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SHOULD PUBLIC PLANS ENGAGE IN SOCIAL INVESTING?

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Introduction

Social investing is a movement that advocates incorporating social and environmental considerations, as well as financial factors, when making investment decisions. The most recent incarnation of this movement is the initiative by state legislatures to force public pension funds to sell their holdings of companies doing business in Sudan. The effort to divest Sudan-linked stocks began in 2004 after the U.S. government characterized the killing and displacement in Darfur province as genocide.¹ Riding on the coattails of the success of the Sudan effort, state legislatures have now targeted Iran, with a goal of "terror-free" investing. The emotional appeal of such actions is powerful. Over 2 million civilians have been displaced and more than 200,000 slaughtered in Darfur since 2003.² And Iran refuses to back away from its pursuit of nuclear weapons.³ But strong arguments also exist against using public pension plans to accomplish foreign policy goals.

This *brief* explores the current world of social investing, the recent efforts regarding the Sudan and Iran, the likely impact of social investing on the target firms, and the reasons why such activity may be inappropriate for public pension plans.

What Is Social Investing? How Much? Who's Doing It?

Social investing takes three primary forms: 1) screening (either excluding "bad" companies or including "good" companies); 2) shareholder advocacy; and 3) community investing. The Social Investment Forum (SIF), a trade group of social investors, reports that at the end of 2005, in terms of assets under management, screening is by far the most prevalent approach (see Figure 1). Significantly less is involved in shareholder advocacy, and community investing activity is tiny.

FIGURE 1: SOCIAL INVESTING BY TYPE OF ACTIVITY AS A PERCENT OF ASSETS UNDER MANAGEMENT



Source: Social Investment Forum (2006)

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TABLE 1. ASSETS IN SOCIALLY SCREENED PORTFOLIOS, 1995-2005 (BILLIONS)

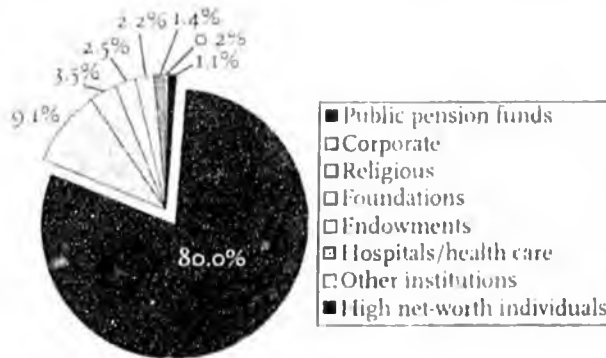
Year	Mutual funds	Separate accounts	Total
1995	\$12	\$150	\$162
1997	96	433	529
1999	154	1,343	1,497
2001	140	1,870	2,010
2003	151	1,992	2,143
2005	179	1,506	1,685

Source: Center for Retirement Research at Boston College (2006).

The Social Investment Forum reports that as of the end of 2005, mutual funds with social screens held \$179 billion and that socially screened "separate accounts," which are managed for individuals and institutional clients, held \$1,506 billion (see Table 1). The SIF calculates that these totals amount to 9.4 percent of all public and private assets under management.

The bulk of the money in separate accounts (80 percent) is the assets of public pension funds (see Figure 2). And screening is pervasive among public funds. The SIF numbers suggest that, in 2005, \$1.2 trillion of public pension fund assets were screened by some criteria. These screened assets accounted for 45 percent of total state and local pension holdings in that year.⁴

FIGURE 2. ASSETS UNDER MANAGEMENT BY INVESTOR TYPE, 2005



Source: Social Investment Forum (2006).

The screens vary by the nature of the customer. As of 2005, by far the most popular approach for mutual funds was a negative screen for tobacco; alcohol came in second; gambling third.⁵ But the pattern for institutional separate accounts, which is dominated by public plans, is quite different. For these accounts, the MacBride Principles (relating to fair hiring in Northern Ireland), Human Rights, the Environment, and Equal Employment Opportunity ranked among the top social concerns (see Figure 3).

FIGURE 3. SOCIAL SCREENING BY INSTITUTIONAL INVESTORS, 2005 (BILLIONS)



Source: Social Investment Forum (2006).

Note that almost none of the screened money is held in private sector defined benefit pension funds.⁶ These private plans are covered by the Employee Retirement Income Security Act (ERISA), and right from the beginning the Department of Labor has stringently enforced ERISA's duties of loyalty and prudence.⁷ In 1980, the chief administrator of the Department of Labor's pension section published an influential article that warned that the exclusion of investment options would be very hard to defend under ERISA's prudence and loyalty tests.⁸ And a 1994 Interpretive Bulletin reminded fiduciaries that they are prohibited from subordinating the interests of participants and beneficiaries "to unrelated objectives."⁹ Thus, ERISA fiduciary law has effectively constrained social investing in private sector defined benefit plans.¹⁰ Social investing is a public pension fund phenomenon.

Recent Developments – Sudan and Now Iran

During 2005, and therefore not reflected in Figure 3, state legislatures in Arizona, Illinois, Louisiana, New Jersey, and Oregon passed legislation related to companies with operations in Sudan.¹¹ Since then some states have branched out to include Iran. And Missouri has taken the lead in initiating an entirely “terror-free” investment policy. American companies have been barred for some time from doing business in either Sudan or with states considered sponsors of terrorism according to the U.S. State Department (Cuba, Iran, North Korea, Sudan and Syria).¹² But in a world of global investing, U.S. investors can have a link to Sudan or “terror states” through foreign stock holdings. Such foreign holdings would be most affected by the recent state legislation.

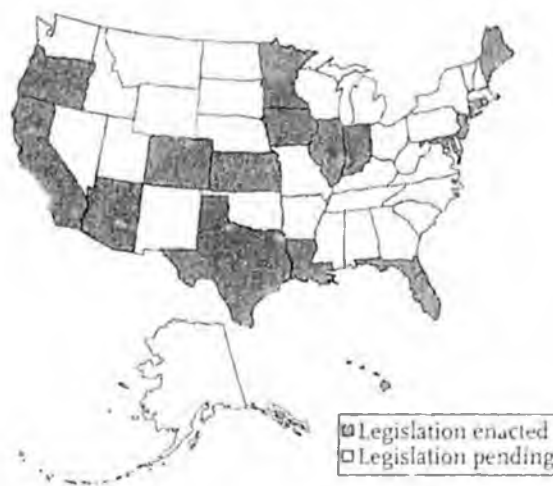
Sudan

As of August 2007, eighteen states have passed laws regarding divestment of state pension and other funds from Sudan (see Figure 4).¹³ Divesting is not easy, however. State and local pension funds tend to invest in global indices, so the exercise involves identifying the companies with links to Sudan and then constructing a Sudan-free index that mimics established benchmarks.

