

**Bill Number: SB 903 (Anderson) as amended on July 1, 2011.**

## **SUMMARY**

SB 903 requires that any determination made by CalSTRS that an action as specified in the California Public Divest from Iran Act would be a breach of fiduciary duty be made in a public hearing of the full board after proper public notice and an opportunity for public comment.

## **PURPOSE OF THE BILL**

SB 903 addresses concerns that public retirement systems in this state invest in publicly traded foreign companies that may be at risk due to business ties with foreign states such as Iran that sponsor terrorism and are involved in the proliferation of weapons of mass destruction.

## **BOARD POSITION**

**Oppose.** This measure would infringe on the investment authority of the Teachers' Retirement Board (board) and potentially compromise its fiduciary responsibility.

## **SUMMARY OF AMENDMENTS**

The amendment of July 1, 2011 makes the California Public Divest from Iran Act operative only if AB 1151 is enacted and takes effect on or before January 1, 2012.

## **LEGISLATIVE HISTORY**

Public Law 111-195, 111<sup>th</sup> Congress, 2010 (HR 2475—Berman) enacted the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, which among other things granted states and local governments the authority to prohibit investment of state or local government assets in persons that engage in investment activities in the energy sector of Iran, as long as Iran is subject to economic sanctions imposed by the United States.

Chapter 671, Statutes of 2007 (AB 221—Anderson) prohibited CalSTRS and CalPERS from investing in companies with business operations in Iran and require each pension system to sell or transfer any investments in a company with business operations in Iran. When the U.S. repeals its sanctions against Iran, the pension Boards shall notify the Secretary of State, and the prohibitions and requirements in this bill will be repealed.

Public Law 104-172, 104<sup>th</sup> Congress, 1996 (HR 3107--Gilman) enacted the Iran and Libya Sanctions Act of 1996 imposing sanctions on persons making certain investments directly and significantly contributing to the enhancement of the ability of Iran or Libya to develop its petroleum resources, and on persons exporting certain items that enhance Libya's weapons or aviation capabilities or enhance Libya's ability to develop its petroleum resources, and for other purposes.

**ANALYSIS:****Existing Law:**

The fiduciary standards in the Teachers' Retirement Law require the board, CalSTRS officers and employees to discharge their duties with respect to CalSTRS solely in the interests of the members and beneficiaries for the exclusive purpose of providing benefits. Under the provisions, of Section 17 of Article XVI of the California Constitution, as amended by Proposition 162, the board has plenary authority and fiduciary responsibility over the investment of retirement plan assets.

The Constitution states, however, that the Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so and provided the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board.

Chapter 671, Statutes of 2007, (AB 221 - Anderson) enacted the California Public Divest from Iran Act, which requires CalSTRS and CalPERS, when it is consistent with their fiduciary responsibilities, to divest from companies, that are invested in or engaged in business operations with entities in the defense, nuclear petroleum or natural gas sectors of Iran, or that have demonstrated complicity with an Iranian terrorist organization.

**This bill:**

This measure changes the application of the board's fiduciary duty pursuant to Section 17 of Article XVI of the California Constitution relative to investments in Iran. Under the California Public Divest from Iran Act (Act), the CalPERS and CalSTRS boards are required to take specified actions unless the board determines, in good faith, that such actions would not be consistent with its fiduciary duty. This measure changes that standard so that the board would be exempt from taking actions as specified in the Act if such actions would be a *breach* of the board's fiduciary responsibilities. Although the wording is similar, the standard for exercising the board's fiduciary duty would be set much higher. In addition, this measure would require that any determination that an action would be a breach of fiduciary duty be made in a public hearing of the full board after proper public notice and an opportunity for public comment. This measure also includes a provision that makes the Act operative only if AB 1151 is enacted and takes effect on or before January 1, 2012

The public hearing requirement runs counter to the Bagley-Keene Open Meeting Act, as the consideration of whether or not a potential decision violated the board's fiduciary duty under current law would be conducted in closed session. Specifically, it is in conflict with Government Code Section 11126 that authorizes a state body that invests retirement, pension, or endowment funds to consider investment decisions in closed sessions.

