleperformance S.A.	Stock	35,310	\$ 1,055,581
Carphone Warehouse Group PLC	Stock	344,994	\$ 2,060,456
The Davis Service Group	Stock	146,543	\$ 893,021
Trigano S.A.	Stock	4,015	\$ 106,098
Whitbread	Stock	149,789	\$ 3,939,999
WPP Group PLC	Stock	2,457,506	\$ 27,230,524
WPP Group PLC	ADR	89,096	\$ 4,949,283
Yell Group Plc	Stock	1,812,597	\$ 336,766
	Stock		\$ 250,803,403
	ADR's		\$ 23,486,526
	Bonds		\$ 5,349,114
	Total		\$ 279,639,043

CalSTRS has identified 81 holdings representing 66 companies that have exposure to Northern Ireland but have taken substantial action by adopting the MacBride principles or have global human rights policy that substantially contains the principle of MacBride.

<u>Company Name</u>	<u>Security Type</u>	<u>Shares/Par Value</u>	<u>Market Value</u>
Abertis Infraestructuras S.A.	Stock	245,030	\$ 3,912,138
Allianz SE	Stock (A Shr.)	515,340	\$ 56,686,279
Anglo American	Stock	2,427,609	\$ 106,446,075
Anglo American	Bonds	7,000,000	\$ 8,573,982
AP Moller-Maersk A/S	Stock (A Shr.)	439	\$ 3,484,887
AP Moller-Maersk A/S	Stock (B Shr.)	1,120	\$ 9,094,272
Associated British Foods	Stock	296,575	\$ 4,900,455
Aviva	Stock	2,621,557	\$ 14,477,199
AXA	Stock	1,648,656	\$ 23,736,275
AXA	Bonds	4,795,000	\$ 4,959,895
Banco Santander S.A.	Stock	7,869,620	\$ 74,783,195
Banco Santander S.A.	Bonds	140,000,000	\$ 139,928,592
Bank of Ireland	Stock	2,230,341	\$ 912,542
Barclays	Stock	15,770,573	\$ 62,911,253
Barclays	Bonds	425,000,000	\$ 427,206,476
Barloworld	Stock	963,800	\$ 8,153,689
BG Group Plc	Stock	5,563,804	\$ 100,641,603
Bombardier	Stock	1,269,472	\$ 5,809,092
BT Group plc	Stock	7,754,296	\$ 20,529,473
BT Group plc	Bonds	10,000,000	\$ 13,509,870
Bunzl PLC	Stock	284,837	\$ 3,111,792
Canon	Stock	2,524,952	\$ 118,908,149
Carillion Plc	Stock	335,818	\$ 1,736,838
Cattles PLC	Stock	175,308	\$ -
Celesio	Stock	93,479	\$ 2,202,521
Charter PLC	Stock	218,417	\$ 2,328,340
Coca-Cola Hellenic Bottling Co.	Stock	147,658	\$ 3,777,000
Coca-Cola Hellenic Bottling Co.	Bonds	8,000,000	\$ 8,672,140
Compass Group	Stock	3,400,982	\$ 29,422,184
Compagnie De Saint Gobain SA	Stock	636,353	\$ 28,591,264
CRH	Stock	901,526	\$ 15,725,605
CRH	Bonds	14,500,000	\$ 15,045,018
Danske Bank AB	Stock	637,306	\$ 15,850,697
Danske Bank AB	Bonds	10,000,000	\$ 10,263,197
DCC	Stock	66,961	\$ 1,753,641
Deutsche Lufthansa	Stock	219,555	\$ 4,685,783
Deutsche Post AG	Stock	1,036,377	\$ 16,654,679
Diageo	Stock	2,886,599	\$ 51,427,924
Diageo	Bonds	12,000,000	\$ 13,247,613
France Telecom	Stock	2,840,148	\$ 57,675,712
Fujitsu	Stock	1,919,900	\$ 12,307,345

Home Retail Group plc	Stock	723,614	\$ 2,271,873
HSBC Holdings	Stock	22,609,707	\$ 228,347,449
HSBC Holdings	Bonds	177,000,000	\$ 180,367,536
Independent News & Media	Stock	229,545	\$ 145,176
Inditex	Stock	421,743	\$ 31,875,155
Johnston Press PLC	Stock	125,190	\$ 19,496
Kingfisher	Stock	2,810,154	\$ 10,284,531
Kuehne & Nagel International AG	Stock	43,618	\$ 5,632,223
Kyocera	Stock	141,500	\$ 14,425,331
Legal & General	Stock	14,072,622	\$ 20,031,235
Linde Group, The	Stock	190,786	\$ 26,723,059
Marks & Spencer	Stock	1,391,230	\$ 8,072,876
Metro	Stock	510,626	\$ 36,731,714
Micro Focus International Plc	Stock	158,451	\$ 817,775
Nordea Bank AB	Stock	3,584,833	\$ 35,707,640
Nordea Bank AB	Bonds	260,000,000	\$ 260,667,294
Nutreco Holding NV	Stock	136,845	\$ 9,637,260
Regis	Stock	163,495	\$ 2,913,481
Royal Bank of Scotland	Stock	14,836,273	\$ 8,685,277
Sainsbury, J.	Stock	2,214,304	\$ 12,266,132
SAS AB	Stock	119,988	\$ 385,594
Schlumberger	Stock	4,252,086	\$ 328,856,331
Signet Jewelers	Stock	530,243	\$ 21,119,578
Smith WH Group	Stock	124,321	\$ 914,814
Sodexo	Stock	77,724	\$ 4,912,657
Telefonica SA	Stock	5,057,236	\$ 107,899,534
Telefonica SA	Bonds	32,000,000	\$ 34,279,124
Tesco	Stock	15,898,696	\$ 102,580,059
Thales	Stock	78,722	\$ 2,767,885
The Capita Group plc	Stock	731,786	\$ 7,430,503
ThyssenKrupp AG	Stock	311,039	\$ 11,912,006
TNT NV	Stock	544,177	\$ 13,023,605
Trinity Mirror	Stock	191,934	\$ 208,489
Tyco International	Stock	1,470,076	\$ 55,701,179
Tyco International	Bonds	8,000,000	\$ 8,406,104
Vodafone Group	Stock	73,459,016	\$ 183,900,367
Vodafone Group	ADR	34,200	\$ 857,052
Vodafone Group	Bonds	16,000,000	\$ 17,706,776
Wincanton	Stock	66,604	\$ 178,408
Zurich Financial Services	Stock	237,877	\$ 53,293,803

Stock	\$ 2,212,310,396
ADR's	\$ 857,052
Bonds	\$ 1,142,833,617
Total	\$ 3,356,001,065

Shareholder Proposals Relating to Northern Ireland

In 2010, one company, Regis Corporation, had a shareholder proposal on their proxy requesting the company implement the MacBride principles. In accordance with the law and CalSTRS fiduciary duty, CalSTRS voted for the proposal. CalSTRS will continue to support shareholder proposals related to operations in Northern Ireland when they are in line with CalSTRS fiduciary duties.

CalSTRS Report on Companies with Possible Exposure to World War II Forced Labor

Process

CalSTRS contracted with ISS, a division of MSCI, to provide a list of companies with potential exposure to forced labor reparations. CalSTRS compared the list to CalSTRS holdings in order to produce this report.

Companies with Potential Forced Labor Exposure

The following list is comprised of companies that have been identified as having a past tie to World War II forced labor. As noted above, not all of the portfolio companies are facing lawsuits over this behavior, but CalSTRS is presenting the global list for the purposes of the potential scope of the risk to the CalSTRS portfolio. CalSTRS has determined that it holds \$2,458,897,705 worth of equity with exposure to World War II forced labor, which represents 3.21 percent of its equity holdings. Additionally, CalSTRS holds \$771,211,364 worth of bonds with exposure to World War II forced labor, which represents 2.83 percent of its fixed income portfolio. In total, CalSTRS holds \$3,230,109,069 worth of securities with exposure to World War II forced labor, which represents 2.30 percent of the total Fund.

CalSTRS has identified four companies that are currently facing lawsuits or have previously judicated suits being appealed regarding their past involvement in forced labor. CalSTRS has sent a letter to each of the companies requesting they resolve all matters relating to forced labor ([Attachment L](#)).

<u>Company Name</u>	<u>Security Type</u>	<u>Shares/Par Value</u>	<u>Market Value</u>
Kajima Corporation	Stock	800,200	\$ 1,996,440
Mitsubishi Materials Corp.	Stock	970,000	\$ 2,999,045
Mitsui Mining and Smelting	Stock	543,570	\$ 1,648,165
Taisei Corp.	Stock	845,000	\$ 1,906,470
		Stock	\$ 8,550,120
		Total	\$ 8,550,120

CalSTRS has identified 14 companies that have had cases filed against them that were either dismissed or rejected and have not had appeals filed or have run out of appeals.

<u>Company Name</u>	<u>Security Type</u>	<u>Shares/Par Value</u>	<u>Market Value</u>
Ishihara Sangyo Kaisha Ltd.	Stock	239,000	\$ 191,154
Kawasaki Heavy Industries	Stock	1,179,185	\$ 3,645,803
Mitsubishi Heavy Industries	Stock	2,699,491	\$ 9,699,735
Mitsui & Co.	Stock	2,525,168	\$ 39,398,288
Mitsui Engineering & Shipbuilding Co.	Stock	570,000	\$ 1,313,239
Mitsui OSK Lines Ltd.	Stock	3,372,000	\$ 23,145,517
Nippon Sharyo, Ltd.	Stock	64,000	\$ 286,499
Nippon Steel Corp.	Stock	4,457,781	\$ 14,740,424
Nittetsu Mining Co. Ltd.	Stock	62,000	\$ 227,958
Sumitomo Chemical Co. Ltd.	Stock	2,378,100	\$ 10,191,452
Sumitomo Heavy Industries	Stock	673,000	\$ 4,129,426
Taiheiyo Cement Corp.	Stock	682,000	\$ 838,558
UBE Industries Ltd.	Stock	711,000	\$ 1,807,843
Furukawa Co.	Stock	216,000	\$ 239,799
		Stock	\$ 109,855,694
		Total	\$ 109,855,694

CalSTRS has identified 26 holdings representing 23 companies, which are accused of using forced labor or have evidence that they used forced labor but do not have any lawsuits filed against them. CalSTRS will continue to monitor these companies and contact them if lawsuits are filed.

<u>Company Name</u>	<u>Security Type</u>	<u>Shares/Par Value</u>	<u>Market Value</u>
Daido Steel Co. Ltd.	Stock	255,000	\$ 1,366,778
Dow Chemical Co.	Bonds	52,300,000	\$ 60,343,387
Dow Chemical Co.	Stock	4,873,025	\$ 151,940,919
Hitachi Zosen	Stock	531,000	\$ 741,638
Holcim	Stock	302,439	\$ 19,617,419
Honeywell International Inc.	Bonds	12,000,000	\$ 13,337,902
Honeywell International Inc.	Stock	2,293,340	\$ 114,001,931
IHI Corp.	Stock	1,062,09	\$ 2,193,362
Kloekner Werke	Stock	51,051	\$ 1,286,248
Mitsubishi Corp.	Stock	2,737,201	\$ 69,140,710
Namura Shipbuilding Co. Ltd.	Stock	25,300	\$ 121,411
Nippon Express	Stock	756,000	\$ 3,014,253
Nippon Soda Co.	Stock	95,000	\$ 378,775
Nissan Motor Co. Ltd.	Bonds	5,000,000	\$ 5,171,527
Nissan Motor Co. Ltd.	Stock	3,419,159	\$ 32,040,585
OC Oerlikon Corporation AG	Stock	100,493	\$ 461,782

Pitney Bowes Inc.	Stock	569,294	\$ 12,490,310
Saint-Gobain (Compagnie de)	Stock	636,353	\$ 28,591,265
Shin-Etsu Chemical Co. Ltd.	Stock	484,703	\$ 23,665,217
Showa Denko KK	Stock	1,124,089	\$ 2,294,607
Sulzer AG	Stock	31,544	\$ 4,130,121
Sumitomo Corp.	Stock	1,279,600	\$ 16,680,473
Sumitomo Metal Industries Ltd.	Stock	6,525,607	\$ 15,813,516
Toshiba	Stock	3,374,142	\$ 17,561,489
Von Roll Holding Ltd.	Stock	62,343	\$ 277,094
Yodogawa Steel Works Ltd.	Stock	98,000	\$ 377,868
	Stock		\$ 518,187,771
	Bonds		\$ 78,852,816
	Total		\$ 597,040,587

CalSTRS has identified 53 holdings representing 42 companies that have a past tie to World War II forced labor and have participated in, had a subsidiary participate in, or had a previous entity participate in a reparations program, such as the German “Remembrance, Responsibility and the Future” Foundation, the Swiss Banks settlement, or their own settlement agreement. Given the current judicial climate, it is unlikely (but not impossible) that they will face any further liabilities related to WWII forced labor.

<u>Company Name</u>	<u>Security Type</u>	<u>Shares/Par Value</u>	<u>Market Value</u>
ABB	Stock	2,814,577	\$ 54,924,774
BASF AG	Stock	1,023,159	\$ 76,584,057
Bayer AG	Stock	1,073,196	\$ 78,163,955
Bayerische Motoren Werke AG	Pref. Stock	41,169	\$ 2,396,890
Bayerische Motoren Werke AG	Stock	650,574	\$ 49,060,009
Beiersdorf AG	Stock	86,919	\$ 5,060,489
Bucher Industries AG	Stock	4,881	\$ 759,060
Continental AG	Stock	37,043	\$ 2,884,080
Daimler AG	Bonds	17,640,000	\$ 20,591,129
Daimler AG	Stock	1,170,015	\$ 75,955,319
Deere & Co.	Bonds	20,000,000	\$ 21,917,466
Deere & Co.	Stock	2,315,867	\$ 172,995,265
Deutsche Bank AG	Bonds	160,250,000	\$ 163,040,138
Deutsche Bank AG	Stock	1,012,577	\$ 48,236,657
Deutz AG	Stock	35,172	\$ 254,107
E.ON AG	Stock	1,986,122	\$ 57,151,000
Eastman Kodak Co.	Stock	697,490	\$ 3,285,178
Ford Motor Co.	Bonds	26,171,675	\$ 29,792,793
Ford Motor Co.	Stock	10,783,529	\$ 171,889,452
GEA Group AG	Stock	219,524	\$ 5,292,372
General Motors Corp.	Bonds	6,270,000	\$ 2,175,010
General Motors Corp.	Pref. Stock	31,300	\$ 1,586,910

General Motors Corp.	Stock	386,290	\$ 13,211,118
Georg Fischer AG	Stock	2,713	\$ 1,340,576
H & R Wasag AG	Stock	10,846	\$ 281,246
Hochtief AG	Stock	49,947	\$ 3,709,304
Jenoptik AG	Stock	16,059	\$ 105,423
JFE Holdings	Stock	400,300	\$ 12,715,749
Lonza Group AG	Stock	38,844	\$ 3,018,429
MAN SE	Stock	150,197	\$ 17,698,367
Merck KGaA	Stock	91,806	\$ 7,187,236
Nachi-Fujikoshi Corp.	Stock	103,000	\$ 312,308
NCR	Stock	553,153	\$ 7,959,872
Nestle SA	Stock	4,591,820	\$ 251,313,114
Nippon Yakin Kogyo	Stock	103,000	\$ 287,716
Nishimatsu Construction Co.	Stock	227,000	\$ 281,819
Novartis AG	ADR	30,735	\$ 1,641,556
Novartis AG	Bonds	7,000,000	\$ 7,900,531
Novartis AG	Stock	3,137,681	\$ 167,634,708
Rheinmetall	Stock	61,150	\$ 3,957,810
Roche Holding AG	Bonds	8,780,000	\$ 9,521,816
Roche Holding AG	Stock	933,630	\$ 129,080,179
Salzgitter AG	Stock	29,882	\$ 1,928,023
Sanofi-Aventis	Stock	1,797,656	\$ 109,001,749
Siemens AG	Stock	1,377,060	\$ 151,097,163
Solvay SA	Stock	49,690	\$ 4,815,719
Teijin	Stock	784,266	\$ 3,164,401
ThyssenKrupp AG	Stock	311,039	\$ 11,912,006
Tui AG	Stock	111,583	\$ 1,179,455
UBS	Bonds	435,705,103	\$ 437,419,665
UBS	Stock	4,773,653	\$ 71,985,557
Volkswagen AG	Pref. Stock	193,474	\$ 31,179,608
Volkswagen AG	Stock	57,739	\$ 7,824,334
	Stock		\$ 1,785,499,155
	ADR		\$ 1,641,556
	Pref. Stock		\$ 35,163,408
	Bonds		\$ 692,358,548
			\$ 2,514,662,667

Conclusion

As noted in this report, CalSTRS will continue to invest its funds in a responsible and prudent manner. CalSTRS will continue to implement the California Statutes referenced in this report and adhere to the Board's Investment Policy for Mitigating Environmental, Social, and Geopolitical Risks.

CalSTRS continues to secure a strong retirement fund for the teachers of California while remaining consistent with its ethical responsibilities and fiduciary obligations. Thus, the philosophy of identifying and addressing risks is interwoven into the business goals of CalSTRS. CalSTRS' investment goals are to:

- a) Achieve a rate of return on the total assets of the Fund that in the long run exceeds the actuarial discount rate used to value the liabilities of the State Teachers' Retirement Plan for funding purposes, so as to ensure that sufficient assets are available to meet the liabilities on an on-going basis.
- b) Reduce the contributions required to fund those liabilities by maximizing the long-term investment return on assets at a level of risk that is acceptable to the Board.
- c) Maintain a certain level of stability in pension contributions so as not to adversely impact the long-term viability of CalSTRS and its ability to continue to meet pension obligations.
- d) Manage the investments of the Fund in a prudent manner so as to maintain the confidence of members as well as the general public in the California State Teachers' Retirement System.

Attachment A: Investment Policy for Mitigating Environmental, Social, and Geopolitical Risks (ESG)

PRINCIPLES

The fiduciary responsibility of the Board, as described in detail within the overall Investment Policy and Management Plan, is to discharge its responsibility in the sole and exclusive interest of the participants and beneficiaries in a manner that will assure the prompt delivery of benefits and related services.

CalSTRS invests a multi-billion dollar fund in a unique and complex social-economic milieu and recognizes it can neither operate nor invest in a vacuum. The System's investment activities impact other facets of the economy and the globe. As a significant investor with a very long-term investment horizon and expected life, the success of CalSTRS is linked to global economic growth and prosperity. Actions and activities that detract from the likelihood and potential of global growth are not in the long-term interests of the Fund. Therefore, consideration of environmental, social, and governance issues (ESG), as outlined by the CalSTRS 21 Risk Factors, are consistent with the Board fiduciary duties.

Consistent with its fiduciary responsibilities to our members, the Board has a social and ethical obligation to require that the corporations and entities in which securities are held meet a high standard of conduct and strive for sustainability in their operations. As an active owner, CalSTRS incorporates ESG into its ownership policies and practices.

Since CalSTRS is a long-term investor and may hold an investment in a corporation or entity for decade after decade, short-term gains at the expense of long-term gains are not in the best interest of the Fund. Sustainable returns over long periods are in the economic interest of the Fund. Conversely, unsustainable practices that hurt long-term profits are risks to the System's investment.

Since CalSTRS must invest huge sums of moneys for long periods of time to pay for future benefits promised to California Teachers, our actions to invest in securities of a corporation predominately reflects a judgment that the ownership will produce a sustainable rate of return which will make it an attractive investment and help CalSTRS meet its long-term obligations. It is important to note that CalSTRS ownership of a security in a company does not signify that CalSTRS approves of all of the company's practices or its products or that CalSTRS believes a particular company is an attractive

investment since the security may be owned due to its membership in a particular index or for risk mitigation purposes.

Since 1978, CalSTRS has used a written policy, the Statement of Investment Responsibility (SIR), to navigate the complex landscape of ESG issues. The long history of this document is testimony to the national leadership of CalSTRS among pension funds in addressing ESG matters through a written policy. The SIR will continue its longevity as guidance on proxy voting; however this Policy now replaces the SIR as CalSTRS's preeminent policy on ESG matters.

POLICY

Geopolitical Risks and Social Risks: To help manage the risk of investing a global portfolio in a complex geopolitical environment, CalSTRS has developed a series of procedures to follow when faced with any major geopolitical and social issue as identified by the 21 risk factors. It is important to note that fiduciary standards do not allow CalSTRS to select or reject investments based solely on social criteria.

When faced with a corporate decision that potentially violates CalSTRS Policies; the Investment Staff, CIO and Investment Committee will undertake the following actions:

- A. The CIO will assess the gravity of the situation both as an ESG risk and as to the System. The extent of the responsibility of the System to devote resources to address these issues will be determined by: 1) the number of shares held in the corporation, and 2) the gravity of the violation of CalSTRS Policies.
- B. At the CIO's direction, the Investment Staff will directly engage corporate management to seek information and understanding of the corporate decision and its ramifications on ESG issues.
- C. The CIO and investment staff will provide a report to the Investment Committee of the findings and recommend any further action of engagement or need to commit further System resources. The Investment Committee can marshal further resources given the gravity of the situation.

To assist CalSTRS Staff and external investment managers in their investment analysis and decision-making, CalSTRS has developed a list of 21 risk factors that should be included within the financial analysis of any investment decision. This list is not exhaustive and does not attempt to identify all forms of risk that are appropriate to consider in a given investment transaction; however they do provide a framework of other factors that might be overlooked. These risk factors should be reviewed for an investment in any asset class whether within the U.S. or across the globe.

CalSTRS expects all investment managers, both internal and external to assess the risk of each of the following factors when making an investment. The manager needs to balance the rate of return with all the risks including consideration of the specific investments exposure to each factor in each country in which that investment or company operates.

<i>CALSTRS 21 RISK FACTORS</i>	
Monetary Transparency	The long-term profitability by whether or not a country or company has free and open monetary and financial data, and its observance of applicable laws.
Data Dissemination	The long-term profitability by whether or not a country is a member of the IMF (or similar organization) and satisfies the conditions for access, integrity, and quality for most data categories.
Accounting	The long-term profitability by whether or not the accounting standards are formulated in accordance with International Accounting Standards or the U.S. Generally Accepted Accounting Principles.
Payment System: Central Bank	The long-term profitability by whether the activities of a country's central bank encompass implementing and ensuring compliance with principles and standards which are established to promote safe, sound, and efficient payment and settlement systems.
Securities Regulation	The long-term profitability by exposure to operations in countries that have not complied with IOSCO objectives, which provide investor protection against manipulation and fraudulent practices.
Auditing	The investment's long-term profitability by whether or not the country uses International Standards on Auditing in setting national standards.
Fiscal Transparency	The investment's long-term profitability by its exposure or business operations in countries that do not have not some level of fiscal transparency such as publication of financial statistics, sound standards for budgeting, accounting, and reporting.

<p>Corporate Governance</p> <p>The investment's long-term profitability by whether or not the government recognizes and supports good corporate governance practices and whether it generally adheres to OECD principles.</p>
<p>Banking Supervision</p> <p>The investment's long-term profitability from its exposure to countries that have not endorsed/complied with the Basel Core Principles. An endorsement includes an agreement to review supervisory arrangements against the principles and bring legislation in line with the principles where necessary.</p>
<p>Payment System: Principles</p> <p>The investment's long-term profitability by whether a country complies with the 10 Core Principles for Systemically Important Payment Systems, which includes operational reliability, efficiency, real time settlement, final settlement in central bank money; and whether rules and procedures are clear and permit participants to understand the financial risks resulting from participation in the system.</p>
<p>Insolvency Framework</p> <p>The investment's long-term profitability from its business operations and activities in specific countries with regard to bankruptcy reform or insolvency legislation.</p>
<p>Money Laundering</p> <p>The investment's long-term profitability from exposure and whether or not a country has implemented an anti-money laundering regime in line with international standards; consideration should be given to compliance with the 40 recommendations in the Financial Action Task Force (FATF) on Money Laundering; and whether it is a member of FATF.</p>
<p>Insurance Supervision</p> <p>Whether or not a country has a regulatory framework in line with International Association of Insurance Supervisors (IAIS) Principles.</p>
<p>Respect for Human Rights</p> <p>The investment's long-term profitability from its business operations and activities in countries that lack or have a weak judicial System. Assess the risk to an investment's long-term profitability from its business operations and activities in a country that engages in or facilitates the following: arbitrary or unlawful deprivation of life, disappearance, torture and other cruel, inhuman, or degrading treatment or punishment, arbitrary arrest, detention, or exile, arbitrary interference with privacy, family, home, or correspondence, use of excessive force and violations of humanitarian law in internal conflicts. Consideration should be given to governmental attitude regarding international and non-governmental investigation of alleged violations of human rights.</p>
<p>Respect for Civil Liberties</p> <p>The investment's long-term profitability from operations, activities, and business practices in countries or regions that do not allow freedom of speech and press, freedom of peaceful assembly and association, freedom of religion, freedom of movement within the country, allowance for foreign travel, emigration, and repatriation.</p>

<p>Respect for Political Rights</p> <p>The investment’s long-term profitability from business practices and activities in countries that do not allow their citizens the right to advocate for change to their government.</p>
<p>Discrimination Based on Race, Sex, Disability, Language, or Social Status</p> <p>The investment’s long-term profitability from business practices and activities on discrimination, such as discrimination against women, children, and persons with disabilities, national/racial/ethnic minorities, or indigenous people.</p>
<p>Worker Rights</p> <p>The investment’s long-term profitability from management and practices globally in the area of worker’s rights; specifically the right of association, the right to organize and bargain collectively, prohibition of forced or bonded labor, status of child labor practices and minimum age for employment, acceptable work conditions, or human trafficking.</p>
<p>Environmental</p> <p>The investment’s long-term profitability from activities and exposure to environmental matters such as; depleting or reducing air quality, water quality, land protection and usage, without regard for remediation. Consideration should be given to how a company is dealing with the impact of climate change, including whether the government is taking steps to reduce its impact, exacerbating the problem, or oblivious to the risk.</p>
<p>War/Conflicts/Acts of Terrorism</p> <p>The investment’s long-term profitability from business exposure to a country or region that has an internal or external conflict, war, acts of terrorism or involvement in acts of terrorism, and whether the country is a party to international conventions and protocols.</p>
<p>Human Health</p> <p>The risk to an investment’s long-term profitability from business exposure to an industry or company that makes a product which is highly detrimental to human health so that it draws significant product liability lawsuits, government regulation, United Nations sanctions and focus, and avoidance by other institutional investments.</p>

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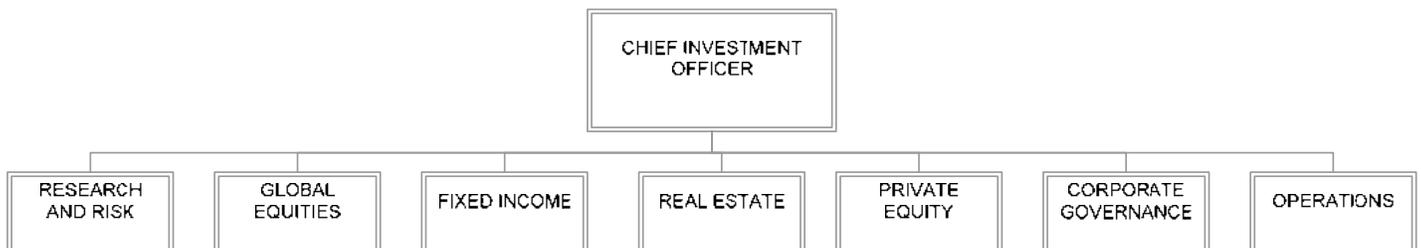
INVESTMENT BRANCH

10 - Year Financial Plan

Mission & Organization Chart

The singular mission of the Investment Branch is to generate the required investment return to meet the Actuaries assumptions; in dollar terms, that means we need to earn \$13.6 billion each year. To reach even higher, our goal is to add an additional **60 basis points of excess return above the benchmark each year**. That equates to adding \$1 billion of extra return above what the markets generate. Clearly, in Fiscal Year 07-08, we were not able to deliver on the primary goal and only partially met the higher goal. That will not deter us. **Our goal for Fiscal Year 08-09 is to earn \$15 billion for the Fund.**

Within the business plans, each unit will highlight their share of our 60 basis point objective and describe what they need to deliver those results. In this branch wide business plan and financial plan, we will discuss some of the organizational changes we are going to make to help improve results. **The theme for FY 08-09 is “Making Moves.”** Within the Branch, we are proposing four organizational changes and at the end of the year will be the biggest move, moving the entire organization into the new CalSTRS Headquarters building.



Key Success Factors & Challenges

As you review the market cycles for each of the major asset classes, one startling picture emerges; we are in the most challenging investment market since the internet bubble burst in 2001. Before that, you have to go back to 1979 -1981 to find a similar picture of high inflation and a poor, slow global economy. Unfortunately, we may only be at the start of this period. No matter what, we are faced with one of the most difficult investment climates we have seen in 20 years. It will be harder than ever to generate the desired return.

In 2003 to 2007, when we were able to generate a double digit return year in and year out, it's like the old saying; in a rising tide all the boats rise, even the leaky ones. When the tide recedes you find out where the problems are or, as Warren Buffet said, you find out who

doesn't have swim trunks. One of the greatest challenges will be that little inefficiencies were masked in our years of big gains, but they will become huge impediments and drags during years of low market returns.

We operate an investment management company inside a government business model. Ennis Knupp has demonstrated that the government model costs 40 basis points per year¹ versus other more traditional money management business models. Since the CalSTRS Board has some broader authority than most Public funds, the cost difference may not be as great, but the business model is without a doubt not the right fit, nor the most efficient. Simple investment activities such as contracting for professional consulting services, hiring investment managers, travel, and staffing all become much more difficult and costly under our structure. In our future, these inefficiencies may become too burdensome. Our peers at university endowments and public pensions in Canada, U.K., and the Netherlands have all hit that point and created more efficient business models for their investment operations. Our success may depend upon our willingness to develop an alternative business model in the future.

Business Plan

The organizational structure of the Investment Branch has remained static since 1997. Like the dynamic markets, we periodically need to make changes to adapt to the changing conditions. In keeping with our theme of "Making Moves", the Chief Investment Officer is proposing to institute four changes within the Investment Branch for FY 08-09:

1. **Create a separate and distinct Corporate Governance Unit** – Based upon the desire to continually improve and grow our corporate governance effort, the CIO is going to move Corporate Governance out from a subset of Global Equity and set it up as its own unit. Headed by a new Director of Corporate Governance, the position will report directly to the CIO and become a distinct unit within the Investment Branch. While it will continue to work side by side with Global Equities, due to the Active corporate governance managers, the unit needs to reflect our policy that corporate governance is involved and over all the asset classes, not just U.S. stocks. As a separate unit, it will receive the recognition and independence to help meet the Investment Committee's overall objectives.
2. **Create a new Research & Risk Unit** – In the last two business plans, the CIO has described the need for an in-house research unit. This is the year to separate it out and create a distinct unit to conduct research, manage our portfolio wide risks, incubate innovative ideas, and assist the CIO in managing the asset allocation. Steven Tong has accepted the challenge of leading this new unit and developing our research capabilities.

¹ Ennis Knupp Research, *Can Public Funds Compete?*, June 2004

This unit will be able to explore and evaluate all the cross-asset class opportunities that have begun to appear in our landscape. If the Investment Committee approves, this new unit can also serve to incubate new ideas and test their viability for the Portfolio.

3. **Merge Internal Equity and External Equity into one Global Equity Unit** – Historically at CalSTRS, these two units have operated separately and reported to two Directors. By placing the units under one new Director of Global Equity we can realize even more value. These two teams share a great deal in common and in most funds they operate as one unit. After careful consideration, the CIO believes the optimal structure is to join the two as one unit. We are in the process of recruiting to fill a vacant, Director of Global Equities position.
4. **Change the name of Alternative Investment to Private Equity** – While not as significant as the prior three changes, it reflects the organization’s change that new “alternative investment” vehicles will be reviewed by the Research & Risk Unit. Therefore, the prior Alternative Investment (AI) group will be renamed for exactly what they manage – which is 100% private equity. When AI was established back in the early 1990’s, private equity and real estate were considered the “alternative investments”. Today there is a potpourri of investments that are an alternative to traditional stocks and bonds. Yet at the same time, private equity has gone from an alternative to a complete industry and a traditional asset class; therefore, our naming convention needs to adjust to reflect the realities of today.

The final big move will take place, fittingly, at the end of the fiscal year as we move the entire organization and trading desk to the new CalSTRS Headquarters Building. This will be no small feat, not just for Investments, but for all of CalSTRS. Since Investments has half of the critical CalSTRS’ operations² that need to be up and running within 24 hours, the move is a major event and must be handled efficiently to ensure smooth operations and to not disrupt returns.

Financial Plan

A key component of the business plan is the financial plan. To gauge our resource needs and to manage our costs, the CIO develops the following 10-Year Financial Plan. Research has shown that investment firm’s costs are driven by a combination of assets under management (AUM) and the complexity of the portfolio. The following plan shows the anticipated growth of AUM. The 10-Year Financial Plan assumes the current level of complexity of the Portfolio. If more asset classes are added and the current asset classes grow more diverse, the cost structure will rise. To validate the plan, we compare our plan five years out to the cost structure and staffing of present day funds that are \$240 to \$250 billion in size. CalPERS, the Dutch Fund APB, the Korean Pension Service (KPS), the Norwegian Pension Fund, and the two halves of TIAA-CREF serve as examples. Our plan forecasts a smaller staff and cost

² According to the CalSTRS Business Continuity and Incident Management Plan, the Investment Branch has 15 of the 30 crucial functions

compared to all the others, with the sole exception of the Norwegian fund which is run by the government constrained Federal Reserve Bank. If CalSTRS grows as complex as CalPERS or ABB, the current plan underestimates the cost and staffing.

Not surprising, the more complex an investment portfolio becomes, the higher the overall cost structure. According to the CEM, back in 2004, when CalPERS was our size today, their investment operation ran at a cost of 24.7 basis points. This compares to our current CEM cost factor of 17 basis points. In the 10-Year Financial Plan, we estimate the budget cost to be around 12 basis points, the difference compared to the CEM figure has to do with the expensing rather than amortization of private equity management fees.

Regardless of the methodology, the cost difference between CalSTRS and our peers is significant and is directly linked to our investment structure and the use of high cost external investment managers. In 2012, when CalSTRS is expected to be the same size as CalPERS is today, we forecast our cost to be well below CalPERS or APB. The difference in cost structures is the result of the more extensive use of external investment managers, the use of higher cost business structures, and lastly, a sizeable increase in internal staff.

The lion's share of the cost to manage the total investment portfolio is driven by the external investment managers, Line 7 in the Financial Plan. In total, they comprise 82% of the annual cost. The decision to shift from an active/passive mandate to 100% external active managers in emerging markets increased our costs by \$40 million per year. Considering all of the remaining expenses are less than that single change, which involved just 10% of the assets; demonstrates the magnitude and impact of external manager costs. The active / passive decision drives the total fund basis point costs more than any other figure and is just another example of the complexity within the Investment Portfolio.

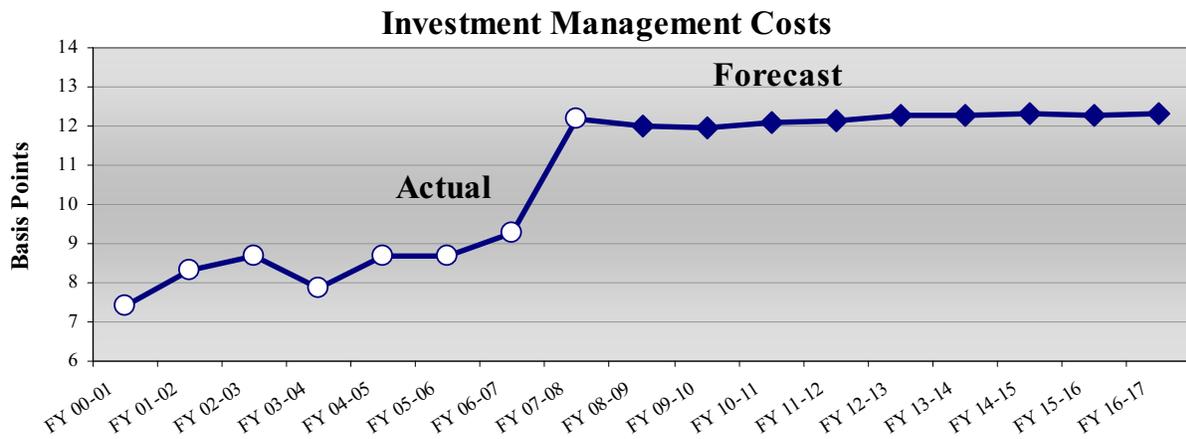
While our peers became more complex as they grew to \$200 billion, as mentioned below, the CalSTRS 10-Year Plan does not assume that increase in complexity. Any change in the Portfolio structure would be given careful consideration by the Investment Committee. By using a baseline financial plan, it will afford the easy comparison of cost benefit every time a new idea is considered. That establishes a level of discipline that has served CalSTRS well over the years.

Budget and Resources

Our FY 08-09 Budget has already been approved by the Board and supported by the Department of Finance. In addition, the Investment Branch's budget request for FY 09-10 has also been submitted for consideration to the CalSTRS Executive Staff. Looking to the

future, our Support Budget, Line 6 in the 10-Year Financial Plan, will grow as the AUM grows, and our Continuous Appropriation, Line 15, will grow as the Portfolio becomes more complex. The cost of professional services, Line 9 in the plan, is comprised of investment consultants, independent fiduciaries, and legal services, and it is forecast to grow to our third largest cost factor behind internal staff salaries and benefits.

Below is a graph of the past and forecasted basis point costs of the Investment Portfolio. The significant increase between FY 06-07 and FY 07-08 is a result of higher external investment management fees, Line 7. They jumped in part due to the growth of the Portfolio by \$26 billion last year and by the planned increase in active management. The costs are detailed in the 10-Year Plan.



³ CalPERS Web Site, 2005 Press release of their Dec. 31, 2004 CEM Report



	FY 07-08	FY 08-09	FY 09-10	FY 10-11	FY 11-12	FY 12-13	FY 13-14	FY 14-15	FY 15-16	FY 16-17	FY 17-18
Retirement Funds (Net)	\$ 164,650,232	\$ 175,236,551	\$ 186,248,948	\$ 197,680,362	\$ 213,890,152	\$ 231,429,144	\$ 250,406,334	\$ 270,939,653	\$ 293,156,705	\$ 317,195,555	\$ 343,205,590
Cash Balance Plan	\$ 96,510	\$ 104,231	\$ 112,569	\$ 121,575	\$ 131,301	\$ 141,805	\$ 153,149	\$ 165,401	\$ 178,633	\$ 192,924	\$ 208,358
Supplemental Def. B.	\$ 5,352,173	\$ 6,869,886	\$ 7,989,776	\$ 8,869,276	\$ 8,691,890	\$ 8,518,053	\$ 8,347,692	\$ 8,180,738	\$ 8,017,123	\$ 7,856,781	\$ 7,699,645
CalSTRS 403(b) plan*	\$ 169,590	\$ 198,853	\$ 230,750	\$ 265,517	\$ 303,414	\$ 344,721	\$ 389,746	\$ 438,823	\$ 492,317	\$ 550,626	\$ 614,182

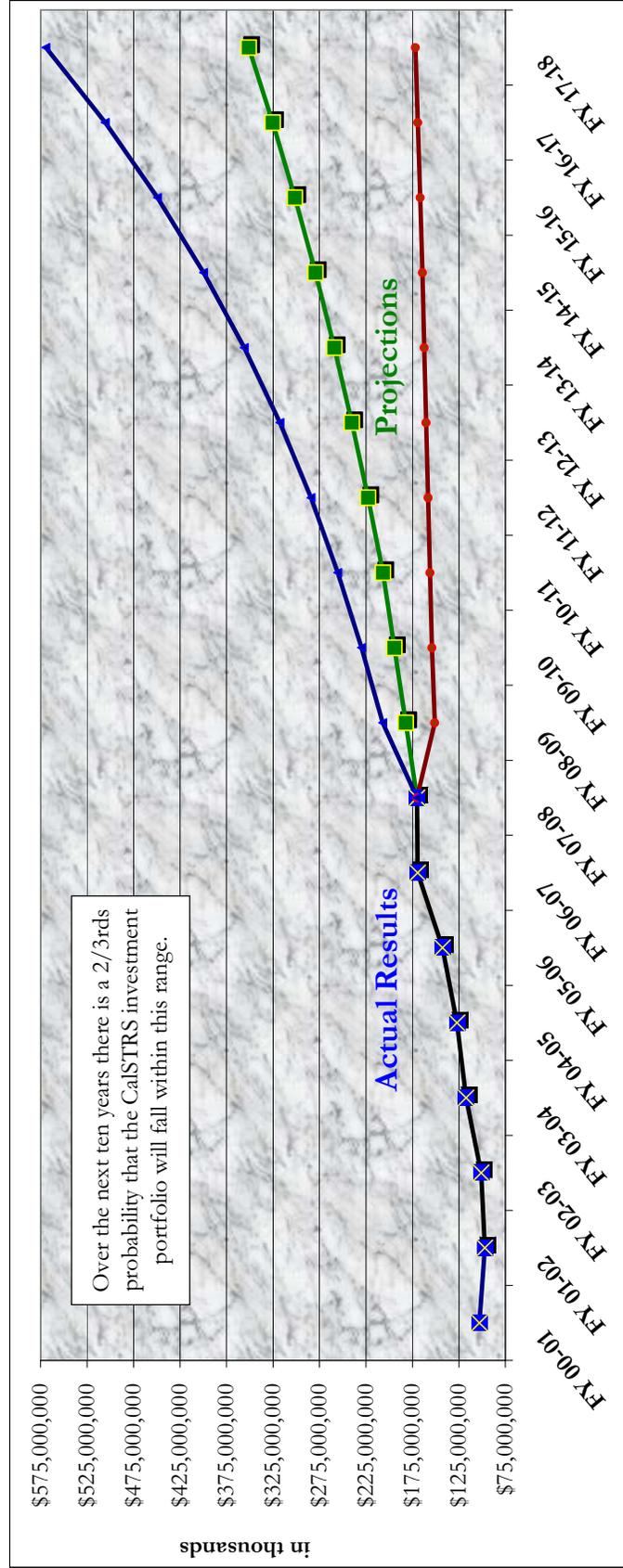
Total (less 403(b)) \$ 170,098,915 \$ 182,210,668 \$ 194,351,293 \$ 206,671,213 \$ 222,713,343 \$ 240,089,002 \$ 258,907,175 \$ 279,285,792 \$ 301,352,461 \$ 325,245,259 \$ 351,113,593

**403(b) assets managed outside the Investment Branch and not included in growth estimate.*

Low Return Environment** \$ 170,098,915 \$ 150,948,624 \$ 154,106,515 \$ 156,137,127 \$ 158,210,034 \$ 160,286,011 \$ 162,265,189 \$ 164,343,499 \$ 166,725,105 \$ 169,222,746 \$ 171,841,294

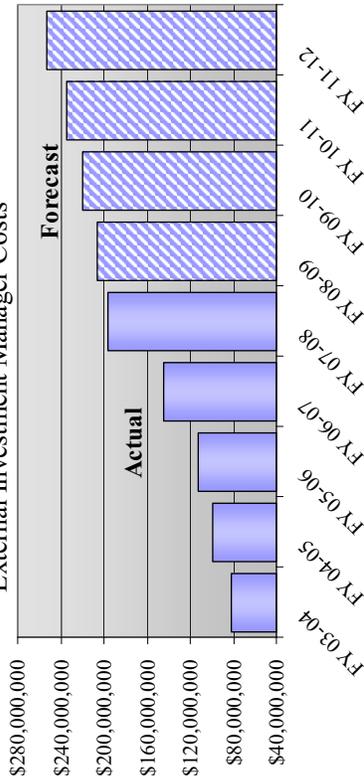
High Return Environment* \$ 170,098,915 \$ 207,033,698 \$ 229,902,108 \$ 255,312,951 \$ 284,108,596 \$ 317,577,412 \$ 355,995,847 \$ 399,667,846 \$ 449,237,482 \$ 505,483,855 \$ 569,338,912

***Return assumptions based on CalSTRS capital market Assumption for 10 year growth. High and low estimate based on 10 year standard deviation for CalSTRS current asset mix.*



This forecast is based upon the current CalSTRS capital market assumptions over the next ten years. Actual result will vary widely. Since this chart is based upon a ten year average, individual years return can and will vary significantly. The purpose of the chart is to help explain the potential growth in the investment portfolio. Asset allocation shifts and changes in the assumption will move the chart. As described above this only includes one standard deviation, or two thirds of the potential outcomes. This information is for estimation of the CalSTRS business plan and should not be used for any other forecast without the consultation of the CalSTRS Investment Branch.

External Investment Manager Costs



The increase in investment manager fees from FY 06-07 to FY 07-08, Line 7 in the budget plan, reflects the decision in 06 to hire more active managers to help generate a higher rate of return net of fees. A majority of the increase (\$40 million) is from the retention of active emerging market managers, another part (\$9 million) is due to the increase of external managers in fixed income. The total plan costs rose from an average of around 9 basis points to 12 basis points.

