BILL NUMBER: AB 1019 (Holden) as introduced February 18, 2021

SUMMARY

AB 1019 prohibits state trust money from being used to make additional or new investments or renew existing investments in investment vehicles issued or owned by the government of Turkey, its instrumentalities or political subdivisions. It also indemnifies present, former and future board members, officers and employees of and investment managers under contract with those state trust funds for actions related to the bill. AB 1019 would no longer apply if the government of Turkey adopts a policy to acknowledge the Armenian Genocide and embark on a path of affording justice to its victims.

BOARD POSITION

Oppose. The board's policy is to oppose legislation that infringes on the investment authority of the board or is inconsistent with the investment policy adopted by the board as presented in the CalSTRS Investment Policy and Management Plan.

REASON FOR THE BILL

According to the author, Turkey's ongoing denial of the Armenian Genocide prevents justice for the families of genocide survivors and creates a dangerous environment for minority communities in Turkey and neighboring Armenia, and divestment would pressure Turkey to recognize the Armenian Genocide and take steps towards justice to its victims.

ANALYSIS

Existing Law:

Under the provisions of Section 17 of Article XVI of the California Constitution, as amended by Proposition 162 of 1992, the CalSTRS board has plenary authority and fiduciary responsibility over the investment of retirement plan assets and is required to discharge its duties solely in the interests of its members and beneficiaries for the exclusive purpose of providing benefits. The board must invest the assets of the plan with the care, skill and diligence of a prudent person engaged in a similar enterprise so as to maximize the investments and minimize the risk of loss. When considering investments, the preservation of principal and maximization of income is the primary and underlying criteria for the selection and retention of securities. The Constitution states, however, that the Legislature may by statute prohibit certain investments by a retirement board when 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.

Under the provisions of the U.S. Constitution, federal laws preempt state laws, and the federal government maintains responsibility over foreign affairs and has the power to regulate commerce with foreign nations. More specifically, the Supremacy Clause (Article VI, Clause 2) establishes that federal laws and treaties made under its authority constitute the supreme law of the land. Additionally, the Constitution gives the president authority over foreign affairs (Article II, Section 2, Clause 2). Lastly, the Commerce Clause (Article I, Section 8, Clause 3) gives Congress the power to regulate commerce with foreign nations.

Government Code section 7513.74 establishes multiple requirements for the CalSTRS and CalPERS boards to divest from Turkish government investment vehicles if a federal law is passed to impose sanctions on the government of Turkey for failure to officially acknowledge its responsibility for the Armenian Genocide. Neither board shall be required to take action unless the board determines in good faith that the action is consistent with its fiduciary responsibilities. Current law also indemnifies present, former and future board members, officers and employees of and investment managers under contract with those retirement systems for related actions. Because such a federal law has not been enacted, these requirements are not currently operative. These provisions will be repealed on the earlier of either a determination that the government of Turkey has officially acknowledged its responsibility for the Armenian Genocide or January 1, 2025.

This Bill:

Specifically, AB 1019:

- Prohibits the State Teachers' Retirement Fund from being used to make additional, new or renewed investments in any investment vehicle issued or owned by the government of Turkey, its instrumentalities or political subdivisions.
- Defines "investment" as:
    - An extension of credit made to a business.
    - Funds or other assets given to a business in exchange for any of the following:
        - A security interest in other assets of that business.
        - The beneficial ownership or control of a share or interest in that business.
        - A bond or other debt instrument issued by that business.
- Indemnifies present, former and future board members, officers and employees of and investment managers under contract with CalSTRS for actions related to the bill.
- Would no longer apply if the government of Turkey, by resolution of its legislature or head of state, adopts a policy to acknowledge the Armenian Genocide and embark on a path of affording justice to its victims.

The board's policy is to oppose legislation that restricts its ability to invest in specific areas because, as described in its Divestment Policy, such restrictions could impair the board's ability to exercise its fiduciary obligation to act exclusively for the benefit of the retirement plan members and beneficiaries. Divestment carries the risk of adversely affecting an investment portfolio. This is especially concerning as investment returns affect the CalSTRS Funding Plan, which placed CalSTRS on a trajectory toward full funding.