Generally, the states have asked their money managers to figure out which stocks have a Sudan link. Money managers, in turn, have left it to the social investing firms, such as KLD Research and Analytics, Institutional Shareholders Services, and the Conflict Securities Advisory Group to identify companies involved in Sudan. KLD originally said that 124 companies were on its Sudan list, including eight American companies.¹⁴ The social investing firms refuse to make the names public, however, since that is how they earn their money.¹⁵ And apparently, the lists are not definitive. Some companies appeared on the original KLD list even though they were not actually doing business in Sudan. And for at least one, 3M, its involvement was the result of a U.N. purchase of Scotchshield Ultra Safety and Security Film to protect embassy and mission windows from explosions, a transaction that was authorized by the federal government.¹⁶

The Sudan Divestment Task Force (2007) publishes a more tightly targeted list, recommending the divestment of only 28 companies. These are compa-

FIGURE 4. STATES THAT HAVE ENACTED OR ARE CONSIDERING SUDAN DIVESTMENT LEGISLATION, 2007



Sources: National Conference of State Legislatures (2007); Office of Missouri State Treasurer (2005); Sudan Divestment Task Force (2007); State of Arizona (2005); State of Arkansas (2007); and State of Louisiana (2005 and 2007)

nies that 1) do business with the Sudanese government; 2) provide little benefit to the disadvantaged of Sudan; and 3) have not developed policies to prevent their business activities from inadvertently contributing to the government's genocide capability.

Fund managers take the Sudan-link list and attempt to construct “Sudan Free” funds that mimic popular benchmarks. This step is also a challenge. According to the chief investment strategist at Northern Trust, whose fund tracks the Morgan Stanley Capital International Europe Australasia Far East index (MSCI EAFE) index, constructing a “Sudan-free” index will require divesting 25 companies or 9 percent of assets.¹⁷

Despite the challenges involved, public funds have moved \$2.2 billion away from Sudan-linked companies between 2005 and 2007.¹⁸

Iran

More recently, “terror-free” investment has been picking up steam. The primary targets are companies doing business in Iran.¹⁹ As noted above, U.S. companies have long been barred from operating in Iran, but more than 200 multinationals have investments there, from Royal Dutch Shell and France's telecommunications-equipment company Alcatel to Sweden's electronics company Ericsson.²⁰

On June 8, 2007, Florida's governor signed a Sudan and Iran Divestiture bill into law. Florida follows other states with regard to Sudan, but is the first to enact divestiture legislation for companies doing business with Iran.²¹ Louisiana, which had passed "terror-free investing" legislation in 2005, permits — but does not require — divestment. Arizona, which also passed legislation in 2005, only requires the public retirement system to disclose investments in terror-linked companies. In Illinois, the state Senate passed an Iran divestment bill on June 14, 2007 which would compel the state's five retirement systems to divest Iran-connected companies in energy and other natural resources.²² California, Georgia, Kansas, Michigan, Missouri, New Jersey, New York, Ohio, Oklahoma, Oregon, Pennsylvania, and Texas are also considering adopting Iran-free investing (see Figure 5).²³

If some of the bills are passed in their broadest form, institutions may be forced to sell \$18 billion

in investments.²⁴ Selling all Iran-related securities would add substantial risk to an indexed international equity portfolio. State Street Global Advisors (SSgA), Boston, has had preliminary conversations with clients about Iran divestments. SSgA estimates that if all companies with ties to Iran were removed from Morgan Stanley's EAFE index and replaced with similar performing companies, it would introduce a tracking error of up to 200 basis points, compared to the tracking error on a typical index of between five and 10 basis points.²⁵

Some state legislatures, however, are limiting the scope of divestiture to energy-related stocks, arguing that such action is likely to be most effective in curbing terrorist activities. Narrowing the scope greatly reduces the number of stocks and amount that would have to be sold.²⁶

Iran is a more politically complicated issue than Sudan. Sometimes promoters of "divest Iran" suggest that the effort is aimed at Al Qaeda.²⁷ But Al Qaeda is an enemy without a state and therefore difficult to target. In addition, the U.S. government is not enthusiastic about the effort, because it is working on its own initiative with allies to curtail business transactions tied to nuclear activities and support for terrorism. Treasury and State Department officials have expressed concern that broad-based divestiture could cause a backlash if allies feel that a wide range of companies is under attack.²⁸

Despite the complexities involved with Iran, some states have gone even further and are pursuing "terror-free" investing, which extends the scope of the boycott to all the countries on the U.S. State Department's State Sponsors of Terrorism list, which includes Cuba, Syria, and North Korea. Missouri has been at the forefront of this movement. The State Treasurer claims that at least 500 big foreign companies and multinationals do at least some business in countries identified as sponsoring terrorism.²⁹ The Treasurer's goal is to have all Missouri's investments "terror-free," although the state legislature has not yet passed divestiture legislation for the state pension funds.³⁰ Anti-terrorism bills have been enacted in Arizona, Florida, and Louisiana.

Given the substantial amount of social investing by public pension funds, it is useful to consider the likely impact of such activity on the targets of the social screen and the likely impact on the pension funds themselves.

FIGURE 5. STATES THAT HAVE ENACTED OR ARE CONSIDERING ENACTING DIVESTITURE LEGISLATION, 2005-2007



Sources: National Conference of State Legislatures (2007); Office of Missouri State Treasurer (2005); State of Arizona (2005), and State of Louisiana (2005 and 2007).

The Economics of Social Investing

The academic literature suggests that social screens are likely to have very little impact on the target company and that the impact on the pension fund depends on the scale of the screen.

Impact on Targeted Company

The SIA report suggests that social investing will have a financial impact — that investors are putting their money to work in ways that will build “a better, more just, and sustainable economy.” The academic literature on the stock market, however, suggests the opposite. And a comprehensive survey on the effect of the South African boycott — the largest and most visible social action — documents virtually no effect, suggesting the real world mirrors the textbook model.

According to standard finance theory, the price of any stock equals the present discounted value of expected future cash flows. Thus, the stock of a particular firm has a lot of close substitutes, which makes the demand curve for a particular stock, in economists’ terms, almost perfectly elastic.³³ That is, even a big change in quantity demanded will lead to only a small change in price. And any significant deviation from the fundamental price would represent a profitable trading opportunity that market participants would quickly exploit and thus correct.³⁴ In other words, boycotting tobacco stocks or international companies doing business in Sudan or Iran may result in a temporary fall in the stock price, but as long as some buyers remain they can swoop in, purchase the stock, and make money. And the buyers are out there. The “Vice Fund,” which was established in September 2002, specializes in only four sectors — alcohol, tobacco, arms, and gambling, and thus stands ready to buy the stocks screened out of standard portfolios.³⁵ Thus, the textbooks suggest that boycotting tobacco companies or international companies doing business in Iran is unlikely to have any impact on the price of their stocks.

A 1999 study took a comprehensive look at how equity prices responded to sanctions and pressures for firms to divest their holdings in South Africa.³⁴ The conclusion that emerges from a series of event studies is that the anti-apartheid shareholder and legislative boycotts had no negative effect on the valu-

ation of banks or corporations with South African operations or on the South African financial markets. This is not to say that the boycott was not important politically, but merely that it did not impact financial markets. The study looks at pressure put on firms from both congressional action and divestiture by pension funds and universities.

The bulk of the congressional action occurred in 1985 and 1986, when the U.S. government passed legislation imposing trade embargoes, currency sanctions, and lending restrictions. Most importantly, the Comprehensive Anti-Apartheid Act of 1986 prohibited new private or public loans to South Africa other than for humanitarian purposes. To test the impact of this prohibition, the study identified ten important legislative events leading up to the 1986 Act and examined their impact on a portfolio of nine banks with South African loans. The results showed few sig-

nificant effects on bank stock prices and where significant they were of the wrong sign.