CalSTRS 10 Year Comprehensive Financial Plan - CalSTRS Budget, Continuous App., and Direct Brokerage Investment Branch

Fiscal Year	FY 07-08	FY 08-09	FY 09-10	FY 10-11	FY 11-12	FY 12-13	FY 13-14	FY 14-15	FY 15-16	FY 16-17	FY 17-18
Total Assets (in billions)	\$ 170.1	\$ 182.2	\$ 194.4	\$ 206.7	\$ 222.7	\$ 240.1	\$ 258.9	\$ 279.3	\$ 301.4	\$ 325.2	\$ 351.1

Investment Branch Support Budget

	96	103	112	121	131	141	151	161	172	184	197
1 Total Staff - PY's (Personnel years)	96	103	112	121	131	141	151	161	172	184	197
2 Staff additions (Total+CG)	8	7	9	9	10	10	10	10	11	12	13
3 Salaries (w/ Benefits)	\$ 9,460,915	\$ 10,574,034	\$ 12,125,838	\$ 13,670,871	\$ 15,571,934	\$ 17,627,062	\$ 19,796,937	\$ 22,296,433	\$ 24,970,772	\$ 27,991,261	\$ 31,219,582
4 General Expense & IT exp./equipment	\$ 183,605	\$ 200,680	\$ 219,590	\$ 240,550	\$ 263,798	\$ 289,603	\$ 318,268	\$ 350,130	\$ 383,570	\$ 423,016	\$ 468,949
5 Travel (starting 2006)	\$ 584,743	\$ 644,077	\$ 709,440	\$ 781,444	\$ 860,765	\$ 948,147	\$ 1,044,412	\$ 1,150,462	\$ 1,267,294	\$ 1,396,006	\$ 1,537,807
6 Publications, HR, Intern prog, Misc (06)	\$ 410,727	\$ 431,164	\$ 452,703	\$ 475,435	\$ 499,459	\$ 524,885	\$ 551,833	\$ 580,438	\$ 610,847	\$ 643,223	\$ 677,747
TOTAL SUPPORT BUDGET	\$ 10,639,990	\$ 11,849,955	\$ 13,507,572	\$ 15,168,301	\$ 17,195,956	\$ 19,389,697	\$ 21,711,450	\$ 24,377,462	\$ 27,234,483	\$ 30,455,506	\$ 33,904,086

Continuous Appropriation

7 Investment Managers	168,931,138	176,988,917	188,111,438	201,633,969	218,167,955	238,372,018	257,918,524	279,067,843	300,485,622	325,125,444	351,785,730
8 Custodian	8,345,000	8,762,250	9,200,363	9,660,381	10,143,400	10,650,570	11,183,098	11,742,253	12,329,366	12,945,834	13,593,126
9 Prof. Services (Consultants & legal)	9,280,500	9,744,525	10,231,751	10,743,339	11,280,506	11,844,531	12,436,758	13,058,595	13,711,525	14,397,102	15,116,957
10 Corporate Governance Staff & OE&E	2,890,500	1,818,430	1,867,023	2,030,592	2,085,192	2,255,127	2,316,475	2,493,564	2,674,555	2,859,681	3,049,192
11 Research & Market Data (from Dir B)	2,295,000	2,729,382	2,954,795	3,132,083	3,320,007	3,519,208	3,730,360	3,954,182	4,191,433	4,442,919	4,709,494
12 Risk management system	3,595,000	4,345,000	4,605,700	4,882,042	5,174,965	5,485,462	5,814,590	6,163,466	6,533,273	6,923,270	7,340,786
13 Software & Equipment (from Dir. B)	458,000	1,675,642	1,817,458	1,926,506	2,042,096	2,164,422	2,294,499	2,432,169	2,578,099	2,732,785	2,896,753
14 Misc.	410,000	426,400	443,456	461,194	479,642	498,828	518,781	539,532	561,113	583,558	606,900
TOTAL CONTINUOUS	\$ 196,205,138	\$ 206,490,546	\$ 219,231,984	\$ 234,470,105	\$ 252,693,762	\$ 274,790,366	\$ 296,213,086	\$ 319,451,604	\$ 343,064,987	\$ 370,012,592	\$ 399,098,937

Directed Brokerage Budget

16 Research & Market Data	123,300	61,650	Potentially discontinue Directed Brokerage.
17 Software & Equipment	82,555	41,278	All costs shift to the Continuous Appropriation budget or the Support budget.
TOTAL DIR. BROKERAGE	\$ 205,855	\$ 102,928	

19 TOTAL EXPENSES	\$ 207,050,983	\$ 218,443,428	\$ 232,739,556	\$ 249,638,406	\$ 269,889,718	\$ 294,180,064	\$ 317,924,535	\$ 343,829,067	\$ 370,299,470	\$ 400,468,098	\$ 433,003,022
20 % of ASSETS (BP's)	12.17	11.99	11.98	12.08	12.12	12.25	12.28	12.31	12.29	12.31	12.33



Asset Allocation Study

The most significant investment move in FY 08-09 will be the 2009 Asset Liability Study, which is conducted every three years. The results of our asset allocation study determine the course for the entire investment program for the future. We have often cited the statistics that over 90% of our return can be explained by the asset allocation we select. The importance of this study can not be overstated.

A major part of this study will be the need for added diversification. The high correlation of U.S. and non-U.S. equities highlights the need to develop further diversification in order to stabilize the returns and mitigate the risks to the Fund. Additionally, we should consider a small allocation to innovation, which would allow the Investment Staff to evaluate new ideas that do not fit within the traditional asset class boundaries. Whether we look at a new asset class, allocate more to the existing asset classes, or create an innovation portfolio, this asset allocation study may prove to be the most important study of the past twelve years.

Conclusion – Picture 2012

For some reason, the idea of the year 2012 sounds far, far away from today. Yet the high school freshmen starting this fall are the “class of 2012”, just four quick years away. Looking at CalSTRS, we estimate there’s a high likelihood we will be around \$240 billion by that time. As stated earlier, that places us at the size the following entities are today: CalPERS; APB (in Euro); GIC Government of Singapore; and the Kuwait Investment Authority. These entities serve as future examples what we might look like in the future. As described, all of these funds exhibit a more complex investment portfolio along with a sizable in-house investment staff. They have also each developed significant direct investment programs and all but one, our State sister fund CalPERS, have opened investment offices around the world.

The list also serves as an example that public pension plans are not just our only peers anymore. The sovereign wealth funds have emerged as larger than either ourselves or CalPERS and have become major institutional investors. As we look to our future, we will face the challenge of finding the most efficient business structure, the question of whether to have investment offices outside the U.S., pressures to add more complexity to the investment portfolios, and the consideration of larger in-house direct investment teams. How we meet and address each of these and other challenges may well be the difference between success and failure. Given the economic conditions we face for the next nine to eighteen months, it may well be a rough start to this brave new future and we may face some of these issues sooner rather than later.

A. GLOBAL EQUITIES

2008-09 Business Plan

Unit Mission & Organization Chart

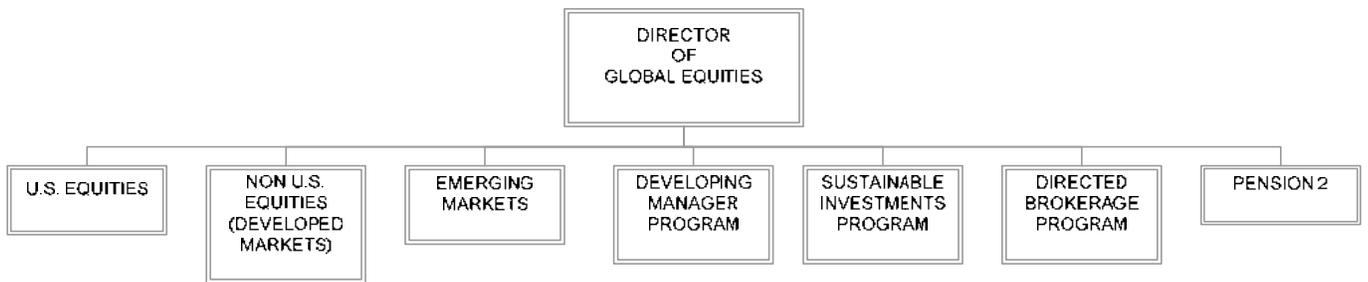
Total investment Alpha Objective
Over the Total Plan Benchmark

60 basis points

Global Equities Asset Class Share

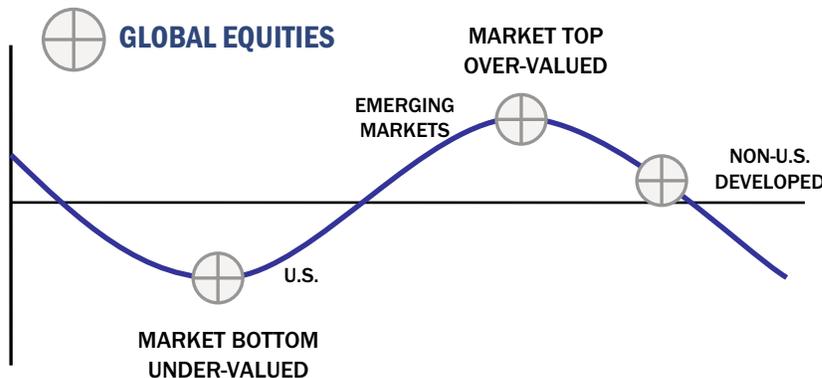
16 basis points

The Global Equities asset class goal is to beat the Russell 3000 ex-tobacco benchmark by 18 basis points for the U.S. Portfolio, and to beat the MSCI All Country World ex-U.S. ex-tobacco Index by 54 basis points for the Non-U.S. Portfolio. Based on our share of the assets, that represents 27% of the total plan objective. An organization chart depicting the structure of the Global Equities Portfolio follows:



Key Success Factors & Challenges

The following graphic depicts a classic text book business cycle. Clearly, the real world is never as efficient. However, it is intended to help illustrate where the Global Equity asset class is in the investment cycle, relative to its historical value and returns.



Global Equities suffered from the same critical factors during the last 12 months as made headlines in the U.S., namely significant losses related to the subprime situation, forced unwinding of leverage, increasingly correlated markets, increased volatility, and the macro effect of doubling oil prices. There was hope that some Non-U.S. markets would decouple themselves from the return characteristics of the U.S. market based on the strength of their growing economies, but this hope proved premature as fear created more highly correlated Global Equities. Elsewhere, the emerging markets are still enjoying high growth rates, particularly in China and the Latin American countries, while some Non-U.S. developed markets are facing both inflationary and growth challenges.

The challenges in moving from a strong bullish market environment to a flat or bearish environment included resisting many strategies presented as attractive “can’t miss” opportunities (e.g., 130/30, long-short, etc.) which relied on cheap leverage or continued low volatility in order to succeed. In resisting the trend to invest in these types of strategies; Global Equities avoided the pitfalls experienced by some in 2007. Looking forward, certain strategies such as frontier markets (e.g., Vietnam), international small cap, and structured products may be more likely to offer lower correlations and better alpha opportunities. However, one of the major challenges to implement these new strategies will be to streamline the Request for Proposal (RFP) process, which has historically been lengthy and cumbersome. Fortunately, there is part of a business process re-engineering project underway to improve these efforts.

Business Plan

Staff intends to review the roster of managers for both the U.S. and Non-U.S. Portfolios. Many managers were selected and funded several years ago. Since these managers were selected, a variety of changes have occurred. The market environment has changed and is now more volatile. As a result, alpha has become much more difficult to generate.

The external managers were originally selected to manage portfolios using styles that were different, but complementary to each other. This diversification assured that, in any given market environment, a significant number of managers were outperforming their benchmarks, even if others were underperforming their benchmarks. Staff will be reviewing and evaluating these manager relationships to assure that they are still appropriate in the current environment. In some instances, manager assets may need to be increased or decreased. In other instances, some managers may be replaced, or new managers may be added to the roster.

Staff will also be exploring new sources for generating alpha. Staff will be evaluating a variety of structured products such as asset trusts, structured notes, warrants, portable alpha, swaps, etc., that generate an index return plus a guaranteed amount of alpha above the benchmark. These types of investments are very risk controlled, easy to move into and out of as needs change, and provide a source of guaranteed alpha.

Staff will also be issuing a series of Requests for Proposals (RFPs) in order to replace current managers and/or add new managers to the roster. These RFPs will also be utilized to create a pool of managers that staff may fund at future dates as conditions warrant. The first RFP will focus on soliciting U.S. large capitalization managers in all investment styles (growth, value, and core). The second RFP will target Non-U.S. small capitalization managers. Other RFPs may be issued on an as-needed basis.

Asset Allocation Study

Review the current CalSTRS equity structure and consider transitioning to a Global Equity structure, utilizing a single Global Equity benchmark and combining U.S. and Non-U.S. equity into one asset class (Global Equities), thereby eliminating the “Home Country Bias”. One of the key drivers for going global is the access to a wider investment opportunity set which may provide better risk-reward trade-offs on sectors, provide a more uncorrelated return benefit, exhibit less volatility, and be more likely to add alpha.

However, the Board needs to consider a number of issues which will be presented by staff over the course of the year including assessing the risks associated with combining the two asset classes into one large “bucket” with a weight of approximately 60% of the total portfolio. Other considerations include currency risk and hedging associated with shifting approximately 23% from the U.S. markets into the Non-U.S. markets; and the optimum utilization of global mandates vs. regional mandates to implement the proposed structure.

In addition to moving to a global equity structure, we would like to explore modifying the policy benchmark to include small cap Non-U.S. stocks to gain added investment opportunities and diversification. Currently, the Non-U.S. passive managers and two active managers are benchmarked to MSCI EAFE + Canada IMI (Investable Market Index), giving some exposure to small cap; however, there is a need to complete a manager search for additional active managers specializing in small cap strategies. Finally, staff intends to explore a potential allocation to “Frontier Markets” outside of the traditional Developed Non-U.S. and Emerging Markets for added investment opportunities and diversification.

Budget and Resources

As more complex investment strategies are introduced into the Global Equity marketplace, costs and fees are rising in tandem. Relationships with talented managers who can consistently generate alpha are becoming more expensive. Recent RFP searches have demonstrated that talented managers are commanding, and have been receiving, higher fees than have previously been charged in the past. According to a Greenwich Associates study, the mean fees paid to outside managers have increased approximately 20% over the period 2003 through 2007.

Staff is also observing a “blurring of the lines” between public and private equity strategies. Investment managers are developing sophisticated investment strategies which utilize a blend of public and private equity components. As a result, they are seeking fees that more closely resemble those of private equity managers. Only the very best managers can justify charging these higher fees.

Along with more complex investment strategies comes the need to retain more sophisticated, experienced staff to select, evaluate, and monitor these innovative investment strategies. Compensation levels need to remain competitive in order to incentivize talented employees to remain on staff. Additionally, more robust research and analytical tools will need to be acquired to adequately monitor the portfolio. Travel costs will also increase as staff will be required to travel more frequently to managers’ headquarters around the globe to monitor portfolio activities.

Conclusion – Picture 2012

Over the next several years, staff will be looking to add incremental alpha to the total Fund by evaluating and implementing a variety of structural enhancements and products to the Global Equity Portfolio.

- The size of the Global Equity Portfolio will be approximately \$144 billion, and may likely be focused on a global asset allocation strategy.
- Staff will have access to additional research and analytical tools to implement asset allocation shifts and rebalance the portfolio as determined by market conditions.
- Relationships will be maintained with only the highest conviction active managers which generate high sources of consistent alpha.
- A variety of structured products will be utilized throughout various components of the portfolio with lower risk characteristics and guaranteed sources of alpha. These strategies will complement a number of “traditional” enhanced index products.
- Passive strategies will continue to be utilized to guarantee benchmark returns; however, the allocation to these strategies will likely be reduced from current levels.
- Optimum allocation mix will be approximately: 1/3 active strategies, 1/3 enhanced index and structured products, 1/3 passive management.

B. INTERNAL EQUITIES

2008-09 Business Plan

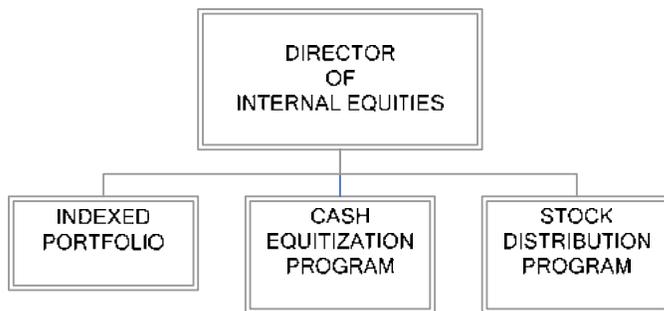
Unit Mission & Organization Chart

Expected Portfolio Excess Return	8 basis points
Expected Excess Return Contribution to U.S. Equity Asset Class	3 basis points

April 1, 2008 marked Internal Equities' 10th anniversary for managing the Internal Indexed Portfolio. Currently, this portfolio represents approximately 34% of the total domestic equity component. The portfolio is expected to generate performance of a customized benchmark (Russell 1000 ex-Tobacco Index). Since inception, staff has been able to provide solid relative returns. The portfolio has outperformed the benchmark while maintaining the risk characteristics of the index. The strategic performance objective for the portfolio is to earn 8 basis points (bps) above the stated benchmark on an annual basis.

Internal Equities also manages the Cash Equitization Program for both U.S. and non-U.S. equities. Within the CalSTRS' Global Equity Portfolio, the typical equity manager's goal is to be fully invested at all times, but in practice that is often not the case. Each equity manager may hold up to 5% incremental cash of their respective portfolio market value. Holding incremental cash can impact the overall investment performance of an equity portfolio versus its benchmark by creating a 'cash drag' effect. The cash instruments are expected to underperform the equity asset class over long-term holding periods; therefore, having ongoing exposure to cash is detrimental to performance. The Program goal is to invest 80% percent of the global equity managers' combined cash balances to minimize the risk associated with holding cash.

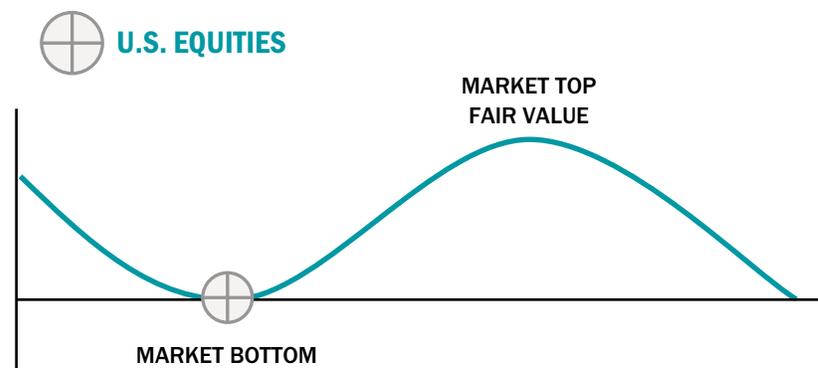
Business units:	Personnel Years
Indexed Portfolio	2.50
Cash Equitization Program	0.75
Stock Distribution Program	0.75
Support Staff	1.00
Total Staff	5.00



Key Success Factors & Challenges

The following graph depicts a classic text book business cycle. Clearly the real world is never as efficient; however, it is intended to help illustrate where the U.S. equity asset class is in the investment cycle relative to its historical value and returns.

Theoretical Market Cycle



The U.S. equity market is trying to respond positively to the monetary policy ease. Also, a less negative tone in the recent economic data continues to help the equity market move higher. However, the U.S. equity market continues to face headwinds with rising oil prices. The market outlook for the remainder of 2008 is a moderate gain. The longer term outlook for the equity market continues to be a low-return environment.

Business Plan

The Internal Equities Unit seeks to consistently produce positive relative returns while minimizing or eliminating exposure to unintended or uncompensated risk. Faced with a potentially lower return equity market, staff continues to search for sources of additional performance above the benchmark.

Derivatives have become more widely used by plan sponsors. In 2008/09, staff anticipates that it will bring to the Investment Committee a proposal to create a comprehensive derivative strategy. The derivative strategy will provide CalSTRS with additional tools and help improve the current investment management processes by enhancing performance and/or minimizing risk. During the 2007/08 fiscal year, a study group consisting of investment staff from Fixed Income, Global Equities, and Internal Equities began to investigate and determine the appropriate framework for implementing a comprehensive derivative strategy. The goal is to identify and implement investment strategies that would aid in achieving the Board-established long-term performance objectives.

Additionally, as the Investment Committee considers internal versus external management, staff will help the Committee review and analyze the issues associated with each of these options. Staff will assist the Committee in developing a list of initiatives it believes are appropriate for internal management. The program's initiatives will integrate the overall goal of the total fund with investment strategies employed in other segments of the CalSTRS fund. Staff will bring forward to Committee these initiatives for consideration and approval.

In July 2007, the Investment Committee approved expansion of the Cash Equitization Program to include equitization of the residual cash held by CalSTRS' non-U.S. equity managers. In the second quarter of 2008, staff began to implement cash equitization for the non-U.S. equity segment. The expansion will enable CalSTRS to keep the non-U.S. equity exposure in line with adopted strategic asset allocation target. Staff expects to reach its equitization objective by the beginning of the fourth quarter of this year. The size of the program will be approximately \$400 million.

Budget and Resources

CalSTRS' internally managed indexed portfolio's performance and costs have been competitive with outside management. Currently, total cost to operate the program runs approximately 3/10 of one basis point. As long as these costs remain competitive with external management, the group should continue to have a significant role in passive investment management for CalSTRS over the course of the foreseeable future.

Internal Equities will continue to focus on long-term incentives for its investment professionals. Anecdotally, it is those organizations which have devoted an appropriate amount of resources that have most often tended toward keeping their best talent.

Conclusion – Picture 2012

Internal Equities anticipates that the decision to manage portions of the CalSTRS' Global Equity Portfolio internally or outsource this function will be a key issue over the next several years. There are additional equity strategies institutional investors are deploying internally in an effective manner. Staff will explore these strategies and examine the tradeoffs in undertaking an internal approach to managing segments of the global equity portfolio. If internal management can maintain a level of tracking error equivalent to that produced by CalSTRS' external equity managers, then any reduction in management costs through internal management improves returns.

We anticipate that CalSTRS will face enormous challenges in investment performance. Faced with these demands, staff will continue to explore other equity investment strategies. Also, we will continue to examine performance attribution and the investment process. We will concentrate on developing sources of alpha that complement the existing investment management core strategies.

C. FIXED INCOME

2008–09 Business Plan

Unit Mission & Organization Chart

Total Investment Alpha Objective Over the Total Plan Benchmark	+60 basis points
Fixed Income Portfolio Assets Share	+ 3 basis points
Currency Management Program Share	n/a basis points
Securities Lending Program Share	+ 5 basis points

The primary, or core, function of the Fixed Income Unit is to manage the System's allocation to fixed income assets in such a way as to provide diversification to the Total Investment Portfolio while maximizing the risk-adjusted return. In addition to the investment management function, other "non-core" investment programs (i.e., Currency Management and Securities Lending) that have been designed to add incremental income to the Fund are also managed within the Fixed Income Unit.

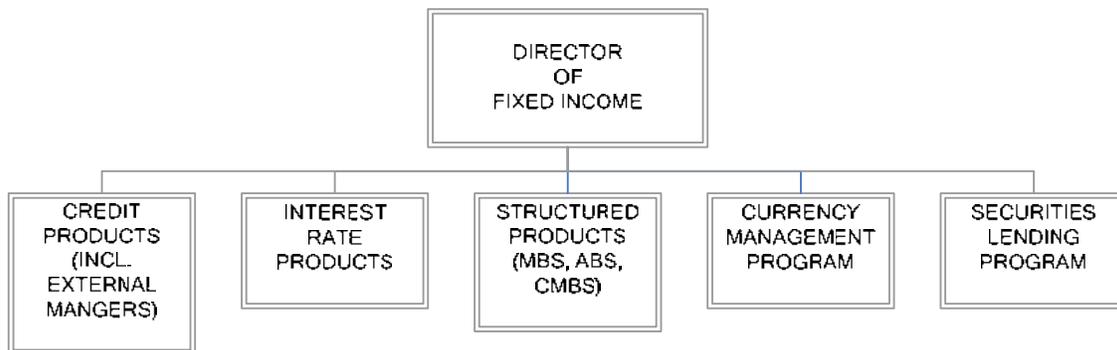
The strategic performance objective for the CalSTRS' Fixed Income Portfolio (Portfolio) is out-performance vs. the Policy Benchmark [(95%) Lehman Brothers Aggregate + (5%) U.S. High Yield Cash Pay 2% Issuer Constrained Index (ex-tobacco)] over a full market cycle, which is usually considered to be three to five years. The internally managed fixed income assets are expected to outperform their benchmark by up to 10 basis points annually and the externally managed fixed income assets are expected to outperform their benchmark by up to 35 basis points annually. Based on our share of the assets, that represents 5% of the total plan objective.

The primary emphasis of the Currency Management Program is the preservation of the value of the Fund's non-U.S. public and private equity assets against a strengthening U.S. dollar. A secondary objective is to design strategies to take advantage of potential alpha opportunities in the currency markets. As a result, there is no formal alpha generation target over the performance benchmark (the MSCI EAFE plus Canada on an un-hedged basis). Once the external currency managers are selected and funded, they will each be given an alpha target.

The Securities Lending Program generates incremental income to the Fund through collateralized, low-risk, short-term loans using a portion of the lendable assets within the Investment Portfolio. Although there are no explicit goals with respect to alpha generation, the Program has consistently added five basis points annually to the return of the Fund, representing approximately 8% of the total plan objective.

Currently, nineteen staff members are responsible for the management of the portfolios and programs within the Fixed Income Unit as follows:

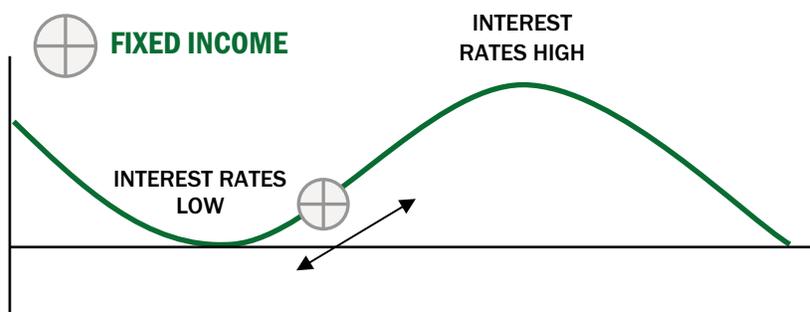
Business Units:	Personnel Years
Fixed Income Assets (long-term and short-term)	13.0
Currency Management Program	2.0
Securities Lending Program	2.0
Support Staff	2.0
Total Staff	19.0



Key Success Factors & Challenges

The following graphic is intended to illustrate where the fixed income asset class is in the current investment cycle.

Theoretical Market Cycle



At this time last year, the Federal Reserve (Fed) had been holding short-term interest rates steady at 5.25% in an attempt to constrain both growth and inflation. However, by July 2007, investors worldwide were beginning to feel the fallout from subprime mortgage losses and the resulting financing uncertainties within the credit markets. In response to the apparent contagion that had originated in the mortgage market and subsequently spread to the global credit and equity markets, the Fed began to move aggressively to avert a recession and increase liquidity by lowering short-term interest rates 325 basis points to the current level of 2%.

While conditions appear to be stabilizing somewhat, the persistent and extreme flight to quality within the market has resulted in a 7.5% fiscal year-to-date total return on fixed income assets, with U.S. Government securities leading the way with greater than 10% returns, as liquidity and safety concerns dominate. Currently, risk-taking and liquidity are showing some signs of improvement. However, looking forward, we see the Fed continuing to pay particular attention to the consumer, with consumer spending being the wild card that might turn a housing-led slowdown into a consumer-led recession. As a result, as depicted in the diagram above, fixed income should provide a moderate, but lower, total return in this environment.

Despite the market environment and the challenges and opportunities it may present, the factors that will be critical to accomplishing our strategic performance objectives across each of the portfolios/programs managed within the Fixed Income Unit reside in: 1) the recruitment and retention of well-qualified staff and, 2) the ability of the investment staff to focus on the core, return-producing priorities within the constantly evolving, increasingly volatile fixed income, currency and lending markets.

Given CalSTRS' unique business model, an ongoing challenge has been, and will continue to be, the attraction and retention of employees that have a diverse range of skills in today's multi-faceted investment markets. Historically, it has been difficult to recruit experienced staff given the compensation structure and hiring process that has been in place. Steps have been taken to address these issues. However, in order to mitigate the risk of losing key back-up staff, CalSTRS will have to continue to evaluate various compensation options, as well as best hiring practices, across the entire Investment Officer series. The optimal compensation structure is one that aligns interests across the full spectrum of staff responsible for contributing to the management of the assets.

In addition to attracting and retaining the highest caliber investment talent, another priority is to provide staff with the ability to efficiently implement strategies designed to meet the

Fund's financial goals. The effective use of technology and education to enhance returns and structure portfolios to outperform has been a philosophy that CalSTRS has embraced over the years. However, opportunities to update or streamline contracting and Request for Proposal (RFP) processes need to be given priority so that opportunities for maximizing the value of the Portfolio's assets are not missed. The processes currently in place makes it difficult to be tactical in that, in some cases, it can take up to a year to implement new strategies and mandates. As referenced earlier, in these plans, a business process re-engineering project is underway to address these issues. The current environment, in which the System is struggling with an unfunded liability and low return prospects on the horizon, makes it even more important for the investment staff to be able to focus their time and efforts toward maximizing the value of the Portfolio's assets in the most efficient manner.

Business Plan

Staff completed the initial phase of the Fixed Income Portfolio (Portfolio) restructuring this past year to reflect the current targeted configuration of 80% Core (i.e., internally managed) and 20% Opportunistic (i.e., externally managed). To date, the Opportunistic portion of the Portfolio includes both a Core Plus and dedicated High Yield mandate. The next phase will involve exploring more opportunities in the form of "crossovers" that have characteristics that fall between Real Estate and Fixed Income or Alternative Investments and Fixed Income, as some fixed income security valuations are hitting historical lows and in many instances are already approaching pricing levels that are normally found in distressed and near-distressed quality securities that generally occupy this space. Finally, the Opportunistic portion of the Portfolio will be expanded this year to include a variety of Developing Managers. We have completed the RFP process and are currently negotiating fees and other contract terms and expect this to be a highly imitated program. We believe that the diversification across each of these "crossover" and developing manager mandates will better position us to accomplish the Fund's long-term risk-adjusted return objectives.

The Currency Management Program (CMP) is also in the process of integrating the internal/external management model used throughout the Investment Portfolio. As a result of a multi-year study, it was determined that the CMP could benefit from the additional resources and diversification provided by including external management. Staff is already deep into the protracted manager selection process, with onsite interviews of managers that specialize in currency alpha scheduled throughout the summer.

The Securities Lending Program (SLP) continues to offer a steady income stream, contributing a record \$130 million to the Fund for the twelve months ending December 31, 2007. Since

it has been several years since we have formally re-priced the SLP, we anticipate initiating the Request for Proposal (RFP) process later this fiscal year in order to ensure that the structure continues to maximize our asset utilization and earning potential.

As a result, the major work plan initiatives for the fixed income team this year will include the completion of the Currency Manager RFP, along with the ongoing fine-tuning of the Opportunistic strategy within the Fixed Income Portfolio. Our goal will be to begin work on the development of an RFP for the Securities Lending Program after completing our work on the Currency Manager selection.

Asset Allocation Study

During the last asset allocation review in 2006, the Investment Committee reduced the allocation target for Fixed Income from 26% to 20% of the Investment Portfolio. At this level, CalSTRS' exposure to fixed income assets is among the lowest across its public sector peers and within the average range for an Endowment Fund. This current level appears appropriate given our funding status and typical role of the asset class to enhance portfolio value while simultaneously producing real income and curbing overall risk through diversification.

Budget and Resources

As investors' interests have evolved, so have the fixed income markets, in that many of the minor (or nonexistent) bond segments of ten to fifteen years ago are now playing a much larger role. With the creation of new types of securities, the markets have become much more complex. As a result, a major issue associated with the management of CalSTRS' fixed income assets and programs over the longer term is how to continue to integrate the evolution of the markets into the portfolio as those assets continue to grow in step with the total investment portfolio.

In response to the evolution of the markets, CalSTRS has adopted a portfolio structure across the asset classes and programs that include both internal and external asset management. Within Fixed Income, the Core Strategy, which is managed internally and represents a majority of the fixed income assets, is an efficient, cost-effective way to provide broad, market-like returns over time. The Opportunistic portion of the Portfolio is comprised of externally managed mandates with higher risk levels and higher expected risk-adjusted returns, requiring expertise or resources not currently readily available to staff.

Since 2001, the externally managed portion of the Portfolio has grown from roughly 5% to 20%, with an upper threshold of 30%. Consequently, given the growth in external management and the additional technology necessary to properly manage the risk associated with the more complex structure, the trend line for costs has risen over the past couple of years. While staff anticipates that costs will continue to rise as we further develop our Opportunistic strategies and external management, they should increase at a slower rate and level off over the next year or two. Furthermore, even with the increased costs, the new structure has generated higher risk-adjusted returns while CalSTRS remains competitive compared to the cost structure of our peers, based upon recent surveys.

Conclusion – Picture 2012

In spite of the recent turbulent environment, the fixed income team continues to believe that the best prospects to continue to add value going forward will be to research and recommend additional active, Opportunistic Strategies for inclusion in the Portfolio and programs. While adding to these strategies will modestly increase the level of risk within the Portfolio (along with the additional costs associated with external management), we are confident that it will also better position us to meet the Fund's long-term performance objectives.

By 2012, it is estimated that the Fund will have grown to \$240 billion. Assuming the current target allocation of 20%, the Fixed Income Portfolio will be approaching the \$50 billion level. While we believe that the sub-asset classes within the Core Strategy (e.g., Governments, Corporates and Securitized assets) will still be major market drivers of the fixed income | return, we expect that more specialized and complex opportunities will be available. In order to maximize our risk-adjusted return in a cost-effective manner, staff will need to be capable of developing, evaluating, and efficiently implementing these new strategies in a smooth and timely process that takes into account dynamic markets and opportunities that fall outside of the current RFP and contract processes.

D. REAL ESTATE

2008-09 Business Plan

Mission & Organization Chart

Total Investment alpha objective over the total plan benchmark

60 Basis Points

Real Estate Portfolio Share

16 Basis Points

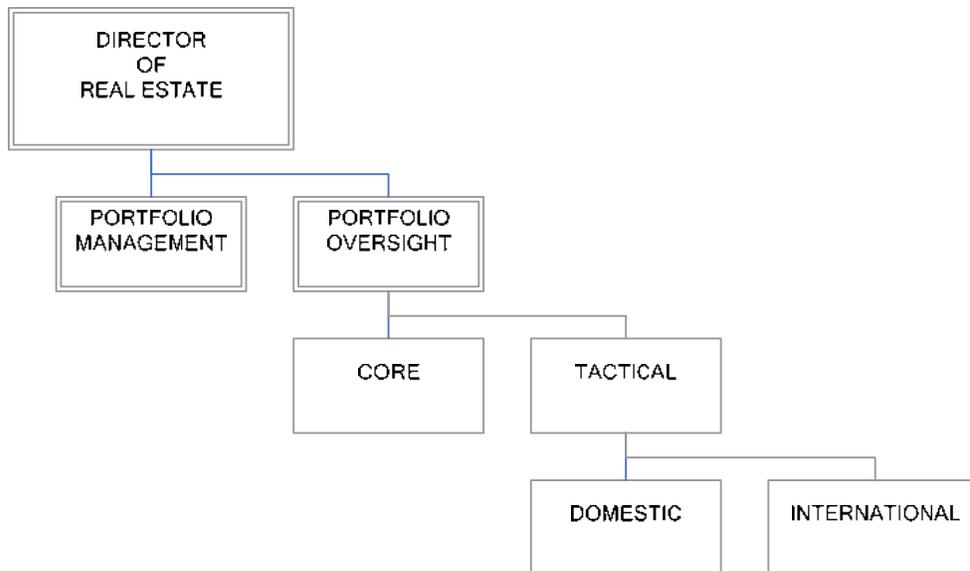
The primary objective of the real estate asset class, within the overall CalSTRS Portfolio, is to provide diversification. The secondary objective is enhanced yields and stable cash flows.

The strategic performance objective for CalSTRS' Real Estate Portfolio is to outperform vs. the National Council of Real Estate Investment Fiduciaries (NCREIF) Index. The NCREIF Index is a widely used index of unleveraged quarterly total returns produced by a database of commercial real estate properties (office, retail, industrial, hotel, and apartment), held by tax-exempt institutional investors. As of March 31, 2008, the NCREIF database was valued at \$328 billion. The core portfolio has a long-term targeted minimum real net-of-fees IRR of 5% and is expected to produce market level returns over time with a commensurate level of risk. Hence, its performance is expected to mirror the composite NCREIF Property Index on a net-of-fees basis. The tactical portfolio has a targeted minimum real net-of-fees IRR of 9%. Overall, we expect the tactical portfolio to exceed the index by 300 basis points. Assuming a 50/50 weighting of tactical and core, we have set a goal to exceed the NCREIF Index by 150 basis points.

At present, investments are 80% domestic-20% international with a long term goal of 20%-30% of the portfolio to be in international markets.

Currently, fifteen staff members are responsible for the management of the Real Estate Unit. This is the same amount as stated in last year's business plan. However, due to challenges in recruitment and retention we are just filling those positions and will be fully staffed at 15 for the first time by the end of July.

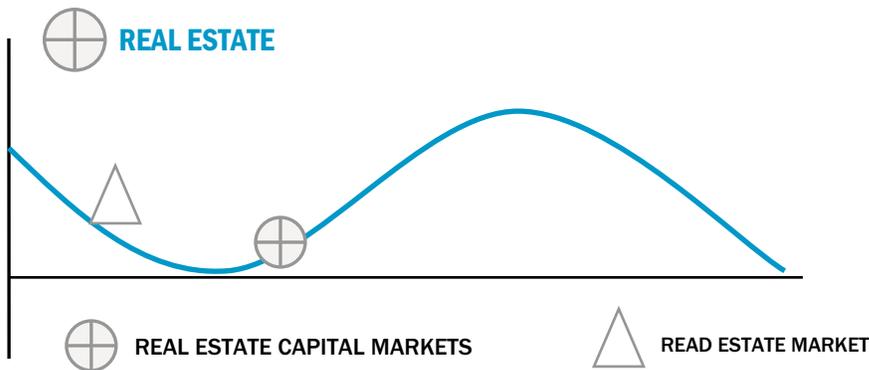
Business Units:	Personnel Years
Real Estate Portfolio Management	10
Real Estate Portfolio Oversight	3
Support Staff	2
Total Staff	15



Key Success Factors & Challenges

The following graphic on the next page is intended to illustrate where the real estate asset class is in the current investment cycle. It is important to note that real estate is a local business, and the position in the cycle can vary significantly depending on the real estate product type and the make up of individual local economies

Theoretical Market Cycle



Generally, the commercial real estate market is showing signs of weakness from both a slowdown in the general economy and the lack of liquidity in the debt markets. The drop in housing values across the nation has dropped both real and perceived wealth of consumers and is projected to dampen consumer spending in the near term.

In total, real estate operations have fared well so far with commercial property occupancies above 90% in most major markets. Leasing activity has slowed from recent peaks but lease rates have generally held somewhat firm due in large part to a lack of new supply. We anticipate leasing to stay slow over the next several quarters until the economy takes a positive turn. A benefit of rising commodity prices for construction such as cement, gypsum and steel is the limited amount of construction underway which, if higher, would put additional downward pressure on lease rates.

On the capital front, there is significant equity capital available to invest but limited debt with the exception of low to moderate mortgages for high quality assets in top markets. Commercial sales have slowed dramatically as buyers and sellers can not agree on pricing. Our expectation is that, although the debt markets will stabilize and capital will return to the market, loan to value ratios will be lower and rates slightly higher compared to previous years. The net effect will be a reduction in values in the short term. However, opportunities should come from pressure on sellers or developers who overleveraged their assets and are in need of capital.

In summary, it will be a challenging time to retain values in the existing portfolio, but we feel our partner selection of top-tier managers will help us outperform the market. The slowing down of the velocity of transactions gives our partners and staff more time to

consider opportunities. In the past, we had mentioned that discretion to staff was a key issue due to quick turnaround times for investment opportunities. Today, there are less time-sensitive transactions, and therefore, more time to consider other opportunities in the market.

The key external factors for strong returns from the portfolio are an improving economy and stabilization of the debt markets. Key internal factors are as always staff recruitment, retention and training. The theme of complex opportunities that cross over asset classes is expected to continue. This further deepens the need to bring together staff from multiple disciplines to work together to make sound investment decisions.

Business Plan

Our Business Plan for the year is based on a reaction to the realities of the market today with an eye toward the opportunities available in the future. Having met our allocation target, we will focus on the existing portfolio, working with our partners to maximize returns and selectively readying assets for sale. The best partners are the ones who outperform in difficult markets and we will use this time, and the recent additions to staff, to evaluate our current investment relationships.

Internally, training of new and existing staff will be the first priority. We have many commitments outstanding with existing partners to take advantage of market opportunities, and we will continue to evaluate follow on investments with partners who have strong track records. We will implement initiatives started in previous years, such as our land and housing and real estate debt strategies. We are confident that we will see ample opportunities in both areas due to the current distress in those markets. New initiatives will be limited. We are currently evaluating a REIT strategy that was put on hold last year.

Budget and Resources

This is a year of significant change for the Real Estate staff. We lost two key employees and are in the process of filling those along with three new positions approved prior to last year's budget. The addition of new staff will allow us to address the challenge mentioned last year of managing an increasingly large and complex portfolio. We will not be certain of a need for additional staffing until this current group has an opportunity to get acclimated with our existing team and portfolio.

The portfolio has grown dramatically over the past three years in both number of relationships and overall value. Note that in July 2005, the portfolio was managed by nine staff and oversaw 45 relationships with a total value of \$7.3 billion. As of March 31, 2008, the portfolio has 63 relationships and a total value of roughly \$19.5 billion. We have also grown the investments in international markets from \$604 million to \$4,100 million over that time frame. These international investments are diversified throughout the world including Asia, Europe, North America and South America. Also, in search for alpha, we now invest more in debt, land development, commercial construction and mixed use projects. In all, the additional staff will focus on overseeing our partner relationships and the many new investments they have made on CalSTRS' behalf.

We have utilized our independent fiduciaries to assist staff in the growth of the portfolio. We will continue to use this outsource model where expertise is needed in both evaluation of new opportunities and oversight of existing platforms, in addition to any problem assets or partner relationships that may arise during this market cycle. We will constantly look to move work in house once staff is trained and has ample time. However, we will constantly seek out second opinions from these outside fiduciaries to insure we are acting in our best fiduciary capacity.

Asset Allocation Study

During the last asset allocation review in 2006, the Investment Committee raised the allocation target for Real Estate from 8% to 11% of the Investment Portfolio. Due to higher than normal appreciation of real estate assets along with lower than anticipated stock returns, we are currently approaching 12%. Assuming normalized returns for the public portfolios, we believe we will remain in the upper end of our range of 9 to 13% over the next few years with a reduced investment pace. We feel this is appropriate given the current market climate and the opportunity set currently in the marketplace. We also expect the portfolio to show some volatility in returns in the next two years but will overall outperform its benchmark over three and five year periods.

Conclusion – Picture 2012

The current real estate market creates many challenges and opportunities. The economic slowdown in the United States and Western Europe will flatten real estate returns in the near term while the lack of available debt capital in both markets will create distress opportunities for both our opportunistic partners and even our low leverage core investors. Although the great run up of real estate values appears over for now, we welcome the

slower pace as an opportunity to evaluate our portfolio and the relative strengths of our existing partners. We have ample commitments to a diverse set of strategies and expect to see some interesting opportunities over the next few years. Selling assets is currently challenging, but we will test pockets of prosperity in order to take profits made over the last cycle.

Predicting the future is always a risk, but looking forward to 2012/13 should have some similar characteristics to today's market and current trends. The portfolio will likely be more global, and we will likely have asked and answered the question of international field offices for CalSTRS real estate and other investment office disciplines. Due to the growth of sovereign wealth funds, we will likely have formed a number of relationships where we invest along side these groups to both grow our domestic platforms and gain access to international partners. I also expect CalSTRS will invest more with operating companies so we can participate more fully and with better alignment in the profits our managers produce. Assuming a fund size of roughly \$240 billion, the real estate portfolio may have a value of \$25 to \$30 billion depending on the Board's allocation targets. However, I see the number of relationships staying the same or getting smaller as we focus on top performing partners. I expect that we will add more specialized personnel to oversee significant strategies such as our growing real estate debt program and currently infant land and single family housing investments.

Regardless of the size, breadth, or complexity of the portfolio, we should stay true to a disciplined approach that aligns CalSTRS capital with high-quality partners who know their markets.