Under the provisions of the U.S. Constitution, the federal government maintains authority over foreign affairs and commerce with foreign countries. Prior legislation prohibiting investments in Sudan and Iran did not come into constitutional conflict with federal authority because Congress granted authorization to the states to enact such legislation in accordance with specific parameters. In contrast, a much broader law in Illinois called the Illinois Sudan Act, which contained provisions that were not authorized by Congress, was ruled unconstitutional because it interfered impermissibly with the federal government's power over foreign affairs and commerce with foreign countries.

In addition, CalSTRS follows an investment strategy, adopted by the board, of diversification and passive index management that does not generally exclude or include any investments in companies, industries or geographic areas. AB 1019 would require CalSTRS to actively exclude new, additional or renewed investments in Turkish investment vehicles, reducing the diversification of the portfolio, increasing risk, and creating opportunity costs as well as costs to customize benchmark indices. While a specific investment restriction may be intended to address a concern associated with only a fraction of the portfolio, there can be cumulative effects from multiple investment restrictions.

LEGISLATIVE HISTORY

AB 1320 (Nazarian, Chapter 459, Statutes of 2019) prohibited the CalSTRS and CalPERS boards from making additional or new investments or renewing investments in Turkish investment vehicles, if a federal law is passed to impose sanctions on the government of Turkey for failure to officially acknowledge its responsibility for the Armenian Genocide, and required divestment from such investments within 18 months of the passage of such a federal law, subject to the fiduciary duty of the boards. The bill also required a report to the Legislature and provided for indemnification and repeal, as specified.

AB 1597 (Nazarian, 2018) would have prohibited the CalSTRS and CalPERS boards from making additional or new investments or renewing existing investments in any Turkish investment vehicle, immediately upon passage of a federal law imposing sanctions on Turkey for failure to acknowledge the Armenian Genocide, and would have required divestment from such investments within six months of the passage of such a federal law, subject to the fiduciary duty of the boards. The bill also would have required a report to the Legislature and provided for indemnification and repeal, as specified. This bill was vetoed.

AJR 3 (Nazarian, Resolution Chapter 56, Statutes of 2017) designated 2017 as “State of California Year of Commemoration of the Anniversary of the Armenian Genocide of 1915-1923” and April 24, 2017, as the “State of California Day of Commemoration of the 102nd Anniversary of the Armenian Genocide of 1915-1923” and called upon the U.S. President and Congress to formally and consistently reaffirm the Armenian Genocide.

AB 1410 (Nazarian, 2015) would have sought to encourage the government of Turkey to acknowledge, and to reach resolution on reparations for survivors of, the Armenian Genocide by requiring CalSTRS and CalPERS to divest of any Turkish investment vehicle. The bill also would have required a report to the Legislature and provided for indemnification, as specified. This bill was held in the Assembly Appropriations Committee.

H.Res.154 (Dold, 2015) would have called on the U.S. President to work toward equitable, constructive, stable and durable Armenian-Turkish relations based upon Turkey’s full acknowledgment of the facts and ongoing consequences of the Armenian Genocide and a fair, just and comprehensive international resolution of this crime against humanity. This resolution was held in the House Committee on Foreign Affairs.

S.Res. 410 (Menendez, 2014) would have expressed the sense of the U.S. Senate: (1) in remembrance of the anniversary of the Armenian Genocide on April 24, 2014, and (2) that the U.S. President should ensure that U.S. foreign policy reflects appropriate understanding and sensitivity concerning issues related to human rights, crimes against humanity, ethnic cleansing and genocide documented in the U.S. record relating to the Armenian Genocide. This resolution was held on the Senate Floor.

SB 424 (Poochigian, Chapter 9, Statutes of 2005) established April 24 of each year as the “California Day of Remembrance of the Armenian Genocide” and the period beginning on the Sunday before that day through the following Sunday as the days of remembrance of the Armenian Genocide.