Pension funds and universities also put

pressure on corporations. Pension fund involvement in the South African issue began when a number of churches threatened to divest from banks doing business in South Africa. In 1977, the first iteration of the “Sullivan principles,” which called for non-segregation of races and equal pay for equal work, was adopted in the hope that by adhering to these principles, companies could continue doing business in South Africa and at the same time promote non-discrimination policies.³⁵ But many felt that the Sullivan principles did not go far enough, so Reverend Sullivan called in 1987 for companies to withdraw completely from South Africa. Many funds began to divest themselves even of companies that had followed these principles.³⁶ The study looked at the effect of 16 pension fund divestments on a portfolio of firms with the highest exposure in South Africa. The results showed no evidence that the pension fund divestment announcements hurt firms with major South African operations.

In short, financial textbooks characterize the demand curves for individual stock as infinitely elastic, so the price of the stock of a targeted company is unlikely to be affected by a boycott so long as additional buyers remain to scoop up the profit opportunity. The fact that an effort as large as the boycott of firms doing business in South Africa had virtually no effect on stock prices suggests that the financial effect of social investing on target firms is roughly zero.

*Injecting politics into pension policy
is problematic.*

Impact on the Pension Fund

But does social investing affect the pension fund adversely? Modern portfolio theory states that investors should diversify their asset holdings over a variety of securities, so that the returns on all financial assets do not move in lockstep.³⁷ The question is how many securities are needed for the portfolio to be efficient? The answer is that an investor needs only 20-30 stocks to construct a fully diversified portfolio.³⁸ The small number of required stocks suggests that eliminating, say, tobacco, which accounts for about 1 percent of the market capitalization of the S&P 500, should leave enough securities to construct something very, very close to the market index. As the number excluded increases, it would become increasingly difficult to duplicate the market.³⁹

In terms of evidence, considerable research has compared the risk-adjusted return of screened portfolios to the return of unscreened portfolios. Most of the studies cover the period since the mid-1980s.

Overall, the results show that the differences in risk-adjusted returns between the screened portfolios and unscreened portfolios are negligible

and in most cases zero.⁴⁰ A few studies have focused on the effects of divestiture of tobacco stocks in the 1990s and show that the risk and returns for the S&P 500 with and without tobacco stocks were almost identical.⁴¹

In addition to comparing the performance of screened portfolios to the S&P 500, several studies have examined the performance of social investment funds relative to the S&P 500. The Domini Social Index includes 400 U.S. companies that pass multiple and broad-based social screens, and the Calvert Social Index is a broad-based index including 659 companies. The majority of these studies show that socially screened funds have no significant effect on risk-adjusted returns.⁴²

In contrast, the evidence from the early days of the South Africa divestiture suggested that screening out stocks meant large losses. For example, in the 1970s, Princeton University reported that the stocks that had been excluded because of South Africa ties outperformed other holdings by 3 percent.⁴³ As time passed and researchers undertook more comprehensive studies, the conclusions shifted. For example, one study examined the performance of a South-Af-

rica free portfolio compared to an unscreened NYSE portfolio for the period 1960-1983 and found that, after adjusting for risk, the portfolio excluding South Africa companies actually performed better than the unscreened portfolio.⁴⁴ The positive results occurred because companies with South Africa ties were large and excluding these companies increased reliance on small-cap stocks, which performed better on a risk-adjusted basis during this period. During the late 1980s, the results were also mixed. On the one hand, a 1998 study analyzed data from the Surveys of State and Local Employees (PENDAT) from the early 1990s and found no significant effect on returns from restrictions on South Africa investments.⁴⁵ On the other hand, the S&P 500 including South Africa stocks performed slightly better than the index without the stocks, and one study of public pension plans found that South Africa restrictions had a negative effect on returns.⁴⁶ Thus, a large divestiture movement could have some negative effect on returns earned by public plans.

State actions may conflict with federal foreign policy.

Another aspect that has received less attention is the administrative costs of social investing. It is possible that social investing is

associated with higher fees and therefore has lower net returns because additional resources are required by fund managers to do the screening. The 2003 SIF Report concluded that socially responsible funds appear as competitive as other funds when it comes to administrative costs. However, others challenge this view by pointing out that some of the large-cap social index funds have above-average fees.⁴⁷ Moreover, in the case of Sudan and Iran, constructing new indices to match existing benchmarks involves substantial costs.

In short, theoretical models of portfolio choice imply that restricting the portfolio to socially responsible investments could have an effect on the rate of return by limiting the ability to diversify. Given the large number of stocks available, however, the cost — using traditional asset pricing models — is likely to be negligible. The bulk of the studies, which compare risk-adjusted returns for socially screened portfolios to those of unrestricted portfolios, supports this claim. Although a "terror-free" effort as large as the South African divestiture may have had some effect,⁴⁸ And administrative costs may be an important issue.

Public Plans Are Not Suited to Social Investing

In the late 1970s, some observers identified the large and rapidly growing funds in state and local pension plans as a mechanism for achieving socially and politically desirable objectives. The initial debate focused on attempts to exclude from pension portfolios companies with specific characteristics, such as those with almost totally nonunion workforces or investments in South Africa. The focus quickly shifted to undertaking pension investments that would foster social goals such as economic development and home ownership.⁴⁹ Advocates generally contended that the broader goals could be achieved without any loss of return.

Early reports, however, suggested that the targeting did involve sacrificing return. For example, a 1983 study of state-administered pension funds showed that many states had purchased publicly or privately insured mortgage-backed pass-through securities to increase homeownership in their state.⁵⁰ Analysis of the risk/return characteristics of these targeted mortgage investments revealed that 10 states either inadvertently or deliberately had sacrificed as much as 200 basis

points to foster homeownership. Similarly, in 1992, Connecticut's state pension fund lost \$25 million attempting to shore up Colt Industries. The firm went bankrupt two years after the fund bought a 47 percent interest in an attempt to protect Connecticut jobs.⁵¹ In Kansas, the state pension fund lost between \$100 and \$200 million on defaulted loans from an in-state investment program that included a chain of video stores, a steel mill, and a failed savings and loan bank.⁵² State and local pension funds were on a naive and dangerous path.⁵³

The losses in the 1980s and early 1990s were a sharp wake-up call to a number of public pension fund managers who appeared to believe that they could accomplish social goals without sacrificing returns. Over the last 20 years, the rhetoric associated with targeted investments has changed markedly. Public pension fund managers, sensitive to the potential for losses, go out of their way to make clear that they are no longer willing to sacrifice returns for social considerations; almost every definition of social investing includes a requirement that the investment produce a "market rate of return."

In the recent debate regarding Sudan and Iran, trustees of public plans have spoken out opposing such initiatives. Administrators at California's large public pension funds — CalPERS and CalSTERS — oppose the California bills requiring divestiture. A CalPERS spokesman said that determining which companies have dealings with Iran would be a struggle: "We don't necessarily have the resources or the expertise."⁵⁴ Similarly, the executive director of Massachusetts' Pension Reserves Investment Management Board, which invests public plan assets, said "You hire us to make you money, and when you restrict our ability to pick stocks, you likely restrict our ability to get returns."⁵⁵ Ohio's legislature initially considered following the Missouri model making investments "terror-free" by filtering out all stocks with links to North Korea, Syria, Sudan or Iran. The pension fund administrators argued that the measure would affect stocks of more than 170 companies and require the funds to sell more than \$9 billion. Administrative costs would exceed \$60 million.⁵⁶

Moreover, legislative mandates for pension fund investing may have implications elsewhere in the state. For example, in the case of Ohio the "terror-

*Divestment can be complicated,
costly, and ineffective.*

free" investing bill would have roped in companies such as Honda, DaimlerChrysler AG, Bridgestone Corporation, Siemens,

and Thyssenkrupp AG, all of which had investments in Ohio.⁵⁷ The pension funds estimated these companies employed more than 45,000 workers. In response, the legislature narrowed the scope of the effort and decided to go after only those companies with more than \$20 million in Iran's energy sector.⁵⁸

Most importantly, three aspects of public pension funds make them particularly ill-suited vehicles for social investing.