E. ALTERNATIVE INVESTMENTS

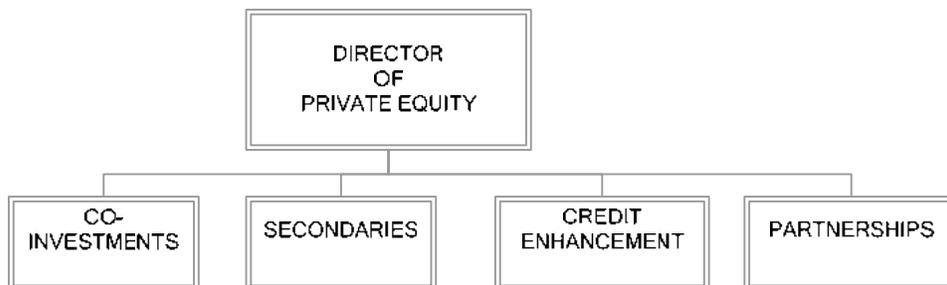
2008-09 Business Plan

Unit Mission & Organization Chart

CalSTRS Total Investment Objective Over the Total Plan Benchmark **60** basis points

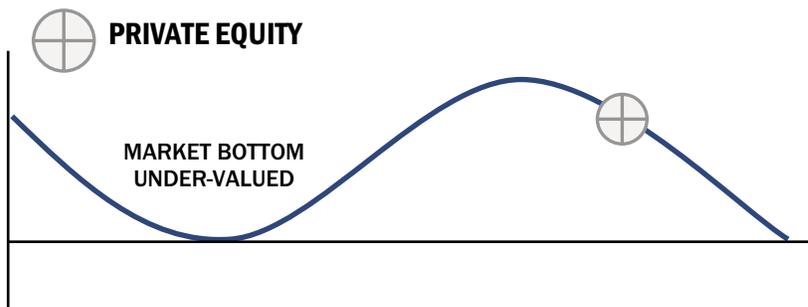
Alternative Investments Asset Class Share **12** basis points

The Alternative Investments (AI) asset class goal is to outperform its Russell 3000 plus 300 basis point benchmark by 120 basis points. The CalSTRS total plan outperformance objective is 60 basis points over the total plan benchmark. AI's 10% share of total assets translates into 12 of the 60 basis points of expected total plan outperformance, or 20% of the total. AI manages the CalSTRS Credit Enhancement Program, which has the goal of earning fee income on an opportunistic and zero loss basis.



Key Success Factors & Challenges

Theoretical Market Cycle



After a four year up-cycle of strong investment activity and returns as reflected by new investments and liquidity events, the Private Equity asset class in the United States and Europe is now experiencing a correction period due to the changing capital markets. This is primarily due to the re-pricing of risk by institutional debt investors.

Distressed debt is counter cyclical to the Private Equity market and is currently a leading private markets investment opportunity. CalSTRS has positioned itself for the correction by increasing its allocation to distressed debt from 3.3% of the AI commitments as of March 2005, to 8.6% in March 2008. Venture capital is recovering from the excesses of 2000.

Keys to Success

- CalSTRS must maintain its position as being a highly sought after Limited Partner (LP) by the General Partner (GP) community. It is important to be a long term, successful, disciplined investor and to have an experienced and sophisticated investment team as global institutional investors are seeking the same opportunities that CalSTRS pursues.
- The Private Equity industry is changing rapidly and is becoming much more complex with alternative products and ownership structures available for investment. The support of the CalSTRS Investment Committee is critical to Alternative Investments' future success in managing its portfolio when modifying policy allocations as market conditions change.
- CalSTRS needs to expand its global reach and presence, as well as have the resources to be a global investor in developed and developing markets.

Challenges Before Us

The CalSTRS AI Program executes its strategy with a lightly resourced team in a very competitive environment. GP's and many of the LP's seek out the top professional talent in the world and provide their teams with the highest quality resources possible to implement their respective strategies. GP's and some LP's use speed and agility as competitive advantages.

CalSTRS has slow and cumbersome administrative processes which often create impediments to being able to contract with advisors, consultants, and legal resources. The Human Resources processes are challenging to navigate while compensation structures make it challenging to attract and retain the best talent.

Business Plan

In 2008-09, the CalSTRS AI Program is competing against other top global institutional investors seeking out the best investment funds and opportunities. CalSTRS will execute the following strategies:

- Alternative Investments will maintain its core strategy of concentrated investments to top performing managers, which will be complemented by direct investments in GP management companies, and co-investments alongside of GPs in portfolio companies. CalSTRS will deploy assets in buyouts, distressed debt, venture capital, special situations, and other investments that have private equity types of returns.
- While the U.S. and developed European markets remain the core of the CalSTRS Portfolio, we will selectively invest in the Rest of World (ROW), which represents approximately 9.1% percent of the Private Equity investment universe.
- We will continue managing and investing specialized portfolios such as the Proactive and Clean Energy Portfolios, which are designed to capture new market opportunities and/or new drivers of value creation. We believe that clean energy production is currently a relatively attractive opportunity in light of the increasing demands for energy on a global basis. These two portfolios have not yet demonstrated a profitable long-term track record.
- The Credit Enhancement Program will increase fee income and continue to build on the geographic diversification of the program.

Budget and Resources

The market value of the CalSTRS Private Equity Portfolio has gone from \$6 billion in June 2005, to \$17 billion in June 2008, while expenses have gone up marginally in that three year period of time (with only three additional staff members). Organizations that outsource such services pay higher costs, typically 1% management fees, and carried interest to the investment teams.

The CalSTRS AI Program is a low cost provider of its services. Costs are expected to increase as the AI Program grows to a projected \$34 billion in 2012. As the fund grows, additional costs will come from supporting infrastructure, including staffing (an estimated 10 new investment staff members), the required advisors, independent fiduciaries, and legal support. The globalization of investments will require additional travel costs.

Asset Allocation Study

At the development of the next CalSTRS Asset Allocation Plan, the CalSTRS Investment Committee will need to determine its interest for illiquid private equity assets beyond the current allocation of 10%. For many years, it was difficult to reach the portfolio allocation for Alternative Investments when the target was 5%. In 2006, the allocation target was increased to 9%. This was to be reached over a 3-4 year period.

The Private Equity industry has experienced unprecedented growth over the last three years, as the 9% target was reached in 2008. The portfolio now stands at 10% of Total CalSTRS Assets. Staff has modeled the portfolio based on projected commitments and investment returns and it projects that the market value of Private Equity Assets will be \$34 billion, or 15%, of the total CalSTRS portfolio in 2012.

While Private Equity is considered a high risk asset class, primarily due to the leverage applied to investments, the risk is offset partly due to the following reasons:

- A stronger alignment of interest between private owners and management,
- The investment benefits of active management, and
- The strong diversification with the portfolio being invested in approximately 4,000 companies.

Illiquid private equity assets also provide the benefit of lower volatility due to investment valuations being marked to market on a quarterly basis, as opposed to the daily pricing of public equities.

Conclusion – Picture 2012

The CalSTRS AI Program is projected to have a market value of \$34 billion in 2012. The program will maintain its core strategy of larger investments with the top investors in the world, but will also evolve in several ways, including:

- More global investments, with a greater footprint in the emerging economies of the world;
- More co-investments alongside CalSTRS GPs, and direct investments and joint ventures with other partners for the purpose of earning higher returns;
- Become a larger investor in the clean and alternative energy markets, including energy efficiency strategies;
- Become a footprint in commodity based investment opportunities around the world; and
- Establish CalSTRS staff domiciled in European and Asian locations within CalSTRS corporate offices alongside of other pension funds in order to have a deeper reach into these markets.

In 2012, CalSTRS will maintain its status as a world class private equity investor, whose private equity portfolio is driven by the best practices and governance in the industry, and will continue to generate top quartile performance returns.

F. CORPORATE GOVERNANCE

Business Plan

Unit Mission & Organization Chart

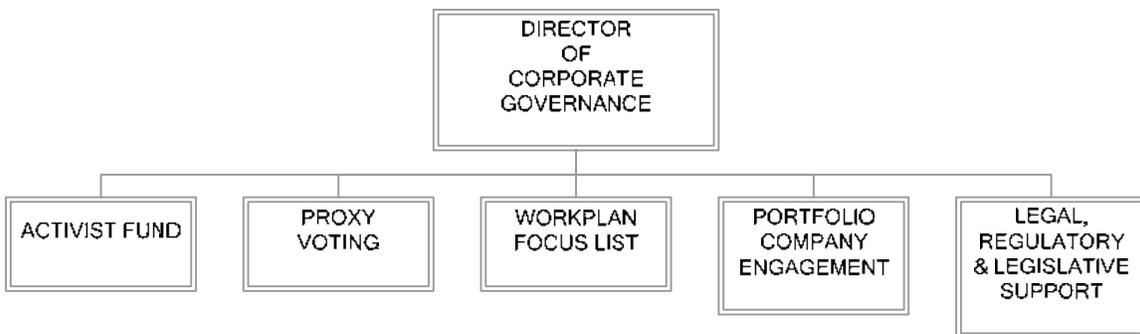
The Corporate Governance Program does not have a stated numerical performance objective. The program's efforts in this area are to augment the Global Equity Performance Objective of earning, over time, 16 bp above the stated plan benchmarks, currently the Russell 3000 ex-Tobacco Index and the MSCI All Country World ex-U.S. ex-Tobacco Index.

Total Investment Objective **60** basis points
Over the Total Plan Benchmark

Corporate Governance Activist Manager Portfolio Share **3** basis points

The Corporate Governance Activist Manager Portfolio goal is to beat the Russell 3000 ex-tobacco benchmark by 150 basis points for the U.S. component of the portfolio, and to beat the MSCI All Country World ex-U.S. ex-tobacco Index by 150 basis points for the Non-U.S. component of the portfolio. Based on our share of the assets, that represents 5% of the total plan objective.

The Corporate Governance Staff's other goals center on promoting best governance practices within the CalSTRS Investment Portfolio. The promotion of these best practices occurs through proxy voting, the CalSTRS focus list, support of legislative and regulatory issues that favor investors, and Staff's various corporate engagement efforts. An organization chart depicting the structure of the Corporate Governance Unit follows:

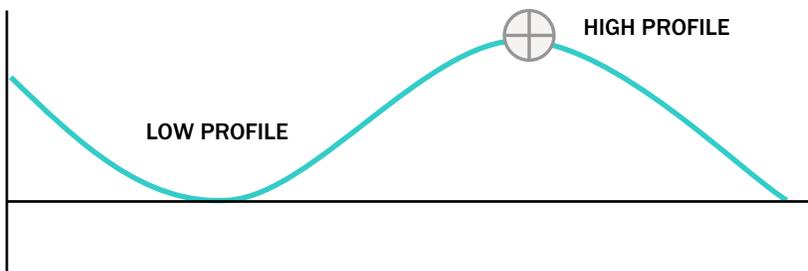


Key Success Factors & Challenges

To better understand how successful Staff will be in achieving its stated goals, one has to understand where corporate governance sits in terms of importance to the investment

community. A key factor to our success will be governance maintaining its high profile amongst investors, fund managers, and corporations. Retaining and attracting competent, motivated staff is also a significant challenge for the Corporate Governance Unit. As long as corporate governance retains its importance, efforts at affecting investor-favorable change will continue, and continue to be successful.

CORPORATE GOVERNANCE IN THE INVESTMENT COMMUNITY



To get a better appreciation of how future success will be measured, the accomplishments of the last year need be considered. Over the past 12 months, the Corporate Governance Unit has grown the Activist Manager Portfolio from one to three managers, bringing total assets under management up to \$1.85 billion. Additionally, the portfolio has gone international with the funding of the Governance for Owners' European Focus Fund.

Staff has also increased its role in promoting climate risk awareness, taking leadership positions in the Investor Network on Climate Risk (INCR) and other investor coalitions, while working to strengthen existing relationships with organizations such as the Carbon Disclosure Project (CDP) and the Enhanced Analytics Initiative (EAI). For the first time this proxy season, CalSTRS filed two climate risk shareholder proposals, one of which went to a vote and received 33% support. Staff made diversity a key issue and began looking into ways to promote diversity of corporate boards within the CalSTRS Portfolio, bringing together experts in the field to discuss strategies and outcomes.

Maintaining the growth of the Activist Manager Portfolio presents several challenges. In terms of those managers already under contract, the poor financial market conditions put more pressure on their concentrated portfolios than that put on traditional equity managers. Regarding new activist managers, the contract negotiations have proven to be lengthy processes. Managers have presented partnership agreements that included unexpected terms that are unfavorable to CalSTRS. Only through protracted talks can acceptable terms

be obtained. Staff has found that much of the time required for finalizing these agreements results from poor communication between fund managers and their attorneys. Regarding potential activist managers, Staff would be better situated to choose new managers with strong performance histories and compelling investment strategies if it were able to do so outside the RFP process.

When looking at the Portfolio Company Engagement Program, a big challenge to success has been maintaining channels of communication between CalSTRS and its portfolio companies, CalSTRS and other investors, or between business units within CalSTRS. Staff has had to be diligent in pursuing meetings with companies, in participating in our numerous collaborative efforts, in talking to other investors on issues of importance, and in maintaining lines of communication with the CalSTRS Legal and Media Relations Departments. Portfolio companies are often reluctant to speak with shareholders and establishing a dialogue is critical to engagement success. When engaging investors and shareholders on issues such as climate risk, Staff has found it difficult to convince them that strong performance doesn't preclude the need for corporate change. If companies are doing well, shareholders are reluctant to embrace change. Communicating between departments can also be difficult due to conflicting schedules and differing priorities.

Business Plan

Diversity

The Corporate Governance Unit will continue its efforts at promoting diversity on corporate boards. As this is a relatively new focus for CalSTRS, Staff will be contacting other investors who have familiarity with this issue in the hopes that their experiences can help shape the CalSTRS program. Staff intends to use its various data sources to develop a screening process through which portfolio companies can be evaluated on their diversity efforts. This process will enable Staff to more effectively engage portfolio companies. Staff also intends to host a diversity conference, in affiliation with a major academic institution, which will allow for in-depth dialogue on this important issue.

Environmental

CalSTRS Corporate Governance Staff will leverage the successes of 2007-2008 into making climate risk awareness an even more visible part of the Corporate Governance Program. Staff intends to take an even greater leadership role in the Global Warming Shareholder Campaign by increasing the number of company engagements and filings next year.

CalSTRS will provide greater support to the Carbon Disclosure Project by developing an engagement program targeted at those portfolio companies that failed to respond to the CDP's most recent survey request. Staff will also make promoting the Enhanced Analytics Initiative a priority. Finally, Staff will look to develop new relationships with organizations such as the Chicago Climate Exchange.

Engagement

Staff intends to use the experiences of last year's shareholder proposal efforts to help create an even stronger program for engaging portfolio companies on the many issues of importance to CalSTRS, particularly diversity and climate risk. During the summer, Staff will utilize its expertise at portfolio screening to identify companies with both poor performance and either inadequate climate risk disclosure or little evidence of board diversity. These "higher risk" companies will then be targeted for engagement by Staff, which will occur during the fall. Staff will then be in a position to decide which companies should be the focus of shareholder proposals, which are usually filed during December and January. Staff will then be able to engage shareholders and the investment community on the merits of the proposals CalSTRS is putting forth prior to the spring proxy season. Staff will be increasing its leadership role in investor campaigns that are aimed at climate risk management and diversity awareness and, by doing so, will be better positioned to guide the resources of collaboration towards the goal of reducing CalSTRS climate risk exposure and improving board diversity. Similarly, by increasing our support of organizations such as Ceres, the Carbon Disclosure Project, and Catalyst, CalSTRS can influence the type of information that is provided to investors.

Improvement

Continuing to improve our profile within the investment community is another goal of the Corporate Governance Staff. To achieve this, Staff needs to be active while making sure that its activities are being properly communicated. CalSTRS will continue to sponsor reports and white papers, speak at conferences, and host panels. However, Staff will work to ensure that these efforts are well publicized by providing updates on governance activities to the CalSTRS Media Relations Department. Through regularly scheduled meetings, Staff can provide information on upcoming events that could be promoted through press releases, news articles, or website announcements. This would allow for timely pre- and post-event publicity.

Asset Allocation Study

Though the Corporate Governance unit is working to finalize new manager partnership agreements, Staff believes that additional resources could be effectively managed. After funding all the new activist managers, the Corporate Governance Unit will be responsible for eight managers who will have combined assets under management of approximately \$3.5 billion. The Corporate Governance Unit could, at present staffing levels, comfortably monitor an additional four to six funds that could bring assets under management up to between \$5 billion and \$6 billion. The majority of this increased funding would be best directed to international funds, as the current activist manager funding ratio is targeted to be about 70% domestic and 30% international. This increased allocation to the activist manager strategy would provide additional alpha as these managers have historically been sources of higher returns. It would also provide greater strategy and size diversification in the actively managed component of the CalSTRS Equity Portfolio.

Budget and Resources

Along with the growing prominence of corporate governance comes the need to employ more robust research tools that will allow Staff to adequately analyze the portfolio across a variety of issues. Gone are the days when only proxy service advisors were required to provide information on ballot issues. Today's corporate governance analyst must be prepared to determine a portfolio company's degree of involvement in issues ranging from executive compensation to geopolitical risk to board diversity. Attention to these diverse but distinct topics requires a broad array of research "tools", and these services do not come cheaply. Today's governance toolkit is substantively more expensive than those seen just a few years ago, and tomorrow's toolkit will likely be more expensive than today's. Fortunately, Staff is subject to a continuous appropriations budget which allows for the engagement of the necessary research service providers.

Conclusion – Picture 2012

Over the next few years, the Corporate Governance Unit will be looking to expand its Activist Manager Portfolio to provide a complementary, diversifying investment style to the CalSTRS traditional active equity investment strategy. Additionally, Staff will be looking to leverage its growing reputation as a leader in the investment community into becoming the premier investment partner. Staff's goals are:

- Growing the Activist Manager Portfolio to include small, mid and large-cap managers investing in all developed markets.

- Growing the Activist Manager Portfolio to include small, mid and large-cap managers investing in all developed markets.
- Expanding the Activist Manager Program to include emerging markets where activist managers are less active, leaving more “low hanging fruit.”
- Developing a robust system of company engagement that is scalable to any issue in any market and involving any portfolio company.
- Being recognized throughout the worldwide investment community as the preferred collaborative partner.
- Being recognized by our portfolio companies as the desired investor.



G. OPERATIONS

2008–09 Business Plan

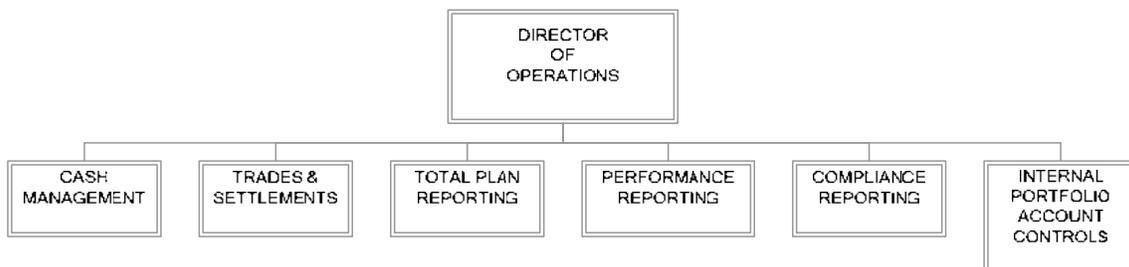
Unit Mission & Organization Chart

Investment Operations provides middle-office support and services for internal and external portfolio management activities. Investment Operations manages a portion of the cash allocation which is used to fund benefit payments, ensures all available cash is invested and that funds are made available to cover purchases in other asset classes or investment programs. In addition, Investment Operations manages the processing of daily cash movements, transactions and settlements, cash forecasting, performance reporting and portfolio controls over cash, accruals and positions.

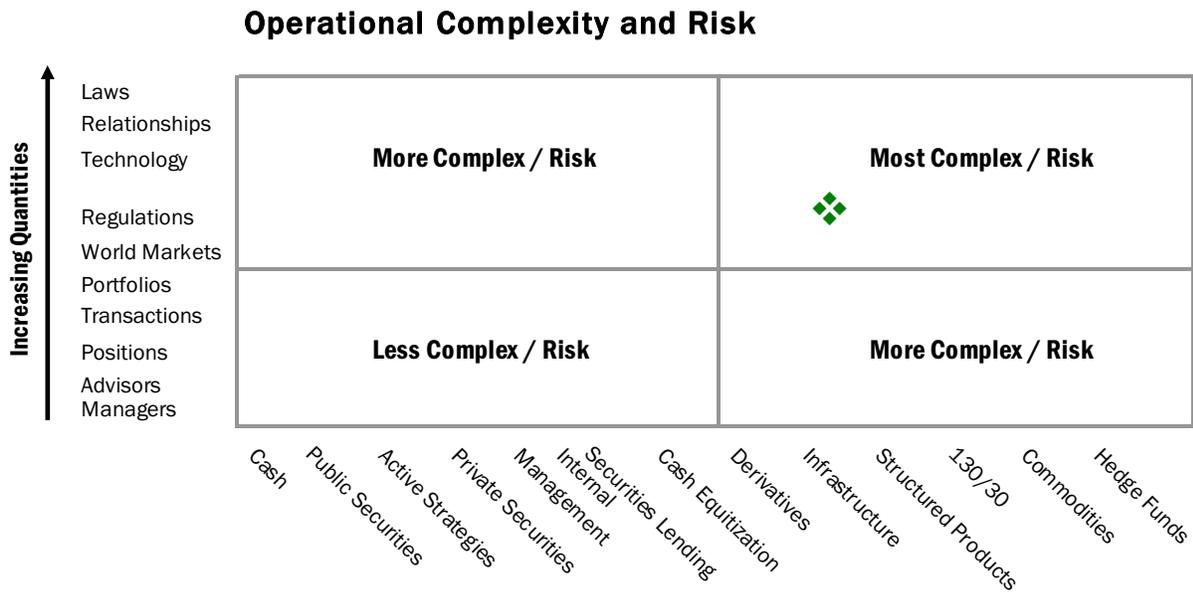
Investment Operations' focus is on all aspects of asset management operations, from new program launches, operational risk reviews, technology reviews, to supporting investment managers' requirements - all from an expert institutional operations perspective. We provide specialist investment operations consulting services based on expert program knowledge and an implementation track record for all asset classes. Our emphasis is on a complete end-to-end approach, operational risk mitigation, proper controls, and quality reporting.

Lastly, you can't manage \$170 billion and 200 portfolios with just 90 staff unless you use a huge amount of technology. We are a hub to coordinate and facilitate the delivery of technology to the Investment Office. Our goals are for straight through processing of transactions, effective and efficient integrated systems, combined with high quality staff.

Business units:	Personnel Years
Cash Balances, Trades & Settlements	7.0
Portfolio Reporting & Performance	6.0
Administration & Management	1.0
Support Staff	1.0
Total Staff	15.0



Key Success Factors & Challenges



CalSTRS Investment Plan and Programs continue to grow more complex each year, increasing operational complexity and risk. It is critical to understand these risks and implement mitigating measures. During the past 18 months, we increased the number of separate portfolios by over 50% to 200, mostly due to the emerging U.S. Equity Manager Program. The Non-U.S. Cash Equitization Program, new cash management tools like the Reverse Repo, active fixed income external management, increased use of derivatives and fixed income hybrid partnership investments have increased operational complexity and workloads.

As this trend continues, these new complex investments and programs put a strain on staff with increased workloads and operational risks that must be controlled. It is critical that Operations is properly staffed with investment professionals that have the financial competencies to deal with the complexities and higher volumes that come with implementing these new initiatives.

Our primary challenge facing us is in assessing whether we have sufficient human resources, recruitment and retention of qualified staff. The government structure we operate under does not allow for the flexibility or efficiency in hiring applicants directly from private industry. Frequently, staff is hired in the Operations Unit and is soon attracted to front office positions which have higher classifications and salary structures.

Another challenge we face is not only to keep current with the industry, but to gain understanding of how advances in operations, performance measurement, technology, processing services and compliance are impacting the securities business in a time of accelerating change. Our last challenge this year will be to plan and move the Investment Office technology and staff to our new headquarters building in West Sacramento in an uneventful way.

Business Plan

Investment Operations' overall goal is to align our services and functions to investment activities and programs that cut across all asset classes for the success and implementation of the Investment Policy & Management Plan. We seek to minimize operational risks and establish effective controls by using portfolio management tools to perform independent quality verifications of the custodian and front office systems. We strive to provide management with the highest quality investment reporting and value-added services allowing them to make sound investment decisions.

With dedicated staff and the assistance of State Street Bank resources, we have been successful in establishing internal controls and policies and procedures which are used on a daily basis to mitigate operational risks. Operations' staff works closely with internal and external managers/advisors to refine our processes and functions servicing assets on a post trade basis. Our core services include cash allocation management; cash forecasting; trade processing; position, cash and trade reconciliation; collateral management; performance reporting; corporate action processing; work flow; operational risk management and compliance; data management; portfolio reporting; and straight through processing (STP).

Many of Operations' daily specialized functions and processes are identified as mission critical and must be completed correctly every day before close of business; staff are trained (2-4 deep) to cover each other's function to accommodate workload spikes and normal leave. To illustrate the demands on Operations staff, our daily functions have a one to two hour recovery time objective (RTO), which is documented in our Business Continuity Plan.

Investment Operations Unit specific objectives for this year are:

- Implement an automated trade flow system for Real Estate and Corporate Governance
- Upgrade our PORTIA investment reporting control system
- Plan and coordinate our move to the new West Sacramento headquarters building

Asset Allocation Study

Strategic or tactical asset allocation shifts have a wide range of potential impact on operational resources and risks. There are many facets to consider, for instance transaction volume, complexity and implementation speed. With our current asset allocation to cash set to zero, constant vigilance is required to ensure sufficient quantities are available to meet the needs for benefit payments and contributions to non-cash asset classes.

Budget and Resources

Operations staff must understand the implications of the Investment Office's annual business plans. We must work with the CIO, Investment Directors and their staff throughout the year and be ready to implement the new projects. Additional staff at appropriate levels will be needed to be able to maintain our high standard of care. With additional staff, we can respond to the factors that continue to increase within our changing and complex environment: active and in-house management, non-Operations Investment staff, portfolios, transaction volume, complex products and programs, multiple counter parties, risk management, audits, and reporting and regulations.

As more complex investment products and strategies are introduced, Operations staff will need to become more specialized. It has become more difficult to be a generalist in functions performed by the staff. The use of derivatives places a tremendous strain on Operations staff and requires a scalable, flexible, middle-office technology and skilled staff. Financial technology continues to evolve at a rapid pace and front, middle and back office systems will be more complex, integrated and costly. Data management, classification and security will also become more important and costly to maintain.

Conclusion—Picture 2012

This coming year we will support the expansion of the Currency Program; Fixed Income Emerging Managers, structured and derivative products (i.e. asset trusts, structured notes, warrants, treasury futures, swaps, options); public fixed and equity manager RFPs; transition management; and fixed asset financing. We expect to take a consultative approach with each Business Unit and create a solution that best meets their needs.

Looking toward the future, it is clear that Operations' functions will become more demanding, complex and specialized. We may have 300 separate portfolios and many more broker, manager and vendor relationships. Developing staff competencies will be essential to support

the investment programs and the challenges we all face in an increasingly knowledge-based economy. Human knowledge and expertise are the foundation of our organization.

As our use of derivative products increases, we will look to create specialized groups who will have the core competencies to process and report on these complex investments. The use of derivatives and the blurring of asset classes will make performance reporting more challenging. It will be necessary to develop groups that focus on performance analysis, measurement and reporting across the portfolio.



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November 19, 2010

Wolfgang Hauser, Chief Executive Officer
Intertek Group
25 Savile Row
London W1S 2ES
United Kingdom

Dear Mr. Hauser,

This letter is sent to you on behalf of the California State Teachers' Retirement System (CalSTRS). As you may be aware, CalSTRS is a public pension fund established for the benefit of California's public school teachers over 90 years ago. CalSTRS serves the investment and retirement interests of over 847,000 plan participants. As of October 31, 2010, the CalSTRS portfolio was valued at over **\$141 billion**; approximately **\$76 billion** of the fund's assets are invested in the public equity markets, on both a domestic and an international basis. A significant percentage of CalSTRS' public equity portfolio is invested in the indexed or passive style of investment management; these stocks do not trade on company news or events; we hold these stocks for the long-term. We do use our corporate governance rights to address issues with corporations that are held in our portfolio; in our view, this strategy is more efficient for the investing considerations of diversification, minimizing risks and costs, and maximizing returns than simply selling a security each time we have shareholder concerns.

Our independent research providers have identified Intertek as doing business in, or with Sudan. Currently, CalSTRS owns 227,419 shares of your company. We are concerned that any possible connection between your company and the terrorist activities or the violation of humanitarian rights taking place in Sudan may negatively affect your business and our investment in your company. We believe that any association with the atrocities taking place in Sudan by your company poses a serious risk to your ability to create sustainable and responsible long-term value creation.

In several states, legislation has been enacted or is being publicly discussed to address investments in companies doing business in or with Sudan. In California, AB2941 requires the California Public Employees' Retirement System and the California State Teachers' Retirement System to encourage companies in which they invest in to act responsibly and

not take actions that promote or otherwise enable human rights violations in the Sudan. Additionally, the legislation requires that we periodically follow up with identified companies to ensure they are acting responsibly with regards to Sudan.

In addition, Sudan is not only designated as a terrorist sponsoring country by the United States government, but is also embroiled in domestic conflicts in which the Sudanese government has been charged with arming militia that have engaged in genocide which has been documented by the United Nations Commission of Inquiry on Darfur. As shareowners, we are concerned that companies that do business in Sudan may be perceived as furthering or condoning the egregious human rights violations currently occurring there.

Therefore, we are requesting an updated disclosure of your direct or indirect business activities in Sudan so that we, as fiduciaries, can accurately assess the risk associated with your activities there and make informed investment decisions.

We request that you answer the following questions:

- (1) Does your company, any subsidiary of your company, or joint venture thereof (“Affiliated Business Entity”) engage in any direct or indirect business activity in Sudan? If yes, identify the name and nature of such business and how long has such business been taking place?
- (2) What portion of you company’s or any Affiliated Business Entity’s current revenue stream is from any direct or indirect business activity in Sudan, and what portion of the company’s or Affiliated Business Entity’s total assets were used to earn said revenue?
- (3) Has your company or any Affiliated Business Entity made a capital investment in Sudan?
- (4) Has your company or any Affiliated Business Entity entered into any licensing agreement with the Sudan government in order to engage in current or future business activities?
- (5) Is your company or an Affiliated Business Entity doing any business with a corporation that is owned by the Sudan government?
- (6) How many employees of your company or Affiliated Business Entity are in Sudan?
- (7) What fees and/or taxes do your company and/or any Affiliated Business Entity pay to the Sudan government and what are the fees and/or taxes for?

- (8) What is your company's perspective on the situation in Sudan's Darfur region and humanitarian issues surrounding the North-South conflict? Has your company taken any action or implemented any policies that are pertinent to relieving that situation?
- (9) Has your company or any Affiliated Business Entity done anything to promote and/or protect human rights from the atrocities taking place in Sudan?

If you have any questions, please feel free to contact Philip Larrieu of the Corporate Governance staff at:

Philip Larrieu
Investments – Corporate Governance
100 Waterfront Place, MS-4
West Sacramento, CA 95605-2807
(916)414-7417

I trust this letter conveys the urgency of this matter and we hope to meet with you soon.

Sincerely,



Christopher Ailman
Chief Investment Officer

California State Teachers'
Retirement System
Investments
100 Waterfront Place, MS-04
West Sacramento, CA 95605-2807
(916) 414-7400 Fax (916) 414-7533
cailman@calstrs.com

November 19, 2010

Jung Gyeom Kim, Chief Executive Officer
Hyundai Engineering and Construction Co.
140-2, Gye-Dong
Seoul 110-920 South Korea

Dear Jung Gyeom Kim:

This letter is sent to you on behalf of the California State Teachers' Retirement System (CalSTRS). As you may be aware, CalSTRS is a public pension fund established for the benefit of California's public school teachers over 90 years ago. CalSTRS serves the investment and retirement interests of nearly 847,000 plan participants. As of October 31, 2010, the CalSTRS portfolio was valued at over **\$142 billion**; approximately **\$75 billion** of the fund's assets are invested in the public equity markets, on both a domestic and an international basis. A significant percentage of CalSTRS' public equity portfolio is invested in the indexed or passive style of investment management; these stocks do not trade on company news or events; we hold these stocks for the long-term. We do use our corporate governance rights to address issues with corporations that are held in our portfolio; in our view, this strategy is more efficient for the investing considerations of diversification, minimizing risks and costs, and maximizing returns than simply selling a security each time we have shareholder concerns. Currently CalSTRS holds \$78,295 worth of Hyundai Engineering and Construction Co. stock.

On October 14, 2007, California Governor Arnold Schwarzenegger signed into law AB221 the California Public Divest from Iran Act. This law requires CalSTRS and other California pension funds to divest from companies with ties to Iran if certain conditions are met. Currently Hyundai Engineering and Construction Co. has been identified as a company that may have problematic ties to Iran.

As a long-term investor, we are concerned with risks posed by companies in our portfolio operating in sensitive areas such as Iran. To address these risks from an investor prospective the CalSTRS Board has adopted a 21-point Geopolitical Risk policy, which is available in the board policy manual at our website www.calstrs.com.

CalSTRS would like to engage in an open dialogue with you regarding your company's ties to Iran. We are requesting full disclosure of your direct or indirect business activities in Iran so that we, as fiduciaries, can accurately assess the risk associated with your activities there and make informed investment decisions.

We request that you answer the following questions:

- (1) Does your company, any subsidiary of your company, or joint venture thereof ("Affiliated Business Entity") engage in any direct or indirect business activity in Iran? If yes, identify the name and nature of such business and how long has such business been taking place?
- (2) What portion of you company's or any Affiliated Business Entity's current revenue stream is from any direct or indirect business activity in Iran, and what portion of the company's or Affiliated Business Entity's total assets were used to earn said revenue?
- (3) Has your company or any Affiliated Business Entity made a capital investment in Iran?
- (4) Has your company or any Affiliated Business Entity entered into any licensing agreement with the Iran government in order to engage in current or future business activities?
- (5) Has your company or any Affiliated Business Entity made sales of gasoline to Iran?
- (6) Has your company or any Affiliated Business Entity purchased oil or Natural gas from Iran?
- (7) Is your company or an Affiliated Business Entity doing any business with a corporation that is owned by the Iranian government?
- (8) How many employees of your company or Affiliated Business Entity are in Iran?
- (9) What fees and/or taxes does your company and/or any Affiliated Business Entity pay to the Iran government and what are the fees and/or taxes for?

Additionally, to better understand your exposure to Iran and your company's actions around the issue we would also like to meet with you or representatives of your company in person. We believe a meeting in person will help us better understand and be more comfortable with your involvement with Iran. If you are planning to have the appropriate people in the United States in the near future, we would appreciate the opportunity to meet with them. We can easily arrange to meet in anywhere in the United States, however, Sacramento, San Francisco, Los Angeles, New York, Chicago, or Washington D.C. are the most convenient for us.

Jung Gyeom Kim
November 19, 2010
Page 3

If there are no plans for the appropriate people to be in the United States, we often have staff travel abroad to London and Tokyo. If necessary, we can arrange to have staff meet at your headquarters in Seoul.

If you have any questions, please feel free to contact Philip Larrieu of the Corporate Governance staff at:

Philip Larrieu
Investments – Corporate Governance
100 Waterfront Place, MS-4
West Sacramento, CA 95605
(916)414-7417

I trust this letter conveys the importance of this matter and we hope to hear from you soon.

Sincerely,

A handwritten signature in black ink, appearing to read 'C. Ailman', written in a cursive style.

Christopher Ailman
Chief Investment Officer



Attachment E

California State Teachers'
Retirement System
Investments
100 Waterfront Place, MS-04
West Sacramento, CA 95605-2807
(916) 414-7400 Fax (916) 414-7533
cailman@calstrs.com

November 19, 2010

Bertrand de la Noue
Vice-President Investor Relations
Total S.A.
2 Place Jean Miller
La Defense 6
92078 Paris La Defense Cedex

Dear Mr. Bertrand de la Noue,

This letter is sent to you on behalf of the California State Teachers' Retirement System (CalSTRS). As you may be aware, CalSTRS is a public pension fund established for the benefit of California's public school teachers over 90 years ago. CalSTRS serves the investment and retirement interests of over 847,000 plan participants. As of October 31, 2010, the CalSTRS portfolio was valued at over **\$142 billion**; approximately **\$75 billion** of the fund's assets are invested in the public equity markets, on both a domestic and an international basis. A significant percentage of CalSTRS' public equity portfolio is invested in the indexed or passive style of investment management; these stocks do not trade on company news or events; we hold these stocks for the long-term. We do use our corporate governance rights to address issues with corporations that are held in our portfolio; in our view, this strategy is more efficient for the investing considerations of diversification, minimizing risks and costs, and maximizing returns than simply selling a security each time we have shareholder concerns.

In California, AB2941 requires the California Public Employees' Retirement System and the California State Teachers' Retirement System to encourage companies in which they invest in to act responsibly and not take actions that promote or otherwise enable human rights violations in the Sudan. Additionally, the legislation requires that we periodically follow up with identified companies to ensure they are acting responsibly with regards to Sudan.

Our independent research providers have identified Total S.A. as doing business in, or with Sudan. Currently, CalSTRS owns 2,741,498 shares of your company. Our previous analysis placed Total S.A. in a "Monitor" status and not subject to divestment. We are requesting an updated disclosure of your direct or indirect business activities in Sudan so that we, as fiduciaries, can accurately assess the risk associated with your activities there and make informed investment decisions.

We request that you answer the following questions:

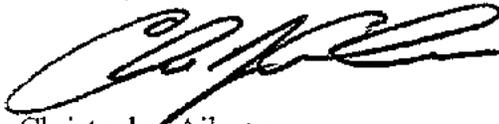
- (1) Does your company, any subsidiary of your company, or joint venture thereof ("Affiliated Business Entity") engage in any direct or indirect business activity in Sudan? If yes, identify the name and nature of such business and how long has such business been taking place?
- (2) What portion of your company's or any Affiliated Business Entity's current revenue stream is from any direct or indirect business activity in Sudan, and what portion of the company's or Affiliated Business Entity's total assets were used to earn said revenue?
- (3) Has your company or any Affiliated Business Entity made a capital investment in Sudan?
- (4) Has your company or any Affiliated Business Entity entered into any licensing agreement with the Sudan government in order to engage in current or future business activities?
- (5) Is your company or an Affiliated Business Entity doing any business with a corporation that is owned by the Sudan government?
- (6) How many employees of your company or Affiliated Business Entity are in Sudan?
- (7) What fees and/or taxes do your company and/or any Affiliated Business Entity pay to the Sudan government and what are the fees and/or taxes for?
- (8) What is your company's perspective on the situation in Sudan's Darfur region and humanitarian issues surrounding the North-South conflict? Has your company taken any action or implemented any policies that are pertinent to relieving that situation?
- (9) Has your company or any Affiliated Business Entity done anything to promote and/or protect human rights from the atrocities taking place in Sudan?

Bertrand de la Noue
November 19, 2010
Page 3

If you have any questions, please feel free to contact Philip Larrieu of the Corporate Governance staff at:

Philip Larrieu
Investments – Corporate Governance
100 Waterfront Place, MS-4
West Sacramento, CA 95605-2807
(916)414-7417

Sincerely,

A handwritten signature in black ink, appearing to read 'C. Ailman', written in a cursive style.

Christopher Ailman
Chief Investment Officer



Attachment F

California State Teachers'
Retirement System
Investments
100 Waterfront Place, MS-04
West Sacramento, CA 95605-2807
(916) 414-7400 Fax (916) 414-7533
cailman@calstrs.com

November 19, 2010

Stefano Lucchini, Senior Executive Vice President
ENI S.P.A.
Piazzale Enrico Mattei
1-00144 Rome
Italy

Dear Mr. Stefano Lucchini,

This letter is sent to you on behalf of the California State Teachers' Retirement System (CalSTRS). As you may be aware, CalSTRS is a public pension fund established for the benefit of California's public school teachers over 90 years ago. CalSTRS serves the investment and retirement interests of nearly 847,000 plan participants. As of October 31, 2010, the CalSTRS portfolio was valued at over **\$142 billion**; approximately **\$75 billion** of the fund's assets are invested in the public equity markets, on both a domestic and an international basis. A significant percentage of CalSTRS' public equity portfolio is invested in the indexed or passive style of investment management; these stocks do not trade on company news or events; we hold these stocks for the long-term. We do use our corporate governance rights to address issues with corporations that are held in our portfolio; in our view, this strategy is more efficient for the investing considerations of diversification, minimizing risks and costs, and maximizing returns than simply selling a security each time we have shareholder concerns.

In California, AB221 requires the California Public Employees' Retirement System and the California State Teachers' Retirement System to encourage companies in which they invest in to act responsibly and not take actions that promote terrorism or otherwise enable the Iranian pursuit of nuclear weapons. Additionally, the legislation requires that we periodically follow up with identified companies to ensure they are acting responsibly with regards to Iran.

Our independent research providers have identified ENI S.P.A. as doing business in, or with the country of Iran. Currently, CalSTRS owns 3,902,441 shares of your company. Our previous analysis placed ENI S.P.A. in a "Monitor" status and not subject to divestment. We are requesting an updated disclosure of your direct or indirect business activities in Iran so that we, as fiduciaries, can accurately assess the risk associated with your activities there and make informed investment decisions.

We request that you answer the following questions:

- (1) Does your company, any subsidiary of your company, or joint venture thereof ("Affiliated Business Entity") engage in any direct or indirect business activity in Iran? If yes, identify the name and nature of such business and how long has such business been taking place?
- (2) What portion of you company's or any Affiliated Business Entity's current revenue stream is from any direct or indirect business activity in Iran, and what portion of the company's or Affiliated Business Entity's total assets were used to earn said revenue?
- (3) Has your company or any Affiliated Business Entity made a capital investment in Iran?
- (4) Has your company or any Affiliated Business Entity entered into any licensing agreement with the Iran government in order to engage in current or future business activities?
- (5) Has your company or any Affiliated Business Entity made sales of gasoline to Iran?
- (6) Has your company or any Affiliated Business Entity purchased oil or Natural gas from Iran?
- (7) Is your company or an Affiliated Business Entity doing any business with a corporation that is owned by the Iranian government?
- (8) How many employees of your company or Affiliated Business Entity are in Iran?
- (9) What fees and/or taxes does your company and/or any Affiliated Business Entity pay to the Iran government and what are the fees and/or taxes for?

Emmanuelle Chatelain
November 19, 2010
Page 3

If you have any questions, please feel free to contact Philip Larrieu of the Corporate Governance staff at:

Philip Larrieu
Investments – Corporate Governance
100 Waterfront Place, MS-4
West Sacramento, CA 95605-2807
(916)414-7417

Sincerely,

A handwritten signature in black ink, appearing to read 'C. Ailman', written in a cursive style.

Christopher Ailman
Chief Investment Officer

o n i s i s n s r i						
Company Name (Domicile)	Summary of Ties to Sudan	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010		
1 Bharat Heavy Electricals (India)	Bharat Heavy Electricals has contracts to build power plants in Sudan.	In 2009, Bharat Heavy Electricals was designated as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0		
2 Kunlun Energy Co. (formerly CNPC Hong Kong) and Sinopec a linked company (China)	While Kunlun energy has no activity in Sudan, its parent, CNPC, is the largest partner of several oil consortiums that have active oil exploration and production operations in Sudan.	In 2009, Sinopec and its related companies including CNPC Hong Kong were designated as "Restricted." In February 2010, CNPC Hong Kong changed its name to Kunlun Energy Co. Sinopec and all of its subsidiaries, including Kunlun Energy Co., remain "Restricted."	0	\$0		
3 Dongfeng Motor Group and Dongfeng Automobile Company Ltd. a linked company (China)	Dongfeng Motor Group and Dongfeng Automobile Co. have reportedly supplied military vehicles to the Sudanese government. The Companies did not reply to CalSTRS requests for information.	In 2009, DongFeng Motor Group and Dogfeng Automobile Company were designated as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0		
4 MISC Bhd (Malaysia)	MISC is a Malaysian shipping company that is linked to Iran through its parent company, Petronas (which is also "Restricted"). Additionally, MISC has a joint venture, which provides shipping services to Sudan.	In 2009, MISC was designated as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0		
5 Oil and Natural Gas Company of India (India)	Oil and Natural Gas Company of India (ONGC) has interests in multiple Sudanese oil blocks.	In 2009, ONGC was designated as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0		
6 PECD Berhad (Malaysia)	PECD has an ongoing contract to build an oil export terminal in port Sudan.	In 2009, ONGC was designated as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0		
7 PetroChina and CNPC - as connected corporations to the Chinese National Oil Company (China)	PetroChina has no operations in Sudan but is linked through their parent, CNPC, which has multiple interests in the country.	In 2009, CalSTRS designated PetroChina as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0		

Company Name (Domicile)	Summary of Ties to Sudan	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
8 Petronas (Malaysia)	Petronas has interest in several Sudan oil fields.	In 2009, CalSTRS designated Petronas as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0
9 Sudan Telecom Company (Sudan)	Sudatel provides telecommunication services in Sudan and reportedly cut services to villages in Darfur when attacks were imminent.	In 2009, CalSTRS designated Sudan Telecom as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0

Companies in Monitor				
Company Name (Domicile)	Summary of Ties to Sudan	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
1 Alstom (France)	Alstom provides parts and installation services for the Meow Dm project. The company's main involvement in the country is expected to end at the end of 2010 with a two-year warranty period.	In 2009, CalSTRS designated Alstom as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	197,462	\$8,157,356
2 Atlas Copco (Sweden)	Atlas Copco has a sales agreement with a distributor selling mainly mining equipment in Sudan.	In 2009, CalSTRS designated Atlas Copco as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	365,926	\$7,196,138
3 Petrofac Limited (United Kingdom)	Petrofac provides limited technical and management support and materials to operations in Sudan. The Conflict Risk Network (formerly the Sudan Divestment Task Force) has confirmed that they believe the company's humanitarian projects in Sudan meets the criteria of "substantial action."	In 2009, CalSTRS designated Petrofac as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	554,630	\$12,014,812
4 Seadrill (Norway)	In December 2009, Seadrill reported it was starting its first operation in Sudan in early 2010 and was scheduled to be completed in the third quarter 2010.	Seadrill was not identified on the CalSTRS 2009 Sudan List. Seadrill was designated as "Review" in early 2010 and moved to "Monitor" as it appears their operations in Sudan are complete; however, the company has not committed to avoiding Sudan business in the future.	573,751	\$17,572,574

Company Name (Domicile)	Summary of Ties to Sudan	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
5 Schlumberger (France)	Schlumberger's provides oil field services to several clients in Sudan. The Conflict Risk Network (formerly Sudan Divestment Task Force) has determined Schlumberger's humanitarian activities in Sudan constitute "substantial action."	In 2009, CalSTRS designated Schlumberger as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	4,252,086	\$328,856,331
6 Total SA (France)	Total has a 32.5% interest in Block B in Sudan. The block has been inactive since 1985 due to security concerns. Total is considering resuming operations in Block B but has confirmed to CalSTRS that it will not return until they are satisfied with the security and humanitarian conditions in Sudan.	In 2009, CalSTRS designated Total as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	Common 2,711,371 Strip 10,000 Bonds \$300,000	Common \$131,704,249 Strip 13.02 Bonds \$321,725
7 Wartsila (Finland)	Wartsila has declared it will fulfill existing contracts in Sudan but has committed to not accept new business in the country. Additionally, Wartsila has committed to support certain humanitarian activities that the Conflict Risk Network (formerly Sudan Divestment Task Force) has determined to be "substantial action."	In 2009, CalSTRS designated Wartsila as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	65,939	\$4,575,062

o n i s n r i				
Company Name (Domicile)	Summary of Ties to Sudan	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
1 Intertek Group plc (United Kingdom)	Intertek's Caleb Brett division provides oil testing services, through an agency agreement with a Sudanese company, to international oil companies operating in Sudan.	Intertek was not designated on the 2009 Sudan list. Intertek was designated as "Review" in 2010, and the engagement process was started.	227,419	\$6,424,666

	Company Name (Domicile)	Summary of Ties to Sudan	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
2	JX Holdings (Japan)	JX Holdings was formed through a merger between Nippon Oil and Nippon Mining. Nippon oil reported in its 2009 Corporate Social Responsibility Report (CSR) that they purchase Sudanese oil in the spot market.	Neither JX Holdings nor Nippon Oil were designated on the 2009 Sudan list. JX Holdings was designated as "Review" in 2010, and the engagement process was started.	2,207,700	\$13,651,529



GUIDANCE ON RESPONSIBLE BUSINESS IN CONFLICT-AFFECTED AND HIGH-RISK AREAS:

A RESOURCE FOR COMPANIES AND INVESTORS

A joint UN Global Compact – PRI publication



United Nations Global Compact



“Guidance on Responsible Business in Conflict-Affected and High-risk Areas: A Resource for Companies and Investors”

aims to assist companies in implementing responsible business practices in conflict-affected and high-risk areas consistent with the Global Compact Ten Principles. It seeks to provide a common reference point for constructive dialogue between companies and investors on what constitutes responsible business practices in difficult operating environments, though it does not provide guidance on investment practices of financial institutions.

