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Missouri Treasurer's Demand: 'Terror-Free' Pension Funds

By CRAIG KARMIN
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Sarah Steelman, the Missouri state treasurer, is emerging as a thorn in the side of a set of powerful global investors.

As pension funds face pressure from politicians to divest themselves from Iran and other countries deemed terrorism sponsors, she has staked out a zero-tolerance approach to investments like these. That's given the 49-year-old Republican a prominent voice in the wave of new legislation -- from Ohio to California -- targeting the $1 trillion pension-fund industry.

Ms. Steelman's own state legislature has declined to go along with her campaign. But a dozen other states -- including Florida, California and Texas -- have passed laws that could compel pension funds to divest themselves of holdings in companies that do business in countries like these. While U.S. companies are banned from doing business in those countries, many foreign companies are active there.


Missouri State Treasurer

Sarah Steelman, Missouri treasurer, contacted all 49 other state treasurers about terror-free divestment laws.

The list of companies potentially affected is extensive. Ms. Steelman says that nearly 500 big foreign companies and multinationals do at least some business in what the U.S. government considers terror-sponsoring nations.

Proposals in other states are considerably less far-reaching than what Ms. Steelman would like to see. For instance, some states focus on prohibiting investments in just a couple dozen companies in Iran's energy sector.

Last summer, Ms. Steelman unveiled what she calls a "terror free" fund -- a small fund, intended as a model, designed to avoid investments in nations considered terror sponsors. In its first eight months of existence, her fund has returned 27%, she says. "People said fund performance was going to suffer. We've shown that's just not true."

Many pension funds dismiss those returns, pointing out that the period is too short to be meaningful.

The dispute raises questions about what role taxpayer-supported pension funds should play in world affairs. Funds argue that while legislative efforts like these may be well-meaning, they conflict with a fund's fiduciary duty to get the best returns for beneficiaries. Complying with the anti-terror push, they say, could crimp returns.

Some fund managers also argue that the approach is misguided: Funds would have more influence over the offending companies by bringing pressure on them as shareholders.

"When you divest, you lose your place at the table," says Clark McKinley, spokesman for the California Public Employees' Retirement System. The $244 billion pension fund opposes pending legislation that could require Calpers to sell billions of dollars of investments in companies with Iran links.

The Center for Security Policy, a conservative Washington, D.C., think tank, says that it has identified 100 public pension funds in the U.S. that have about $188 billion invested in companies doing business in nations branded terror sponsors by the U.S. government.

"There is not a public pension fund out there that is not seriously looking at this issue," says Mark Tulay, a director at Institutional Shareholder Services, a consulting firm.

Ms. Steelman and other divestment proponents often cite the situation in South Africa two decades ago, when government sanctions and pension-fund divestment were widely credited with helping end the apartheid regime.

Ms. Steelman embraced the antiterrorism issue early on in her term, which began in January 2005. She started by examining the backgrounds of the broker-dealers employed by the Missouri state treasury. She says she fired two European banks after learning of their business ties to Iran. She hired a money manager to screen for links to Iran and other blacklisted states for her new terror-free fund. That small $7 million fund invests Missouri money set aside for cultural activities.

Ms. Steelman spent much of 2006 reaching out to state lawmakers and contacting all 49 of the other state treasurers about passing terror-free divestment laws. She has also offered guidance to officials in other states on how to respond to pension-fund objections.

"As soon as we introduced the legislation, we scrambled to find experts on the topic," says Joel Anderson, the California assemblyman who sponsored his state's bill calling for divestment from companies doing business in Iran. Ms. Steelman has "been very helpful with the hurdles we had to overcome." The bill passed unopposed in the Assembly earlier this month and now heads to the California Senate.

Ms. Steelman has had less luck winning over the pension funds -- in her state or elsewhere. The antiterrorism bills vary from state to state: Some call for rapid divestment in more than 100 companies, while others are limited to about 20 and call for sales only after the funds talk to the companies.

Missouri's biggest public pension fund says it is waiting for clarification from Washington. "I'm looking for the federal government to give guidance on which companies to divest from, not the opinion of third-party organizations," says Steve Yoakum, executive director for the $32 billion Public School Retirement System of Missouri.

In general, pension-fund managers say complying with the new laws will cost money and hurt returns. Calpers, for instance, estimates that if the current bill becomes law, the fund would have to sell about $2 billion in investments at a cost of as much as $25 million. Calpers estimates that had a version of the California bill been in place in the past five years, it would have reduced the value of the fund's holdings by $725 million.

California State Teachers' System, a $171 billion pension fund, hasn't estimated the cost of compliance with the bill. But Calstrs Chief Executive Officer Jack Ehnes says he think a more effective strategy would be to make the case to these companies as major shareholders. "The first step is active engagement with the companies," he says.

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