First, the decision-makers and the stakeholders are not the same people. The decision-makers are either the fund board or the state legislature. The stakeholders are tomorrow's beneficiaries and/or taxpayers. If social investing produces losses either through higher administrative costs or lower returns, tomorrow's taxpayers will have to ante up or future retirees will receive lower benefits. The welfare of these future actors is not well represented in the decision-making process.

Second, whereas the investment practices of many large public funds are first rate, other boards are much less experienced. The boards of smaller

funds often consist of between five and eleven people including mayors, treasurers, comptrollers, city councilors, union leaders, and citizens. The process is often conducted behind closed doors and subject to little public scrutiny. Moreover, many state and local plans are still run in-house and involve the selection of individual stocks rather than broad-based indices. A front page *New York Times* article reported that political money sometimes affects pension investment decisions. As a result, pension boards may overlook excessive fees or high rates of turnover, and they may approve inappropriate investments.⁵⁹ Introducing divestment requirements into such an environment is problematic.

The final issue is the slippery slope. This round of divestment began with Sudan and involved only a few stocks. It is quickly spreading to Iran, where the issues are even more complicated and the number of companies substantially greater. If "terror-free" investing gains momentum, what is going to stop the spread to, say, Saudi Arabia, original home of 15 of the 19 hijackers involved in the 9/11 terrorist attacks? At some point, the administrative costs of broad-based divestiture will balloon and excluding large numbers of companies will definitely hurt returns.

Conclusion

Everyone is horrified by genocide, and no one wants to support terror. Yet even those who sell socially responsible funds admit that the issue of divestiture is complex. "You have to ask yourself what your goal is with divestment. What's there if the government falls? Is there a government there that will take over and be better? If the companies that pull out provide money, goods, and services, is there an understanding that will make the people poorer in the short run?"⁶⁰ Yes, the regime changed in South Africa, but many South Africans say that it was the cultural boycott — particularly in sports — rather than the divestiture of companies with South-Africa-linked activities that resulted in the peaceful ascendance of Nelson Mandela as president.⁶¹

In addition to the issue of effectiveness, the fundamental question is where foreign policy should be made. Sudan does not raise as many issues in this regard as Iran. The State Department is working closely with foreign governments to get specific companies to stop selected activities, particularly in Iran's energy sector. Additionally, in more than one instance, federal courts have ruled that state legisla-

tion regarding social investment was unconstitutional on grounds that it overlapped with federal regulations.⁶² Statements by officials at both Treasury and the State Department make clear their concern that a broad-based divestiture could disrupt the government's effort.

But even assuming that divestment is an effective mechanism to stop genocide and reduce terror risk and that state legislatures and pension fund boards are the right place to make foreign policy, the issue remains whether pension funds are an appropriate vehicle for implementing that policy. The answer seems unquestionably "no." The decision-makers are not the people who will bear the brunt of any losses; rather they will accrue to future beneficiaries and/or taxpayers. In many instances, the environment surrounding public pension fund investing is politically charged and encouraging public pension fund trustees to take "their eyes off the prize" of the maximum return for any given level of risk is asking for trouble. And finally, boycotting companies doing business with particular countries is a slippery slope — today Sudan and Iran, tomorrow Saudi Arabia.

Endnotes

1. Actually, as early as 2000, many college endowments and public pension funds, including CalPERS, did not participate in the initial public offering of PetroChina, because of its involvement in oil extraction in Sudan. See Fried (2006).
2. Amnesty International (2007) and Hagan and Paloni (2006).
3. U.S. Department of Treasury (2007).
4. The Federal Reserve Flow of Funds reports total assets for state and local pension plans of \$2,701.5 billion in 2005.
5. The majority of funds (64 percent) use 5 or more screens; the remainder are divided between those with a single screen (25 percent) and those with 2-4 screens (11 percent).
6. Multi-employer plans have made a few efforts to stimulate demand for union labor, especially in the construction trades. And some health care companies and hospitals screen for tobacco. But generally very little social investment has taken place. The Social Investing Forum (SIF), however, has reported that nearly 10 percent, or \$137 billion, of screened assets are in corporate defined benefit plans. It was impossible for the author to ferret out where this money was. The only corporation mentioned by SIF was the Federal Home Loan and Mortgage Corporation (Freddie Mac). Since Freddie Mac invests most of its money in home mortgages, it is not clear how it is involved in social screening. In a personal communication, SIF's Joshua Humphreys said that there are other corporations that are not included on the list, but SIF refused to give out any additional names.
7. ERISA requires a fiduciary to act "solely in the interests of the [plan] participants and beneficiaries... for the exclusive purpose" of providing benefits to them. A fiduciary must also act "with the care, skill, prudence, and diligence" of the traditional "prudent man." See Langbein, Stabile, and Wolk (2006).
8. Lanoff (1980).
9. U.S. Department of Labor (1994).
10. Some companies offer their employees one or more mutual fund options that pursue social investing criteria. Such an option does not raise any fiduciary concerns because the decision is left entirely to the participant.
11. The New Jersey legislation requires its pension funds to divest holdings in businesses that have equity stakes in the Sudan. A similar bill in Illinois, enacted in June 2005, provides that a fiduciary should not transact any business with a company doing business with Sudan, although in February 2007 the Federal District Court for the Northern District of Illinois ruled this act unconstitutional. Oregon also passed such a law for its public pension funds, while Louisiana legislation permits, but does not require, divestiture of investments linked to the Sudan.
12. U.S. Department of State (2007a). In 1997, President Clinton issued an executive order barring companies from conducting business in the Sudan; foreign businesses do not fall under that restriction.
13. For example, Texas legislation, signed into law on June 15, 2007, will require both the Teacher Retirement System and the Texas Employees Retirement System to ask affected companies to cease business in Sudan and to divest shares of unresponsive companies. The Hawaiian Employees' Retirement System was required to divest from Sudan-related investments when legislation went into effect July 1st. In Connecticut, legislation enables the Treasurer to divest state funds invested in companies doing business in Sudan or decide against further or future investments. Nineteen other states have pending divestment legislation or are taking other actions towards divestment. For example, the New York State Comptroller adopted a targeted Sudan divestment policy for the New York State Common Retirement Fund.
14. Fried (2006).
15. A KLD employee told us that KLD sells their compliance list to institutional money managers who are interested in social divestment and that it is not in the company's best interest to allow outside organizations to obtain their list in whole or in part. KLD also would not provide information about the American companies on the list. This information was obtained through a personal communication with KLD's Randy O'Neill.