This voluntary guidance aims to complement applicable national and international laws by promoting international good practice. It does not presume to replace the private sector’s legal rights and duties to their home and host country governments. Voluntary approaches cannot be a substitute for government action, but they can reinforce the positive impacts of investment in conflict-affected and high-risk areas.

This guidance is designed to stimulate learning and dialogue and to promote collective action and innovative partnerships through Global Compact Local Networks and other initiatives. It was developed by the United Nations Global Compact Office, the Principles for Responsible Investment (PRI) initiative and an expert group comprised of company representatives, investors, civil society leaders, UN representatives and others. It was informed by good corporate practices from around the world, as well as a series of multi-stakeholder events (Istanbul; New York; Khartoum; Tokyo). Global Compact Board members and Global Compact Local Networks have also been involved in its development. It is subject to review in the light of new developments and – like all guidance developed by the Global Compact Office – it is voluntary.

For companies of all sizes, operating a business unit in a high-risk area poses a number of dilemmas with no easy answers. There are challenges, yet a number of difficulties can be defused with early proactive measures. It is our hope that this guidance is a useful resource to help reduce corporate risks and enhance the capacity of companies to make a positive long-lasting contribution to peace and development. We believe there is effectively no contradiction between maximized long-term financial performance and positive contributions to peace and development.

Project Management: Melissa Powell, Adrienne Gardaz, Dawoon Chung, Meng Liu

Copy-Editor: Tom Zoellner

Designer: Hedie Joulæe

Printer: United Nations, New York

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“It is this need to find common solutions to pressing challenges that drives the corporate responsibility movement globally. It makes business a key partner to the United Nations as we pursue our goals for development, peace and security (...). Our mission is an historic one. The challenge before us is clear: ensuring that companies apply the principles of the Compact within their own organizations, while enabling them to make common cause with other companies and other stakeholders is addressing global challenges and helping to meet the needs of the world’s people.”

— H.E. Mr. Ban Ki-moon, United Nations Secretary-General



Introduction

1. The following conditions often prevail in conflict-affected and high-risk areas: human rights violations; presence of an illegitimate or unrepresentative government; lack of equal economic and social opportunity; systematic discrimination against parts of the population; lack of political participation; poor management of revenues, including from natural resources; endemic corruption; and chronic poverty with associated heightened risks and responsibilities.

2. As used in this document, the term “investors” refers to a number of financial agents including asset owners (such as pension funds, government reserve funds, foundations, endowments, insurance and reinsurance companies and depository organizations) and investment managers. This guidance will also be relevant for professional service providers engaging with investee companies on behalf of their client financial institutions. Further information on these terms is available on the Principles for Responsible Investment’s website at: www.unpri.org/faqs/#whocansign.

Companies and their investors are paying increased attention to the challenges and opportunities of doing business in conflict-affected and high-risk areas. These areas differ significantly from more stable operating environments and require companies and investors to take into consideration additional factors.¹ Various tools have been developed to help companies implement responsible business practices in these sensitive areas, yet they still face many challenges. Two major difficulties have been the lack of agreement on what constitutes “responsible” business in conflict-affected and high-risk areas, and the practical challenges unique to such contexts.

Purpose

The primary purpose of this guidance document is twofold:

- To assist companies in implementing responsible business practices by living up to the Global Compact Ten Principles in conflict-affected and high-risk areas so they may maximize their long-term financial performance and make positive contributions to peace and development, while minimizing risks and negative impacts to both the business and society.
- To provide a common reference point for constructive engagement in conflict-affected and high-risk areas, as opposed to divestment, between companies and investors² (specifically shareholders and potential shareholders).

Context

The primary responsibility for peace, security and development rests with governments, but the private sector can make a meaningful contribution to stability and security in conflict-affected and high-risk areas. Commercial activities have direct and indirect positive impacts by creating job opportunities, generating revenues that advance economic development and recov-

ery, making sustainable investments in cities and towns, creating inclusive hiring policies that build good relations between ethnicities and communities, developing “bottom of the pyramid” business strategies and promoting best practices in the areas of human rights, labour, the environment and anti-corruption. Business can also be a powerful incentive for bringing people together across national and cultural lines, creating relationships based on a shared sense of identity and purpose, overcoming differences that, in the wider society, are more difficult to surmount. These contributions can be made by companies of all forms: small and large, public and private, international and local.

Yet in some cases, companies may negatively impact their own operations and their activities may exacerbate conflict or instability — even if their intentions are for the best. One common pitfall is hiring or consulting with one group of local stakeholders while ignoring the rest, unintentionally benefiting one group over another which can foster grievances between communities. Well-meaning social investment projects may undermine a government’s role in providing basic services. And poorly-trained security forces might use excessive force around company assets resulting in human rights abuses. Such impacts can create reputational, operational, and financial risks for companies and investors. Engagement with companies operating in conflict-affected and high-risk areas can increase investors’ understanding of highly complex situations and access to information regarding companies’ activities, promote the development of good policies and risk mitigation strategies related to such activities, and encourage companies’ positive contributions to sustainable peace and development. When companies and investors are able to understand and take steps to address complex issues associated with such contexts, they can mitigate the risks and negative impacts posed to and/

or by corporate activities, ensure long-term financial performance of business and play an important role in supporting peace and development.

Using this document³

This guidance does not offer technical instructions. It is not intended to serve as a blueprint for responsible behavior in all conflict-affected and high-risk areas. It complements responsible practices in peaceful and stable contexts, in situations of instability or conflict. This Guidance is offered to help companies improve their conduct, and provides a point of reference for engagement between companies and investors. It is designed to stimulate learning and dialogue and promote collective action and innovative partnerships through Global Compact Local Networks and other initiatives. It is subject to review in the light of new experiences and developments and, like all guidance developed by the Global Compact Office, is not a mandatory requirement for participants.

The Guidance categorizes responsible business practices into four areas:

- Core Business
- Government Relations
- Local Stakeholder Engagement
- Strategic Social Investment

Each section is structured in a similar fashion and includes:

- Definitions of relevant terminology
- Opportunities
- Challenges⁴
- Guidance points
- Explanatory notes
- Brief examples illustrating the guidance points

All of the sections are complementary and, given the cross-cutting nature of some aspects, should be considered in intercon-

THE MEANING OF “CONFLICT-AFFECTED” AND “HIGH-RISK” IN THIS DOCUMENT:

There is no single definition for the terms “conflict-affected” or “high risk” areas. This Guidance may be relevant for a variety of contexts, including countries, areas or regions:

- That are not currently experiencing high levels of armed violence, but where political and social instability prevails, and a number of factors are present that make a future outbreak of violence more likely (these factors are explained further throughout the document).
- In which there are serious concerns about abuses of human rights and political and civil liberties, but where violent conflict is not currently present.
- That are currently experiencing violent conflict, including civil wars, armed insurrections, inter-state wars and other types of organized violence.
- That are currently in transition from violent conflict to peace (these are sometimes referred to as ‘post-conflict’; however transition contexts remain highly volatile and at risk of falling back into violent conflict).

nection with the other parts of the guidance. Good practice with regard to one section should not be considered a substitute for another. The guidance is complemented by an annex that builds upon existing resources in the field and provides a list of tools and initiatives that can be considered for further support.

In general, **companies are encouraged to:**

- Develop policies and procedures for engagement with investors and be open to discussing concerns outlined within this guidance.
- Make reasonable efforts to disclose information that will enhance investors’ understanding of business activity in a timely manner and taking account of legal and commercial considerations.

3. As used in this document, the term “engagement” is to be understood as an overall description for a two-way conversation between a company and its shareholders and/or potential shareholders for the purpose of communicating views and concerns on issues that can impact the long-term performance of the company. Such dialogue can vary from regular correspondence to resolutions on company ballots at Annual General Meetings (AGMs), or in-depth meetings over a significant time period. However, the term “engagement” is also used to refer to a company’s relations to the government and other stakeholders as outlined in other sections of this Guidance.

4. The term “challenge” is used to refer to the risks to a company which may result from the impacts of its operations.

- Refer to this guidance at the earliest stages of their operations and throughout, especially during their initial consideration of investment.
- Use their annual “Communication on Progress” to report on the implementation of this guidance and make sure it receives wide circulation among the stakeholders.
- Ensure the involvement of their Boards and senior management on these issues to demonstrate high-level concern for the challenges of operating in such contexts.
- Join a Global Compact Local Network in an operational area. These are country-specific, multi-stakeholder platforms which can have a multiplying effect on a company’s good intentions. Actions are often more effective when taken collectively and in a multi-stakeholder context.

Investors are encouraged to:

- Make reasonable efforts to assess all public information when engaging companies.
- Make reference to this guidance during dialogues with investee companies with operations or interests in conflict-affected or high-risk areas.
- Review the company’s annual Communication on Progress to access relevant information about a company’s implementation efforts.
- Improve communications between specialist Economic, Social and Governance (ESG) analysts and fund managers in relation to conflict-related issues discussed with companies.

- Provide constructive feedback to companies on their communications with investors.
- Explain how the information provided by companies will be used in the investment process (selection of sectors and individual assets, basis for ownership decisions, etc).
- Be prepared to act collectively with other investors under appropriate circumstances.

All Global Compact participants are expected to embrace, support and implement a set of Ten Principles in the areas of human rights, labour standards, environmental sustainability, and anti-corruption wherever they do business. There is no doubt that conflict-affected and high-risk areas present a special challenge to this commitment. Failure to adhere to responsible business practices carries additional costs and risks in such contexts, as it can exacerbate tensions and instability. Yet the potential rewards are correspondingly high. A responsible business sector can make a marked contribution to the lasting peace and prosperity of conflict-affected and high-risk areas. This document aims to be a common reference point for this ongoing and vital dialogue.



Core Business

Core Business refers to corporate activities aimed principally at generating profits. This includes operations located at the company's own premises, its branches, subsidiaries and/or joint ventures, as well as trading and procurement links with suppliers.

Opportunities

Companies may face numerous challenges to their operations in conflict-affected and high-risk areas. Through responsible core-business operations, a company can:

- Mitigate risk factors posed to and by corporate activities.
- Reduce operational challenges enhancing its ability to create value.
- Foster stability that would secure long-term benefits for the company.

While securing its operations, it can also make important contributions to the economic development and/or recovery of regions coming out of conflict. For example by:

- Generating tax revenues for host governments that, if managed responsibly, can help them recover and provide services to their citizens after war.
- Creating job opportunities and ensuring equitable access to jobs through sensitive human resource policies, such as youth employment programmes.
- Bringing diverse groups together to work towards shared and mutually beneficial economic and social development.
- Creating value locally by ensuring the use of local products and services in its supply chains wherever possible, particularly including vulnerable and conflict-affected parts of the population.
- Creating infrastructure developments related to company operations which can benefit local communities.

However, if adequate policies and strategies are not in place, core business operations may have unintended consequences and impacts. The most significant challenges relating to a company's core business operations are identified below, with guidance on how they can be addressed.

CHALLENGE

A company may not adequately address all risks and impacts present in such contexts, including its potential to fuel conflict through its core business activities. As a result, the company may be exposed to heightened tensions, and even disruption in its own operating environment.

Guidance Point #1: Companies are encouraged to take adequate steps to identify the interaction between their core business operations and conflict dynamics and ensure that they do no harm. They are encouraged to adapt existing due diligence measures to the specific needs of conflict-affected and high-risk contexts.

Explanatory Note

Conflicts can arise from a number of problems that can be inadvertently exacerbated by private sector investments. Companies are encouraged to take purposeful steps in order to operate in a manner sensitive to the conflict. This includes three overall dimensions:

1. Understand the risks and conflict dynamics present in the operating environment and the potential impacts of their own operations. Examples of these include fuelling corruption, labour issues, or lack of socioeconomic opportunities for local populations. Conflicts can also arise where a company contributes to environmental damage; uses natural resources unsustainably; or restricts access to natural resources such as land and water.
2. Adapt operations to minimize negative risks and impacts.
3. Adapt operations to maximize potential positive contributions through core business operations.



EXTENDING CORE BUSINESS ACTIVITIES TO SUPPORT PEACE

Issue – Two Asian companies in the heavy manufacturing sector adapted products from their core earthmoving range to be suitable for anti-personnel mine clearance activities in post-conflict areas. When using the machines in one village where they operated, they learned that some villagers were actually opposed to mine-clearing activities as they feared that the cleared land would be allocated by the government for commercial agriculture once it had been made safe.

Approach – The example illustrates: first, how a core business activity (heavy manufacturing) can be extended to support peace initiatives (mine clearance). And secondly, that such efforts may have unexpected negative impacts if the specific context is not assessed thoroughly. The company widened the field of stakeholders and included more voices in its process of gathering information.

Result – The land, once cleared of mines, was put to beneficial use by the villagers.

To achieve this, companies should take up the following measures, in line with the due diligence principles outlined in the United Nations Framework for Business and Human Rights, developed by the UN Secretary-General's Special Representative on Business and Human Rights:

1. Develop policies and integrate them into management systems to minimize negative risks and impacts and maximize positive impacts through core business operations.
2. Clearly communicate these policies and steps taken to implement them, for example through a policy statement by the Board. Organizing internal trainings can also raise staff awareness.
3. Conduct a “conflict risk and impact assessment” prior to investing and starting operations. This should complement, and not replace, human rights, environmental and social impact assessment processes.
4. Continue to regularly monitor the operating environment based on credible and reliable sources of information from the pre-acquisition phase. This can be in addition to or integrated in other types of information gathering (such as political risk analysis or security assessments).
5. Work in partnership with reputable third parties with the relevant local expertise and skills, such as in conflict analysis, mediation and arbitration. Relevant partners can be local and international civil society organizations, development agencies, or think tanks and universities.
6. Explore options for contributing constructively to tackle specific risks and conflict issues identified (see paragraph on opportunities above).
7. Track and report on performance, including through their annual Communication on Progress.

CHALLENGE

Grievances and disputes may arise from a company's core business operations among local communities and other stakeholders and may not be detected early enough to be dealt with constructively and in a timely manner. Grievances of those affected may be left to fester and lead to increasing tensions.

Guidance Point #2: Companies are encouraged to make a commitment to addressing grievances and disputes constructively and proactively through dialogue and by having grievances and dispute settlement mechanisms that allow affected parties to raise problems with the company with a clear process for discussion and resolution.

Explanatory Note

In conflict-affected and high-risk areas, communities typically experience high levels of stress and trauma through prevailing insecurity, violence or displacement. Due to the preexisting strain on the population and the volatility of the context, businesses need to pay particular attention to monitoring and adapting their operations to their en-

vironment. Grievance procedures can serve as early warning systems and provide the company with ongoing information on their impacts that can be used to adapt practice, avoid the escalation of disputes and, where necessary, inform a process for resolution.

In order to develop a social license to operate, companies are encouraged to:

1. Strive for meaningful and constructive engagement and dialogue with individuals and communities affected by core business operations. This is also an essential element of impact assessments and monitoring (see also Section 4 on Stakeholder Engagement).
2. Develop policies and mechanisms according to existing standards to settle disagreements and grievances.
3. Inform relevant stakeholders about existing company policies and explain how specific challenges will be addressed.
4. Ensure the broad participation of the community and adopt measures that those participating can raise grievances freely, safely, and in the knowledge that their concerns are dealt with in a timely manner.

DEALING WITH COMMUNITY GRIEVANCES

Issue – Conflicts between local communities and an oil company in Asia over the impacts of the oil operations threatened to cause delays and financial losses for the company.

Approach – The company employed four main strategies to engage more effectively with communities:

1. Community outreach and interviews with key opinion leaders and decision makers.
2. Information dissemination, education, and communication activities for the wider community.
3. Perception surveys and participatory workshops to introduce the project and validate initial survey results.
4. Participatory involvement in the formulation of environmental management plans.

The cost of this engagement was estimated at approximately US\$6 million on a total project cost of US\$ 4.5 billion (0.13% of total costs).

Result – The company calculated that by changing its engagement with local communities, it managed to avoid project delays of approximately 10-15 days, equivalent to an estimated saving of US \$50-72 million through timely completion of construction and avoiding contractual penalties.

CHALLENGE

Companies may become implicated in abuses and allegations of complicity in human rights abuses. Such accusations may be costly both reputationally and financially for a company and seriously affect the concerned communities.

Guidance Point #3: Companies are encouraged to respect emerging international best practices, especially where national law sets a lower standard. Policies, strategies and operational guidance, aligned with the Global Compact's Ten Principles, should be adapted to the specific needs of conflict-affected and high-risk contexts.

Explanatory Note

Systematic and large-scale violations of human rights, humanitarian and criminal law may accompany violent conflict, and can be both a cause and a consequence of conflict and instability. What may begin as apparently "one off" abuse can escalate. In order to avoid accusations of complicity, companies are encouraged to:

1. Develop corporate policies and systems throughout the company to ensure effective respect of, among others, national law, the United Nations Framework for Business and Human Rights developed by the United Nations Secretary-General's Special Representative on Business and Human Rights, United Nations Security Council resolutions, typically on sanctions, international humanitarian law and evolving international best practices.
2. Mainstream policies and systems throughout the company, such as by providing training to employees and develop adequate indicators for compliance.
3. Establish effective systems to monitor compliance and share experiences with peers and stakeholders.

CHALLENGE

Abusive behavior by security forces engaged to protect staff and physical plants may expose the company to accusations of complicity in such abuses.

Guidance Point #4: Companies are encouraged to apply evolving best practices in the management of security services provided by private contractors as well as, to the extent possible, public security forces.

Explanatory Note

In conflict-affected and high-risk areas, companies may hire private security providers or work with public security providers to protect their operations and personnel. If security providers use excessive force, it may amount to a human rights violation, which can have significant negative consequences for the company's reputation and financial performance. This may be the case even where the company did not intend or order the actions. Companies are encouraged to:

1. Build provisions on evolving best practices into the contract with security providers.
2. Screen potential security providers' track records, including their human rights records, and ensure they have requisite policies and codes of conduct that reflect good practice in security provision.
3. Consult regularly with host governments and local communities about the impact of security arrangements on those communities.
4. Record and report any credible allegations of human rights abuses by security providers to appropriate host government authorities in a company's area of operation.
5. Provide relevant human rights training to security forces, where possible.
6. Join voluntary initiatives offering guidance, such as the Voluntary Principles on Security and Human Rights.

For additional guidance, see also Guidance Point 2 in the section on Government Relations.



DEALING WITH THE SUPPLY CHAIN

Issue – A large North-American company is producing computers and related hardware products. While their direct suppliers do not necessarily operate in conflict-affected and high risk areas, they have learned that critical raw materials used in their products may have come from areas controlled by armed actors.

Approach – The company joined forces with other industry peers to create a certification mechanism on certain minerals such as tin, coltan and cassiterite coming from conflict-affected and high-risk countries. It also asked some of its suppliers – those deemed “high risk” – to complete a self-assessment questionnaire to identify potential social and environmental responsibility performance risks.

Result – These self-assessments began with an important psychological effect. They helped its suppliers become more familiar with the company’s expectations of what it means to conform to the supply chain code of conduct. The company then reviewed the results of the self-assessment and asked some of them to implement an improvement plan. The company has engaged more than 600 suppliers in this process and conducted over 500 supplier site-audits in the last ten years. The company has made available as much information on those audits as possible. It has listed the majority of its suppliers in an effort to be more transparent.

CHALLENGE

Companies may inadvertently provide financial or material means that facilitates armed conflict, causing reputational, legal, operational and financial risks for the company. This can happen more generally through business relations and transactions with conflicting parties, inadequate supply-chain management or through extortion payments to armed groups.

Guidance Point #5: Companies are encouraged to carefully monitor their business relations, transactions as well as flows of funds and resources and to develop a rigorous supply chain management system to assess and monitor if and how their suppliers obtain resources and raw materials in conflict-affected and high-risk areas. In so doing, companies

can help to ensure that they are not providing funding or support to armed actors who may benefit from revenues generated by the sale of such goods and resources.

Explanatory Note

Companies should be aware that purchasing commodities through suppliers and supply chains which may be connected to armed actors may result in financial or in-kind support to violent or criminal factions. A thorough and extensive supply chain management system is critical to reducing these risks in high-risk areas. Companies are encouraged to:

1. Carefully examine and monitor existing and newly established business relations and transactions to verify that they do not supply funding or other resources to armed groups.

2. Conduct an extensive mapping exercise and focus due diligence on their suppliers to verify the origin of products they purchase, as well as understand the set of risks involved at different levels of the supply chain.
3. Expand their supply chain due diligence process to sub-tier suppliers which are responsible for providing goods and services to companies' strategic suppliers. In conflict-affected and high risk areas, these sub-tier suppliers often provide raw materials and thus pose the most significant challenge to companies in implementing responsible business practices.
4. Develop a robust mechanism for monitoring business and funding transactions in conflict-affected and high-risk areas and set up procedures for supply chain engagement and regularly communicate with suppliers about the company's expectations and standards.
5. Encourage their suppliers and sub-tier suppliers to develop the capacity to implement responsible business practices.

CHALLENGE

Vast sums of money and/or the sudden influx of revenues legally generated by companies may lead to corruption both between private sector entities and between the private sector and the public sector. Further, in some situations, there may be a lack of regional and local capacity to manage such influx.

Guidance Point #6: Companies are encouraged to develop detailed policies on specific bribery issues and put in place robust management procedures such as risk assessment, training and whistle-blowing to prevent corruption. Such policies and procedures should be applied to any third-party (i.e. governments, local suppliers, joint-venture partners, agents or community organisations) contracting with the company.

Explanatory Note

Corruption can take place between private sector entities and between the private sector and the public sector. It can take the form of brib-

ery, kickbacks, extortion, protection money, facilitation payments, fraud, money laundering, influence peddling and political and charitable contributions. When systematic, such practices often aggravate grievances among populations and can fuel conflict. Companies are encouraged to:

1. Place particular emphasis on due diligence against corruption, by adopting stringent anti-corruption measures and regulations against financial misconduct.
2. Be transparent about the selection process for awarding contracts.
3. Organize periodic workshops and trainings for employees and contractors on anti-corruption measures.
4. Where possible, join voluntary initiatives promoting revenue transparency such as the Extractive Industries Transparency Initiative or the Wolfsberg Anti-Money Laundering Principles for Private Banking.

For additional guidance on transparency, see also Guidance Point 3 in the section on government relations.

JOINT INITIATIVE TO STEM THE FLOW OF CONFLICT-DIAMONDS

Issue – Diamond traders were accused of fueling devastating civil wars in Africa through the purchase of rough diamonds from rebel groups.

Approach – The international Kimberley Process Certification Scheme (KPCS) was set up, supported by leading international companies. It says that participating states must put in place national legislation and institutions, establish export, import and internal controls and commit to transparency and the exchange of statistical data.

Participants can only legally trade with other participants who have also met the minimum requirements of the scheme, and international shipments of rough diamonds must be accompanied by a certificate guaranteeing that they are conflict-free.

Result – The flow of conflict diamonds was stemmed and fragile countries saw some stabilization of their economies.

Government Relations

Government Relations refers to interactions between the company and government officials, agencies and organizations. Companies interact with governments at multiple levels, from the local to municipal/provincial up to the central government apparatus. At issue may be the granting of licenses, the payment of taxes, the use of public services and other contractual relationships. Government relations also include legitimate public and private lobbying activities to shape the operating environment for business. For companies that operate across borders, this includes dealings with both home and host governments.

Opportunities

In conflict-affected and post-conflict areas, government relations may be complicated by the absence of a clearly identifiable government or one that is not supported by large sections of the population. Carefully considered government relations may therefore be an effective means for a company to:

- Avoid actual or perceived complicity in human rights abuses by government actors.
- Contribute to successful risk management by reducing the risk of the company becoming a target for community grievances.
- Protect its reputation.
- Foster constructive relations that may translate into a competitive advantage.
- Promote strong governance practices that are a central feature of a stable operating environment for business.

All of these outcomes are in the long-term interests of companies, and provide a compelling proposition for investors. In addition to being critical to successful risk management and ensuring that the company does no harm, well-managed government relations efforts may contribute to peace-building processes and help encourage sustainable development by:

- Promoting the “peace dividend” of a political resolution to a conflict for example through local business or multi-stakeholder coalitions, such as Global Compact Local Networks.

- Drawing on political and material resources from outside the context.
- Encouraging the development of institutions, and governance mechanisms to address or forestall the economic, political and social grievances that drive conflict.
- Supporting transparent and accountable mechanisms to govern the allocation, transfer and use of water, land and other resources.
- Encouraging the development and enforcement of effective labour laws, tax codes and other business regulations.

CHALLENGE

A company may find it difficult to avoid actual or perceived political involvement in a context and then may wrongly assume that inaction or withdrawal are the only available courses of action.

Guidance Point #1: Companies are encouraged to explore all opportunities for constructive corporate engagement with government as well as set good examples in their dealings with governments in order to support peace.

Explanatory Note

Through their interactions with government, both local and international business can promote good governance and support both political will and government capacity to address, resolve and forestall conflict.

Local private sector can contribute to peace-building efforts by:

1. Providing material support to peace negotiations.
2. Adopting hiring and workplace policies that cut across ethnic or racial divides (e.g. the Sullivan and MacBride Principles).
3. Mobilizing public opinion (e.g. a public campaign run by a group of trade associations in 2001 encouraged citizens to speak out on the urgency of peace).

Engaging with governments on conflict-related issues can be more sensitive for international companies, given concerns that their actions may be considered unwelcome interventions. However, opportunities for engagement may be present during various points of a project cycle and may be proactive or reactive to specific events. Based on a rigorous analysis of the situation in economic, ethical and legal terms, a wide spectrum of

engagement opportunities exist. Companies may choose to employ any or a combination of these strategies:

1. Directly engage the government with their concerns, including for example by articulating the shared interest of government and business in peace and stability, in public and/or private forums.
2. Seek to address their concerns indirectly by engaging with third parties, such as the Global Compact Local Networks or convening business roundtables or multi-stakeholder conferences.
3. Engage in efforts that support governance capacity and support international best practice in resource governance, where possible, through joining initiatives that provide forums for business-government engagement on transparency and accountability, such as the CEO Water Mandate or the Extractive Industries Transparency Initiative.

RESPONDING TO INCIDENTS OF VIOLENCE

Issue – A community meeting in Southern Africa was bombed amidst tensions over resettlement of the population. A company with major operations in the area was then faced with a choice - what to do about it?

Approach – Silence and/or withdrawal from the area was rejected. The company instead embraced a three-fold strategy:

1. Writing a letter of protest to the government, issuing a public statement condemning the incident and calling for a full and public inquiry.
2. Re-iterating an offer to train the local authority responsible for resolving re-settlement issues that were a source of tension.
3. Initiating and co-hosting a multi-stakeholder forum on the most effective means of creating the right business climate for investment without the fear of perceived complicity in human rights abuses. This also led to the establishment of a Global Compact Local Network.

Result – A proactive government relations strategy which sought to (a) generate political will (i.e. the letter of protest and public statement) and support stronger governance capacity (i.e. the offer of re-settlement training); (b) investigate the immediate incident and its causes; and (c) promote the shared interests of business and government in peace (i.e. through the multi-stakeholder forum).

CHALLENGE

Human rights violations by government actors may expose the company to accusations of complicity in these abuses. Further, perceptions that a company may somehow benefit from abuses may make it a focus of local disruption and international attention, negatively impacting its operations and reputation.

Guidance Point #2: Companies are encouraged to take all necessary measures to avoid complicity in human rights violations by government actors in relation to all aspects of the company's operations.

Explanatory Note

Companies are encouraged to:

1. Include in their risk assessments the possibilities of being indirectly or directly complicit in human rights abuses, in the illegal use of force and/or in gross human rights violations.
2. Develop policies, practices and operational guidance on government relations with regard to the environmental protection and natural-resource management, the rights of labour and indigenous peoples and the use of public security forces.

It is important to note that challenges are greater for companies:

- Involved in sectors strategically important to the government or the conflict (i.e. extractive, infrastructure, defense and telecommunications sectors, amongst others).
- With significant or sustained interaction with the government, through joint-venture arrangements.
- Which provide large source of tax revenue (i.e. the risk being that the company is seen as implicitly supporting the government, and so becoming a proxy target).

All companies are exposed to government-related challenges in conflict-affected or high-risk areas, regardless of their size or sector. Employees may be affected, for example, by the illegal use of force and/or gross human rights violations, requiring company engagement with local or national authorities. A company may usefully develop policies and operational guidance on such issues identified through risk assessments. In such situations, some companies have provided legal support to their employees.

CHALLENGE

Companies may expose themselves to reputational risks if they engage in corrupt practices in their relations with government officials. Such practices may also undermine the development and strengthening of accountable governance mechanisms.

Guidance Point #3: Companies are encouraged to develop clear policies and robust management practices to prevent corrupt relations with government officials. Within legal and commercial constraints, companies are encouraged to promote transparency with host governments and be as transparent as possible with other stakeholders about their relationships with governments.

Explanatory Note

Lack of transparency may foster the perception of corrupt entanglement with the government. Silence toward government malfeasance may also be a poor communication strategy, because the company risks being seen as indifferent and may therefore see its operations targeted by parties in the conflict.

On the other hand, companies can bring significant expertise in financial accounting mechanisms – expertise that can contribute to strengthening accountability mechanisms. Engagement with government actors on corruption and transparency, and follow-up communication with stakeholders, can be most effective through collective initiatives such as Global Compact Local Networks.

For additional guidance on anti-corruption, see also Guidance Point 6 of the Core Business section.



CONSTRUCTIVE ENGAGEMENT WITH GOVERNMENT

Issue – Projects that generate large government revenues may exacerbate tensions between conflicting parties, for example between different regions or a region and a central government. The company's risk of becoming a target increases if there is a lack of transparency about the terms of a project. Yet, a company's ability to share information is often restricted by legal and commercial considerations. A company with oil and gas interests in the Middle East was aware of this dynamic before it went into negotiations with a regional government.

Approach – Prior to entry, the company undertook due diligence and extensive stakeholder engagement, both locally and internationally, to: a) assess the exact nature of the risks posed by and to the projects, and b) identify strategies to minimize those risks.

The strategy the company employed included:

1. Requiring the redrawing of the boundaries for one of the projects to lie solely within the area under the recognized control of the regional authority.
2. Negotiating an option for the company to leave the project after a set period, which allowed the regional and central governments time to resolve outstanding legal and political issues associated with the creation of production-sharing agreements.
3. Making public the payments made to the regional government to support infrastructure and capacity building projects in the region.
4. Confirming the mutual commitment of the regional government and the company to transparency in promoting respect for and compliance with voluntary principles and international best practices such as the Extractive Industries Transparency Initiative or the Voluntary Principles on Security and Human Rights.

Result – A creative strategy developed through extensive stakeholder consultation, and in collaboration with government actors, reduced risks to the company through (a) clarifying the content and structure of relations between the company and different government actors, and (b) encouraging transparency and promoting human rights observance.

Local Stakeholder Engagement

Local Stakeholder Engagement refers to consultation and communication strategies for the purpose of building ongoing relationships with local communities. Local stakeholder engagement can be complementary to global stakeholder engagement and may take place with relevant local communities and civil society organizations. It may address a wide array of issues, including company policies, core business operations and social investment.

Opportunities

Constructive and regular stakeholder engagement, by the company and its contractors, may be an effective means for a company to build a relationship of trust with all concerned parties, so as to position the company as a predictable entity in a context where there may be distrust and/or violence. A company may also:

- Demonstrate its respect for local actors, its willingness to listen to local people and a genuine concern for community well-being.
- Develop a more predictable and stable working environment through early and continued engagement.
- Bring together parties who may have common needs, fostering positive relationships between conflicting groups and reducing the possibility of violent conflict.
- Encourage or support the activities of reputable independent third parties. Global Compact Local Networks can also help to identify suitable and well-motivated civil society organizations which can assist in this process.

CHALLENGE

Lack of ongoing and genuine engagement may increase company costs and resource-strain. A lack of proactive engagement may leave stakeholders feeling like they have few options other than disruptive behavior as a way to attract attention. Work stoppages, media coverage and questions by investors can result in a company spending valuable time and resources responding to conflict.

Guidance Point #1. Companies are encouraged to establish strategic and rigorous stakeholder engagement mechanisms across company and contractor operations, including establishing key performance indicators to demonstrate that the company is accessible and accountable.

Explanatory Note

A company's stakeholder engagement strategy should be made operational throughout all company departments and company's contractors. Companies are encouraged to:

1. Ensure proactive and inclusive community consultation, referencing current international standards on Free Prior Informed Consultation or Consent.
2. Implement formal and transparent communication procedures, including publication of meeting minutes and a registry for commitments made by the company.
3. Develop a formal grievance procedure agreed upon with stakeholders, taking into account different approaches to grievance-based concerns and criminality-induced violence.
4. Invest in front-line conflict management capacity and training for staff to professionalize around the issues of conflict resolution, consensus building and facilitating community meetings.
5. Support capacity building of local stakeholders in the ability to be a genuine part of decision-making role, including the involvement of civil society.
6. Ensure that all policies affecting local stakeholders (hiring, compensation, security, etc.) are designed in recognition of the specific operating environment.
7. Utilize conflict analysis tools to understand the impacts of stakeholder engagement activities.
8. Work with independent and trusted third parties such as those identified through the Global Compact Local Networks.



CHALLENGE

Company actions can potentially exacerbate inter- and intra-community tensions and may increase the likelihood of violence directed against a company. Dealing with only one party in the conflict can be perceived by its adversaries as siding with that group and can make corporate operations a target for violence. At the same time, conferring legitimacy to those involved with the conflict may expose the company to the risk of extortion, reward violence or make the company potentially complicit in human rights abuses.

Guidance Point #2: In the context of existing inter- and intra-group tensions, companies are encouraged to take a broad and inclusive approach towards stakeholder engagement.

Explanatory Note

Taking a narrow approach to stakeholder engagement or engaging with the “wrong” leadership may lead to inter-community conflict, by making people feel that they need to compete for access to company decision-makers and company benefits. In developing an inclusive and participatory engagement strategy related to their activities, companies are encouraged to identify legitimate representatives of the community and:

1. Assess if “official” or elected representatives enjoy broad support among their constituency. Propose collective action in stakeholder engagement.
2. To the extent possible, use multiple venues for engagement: informal sports events or festivals, formal meetings with official representatives, public meetings, advisory board of informal leaders, etc. Make sure that some venues are public so that all people have access to the same information.
3. Perform stakeholder mappings to understand positions and interests of each group within the context, and to develop a strategy of engagement for each group.
4. Take a cautious approach to engaging with armed groups. In some cases talking to aggrieved parties can aid due diligence processes and help provide a more accurate understanding of the conflict. However engaging with crimi-

nal or armed groups at a business level may expose the company to allegations of bribery, corruption and illegality. Transparent contractual relationships are generally difficult in this context.

5. Reference current international laws and standards for guidance on financial transactions regarding interactions with groups listed on international terrorist lists.
6. Take a broad and inclusive approach to providing opportunities, such as jobs, in the community. Be careful that job programmes that integrate ex-combatants into the local economy do not create unfair competition with local stakeholders who chose to stay out of the conflict.
7. Use independent and reliable third parties to analyze and understand local power structures. Developing or working with Global Compact Local Networks may contribute to this process.

CHALLENGE

International attention to business activities in conflict-affected and high-risk areas may increase a company’s reputational risks. It can create a space for outsiders (advocacy groups, politicians, criminal elements) to gather popular support against the company, cause an unstable working environment and generate negative international press.

Guidance point #3: Companies are encouraged to engage proactively with relevant civil society organizations and international organizations.

Explanatory Note

Companies are encouraged to develop an inclusive and participatory engagement strategy related to their activities with a broad, rather than narrow, representation of local civil society and to:

1. Take collective action. Work with Local Global Compact Networks to contribute to local solutions.
2. Engage with independent and informed third parties to communicate the company’s business principles, values, and commitment to UN Global Compact Principles.

CHALLENGE

Insufficient or late engagement with local communities may heighten security risks for business activities. Taking an outcome-focused approach towards engagement, rather than a participatory and inclusive process, may cause people to feel that they have not been consulted on matters that affect their lives. An increase in tensions between the company and community may escalate into obstructive behavior against the company, and a possible shutdown of business activities.

Guidance Point #4: Companies are encouraged to promote and take action towards constructive and peaceful company-community engagement.

Explanatory Note

With a view to approaching communities as partners in preventing and managing con-

flict, rather than automatically treating them as a risk factor, companies are encouraged to:

1. Identify constructive leaders who advocate a non-violent approach.
2. Focus on engagement as a transparent, open and ongoing “consultative” process aimed at meeting both stakeholders’ and company’s needs, instead of viewing it as a “negotiated” process.
3. In partnership with stakeholders, clearly define goals, desired outcomes, and mutual expectations regarding communication, relationship building, and respectful engagement.
4. Recognize that the importance of non-tangibles like building trust, respect and a sense of neighborliness are as important as material benefits the company may have to contribute.
5. Work with reliable independent third parties who can provide disinterested input.

STAKEHOLDER ENGAGEMENT AND RISK MANAGEMENT

Issue – A company sought a project in Latin America amidst a regional conflict, and some were calling for a corporate policy of isolation and silence. Minimizing contact with feuding communities was one possible risk-mitigation strategy.

Approach – Isolation was judged to be the riskiest approach and the company actively sought ways to maximize contact with local communities to: a) be better informed about the exact nature of the risks and threats to corporate activities, and b) use the friendly reputation the company had within the community as a means to minimize risk, both through the influence communities had over illegal armed groups (both guerilla groups and paramilitary groups), as well as being warned by the community about possible threats. The community engagement strategies that the company employed included:

1. Gathering knowledge of the political operating environment by employing experienced community affairs staff and working closely with the communities.
2. Obtaining knowledge and understanding of the direct and indirect impacts of corporate activities, including security, economic, cultural, and social impacts.
3. Senior management of the company were entirely local, enabling, in this context, an alignment of the personal values of its staff with the business objectives of the company.

Result – Stakeholder-focused management systems and a concerted effort to be “part of the community” provided the company with the social capital that has become fundamental to operating successfully in this conflict-affected area.

Strategic Social Investment

Strategic Social Investment refers to the voluntary, and sometimes legally mandated, financial contributions by companies. They can help local communities and broader societies achieve their development priorities and create sustainable opportunities in ways that are sustainable and aligned with strategic business objectives. Social investment does not include resources spent on core business activities such as local hiring, contracting, waste management, or land compensation. Core business activities, however, can be leveraged in a socially beneficial way to complement social investments.

Opportunities

Companies, no matter the size, may have the opportunity to deliver long-lasting programmes that benefit local and regional communities when social investment is strategically aligned with core business activities. Proactive community consultation and strategic planning may serve as a means to bring conflicting groups together rather than exacerbate existing tensions and divisions. It can also help companies to gain political support among local communities for business activities. Development of new enterprises and of independent and sustainable economic activity should be a major goal of such strategic investment.

CHALLENGE

The manner in which benefits are distributed may create competition for resources inside the community. Resentments over resource distribution can potentially create tensions between communities that may jeopardize the security of a company's business activities.

Guidance Point #1: Companies are encouraged to establish strategic social investment programmes built on existing capacities as a component of, not a substitute for, local stakeholder engagement and consultation.

Explanatory Note

With a view to utilizing ongoing stakeholder engagement as a method to inform design and development of social investment projects in conflict-affected and high-risk areas, companies are encouraged to:

1. Define “fair benefits distribution” through stakeholder forums.

2. Ensure, to the extent possible, that benefits are reasonably distributed across communities, not only to host communities, which can exacerbate tensions or competition.
3. Decrease “incentives” for local groups to behave in a violent manner in obtaining company resources and projects.

CHALLENGE

Failing to implement a strategic social investment plan may cause a waste of company resources. Social investment projects that are not aligned with core business strategy and competencies may cause the company to undertake activities in which it has limited expertise and knowledge. This can create mounting expenditures on social investment and reduce the likelihood of success.

Guidance Point #2: Companies are encouraged to employ the same rigor in developing social investment strategies as in other aspects of business operations.

Explanatory Note

Companies are encouraged to execute a planned (not ad-hoc) social investment strategy that takes into account their social impacts, with clear and measurable indicators on the likelihood of increasing or decreasing conflict. With a view to doing so, they are encouraged to:

1. Clearly define objectives that are linked to the conflict-specific business case and link the strategy to other company processes.



2. Take an approach that builds on shared common goals and involves the active participation and commitment of both local communities and the government.
3. Avoid providing free social services, thus ensuring that social investment is strengthening local capacity rather than substituting for government.
4. Employ existing standards and guidance on social investment, such as the Principles for Social Investment (PSI).

CHALLENGE

Failing to achieve long-term sustainable development may reduce a company's return on social investment as well as damage the financial bottom line. If communities are not involved in the identification and development of projects or feel no ownership, social investment efforts will have no long-term impacts, and yield little goodwill for the company. In a conflict-affected or high-risk area, this may increase the perception that the company does not care about the community and could make it a target for obstructive action.

Guidance Point #3: Companies are encouraged to implement strategic social investment as an independent activity, separate from the company's obligations to mitigate or compensate for its operations' impacts.

Explanatory Note

Social investment should be viewed as a complement to, not a substitute for, a conflict-sensitive approach to company's core business operations. In this perspective, companies are encouraged to:

1. Ensure that their social investment strategy is designed around the specific local context, taking into account aspects of the conflict-affected or high-risk area.
2. Develop risk mitigation strategies and policies that specifically address social investment programmatic impacts.
3. Demonstrate transparency, equity and fairness in decision making processes so as not to increase perceptions of corruption, favoritism, or competition.

CHALLENGE

Providing basic services may undermine the government's role. A lack of exit strategy may also place greater resource demands and expectations on business. A company-driven social investment approach undertaken in isolation from the government can become a substitute for government responsibilities, undermine the government's legitimacy in the eyes of its constituencies, and place greater expectations on the company. Unsustainable projects – especially the provision of free services in conflict-affected or high risk areas – can, over time, become a perceived entitlement for local stakeholders, creating recurrent expenditures for the company.

Guidance Point #4: Companies are encouraged to ensure that social investment projects are sustainable and not replacing services which should be provided by the government.

Explanatory Note

Companies are encouraged to design all social investments, no matter the project time frame, with a clear exit strategy, accounting for a community hand-over plan, no free service provision and a blueprint for continued activity without financial input from the company. In doing so, companies are encouraged to:

1. Take into consideration the long-term impacts of a social investment strategy as a method to gauge sustainability of projects.
2. Define how social investment projects will contribute to the company's strategy of managing its impacts on local communities and support sustainable development.
3. Ensure that social investment efforts build on, rather than replace, existing capacities.
4. Work directly with the central and local government to ensure that social investment strategies are in line with regional and local community development plans.
5. Develop an exit strategy in conjunction with local communities, local civil society and local and national government, to ensure that social investment projects can be successfully handed off and taken over by other parties including local and national governments.