AB 2251 (Margolin, Chapter 1351, Statutes of 1992) prohibited state trust funds from making new or additional investments in business firms or financial institutions that engage in discriminatory business practices after January 1, 1994, relating to the Arab League's economic boycott of Israel. The California Attorney General concluded that this bill was pre-empted by federal law and, therefore, not subject to implementation by CalSTRS.

PROGRAM BACKGROUND

ESG Policy

CalSTRS has its own well-established and longstanding process for thoroughly vetting the environmental, social and governance (ESG) risks of potential investments. The board adopted its Statement of Investment Responsibility in 1978, making CalSTRS an industry leader as one of the first pension funds to adopt a written policy to navigate these complex issues. As a key component of that process, the board has developed a list of risk factors as part of its Investment Policy for Mitigating ESG Risks. The ESG Risk Factors help the board to identify and evaluate investment risks relating to the existence of certain conditions, such as recognition of the rule of law, shareholder rights, human rights, the environment, acts of terrorism and other unsustainable practices and governance crises with the potential to hurt long-term profits.

Divestment Policy

In addition to the CalSTRS ESG policy, the board has adopted a Divestment Policy, focusing on engagement, to respond to external or internal initiatives to divest of specific companies or industries. In accordance with this policy, CalSTRS has historically taken the position that active and direct engagement is the best way to resolve issues. Divestment bears the risk of adversely affecting an investment portfolio and severs any chance to advance positive change through shareholder advocacy. Meetings with shareowners and senior management, or the board of directors, are generally more effective in bringing about change in a corporation. Under the policy, the board will only consider divestment after all efforts at engagement have failed, and only then in cases where at least one of the ESG Risk Factors is violated over a sustained timeframe to the extent that it becomes an economic risk to the fund, creates a potential for material loss of revenue and weakens the trust of a significant portion of CalSTRS members. Finally, the Divestment Policy sets forth that the board will only instruct staff to divest of a security when it determines that continuing to hold a security is imprudent and inconsistent with its fiduciary duty.

Armenian Genocide

The Armenian Genocide is largely believed to have begun on April 24, 1915, when hundreds of Armenian intellectual, political, religious and business leaders were arrested and deported from Constantinople. In acknowledgment of its 100th anniversary, California enacted Resolution Chapter 30, Statutes of 2015 (AJR 2, Nazarian), to recognize the Armenian Genocide as a series of events occurring between 1915 and 1923 in which the rulers of the Ottoman Turkish Empire and its successor state, the Republic of Turkey, subjected its Armenian citizens to torture, starvation and murder. Successive Turkish governments have failed to acknowledge the Armenian Genocide and have even convicted journalists and scholars for making reference to the Armenian Genocide. In the fall of 2020, an armed conflict broke out with Azerbaijan fighting against Armenia as well as ethnic Armenians in the breakaway state of Artsakh. National governments, human rights organizations and international observers have generally recognized that Turkey provided military support to Azerbaijan during the conflict, although both Azerbaijan and Turkey deny this.

FISCAL IMPACT

Program Cost – CalSTRS exposure to currency and debt securities directly issued by the government of Turkey is approximately $2.2 million. Additional exposure in global equity and infrastructure investments in which the government of Turkey is the majority owner are approximately $717,000 and $9.7 million, respectively. CalSTRS may incur opportunity costs if suitable alternative investments are unavailable or if such alternative investments do not provide an investment return that meets or exceeds those of the divested securities. Any resulting costs would be passed along to the state and employers in the form of higher contributions to the Defined Benefit Program.

Administrative Costs/Savings – Approximately $43,200 annual ongoing costs resulting from transaction costs for custom indices and additional costs related to external research services. Implementation and ongoing compliance will also require reallocation of staff resources.

SUPPORT

Armenian National Committee of America - Western Region

OPPOSITION

CalSTRS
California Retired Teachers Association

ARGUMENTS

Pro: Could eliminate the perception that CalSTRS is contributing to a continuing denial of the Armenian Genocide by Turkey.

Con: Infringes upon the investment authority of the board.

Reduces the investable universe and could adversely affect portfolio performance.

Lacks clear definition of affected investment vehicles.

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