- 16 Fried (2006). In a personal communication, 3M's Jacqueline Berry also confirmed the sale of the Security Film to the United Nations.
- 17 Fried (2006) and a personal communication with Northern Trust's Priya Khetarpal.
- 18 Pichardo (2007).
- 19 The U.S. House Financial Services Committee on May 23, 2007 passed legislation that would protect public pension funds and their money managers from litigation in response to Iranian divestiture.
- 20 King (2007).
- 21 The new law requires the State's Board of Administration to contact companies with business ties to Sudan and with energy ties in Iran, asking them to stop such activities; unresponsive companies would have to be divested 90 days after the communication. See Pensions and Investments (2007a).
- 22 *Pensions and Investments* (2007b).
- 23 The California legislation, which was proposed in January and as of July is still in committee in the state senate, would force two of the nation's largest pension funds — for the state's public employees and teachers, with combined holdings of \$400 billion — to remove their money from any foreign company doing business with Iran. See Abdollah (2007).
- 24 Pichardo (2007).
- 25 See Pichardo (2007); and also confirmed by a personal communication with SSgA's Gary Conway. Also, according to Northern Trust Global Investments, companies doing business in Iran comprise about 25 percent of the MSCI EAFE index, compared to about 15 percent with ties to Sudan.
- 26 When narrowed, the number of companies involved declines from 100-125 to the 19-25 range. In California, for example, CalPERS would have to divest \$8 billion if a bill introduced by Joel Anderson is passed. If narrowed to companies only with energy interests in Iran, the divestiture requirement drops to \$2 billion. See Pichardo (2007).
- 27 LaFranchi (2007).
- 28 See U.S. Department of Treasury (2007); U.S. Department of State (2007b); and McKinley (2007).
- 29 Karmin (2007).
- 30 See Frick (2007).
- 31 For a summary of the literature on testing the extent to which the supply curve is elastic, see Munnell and Sunden (2005).
- 32 The caveat is, of course, that potential buyers must not think the sale (purchase) reflects a negative (positive) assessment of the firm's financial condition or business prospects that could affect future cash flows. If potential purchasers believe that the seller is disposing of the stock because he knows something adverse they do not, they will revise down their assessment of the stock's value, and the transaction will reduce the price of the stock.
- 33 Apparently the Vice Fund has grown at 20 percent annually since its inception, outpacing the S&P's growth of 16 percent. At first blush, these results appear to contradict the conclusion that screening has no impact, but the period under consideration is far too short for these numbers to have meaningful implications. See Auhers (2007).
- 34 Teoh, Welch, and Wazzan (1999).
- 35 During the 1970s, as opposition against the apartheid government increased, social activists charged that companies investing in South Africa indirectly supported the government and its discrimination policies. In an initial effort to resolve the conflict, the Reverend Leon Sullivan in 1977 introduced a set of guidelines for companies doing business in South Africa, the so-called "Sullivan Principles." By 1987, 127 U.S. companies had signed on to the Sullivan principles (Auerbach, 1987).
- 36 For example, CalPERS divested itself of \$9.5 billion worth of shares of companies holding a South African subsidiary. Pressure to divest and a worsening economic and political environment in South Africa led many companies (IBM, Exxon, Ford, GM and Chrysler) to sell their holdings. See Teoh, Welch, and Wazzan (1999).
- 37 An asset can be characterized by its expected return and the risk associated with that return, measured by the variance in returns. The risk of a specific asset can be broken down into two parts: risks that are unique to that stock (firm risk) and risks that stem from market-wide variations such as business cycle variation, inflation, and interest rate fluctuations

(market risk). When assets are combined in a portfolio, the return on the overall portfolio is given by the average return of the assets. And the risk associated with the portfolio is determined by the variance of the individual returns and the degree to which the individual returns vary together (covariance). Thus, by combining assets into a portfolio that have differing risk characteristics, an investor can create an efficient portfolio — a portfolio that is expected to achieve a given level of expected returns while minimizing risk.

38 Assume an investor plans to divide his money among n stocks selected from the entire market portfolio. The portfolio variance is given by:

$$\text{Portfolio variance} = 1/n * \text{average variance} + (1 - 1/n) * \text{average covariance}$$

As the number of securities in the portfolio increases, the contribution to total risk from the individual firm-specific risk decreases and the contribution from how the risks vary in relation to each other (covariance) increases. Thus, as the number of securities increases, the overall portfolio variance approaches the economy-wide risk, represented by the second term in the equation. With 2 stocks in the portfolio, half of the overall variance is due to firm specific risk and half to market risk. By the time a portfolio contains 10 securities, 90 percent of the portfolio's variance should be determined by the market risk. With a 20 stock portfolio, 95 percent of the variance should be determined by the overall market risk. See Brearley and Myers (1988).

39 Rudd (1987) and Grossman and Sharpe (1986) argue that the investor will not be able to exactly duplicate the market portfolio, because the screened portfolio will have relatively greater covariation in returns. Rudd also argued that social investing will introduce size and other biases into the portfolio, which will lead to a deterioration in long-run performance.

40 Guerard (1997); Hamilton, Jo, and Statman (1993); Statman (2000); Bauer, Koedijk, and Otten (2002); Dhrymes (1998), and Bello (2005). A similar result has been found for bond portfolios (D'Antonio, Johnsen and Hutton, 1997).

41 DiBartolomeo (2000). In the late 1980s and early 1990s, tobacco stocks performed slightly better than the S&P 500 but during the second half of the 1990s the tobacco stocks underperformed the S&P 500 on a risk-adjusted basis (Social Investment Forum, 1999;

and Ferrari, 2000). However, the overall effect of divesting tobacco stocks should be small because they only account for about 1 percent of the S&P 500.

42 Kurtz and DiBartolomeo (1996); DiBartolomeo and Kurtz (1999); DiBartolomeo (1996); and Bello (2005). Some critics of these results contend that the comparable returns reflect the fact that the screened funds invest a higher proportion of their assets in small cap stocks. Small caps have out-performed large caps over the period 1995 to 2007 by more than 3 percentage points (10.9 percent versus 7.8 percent). The discrepancy since the trough in the market in 2002 has been even greater (20.0 percent versus 11.0 percent). Bello (2005) contends, however, that the sizes of the companies in the screened and unscreened portfolios are very similar.

43 Malkiel (1991).

44 Grossman and Sharpe (1986).

45 Munnell and Sundén (2001).

46 Romano (1993).

47 Hickey (2000).

48 A recent study (Karolyi, 2007) of terror-free investing concluded that there were no significant differences in risk or return of stock portfolios screened on the basis of their operations in countries designated as state sponsors of terrorism and the S&P 500. This study, however, focused exclusively on U.S. markets, where very few firms do business in terror-linked countries. The author notes that "Broadening the analysis to incorporate a global investment strategy may render different results and conclusions."

49 Two books were instrumental to broadening the social investing debate — Rifkin and Barber (1978) and Litvak (1981).

50 Munnell (1983).

51 Schwimmer (1992); and Langbein, Stabile, and Wolk (2006).

52 White (1991).

53 In their initial forays into economically targeted investments, public pension fund managers generally

did not appear to recognize the "Catch-22" nature of the exercise. For the most part, the goals of increasing in-state housing investment and maximizing returns are inconsistent in the United States' highly developed capital markets. Any housing investment that offers a competitive return at an appropriate level of risk, such as a GNMA, does not need special consideration by public pension plans nor would such consideration increase the long-run supply of mortgage loans. Investments by pension funds that would increase the supply of housing funds must by definition either produce lower returns or involve greater risk. Sophisticated advocates of targeted investments recognized the efficiency of the market for housing finance and argued that pension funds could make a contribution through innovative forms of housing finance. But that was not what was going on in 1983; the in-state mortgages purchased by public pension funds tended to be conventional fixed-rate 30-year mortgages. See Munnell (1983).