STAKEHOLDER CONSULTATION FOR STRATEGIC SOCIAL INVESTMENT

Issue – A major oil and gas project in Africa was threatening to trigger violence between communities (with the risk of evolving into a company-community conflict) over employment, contracts and community projects.

Approach – It was widely known that an exclusive focus on the nearby community would lead to further violent conflict instigated by those who felt left out. Instead, the company brought in an independent mediator to negotiate a benefit distribution agreement between all communities based on 1) population size, 2) ancestral ownership, and 3) disruption they would experience during construction due to proximity.

Negotiations took place at three levels: 1) consultation with traditional rulers, 2) establishing principles of negotiations with three dominant communities, and 3) final negotiations with all stakeholders including all communities, the company, government representatives and contractors.

Result – The project was implemented without any conflict between communities or with the company. The project was completed with zero down days due to community unrest.

Summary of Guidance Points

CORE BUSINESS

Guidance Point #1: Companies are encouraged to take adequate steps to identify the interaction between their core business operations and conflict dynamics and ensure that they do no harm. They are encouraged to adapt existing due diligence measures to the specific needs of conflict-affected and high-risk contexts.

Guidance Point #2: Companies are encouraged to make a commitment to addressing grievances and disputes constructively and proactively through dialogue and by having grievance and dispute settlement mechanisms that allow affected parties to raise problems with the company with a clear process for discussion and resolution.

Guidance Point #3: Companies are encouraged to respect emerging international best practices, especially where national law sets a lower standard. Policies, strategies and operational guidance, aligned with the Global Compact's Ten Principles, should be adapted to the specific needs of conflict-affected and high-risk areas.

Guidance Point #4: Companies are encouraged to apply evolving best practices in the management of security services provided by private contractors as well as, to the extent possible, public security forces.

Guidance Point #5: Companies are encouraged to carefully monitor their business relations, transactions as well as flows of funds and resources and to develop a rigorous supply chain management system to assess and monitor if and how their suppliers obtain resources and raw materials in conflict-affected and high-risk areas. In so doing, companies can help to ensure that they are not providing funding or support to armed actors who may benefit from revenues generated by the sale of such goods and resources.

Guidance Point #6: Companies are encouraged to develop detailed policies on specific bribery issues and put in place robust management procedures such as risk assessment, training and whistle-blowing to prevent corruption. Such policies and procedures should be applied to any third-party (i.e. governments, local suppliers, joint-venture partners, agents or community organizations) contracting with the company.

GOVERNMENT RELATIONS

Guidance Point #1: Companies are encouraged to explore all opportunities for constructive corporate engagement with government as well as set good examples in their dealings with governments in order to support peace.

Guidance Point #2: Companies are encouraged to take all necessary measures to avoid complicity in human rights violations by government actors in relation to all aspects of the company's operations.

Guidance Point #3: Companies are encouraged to develop clear policies and robust management practices to prevent corrupt relations with government officials. Within legal and commercial constraints, companies are encouraged to promote transparency with host governments and be as transparent as possible with other stakeholders about their relationships with governments.

LOCAL STAKEHOLDER ENGAGEMENT

Guidance Point #1: Companies are encouraged to establish strategic and rigorous stakeholder engagement mechanisms across company and contractor operations, including establishing key performance indicators to demonstrate that the company is accessible and accountable.

Guidance Point #2: In the context of existing inter- and intra-group tensions, companies are encouraged to take a broad and inclusive approach towards stakeholder engagement.

Guidance point #3: Companies are encouraged to engage proactively with relevant civil society organizations and international organizations.

Guidance Point #4: Companies are encouraged to promote and take action towards constructive and peaceful company-community engagement.

STRATEGIC SOCIAL INVESTMENT

Guidance Point #1: Companies are encouraged to establish strategic social investment programmes built on existing capacities as a component of, not a substitute for, local stakeholder engagement and consultation.

Guidance Point #2: Companies are encouraged to employ the same rigor in developing social investment strategies as in other aspects of business operations.

Guidance Point #3: Companies are encouraged to implement strategic social investment as an independent activity, separate from the company's obligations to mitigate or compensate for its operations' impacts.

Guidance Point #4: Companies are encouraged to ensure that social investment projects are sustainable and not replacing services which should be provided by the government.



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Annex

1. Further resources on specific Guidance Points

CORE BUSINESS

Guidance Point #1:

- “Business Guide for Conflict Impact Assessment & Risk Management,” UN Global Compact, available at http://www.unglobalcompact.org/docs/issues_doc/Peace_and_Business/Business-Guide.pdf
- “Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones,” the Organisation for Economic Co-operation and Development, available at <http://www.oecd.org/dataoecd/26/21/36885821.pdf>
- “Guide to Operating in Areas of Conflict for the Oil & Gas Industry,” International Petroleum Industry Environmental and Conservation Association, available at http://www.ipieca.org/activities/social/social_publications.php#4
- “Guide to Human Rights Impact Assessment and Management,” UN Global Compact, with the International Finance Corporation and International Business Leaders Forum, available at <http://www.guidetohria.org>
- “Conflict-Sensitive-Business Practice: Guidance for Extractive Industries,” International Alert, available at http://www.international-alert.org/pdf/conflict_sensitive_business_practice_section_1.pdf
- The UN Global Compact’s Principles 7, 8 and 9 provide further guidance on environmental issues: <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/environment.html>
- “Protect, Respect and Remedy: a UN Framework for Business and Human Rights” A/HRC/8/5, 2008 and “Business and Human Rights: Further steps toward the operationalization of the “protect, respect and remedy” framework”, A/HRC/14/27 2010: reports of the UN Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, available at <http://www.business-humanrights.org/SpecialRepPortal/Home>

Guidance Point #2:

- “Good Practice Note: Addressing Grievances from Project-Affected Communities,” International Finance Corporation, available at http://www.ifc.org/ifcext/sustainability.nsf/Content/Publications_GPN_Grievances
- The website of the IFC’s Compliance Advisor Ombudsman: <http://www.cao-ombudsman.org>
- “Handling and Resolving Local-Level Concerns and Grievances,” International Council on Mining and Minerals, available at <http://www.icmm.com/page/15822/icmm-presents-new-guidance-note-on-handling-and-resolving-local-level-concerns-and-grievances>
- “Grievance Mechanisms for Business and Human Rights Strengths, Weaknesses and Gaps,” John F. Kennedy School of Government, Harvard University, available at http://www.hks.harvard.edu/m-rcbg/CSRI/publications/workingpaper_40_Strengths_Weaknesses_Gaps.pdf
- Rights Compatible Grievance Mechanisms – A Guidance Tool for Companies and Their Stakeholders,” John F. Kennedy School of Government, Harvard University, available at http://www.hks.harvard.edu/m-rcbg/CSRI/publications/Workingpaper_41_Rights-Compatible%20Grievance%20Mechanisms_May2008FNL.pdf
- “Embedding Rights-Compatible Grievance Procedures for External Stakeholders Within Business Culture,” John F. Kennedy School of Government, Harvard University, available at http://www.hks.harvard.edu/m-rcbg/CSRI/publications/report_36_sherman_grievance.pdf
- “Protect, Respect and Remedy: a UN Framework for Business and Human Rights” A/HRC/8/5, 2008 and “Business and Human Rights: Further steps toward the operationalization of the “protect, respect and remedy” framework”, A/HRC/14/27 2010: reports of the UN Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, available at <http://www.business-humanrights.org/SpecialRepPortal/Home>

Guidance Point #3:

- The UN Global Compact’s Principles 1 and 2 provide further guidance: http://www.unglobalcompact.org/Issues/human_rights/Tools_and_Guidance_Materials.html
- “The Labour Principles of the United Nations Global Compact: A Guide for Business,” UN Global Compact, available at http://www.unglobalcompact.org/issues/Labour/Tools_Guidance_Materials.html
- “Business and International Humanitarian Law: An Introduction to the Rights and Obligations of Business Enterprises under International Humanitarian Law,” International Committee of the Red Cross, available at <http://www.icrc.org/web/eng/siteeng0.nsf/html/p0882>
- “Guide for Integrating Human Rights into Business Management,” Business Leaders Initiative on Human Rights, UN Global Compact and Office of the United Nations High Commission for Human Rights, available from <http://www.integrating-humanrights.org/>
- The Swiss Initiative on Private Military and Security Companies, which aims to promote a ‘Global Code of Conduct for Respect of Human Rights and International Law’ in the global security industry, available at http://www.dcaf.ch/privatisation-security/PSC_PMC-CoC_Draft_11.01.2010.pdf

Guidance Point #4:

- “The Voluntary Principles on Security and Human Rights” available at <http://www.voluntaryprinciples.org>
- “Voluntary Principles Performance Indicators,” International Alert available from http://www.international-alert.org/pdf/Voluntary_Principles_on_Security_and_Human_Rights.pdf.
- The “Red Flags”, especially explanation and case examples under “Engaging Abusive Security Forces”: at <http://www.redflags.info>.
- The World Bank, Multilateral Investment Guarantee Agency and Anvil Mining toolkit, available at http://www.miga.org/documents/VPSHR_Toolkit_v3.pdf

Guidance Point #5:

- “Supply Chain Sustainability. A Practical Guide to Continuously Improving Upstream Impacts by Applying the UN Global Compact Principles”, Global Compact – Business for Social Responsibility, available at http://www.unglobalcompact.org/Issues/supply_chain/index.html
- “The Kimberley Process”, further information available at www.kimberleyprocess.com.
- “The OECD Financial Action Task Force”, further information available at <http://www.fatf-gafi.org>.
- “Conflict-Sensitive-Business Practice: Guidance for Extractive Industries, Flashpoint Issue on dealing with armed groups”, International Alert, available at http://www.iisd.org/pdf/2005/security_conflict_sensitive_business.pdf
- The “Red Flags”, explanation and case examples of “financing international crimes”: <http://www.redflags.info>.

Guidance Point #6:

- The UN Global Compact’s 10th Principle, provides further guidance available at http://www.unglobalcompact.org/Issues/transparency_anticorruption/index.html
- “The UN Global Compact Reporting Guidance on the 10th Principle” (2009) available at http://www.unglobalcompact.org/docs/issues_doc/Anti-Corruption/UNGC_AntiCorruptionReporting.pdf
- “Anti-Corruption Instruments and the OECD Guidelines for Multi-National Enterprises,” OECD, available at <http://www.oecd.org/dataoecd/0/33/2638728.pdf>
- The Extractive Industry Transparency Initiative (EITI): <http://eititransparency.org/>
- “Transparency International Integrity Pact”: http://www.transparency.org/global_priorities/public_contracting/integrity_pacts
- “The Wolfsberg Anti-Money Laundering Principles for Private Banking”, available at <http://www.wolfsberg-principles.com/privat-banking.html>
- “IMF Draft Guide on Resource Revenue Transparency”, available at <http://www.imf.org/external/nplfad/2004/grrrt/eng/guide.pdf>

GOVERNMENT RELATIONS

Guidance Point #1:

- “The Role of Local Business in Peacebuilding”, the Berghof Research Centre for Constructive Conflict Management, available at http://www.berghof-handbook.net/documents/publications/killick_et_al_handbook.pdf
- “How Business Can Encourage Governments to Fulfil their Human Rights Obligations”, a Good Practice Note by the UN Global Compact’s Human Rights Working Group, available at http://www.unglobalcompact.org/docs/issues_doc/human_rights/Resources/Governments&HumanRights_Good_Practice_Note.pdf
- “Local Business, Local Peace”, International Alert, available at http://www.international-alert.org/peace_and_economy/index.php

Guidance Point #2:

- The UN Global Compact’s 2nd Principle provides further guidance: <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/Principle2.html>
- The “Final Report of the ICJ Expert Legal Panel on Corporate Complicity in International Crime”, available at <http://www.business-humanrights.org/Updates/Archive/ICJPaneloncomplicity>

Guidance Point #3:

- The UN Global Compact’s 10th Principle provides further guidance: http://www.unglobalcompact.org/Issues/transparency_anticorruption/index.html
- The “UN Global Compact Reporting Guidance on the 10th Principle”, (2009) available at http://www.unglobalcompact.org/docs/issues_doc/Anti-Corruption/UNGC_AntiCorruptionReporting.pdf
- “Anti-Corruption Instruments and the OECD Guidelines for Multi-National Enterprises,” OECD, available at <http://www.oecd.org/dataoecd/0/33/2638728.pdf>
- The Extractive Industry Transparency Initiative (EITI): <http://eitransparency.org/>

LOCAL STAKEHOLDER ENGAGEMENT

Guidance Point #1:

- “Performance Standards on Social and Environmental Sustainability,” International Finance Corporation, available at <http://www.ifc.org/ifcext/sustainability.nsf/Content/EnvSocStandards>
- “Stakeholder Engagement: A Good Practice Handbook for Companies Doing Business in Emerging Markets,” Overseas Development Initiative, available at <http://www.odi.org.uk/resources/download/1436.pdf>
- “Getting it Right: Making Corporate-Community Relations Work”, Anderson, Mary B. and Luc Zandvliet, Sheffield, UK: Greenleaf Publishing, 2009.
- “Setting Up a Multi-Stakeholder Panel as a Tool for Effective Stakeholder Dialogue,” UN Global Compact Human Rights Working Group, available at http://www.unglobalcompact.org/docs/issues_doc/human_rights/Resources/Stakeholder_Panels_Good_Practice_Note.pdf

Guidance Point #2:

- “Conflict-Sensitive Business Practice: Guidance for Extractive Industries,” International Alert, especially “Flashpoint 6: Dealing with Armed Groups,” available at http://www.international-alert.org/pdf/conflict_sensitive_business_practice_section_1.pdf
- “Stakeholder Engagement: A Good Practice Handbook for Companies: Doing Business in Emerging Markets,” International Finance Corporation, available at <http://www.odi.org.uk/resources/download/1436.pdf>
- “Stakeholder Consultation Issue Paper,” CDA Collaborative Learning Project – Corporate Engagement Project, available at http://www.cdawww.com/cdawww/pdf/issue/issue_paper_stakeholder_consultation_november_2004_Pdf.pdf



Guidance Point #3:

- “Proactive Stakeholder Engagement: A Practical Guide for Companies and Stakeholders,” CRS Europe, available at http://www.csreurope.org/data/files/toolbox/Stakeholder_engagement.pdf
- “Guide to Engaging with NGOs,” Business for Social Responsibility, available from http://commdev.org/files/1922_file_BSR_Guide_to_Engaging_NGOs.pdf

Guidance Point #4

- “Getting it Right: Making Corporate-Community Relations Work”, Anderson, Mary B. and Luc Zandvliet, (Sheffield, UK: Greenleaf Publishing, 2009)

STRATEGIC SOCIAL INVESTMENT

Guidance Point #1, #2, #3, #4:

- “Guide to Successful, Sustainable Social Investment for the Oil & Gas Industry”, 2008 International Petroleum Industry Environmental and Conservation Association, available at <http://www.iecea.org/activities/social/downloads/publications/SocialInvestmentGuide.pdf>
- “Strategic Community Investment Quick Guide”, International Finance Corporation available at <http://www.ifc.org/ifcext/advisoryservices.nsf/Content/70040EB805511D33852576D600517C21?OpenDocument>
- “Sustainable Business and Peace: A Resource Pack on Corporate Responsibility for Small and Medium Enterprises,” UN Global Compact, available at http://www.unglobalcompact.org/docs/issues_Peace_and_Business/Sustaining_Business_and_Peace.pdf
- “Guide to Successful, Sustainable Social Investment for the Oil & Gas Industry”, 2008, IPIECA, available at <http://www.iecea.org/activities/social/downloads/publications/SocialInvestment-Guide.pdf>

2. General sources of information

AccountAbility

<http://accountabilityaa1000wiki.net/>

See, especially:

- “From Words to Action: The Stakeholder Engagement Manual”: <http://www.accountability21.net/publications.aspx?id=904>
- “AA1000 Stakeholder Engagement Standard”: <http://www.accountability.org/aa1000ses>

AlertNet (Thomson Reuters Foundation)

<http://www.alertnet.org/>

Humanitarian news network based around a website, aiming to keep relief professionals and the wider public up-to-date on humanitarian crises around the globe. The website is organized geographically as well as according to topic.

Berghof Research Centre for Constructive Conflict Management

http://www.berghof-center.org/std_page.php?LANG=e&id=13

See, especially:

- “The Role of Local Business in Peacebuilding”: http://www.berghof-handbook.net/documents/publications/killick_et_al_handbook.pdf

Business Leaders Initiative on Human Rights

<http://www.integrating-humanrights.org/>

See especially:

- “Guide for Integrating Human Rights into Business Management” Business Leaders Initiative on Human Rights, UN Global Compact and Office of the United Nations High Commission for Human Rights.

Business for Social Responsibility (BSR)

<http://www.bsr.org/>

See, especially:

- “Guide to Engaging with NGOs”: http://commdev.org/files/1922_file_BSR_Guide_to_Engaging_NGOs.pdf

CDA, Collaborative Learning Projects

<http://www.cdainc.com/cdawww/publication.php>

See especially:

- “Getting it Right: Making Corporate-Community Relations Work”, Anderson, Mary B. and Luc Zandvliet, (Sheffield, UK: Greenleaf Publishing, 2009)
- “Corporate Engagement Project. Stakeholder Consultation Issue Paper”: http://www.cdainc.com/cdawww/pdf/issue/issue_paper_stakeholder_consultation_november_2004_Pdf.pdf
- “Corporate Engagement Project Framework”: <http://www.youtube.com/watch?v=G0eBMpX9wIA>
- “Do No Harm: How AID Can Support Peace – Or War”: <http://www.cdainc.com/cdawww/publication.php>

CSR Europe

<http://www.csreurope.org/>

See, especially:

- “Proactive Stakeholder Engagement: A Practical Guide for Companies and Stakeholders”: http://www.csreurope.org/data/files/toolbox/Stakeholder_engagement.pdf

Danish Institute for Human Rights

<http://www.humanrights.dk/>

See, especially:

- “Country Risk Assessment Reports”: http://humanrightsbusiness.org/?f=country_risk
- “Doing Business in High-Risk Human Rights Environments”: http://www.humanrightsbusiness.org/files/11111/file/doing_business_in_highrisk_human_rights_environments__180210.pdf

Engineers Against Poverty

<http://www.engineersagainstpoverity.org/>

See, especially:

- “A Systemic Approach to Project Social Risk Management”: http://www.engineersagainstpoverity.org/db/documents/social_risk_management_briefing_note.pdf

Extractive Industry Transparency Initiative

<http://eitransparency.org/>

Voluntary multi-stakeholder initiative bringing together companies, government, investors and civil society to improve transparency and accountability in the extractive sector with the purpose of reducing poverty, conflict and corruption frequently associated with the concept of the resource curse.

Global Network Initiative

<http://www.globalnetworkinitiative.org/>

Initiative formed by a multi-stakeholder group of companies, civil society organizations, investors and academics that aimed at negotiating and creating a collaborative approach to protect and advance freedom of expression and privacy in the ICT sector.

Heidelberg Institute on International Conflict Research

www.hiik.de/en/index_e.htm

Publishes a “Conflict Barometer” annually, which describes recent trends in conflict development, escalations, and settlements.

International Alert

http://www.international-alert.org/peace_and_economy

International Alert’s work offers detailed policy and operational guidance, research, advisory and training services to companies operating in conflict-affected areas. See, especially:

- “Conflict-Sensitive-Business Practice: Guidance for Extractive Industries”: http://www.international-alert.org/pdf/conflict_sensitive_business_practice_section_1.pdf
- “Local Business, Local Peace”: http://www.international-alert.org/peace_and_economy/index.php
- “Conflict-Sensitive Business Practice: Engineering Contractors and their Clients”: http://www.international-alert.org/pdf/CSBP_Engineering_contractors_clients.pdf
- “Conflict Sensitive Project Funding: Better Lending Practices in Conflict Prone States”: http://www.international-alert.org/pdf/CSBP_Finance_Lending_Conflict.pdf
- “Voluntary Principles Performance Indicators”: http://www.international-alert.org/pdf/Voluntary_Principles_on_Security_and_Human_Rights.pdf

International Commission of Jurists

<http://www.icj.org/>

See, especially:

- The “Final Report of the ICJ Expert Legal Panel on Corporate Complicity in International Crime”, available at <http://www.business-humanrights.org/Updates/Archive/ICJPaneloncomplicity>

International Council on Mining and Minerals

<http://www.icmm.com/>

See, especially:

- “Handling and Resolving Local-Level Concerns and Grievances”: <http://www.icmm.com/page/15822/icmm-presents-new-guidance-note-on-handling-and-resolving-local-level-concerns-and-grievances>
- “Community Development Toolkit”: <http://www.icmm.com/page/629/community-development-toolkit>
- “Mining: Partnership for Development”: http://www.unglobalcompact.org/docs/issues_doc/Financial_markets/Zurich_Report_WhoCaresWins.pdf

International Crisis Group

<http://www.crisisgroup.org/home/index.cfm>

NGO providing regular reports and briefing papers on conflict affected and conflict prone countries.

Institute for Economics and Peace

<http://www.economicsandpeace.org>

Non-profit research institute dedicated to developing the inter-relationships between business, peace and economic development. Products include the ground-breaking Global Peace Index.

International Finance Corporation

<http://www.ifc.org/>

See, especially:

- “Performance Standards on Social and Environmental Sustainability”: <http://www.ifc.org/ifcext/sustainability.nsf/Content/EnvSocStandards>
- “Stakeholder Engagement: A Good Practice Handbook for Companies: Doing Business in Emerging Markets,”: <http://www.odi.org.uk/resources/download/1436.pdf>
- “Good Practice Note: Addressing Grievances from Project-Affected Communities”: http://www.ifc.org/ifcext/sustainability.nsf/Content/Publications_GPN_Grievances
- “Strategic Community Investment Quick Guide”: <http://www.ifc.org/ifcext/advisoryservices.nsf/Content/70040EB805511D33852576D600517C21?OpenDocument>
- The website of the IFC’s Compliance Advisor Ombudsman: <http://www.cao-ombudsman.org>

International Labour Organization

<http://www.ilo.org>

See, especially:

- “The Labour Principles of the United Nations Global Compact. A Guide for Business”: http://www.ilo.org/public/libdoc/ilo/2008/108B09_260_engl.pdf
- “Business and Decent Work in Conflict zones: A “Why?” and “How?” Guide”: http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_crisis/documents/publication/wcms_116628.pdf

International Red Cross and Red Crescent

www.icrc.org

See, especially:

- “Business and International Humanitarian Law: An Introduction to the Rights and Obligations of Business Enterprises under International Humanitarian Law”: <http://www.icrc.org/web/eng/siteeng0.nsf/html/p0882>

International Petroleum Industry Environment Conservation Association (IPIECA)

<http://www.ipieca.org/>

See, especially:

- “Guide to Operating in Areas of Conflict for the Oil & Gas Industry”: http://www.ipieca.org/activities/social/social_publications.php#4
- “Guide to Successful, Sustainable Social Investment for the Oil & Gas Industry”: <http://www.ipieca.org/activities/social/downloads/publications/SocialInvestmentGuide.pdf>

John F. Kennedy School of Government, Harvard University

<http://www.hks.harvard.edu/>

See, especially:

- “Grievance Mechanisms for Business and Human Rights Strengths, Weaknesses and Gaps”: http://www.hks.harvard.edu/m-rcbg/CSRI/publications/workingpaper_40_Strengths_Weaknesses_Gaps.pdf
- “Rights Compatible Grievance Mechanisms — A Guidance Tool for Companies and Their Stakeholders”: http://www.hks.harvard.edu/m-rcbg/CSRI/publications/Workingpaper_41_Rights-Compatible%20Grievance%20Mechanisms_May2008FNL.pdf
- “Embedding Rights-Compatible Grievance Procedures for External Stakeholders Within Business Culture”: http://www.hks.harvard.edu/m-rcbg/CSRI/publications/report_36_sherman_grievance.pdf

Kimberly Process

<http://www.kimberleyprocess.com/>

Joint governments, industry and civil society initiative to stem the flow of rough diamonds used by rebel movements to finance wars against legitimate governments.

Organisation for Economic Co-operation and Development (OECD)

<http://www.oecd.org/>

See, especially:

- “Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones”: <http://www.oecd.org/dataoecd/26/21/36885821.pdf>
- “The OECD Financial Action Task Force”: <http://www.fatf-gafi.org>
- “Anti-Corruption Instruments and the OECD Guidelines for Multi-National Enterprises”: <http://www.oecd.org/dataoecd/0/33/2638728.pdf>
- “Due Diligence for responsible supply chain management of minerals from conflict-affected and high-risk areas”: http://www.oecd.org/document/36/0,3343,en_2649_34889_44307_940_1_1_1_1,00.html

Red Flags

<http://www.redflags.info/>

Lists business practices which may result in legal liabilities for a company that operates in high-risk zones, including in conflict affected areas.

ReliefWeb

<http://www.reliefweb.int/rw/dbc.nsf/doc100?OpenForm>

Website providing timely information on humanitarian emergencies and natural disasters and run by the United Nations Office for the Coordination of Humanitarian Affairs (OCHA).

Swiss Initiative on the Global Code of conduct for Private Security Companies and Private Military Companies

http://www.dcaf.ch/privatisation-security/PSC_PMC-CoC_Draft_11.01.2010.pdf

Code of conduct resulting from an active collaboration of members of the private security industry, the Swiss Department of Foreign Affairs, the Geneva Centre for the Democratic Control of Armed Forces (DCAF) and the Geneva Academy of International Humanitarian Law and Human Rights (ADH). It lays down international industry norms and standards for the provision of private security services.

United Nations Global Compact

<http://www.unglobalcompact.org/>

See, especially:

- The UN Global Compact Ten Principles in the areas of human rights, labour, the environment and anti-corruption: <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html>
- “Business Guide for Conflict Impact Assessment & Risk Management” http://www.unglobalcompact.org/docs/issues_doc/Peace_and_Business/BusinessGuide.pdf
- “Guide to Human Rights Impact Assessment and Management” UN Global Compact, with the International Finance Corporation and International Business Leaders Forum, <http://www.guidetohria.org>
- “The Labour Principles of the United Nations Global Compact: A Guide for Business”: http://www.unglobalcompact.org/issues/Labour/Tools_Guidance_Materials.html
- “Supply Chain Sustainability. A Practical Guide to Continuously Improving Upstream Impacts by Applying the UN Global Compact Principles”, Global Compact – Business for Social Responsibility: http://www.unglobalcompact.org/Issues/supply_chain/index.html
- “The UN Global Compact Reporting Guidance on the 10th Principle” 2009 available at http://www.unglobalcompact.org/docs/issues_doc/Anti-Corruption/UNGC_AntiCorruptionReporting.pdf

- “How Business Can Encourage Governments to Fulfil their Human Rights Obligations”, a Good Practice Note by the UN Global Compact’s Human Rights Working Group: http://www.unglobalcompact.org/docs/issues_doc/human_rights/Resources/Governments&HumanRights_Good_Practice_Note.pdf
- “Setting Up a Multi-Stakeholder Panel as a Tool for Effective Stakeholder Dialogue,” UN Global Compact Human Rights Working Group: http://www.unglobalcompact.org/docs/issues_doc/human_rights/Resources/Stakeholder_Panels_Good_Practice_Note.pdf
- “Sustainable Business and Peace: A Resource Pack on Corporate Responsibility for Small and Medium Enterprises,” UN Global Compact, available at http://www.unglobalcompact.org/docs/issues_doc/Peace_and_Business/Sustaining_Business_and_Peace.pdf
- “Who Cares Wins”: http://www.unglobalcompact.org/docs/issues_doc/Financial_markets/Zurich_Report_WhoCaresWins.pdf
- The CEO Water Mandate: http://www.unglobalcompact.org/Issues/Environment/CEO_Water_Mandate/

UN Secretary-General’ Special Representative on the issue of human rights and transnational corporations and other business enterprises:

<http://www.business-humanrights.org/SpecialRepPortal/Home>

See especially:

- “Protect, Respect and Remedy: a UN Framework for Business and Human Rights” A/HRC/8/5, 2008
- “Business and Human Rights: Further steps toward the operationalization of the “protect, respect and remedy” framework”, A/HRC/14/27 2010

Voluntary Principles on Security and Human Rights

<http://www.voluntaryprinciples.org/>

Guidance to companies operating in zones of conflict or fragile states so that they can ensure that security forces – public or private – protecting the companies’ facilities operate in a way that protects the company’s assets while respecting human rights and fundamental freedoms.

The World Bank

<http://www.worldbank.org/>

See, especially:

- World Bank MIGA and Anvil Mining: http://www.miga.org/documents/VPSHR_Toolkit_v3.pdf

World Resources Institute

<http://www.wri.org/projects>

See, especially:

- ‘Development Without Conflict – the Business Case for Community Consent’: <http://www.wri.org/publication/development-without-conflict>



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The Ten Principles of the United Nations Global Compact

HUMAN RIGHTS

- Principle 1 Businesses should support and respect the protection of internationally proclaimed human rights; and
Principle 2 make sure that they are not complicit in human rights abuses.

LABOUR

- Principle 3 Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
Principle 4 the elimination of all forms of forced and compulsory labour;
Principle 5 the effective abolition of child labour; and
Principle 6 the elimination of discrimination in respect of employment and occupation.

ENVIRONMENT

- Principle 7 Businesses are asked to support a precautionary approach to environmental challenges;
Principle 8 undertake initiatives to promote greater environmental responsibility; and
Principle 9 encourage the development and diffusion of environmentally friendly technologies.

ANTI-CORRUPTION

- Principle 10 Businesses should work against corruption in all its forms, including extortion and bribery.



GAO**Report to Congressional Requesters**

June 2010**SUDAN DIVESTMENT****U.S. Investors Sold
Assets but Could
Benefit from
Increased Disclosure
Regarding Companies'
Ties to Sudan****GAO**

Accountability * Integrity * Reliability



Highlights of [GAO-10-742](#), a report to congressional requesters

Why GAO Did This Study

Recognizing the humanitarian crisis in Darfur, Sudan, Congress enacted the Sudan Accountability and Divestment Act (SADA) in 2007. This law supports U.S. states' and investment companies' decisions to divest from companies with certain business ties to Sudan. It also seeks to prohibit federal contracting with these companies. GAO was asked to (1) identify actions that U.S. state fund managers and investment companies took regarding Sudan-related assets; (2) describe the factors that these entities considered in determining whether and how to divest; and (3) determine whether the U.S. government has contracted with companies identified as having certain Sudan-related business operations and assess compliance with SADA's federal contract prohibition provision. GAO surveyed states, analyzed data on investment companies and companies with Sudan-related business operations, assessed federal contracts, and reviewed documents and interviewed officials from the Securities and Exchange Commission (SEC), among other federal agencies.

What GAO Recommends

GAO recommends that the SEC consider issuing a rule requiring companies that trade on U.S. exchanges to disclose their business operations tied to Sudan, as well as possibly other state sponsors of terrorism. The SEC's Division of Corporation Finance agreed to present GAO's recommendation to the commission.

View [GAO-10-742](#) or [key components](#). For more information, contact Thomas Melito at (202) 512-9601 or melitot@gao.gov.

SUDAN DIVESTMENT

U.S. Investors Sold Assets but Could Benefit from Increased Disclosure Regarding Companies' Ties to Sudan

What GAO Found

Since 2006, U.S. state treasurers and public pension fund managers have divested or frozen about \$3.5 billion in assets primarily related to Sudan in response to their states' laws and policies; U.S. investment companies, which also sold Sudan-related assets, most commonly cited normal business reasons for changes in their holdings. State fund managers GAO surveyed indicated that their primary reason for divesting or freezing Sudan-related assets was to comply with their states' laws or policies. Thirty-five U.S. states have enacted legislation or adopted policies affecting their investments related to Sudan, primarily in response to the Darfur crisis, as well as in response to Sudan's designation by the U.S. government as a state sponsor of terrorism. GAO also found that the value of U.S. shares invested in six key foreign companies with Sudan-related business operations declined by almost 60 percent from March 2007 to December 2009. The decline cannot be accounted for solely by a reduction in stock prices for these companies, indicating that U.S. investors, on net, decided to sell shares in these companies. Investors indicated that they bought and sold Sudan-related assets for normal business reasons, such as maximizing shareholder value.

U.S. states and investment companies have often considered three factors when determining whether and how to divest. First, they have considered whether divesting from Sudan is consistent with fiduciary responsibility—generally the duty to act solely and prudently in the interest of a beneficiary or plan participant. Second, they have considered the difficulty in identifying authoritative and consistent information about companies with Sudan-related business operations. GAO analyzed three available lists of these companies and found that they differed significantly from one another. While information directly provided by companies through public documents such as disclosures required by the SEC is a particularly reliable source of information on these companies, federal securities laws do not require companies specifically to disclose business operations in state sponsors of terrorism. The SEC has the discretionary authority to adopt a specific disclosure requirement for this information, but has not exercised this authority. Third, investors have considered the effect that divestment might have on operating companies with Sudan-related business activities, such as prompting companies interested in promoting social responsibility to leave Sudan, creating room for companies that do not share that interest to enter the Sudanese market.

GAO's analysis, including a review of a non-random selection of contracts, indicates that the U.S. government has complied with SADA's contract prohibition provision. Specifically, the U.S. government has contracted with only one company identified on a widely-used list of companies with business ties to Sudan, and the contracts awarded to this company did not violate SADA. The U.S. government has contracted with subsidiaries and affiliates of companies with business ties to Sudan, as permitted under SADA.

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Abbreviations

ERISA	Employee Retirement Income Security Act
FAR	Federal Acquisition Regulations
OFPP	Office of Federal Procurement Policy
ORCA	Online Representation and Certifications Application
PERS	Public Employee Retirement System
SADA	Sudan Accountability and Divestment Act
SEC	Securities and Exchange Commission

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United States Government Accountability Office
Washington, DC 20548

June 22, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives

The Honorable Michael E. Capuano
House of Representatives

The Honorable Barbara Lee
House of Representatives

Since 1993, the U.S. Secretary of State has included Sudan on the “State Sponsors of Terrorism” list for repeatedly providing support for acts of international terrorism.¹ In 2003, U.S. concerns grew, as militias supported by the Sudanese government in Khartoum began waging what the U.S. government has characterized as genocide against the civilian population of Darfur. According to several nongovernmental groups and experts, this campaign may be financed, in part, by revenue collected from companies with business operations in Sudan (“operating companies”), particularly in four key economic sectors—power production, mineral extraction, oil-related activities, and production of military equipment. In 2007, the U.S. Congress enacted the Sudan Accountability and Divestment Act² (SADA), which supports U.S. states’ voluntary decisions to divest from foreign companies conducting certain business operations in Sudan in these four key economic sectors.³ The act also contains a “safe harbor” provision,

¹The U.S. Secretary of State designates countries as state sponsors of terrorism pursuant to three laws — section 6(j) of the Export Administration Act; section 40 of the Arms Export Control Act; and section 620A of the Foreign Assistance Act. Taken together, the four main categories of sanctions resulting from designation under these authorities include restrictions on U.S. foreign assistance; a ban on defense exports and sales; certain controls over exports of dual use items (items that have commercial uses as well as military or nuclear proliferation uses); and miscellaneous financial and other restrictions.

²P.L. No. 110-174, 121 Stat. 2516-23.

³Under U.S. sanctions, U.S.-based companies are prohibited from doing business in Sudan (31 C.F.R. Part 538). Certain exemptions to this rule exist. For example, nongovernmental organizations involved in humanitarian or religious activities in Sudan are generally allowed to perform these activities.

which gives investment companies that divest⁴ from these companies safe harbor from lawsuits “based solely upon the investment company divesting from, or avoiding investment in, securities issued by persons⁵ that conduct or have direct investments in business operations” designated under SADA, provided the investment companies file disclosure forms with the SEC in accordance with SADA. In addition, the act seeks to prohibit the U.S. government from contracting with companies that conduct certain business operations in Sudan. To that end, section 6 of the act (Prohibition on United States Government Contracts) requires all U.S. government agencies to ensure that each contract entered into for the procurement of goods or services includes a clause requiring the contractor to certify that it does not conduct certain business operations in Sudan in the four key economic sectors. The federal rule implementing this requirement stipulates that, in most cases, the required certification must be included in the solicitation for each new federal contract.⁶

At your request, we (1) identified actions that U.S. state fund managers and U.S.-based investment companies have taken regarding their Sudan-related assets and attempted to determine the reasons for these actions; (2) described the factors that these entities considered in determining whether and how to divest; and (3) determined whether the U.S. government has contracted with companies identified as having Sudan-related business operations and assessed compliance with the contract prohibition provision of SADA.

To address the first two objectives regarding U.S. states’ actions, we conducted a survey of treasurers and public pension fund managers in all 50 states and the District of Columbia.⁷ Specifically, we surveyed (1) the 51 state treasurers or their equivalents; (2) the 51 state-run public employee retirement system funds; and (3) managers of 50 other state-run

⁴SADA does not define divestment. For the purposes of this report, we use the term “divestment” to mean the relinquishment of all assets held in specified companies in order to reduce financial or political support for an entity and change that entity’s behavior.

⁵Under SADA, the term “person” includes, among others, a corporation, company, business association, and their successors, subunits, parent companies, or subsidiaries.

⁶Federal Acquisition Regulation (FAR) § 25.702.

⁷Throughout this report, the term “state” refers to the 50 states and the District of Columbia.

public pension funds, such as teacher retirement funds.⁸ (In some states, holdings are contained in several funds managed by different individuals.) We chose the first and second categories because they were frequently identified in state laws as the entities responsible for implementing any divestment actions. We chose the third category to include the funds with the largest asset values after the funds managed by public employee retirement systems and treasurers, since some state laws also affected these state-run funds. For the purposes of this report, we refer to the individuals in each of these categories as “state fund managers.” We administered the survey between February and April 2010. Ninety-one percent (or 138 of 151) of fund managers responded to our survey, with at least 1 fund manager from each of the 51 states providing responses. We also reviewed state laws and policies⁹ regarding investment of their Sudan-related assets.¹⁰

To identify the actions that investment companies took regarding their Sudan-related assets, we first had to identify foreign operating companies with business ties to Sudan as a way to isolate and track U.S. investors’ holdings in these companies. We obtained and compared three lists of such operating companies, including those that are widely used by states in determining whether and how to divest from Sudan. From these lists, we selected six operating companies that appeared on all three lists, including companies that have been targeted through public divestment campaigns, and have operations in Sudan’s oil sector, which plays a central role in that country’s economy. To analyze U.S. investment companies’ holdings in these six key foreign operating companies, as well as the stock prices of these companies, we used shareholder ownership and market data (purchased from Thomson Reuters). We also interviewed investment companies regarding Sudan-related assets. We identified these companies by selecting those that had spoken publicly about the issue of Sudan divestment, as well as by issuing an invitation through a large national association of investment companies to all of its

⁸We discovered 1 fund from our third population to be out of our scope because it was a municipal-run fund, not a state-run fund. The removal of this fund reduced our third population from 50 to 49 funds and our total population from 152 to 151 funds.

⁹For the purposes of this report, we use the term “policy” to refer to a written statement outlining actions or positions that a government entity intends to take.

¹⁰For the state treasuries and pension funds, our analysis is based primarily on equities, but also includes some debt. For the investment companies, our analysis is based exclusively on equities.

members.¹¹ Six investment companies agreed to speak with us, and one provided written answers anonymously from 31 of its sub-advisers. In addition, we interviewed eight foreign operating companies that have Sudan-related business operations or had previously operated in Sudan. We identified and contacted 22 companies that appeared on at least one of the lists we analyzed and represented a mix of both Western (primarily European) and Eastern (or Asian) companies. Nine agreed to speak with us, all of them Western.¹² Finally, we reviewed documents and interviewed agency officials from the SEC and the Departments of Justice, State, and Treasury. (States are required to submit written notice of divestment to the Department of Justice; investment companies seeking to rely upon the safe harbor provision of SADA are required to disclose their divestment in a filing with the SEC.) The SEC is responsible for overseeing the federal securities laws, which require public companies to disclose information about their operations, among other things, to investors. Through its Office of Global Security Risk, the SEC monitors operating companies' disclosure of material¹³ business activities in or with ties to state sponsors of terrorism and issues comments to these companies when appropriate. The Department of State oversees U.S. foreign policy toward Sudan, and the Department of the Treasury administers and enforces U.S. sanctions against Sudan.

To address the third objective, we searched the Federal Procurement Data System—Next Generation on March 2, 2010, to determine whether the U.S. government awarded federal contracts from June 12, 2008, to March 1, 2010, to foreign companies identified as having business ties to Sudan, as well as to some of their subsidiaries and affiliates. (We determined that this data system was sufficiently reliable for the purposes of our review because we did not need to identify the universe of contracts subject to SADA in order to complete our analysis.)¹⁴ We then selected the highest

¹¹According to this association, its members represent about 98 percent of all investment companies registered with the Securities and Exchange Commission (SEC).

¹²Ultimately, we spoke with only eight of these companies because the ninth company did not respond to our last communication attempting to schedule the meeting.

¹³The meaning of “material information” is not explicitly defined by law, but the Supreme Court has determined that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision or the information would significantly alter the total mix of available information.

¹⁴GAO has identified data reliability weaknesses in the Federal Procurement Data System. For example, see GAO, *Federal Contracting: Observations on the Government's Contracting Data Systems*, [GAO-09-1032T](#) (Washington D.C.: Sept. 29, 2009).

dollar amount contract or contract modification for each of the 31 companies we identified and, if the solicitation was issued on or after June 12, 2008—when the interim implementing regulations took effect—reviewed the solicitation or other relevant documentation for presence of the applicable Sudan-related certification clause.¹⁵ We also reviewed federal rules related to the requirement and interviewed U.S. officials at the Office of Management and Budget, the Department of the Treasury, and the General Services Administration.

We conducted this performance audit from August 2009 to June 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. (App. I provides a detailed discussion of our objectives, scope, and methodology.)

Results in Brief

U.S. state fund managers reported that, since 2006, they have divested or frozen¹⁶ about \$3.5 billion in assets primarily related to Sudan in response to their state laws and policies; U.S. investment companies, which also sold Sudan-related assets, most commonly cited normal business reasons for changes in their holdings. We found that, from 2006 to 2010, 23 states divested their assets from a total of 67 operating companies, with New Jersey's divestment of almost \$2.2 billion representing about 62 percent of the total. The fund managers responding to our survey who had divested or frozen or planned to divest or freeze their states' Sudan-related assets indicated that their primary reason for doing so was to comply with their states' laws or policies, rather than out of concern for the situation in Darfur. Thirty-five U.S. states have enacted legislation or implemented policies affecting investments related to Sudan, primarily in response to the Darfur crisis, as well as in response to Sudan's designation by the U.S. government as a state sponsor of terrorism. They also reflect a variety of approaches, such as mandating or encouraging divestment and prohibiting state contracts with certain companies that have business operations

¹⁵Our findings related to this analysis cannot be generalized to the entire universe of new contracts awarded to these companies since June 12, 2008.

¹⁶For the purposes of this report, freezing assets means withholding additional or new investments from one's current investments.

related to Sudan. Data indicate that U.S.-based investment companies have also reduced their Sudan-related holdings. Specifically, we determined that, from March 2007 to December 2009, the total value of U.S. shares invested in six key foreign companies with Sudan-related business operations declined by almost 60 percent. This decline cannot be accounted for solely by a reduction in stock prices for these companies, indicating that U.S. investors, on net, decided to sell shares in these companies. Most commonly, U.S. investment companies told us or reported that they bought and sold Sudan-related assets for normal business reasons, such as maximizing shareholder value consistent with the guidelines in each fund's prospectus, as well as in response to specific client instructions.

U.S. states and investment companies have often considered the following three factors when determining whether and how to divest from companies tied to Sudan:

- *Whether divesting from Sudan is consistent with fiduciary responsibility.*¹⁷ For example, of the 29 state fund managers responding to our survey who had divested or frozen their Sudan-related assets, or planned to do so, 17 (or 59 percent) said they were concerned to a moderate or large extent that “it would be difficult to divest while ensuring that fiduciary trust requirements were not breached and my office/state was not made vulnerable to law suits.” Private investment companies expressed differing views on their fiduciary duty in the context of Sudan-related divestment. Some expressed the view that taking social concerns into account when making investment decisions, rather than focusing on maximizing returns on investment, is inconsistent with fiduciary responsibility. Other companies, particularly those identifying themselves as socially responsible, expressed the view that divesting from Sudan is consistent with fiduciary responsibility, provided that the divested assets are placed in alternative investments that can compete financially. Despite the different views expressed on fiduciary responsibility in the context of divesting for social reasons, several investment companies told us that SADA’s safe harbor provision from lawsuits alleging breach of fiduciary duty was not necessary, either because they viewed divesting for social concerns as consistent with fiduciary responsibility or because they would

¹⁷State fiduciary law varies from state to state through state constitutions, statutes, and common law. However, for the purposes of this report, fiduciary responsibility is defined as the duty to act solely in the interest of a participant or beneficiary and for the exclusive purpose of providing benefits to the participant and beneficiary.

not characterize their decision to sell shares related to Sudan as divestment. As of May 2010, two investment companies have taken advantage of the safe harbor provision.

