CalPERS

Investment Committee

Agenda Item 9c

March 18, 2019

Item Name: CalPERS Divestment Overview

Program: Total Fund

Item Type: Information

Executive Summary

This item provides a high-level overview of the divestment policy and active divestments of the California Public Employees' Retirement System ("CalPERS" or "System"). Additional information is provided in the following attachments:

1. The section of the CalPERS Total Fund Investment Policy addressing divestment (Divestment Policy)[1]
2. Estimates, from Wilshire Associates (Wilshire), of the economic impact of CalPERS divestments through June 30, 2018.
3. A summary of CalPERS' active divestments

Strategic Plan

A shared understanding of the CalPERS Divestment Policy will support board members and staff in their capacities as stewards of the System in fulfilling our mission – the sustainable delivery of promised pension benefits.

The Divestment Policy itself supports the Strategic Plan Goal of strengthening the long-term sustainability of the pension fund. An effective divestment policy assists CalPERS in (1) delivering targeted, risk-adjusted investment returns and (2) keeping our stakeholders informed and engaged on how we balance competing considerations in order to achieve that goal.

Investment Beliefs

This item supports Investment Belief 10, in particular the sub-beliefs that CalPERS will be best positioned for success if it has strong governance and operates with effective, clear processes. CalPERS divestment policy supports Investment Belief 1, specifically the sub-belief that a primary measure of the System's success is ensuring the ability to pay promised benefits through the maintenance of an adequate funded status.

[1] The CalPERS Divestment Policy is contained in §VII of the CalPERS Total Fund Investment Policy.

Background

This item responds to direction from the Chair of the Investment Committee (Committee) at the February 19, 2019 meeting of the Committee that staff prepare and return to the Committee with an informational overview of (1) CalPERS' policy regarding divestment and (2) CalPERS' active divestment mandates.

<u>CalPERS Divestment Policy</u>

Divestment has been a controversial topic within the public pension community for decades. While, as a California state agency, CalPERS is sensitive to public policy issues, we recognize that our primary duty and obligation is to our members and beneficiaries. The Divestment Policy therefore acknowledges the following:

- CalPERS board members and staff have fiduciary duties of loyalty and prudence pursuant to the California Constitution and California Government Code Section 20151.
- While CalPERS wants companies in which it invests to meet high corporate governance, ethical, and social conduct standards, an investment in a company does not necessarily signify that CalPERS approves of the company's policies, products, or actions.
- Divestment appears to almost invariably harm investment performance by compromising investment strategies and increasing transaction costs.
- There appears to be considerable evidence that divesting is an ineffective strategy for achieving social or political goals. This is because the usual consequence is often a mere transfer of ownership of divested assets from one investor to another.
- Investors that divest lose their ability as shareowners to influence a company to act responsibly.

A copy of the Divestment Policy in its entirety is provided as Attachment 1.

Note that the term "divestment," as used in our policy, does *not* refer to investment decisions made for the primary purpose of maximizing the fund's risk-adjusted return, such as, for example, the exclusion or sale of portfolio holdings as a result of staff's day-to-day portfolio management activities, the Board's determination of the Strategic Asset Allocation Targets during each Asset-Liability Management (ALM) cycle, or this Committee's enunciation of investment policy and establishment of the fund's benchmarks.

To ensure that prior divestment decisions remain supportive of the prudent stewardship of the System's assets, the Divestment Policy requires two types of ongoing periodic review:

1. That Wilshire, as the Board's General Pension Consultant, monitor and provide an annual report to the Committee on the estimated impacts of all then in-force divestments; and
2. That staff review all in-force divestments, and present findings to the Committee for affirmative action, at least once every five years.

Wilshire's most recent recurrent annual review (covering the period ended June 30, 2018) was presented at the December 17, 2018 meeting of the Committee and is available on the CalPERS Board of Administration Meeting Archives as agenda item 8a. For purposes of this informational agenda item, Wilshire has updated their analysis to include additional details. This analysis is provided as Attachment 2.

Regarding the cyclical 5-year review and affirmation, pursuant to direction from the Committee Chair in October 2018, the 5-year review and affirmation for all CalPERS active divestment mandates is currently scheduled for 2021.

CalPERS' active divestments

CalPERS currently has six active divestment mandates in (broadly speaking) the following areas: tobacco, emerging market equity principles, Sudan, Iran, assault weapon manufacturers, and thermal coal, as described in more detail in Attachment 3, CalPERS Divestments Summary Table.

The Iran, Sudan, and thermal coal divestments were dictated by the California Legislature, and the rest by board mandate.

Analysis

Not applicable as this item is intended as an informational recap of CalPERS' active divestments and policy regarding divestment.

Budget and Fiscal Impacts

Not applicable.

Benefits and Risks

Not applicable as this item is intended as an informational recap of CalPERS' active divestments and policy regarding divestment.

Attachments

Attachment 1 – CalPERS Total Fund Policy, Divestment Section
Attachment 2 – Wilshire Associates' Financial Analysis of CalPERS' Divestment Programs
Attachment 3 – CalPERS Divestments - Summary Table

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