Investment Committee

Agenda Item 8c

August 13, 2018

Item Name: Iran/Sudan Update

Program: Total Fund

Item Type: Information

Executive Summary

This item provides an update to the Committee on:

1. The status of CalPERS' 5-year review of its Iran/Sudan divestment program pursuant to the Acts in light of recent developments in the U.S. foreign policy with respect to Iran; and

2. The timing of this year's annual divestment review in compliance with the California Public Divest from Iran Act and the Sudan Act (collectively, the Acts).

Pending any intervening updates to the Investment Committee's calendar, staff will plan to undertake the 5-year review of the Acts' divestment mandates in 2020.

Strategic Plan

This item does not directly support the CalPERS 2017-22 Strategic Plan.

Investment Beliefs

This item does not directly support CalPERS' Investment Beliefs.

Background

The Acts
The Acts prohibit the boards of the California Teachers' Retirement System and CalPERS from investing in companies with specified business activities in Iran and Sudan, respectively, subject to the fiduciary duties of the Board as described in the California Constitution. The Acts are codified in Government Code (G.C.) §7513.6 (Sudan Act), and G.C. §7513.7 (California Public Divest from Iran Act).

CalPERS Periodic Divestment Review Requirement
In April of 2017 the Committee revised the divestment section of the Total Fund Policy to establish a cyclical 5-year review process for each active divestment. The purpose of the 5-year review is to ensure that prior divestment decisions remain supportive of the prudent stewardship

of the System's assets, consistent with the Committee's fiduciary obligations. Periodic review of CalPERS' active divestment mandates supports the key objective of delivering our target risk-adjusted investment returns.

JCPoA – Initiation and U.S. Withdrawal
On July 14, 2015, Iran and an international coalition of countries consisting of China, France, Germany, Russia, the United Kingdom, the U.S., and the European Union reached agreement on a Joint Comprehensive Plan of Action (JCPoA) regarding Iran's nuclear program. The JCPoA went into effect on October 18, 2015 and the participants began taking steps necessary to implement their respective JCPoA commitments.[1] Among other things, some companies with significant market capitalization expressed interest publicly in doing business in Iran, among them Boeing, General Electric, and Total S.A. And on January 13, 2017, President Obama issued an executive order suspending its comprehensive economic sanctions against Sudan ostensibly based upon "sustained progress" on several fronts. Given the activities at the federal level, staff had scheduled the 5-year review of the Acts for this calendar year.

Subsequently, on May 8, 2018, President Trump announced the withdrawal of the U.S. from the JCPoA, and, correspondingly, his intention to re-impose sanctions on Iran following a "wind-down" period, during which affected entities seeking to avoid possible sanction actions by the U.S. could discontinue business activities in Iran.[2] According to a "frequently asked questions" bulletin published by the U.S. Office of Foreign Assets Control:

> *"Persons engaging in activity undertaken pursuant to the U.S. sanctions relief provided for in the JCPoA should take the steps necessary to wind down those activities by either August 6, 2018, or November 4, 2018, as applicable, to avoid exposure to sanctions or an enforcement action under U.S. law."*[3]

Analysis

Unsettled Conditions
In a letter dated June 4, 2018[4], leaders from Britain, France, and Germany requested that the U.S. refrain from imposing secondary sanctions on companies who continue to engage in business activities with respect to Iran and the JCPoA. However, recent news reports indicate that U.S. Secretary of State Michael Pompeo and Treasury Secretary Steven Mnuchin have rejected the request, stating that the U.S. is seeking to apply "unprecedented financial pressure" on the Iranian regime.[5]

Separately, on June 6, 2018 the European Union took action in an apparent attempt to mitigate the potential damage to European firms' dealings with Iran by initiating amendment of Regulation (EC) Number 2271/96 of 22 November 1996[6] (the "Blocking Statute") to include U.S. laws and regulations that authorize/require extra-territorial sanctions on Iran[7], specifically the:

- Iran Sanctions Act of 1996

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[1] *Office of Foreign Assets Control JCPoA Implementation Resource Center, accessed July 13, 2018*

[2] *Office of Foreign Assets Control Iran Sanctions Program Resource Center, accessed July 13, 2018*