54 McKinley (2007) and also confirmed by a personal communication with CalPERS' Brad Pacheco.

55 Mishra (2006).

56 King (2007).

57 Ohio Retirement Study Council (2007).

58 King (2007).

59 Walsh (2004).

60 The comment is from Julie Gorte, director of social research at Calvert Investments (Fried, 2006).

61 Authers (2007).

62 Stern (2007).

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Public Footprints in Private Markets

Sovereign Wealth Funds and the World Economy

Robert M. Kimmitt

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Public Footprints in Private Markets

Sovereign Wealth Funds and the World Economy

Robert M. Kimmitt

IN 1953, eight years before its independence from the United Kingdom, Kuwait established the Kuwait Investment Board to invest its surplus oil revenue. That was perhaps the first-ever “sovereign wealth fund” (SWF), although the term would not exist for another 50 years. SWFs are large pools of capital controlled by a government and invested in private markets abroad. Today, they are growing rapidly in both number and size. Twelve SWFs been established since 2005, and altogether SWFs control roughly \$2.5 trillion—a figure now growing, according to some estimates, by \$1 trillion a year.

These developments should not cause alarm, but they do raise legitimate policy questions. Governments should consider the implications of SWFs’ growing importance with calm and precision. Many concerns, aired frequently in policy debates and prominently in the media, have been exaggerated, in part because of a lack of understanding of SWFs and other vehicles for sovereign investment. A fuller picture of SWFs’ history, purpose, size, growth, and broader systemic implications is needed. Such an understanding, along with a set of clear policy principles for both SWFs and the countries in which they invest, will help preserve openness to foreign investment and promote financial stability worldwide.

ROBERT M. KIMMITT is Deputy Secretary of the U.S. Department of the Treasury.

THE FOUR SOVEREIGNS

TO FRAME this policy discussion, it is useful to differentiate among four kinds of sovereign investment: international reserves, public pension funds, state-owned enterprises, and SWFs. International reserves, as defined by the International Monetary Fund (IMF), are external assets that are controlled by and readily available to finance ministries and central banks for direct financing of international payment imbalances. Countries typically keep reserves on hand to cushion an export shortfall or to intervene to defend the currency in a financial crisis. Reserves are by definition invested in highly liquid and marketable securities, which usually means highly rated industrialized-country government bonds.

Public pension funds are investment vehicles funded with assets set aside to meet the government's future entitlement obligations to its citizens. Public pension funds differ from SWFs in that they are denominated and funded in the local currency, usually with relatively low exposure to foreign assets. However, it is expected that pension funds will increasingly invest abroad, in some cases using national SWFs to manage their assets.

State-owned enterprises (SOEs) are companies over which the state has significant control, through full, majority, or significant minority ownership. SOEs can themselves undertake foreign investment. This category includes a wide variety of entities, including manufacturing and financial firms.

Finally, SWFs are generally defined as government investment vehicles funded by foreign exchange assets and managed separately from official reserves. SWF managers typically have a higher tolerance for risk and seek higher returns than do official reserve managers.

SWFs generally fall into two categories according to the source of the foreign exchange assets. Commodity SWFs are funded by commodity exports that are either owned or taxed by the government. These funds serve different purposes— including fiscal revenue stabilization, intergenerational saving, and balance-of-payments sterilization (that is, keeping foreign exchange inflows from stoking inflation). Given the current extended rise in commodity prices, many funds initially established for the purposes of fiscal stabilization or balance-of-payments sterilization have evolved into intergenerational savings funds.

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Noncommodity swfs are typically established through transfers of assets from official foreign exchange reserves. Large balance-of-payments surpluses have enabled noncommodity exporters to transfer “excess” foreign exchange reserves to standalone investment funds that can be managed for higher returns. Noncommodity funds often arise from an exchange-rate intervention involving a domestic liquidity increase that has to be absorbed by issuing domestic debt to avoid unwanted inflation. Their net return depends on the difference between the yield earned on investments and the yield paid on domestic debt. The assets of this type of swf, accordingly, may be thought of more as borrowed money than traditional wealth.

Given that sovereign investment takes these different forms, why has there been so much focus on swfs alone? First, swfs appear to be set for rapid and perhaps prolonged growth. Second, swfs raise issues that also bear on other types of sovereign investment—financial-market issues, which also relate to international reserves and public pension funds, and investment issues, which also relate to SOEs.

SWFS: THE ISSUES

SWFS HAVE existed in a number of places—not only Kuwait but also Abu Dhabi and Singapore—for over 25 years. What is remarkable today is the increase in their number and size. There are now, by some definitions, as many as 40 different swfs. Estimates of the size of swfs are hindered by the fact that they are often not transparent, but the IMF approximates that swf assets are today somewhere between \$1.9 trillion and \$2.9 trillion. Projections of their future size are also uncertain, as the value of swfs depends heavily on commodity prices and exchange-rate policies. However, a number of private financial institutions have estimated that swf assets will reach \$10–\$15 trillion by 2015.

Whether these are considered large or small figures depends on the metric used. If one wishes to make swfs appear large, one can note that the current market capitalization of the S&P 500 is roughly \$12 trillion. If one wishes to make them appear small, one can note that \$12 trillion is only a fraction of the estimated \$190 trillion in total global financial assets. SWFS can also be compared to other investor

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classes. Once again, if one wishes to make SWFs appear large, one can note that hedge funds manage an estimated \$1.5 trillion. If one wishes to make them appear small, one can note that assets managed by mature-market institutional investors (such as pension funds and endowments) are about \$53 trillion.

Two points, however, are inescapable regardless of the metric. The first is that SWFs are already large enough to be systemically significant. The second is that they are likely to grow larger over time, in both absolute and relative terms, which calls for a discussion of the issues this growth may raise for the international financial system.

The first issue to consider is whether the formation of SWFs perpetuates undesirable underlying macroeconomic and financial policies. Clearly, it is critical that noncommodity funds, made up of excess reserves accumulated through exchange-rate interventions, not use SWFs as a mechanism simply to accumulate more foreign assets in an effort to keep the currency from appreciating. The perpetuation of undesirable underlying policies is less of a concern with commodity funds, since governments are essentially replacing a physical asset in the ground with a financial asset in a bank account to be drawn on by future generations. However, even commodity-exporting countries need to make sure that their SWFs operate within a framework of sound domestic fiscal, monetary, and exchange-rate policies.

Second, since SWFs are an outgrowth of domestic and international economic and financial policies, it makes sense to consider them in terms of their potential impact on financial stability. Here, there is much reason to be reassured. SWFs are in principle long-term investors, which typically do not deviate from their strategic asset allocations in the face of short-term volatility. They are not highly leveraged, and it is difficult to see how they could be forced by regulatory capital requirements or sudden investor withdrawals to liquidate their positions quickly. In this context, SWFs may be considered a force for financial stability—supplying liquidity to the markets, raising asset prices, and lowering borrowing yields in the countries in which they invest. Still, responsible public policy requires a thorough consideration of the potential impact of SWFs on financial markets. SWFs represent large, concentrated, and often opaque positions in financial markets. A sudden shift by SWFs in illiquid markets can cause price volatility. Further,

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since many SWFs disclose little of their investment policies, mere rumors of SWF shifts may cause the private sector to react.