- *The difficulty in identifying authoritative and consistent information about companies with Sudan-related business operations.* Under SADA, states that divest from operating companies with business operations in Sudan must use credible information to identify those companies. However, there is no single, authoritative list of operating companies with business ties to Sudan, and the three lists we analyzed differed significantly from one another. Although information provided directly by companies is particularly useful to investors, companies' SEC disclosure filings do not consistently contain all information about their operations in Sudan because federal securities laws do not specifically require companies to report all activities in or ties to U.S.-designated state sponsors of terrorism, including Sudan. Although the SEC has the discretionary authority to request additional information from companies that trade on U.S. exchanges, it has not exercised this authority by adopting a specific disclosure requirement and has indicated that it is committed to the practice of relying on companies to ensure that their disclosures contain all material information about their operations in these countries.
- *The effect that divestment might have on operating companies with Sudan-related business activities.* Some advocates and investors have raised concerns that divestment campaigns can prompt companies interested in promoting corporate social responsibility to leave, creating room for companies that do not share that interest to enter the Sudanese market. As a result of this concern about divestment, some advocacy groups, as well as some U.S. states and investment companies, have increasingly focused on engaging with operating companies to improve their business practices. For example, they have written letters to or met with companies' senior management encouraging them to fund humanitarian programs that aid the Sudanese people, conduct human rights assessments of their business operations in Sudan, or pressure the Sudanese government to change its practices.

Our search of federal contract awards since June 12, 2008, as well as our review of a selection of contracts, indicates that the U.S. government has complied with SADA's federal contract prohibition provision. We determined that, of 88 companies identified on a widely used list of companies that have business ties to Sudan, only 1 has received federal contracts since the requirement took effect. However, because of the contract type, the Sudan-related certifications were not required for these

particular contracts, and therefore there was no violation of SADA. The U.S. government has contracted with subsidiaries and affiliates of companies with business ties to Sudan, as permitted under SADA. We found that all contracts that we selected for review complied with federal rules implementing SADA. We also found that no contracting agency has requested a waiver from the contract prohibition requirement. Such a waiver, if granted, would allow a company to obtain federal contracts even while conducting business operations in Sudan that are normally prohibited under SADA. Finally, we determined that no companies had been included on the list of contractors barred from federal contracting for falsely certifying that they did not conduct prohibited business operations in Sudan.

In order to enhance the investing public's access to information it needs to make well-informed decisions when determining whether and how to divest Sudan-related assets, we recommend that the SEC consider issuing a rule requiring companies that trade on U.S. exchanges to disclose their business operations related to Sudan, as well as possibly other state sponsors of terrorism.

The SEC's Division of Corporation Finance provided written comments on a draft of our report, which are reprinted in appendix IV. The Division of Corporation Finance agreed that it would present our recommendation to the commission for its consideration. However, the division expressed concern that adopting a disclosure requirement that is excessively broad and beyond what GAO recommends could possibly lead to a volume of information that would overwhelm the investor and possibly obscure other material information.

Background

Since gaining independence from Britain and Egypt in 1956, Sudan has endured civil war rooted in cultural and religious divides. The North, which has traditionally controlled the country, has sought to unify it along the lines of Arabism and Islam, whereas non-Muslims and other groups in the South have sought, among other things, greater autonomy. Since 1993, the Secretary of State has included Sudan on the "State Sponsors of Terrorism" list for harboring and supporting local and international terrorists. In 1997, the U.S. government imposed a trade embargo against the entire territory of Sudan and a total asset freeze against the Government of Sudan,¹⁸ and in 2006 it blocked the property and interests

¹⁸Executive Order 13067.

in property of certain persons connected with the conflict in Darfur,¹⁹ where militias supported by the Sudanese government led a “campaign of genocide” and forced displacement. The Department of the Treasury’s Office of Foreign Assets Control administers and enforces these sanctions in part through its Specially Designated Nationals list, which identifies individuals and companies owned or controlled by, or acting for or on behalf of, targeted countries, including Sudan.²⁰

As awareness of the Darfur conflict and the role of the Sudanese government in perpetuating the conflict grew, activists at U.S. colleges and universities and political officials at city and state levels in the United States initiated campaigns to encourage divestment from Sudan. This Sudan divestment movement was coordinated, in part, by the Sudan Divestment Task Force, a U.S.-based initiative established in 2005 and incorporated in 2006 as a project of the Genocide Intervention Network, a nonprofit organization based in Washington, D.C. This task force developed a divestment approach called “targeted” divestment, which aims to maximize impact on the Sudanese government and minimize potential harm to Sudanese civilians. It also created model legislation for use by U.S. states based on this approach.

SADA, enacted in December 2007, appears to incorporate many of the elements of this targeted divestment approach. For example, SADA applies to companies operating in four key economic sectors—power production, mineral extraction, oil-related activities, and production of military equipment—and outlines several exceptions to operations in these sectors. Specifically, it exempts business operations that

- are conducted under contract directly and exclusively with the regional government of southern Sudan [which is autonomous from the Khartoum-based government of Sudan];
- are conducted under a license from the Department of the Treasury’s Office of Foreign Assets Control or are expressly exempted under federal law from the requirement to be conducted under such a license;

¹⁹Executive Order 13400.

²⁰It also lists individuals, groups, and entities, such as terrorists and narcotics traffickers designated under programs that are not country specific. Collectively, these individuals’ assets are blocked and U.S. persons are generally prohibited from dealing with them.

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- consist of providing goods or services to marginalized populations of Sudan;
 - consist of providing goods or services to an internationally recognized peacekeeping force or humanitarian organization;
 - consist of providing goods or services that are used only to promote health or education; or
 - have been voluntarily suspended.

In addition, business operations in the oil sector are exempted if the company is involved in the retail sale of gasoline or related consumer products in Sudan but is not involved in any other oil-related activity, or if the company is involved in leasing, or owns, rights to an oil block in Sudan but is not involved in any other oil-related activity. For the purposes of this report, the term “prohibited business operations” refers to business operations in Sudan in the sectors of oil, power production, mineral extraction and production of military equipment, provided that they do not qualify for one of the exceptions listed above.

Under SADA, the SEC was directed to prescribe regulations that require disclosure by each registered investment company that divests itself of securities in accordance with SADA. Under the SEC’s regulations, investment companies seeking to rely upon the safe harbor provision of SADA must disclose the divestment on their next form N-CSR or form N-SAR²¹ that it files following the divestment.²² The information disclosed must include, among other things, the specific securities divested, the magnitude of divestment, and the dates that the securities were divested. In addition, if the investment company continues to hold any securities of the company from which it divested, it will be required to disclose, among other things, the total number of shares or, for debt securities, the principal amount of such securities, held on the date of filing.

²¹The N-CSR filing is the certified shareholder report of registered management investment companies. The N-SAR filing is the semi-annual report for registered management companies.

²²73 Fed. Reg. 23328, 23330 (Apr. 30, 2008).

U.S. State Fund Managers and Investment Companies Have Sold Sudan-related Assets for Varying Reasons

Our survey responses show that state fund managers have divested or frozen about \$3.5 billion in assets primarily related to Sudan in response to their states' laws and policies. The value of U.S. investment companies' Sudan-related asset holdings has declined considerably since March 2007, and companies told us that their decisions regarding these shares were motivated primarily by normal business reasons.

State Fund Managers Reported That They Have Divested or Frozen about \$3.5 Billion in Assets Primarily Related to Sudan in Response to Their States' Laws and Policies

Fund managers from 23 of the states responding to our survey reported that, from 2006 to January 2010, they divested or froze almost \$3.5 billion in assets held in 67 operating companies they identified as related either to Sudan specifically or to a larger category of divestment targets, such as state sponsors of terrorism. New Jersey accounted for almost \$2.2 billion, or about 62 percent, of this total. (See table 1.) Illinois was 1 of the 23 states that reported divesting or freezing its Sudan-related assets, but it did not provide the value or dates of these actions.

Table 1: Total Sudan-related Assets Divested or Frozen by States, 2006 to January 2010

State	Total amount divested or frozen	Earliest divestment or freezing action	Most recent divestment or freezing action
New Jersey	\$2,162,564,000	^a	May 2006
Oregon	362,000,000	2006	2009
Texas	225,990,790	October 2008	January 2009
Massachusetts	164,489,806	March 2008	March 2008
Florida ^b	154,947,926	April 2008	July 2008
California	81,739,949	May 2006	September 2008
Colorado	76,066,122	July 2007	January 2010
Indiana ^b	67,203,695	December 2008	December 2009
Maryland ^b	35,430,790	September 2007	April 2008
Michigan ^b	24,332,285	May 2009	December 2009
Maine ^c	21,500,000	April 2006	June 2009
Connecticut ^b	15,388,947	May 2007	September 2009
Kansas	13,378,022	^a	June 2008
Hawaii	13,288,052	February 2008	December 2008
New York ^b	12,300,000	June 2009	June 2009

State	Total amount divested or frozen	Earliest divestment or freezing action	Most recent divestment or freezing action
New Mexico	12,000,000	^a	January 2008
Iowa	10,576,749	October 2007	October 2008
New Hampshire	5,636,966	September 2008	March 2009
Ohio ^b	2,341,595	November 2009	November 2009
Minnesota	1,012,038	January 2008	April 2009
Pennsylvania	945,247	January 2008	January 2008
Arizona ^b	727,480	November 2009	November 2009
Total^d	\$3,463,860,458		

Source: GAO's survey of states and public state investment reports.

^aStates with no entry for "earliest date" did not provide us with this information.

^bThe state has a law or policy, which either focuses on both Sudan and Iran or targets state sponsors of terrorism.

^cMaine's law on Sudan-related investments, enacted in 2005, expired July 1, 2009.

^dThis total reflects the amounts divested or frozen as reported in responses to our survey or in public documents. There may be additional fund managers whose funds were not included in our survey population or who divested but did not respond to our survey.

All of the states that reported having divested or frozen Sudan-related assets had laws or policies regarding their Sudan-related assets, and the state fund managers who responded to our survey cited compliance with these laws and policies as their primary reason for divestment. In response to our survey, 29 fund managers from 23 states²³ reported that they had divested or frozen their Sudan-related assets or planned to do so. Nineteen of these fund managers said they were required to divest by their state's law or policy; eight said they were not required to divest.²⁴ When asked in our survey to consider various possible reasons for divesting and characterize them as major, moderate, or minor reasons, all of the fund managers responding to these questions who indicated they were required to divest cited their state's requirement as a major reason for divesting. In comparison, only two of the managers who indicated they were required to divest said they divested in order to reduce the financial risk their fund was exposed to, and only seven said that concerns about supporting

²³There are more fund managers than states because the pension holdings in some states are contained in several funds managed by different individuals.

²⁴Two of the 29 fund managers who indicated that they had divested or frozen their Sudan-related assets or planned to do so did not respond to our questions about the reasons for their divestment.

genocide or supporting state sponsors of terrorism were a major or moderate consideration when divesting.

35 States Have Enacted Laws or Adopted Policies Affecting Sudan-Related Investments, Largely out of Concern Regarding Darfur

Thirty-five U.S. states have enacted legislation, adopted policies, or both affecting their Sudan-related investments.²⁵ Specifically, 26 states have current legislation that affects their Sudan-related investments, and 9 states without Sudan-related legislation have policies regarding Sudan-related investments.²⁶ In three of the states with such legislation, individual funds not covered by the legislation also issued their own policies affecting their Sudan-related investments. For example, Indiana's law requires the Teachers Retirement Fund and the Public Employees Retirement Fund (both overseen by the governor) to divest from Sudan-related companies. In addition, the Indiana state treasurer issued a policy statement prohibiting all state funds under the treasurer's management (such as the State Police Pension Fund) from investing in any debt issued by a state sponsor of terrorism.

The 35 states that enacted or adopted these laws and policies did so often out of concern for the genocide in Darfur, as well as some concerns about terrorism. Specifically, 29 states' laws or policies identify the genocide in Darfur (or in Sudan) as a finding in enacting the measure or say that the measure may expire or cease to be effective after the genocide in Darfur has halted.²⁷ For example, California's law requiring divestment from companies with Sudan-related business operations states that the law will remain in effect until "the government of Sudan halts the genocide in Darfur for 12 months as determined by both the Department of State and the Congress of the United States" or until "the United States revokes its current sanctions against Sudan." Some states, including some that target Sudan, have laws or policies that target countries or entities due to

²⁵Some state fund managers reported having issued policy guidance regarding how state law affects their funds. While we consulted these policies when necessary, we focused our analysis on state laws and non-legislative policies because the legislative policies generally reflected the state laws.

²⁶One additional state had a law that expired. Maine enacted legislation in 2005, which expired in July 2009. Fifteen states considered but failed to pass bills related to Sudan and Sudan-related investments.

²⁷Maryland's law states that, notwithstanding any other provisions, the act may not be applied to certain investments or divestment actions if the U.S. Congress or President affirmatively declare, among other things, that the government of Sudan has ceased attacks on civilians.

terrorism concerns. For example, Colorado’s law requiring Sudan divestment by public pension plans begins with eight declarations regarding Darfur, genocide, and human rights abuse.²⁸ The law then cites concerns about U.S. sanctions against Sudan and the designation of Sudan as a state sponsor of terrorism in 1993, as well as a statement regarding the “financial risk posed by investments in companies doing business with a terrorist-sponsoring state.” In contrast, Pennsylvania’s Treasurer’s policy does not mention Sudan specifically, but requires the state treasurer to “determine whether a company in which it is considering investing, or a company in which it already holds a position, is doing sufficient business—directly, or through contractual or ownership interests—in or with a state sponsor of terrorism.” Six states have laws or policies that target both Sudan and Iran. In addition, a few states have laws or policies focusing on companies identified by the U.S. Department of the Treasury’s Office of Foreign Assets Control in its list related to sanctions, or the Department of State’s list of Foreign Terrorist Organizations.²⁹

The 35 states’ laws and policies we identified vary in the specificity with which they address the sale and purchase of Sudan-related assets. For example, only one law explicitly defines “divestment action,”³⁰ while most of the laws describe only the actions required to achieve divestment. In addition, two laws state that a “public fund shall sell, redeem, divest or withdraw all publicly traded securities of the company” on their “scrutinized companies list,” with certain exceptions. Other laws simply state that the public fund in question “shall divest” from or “shall not be

²⁸ Arizona targets Sudan specifically but also targets all state sponsors of terrorism. The District of Columbia and Maryland have laws mandating divestment from Sudan- and Iran-related companies. Florida and Louisiana have laws requiring some of their public retirement systems to offer a terror-free index fund option to their retirees. Georgia targets “any corporation that is included in the terrorism sanctions issued by the Office of Foreign Assets Control of the United States Department of the Treasury.”

²⁹ According to the Department of State, this list identifies foreign organizations that the U.S. government has determined engage in terrorist activity, as defined in section 212 (a)(3)(B) of the INA (8 U.S.C. § 1182(a)(3)(B)), or terrorism, as defined in section 140(d)(2) of the Foreign Relations Authorization Act, Fiscal Years 1988 and 1989 (22 U.S.C. § 2656f(d)(2)), or that retain the capability and intent to engage in terrorist activity or terrorism. In addition, the organizations’ terrorist activities or terrorism must threaten the security of U.S. nationals or the national security (national defense, foreign relations, or the economic interests) of the United States.

³⁰ Maryland state code, Division II, Title 21, Subtitle 1, says “divestment action” means “selling, redeeming, transferring, exchanging, otherwise disposing of, and refraining from further investment in certain investments.”

invested in” companies with ties to Sudan. Most states with laws and policies requiring divestment also prohibit or restrict future investments in Sudan-related companies. However, some laws and policies only mention prohibiting future investments but do not require divestment of Sudan-related investments held prior to enactment of the measures.

In addition to divestment, many state laws and policies also mandate or encourage engagement—identifying companies and leveraging power as a shareholder or potential shareholder in an effort to change the investment or operating behavior of that company. Notably, most states that require or encourage divestment also require or encourage the state funds to communicate with companies prior to divesting. Eight laws state that if, after a certain number of days following a public fund’s first engagement with a company, the company continues to have scrutinized active business operations a “public fund shall sell, redeem, divest or withdraw all publicly traded securities of the company” on their “scrutinized companies list,” with certain exceptions.³¹ Arizona’s law requires the public fund to review the list of companies it invests in directly and identify those companies that may have both business in specific sectors and ties to Sudan. The public fund must put the identified companies on a “scrutinized companies” list and send a written notice informing the company of its scrutinized status and that it may become subject to divestment by the fund. If the company fails to respond with information about its activities or does not cease its scrutinized business operations within 180 days, the fund “shall sell, redeem, divest or withdraw all publicly traded securities of the company.” Finally, a limited number of states prohibit state contracting with companies operating in Sudan.³² Table 2 outlines the laws and policies in effect with regard to Sudan-related investments in 35 states.

³¹This wording is used in the state codes of Arizona, Colorado, Florida, Hawaii, Massachusetts, New Hampshire, North Carolina, and Rhode Island.

³²These states include Arizona, California, Georgia, and Utah. Although Utah has a law that prohibits state contracts, it does not appear in table 2 because it does not have any laws or policies specifically regarding investment of Sudan-related assets.

Table 2: State Laws and Policies Regarding Sudan-related Assets Effective as of April 2010

	State	Has law(s)	Has non-legislative policy	Requires engagement	Requires divestment	Encourages engagement	Encourages divestment	Prohibits future direct investment	Prohibits state contracts with firms operating in Sudan
1.	Arizona	•		•	•			•	•
2.	California	•		•	•			• ^a	•
3.	Colorado	•		•	•			•	
4.	Connecticut	•		•	• ^b		• ^b	• ^b	
5.	District of Columbia	•		•	•			•	
6.	Florida	• ^c		•	•			•	
7.	Georgia	•						•	•
8.	Hawaii	•		•	•			•	
9.	Illinois	•			•			•	
10.	Indiana	•	•	• ^d	• ^d			• ^d	
11.	Iowa	•		•	•			•	
12.	Kansas	•		•	•			•	
13.	Louisiana	• ^c							
14.	Maryland	•		•	•			•	
15.	Massachusetts	•			•	•		•	
16.	Michigan	•	•	• ^e	• ^e		• ^e	• ^e	
17.	Minnesota	•		•	•			•	
18.	New Hampshire	•		•	•			•	
19.	New Jersey	•			•			•	
20.	North Carolina	•		•	•			•	
21.	Ohio	•		•	•				
22.	Oregon	•		•			•	•	
23.	Rhode Island	•		•	•			•	
24.	South Carolina	•	•		• ^f			• ^f	
25.	Tennessee	• ^g							
26.	Texas	•		•	•			•	
27.	Missouri		• ^h						
28.	Nevada		•		•			•	
29.	New Mexico		•		•			•	
30.	New York		•	•			•		

State	Has law(s)	Has non-legislative policy	Requires engagement	Requires divestment	Encourages engagement	Encourages divestment	Prohibits future direct investment	Prohibits state contracts with firms operating in Sudan
31. Pennsylvania		•	• ⁱ		• ⁱ	• ⁱ		
32. Vermont		•				•	•	
33. Washington		•			•	•		
34. Wisconsin		• ^j			• ^j			
35. Wyoming		•		•			•	
35 Total States Affected	26	12	21	25	4	7	27	3

Source: GAO analysis of state legislation, policies, and survey responses.

Notes: We believe our review of states' laws and policies and survey responses from relevant state officials provides a reasonable basis for the numbers in the table. The vague language in some states' laws and policies, as well as their interpretation as indicated by some state officials' survey responses, can impact the conclusion about whether a law or policy contains a provision that falls within one of the designated categories.

These laws and policies affect different funds within each state (e.g., some affect the state treasurers' assets; others affect the state investment boards' assets; and others affect multiple funds). The chart summarizes the approaches taken by the various laws and policies that are in effect in each state, since several states, including Arizona, California, Florida, Illinois, Indiana, Michigan, South Carolina, and Pennsylvania, have more than one law or policy.

^aIn addition, California's law regarding the University of California system indemnifies the regents and other officials and employees of the University of California for decisions not to invest in the future.

^bWhile Connecticut law mandates divestment from government of Sudan-owned debt and securities and prohibits future direct investment in these assets, it only encourages (but does not require) divestment from Sudan-related companies and recommends avoiding future direct investment in them.

^cIn addition, Florida's laws require that the Municipal Police Pensions, the Public Employee Optional Retirement Plan, and the Firefighter Pensions create a terror-free index. Louisiana's law requires public funds to invest an unspecified portion of their assets in a similar terror-free index.

^dWhile Indiana's Public Retirement and Disabilities Benefits law requires engagement and divestment and prohibits future direct investment, the Indiana treasurer's policy only prohibits future investment.

^eWhile Michigan's law requires the public employee retirement system authorities to engage and divest, the Municipal Employees Retirement System's policy does not mention engagement, and encourages divestment and the prohibition of future direct investment.

^fBoth South Carolina's Retirement System law and Investment Commission policy prohibit future direct investment. While the law requires divestment, the policy does not mention divestment.

^gTennessee's law requires the treasurer to monitor the state's holdings related to state sponsors of terrorism and report them to the Council on Pensions and Insurance, but does not mention any further action.

^hAccording to a Missouri State Employee Retirement System official, if they receive a list of terrorist-sponsoring companies from a federal agency, they are obligated to divest in accordance with their policy.

ⁱA Pennsylvania Public School Employees Retirement Board resolution mandates engagement and another encourages divestment. The Pennsylvania Treasury's policy encourages engagement first. If engagement does not elicit an acceptable response, Treasury will consider either making no new investments or pursuing divestment consistent with sound investment practice.

^jWisconsin's Investment Board policy "opposes divestment, whether total or targeted." The policy encourages engagement and the sale of assets based on "risk and economic factors."

The Value of U.S. Investment Companies' Sudan-related Asset Holdings Has Declined Considerably since March 2007; Investment Companies Cited Normal Business Reasons as Their Motivation for Buying or Selling These Assets

Our analysis shows that U.S.-based investment companies have sold some or all of their Sudan-related shares in six key foreign companies with Sudan-related business operations. Specifically, we found that U.S. holdings in these six companies fell from \$14.4 billion at the end of March 2007 to \$5.9 billion at the end of December 2009, a decline of nearly 60 percent. The number of investors holding these assets also declined, from 303 in March 2007 to 272 in December 2009, a 10 percent drop. While hundreds of U.S. investors have held shares in these six companies, 80 percent of the value of these shares, on average, has been held by the top 20 investors.³³

This decline of nearly 60 percent in the value of Sudan-related shares held cannot be accounted for solely by changes in share prices, indicating that U.S. investors, on net, chose to sell shares in these companies. In order to determine whether the decline in value of Sudan-related equities was due solely to fluctuations in the market value of shares we constructed price indices for the U.S. holdings. Any decline in the value of the Sudan-related holdings not explained by a decline in prices indicates selling, on net, of Sudan-related equities. We constructed three different price indices using three standard methods to estimate changes in prices.³⁴ All three price indices indicate that U.S. investors, on net, sold shares of Sudan-related companies. Based on the price index weighted to the U.S. portfolio of Sudan-related equities, prices rose by roughly 7 percent from March 2007 to December 2009, while equity holdings fell by nearly 60 percent (see fig. 1). This suggests that net selling of Sudan-related equities explains the majority of the decline in U.S. holdings. However, it is not certain if this selling is related to conditions specific to Sudan or represents a more general reallocation of assets by U.S. investors.³⁵ Nevertheless, some

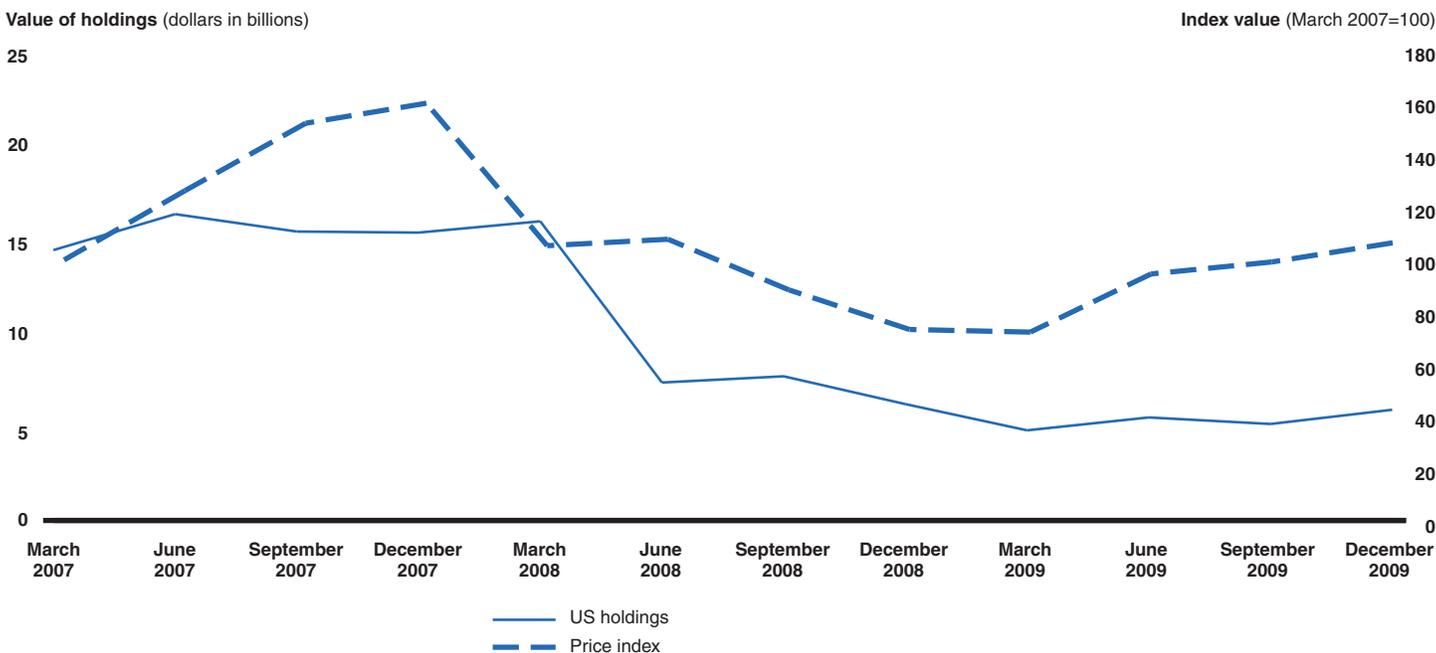
³³Many of the same investment companies have appeared frequently in the group of top 20 investors from March 2007 to December 2009. For example, 15 firms appeared in more than half of the 12 financial quarters during this time period, including 4 that were in the top 20 for each of the 12 quarters.

³⁴The three index types we chose were based on standard price index methods used to aggregate many prices into a single index value: a capitalization weighted index, a LasPeyres index, and a Paasche index. Using Thomson Reuters Datastream (a financial database that includes global equity markets), we were able to identify price and market value data for 18 securities (corresponding to five different companies) that we used to calculate our price indices. See app. II for more information on our price index methodology.

³⁵To construct a control or comparison group would require more frequent and timely data than were readily available.

evidence suggests that Sudan-specific factors may have influenced investors' decisions to sell. Specifically, from December 2007 to December 2008, U.S. holdings in Sudan-related equities declined as a percentage of foreign oil and gas equity holdings (the proportion fell from 3.4 percent to 2.3 percent) and as a percentage of all foreign equity holdings (the proportion fell from 0.3 percent to 0.2 percent).

Figure 1: U.S. Holdings and Prices of Sudan-related Companies, March 2007 to December 2009



Source: GAO analysis of Thomson Reuters data.

Investors said they weighed various factors in their decisions regarding their Sudan-related assets.³⁶ We interviewed or obtained information from 37 institutional advisers on their views regarding Sudan-related assets. Most commonly, investors stated that they bought and sold Sudan-related assets for normal business reasons, such as maximizing shareholder value consistent with the guidelines in each fund's prospectus, as well as in response to specific client instructions. In the process of assessing an

³⁶Some investors we interviewed did not directly hold Sudan-related assets because, as self-designated socially responsible investment companies, they screen out these assets or because the nature of the funds they managed precluded the inclusion of Sudan-related assets.

investment, “normal business reasons” could incorporate, as appropriate, information related to the target company’s environmental, social, governance, and other practices.

Each of the investment companies we interviewed issued a corporate statement regarding Sudan-related investing, and these corporate statements reflect a variety of investor perspectives.³⁷ For example, one firm’s corporate statement observed that “The situation in Darfur is the most urgent human rights and humanitarian crisis in the world right now...and we resolved to make the most appropriate contribution we could—above and beyond ensuring that our own funds do not invest in companies materially involved in Sudan.” Another company’s statement expressed its sensitivity to the ongoing tragedy in Darfur and respected the request by some investors to divest holdings in companies that have Sudan-related activities as one way to bring pressure to bear on the Sudanese government. This company, however, explained that “when it is appropriate to remain actively invested in a company, we will do so, thus retaining the ability to oppose company practices that we do not condone. This, in the long term, may have the greatest chance of ending those practices.”

Only one investment company we spoke with indicated that it was considering the sale of its Sudan-related assets for socially-motivated reasons. Specifically, this company stated that it would pressure companies that maintain business relations with the Sudanese government to cease those relations or to attempt to end genocide and ease suffering in Darfur. It would divest from these companies if they failed to take meaningful steps to respect human rights within a reasonable amount of time.³⁸ Another investment company issued a public statement regarding its sale of shares in a specific company with business ties to Sudan saying that it “sold shares based on valuation, reputational, and commodity risk.” This company also decided to exclude certain companies from future investments because they posed high risk due to their ties to the Sudanese government and its connection to human rights abuses. Other investment

³⁷One investment company’s policy was not Sudan-specific, but more generally worded regarding social concerns and investing.

³⁸Data indicate that, as of April 22, 2010, this firm sold its shares of three of the companies it identified as having business relations with the Sudanese government. This firm decided to retain or increase its shares in another company it had identified because it said that this company was receptive to its efforts to encourage the company to improve its business practices in Sudan.

companies similarly expressed the view that their investment processes (or financial assessments) consider all risk factors relevant to a company's long-term sustainability, including those related to social and political issues, though this may or may not result in the sale of Sudan-related assets.

U.S. Investors Have Often Considered Three Factors When Determining Whether and How to Divest from Companies Tied to Sudan

Investors we contacted (including both state fund managers and private investment companies) told us they consider whether a decision to divest Sudan-related assets is consistent with fiduciary responsibility—generally the duty to act solely and prudently in the best interest of the client.³⁹ These investors, particularly state fund managers, have also faced challenges in identifying which foreign companies have business ties to Sudan and may warrant divestment. Finally, investors we spoke with have taken into account the effects of divestment on foreign operating companies with business ties to Sudan.

Investors Weighing Sudan Divestment Options Have Considered Their Fiduciary Responsibilities

State Fund Managers Responsible for Sudan Divestment Have Been Concerned about Fiduciary Responsibility

Representatives from organizations that advocate for the interests of state fund managers told us that fiduciary duty could be a disincentive to divesting but that it depends on how each individual state's law is written. For instance, they expressed concerns that if the laws place emphasis on maximizing returns first and on divesting as a secondary priority, then fiduciary responsibility can be a disincentive to divesting.⁴⁰ While some states make no explicit mention of fiduciary responsibility in their divestment policies and laws, some state constitutions describe this responsibility and emphasize its priority above all other responsibilities. For example, California's state constitution says the retirement board of

³⁹Managers of state investment funds are generally responsible for meeting the duties established by applicable state law. Fiduciary responsibilities for other investment fund managers may be established by the underlying investment fund documents and applicable law, including common law.

⁴⁰State fiduciary law varies from state to state. Therefore, we did not make any broad generalization regarding these laws.

public pension systems must maximize benefits and minimize employer contributions and administrative costs, concluding that “a retirement board’s duty to its participants and their beneficiaries shall take precedence over any other duty.” In 2009, the New Hampshire Retirement Plan and the New Hampshire Judicial Retirement System sued the state, arguing that complying with the state’s Sudan divestment legislation would have been inconsistent with their fiduciary trust obligations under the state constitution.⁴¹

State policies vary in how they characterize fund managers’ fiduciary responsibilities in divesting Sudan-related assets. For example, the State of Wisconsin Investment Board’s Sudan-related policy describes its fiduciary responsibility as the duty to “invest in the best financial interest of the trust funds it manages” and concludes that “this means that the [board] may not make investments based on political, social, or personal reasons.”⁴² In contrast, the Washington State Investment Board’s policy states that its “fiduciary responsibilities include watching for potential impacts on the valuations of its investments that may result from reputational risks to the companies in which the [board] invests that may flow from companies doing business in Sudan.” In addition, the Vermont Pension Investment Committee determined that it would be prudent to refrain from investing in certain companies identified as having prohibited business operations in Sudan because the value of its portfolio could suffer if it continued to hold these securities while other investors took affirmative action to sell them.

Many state laws allow fund managers to stop divesting or to reinvest if there is a drop in the fund’s value. For example, under Hawaii law, the board of trustees of the state employees’ retirement system can stop divesting from and reinvest in scrutinized companies if, in the board’s good faith judgment, the value of the assets managed by the board drops 50 basis points (or 0.5 percent). Additional states that have laws with a 50 basis point threshold for ceasing divestment and reinvesting include Colorado, the District of Columbia, and Indiana. Other states have similar

⁴¹The Board of Trustees of the New Hampshire Judicial Retirement Plan and the New Hampshire Retirement System v. Gardner, New Hampshire Supreme Court (No. 2009-0621). This case was still pending as of May 11, 2010.

⁴²While the Wisconsin Investment Board concluded that it is against “total or targeted” divestment, it screens each investment related to Sudan, engages with companies, and reserves the right to sell Sudan-related investments depending on the estimated cost of the sale versus the risk-related cost of keeping the investment.

provisions with lower thresholds. For example, under Arizona law, the threshold is 25 basis points.⁴³

While most of the 35 states' Sudan-related measures generally require divestment of Sudan-related assets consistent with the investing authority's fiduciary responsibilities, laws and policies enacted or implemented by 6 states—California, Hawaii, Kansas, Maryland, Ohio, and South Carolina—include clauses explicitly stating that the investing authority should only divest if doing so will not constitute a breach of fiduciary trust. For example, Kansas's law states that, "Nothing in this section shall require the board to take action...unless the board determines, in good faith, that the action...is consistent with the fiduciary responsibilities of the board..." Notably, some fund managers responding to our survey indicated that they believed their fiduciary responsibilities allowed them not to divest, even though their laws and policies did not include provisions specifically exempting them from divestment requirements.

Our survey results demonstrate that state fund managers, when expressing concerns about fiduciary responsibility, focused on the impact that divestment might have on a fund's returns and administrative costs. Respondents who divested and those who did not frequently cited fiduciary responsibility as a concern. Specifically, 17 of the 29 fund managers (or 59 percent) who had divested or frozen their Sudan-related assets, or planned to do so, said they were concerned to a moderate or large extent that "it would be difficult to divest while ensuring that fiduciary trust requirements were not breached and my office/state was not made vulnerable to law suits." This same concern was also cited as a moderate to large concern for 25 of the 41 (or 61 percent) fund managers who did not divest. In contrast, only 5 of the 29 (17 percent) managers who divested or planned to divest and 3 of the 41 (7 percent) who did not divest were concerned to a large or moderate extent that divesting might force an operating company out of the Sudanese market, leaving room for one with more questionable business practices.

⁴³ Furthermore, many state laws allow for alternative Sudan-free investments to replace any investments in Sudan-related companies. For example, California law allows investment of public employee retirement funds in an "alternative fund or account" which excludes the targeted Sudan-related companies. If the state's public employee retirement fund's board determines that the new investment fund or account is "financially equivalent" to the existing fund or account, then the board may transfer its investments from the existing fund or account to the new fund or account.

Survey results also showed concern among state fund managers, regardless of whether they divested, regarding the financial risk of divesting. Specifically, 20 of the 29 managers (or 69 percent) who divested or planned to divest and 18 of the 41 (44 percent) who did not divest were concerned to a large or moderate extent that divestment could cause their funds to incur high transaction costs, earn reduced returns on investment, or both. Finally, only 4 of the 29 fund managers (14 percent) who divested or planned to divest said that reducing the exposure of their funds' investments to financial risk was a major reason for divestment. (Two more managers said it was a minor or moderate reason.) Likewise, only 3 of the 29 (10 percent) said divestment would improve returns on their offices' investments.

Although fiduciary responsibility was the primary concern for state fund managers in considering divestment, only a few managers responded that they took advantage of applicable state laws or policy provisions explicitly allowing them not to divest if they determined that doing so would conflict with their fiduciary responsibility. Specifically, only 4 of the 41⁴⁴ fund managers who did not divest or freeze any of their Sudan-related assets said their state had a law or policy containing such an explicit provision. Eleven fund managers who divested did so even though they said their state's law or policy contained such an explicit provision.

Investment Companies
Expressed Differing
Perspectives on Their Fiduciary
Responsibilities, Based on
Their Institutional Focus and
Investment Approach

Private investment companies expressed differing perspectives on whether divesting from Sudan is consistent with their fiduciary responsibilities. The investment companies we interviewed or obtained information from generally explained fiduciary responsibility to mean making investment decisions in the best interests of their clients, consistent with the guidelines in their funds' published prospectuses. However, investment companies' determination as to what constitutes the best interest of the client differs, depending on their investment approach.

According to investment companies whose primary goal is maximizing returns, ceasing to invest in companies with Sudan-related operations based on criteria other than financial merit is inconsistent with their fiduciary responsibilities, unless their clients established these restrictions. Some of these investors stated that limiting the number of investment opportunities based on non-financial criteria can result in

⁴⁴This number does not include those respondents who said they had no Sudan-related assets to divest.

lower investment returns. These firms indicated that they may take factors, such as a company’s environmental, social, and corporate governance standards, into account in order to assess the financial strength of that company as a possible investment. The results of these firms’ financial analyses of these risk factors vary. For example, several investment companies cited Sudan-related risk factors in their decisions to remove select securities from their portfolios. Others evaluated the risks and chose to continue to hold or increase their Sudan-related asset holdings.

Other investment companies, particularly those identifying themselves as socially responsible, maintained that divesting from Sudan based on non-financial criteria is consistent with fiduciary responsibility, as long as alternative equities selected can compete on the basis of financial criteria.⁴⁵ According to these investment companies, creating financially viable investment options that respond to social concerns, such as genocide or the environment, is the primary goal. As one firm’s prospectus explains, “socially responsible investors seek to use their investments to create a more fair and sustainable world...and encourage greater corporate responsibility.” Another’s prospectus states that it seeks to invest in companies and other enterprises that demonstrate positive environmental, social and governance performance as they address corporate responsibility and sustainability challenges. The self-designated socially responsible investment companies we interviewed typically described a two-part process for selecting investments—screening them according to their particular fund’s social criteria and evaluating investments for their financial soundness. These firms also expressed confidence that taking non-financial factors into account results in an investment product that is competitive with other investments.

⁴⁵For example, SADA incorporates 29 C.F.R § 2509.94-1, which is the Department of Labor’s “Interpretive Bulletin relating to the fiduciary standard under ERISA [the Employee Retirement Income Security Act] in considering economically targeted investment.” This guidance states that the fiduciary standards applicable to economically targeted investments, which would include Sudan divestment activities under SADA, are no different than the standards applicable to plan investments generally. Under this guidance, fiduciaries may generally take social issues into account as long as the alternative investments are not expected “to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or [to be] riskier than alternative available investments with commensurate rates of return.” The Department of Labor has issued more recent guidance (see 29 C.F.R. § 2509.08-1). However, 29 C.F.R. § 2509.94-1 remains applicable to ERISA plan divestments made under SADA.

As of May 2010, two companies that sold their Sudan-related assets had relied upon SADA's "safe harbor" provision by filing disclosures of such divestments with the SEC. Most companies told us that this provision, which limits the civil, criminal, and administrative actions that may be brought against firms that divest from, or avoid investing in, companies with prohibited business operations in Sudan, was not necessary to their decision-making regarding Sudan-related assets.

U.S. Investors Have Faced Difficulties Identifying Operating Companies with Ties to Sudan, including Those Monitored by the SEC

States Have Relied Heavily on Nongovernmental and Private Lists of Companies with Business Ties to Sudan, Which Often Conflict

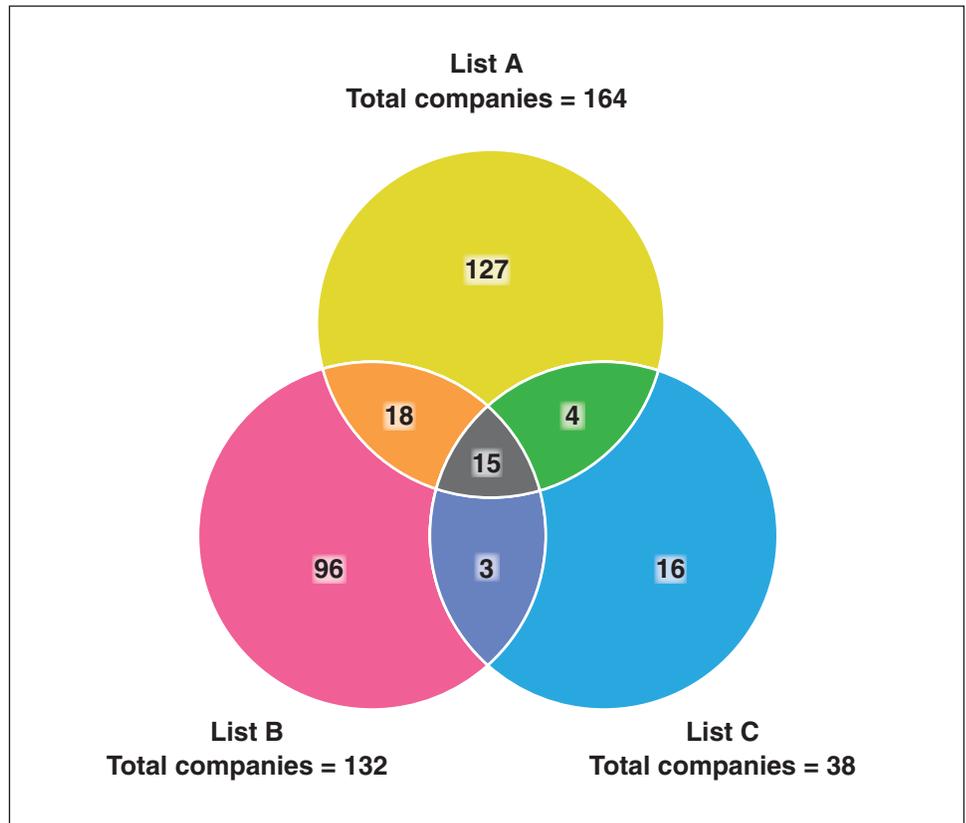
SADA requires that, before divesting from Sudan-related companies, responsible entities must use credible, publicly available information to identify which companies have prohibited business operations related to Sudan. Nongovernmental organizations and private companies have sought to create and, in some cases, sell their lists of operating companies with business ties to Sudan to the public. Our survey results indicate that state treasurers and public pension fund managers have relied heavily on these sources of information to identify companies with ties to Sudan. For example, 42 out of 61 fund managers (or 69 percent) who attempted to identify companies with ties to Sudan used private research firms and 48 out of 61 fund managers (or 79 percent) used nongovernmental advocacy organizations. Thirty-two of the 42 fund managers (or 76 percent) who used private research firms found them to be "very useful" or "useful." Similarly, 32 of the 48 fund managers (or 67 percent) who consulted nongovernmental groups found them to be "very useful" or "useful." However, some fund managers, even those that considered the sources they consulted to be sufficient or somewhat sufficient for identifying companies tied to Sudan, also reported concerns with the lists. For example, one treasurer stated that "Commercial sources of information are only moderately reliable. We are never confident that we are receiving complete and accurate information on companies in emerging markets." Another respondent noted that "Information was dated, not current or incomplete. Information also was often misleading as to the effect of the company's involvement." Finally, one respondent concluded that "It is difficult for anyone to get accurate information in this regard. Our sources did as well as possible."

These concerns have been echoed in other public statements. For example, in 2005, representatives from 50 public employee retirement systems wrote to the Departments of State, Treasury, and Commerce, as well as the SEC, requesting assistance in identifying any publicly traded companies that are of concern to the U.S. government. Specifically, they cited a need for adequate information to determine whether companies in which their funds are invested are doing business in Sudan so that they can make informed investment decisions.⁴⁶ In addition, the Pennsylvania Public Employee Retirement Commission observed in an October 2007 report that the cost of monitoring investment in companies tied to Sudan is “compounded by the fact that no governmental agency provides a list of such companies and the pension systems are compelled to purchase that service from private contractors, thereby delegating substantial administrative discretion.”

Our analysis of available lists indicates that they differ significantly from one another. We compared three lists of companies with business ties to Sudan—one from a widely-used nongovernmental organization, one from a widely-used private research company, and one from an investment company that has designated itself as socially responsible. We found that, of the over 250 companies identified on one or more of these lists, only 15 appeared on all three. Figure 2 illustrates the extent to which these lists differ from one another.

⁴⁶In June 2007, the SEC experimented with a Web site to provide direct access to public companies’ 2006 annual report disclosures concerning past, current, or anticipated business activities in state sponsors of terrorism, including Sudan. The SEC indefinitely suspended the site after 1 month, citing concerns about the timeliness of data contained in the disclosures, as well as the possible negative connotation that could attach to a company, even though the company’s disclosures may have concerned benign activities. See 72 Fed. Reg. 65862 (Nov. 23, 2007). Other U.S. agencies have declined to publish lists of companies with business ties to Sudan, citing concerns that creating such a list would impose an ongoing, burdensome requirement on them; risk alienating U.S. allies by “blacklisting” companies based in those countries; subject the agencies to legal challenges; and present difficult issues in determining what type and amount of evidence would suffice to include a company on the list.

Figure 2: Comparison of Three Lists Identifying Operating Companies with Ties to Sudan



Source: GAO analysis of three lists of companies with business ties to Sudan.

Note: Some of the companies that appear in only one list are mentioned in profiles of other companies identified in another list. For example, some companies identified in List A are mentioned in profiles of other companies included in List B.