[3] *Office of Foreign Assets Control FAQ issued May 8, 2018, updated June 27, 2018, accessed July 13, 2018*

[4] *A copy of the letter as provided within a June 6, 2018, New York Times article, "Europe Asks U.S. for an Exemption from Sanctions on Iran" by Steven Erlanger and Milan Schreuer.*

[5] *Bloomberg News "Mnuchin, Pompeo Reject European Bid for Iran Waivers" July 13, 2018, by Nick Wadhams*

[6] *Council Regulation (EC) No. 2271/96 of 22 November 1996 Protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom*

[7] *Annex – EC No. 2271/96 of 22 November 1996*

- Iran Freedom and Counter-Proliferation Act of 2012
- National Defense Authorization Act for Fiscal Year 2012
- Iran Threat Reduction and Syria Human Rights Act of 2012
- U.S. Iranian Transactions and Sanctions Regulations

The amended Blocking Statute will prohibit European Union companies from complying with the U.S. sanctions, and provides a mechanism for entities/persons to claim damages incurred through compliance with the identified sanctions.[8]

Deferral of CalPERS 5-year Review
Given the phased nature of the wind-down process, and the as-yet-unsettled nature of international relations and implications for global business activities and sanctions related to Iran, staff believes it is premature to undertake CalPERS' 5-year review of the California Public Divest from Iran Act divestment mandate.

And, as the content and themes of the California Public Divest from Iran Act divestment is similar to those posed by the Sudan Act, staff is of the belief that taking up the 5-year review for both Acts simultaneously makes the highest use of staff's and the Committee's time. Staff therefor has amended the schedule for CalPERS' 5-year divestment reviews to defer the review for both Acts until 2020.

This Year's Annual Review
While the 5-year review is being deferred, staff will be returning to the Committee in the coming months to undertake the routine activities associated with CalPERS' annual compliance with G.C. §§ 7513.6 & 7513.7. The timetable for the annual review items is, accordingly, as follows:

1. September 2018
   a. Open session – "California Public Divest from Iran Act and Sudan Act – Adoption of Findings"
   b. Closed session – "California Public Divest from Iran Act and Sudan Act"

2. December 2018
   a. Open session – "Report to the Legislature – California Public Divest from Iran Act and Sudan Act Compliance"

Table 1 below outlines the tentative schedule for 5-year divestment reviews now through 2022.

Table 1 – CalPERS 5-year Divestment Review Schedule

Ref #	Active Divestment	Scheduled Year
1.	CalPERS Manufacturers of Assault-Style Weapons Illegal in CA Divestments	2019
2.	Iran/Sudan Acts (G.C. §7513.6, G.C. §7513.7)	2020
3.	CalPERS Emerging Equity Market Principles Divestments	2021
4.	CalPERS Primary Tobacco Producers Divestments	2021
5.	Thermal Coal Mining (G.C. §7513.75)	2022

[8] *Lexology, "International Firms Caught Between U.S. Iran Sanctions and EU Blocking Statute" July 13, 2018, A. Craig, J. Beck and L. Ruessmann, Venable LLP.*

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

The deferral of the 5-year review of the Acts' divestment mandates to 2020 provides the following benefits:

- Makes highest use of CalPERS' resources and the Committee's time by allowing time for the disposition of sanctions associated with the U.S.'s withdrawal from the JCPoA to become clearer.
- Accommodates the Committee's request at the April 16, 2018 Committee meeting to take up the 5-year review of CalPERS' firearms-related divestments in 2019.

Staff has not identified any risks associated with the deferral of the 5-year review of the Act's divestment mandates. Considering the presently unsettled nature of U.S. foreign policy and associated sanctions with regards to Iran, and the reaction of global markets and multi-national entities, staff is of the opinion that undertaking a comprehensive review at this time would be premature. However, should conditions change to such an extent as to have material implications for CalPERS' compliance with the tenets of G.C. §7513.7, staff will return to the Committee for consideration and guidance.

Attachments

There are no attachments for this item.

Katherine H. Crocker
Investment Director
Investment Compliance & Operational Risk

Elisabeth Bourqui
Chief Operating Investment Officer