The third and perhaps most critical set of issues relates to SWF investment that involves taking active control of private firms. The most obvious consideration is national security. As with any form of foreign investment, countries on the receiving end of SWF investment need to ensure that national security concerns are addressed, without unnecessarily limiting the benefits of an open economy. Such concerns do not stem only from cases in which an SWF gains a formal controlling share of a company; they can also arise when an investor seeks board seats or outsized voting rights—anything beyond a purely passive investment.

In the United States, balancing open investment with the need to protect national security is done through the Committee on Foreign Investment in the United States. CFIUS is designed to review foreign investments in a manner that preserves national security without creating unnecessary or counterproductive barriers to participation in the U.S. market. The CFIUS process supports open investment by focusing only on those transactions that relate to national security.

Even in the wake of some high-profile controversies—such as the Chinese national oil company CNOOC's attempted purchase of a U.S. oil company or Dubai Ports World's possible takeover of operations at U.S. ports—the vast majority of foreign investments reviewed by CFIUS continue to be processed expeditiously and without controversy within a 30-day investigation period. In 2006, there were approximately 10,000 mergers and acquisitions in the United States. Of these, 1,730 were cross-border transactions, and only 113, or roughly 6.5 percent, came before CFIUS. None of these transactions was blocked.

Congress passed a new CFIUS law in the summer of 2007 that mandates additional scrutiny and higher-level clearances for transactions involving foreign government control. However, this additional scrutiny comes in the context of provisions for greater certainty for investors, more accountability from the U.S. administration, and better communication between CFIUS and Congress. It also reinforces the disciplined approach that allows CFIUS to focus its attention on the very small share of cases that raise genuine national security concerns.

There are also non-national-security issues associated with the potential increase in foreign public ownership of private firms. First, the

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U.S. economy is built on the belief that private firms allocate capital more efficiently than governments. Second, foreign governments could conceivably employ large pools of capital in noncommercially driven ways that are politically sensitive even if they do not have a direct impact on national security. Examples would include investment decisions made to promote a given foreign or social policy. Third, there is the potential for perceived or actual unfair competitive advantages relative to the private sector. For instance, a government could use its intelligence or security services to gather information that is not available to a commercial investor. With a sovereign guarantee, a SWF could also obtain or extend financing (if needed) at interest rates that a commercial investor could not. It is also possible for a SWF to take an indirect approach by channeling foreign exchange through domestic SOEs, which in turn invest abroad.

FIRST, DO NO HARM

HOW SHOULD the United States and other recipient countries of SWF investments respond to their increased importance? First, they should take care to do no harm. They should recognize that SWFs have not caused significant financial-market disruption and that the overwhelming majority of SWF investments do not involve partial or complete control of firms. And even for investments that do involve control, there is little evidence of any ulterior foreign policy motives in practice.

Recipient countries should also maintain their unequivocal support for international investment. President George W. Bush reaffirmed this long-standing U.S. policy in his "Statement on Open Economies" on May 10, 2007, the first such statement in 16 years. The benefits of market-driven free investment flows are many. There are static gains as U.S. businesses are able to expand by tapping international capital. From a macroeconomic perspective, investment inflows help finance the country's current account deficit. There are also important dynamic gains from the resulting business competition. Prices of goods and services decrease, their availability and variety increase, and the productivity and efficiency of domestic businesses rise.

The U.S. economy benefits significantly from inward and outward foreign direct investment. U.S.-headquartered multinational companies

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that invest abroad have contributed strongly to overall productivity growth in the United States and thus to rising U.S. living standards. U.S. multinationals accounted for over half of U.S. productivity growth between 1977 and 2000 and for half of the increase in U.S. productivity growth between 1995 and 2000. During this five-year period, productivity at U.S. multinationals surged, growing six percent annually.

Research also shows that foreign-owned firms in the United States employ 4.5 percent of the work force and account for 5.7 percent of output, 19 percent of U.S. exports, 13 percent of research-and-development spending, and 10 percent of all U.S. investment in plant and equipment. These firms also pay more than 30 percent higher compensation (wages and benefits) on average than do their counterparts in the rest of the U.S. economy. And 30 percent of these jobs are in manufacturing, compared with fewer than 10 percent of all U.S. jobs.

The biggest threat to the benefits of foreign direct investment would be a slide toward investment protectionism. As Treasury Secretary Henry Paulson has noted, protectionism, in both investment and trade, would undermine U.S. growth and job creation. And this is not just a U.S. concern: there is also rising protectionism in Europe and other industrialized countries and in emerging markets. Often this investment protectionism is masked by claims of national security concerns or driven by individual firms that might lose out in a given deal.

PRINCIPLES FOR A POLICY RESPONSE

ONE CLEAR conclusion that arises from this discussion is that the benefits of SWF investments to the recipient countries depend on the extent to which the behavior of SWFs is economically driven. If these investments are economically, rather than politically, driven, recipient countries have a strong interest in providing an open, transparent, and predictable framework for SWF investment.

Clearly, both the countries in which SWFs invest and SWFs themselves have certain responsibilities. Policy principles are needed for both sides. The U.S. government is now intensifying direct bilateral outreach efforts with both countries that have SWFs and countries that receive their investment.

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Countries receiving SWF investment should follow four basic principles. First, avoid protectionism. Countries should not erect counterproductive barriers to investment, regardless of whether the investor holds a controlling interest in national firms. Second, uphold fair and transparent investment frameworks. Investment policies and processes, especially those involving national security considerations, should be public, clearly articulated, predictable, and nondiscriminatory. Third, within those frameworks, respect investor decisions. Having laid out the ground rules, recipient countries should not tell SWFs how to invest their money. Decisions on how to allocate investments across countries and asset classes are for the funds' managers alone, particularly given the potential for losses as well as gains. Finally, treat investors equally. Tax and regulatory policies should not discriminate between foreign and domestic entities.

The principle of reciprocity—that is, reciprocal openness to investment—is not on this list despite the fact that many countries with SWFs are themselves far too closed to foreign investment. This is because it is in the United States' interest to be open to market-driven investments—from both private and sovereign entities—even if other countries are not. Still, that is not to say that reciprocity is not considered at all: the reality is that investment policy decisions are made in a broader political context in which reciprocity, as well as the protection of intellectual and physical property, is taken into account.

SWFs, meanwhile, should follow five policy principles of their own. First, invest commercially, not politically. SWF investment decisions should be based solely on economic grounds, rather than political or foreign policy considerations. SWFs should make this statement a formal part of their basic investment management policies. Second, convey world-class institutional integrity. SWFs should be transparent about their investment policies and have strong risk-management systems, governance structures, and internal controls. Although not highly leveraged and, in principle, long-term investors, SWFs can represent large, concentrated, and opaque positions and thus may cause worries of systemic risk. Third, compete fairly with the private sector. SWFs should be careful not to be seen as having an unfair advantage in competing with the private sector for transactions, including by financing acquisitions at below-market rates. Fourth, promote international

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financial stability. As public-sector entities seeking to benefit from healthy global markets, swfs have a strong stake in and responsibility for international financial stability. During times of market stress, swfs should be committed to communicating effectively with the official sector to address financial-market issues. Finally, respect host-country rules. Swfs should comply with and be subject to all applicable regulatory and disclosure requirements of the countries in which they invest.