Some of these discrepancies are likely due to the lists' different criteria for including companies. For example:

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- List A focuses on public and private companies⁴⁷ that the list's creator has determined have material⁴⁸ Sudan-related business operations, primarily in the areas of oil, mineral extraction, power, and defense.
 - List B includes companies (primarily those that are publicly-traded) that have any business ties to Sudan, regardless of the industries in which they operate.
 - List C focuses only on publicly-traded companies that the list's creator has determined provide certain direct benefits to the government of Sudan, particularly in the areas of oil, mining, electricity infrastructure, and military or where the company is otherwise complicit in human rights abuses in Sudan.

These varying criteria, however, cannot explain fully the discrepancies in the lists, indicating that the lists' creators differ in their judgment regarding which companies' ties to Sudan warrant scrutiny. For example, lists B and C both include companies that, according to list A, have ceased their Sudan-related business operations. Five companies that do not appear on list C are companies that, according to list A, are publicly-traded and have material Sudan-related business operations in the same industries that list C covers and that have been largely unresponsive to engagement by shareholders or unwilling to alter problematic practices in Sudan. Similarly, list C, which appears to have the narrowest criteria, includes 16 companies that do not appear on either of the broader two lists.⁴⁹

⁴⁷For a publicly-traded company, this list also identifies parent and subsidiary companies (public or private), provided that ownership stake in these vertical relationships is greater than 50 percent. In this case, the company with Sudan-related operations is the primary company listed. For a private company, the list also identifies its vertical structure and its parent company's vertical structure, provided the ownership stakes in these vertical relationships is greater than 50 percent. In this case, the parent company is the primary company listed.

⁴⁸This organization assesses materiality based on four factors: (1) whether a company has a business relationship with the government of Sudan, is contracted on a government-created project, or is affiliated with a government-created project or armed groups in Sudan; (2) whether a company's industry sector has a direct relationship with the government of Sudan or armed groups in Sudan; (3) whether a company is complicit in acts of violence; and (4) the question of who benefits from a company's investment in Sudan (e.g., marginalized populations or military entities).

⁴⁹Six of these 16 companies were removed from prior versions of List A.

Federal Securities Laws Do Not Specifically Require Operating Companies to Disclose Business Ties to Sudan

Representatives from the organizations that created these lists told us that obtaining and evaluating information on operating companies with business ties to Sudan is difficult. Because companies do not typically publicize details of their business dealings in state sponsors of terrorism, researchers must comb through several different sources of data to extract information on specific companies and then use their judgment to evaluate that information for reliability and accuracy. The researchers we spoke to told us that they rely on a combination of information from company Web sites, personnel, and documents; industry wide publications, such as oil industry newsletters; financial databases, such as Thomson Reuters or Bloomberg; local media reports; and advocacy group publications. Analyzing information from these sources and determining how to use it can be difficult. For example, one researcher told us that it is not clear how to describe a company if it has a dormant interest in an oil lease, but is also running a gas station. In addition, companies change their names, create new subsidiaries or affiliates, or enter and exit different marketplaces.

Research groups we spoke to said that they find information that comes directly from the companies they are examining to be particularly useful. For example, they would consider an SEC disclosure filing to be a reliable source of information. However, the federal securities laws do not require companies specifically to disclose operations in countries designated as state sponsors of terrorism. Nevertheless, SEC regulations require disclosure of such operations if they constitute “material information” that is necessary to prevent a company’s SEC statements from being misleading.⁵⁰ The meaning of “material information” is not explicitly defined by law, but the Supreme Court has determined that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision or the information would significantly alter the total mix of available information.⁵¹ This is a question of both law and fact, and the company is ultimately responsible for the accuracy and adequacy of the information it discloses to investors. According to SEC officials, companies have a strong incentive to make appropriate judgments about materiality because they may face significant federal securities law

⁵⁰17 C.F.R. §§ 230.408, 240.12b-20. The SEC discusses this issue in *Concept Release on Mechanisms to Access Disclosures Relating to Business Activities in or with Countries Designated as State Sponsors of Terrorism*, 72 Fed. Reg. 65862 (Nov. 23, 2007).

⁵¹*TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

liability for disclosure that includes material misstatements or material omissions that make the information provided misleading.

The SEC's Office of Global Security Risk, created in 2004, monitors whether the documents public companies file with the SEC include disclosure of material information regarding global security risk-related issues. According to officials from this office, they focus their reviews on companies with business activities in U.S.-designated state sponsors of terrorism, including Sudan. This office has suggested to companies that any operations they have in state sponsors of terrorism might be considered material because divestment campaigns and legislation mandating divestment from Sudan indicate that investors would consider this information important in making investment decisions. For example, the office has repeatedly noted that "various state and municipal governments, universities, and other investors have proposed or adopted divestment or similar initiatives regarding investment in companies that do business with U.S.-designated state sponsors of terrorism" and has instructed companies that their materiality analysis "should address the potential impact of the investor sentiment evidenced by such actions directed toward companies that have operations associated with Cuba, Iran, Syria, and Sudan." The office also asks companies, in assessing materiality, to take both quantitative factors (such as the amount of company revenue associated with a state sponsor of terrorism) and qualitative factors (such as the potential impact of corporate activities upon a company's reputation and share value) into account.

However, in their correspondence with the SEC, companies have raised concerns about these instructions. For example, one energy company wrote that, "We are concerned that the SEC seems to be implying a ... disclosure obligation with respect to business dealings with Sponsor Countries [state sponsors of terrorism] even though we are not aware of such a rule or regulation." Furthermore, the company wrote that "it is [the company's] view that its business dealings in the Sponsor Countries may be of interest to certain [company] investors but are not material to [company] investors in general or the general investing public. As such, it remains [the company's] view that its dealings in the Sponsor Countries do not need to be further disclosed in its annual reports...." Another oil company wrote to the SEC that, "We believe that any actual divestments of our securities for reasons related to [our limited contacts with state sponsors of terrorism] are isolated incidents and not representative of the overall investment climate and the Company's reputation among investors." Unlike the first company, this company agreed to revise its

annual report for the following year to include information on purchases of crude oil sourced from Sudan and other state sponsors of terrorism.

In general, the Office of Global Security Risk's monitoring of these companies appears limited. For example, SEC officials told us that they have corresponded with 59 of the 74 companies that file periodic reports with the SEC and that they have identified as having ties to Sudan.⁵² However, many of these companies operate in industries not covered under SADA, such as food services, telecommunications, and pharmaceuticals. In addition, our analysis shows that the office has only corresponded with 5 of the 15 companies that are identified in all three of the lists we analyzed and that file with the SEC. All 15 of these companies operate in the four key economic sectors identified in SADA. Furthermore, the office has not always followed up with companies concerning their correspondence, even when it has disagreed with companies' assessments of their operations. For example, in September 2007, the Office of Global Security Risk requested that an oil company whose parent company has extensive Sudan-related business operations disclose in future filings information regarding measures it has taken to ensure that investments in it cannot be used to fund the parent company's operations associated with Sudan. The company replied later that month that it had "concluded that such disclosure is not material information about the company that its investors are entitled to know" and "respectfully disagree[d] with the need for this disclosure." The Office of Global Security Risk responded a little over a month later, stating that it had completed its review of this matter and did not have any further comments at that time. According to an SEC official, this letter does not indicate that the staff agreed with the company's decisions, but rather that the information presented did not appear to be materially misleading. The office did not correspond again with the company until February 2010, after we inquired about the status of communication with the company. In another instance, in December 2005, the Office of Global Security Risk asked an oil company that was reported to have possible ties to Sudan to describe all current, historical, and anticipated operations in, and contacts with Sudan, including through subsidiaries, controlling shareholders, affiliates, joint ventures, and other direct and indirect arrangements. The company did not provide a response

⁵²The Office of Global Security Risk contracts with a private vendor to obtain its list of companies with ties to state sponsors of terrorism, including Sudan. This list is the SEC's primary tool for identifying companies that it will monitor. We contacted the private vendor to obtain a copy of this list, but it declined to provide one free of charge.

to the request; the office reiterated its question to the company in December 2009.

Office of Global Security Risk officials told us that, if they believe a company is not disclosing material information, they will exercise their authority to extensively question the company and continue to comment, with the goal of working with the company to produce the best disclosure for investors. Correspondence with a company ends when the office has no further questions and has determined that the company has provided a reasonable argument as to why its disclosure is not materially incomplete or misleading, even if the office does not fully agree with the company's judgment. These officials also told us that, in cases where the office determines that its comment process has not resulted in full disclosure of material operations by a company, it will refer the company to the SEC's Division of Enforcement for possible investigation. According to SEC officials, the Office of Global Security Risk has referred one company to this division since the office was created in 2004.

The SEC has the discretionary authority to adopt a specific disclosure requirement for companies that trade on U.S. exchanges (such as requiring disclosure of any operations in state sponsors of terrorism). Although the SEC has not done so, it could exercise this authority by issuing an interim rule for comment and a final rule in the *Federal Register*. However, the agency has indicated that it is committed to the practice of relying on companies to ensure that their disclosures contain all material information about their operations in these countries.⁵³

⁵³At an April 2010 hearing before the Senate Appropriations Committee Subcommittee on Financial Services and General Government, however, the SEC Chairman noted that the agency is considering whether public companies should be required to disclose business conduct without regard to materiality between them and one of the four countries designated as state sponsors of terrorism.

Investors We Spoke with Have Considered the Possible Effects of Divestment on Operating Companies and the Sudanese People

Some Operating Companies That Ceased Operating in Sudan Warned of a Negative Effect on the Sudanese People

The companies we spoke with that ceased operating in Sudan expressed concerns about the effect of their departure from the Sudanese market.⁵⁴ For example, one company we spoke with told us that when it decided to leave Sudan and sell its stake in the project in which it was involved to another company, that company refused to sign the sales agreement until language conferring responsibility for continuing the seller's humanitarian programs was removed from the agreement. This same company also told us that it had worked out an agreement with the government of Sudan to monitor planes landing on a company air strip, which a human rights group alleged that the Sudanese military had been using to carry out military campaigns against the South during the civil war. Once the company left Sudan, it could no longer monitor such flights. Another company that left the Sudanese market stated that it had been involved in a nationwide anti-AIDS program in Sudan, which it could no longer participate in after leaving Sudan.⁵⁵ A company that continues to operate in Sudan told us that, should it decide to cease operations, its stake in the project in which it is involved would be taken over by the government of Sudan, which would then own 96 percent of the project. The company indicated that this would not only result in more revenue for the government of Sudan, but also would likely mean the end of humanitarian programs, such as building schools and medical clinics for the local population, in addition to its contribution to charities working in Darfur. Another company that continues to operate in Sudan told us that if it only considered its financial stake in Sudan, it would have likely left Sudan. However, the company decided to stay because it believed that it was important to continue its humanitarian efforts there.

⁵⁴We spoke with eight foreign operating companies, all of them Western.

⁵⁵This company transferred its business operations to another company that it said it trusted, rather than one that would engage in "unethical" business practices.

Some Investors Have Shifted Their Focus away from Divestment and toward Engagement

Because of their concerns with divestment, some investors have shifted their approach toward engaging with companies in order to leverage their resources as shareholders to influence companies' behavior and promote efforts aimed at improving the lives of the Sudanese people. Some advocacy groups that were originally at the forefront of the divestment campaign also have shifted their focus toward engagement. One advocacy group we spoke with stated that it believed that divestment was too blunt of an approach because it targeted a wide array of companies, some of which may not have had material operations in Sudan. Instead, this group argued for an approach that targets companies involved in the industries that are most lucrative for the Sudanese government and that provides alternatives to divestment, such as engaging companies to try to influence their behavior. This group uses a three-step engagement process, which (1) reviews the potential human rights and environmental impact of the company's operations in Sudan, (2) encourages companies to interact outside of their normal sphere of influence, and (3) gains support for programs aimed to help the Sudanese population negatively affected by the Sudanese government or the company's operations. This approach uses the leverage that shareholders have to influence companies to make positive contributions that help the people of Sudan, such as building hospitals and schools, providing training and job opportunities, and contributing to a microfinance loan program.

Like advocacy groups, some U.S. investment companies have also embraced the idea of engagement and increasingly view divestment as a last resort because engagement allows companies to continue operating and provides positive incentives for them to use their resources to help the Sudanese people. The investment companies we spoke to took a variety of different actions to engage operating companies, such as developing a formal engagement policy with a list of actions required to avoid divestment and writing letters to companies. While investment companies stated that these engagement actions did not always result in meaningful changes in company behavior, those companies that were open to engagement often took positive steps and implemented humanitarian projects aimed at helping the people of Sudan. For example, one investment company told us that nearly half of the companies it engaged with were responsive to its outreach efforts and made efforts to address its concerns. In cases where companies continued to be unresponsive to engagement, investment companies had the option to divest their holdings, which some decided to do.

U.S. states have also endorsed engagement as a viable alternative to divestment, with a few states identifying divestment as a last resort.

Nineteen of the 25 states whose laws or policies require divestment also encourage or require engagement. For example, Minnesota law mandates that the State Board of Divestment identify “scrutinized companies” with Sudan-related business operations and send written notice to each company notifying it of possible future divestment if the company does not cease its scrutinized operations within 90 days.⁵⁶ However, under the law, a company can take “substantial action” by conducting humanitarian activities in proportion to its Sudan-related business operations, engaging with the government of Sudan, or formalizing and executing a plan to cease operating in Sudan within 1 year. If a company undertakes these actions, it may no longer be considered a scrutinized company targeted for divestment. Investing authorities of the states with investment laws or policies that provide for engagement believe that they gain more leverage by pressuring companies to change their behavior than by outright divestment, since other investors without the same concerns about Sudan might purchase the divested shares. Twenty of the 29 managers responding to our survey who had divested or frozen their Sudan-related assets, or planned to do so, stated that they could retain these investments if companies changed their behavior in Sudan. However, according to the results of our survey, 10 of the 29 fund managers that answered the related survey question indicated that, to a large to moderate extent, engaging with companies was too difficult or costly. Furthermore, representatives from state advocacy organizations told us that, due to time and resource constraints faced by many states, engagement with companies is a large undertaking for them, and some states may not be able to manage engagement campaigns.

Western Foreign Operating Companies We Spoke with Said They Generally Welcomed Engagement Efforts and Took Actions in Sudan as a Result

The eight foreign operating companies we spoke with generally agreed that, for them, engagement is preferable to divestment because it allows them to continue operating in Sudan and to discuss possible ways to improve the situation there. For example, one company we spoke with argued that divestment ultimately separates the people who advocate for positive change in Sudan from the companies that have the capacity and desire to be constructive actors in Sudan. This company told us that, after a visit to Sudan, the company’s home government issued a report arguing that the company should stay in Sudan so that its humanitarian presence could be maintained. When the company ultimately decided to leave Sudan, advocacy groups stated that losing this company’s presence was a missed opportunity to continue developing and implementing

⁵⁶Subdivision 3, Minnesota Statute 11A.243 (2009).

humanitarian projects in Sudan. Another company argued that the choice to engage companies does not inhibit stakeholders from future divestment, should companies ultimately be unwilling to take positive actions and change the way they conduct their Sudan-related business operations.

The operating companies we spoke with generally appreciated the opportunity to “set the record straight” and to explain their business activities to groups with whom they engaged. These companies consistently told us that they believe their business operations positively impact the Sudanese people. For example, one company told us that 90 percent of its workforce is hired in-country. The company gives these local employees opportunities to receive an education outside of Sudan. Many of the companies we spoke with also explained that their presence is beneficial for the Sudanese people because they often choose to engage in community development. For example, a mining company told us that it built seven schools and a medical clinic, brought water and power supplies to the area around the mine, and started agricultural training programs for the local population. This company said it also convinced its business partners from the Sudanese government to contribute some of their profits from the mine to support a humanitarian organization operating in Darfur.

Almost all of the companies we spoke with said they donated to or became directly involved in humanitarian projects as a direct result of their engagement with various advocacy groups and shareholders. After engaging with an advocacy group, one operating company decided to contribute funding to develop hospital facilities in South Sudan. In addition, a few of the companies we spoke with also engaged with the government of Sudan on politically sensitive issues after being advised to by an advocacy group. For example, as a part of one company’s engagement process with a number of advocacy groups and investors, the company launched an official protest with the government of Sudan when members of the militia opened fire on the local Sudanese population living in the vicinity of the company’s project site. Some companies we spoke with also underwent independent human rights impact assessments of their business operations as a result of engaging with advocacy groups. One company told us that its assessment helped it identify ways to further improve its business operations by promoting more ethnic diversity in the workplace and offering HIV/AIDS testing for employees.

A few of the companies we spoke with decided to limit their business activities in Sudan as a result of engagement processes. For example, one company we spoke with committed to not pursue any new business in

Sudan until the situation in Darfur changes and United Nations peacekeepers are allowed in the country. The company indicated that this commitment sent a strong signal to the government of Sudan, which depends on the company to explore and identify natural resource deposits.

Our Analysis Indicates That the U.S. Government Has Complied with the Federal Contract Prohibition Provision of SADA

We found no evidence to suggest that the U.S. government has awarded contracts to companies identified as having prohibited business operations in Sudan. The U.S. government has, as allowed under federal law, contracted with subsidiaries and affiliates of companies with Sudan-related business operations. We found that for a non-random selection of contracts awarded to these companies, the contractors provided the necessary certification, when required. Furthermore, the U.S. government has not waived this requirement or determined that any contractors submitted false certifications under SADA.

Our Analysis Indicates the U.S. Government Has Not Awarded Contracts That Violate SADA

Section 6 of SADA requires the heads of federal agencies to ensure that each contract for the procurement of goods or services includes a clause requiring the contractor to certify that it does not conduct prohibited business operations in Sudan. SADA's contract prohibition section also contains remedies for false certifications, such as suspending or debaring the contractor from receiving future federal contracts, and provides for waivers in certain situations. Section 6 was implemented in subpart 25.7 of the Federal Acquisition Regulation (FAR) via an interim rule on June 12, 2008,⁵⁷ and a final rule on August 11, 2009.⁵⁸ The FAR rule also includes a solicitation provision whereby parties seeking federal contracts (offerors) certify that, by submission of an offer, they do not conduct any restricted business operations in Sudan.⁵⁹

Based on our analysis of one of the most widely used lists of companies with prohibited business ties to Sudan,⁶⁰ we found that only 1 of 88 companies identified in the list has received federal contracts since the

⁵⁷73 Fed. Reg. 33636.

⁵⁸74 Fed. Reg. 40463.

⁵⁹FAR § 52.225-20 and FAR § 52.212-3(m) for commercial item acquisitions.

⁶⁰We chose to use this list because it focuses on companies identified in the four business sectors targeted in SADA and identifies subsidiaries and affiliates of those companies.

FAR requirements took effect in June 2008. However, the contract certification provision was not required for these particular contracts because they were purchase orders under simplified acquisition procedures,⁶¹ which generally do not require the SADA certification under the FAR.⁶² Therefore, these contract awards were not in violation of SADA's implementing regulations.

In addition to the purchase orders with the company that has business ties to Sudan, we found that from June 12, 2008, to March 1, 2010, the U.S. government awarded 756 contracts to 29 affiliates and subsidiaries⁶³ of the companies identified in the list as having prohibited business ties to Sudan. While SADA aims to prevent companies with prohibited business operations in Sudan from receiving federal contracts, it does not restrict contracting with these companies' affiliates and subsidiaries, provided that the affiliates and subsidiaries certify that they do not have prohibited business operations in Sudan. (Only the company directly bidding on a contract has to certify that it does not have any restricted business operations in Sudan.) Our review of a non-random selection of contracts awarded to these affiliates and subsidiaries indicates that the contractors provided the necessary certification, when required. Therefore, for these specific contracts, the U.S. government has complied with the contract

⁶¹Simplified acquisition procedures under FAR part 13 allow agencies to use a streamlined procurement process for certain acquisitions under specific dollar thresholds, usually \$100,000. Under these procedures, many contractor certifications and representations are not required.

⁶²Contract certifications and representations, including the SADA certification, are usually found in the contract solicitation. Purchase orders do not have solicitations, and so the certifications and representations may not be required. In certain circumstances, agencies using simplified acquisition procedures may still require offerors to submit and maintain their FAR certifications and representations, including the SADA certification, via the Online Representations and Certifications Application (ORCA)—a Web-based application that replaces most of the representations and certifications located directly in the solicitation, allowing contractors to enter this information once for use on all federal contracts.

⁶³These affiliates and subsidiaries were identified by the list that also identified the 88 companies with prohibited business ties to Sudan. The list defines affiliates and subsidiaries as companies where there is a 50 percent or greater ownership stake. For example, for a publicly-traded company with Sudan-related operations, the list identifies as subsidiaries and affiliates those companies of which the parent company owns 50 percent or more.

prohibition section of SADA.⁶⁴ Contract actions to these subsidiaries and affiliates totaled almost \$335 million.⁶⁵

Some advocacy groups have disagreed with the FAR councils' decision to apply the requirement only to the entity directly contracting with the government because it allows companies that have certified to the federal government that they do not conduct prohibited business operations to continue operating in Sudan through their subsidiaries or affiliates. One of these groups expressed particular concern that affiliates and subsidiaries can still receive contracts, but may also receive revenue from or contribute to the operating budget of their parent companies, particularly if they are majority-owned. In their comments on the interim FAR rule, they argued that SADA defines "person" to include subsidiaries, parent companies, and other affiliates and that the FAR councils should implement the contract prohibition provision with this definition in mind. However, the FAR councils concluded that the contract prohibition provision of SADA did not use the term "person" and instead used the term "contractor." Since these terms were not defined in SADA as being synonymous, the FAR councils decided to stay as close as possible to the requirements and definitions used in the statute. The FAR councils also stated that expanding the scope of the rule would require offerors to attest to the business operations of parent companies, subsidiaries, and other affiliates about which they may not have information. In addition, the FAR councils noted that the company may not have any influence over the affairs of its related companies.

⁶⁴We identified the highest dollar amount contract or contract modification for each of the 29 subsidiaries and affiliates. The solicitations for 22 of these contracts were issued after June 12, 2008, and, therefore, were subject to section 6 of SADA. The government complied with SADA by either including the required FAR provisions in the solicitation or incorporating the Sudan certification through other means, such as ORCA. If the contracting officer relied on the electronic ORCA certification and representation submissions, the SADA certification provision may not appear in the solicitation. See FAR subpart 4.12.

⁶⁵Contract actions include new contract awards, modification to those contracts, and modifications to contracts with these entities where the original contract was awarded prior to June 12, 2008.

U.S. Government Has Not Granted Any Waivers to SADA or Determined That Any Companies Submitted False Certifications under SADA

Under section 6(c) of SADA, the certification requirement can be waived on a case-by-case basis if the president determines that it is in the national interest to do so and notifies the appropriate congressional committees in writing. Under the FAR, agencies can seek waivers by submitting requests to the Office of Federal Procurement Policy (OFPP). OFPP reported that no waivers have been issued pursuant to SADA and no agencies have requested such waivers as of May 2010.⁶⁶ OFPP opened a FAR case to consider FAR revisions to establish a process and criteria for waivers.

The U.S. government has not identified any contractors that have submitted false certifications under SADA. Section 6(b) of SADA states that if the agency head determines that a contractor has falsely certified that it did not conduct prohibited business operations in Sudan, he or she may impose a number of penalties. Specifically, the agency head may decide to terminate the contract, suspend or debar the contractor from being eligible for federal contracts for a period of no more than 3 years, or pursue other remedies. In cases where the contractor is suspended, debarred, or proposed for suspension or debarment, SADA requires the Administrator of General Services to add these contractors to the Excluded Parties List System, which tracks companies barred from entering into contracts with the U.S. government.⁶⁷ Based on information we obtained regarding the U.S. government's Excluded Parties List System, we determined that no contractors have been included on the list because of a false certification under SADA.

Conclusions

As global awareness of the genocide in Darfur has grown, so too have efforts to combat this humanitarian crisis. Divestment from Sudan has been at the forefront of these efforts, with activists, students, and politicians from throughout the United States calling on shareholders to pull their funds from companies that directly or indirectly support the

⁶⁶Some advocacy groups have written to OFPP requesting that certain companies be considered for blanket waivers because these companies have agreed to discontinue their operations in Sudan or had taken actions in Sudan that the groups considered positive. However, OFPP staff told us that they only consider waiver requests directly submitted by the executive agency and would only use the letters from advocacy groups as supplemental support for any future waiver requests regarding the companies.

⁶⁷The Excluded Parties List System is an electronic database maintained and posted by the General Services Administration that contains the list of all parties suspended, proposed for debarment, debarred, declared ineligible, or excluded or disqualified from federal contracting.

Sudanese government. However, in deciding whether and how to divest, stakeholders must consider how divestment affects foreign companies operating in Sudan, particularly those that strive to make a positive contribution to the Sudanese people. They must also ensure that divestment is consistent with their fiduciary responsibility. Additionally, they must identify and evaluate conflicting sources of information about which companies have Sudan-related business operations. Requiring companies to disclose their own operations in Sudan (as well as other state sponsors of terrorism) would provide more accurate and transparent information to investors carefully weighing whether and how to divest from Sudan. Furthermore, the strong demand for this information from states that require divestment, as well as from other investors, indicates that this information could be considered material—a judgment that the SEC has suggested in its correspondence with operating companies.

Recommendation for Executive Action

In order to enhance the investing public's access to information it needs to make well-informed decisions when determining whether and how to divest Sudan-related assets, we recommend that the SEC consider issuing a rule requiring companies that trade on U.S. exchanges to disclose their business operations related to Sudan, as well as possibly other U.S.-designated state sponsors of terrorism.

Agency Comments and Our Evaluation

We provided a draft of this report to the SEC and the Office of Management and Budget. Both provided technical comments, which we incorporated into the report as appropriate. The Office of Management and Budget chose not to provide written comments. The SEC's written comments, provided by the SEC Division of Corporation Finance, as well as our responses to these comments, are reprinted in appendix IV. The Division of Corporation Finance agreed that it would present our recommendation to the commission for its consideration. However, the division expressed concern that adopting a disclosure requirement that is excessively broad and beyond what GAO recommends could possibly lead to a volume of information that would overwhelm the investor and possibly obscure other material information.

As we agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this letter. The report will also be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9601 or melitot@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Other contacts and major contributors are listed in appendix V.

A handwritten signature in black ink that reads "Thomas M" followed by a long horizontal flourish.

Thomas Melito
Director, International Affairs and Trade

Appendix I: Scope and Methodology

GAO Survey of U.S. States

To identify the actions that U.S. state fund managers took regarding their Sudan-related assets and the factors they considered when determining whether and how to divest, we designed and administered a Web-based survey of state treasurers and state-run pension fund managers.

The survey asked about (1) Sudan-related state investment laws and/or policies; (2) whether or not the fund engaged with companies that did business in Sudan, the methods used, and the outcomes; (3) whether the fund froze or divested its Sudan-related assets and the reasons for the decision; (4) if the fund froze or divested assets, the names of the companies, dates, and total U.S. dollar values of the assets; and (5) the sources of information the fund used to identify companies with ties to Sudan. Appendix III contains a copy of our questionnaire.

We included three populations in this survey: (1) the 51 state treasurers or their equivalents; (2) the 51 state public employee retirement system (PERS) funds; and (3) managers of 50 other state-run public pension funds, such as teacher retirement funds. For the first two populations, we sent surveys to all of the state treasuries and PERS funds. For the third population, we selected the 50 largest funds based on total asset values from the 2007 Annual Retirement Survey of State Retirement Systems conducted by the U.S. Census Bureau. These 50 funds included in the survey represented approximately 96 percent of the total asset value of all funds in this group. We received responses from 138 of the 151 treasuries and state-run pension funds in our population (see table 3). We discovered 1 fund from our third population of 50 state-run pension funds with the greatest amount of assets under management to be out of our scope because it was a municipal-run fund, not a state-run fund. The removal of this fund reduced our third population from 50 to 49 funds and our total population from 152 to 151 funds. The overall response rate, adjusted for the known and estimated funds that were out of our scope, was 91 percent. Response rates varied slightly among population groups.

We included 117 fund managers in the survey and received responses from 105 managers representing 138 state funds. During data collection, we discovered that several of the funds we surveyed were managed by 1 fund manager. Specifically, 23 fund managers were responsible for more than one fund selected for the survey. Of these 23 managers, 22 completed the survey for one of their funds instead of all of their funds. In all cases, the state fund managers later confirmed that their survey responses would be the same for all funds under their management. We then copied the completed survey responses into each remaining survey that the fund

manager was asked to fill out. The copied responses were independently verified for accuracy.

Table 3: Summary Response Table

	Total number surveyed	Number of respondents	Percent responding
Total number of funds:	151	138	91
(1) State treasuries	51	45	88
(2) PERS funds	51	49	96
(3) Other pension funds	49	44	90
Total number of fund managers	117	105	90
States for which at least one treasurer or pension fund manager responded	51	51	100

Source: GAO analysis of survey response data.

After the survey was closed, we analyzed the survey results to determine what differences existed between the responding and the nonresponding funds. We performed this analysis for three characteristics— total asset holdings, state, and population group. We found no indications of significant bias caused by unit non-response. On the basis of the 91 percent response rate and this analysis, we chose to include the survey results in our report and consider them sufficiently reliable for our purposes.

The practical difficulties of conducting any survey may introduce nonsampling errors, such as difficulties interpreting a particular question, which can introduce unwanted variability into the survey results. We took steps to minimize nonsampling errors by pretesting the questionnaire over the telephone with two state treasurers and five pension fund representatives in December 2009 and January 2010. We conducted pretests to make sure that the questions were clear and unbiased, the data and information were readily obtainable, and the questionnaire did not place an undue burden on respondents. An independent reviewer within GAO also reviewed a draft of the questionnaire prior to its administration. We made appropriate revisions to the content and format of the questionnaire after the pretests and independent review.

We administered the Web-based survey from February 25, 2010, to April 14, 2010. Respondents were sent an e-mail invitation to complete the

survey on a GAO Web server using a unique username and password. Throughout the data collection period, nonrespondents received a reminder e-mail, letter, and telephone call. We also conducted follow-up with respondents by e-mail and telephone to confirm the value and dates of divestment or freezing of Sudan-related assets. Two survey questions gave the respondents the option to submit documentation on the following information instead of entering it on the Web—the list of companies with which the fund engaged and the names of companies, dates, and values of assets from which the fund divested. We entered this information into a spreadsheet, which was later merged with the survey data set for analysis. The data entered were independently verified for accuracy. All data analysis programs were independently verified for accuracy.

State Laws and Policies

To identify state laws and policies enacted regarding Sudan-related investments and state contracts with companies tied to Sudan, we analyzed state legal codes, non-codified laws, state bills, and policies applicable to state treasurers and state-run pension fund managers. Our scope covered all measures (laws and policies) enacted or implemented since 1993 and effective as of April 2010. Using two legal databases, Lexis/Nexis and Westlaw, we searched for (1) all states that had relevant legislation and/or non-legislative policies in effect as of April 23, 2010; (2) states with legislation that was enacted but no longer in effect or repealed by the report issuance date; and (3) states with legislation that was introduced but not passed. As one way to verify this analysis, the team compared the search results to descriptions of state laws and policies provided by survey respondents. To identify non-legislative policies, we used online searches for such policies on state treasurers' and pension funds' Web sites, as well as survey responses. (Several survey respondents provided policies to us by e-mail.) We reviewed state laws and policies to identify provisions that address common subject matter or themes and did not independently interpret those laws or policies. Instead, we relied on survey responses and interviews with the state treasurers and other officials knowledgeable of and responsible for implementing their respective laws and policies in carrying out their duties to manage state employee pension funds.

U.S. Investment Companies

To determine how U.S. investors' Sudan-related asset holdings changed since March 2007, we analyzed volume, value, and other related data of U.S. firms' equity holdings, as reported in the Thomson Reuters ThomsonONE ownership database. The ThomsonONE ownership database is a Thomson Reuters database module that provides ownership and financial information on shares held by institutions (such as investment companies), reflecting the latest filings from stock exchanges

worldwide. After extensive discussions with Thomson Reuters staff about their aggregation methodology for institutions and the funds they manage, sources and frequency of data for non-U.S. traded equities, use of data prior to 2007, and other specific data issues, we determined that the data obtained from Thomson Reuters provide a reasonable basis for our findings on U.S. investors' holdings of certain Sudan-related equities. Our scope covered U.S. investors' holdings of 20 securities of six key foreign companies for each quarter from March 2007 to December 2009. We chose these six key companies with Sudan-related assets because they (1) appear on all three lists we analyzed of companies with business ties to Sudan; (2) include companies that have been targeted through public divestment campaigns; and (3) have operations in Sudan's oil sector, which plays a central role in the country's economy. Included among the 20 securities we analyzed for these six companies are the securities of affiliates where the parent company ownership stake was identified as being greater than 50 percent.¹ We chose this approach because, under the "structure of responsibility," a parent company can use a publicly traded subsidiary in which it has a controlling interest (i.e., greater than 50 percent), to fund other projects, such as operations in Sudan. This relationship is relevant in additional situations, such as

- when the parent company has a Sudan-related business operation, but the parent company is state owned and not publicly traded or
- when the affiliate doing business in Sudan is a private company.

Since equities are not traded in these situations, shareholders may try to gain influence through the publicly traded parent or, if the parent is not publicly traded, through a publicly traded affiliate company over which the parent has a controlling influence.

To attempt to determine the reasons behind U.S. investors' actions regarding Sudan-related assets, we obtained information from investment companies. We identified investment companies by selecting those that had spoken publicly about the issue of Sudan divestment, as well as by issuing an invitation through a large national association of investment companies to all of its members. Six firms agreed to speak with us, and one, which chose to remain anonymous, addressed our questions with written responses from 31 of its 34 sub-advisers. The views these seven

¹One of the three lists we analyzed identified these affiliates.

investment companies expressed are not generalizable to all investment companies. To determine if changes in the value of investor holdings were due to price changes or buying or selling of Sudan-related assets, we constructed price indices for U.S. holdings of Sudan-related equities. (Further information on constructing a control or comparison group to assess whether U.S. investor behavior was driven by Sudan-specific conditions or a general reallocation of assets is in app. II.)

Factors Related to Divestment Decisions

To describe the factors that U.S. states and investment companies considered in determining whether and how to divest, we analyzed relevant data, reviewed documents, and interviewed key individuals.

- For the first factor regarding fiduciary responsibility, we analyzed the results of our state survey, reviewed state laws and policies to identify provisions explicitly allowing fiduciaries to not divest, and interviewed or obtained information from the seven U.S.-based investment companies and from national associations that advocate for the interests of state fund managers.
- For the second factor regarding the difficulty identifying information on operating companies with business ties to Sudan, we analyzed three available lists of these companies—one from an advocacy group (which provided its list in October 2009, January 2010, and February 2010), one from a private research firm (which provided its list in February 2010), and one from a socially-responsible investment company (which provided its list in March 2010). Each of these three groups provided its list at no cost to GAO.² The three lists we analyzed are widely used by investors divesting from companies tied to Sudan or seeking to avoid investing in these companies. We compared the lists to determine which companies appeared on any or all three lists and we interviewed the individuals who created the lists to understand their methodologies, as well as their criteria for including companies on their lists. To examine this second factor, we also reviewed SEC correspondence with foreign operating companies that have business ties to Sudan and interviewed SEC officials about their efforts to monitor these companies. In addition, we analyzed the results of our survey of state fund managers, and interviewed and reviewed information from advocacy groups that represent state investment officials.

²We asked another private research firm to provide a copy of its list, but this firm would not do so free of charge.

- For the third factor regarding the effects of divestment on operating companies in Sudan, we interviewed advocacy groups and investment companies, analyzed the results of our survey, and reviewed provisions of state laws and policies that address engagement with these companies. We also interviewed representatives from eight companies that have or used to have business operations in Sudan. (We sent e-mails or letters to 22 companies soliciting an opportunity to speak with them about their operations in Sudan. We non-randomly selected companies that have appeared on at least one of the lists we analyzed and that represented a mix of both Western and Eastern companies. Of the 22 companies that we contacted, 9 responded that they were willing to speak with us, all of them Western. Ultimately, we spoke with only eight of these companies because the ninth company did not respond to our last communication attempting to schedule the meeting.) The views expressed by these eight operating companies are not generalizable to all operating companies that have or used to have business operations in Sudan. In addition, we reviewed human rights impact assessments conducted for some of these companies.

Contract Prohibition

To determine whether the U.S. government had contracted with companies identified as having business ties to Sudan and to assess compliance with the contract prohibition provision of SADA, we searched for federal contracts awarded to specific companies and obtained and reviewed contract solicitations to see if they contained the applicable Sudan-related certification as required by the Federal Acquisition Regulations (FAR).

- First, we used one of the most widely used lists of companies identified by an outside research organization as having restricted business ties to Sudan. This list identified 88 such companies and also identified affiliates and subsidiaries of these operating companies. While we recognize that available lists of companies with business operations in Sudan are difficult to develop and often conflict with each other, we chose to use this particular list because it focuses on companies identified in the four economic sectors targeted in SADA and identifies subsidiaries and affiliates of those companies.
- We then searched the Federal Procurement Data System—Next Generation on March 2, 2010, for these companies to determine if any federal contracts had been awarded to them from June 12, 2008, when the FAR rule regarding contract prohibition went into effect, to March 1,

2010.³ (We determined that this data system was sufficiently reliable for the purposes of this report because we did not need to identify the universe of contracts subject to SADA in order to complete our analysis.) Our search identified several dozen contractors, of which one is identified on the above-mentioned list as having restricted business ties to Sudan. The remaining contractors are subsidiaries and affiliates of the companies identified as having restricted business ties to Sudan. Twenty-nine of these contractors were awarded a new contract during the time period of June 12, 2008–March 2, 2010. Of those 29, 7 contractors had contract solicitations—where the certification provision would appear—dated before June 12, 2008, and therefore were not included in our selection assessing compliance with SADA.

- For each of the remaining 22 contractors, we then identified the highest dollar amount contract or contract modification and obtained and reviewed the solicitation to verify that the Sudan-related certification was either present or not required. The applicable certification provision varied depending on whether the contract was for commercial items or not and whether the contracting officer relied on electronic Online Representations and Certifications Application certifications for the particular procurement. Other procurements, such as those conducted under simplified acquisition procedures and those that did not use a solicitation, are not required under the FAR to have any Sudan-related certification.

The findings related to our analysis of this selection of contracts cannot be generalized to the entire universe of new contracts awarded to these companies since June 12, 2008.

In addition, we interviewed agency officials who have responsibilities related to SADA’s contract prohibition provision. The agencies they represented included the General Services Administration, the Office of Management and Budget’s Office of Federal Procurement Policy (OFPP), and the Treasury Department’s Office of Foreign Assets Control.

To learn about the development of the FAR rules implementing the contract prohibition provision in SADA and the government’s process for

³This initial search not only identified contracts awarded to these companies from June 12, 2008, to March 1, 2010, but also any modifications to existing contracts that were issued during the time period. These modifications may have been associated with contracts that were awarded before SADA was implemented and therefore would not have contained any Sudan certification.

granting waivers to SADA, we spoke with officials from OFPP. We also spoke with Office of Foreign Assets Control officials regarding U.S. sanctions on Sudan and the process for issuing general and specific licenses that allow businesses to conduct specified operations in Sudan. In addition, we obtained and reviewed documentation of the specific licenses granted for non-humanitarian work in Sudan. We had officials from the General Services Administration search the Excluded Parties List System database in order to determine whether any contractors had been included on it due to the suspension, debarment or proposed suspension or debarment of the contractor for submitting a false certification under SADA. Finally, we interviewed officials from the contracting agencies associated with the 31 contract solicitations we obtained and reviewed in order to understand how they implement the contract prohibition provision. These agencies included the Departments of Defense, Interior, State, and Homeland Security; and the U.S. Agency for International Development.

We conducted this performance audit from August 2009 to June 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Sudan-related Equities Price Index Methodology

This appendix describes the techniques we used to estimate three price indices for Sudan-related equities and challenges in constructing a control or comparison group to assess whether U.S. investor behavior was driven by Sudan-specific conditions or a general reallocation of assets away from foreign equity markets.

Price Index Approaches

We estimated three price indices for select foreign companies with Sudan-related business operations to ensure that our results were not driven by our choice of price index. The three index types we chose were based on standard price index methods: a capitalization weighted index, a LasPeyres index, and a Paasche index. For six select companies, we identified 20 equity securities in which U.S. investors had holdings from March 2007 to December 2009. Using Thomson Reuters Datastream (a financial database that includes global equity markets), we were able to identify price and market value data for 18 of those securities (corresponding to five different companies) for the full time period we studied. The two securities for which we were unable to find data were held by only two and seven investors, respectively.¹ Our price indices are based on those 18 securities.

Capitalization Weighted Index

A capitalization weighted index is defined as

$$I_t^{CW} = \frac{\sum_j P_{j,t} \times Q_{j,t}}{D}$$

Where I_t is the level of the index at some time t , $P_{j,t}$ is the price of equity j at time t , $Q_{j,t}$ is the quantity (number of shares) of equity j at time t , and D is a divisor used to scale the index.² We chose the divisor as the level of the index at the initial time period and multiplied the result by 100, so the index had an initial value of 100. Therefore, our capitalization weighted index becomes

¹The omission of these two securities is unlikely to have a significant impact on our results. One security accounted for at most \$13 million in U.S. holdings (or less than 0.3 percent of Sudan-related holdings at the time). Holdings of the other security accounted for a notable amount (4.8 percent) of the Sudan-related equity portfolio for only a single quarter in the time period we studied, and were negligible for all other quarters.

²*Index Mathematics Methodology*. Standard and Poor's, February 2009.

$$I_t^{CW} = \frac{\sum_j P_{j,t} \times Q_{j,t}}{\sum_j P_{j,0} \times Q_{j,0}} \times 100$$

So changes in the value of the index are driven by changes in the total market value (or capitalization) of the securities.

LasPeyres Index

The LasPeyres index is defined as

$$I_t^L = \frac{\sum_j P_{j,t} \times Q_{j,0}}{\sum_j P_{j,0} \times Q_{j,0}} \times 100$$

Here the quantities (number of shares) are held constant over time, and changes are driven by the changes in the prices in the numerator. As with the capitalization weighted index, we multiply the result by 100, so the index has an initial value of 100.

Paasche Index

The Paasche index is defined as

$$I_t^P = \frac{\sum_j P_{j,t} \times Q_{j,t}}{\sum_j P_{j,0} \times Q_{j,t}} \times 100$$

Unlike the LasPeyres index, the Paasche index allows the composition of shares to fluctuate over time—capturing changes in the U.S. portfolio—while the denominator contains base-year prices, ensuring that changes in the index level are driven by either price changes or changes in the composition of U.S. equity holdings (where the price behavior of new holdings may differ from old holdings). As a result, we believe the Paasche index is the best way to capture the price of the U.S. Sudan-related equity portfolio. Once again, we multiply the result by 100, so the index has an initial value of 100.

Price Index Results and Net Selling Analysis and Potential Comparison Groups

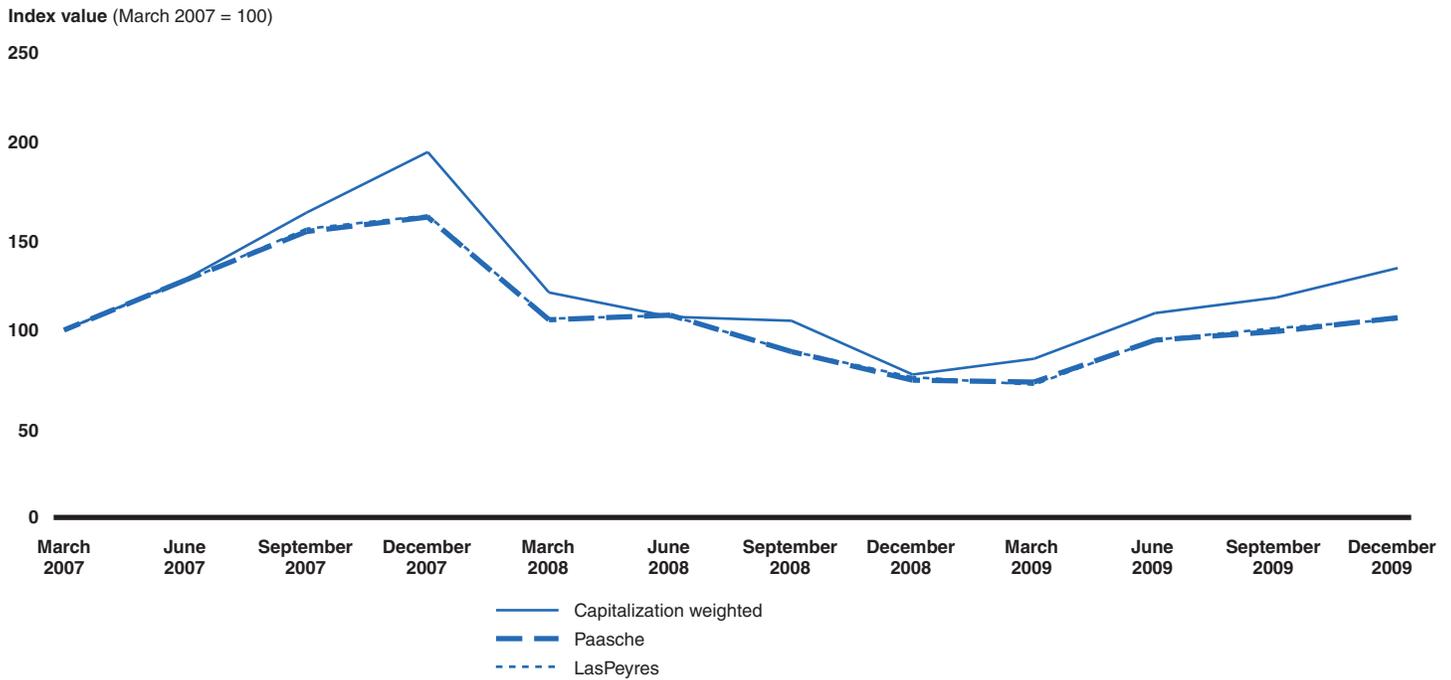
Our analysis is meant to answer the following questions:

- Does the drop in the value of U.S. holdings of Sudan-related equities reflect the selling of securities, a drop in their value, or some combination of the two?
- If U.S. investors, on net, sold shares in Sudan-related companies, was this driven by conditions specific to Sudan (such as SADA or civil conflict) or similar to broad selling of foreign equities or foreign equities in the oil and gas sector?