If the board were to debate the fiduciary responsibility of a specific investment in open session with the required notice period, the investment would be exposed to a potentially negative market impact, which could result in losses for the Teachers'

Retirement Fund. This action would not serve to maximize the investment and would run counter to the board's fiduciary responsibility of maximizing the income for the fund.

This measure and AB 1151 (Feuer) currently require a higher standard for exercising the board's fiduciary duty than what the California Constitution currently requires, which could potentially require the board to compromise its fiduciary responsibility and infringed on its investment authority. Anticipated amendments to AB 1151 would change that standard to one that is consistent with the application of the board's fiduciary duty and plenary authority over investments pursuant to Section 17 of Article XVI of the California Constitution relative to investments in Iran. However, SB 903 continues to require a standard that is beyond that provided in the Constitution, and for that reason is opposed by the board.

## **PROGRAM BACKGROUND**

One of CalSTRS' 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.

Additionally, in compliance with Chapter 671, CalSTRS has identified and maintains a list of companies noted as having some level of or possible ties to Iran. CalSTRS contracts with external service providers to provide it with monthly research on companies with possible ties or exposure to Iran specific investments and holdings. 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, CalSTRS 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, which 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.

CalSTRS engages with all of the companies on the 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. 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.

The initial list of companies with some level of business ties to Iran that was presented to the board in June 2008 was comprised of 23 companies. Three of those companies were already restricted by Chapter 442, Statutes of 2006 (Sudan Divestment), while 18 companies were under review to determine if they met the requirements for divestment and were later determined to not meet the restriction criteria. The remaining two companies were being monitored but were not CalSTRS holdings. Subsequently, one additional company was identified as having ties to Iran was added to the list. By October 2008 CalSTRS' portfolio was free of PetroChina, Petronas, Sinopec, and MISC Bhd, which were restricted under Chapter 442.

More recently, CalSTRS had 29 investments identified as having ties to Iran. Only seven of those companies were subject to the restrictions under the Act, and CalSTRS has divested all seven from its portfolio. CalSTRS identified 19 companies having ties to Iran that do not meet the requirements for divestment. The remaining three companies were reviewed to determine if they met the criteria for divestment, and two were determined to have not met the criteria, while one continued to be undetermined. CalSTRS continues its engagement activities with the remaining undetermined company and plans to meet with the company's management this year. While the status of this company is being determined, CalSTRS has restricted any further investment.

CalSTRS continues to monitor and engage companies identified as having ties to Iran and report annually to the Legislature as mandated by the California Public Divest from Iran Act. To date, CalSTRS has not made a determination that taking action as specified in Chapter 671 would be in conflict or be a breach of its fiduciary duty.

## **FISCAL IMPACT**

Benefit Program Cost – The potential costs of the measure are unknown but could be significant. While CalSTRS staff has not come across an investment that the board felt should be exempt from divestment for fiduciary reasons, it remains a possibility. If the board were to debate the fiduciary responsibilities in relation to a specific investment in open session with the required notice period, the investment would be exposed to potentially negative market impact which could result in significant losses for the Teachers' Retirement Fund.

Administrative Costs/Savings – None.

## **SUPPORT**

AMVETS - Department of California  
Anti-Defamation League  
California Conference of Machinists  
California State Commanders Veterans Council  
California Teamsters Public Affairs Council  
Jewish Public Affairs Committee  
Military Officers Association of America, California Council of Chapters

## **OPPOSITION**

CalSTRS  
CalPERS

## **ARGUMENTS**

Pro: Ensures that CalPERS and CalSTRS are in compliance with the provisions of the California Public Divest from Iran Act.

Con: Imposes a higher standard for the board's fiduciary responsibility than what is set forth in the California Constitution,

Restricts and infringes on the investment authority of the board,

Conflicts with the authority granted under the Bagley-Keene Act, which allows the board to make investment decisions in closed session.

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