CalPERS

Investment Committee

California Public Employees' Retirement System

Agenda Item 9b

February 19, 2013

ITEM NAME: Assault Weapon Manufacturers Portfolio Review

PROGRAM: Total Fund

ITEM TYPE: Total Fund – Information

EXECUTIVE SUMMARY

This item reports CalPERS investment exposure to firearms manufacturers that produce, and distribute to the general public, weapons illegal for public sale under California Firearms Laws 2007. Staff has reviewed the holdings within each asset class seeking to identify such exposure.

Staff identified approximately $5 million of exposure to firearms manufacturers. The exposure is contained in programs which transact in publicly traded equity securities and divestment cost is considered "de minimis."

BACKGROUND

Following the tragic events that took place on December 14, 2012 at Sandy Hook Elementary School in Newtown CT, CalPERS Board Member, Bill Lockyer, California State Treasurer, requested CalPERS conduct a review of its exposure to firearms manufacturing within the investment portfolio. The purpose was to identify exposure to firearms manufacturers that produce and distribute to the general public, assault weapons illegal for public sale under California law (Attachments 2, 3, and 4).

On February 17, 2009, the Investment Committee adopted a Statement of Investment Policy Regarding Divestment (Attachment 1). This policy provides a framework for staff to analyze investments targeted for divestment. The policy also provides criteria by which divestment shall be undertaken. In general, CalPERS policy prefers constructive engagement to divesting as a means of affecting the conduct of entities in which it invests. However, the policy provides specific circumstances under which divestment can be undertaken.

ANALYSIS

Staff conducted the requested review of CalPERS investment portfolio in a manner consistent with the Statement of Investment Policy Regarding Divestment (Attachment 1). The process used by staff incorporates the following steps:

1. Identity Firms – Identification began with a review of global weapons manufacturers to determine those that had equity or debt capital provided from outside investors, manufactured firearms meeting the criteria of California law, and which distributed products to the general public. This step reduced the universe of potentially involved firms from over 200 to 4.

2. Determine Exposure – Having identified the relevant firms, staff screened all Global Equity, Private Equity, Fixed Income, Absolute Return Strategy and affiliate portfolios to determine exposure. For holdings in fund-of-funds, to which staff has no direct access, external portfolio managers were requested to screen holdings. This step resulted in the identification of exposure to 3 of the 4 firms that aggregated to approximately $7 million. The exposure is contained within Global Equity and affiliate portfolios (Absolute Return Strategy portfolios have a small net "short" exposure).

3. Communicate – Letters were sent to the 3 firms where exposure was identified to confirm information about their business and ensure they met the criteria. Staff received a response from 3 firms. The communication resulted in one firm being removed from consideration due to their not meeting the "general public distribution" aspect of the criteria. Two firms remained in consideration at the end of this step represent approximately $5 million in total exposure.

4. Fiduciary Analysis – An analysis of the firm exposure in terms of risk and return was conducted. A starting point of the analysis is determination of the weightings of the applicable firms in both benchmarks and actual exposure. The results of this analysis is summarized in the table below:

Investment Metrics	Domestic	Global
Benchmark Weight	0.0084%	0.0039%
Exposure Weight	0.0075%	0.0037%
Tracking Error Impact	0.0000%	0.0000%
5-Year Relative Performance*	+14.6% (Contribution < 3/100 of a basis point)	
Liquidation Cost Estimate	55 BP - $27,500	

* Annualized performance of basket consisting of the involved securities, holding share exposure constant over period, relative to overall domestic benchmark. Contribution is beginning weight times relative performance.

The benchmark and actual exposure to firms meeting the criteria are very small. This small weighting results in all measures of risk, return, and costs as being considered "de minimis." Roughly 2% of the identified exposure ($93,000) is contained in institutional commingled funds managed externally on behalf of the Affiliate Investment Program.

The identified exposure of $5 million does not include possible exposure to companies that manufacture assault weapons solely for distribution to military and police entities.

5. Inform the CalPERS Investment Committee – The material contained within this agenda item constitutes the provision of information to the Investment Committee. Wilshire Associates has provided an opinion letter – Attachment 5.

RISKS
CalPERS operates in a unique and complex social-economic milieu. CalPERS investment in a company does not necessarily signify that it approves of the company's policies, products, or actions. The criteria for identifying firms specify that they produce and distribute to the general public, firearms that are illegal or require registration for individual to own in California. California law contains criteria and restrictions that are not applicable in other jurisdictions. The available information indicates that the identified firms only distribute firearms through federally licensed dealers and that such weapons are legal for individuals to own in the jurisdictions where they are distributed. Targeting firms for divestment that are engaged in legal business activity raises some specific risk factors as follow:

1. Controversy – The divestment proposal is directed at a category of business where there is great controversy. Controversy is likely or already evidenced, in many business areas where CalPERS has investment exposure.

2. Precedent – Undertaking a divestment within CalPERS investment activities serves to incent future attempts at compelling CalPERS divestment by an array of proponents whose interests do not coincide with CalPERS fiduciary duty.

3. Investment Return Impairment – Past experience indicates that divestment can result in reduced rates of return on assets. While the current circumstance involves asset levels and characteristics that may, by themselves be de minimis, the aggregate of such actions can become material should enough actions be taken.

The mitigation to all of these risks is to follow CalPERS Statement of Investment Policy Regarding Divestment.

ATTACHMENTS
Attachment 1 – CalPERS Divestment Policy
Attachment 2 – California Penal Code 12276.1 – Assault Weapon Characteristics
Attachment 3 – California Department of Justice Assault Weapons List
Attachment 4 – California Department of Justice De-Certified Handgun Models
Attachment 5 – Wilshire Associates Opinion Letter

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