All three price indices indicate that U.S. investors, on net, sold shares of Sudan-related companies, though the estimated amount of selling varies. The values of the three price indices, from March 2007 to December 2009, are in figure 3 below. Prices rose by 6 percent (according to the LasPeyres index), 7 percent (according to the Paasche index) or 33 percent (according to the capitalization weighted index). In comparison, from March 2007 to December 2009, the value of U.S. Sudan-related equity holdings fell by almost 60 percent. Despite this variation in estimated price increases, given that the value of holdings did not increase by more than 6 percent (the smallest estimated price increase) and in fact fell significantly, some net selling must have occurred. Because the composition of the U.S. portfolio changed over time, we believe the results indicated by the Paasche index are the most relevant.³ This suggests that net selling of Sudan-related equities explains the majority of the drop in the value of U.S. holdings. Similarly, from December 2007 to December 2009 (a time period for which SADA was in force), the value of U.S. Sudan-related equity holdings fell by more than 61 percent. During that same time period, prices fell by 34 percent (according to the LasPeyres index), 33 percent (according to the Paasche index) or 32 percent (according to the capitalization weighted index). Because the value of holdings fell by more than any of the price indices, some net selling must have occurred during this time period.

³Results indicated by the Paasche and LasPeyres indices are substantively identical. If U.S. holdings were weighted to the market value of their respective securities (as in the equilibrium of the Capital Asset Pricing Model) and the quantity of outstanding shares were constant, all three indices would collapse to the same value.

Figure 3: Price Indices for the U.S. Sudan-related Equity Portfolio



The question remains open as to whether this net selling of Sudan-related equities was related to conditions specific to Sudan (such as SADA or civil conflict) or broad selling of foreign equities or foreign equities in the oil and gas sector. An ideal approach to this question would involve a comparison group of foreign oil and gas equities available at a similar frequency and time period to the data we collected on Sudan-related equity holdings (quarterly, from March 2007 to December 2009). However, such data are available from public data sources (Treasury International Capital U.S. Portfolio Holdings of Foreign Securities or Bureau of Economic Analysis International Investment Position) on only an annual basis, and data for the end of 2009 were not yet available. We were able to perform a more limited comparison from the end of 2007 to the end of 2008, the first 12 months SADA was in force. During 2008, the value of U.S. Sudan-related equity holdings fell about 59 percent. In comparison, the value of all U.S. foreign oil and gas holdings (according to the 2007 and 2008 Reports on U.S. Holdings of Foreign Securities) fell by only 40 percent, indicating that U.S. investors actively or passively allowed the weight of Sudan-related equity holdings to shrink in their foreign oil and gas portfolio (the proportion fell from 3.4 percent to 2.3 percent).

Similarly, total U.S. foreign equity holdings fell by 46 percent in 2008, indicating that U.S. investors actively or passively allowed the weight of Sudan-related equity holdings to also shrink in their total foreign equity portfolio (the proportion fell from 0.3 percent to 0.2 percent). This is merely suggestive that Sudan-specific factors played a role in U.S. investor selling decisions during 2008.

Appendix III: Questionnaire

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Questionnaire Regarding States' Sudan Investment Policies

U.S. Government Accountability Office

Introduction

The U.S. Government Accountability Office (GAO) is an independent, non-partisan research arm of the legislative branch. GAO assists the U.S. Congress in evaluating the efficiency and effectiveness of federal laws.

The goal of this survey is to describe the effect, if any, of the Sudan divestment campaign on U.S. state-owned assets and on the assets of state-run pension funds. In particular, we hope to identify any challenges faced when considering or implementing divestment policies and laws.

(This survey is part of a larger study requested by the House Financial Services Committee regarding the federal law called the Sudan Accountability and Divestment Act (SADA), Public Law 110-74.) Your responses to this survey will help the GAO answer the House Financial Services Committee's questions about policies and actions affecting each state's assets, including your own.

It is estimated that you will require 30 to 60 minutes to complete this questionnaire. It is divided into 5 sections and has 25 questions and most of the questions are short and may be easily answered by checking a box next to the appropriate response. However, you may need to consult records if your state has divested any assets. After receiving your responses, we may follow up with a brief telephone call to clarify your responses.

The results of this survey will generally be provided in summary form in our report. Individual answers may be discussed, but they will not include any information that could be used to identify individual respondents. For more information, [click here](#).

We understand that there are great demands on your time, so we appreciate your effort in completing this questionnaire. The data you provide in this questionnaire will be a critical input in GAO's report to Congress.

Please complete this questionnaire as soon as possible, but within the next two weeks. Your cooperation in returning the questionnaire promptly is appreciated. When it is issued, we will email you a copy of the report containing these survey results. We plan on issuing the report by summer 2010.

Instructions

To learn more about navigation, exiting and printing the survey, please [click here](#).

Questionnaire Regarding States' Sudan Investment Policies

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To move from section to section: Use the menu bar on the left side of the screen or the "Next section" button at the bottom of each page. Do not use the "Enter" key on your keyboard to navigate through the survey.

To exit and save: Click on the "Exit" button at the bottom of the screen. Always use the "Exit" button to close the survey. If you do not, you will lose all the information that you have entered on the screen of the survey where you improperly exited the program.

To restart your survey: Log onto the survey using your username and password. The survey will restart at the point where you exited.

Indicating You Have Completed the Questionnaire

The final question in the last section asks you to indicate that you have completed this questionnaire. Checking "Complete" tells us that your answers are official and final. Your answers will not be used unless you have done this. Please note we will not send follow-up e-mails to those who have checked the "Complete" button.

Contact

If you have any questions or are experiencing difficulties responding to the questionnaire (for example, if you are unable to complete it online), please contact one of the following persons.

Thank you for your time and assistance.

Section 1: Information on Your State's Sudan-related Investment Policies

NOTE: All questions contained in this survey only pertain to the _____. Even if you have investment authority for additional funds, please only provide answers that pertain to the _____.

1. To the best of your knowledge, has _____ passed any laws or issued any policies that affect investment in companies that do business in Sudan?

Laws or policies may directly target Sudan or include Sudan among a number of countries targeted for divestment, such as state sponsors of terrorism.

(Check only one answer)

- 1. Yes, my state has passed laws and/or state investment authorities have issued policies.
- 2. No, my state has neither passed any laws nor issued any policies. *(Go to question 6.)*
- 3. I don't know if my state has any laws or policies. *(Go to question 6.)*

2. Which authority issued the policy/policies? (For example: the state legislature, the investment board, the governor, etc. If you prefer and it is available, you may e-mail a copy of the policy to: SudanDivestment@gao.gov)

3. To the best of your knowledge, does the law, policy or policies include any of the following provisions?

For the purposes of this survey, to divest is to relinquish assets held in specified companies. This sale of assets is intended to reduce financial and/or political support for an entity in an effort to change that entity's behavior. The sale of assets may also be intended to reduce the investor's exposure to financial risk. Divestment can be implemented either in a blanket manner or a targeted manner. With blanket divestment, all shares in a company are sold immediately upon identification of that company's ties to the scrutinized government. With targeted divestment, companies are contacted first and shares are sold (sometimes in increments) only if the companies do not respond to the concerns of the shareholder contacting them.

For the purposes of this survey, to freeze assets means withholding additional or new investments from (one's current) investments.

Appendix III: Questionnaire

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	Yes	No	Don't know
3a. Requires the person(s) with investment authority to divest from Sudan	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3b. Allows (but does not require) the person(s) with investment authority to divest from Sudan	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3c. Requires the person(s) with investment authority to contact companies prior to divesting	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3d. Allows the person(s) with investment authority to remain invested if targeted companies change their behavior in the Sudan	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3e. Requires the person(s) with investment authority to report any divestment actions taken to the state legislature on a regular basis	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3f. Requires the person(s) with investment authority to identify which companies have ties with Sudan	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3g. Requires the person(s) with investment authority to report the list of identified companies to the state legislature on a regular basis	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3h. Allows the person(s) with investment authority to be indirectly invested in Sudan through mutual funds or hedge funds	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3i. Allows the person(s) with investment authority not to divest if she/he states that divestment would constitute a breach of fiduciary trust	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3j. Prohibits state contracts with companies with ties to Sudan (as defined by the policy/law)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3k. Prohibits future investment in companies with ties to Sudan (as defined by the policy/law)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3l. Other provision (Please specify below)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Other provision:

4. Has the _____ had any written correspondence with the Department of Justice regarding its change of investment policy towards Sudan?
 (Check only one answer)

- 1. Yes
- 2. No
- 3. Don't know
- 4. Not applicable

5. Has the _____ had any written correspondence with the office of the U.S. Special Envoy to Sudan regarding its change of investment policy towards Sudan?

(Check only one answer)

- 1. Yes
 - 2. No
 - 3. Don't know
 - 4. Not applicable
-

Section 2: Engagement

This section specifically asks questions about the engagement of companies. **Engagement** of a company is defined here as: identifying companies and leveraging one's power as a shareholder (or potential shareholder) in an effort to change the investment or operating behavior of that company.

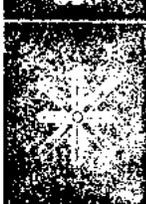
6. Did the _____, or a money manager acting on its behalf, engage with companies who do or did business in Sudan?

(Check only one answer)

- 1. Yes
- 2. No *(Go to question 10.)*
- 3. Don't know *(Go to question 10.)*

7. Which of the following methods did the _____ use when engaging companies?

(Please check one answer per method.)

	Used	Did not use	Don't know
7a. Wrote letter(s)/e-mails to companies concerning their business ties to Sudan	<input type="radio"/>	<input type="radio"/>	
7b. Called or met with companies asking them for information on their business ties to Sudan	<input type="radio"/>	<input type="radio"/>	
7c. Informed companies the _____ might divest or freeze assets if they did not cease all business ties to Sudan	<input type="radio"/>	<input type="radio"/>	
7d. Informed companies the _____ might divest or freeze assets if they did not change the nature of their operations in Sudan, such as providing humanitarian outreach programs for Sudanese people, engaging with the Sudanese Government, or conducting a human rights impact assessment	<input type="radio"/>	<input type="radio"/>	
7e. Used an intermediary to communicate with the targeted companies (For example, Conflict Risk Network)	<input type="radio"/>	<input type="radio"/>	
7f. Other method <i>(Please specify below)</i>	<input type="radio"/>	<input type="radio"/>	

Other method:

8. With which operating companies did the _____ "engage"?

(You may write the names below. However, if it is easier, you may copy the names of the companies from your records and paste them in the space below. You may also send a copy of your records listing the companies to SudanDivestment@gao.gov.)

9. To the best of your knowledge, how many companies gave the following responses after the _____'s engagement with them?

(Please check one answer per response from companies.)

	All	More than half	About half	Less than half	None	Don't know
9a. The targeted companies provided no response to our letters and/or phone calls	<input type="radio"/>					
9b. The targeted companies informed us that they had left/planned to leave Sudan	<input type="radio"/>					
9c. The targeted companies provided more information about their business that revealed there was no need to divest	<input type="radio"/>					
9d. The targeted companies informed us that they changed or will change their operations (for example: limited partnerships with companies that may have strong ties to the Government of Sudan (GOS), committed to refuse any future contracts for work in Sudan once current contract obligations are satisfied, increased extent of humanitarian activities, etc.)	<input type="radio"/>					
9e. The targeted companies informed us that they did not or will not change their practices in Sudan	<input type="radio"/>					
9f. Other response from companies (Please specify below)	<input type="radio"/>					

Other response from companies:

Section 3: Divestment

For the purposes of this survey, to **divest** is to relinquish assets held in specified companies. This sale of assets is intended to reduce financial and/or political support for an entity in an effort to change that entity's behavior. The sale of assets may also be intended to reduce the investor's exposure to financial risk. Divestment can be implemented either in a blanket manner or a targeted manner. With blanket divestment, all shares in a company are sold immediately upon identification of that company's ties to the scrutinized government. With targeted divestment, companies are contacted first and shares are sold (sometimes in increments) only if the companies do not respond to the concerns of the shareholder contacting them.

For the purposes of this survey, to **freeze assets** means withholding additional or new investments from (one's current) investments.

10. Did the _____ divest or freeze assets, or does it plan to divest/freeze, any or all of its Sudan-related assets?

(Check only one answer)

- 1. Yes, the fund has divested and/or frozen some or all of its assets.
- 2. Yes, the fund is planning to divest and/or freeze some or all of its assets.
- 3. No, the fund is not divesting or freezing any of its assets. *(Go to question 19.)*
- 4. The fund did not have assets invested in Sudan-related business. *(Go to question 20.)*
- 5. Don't know *(Go to question 20.)*

11. Which of the following methods did the _____ use, or will use, when divesting/freezing some or all of its Sudan-related assets?

(Please check one answer per method)

	Used	Did not use	Don't know
11a. Divested and/or froze assets without contacting companies the _____ divested from	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
11b. Divested and/or froze assets after communicating with companies and being unsatisfied with their response	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
11c. Informed companies that the _____ would not invest in them in the future unless they changed their business ties or operations in Sudan	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
11d. Other method <i>(Please specify below)</i>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Other method:

12. What were the major, moderate, and minor reasons for the _____'s divesting/freezing assets in Sudan?

(Please check one answer per reason.)

	Major reason	Moderate reason	Minor reason	Not a reason	No opinion
12a. Divesting from Sudan could reduce the financial risk my office's investments were exposed to	<input type="radio"/>				
12b. Divesting from Sudan could improve the returns on my office's investments	<input type="radio"/>				
12c. The _____ was required to divest	<input type="radio"/>				
12d. Divesting from Sudan could alleviate concerns about indirectly supporting a country designated as a State Sponsor of Terrorism	<input type="radio"/>				
12e. Divesting from Sudan could alleviate concerns about indirectly supporting the genocide and human rights abuses in Darfur	<input type="radio"/>				
12f. Divesting from Sudan was likely to have a positive impact (i.e., take revenue source away from the government of Sudan)	<input type="radio"/>				
12g. Other reason <i>(Please specify below)</i>	<input type="radio"/>				

Other reason:

13. To what extent was the _____ concerned about each of the following when divesting/freezing Sudan-related assets?

(Please check one answer per concern.)

	To a large extent	To a moderate extent	To a small extent	To no extent	No opinion
13a. Engaging companies was too difficult and/or costly	<input type="radio"/>				
13b. Divesting could cause my office to incur high transaction costs and/or earn reduced returns on investment	<input type="radio"/>				
13c. It would be difficult to divest while ensuring that fiduciary trust requirements were not breached and my office/state was not made vulnerable to law suits	<input type="radio"/>				
13d. Despite SADA's explicit authorization, it would be difficult to divest while ensuring that the state was not left open to law suits	<input type="radio"/>				

	To a large extent	To a moderate extent	To a small extent	To no extent	No opinion
alleging that divestment practice is unconstitutional	<input type="radio"/>				
13e. Divesting might force an operating company out of the Sudanese market, leaving room for one with more questionable business practices	<input type="radio"/>				
13f. It would be difficult and costly to identify accurate and authoritative information regarding companies with business ties to Sudan	<input type="radio"/>				
13g. There was concern about setting a dangerous precedent for divesting because of other social concerns	<input type="radio"/>				
13h. Other reason (Please specify below)	<input type="radio"/>				

Other reason:

14. Did, or will, the _____ divest or freeze directly-held assets related to Sudan?

(Check only one answer)

1. Yes, all directly-held assets have been, or will be, divested or frozen.
2. Yes, some directly-held assets have been, or will be, divested or frozen.
3. No, directly-held assets have not, or will not, be divested or frozen.
4. The fund had no directly-held assets in Sudan.
5. Don't know

15. Did, or will, the _____ divest or freeze indirectly-held assets (e.g., assets held in a commingled fund) related to Sudan?

(Check only one answer)

1. Yes, all indirectly-held assets have been, or will be, divested or frozen. (Go to question 17.)
2. Yes, some indirectly-held assets have been, or will be, divested or frozen. (Go to question 17.)
3. No, indirectly-held assets have not, or will not, be divested or frozen. (Go to question 16.)
4. The fund had no indirectly-held assets in Sudan. (Go to question 17.)
5. Don't know (Go to question 17.)

16. To what extent were each of the following factors a reason why the

_____ did not or will not divest its indirectly-held assets?

(Please check one answer per factor.)

	To a large extent	To a moderate extent	To a small extent	To no extent	No opinion
16a. As one of many investors, did not have authority to divest	<input type="radio"/>				
16b. It was too costly	<input type="radio"/>				
16c. The law/policy only requires the divestment of directly-held assets	<input type="radio"/>				
16d. Other factor <i>(Please specify below)</i>	<input type="radio"/>				

Other factor:

If the _____ has NOT yet divested or frozen assets, click on link below to go to question 20.

[Click here to skip to question 20.](#)

17. If the _____ has already divested or frozen assets, what was the name/ names of the company/companies from which it divested or froze assets, the date of divestment or freezing, and the value divested or frozen from the company (in U.S. dollars)?

(You may enter the information for up to 5 companies below. If you divested or froze assets from more than 5 companies, or if it is easier to cut and paste information from your records, you may enter the information in the large box at the end of question 17. You may also send a copy of your records listing the companies to SudanDivestment@gao.gov.)

Company #1 from which the fund divested/ froze assets:

17a. Name of company

17b. Date of divestment/ date when value of frozen assets was calculated (month/year)



17c. Value frozen/ divested from the company (in US\$) \$

Company #2 from which the fund divested/ froze assets:

17d. Name of company

17e. Date of divestment/ date when value of frozen assets was calculated (month/year)



17f. Value frozen/ divested from the company (in US\$) \$

Company #3 from which the fund divested/ froze assets:

17g. Name of Company

17h. Date of divestment/ date when value of frozen assets was calculated (month/year)



17i. Value frozen/ divested from the company (in US\$) \$

Company #4 from which the fund divested/ froze assets:

17j. Name of Company

17k. Date of divestment/ date when value of frozen assets was calculated (month/year)



17l. Value frozen/ divested from the company (in US\$) \$

Company #5 from which the fund divested/ froze assets:

17m. Name of Company

17n. Date of divestment/ date when value of frozen assets was calculated (month/year)



17o. Value frozen/ divested from the company (in US\$)

Please enter information on additional companies or from your records below. For each company, please include the company name, date of divestment/ date when value of frozen assets was calculated, and value frozen/ divested from each company.

18. If the _____ has already divested or frozen assets, to the best of your knowledge, how many companies took the following actions after the _____'s divestment from them?

(Please check one answer per action.)

	All	More than half	About half	Less than half	None	Don't know
18a. The targeted companies changed their operations	<input type="radio"/>					
18b. The targeted companies left Sudan	<input type="radio"/>					
18c. The targeted companies increased the number or extent of humanitarian activities they fund in Sudan	<input type="radio"/>					
18d. The targeted companies did nothing	<input type="radio"/>					
18e. Other action (Please specify below)	<input type="radio"/>					

Other action:

After answering question 18, click on link below to go to question 20.

[Click here to skip to question 20.](#)

19. If the _____ did not or will not freeze or divest any Sudan-related assets, to what extent did each of the following factors influence the decision not to freeze or divest Sudan-related assets?

(Please check one answer per factor.)

	To a large extent	To a moderate extent	To a small extent	To no extent	No opinion	Not applicable
19a. The _____ did not divest since it is not required to	<input type="radio"/>					
19b. The _____ determined it had no directly-held assets in companies operating in Sudan	<input type="radio"/>					
19c. The _____ determined it had no indirectly-held assets (i.e., commingled funds) in companies operating in Sudan	<input type="radio"/>					
19d. The _____ determined that it had indirectly-held assets (i.e., commingled funds) in companies operating in Sudan but did not have the authority to divest	<input type="radio"/>					
19e. The _____ did not view divesting as a positive tool to promote change	<input type="radio"/>					
19f. Divesting would have caused State/name of fund to incur high transaction costs and/or earn reduced returns on investment	<input type="radio"/>					
19g. Divesting would have conflicted with my fiduciary trust requirements thereby making the _____ vulnerable to law suits	<input type="radio"/>					
19h. It was too difficult and too costly to identify accurate and authoritative information regarding companies with business ties to Sudan	<input type="radio"/>					
19i. Engaging companies was preferable to divesting	<input type="radio"/>					
19j. Divesting would have forced an operating company out of the Sudanese market, leaving room for one with more questionable business practices	<input type="radio"/>					
19k. Adopting a policy encouraging divestment from Sudan would have set a dangerous precedent for divesting because of other social concerns	<input type="radio"/>					
19l. In order to divest from certain companies, the _____ would have had to sell off entire funds, such as international funds, which are the most	<input type="radio"/>					

	To a large extent	To a moderate extent	To a small extent	To no extent	No opinion	Not applicable
lucrative						
19m. Despite SADA's explicit authorization, divesting would have left the _____ open to law suits alleging that divestment practice is unconstitutional	<input type="radio"/>					
19n. Other factor (Please specify below)	<input type="radio"/>					

Other factor:

Section 4: Sources of Information

20. Did your state, fund, or governing body attempt to identify companies with ties to Sudan?

(Check only one answer)

- 1. Yes
- 2. No *(Go to question 24.)*
- 3. Don't know *(Go to question 24.)*

21. Below is a list of sources commonly used to identify companies with ties to Sudan. How useful were each of these sources to your office as it attempted to identify companies with business operations in Sudan?

(Please check one answer per source.)

	Very useful	Useful	Somewhat useful	Not at all useful	No Opinion	Did not use
21a. Government source: The Securities and Exchange Commission's EDGAR database on-line (SEC)	<input type="radio"/>					
21b. Government source: Treasury Department's Office of Foreign Asset Controls List (OFAC)	<input type="radio"/>					
21c. Commercial or private source: Private research companies (such as CSAG, RiskMetrics, Bloomberg Terminal, etc.)	<input type="radio"/>					
21d. Commercial or private source: Socially responsible investment firm (e.g., Calvert, Domini Investments, etc.)	<input type="radio"/>					
21e. NGOs/Advocacy groups (Such as: Investors Against Genocide, The Sudan Divestment Task Force/Conflict Risk Network)	<input type="radio"/>					
21f. Other source <i>(Please specify below)</i>	<input type="radio"/>					

Other source:

22. Overall, how sufficient did your office think the information provided by the sources it consulted was in identifying companies with business ties to Sudan as defined under the _____'s policy or law?

(Check only one answer)

- 1. Very sufficient
- 2. Sufficient
- 3. Somewhat sufficient
- 4. Not at all sufficient

- 5. No opinion
- 6. Don't know
- 7. Not applicable

23. What are the reason(s) for your response to question 22?

Section 5: Contact information

24. Do you have any additional comments?

25. What are the names, titles, phone number, and e-mail address of the person(s) completing this questionnaire?

(Enter information in boxes below.)

Person #1:

Name

Title

Phone number, including area code

E-mail Address

Person #2:

Name

Title

Phone number, including area code

E-mail Address

Completed

26. If you have completed the survey, please check "Completed" below. Clicking on "Completed" indicates that your answers are final.

Your answers will not be used unless you check **COMPLETED** below.

(Check only one answer)

- 1. Completed
- 2. Not completed

Thank you

Thank you for your participation!

If applicable, please remember to send a copy of your state's divestment policy, a list of companies with which you engaged, and/or the list of companies from which you divested or froze assets, the date of divestment, and value divested to SudanDivestment@gao.gov.

Printing a Copy of Your Survey Responses

[Click here](#) to view and print your survey responses.

Click on the Exit button below to exit the survey. Always use the "Exit" button to exit or close the survey.

Print

Exit

Cancel

Appendix IV: Comments from the Securities and Exchange Commission

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

June 14, 2010

Thomas Melito
Director, International Affairs and Trade
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Melito:

Thank you for the opportunity to review and comment on the Government Accountability Office's draft report entitled *Sudan Divestment: U.S. Investors have Sold Assets but Could Benefit from Increased Disclosure Regarding Companies' Ties to Sudan* (GAO-10-742).

The GAO recommends that the SEC consider issuing a rule requiring companies that trade on U.S. exchanges to disclose their business operations tied to Sudan as well as possibly other state sponsors of terrorism. As the report noted, the federal securities laws do not specifically require public companies to disclose this information. Rather, these laws require this disclosure when the information is "material." It is important to note that companies are not free to make their own judgments as to whether these matters are "material." The materiality test for misstatements or omission of facts is an objective test based on the informational needs of a reasonable investor. In the Division of Corporation Finance's view, companies have a strong incentive to make appropriate judgments about materiality, in that they may face significant federal securities law liability for disclosure that includes material misstatements or material omissions that make the information provided misleading. The Division reviews company filings with this materiality standard for disclosure in mind. Through our review and comment process, the Division questions public companies about their business operations tied to Sudan and other state sponsors of terrorism and, where appropriate, the Division asks companies to explain and revise their disclosure about those ties.

The decision as to whether to adopt corporate disclosure requirements that expand beyond materiality is one which must be presented to the Commission for its consideration. In presenting GAO's recommendation to the Commission, the Division will note that jurisdictions throughout the U.S. have adopted numerous divestiture-like statutes concerning a variety of topics. While the GAO's recommendation relates to investors' access to information about companies' activities with respect to a specific subset of those divestiture statutes – those relating to Sudan – the Division is concerned that if the Commission were to adopt disclosure requirements to facilitate compliance with the broad span of these statutes – without consideration of the materiality of that disclosure to the overall mix of information about a company – the volume of information could overwhelm investors and could possibly obscure other material information. Such an outcome would run counter to the fundamental purposes of

See comment 1.

See comment 2.

Thomas Melito
Page 2

disclosure under the securities laws – i.e., to provide investors with meaningful information and promote price discovery efficiency in the securities markets.

Thank you for the courtesy the GAO extended to the SEC during the course of preparing its report, and thank you again for giving us the opportunity to provide you with comments as you finalize it.

Sincerely,



Meredith B. Cross
Director

The following are GAO's comments on the letter from the SEC's Division of Corporation Finance, dated June 14, 2010.

GAO Comments

1. The meaning of "material information" is not explicitly defined by law, but the Supreme Court has determined that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision or the information would significantly alter the total mix of available information. In evaluating companies' disclosures regarding global security-risk related issues, the SEC's Office of Global Security Risk has asked companies to consider both quantitative and qualitative factors, such as the potential impact of corporate activities upon a company's reputation and share value. As we note in our report, however, companies have generally resisted these instructions and, at times, have refused to disclose information about their ties to Sudan.
2. As we state in our report, the SEC's Office of Global Security Risk has suggested to companies that any operations they have in state sponsors of terrorism might be considered material because divestment campaigns and legislation mandating divestment from Sudan indicate that investors would consider this information important in making investment decisions.

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Thomas Melito (202) 512-9601 or melitot@gao.gov

Staff Acknowledgments

In addition to the contact named above, Cheryl Goodman, Assistant Director; Elizabeth Singer; Katy Forsyth; Michael Hoffman; R.G. Steinman; Julia Becker Vieweg; Sada Aksartova; Kay Halpern; Debbie Chung; Ann Baker; JoAnna Berry; Noah Bleicher; Martin de Alteriis; Patrick Dynes; Etana Finkler; Justin Fisher; Cathy Hurley; Ernie Jackson; Debra Johnson; Julia Kennon; Jill Lacey; Andrea Miller; and Linda Rego make key contributions to this report.

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Washington, DC 20548



n : o r o i o o n i s u o i o r n i u i
i s r o r n

o n i s i s n s r i					
Company Name (Domicile)	Summary of Ties to Iran	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010	
1 Daelim Industrial Co. (South Korea)	In June 2009, Daelim Industrial Co. Ltd won a contract to build pipelines for an LNG storage facility in Iran.	In 2009, Daelim Industrial was designated as "Restricted From Additional Purchase." In early 2010, CalSTRS divested holdings of the company and designated the company as "Restricted."	0	\$0	
2 Kunlun Energy Co. (Formerly CNPC Hong Kong) and Sinopec a linked company (China)	Kunlun Energy Company's parent, Sinopec, is linked to Iran through oil exploration contracts and interests, refining, and commercialization of gas processing products.	In 2009, Sinopec and its related companies, including CNPC Hong Kong, were designated as "Restricted." In February 2010, CNPC Hong Kong changed its name to Kunlun Energy Co. Sinopec and all of its subsidiaries, including Kunlun Energy Co., remain "Restricted."	0	\$0	
3 MISC Bhd (Malaysia)	MISC is a Malaysian shipping company that is linked to Iran through its Parent Company, Petronas (which is also "Restricted"). Additionally, MISC has several ports of call in Iran.	In 2009, CalSTRS designated MISC as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0	
4 Oil and Natural Gas Company of India (India)	Oil and Natural Gas Company of India (ONGC) holds stakes in at least one Iranian gas field and is reportedly considering others.	ONGC was not on the 2009 Iran list but has already been restricted for ties to Sudan. In early 2010, CalSTRS also designated he company as "Restricted" for ties to Iran, as well.	0	\$0	
5 PetroChina and CNPC - as connected corporations to the Chinese National Oil Company (China)	PetroChina is linked to Iran through its parent, China National Petroleum Corp. (CNPC), which has interests in several Iranian oil and gas projects.	In 2009, CalSTRS designated PetroChina as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0	
6 Petronas (Malaysia)	Petronas has interest in multiple gas fields in Iran that are in the production phase. Additionally, in 2010, the company reportedly ceased supplying refined products to Iran. However, the company stated it is due to Iran's lack of demand and has not pledge to cease activities in the country.	In 2009, CalSTRS designated Petronas as "Restricted." CalSTRS has maintained the "Restricted" designation in 2010.	0	\$0	

Company Name (Domicile)	Summary of Ties to Iran	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
7 PTT (Thailand)	PTT, through its subsidiary PTT Exploration and Production, has an interest in an oil block in Iran.	PTT was not on CalSTRS 2009 Iran List. The company was designated as "Review" in early 2010. After the company confirmed its ties and intent to continue its relationship in Iran, PTT and its subsidiaries were designated as "Restricted."	0	\$0

o n i s i n M o n i o r				
Company Name (Domicile)	Summary of Ties to Iran	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
1 Alstom (France)	Alstom maintains an office in Iran but has not taken on new business in the country for several years.	In 2009, CalSTRS designated Alstom as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	197,462	\$8,157,356
2 ENI S.P.A. (Snam Rete Gas S.P.A. –Subsidiary) (Italy)	ENI has interests in three Iranian oilfields, two of which are in the recovery phase. The company reported to CalSTRS that they believe their work on the third is complete, but the National Iranian Oil Company (NIOC) has not yet accepted taking over the project. In February 2010, ENI committed to withdraw from Iran and not take on any further Iranian business.	In 2009, CalSTRS designated ENI and Snam Rete Gas as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	ENI 4,005,773 Snam Rete 2,731,945	ENI \$80,824,947 Snam Rete \$13,016,087
3 INPEX (Japan)	INPEX held a 10% stake in an Iranian oil field, which it withdrew from in 2010, and committed to stop doing business in Iran.	In 2009, CalSTRS designated Lukoil as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	1,756	\$9,024,209
4 Itochu (Japan)	Itochu is part of a joint venture high density polyethylene plant with the Mehr Petrochemical Company.	While chemicals are not a restricted industry, given the close relationship between chemicals and petroleum, CalSTRS designated the company as "Monitor" in 2009. CalSTRS has maintained the "Monitor" designation in 2010.	2,178,988	\$20,184,967

Company Name (Domicile)	Summary of Ties to Iran	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
5 Gazprom (Russia)	In July 2008, Gazprom signed an MOU with the NIOC, which expired in July 2010. Additionally, Gazprom Neft, a subsidiary of Gazprom, signed an MOU with the NIOC providing for joint exploration of oil fields in Iran.	In 2009, CalSTRS designated Gazprom as "Further Review." In 2010, CalSTRS designated Gazprom as "Monitor" after confirming the company has no current investments in the country. While the company has an outstanding MOU, the company views it only as a letter of intent and not binding. CalSTRS will continue to monitor the company for action on their MOU.	ADR (USA) 2,048,119 ADR (UK) 1,717,880 144A 53,140	ADR (USA) \$45,181,505 ADR (UK) \$38,205,651 144A 2,933,593
6 GS Holding Corp and GS Engineering & Construction – Subsidiary (South Korea)	In 2009, the company disclosed it had been awarded a contract to participate in a gas treatment project in Iran. In July 2010, the company announced it was cancelling the contract.	In 2009, CalSTRS designated GS Holdings as "Restricted From Additional Purchase" and was divested in early 2010. After the company confirmed to CalSTRS in November 2010 that it had cancelled its gas sweetening contract and was not seeking new business in Iran, it was removed from the "Restricted" list and designated as "Monitor."	0	\$0
7 Linde AG (Germany)	The Linde Group has not had involvement in the Iranian petroleum industry since 2007. However, Linde does have business units in Iran that market specialty gasses for industrial, food processing, and medical applications.	In 2009, CalSTRS designated Linde as "Monitor." CalSTRS has maintained that designation in 2010 as the company still has operations in Iran and has a history of working in the Iranian petroleum industry.	190,786	\$26,723,059
8 Lukoil (Russia)	Lukoil has withdrawn from Iran due to international pressure and its exposure to United States markets, where it has 2,000 retail gas stations. In March 2010, the company announced it was suspending work on the Anaran field where it had a service contract to explore the field but required no investment on its part. Additionally, in April 2010, the company committed to stop supplying oil to Iran through its trading arm.	In 2009, CalSTRS designated Lukoil as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	ADR (USA) 297,509 ADR (UK) 1,202,600	ADR (USA) \$16,306,468 ADR (UK) \$66,503,780
9 Mitsui Engineering & Shipbuilding (Japan)	Mitsui Engineering & Shipbuilding has two projects in advanced stages of construction. The company has reported it plans to complete its current obligations but plans no further activities in Iran.	In 2009, CalSTRS designated Mitsui Engineering and Shipbuilding as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	570,000	\$1,313,239

Company Name (Domicile)	Summary of Ties to Iran	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
10 OMV (Austria)	OMV had a 34% stake in the Mehr Block of Iran until the end of 2009, but the assets were written off as the field was found to be economically unviable. The consortium withdrew in early 2009, and OMV wrote off the assets. Additionally, OMV had an MOU to develop parts of the South Pars project but withdrew.	In 2009, CalSTRS designated OMV as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	177,003	\$5,965,407
11 Petroleo Brasileiro "Petrobras" (Brazil)	Petrobras had a contract to explore an oil block in Iran that expired in July 2009. The company has stated they have no further activities or plans in Iran.	In 2009, CalSTRS designated Petrobras as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	Common 97,700 ADR (Level 3) 1,481,200 ADR (Level 2) 1,937,700 Preferred 136,927	Common \$1,554,770 ADR (Level 3) \$48,050,128 ADR (Level 2) \$56,735,856 Preferred \$1,957,692 1,184,461
12 Repsol (Spain)	Repsol withdrew from the South Pars development in June 2010. Additionally, Repsol terminated contractual relationships regarding three other exploration blocks in 2009.	In 2009, CalSTRS designated Repsol as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	48,972	1,184,461
13 Royal Dutch Shell (United Kingdom)	Royal Dutch Shell is linked to Iran through two buy-back contracts that are in the recovery phase. Additionally, Shell was part of a consortium with a tentative agreement to develop fields in the South Pars gas field. Shell and its partners never reached a final agreement and withdrew from the project in January of 2010.	In 2009, CalSTRS designated Royal Dutch Shell as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	A Shares (UK) 2,280,982 A Shares (Netherlands) 3,356,664 ADR 9,100 B Shares 2,688,200 Bonds \$45,210,000	A Shares (UK) \$68,772,327 A Shares (Netherlands) \$101,351,374 ADR \$552,097 B Shares \$79,877,866 Bonds \$46,786,728

	Company Name (Domicile)	Summary of Ties to Iran	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
14	Sasol Ltd. (South Africa)	Sasol has a joint venture polyethylene plant in Iran with the state owned National Petrochemical Company.	Sasol was not included in the CalSTRS 2009 Iran list. While chemicals are not a restricted industry, given the close relationship between chemicals and petroleum, CalSTRS has designated the company as "Monitor" in 2010.	516,678	\$22,969,942
15	Siemens AG (Germany)	Siemens AG announced in January 2010 and confirmed to CalSTRS' staff that it would end its business with Iran by mid-2010. CalSTRS did not find the activities of Siemens' business with Iran prior to 2010 met the criteria for divestment.	In 2009, CalSTRS designated Petrobras as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	1,377,060	\$151,097,163
16	Statoil (Norway)	Statoil is tied to Iran through a contract on the South Pars gas field that has been turned over to the NIOC but will continue to assist the NIOC for a limited time during the transition. Additionally, Statoil has two exploration contracts that are on hold. Statoil announced in 2008 that it will withdraw from Iran after the fulfillment of its current contracts.	In 2009, CalSTRS designated StatoilHydro (the company's previous name) as "Monitor." CalSTRS has maintained the "Monitor" designation for Statoil in 2010.	Common 1,314,727 ADR 154,568	Common \$26,061,238 ADR \$3,089,814
17	Technip (France)	Technip has had involvement in Iran as recently as 2008	In 2009, CalSTRS designated Technip as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010 as the company has not confirmed that is not seeking new business in the country.	212,990	\$16,585,670
18	Trevi-Finanziaria Industriale S.P.A. (Italy)	Trevi-Finanziaria Industriale had a contract to work on the foundations at a port in Iran that was completed in September 2009.	Trevi-Finanziaria was not identified on the CalSTRS 2009 Iran list. The company was added to the "Non Holdings that Possibly Meet the Divestment Criteria" in early 2010 and was placed under review when a CalSTRS manager purchased stock in the company. The company confirmed it completed its project in 2009 and was moved to the "Monitor" designation as they have not pledged to stop accepting Iranian business.	22,057	\$272,771

	Company Name (Domicile)	Summary of Ties to Iran	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010												
19	Total SA (France)	Total SA no longer has operations in Iran but is tied to the country through two buy-back contracts, which are in the cost-recovery phase. The company has pledged to withdraw and not seek further business in the country.	In 2009, CalSTRS designated Total as "Monitor." CalSTRS has maintained the "Monitor" designation in 2010.	<table border="1"> <tr> <td>Common</td> <td>2,711,371</td> </tr> <tr> <td>Strip</td> <td>10,000</td> </tr> <tr> <td>Bonds</td> <td>\$300,000</td> </tr> </table>	Common	2,711,371	Strip	10,000	Bonds	\$300,000	<table border="1"> <tr> <td>Common</td> <td>\$131,704,249</td> </tr> <tr> <td>Strip</td> <td>13.02</td> </tr> <tr> <td>Bonds</td> <td>\$321,725</td> </tr> </table>	Common	\$131,704,249	Strip	13.02	Bonds	\$321,725
Common	2,711,371																
Strip	10,000																
Bonds	\$300,000																
Common	\$131,704,249																
Strip	13.02																
Bonds	\$321,725																

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	Company Name (Domicile)	Summary of Ties to Iran	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
1	CNOOC (China)	According to CNOOC's most recent 20-F Filing, the company does not have any ties to Iran, but its state owned parent may.	In 2009, CalSTRS designated CNOOC as "Further Review." CNOOC was being considered for divestment because of the lack of clarity between it and its parent when it was announced CNOOC was buying 33% of Chesapeake Energy's stake in the Eagle Ford Shale project in south Texas. CalSTRS views this purchase as significant because it gives CNOOC US-based assets that could be subject to sanctions. CalSTRS hopes the deal will force the company to make more disclosures about its ties to Iran. Staff is planning to go to China to meet with the company and its parent if meetings can be organized.	11,485,000	\$24,905,501

	Company Name (Domicile)	Summary of Ties to Iran	Summary of Changes From 2009	Shares Held by CalSTRS 11/30/2010	Market Value (\$) of Shares Held by CalSTRS 11/30/2010
2	Hyundai Engineering and Construction Co. (South Korea)	Hyundai Engineering and Construction does not appear to have any current projects in Iran but does have an office in Tehran and expressed interest in taking on projects in the past.	Hyundai Engineering and Construction was designated "Non Holdings that Possibly Meet the Divestment Criteria." In late 2010, one of CalSTRS managers purchased shares of Hyundai Engineering and Construction, and CalSTRS moved the company to "Review" and began the engagement process.	1,170	\$63,778
3	Petrofac Limited (United Kingdom)	Petrofac Limited has one office in Tehran, but it is not clear if they have any business in Iran since completing a project in 2007.	Petrofac was not designated on the 2009 Iran list. Petrofac was designated as "Review" in 2010 and the engagement process was begun.	554,630	\$12,014,812

California State Teachers'
Retirement System
Investments
100 Waterfront Place, MS. 04
West Sacramento, CA 95605-2807
(916) 414-7400 Fax (916) 414-7533
cailman@calstrs.com

November 5, 2010

Rolf Doerig, Chairman
Adecco
Adecco Management & Consulting
Glattbrugg, 8152
Switzerland

Dear Rolf Doerig,

This letter is sent to you on behalf of the California State Teachers' Retirement System (CalSTRS). As you may be aware, CalSTRS is a public pension fund established for the benefit of California's public school teachers over 97 years ago. CalSTRS serves the investment and retirement interests of over 847,000 plan participants. As of October 31, 2010, the CalSTRS portfolio was valued at over **\$141 billion**; approximately **\$76 billion** of the fund's assets are invested in the public equity markets, on both a domestic and an international basis. A significant percentage of CalSTRS' public equity portfolio is invested in the indexed or passive style of investment management; these stocks do not trade on company news or events; we hold these stocks for the long-term. We do use our corporate governance rights to address issues with corporations that are held in our portfolio; in our view, this strategy is more efficient for the investing considerations of diversification, minimizing risks and costs, and maximizing returns than simply selling a security each time we have shareholder concerns. CalSTRS currently holds \$7,749,883 worth of Adecco securities in our portfolio.

Under a 1999 California Law, CalSTRS is required to monitor our portfolio for companies that have operations in Northern Ireland. In addition to the law, CalSTRS investments are governed by a 21-point Geopolitical Risk Policy that can be accessed in our Board Policy Manual found on our website www.calstrs.com. CalSTRS has contracted with ISS, a subsidiary of MSCI Inc., to provide us with information on companies that have operations in Northern Ireland. Furthermore, ISS reports on the companies' identified efforts towards inclusiveness in Northern Ireland. Adecco has been identified as having operations in Northern Ireland and not having taken substantial action towards inclusiveness. As long-term investors, we encourage Adecco to take substantial action such as adopting the MacBride principles to address this issue.

Rolf Doerig
November 5, 2010
Page 2

If you have any questions, please feel free to contact the CalSTRS corporate governance staff at:

CalSTRS - Corporate Governance Unit
Investments
7667 Folsom Blvd, MS-4
Sacramento, CA 95826

Sincerely,

A handwritten signature in black ink, appearing to read 'C. Ailman', written in a cursive style.

Christopher Ailman
Chief Investment Officer



California State Teachers'
Retirement System
Investments
100 Waterfront Place, MS. 04
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(916) 414-7400 Fax (916) 414-7533
cailman@calstrs.com

November 5, 2010

Takashi Yamauchi, Chief Executive Officer
Taisei Corp.
Shinjuku Center Building
Shinjuku-ku, TKY 160-0606
JAPAN

Dear Takashi Yamauchi,

This letter is sent to you on behalf of the California State Teachers' Retirement System (CalSTRS). As you may be aware, CalSTRS is a public pension fund established for the benefit of California's public school teachers over 97 years ago. CalSTRS serves the investment and retirement interests of over 847,000 plan participants. As of October 31, 2010, the CalSTRS portfolio was valued at over **\$141 billion**; approximately **\$76 billion** of the fund's assets are invested in the public equity markets, on both a domestic and an international basis. A significant percentage of CalSTRS' public equity portfolio is invested in the indexed or passive style of investment management; these stocks do not trade on company news or events; we hold these stocks for the long-term. We do use our corporate governance rights to address issues with corporations that are held in our portfolio; in our view, this strategy is more efficient for the investing considerations of diversification, minimizing risks and costs, and maximizing returns than simply selling a security each time we have shareholder concerns. CalSTRS currently holds \$1,804,345 worth of Taisei Corp. securities in our portfolio.

Under a 1999 California Law, CalSTRS is required to monitor our portfolio for companies that have ties to World War II forced labor. In addition to the law, CalSTRS investments are governed by a 21-point Geopolitical Risk Policy that can be accessed in our Board Policy Manual found on our website www.calstrs.com. CalSTRS has contracted with ISS, a subsidiary of MSCI Inc., to provide us with information on companies that have exposure to forced labor during World War II and Taisei Corp. has been identified as having outstanding legal issues relating to World War II Forced Labor. As long-term investors, we encourage Taisei Corp. to resolve any outstanding issues relating to forced labor as soon as possible to mitigate the risks this issue poses to investors.

Takashi Yamauchi
November 5, 2010
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If you have any questions, please feel free to contact the CalSTRS corporate governance staff at:

CalSTRS - Corporate Governance Unit
Investments
7667 Folsom Blvd, MS-4
Sacramento, CA 95826

Sincerely,

A handwritten signature in black ink, appearing to read 'C. Ailman', written in a cursive style.

Christopher Ailman
Chief Investment Officer