These principles are all predicated on the fact that swf asset accumulation is appropriate in the first place. Still, the underlying macroeconomic policies creating the resources for swfs should be under constant review to see that they, too, remain appropriate—both for the countries with swfs and the international financial system.

It is also worth addressing the frequently made comparison between the transparency of hedge funds and the transparency of swfs. Transparency is very important in both cases, but each requires a different approach. Unlike swfs, hedge funds are private-sector entities. Disclosure is important to foster market discipline, which helps to mitigate systemic risk. The key avenues for hedge-fund transparency are between hedge funds and their investors, between hedge funds and their counterparties and creditors, and among counterparties, creditors, and their regulators. These issues are being addressed through the development of voluntary best practices by private-sector groups on both sides of the Atlantic.

This framework for market discipline to mitigate systemic risk does not apply to swfs. Swfs are public-sector entities managing public funds, and profit maximization may not be considered the primary objective. Investor discipline depends on citizens and the government, rather than savvy institutional investors. Swfs' counterparties thus may not exercise market discipline, by limiting exposures or tightening financing terms, because they assume a sovereign guarantee will assure full payment. Public disclosure is therefore appropriate for swfs to mitigate systemic risk.

A STRUCTURAL SHIFT

THE U.S. TREASURY Department has played a leadership role within the U.S. government in seeking better understanding of, and communication with, swfs. The President's Working Group on Financial

Public Footprints in Private Markets

Markets, which brings together key U.S. financial regulators and other members of the U.S. government under Secretary Paulson's chairmanship, has initiated a review of SWFs. The Treasury Department has also undertaken regular outreach and discussion with SWFs and market participants to better understand trends and monitor sovereign investments and acquisitions, and it has initiated in-depth analysis and regular reporting to Congress.

The Treasury Department believes that the principles outlined above can inform the development of two sets of voluntary multilateral best practices to provide an improved framework for SWFs and the recipients of their investment. The wide variety of experience and investment strategies among SWFs, combined with the wide diversity of regimes for regulating inward investment, underscores the need for broadly discussed and accepted best practices.

First, the Organization for Economic Cooperation and Development could identify best practices for countries that receive foreign government-controlled investment, including from SWFs. Recipient countries have a responsibility to maintain openness, and the OECD has a long history of promoting open investment regimes.

Second, the IMF, assisted by the World Bank, could draft a set of best practices for SWFs, building on existing best practices for the management of foreign exchange reserves. These best practices could cover the overall objectives and principles of SWFs, their institutional arrangements, their risk-management frameworks, and their transparency and accountability—including public disclosure. These would provide guidance to new funds seeking to make sound decisions on how to structure themselves, mitigate any potential systemic risk, and help demonstrate to critics that SWFs will continue to be constructive, responsible participants in the international financial system. Even long-standing SWFs are aware that the increase in the number and size of these funds has, rightly or wrongly, raised reputational issues for them all.

To initiate high-level discussion of the impact of SWFs, Secretary Paulson hosted an outreach dinner at the Treasury Department in October 2007 with the finance ministers of the G-7 (the group of highly industrialized countries); the heads of the IMF, the OECD, and the World Bank; and finance ministers and heads of SWFs from eight

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countries: China, Kuwait, Norway, Russia, Saudi Arabia, Singapore, South Korea, and the United Arab Emirates. There was a shared realization of a common interest in maintaining open investment and promoting financial stability. The following day, the International Monetary and Financial Committee—a ministerial-level committee whose members represent all 185 IMF member countries—tasked the IMF with identifying best practices for SWFs. The OECD, meanwhile, is accelerating its own work on developing best practices for recipient countries' investment regimes.

It is hard to escape the conclusion that the ongoing increase in SWF cross-border investment represents a potential structural shift in the global economy. It is incumbent on economic policymakers in all countries to consider fully the implications of this shift and how to respond. The evidence so far suggests that SWFs are seeking to generate higher investment returns without generating political controversy. Although it is imperative that the U.S. government remain vigilant, so long as SWF activities are consistent with free and fair competition based on agreed best practices, keeping the United States' doors open to investment from SWFs will continue to promote growth and prosperity, both at home and abroad. ☺





**U.S. TREASURY DEPARTMENT
OFFICE OF PUBLIC AFFAIRS**

EMBARGOED FOR 9:30 A.M. October 3, 2007
CONTACT Candice Pratsch, (202) 622-3431

**Testimony of Adam J. Szubin,
Director
(Office of Foreign Assets Control)
U.S. Department of the Treasury**

Before the U.S. Senate Committee on Banking, Housing and Urban Affairs

Chairman Dodd, Ranking Member Shelby and Members of the Committee, thank you for the opportunity to speak to you today about the Treasury Department's role in addressing the situation in Darfur and the Sudanese Government's support for terrorism, as well as its views regarding the various Sudan-related pieces of legislation that are pending in the Congress. I welcome the Committee's interest in these matters, and want to take this opportunity to thank the Committee for its continued support of Treasury and OFAC and its mission over the years, in particular as we have pursued sanctions against governments like Sudan.

We share an acute concern about the devastating suffering in Darfur, and an understanding that economic pressure can play an important role in bringing about a

political resolution to this complex situation. Secretary Paulson has made it clear that we should spare no effort in using all tools at the Treasury Department's disposal to advance this goal. For OFAC, and for myself in particular, imposing smart and effective pressure on Sudan has been a foremost priority.

Treasury Department Actions against Sudan

The Scope of Sanctions

The United States has levied economic sanctions against Sudan since 1997. At that time, the Government of Sudan's support for international terrorism and widespread human rights violations led President Clinton to impose comprehensive trade sanctions against Sudan, and block all property of the Government of Sudan in the United States or within the control of U.S. persons anywhere in the world.

Acting with Congress, President Bush amended these broad sanctions in 2006 to carve out certain areas from our sanctions, notably Southern Sudan and Darfur, provided that the relevant transactions do not involve Sudan's petroleum or petrochemical industries or any property or property interest of the Government of Sudan.

In addition to these comprehensive sanctions, the President recently imposed strict economic sanctions against persons responsible for violence or atrocities in Darfur. Issued in accordance with actions taken by the United Nations Security Council, Executive Order 13400 blocked the property of four individuals connected to the conflict in Darfur. It also authorized the Treasury Department to block the property and interests

in property of persons determined to: constitute a threat to the peace process in, and stability of, Darfur; be responsible for conduct related to the conflict in Darfur that violates international law; be responsible for heinous conduct with respect to human life or limb related to the conflict in Darfur; have supplied, sold, or transferred arms or any related materiel related to military activities to the warring parties in Darfur; or be responsible for offensive military overflights in and over the Darfur region. Treasury's authority applies as well to those determined to have materially assisted or supported, or to have acted for or on behalf of, any of the above.

Recent Actions

A primary objective of these sanctions, of course, has been to alter the behavior of those responsible for the terrible suffering in Darfur, first and foremost the Sudanese Government of President Bashir. This past April, on Holocaust Memorial Day, the President issued a clear warning to the Sudanese Government. Either they would live up to their prior commitments and allow the deployment of a joint United Nations-African Union peacekeeping force, or the United States would impose further economic sanctions on the Sudanese Government and seek a United Nations Security Council Resolution to do likewise.

When President Bashir did not follow through, President Bush did. On May 29, Treasury announced the designation of three additional Sudanese individuals and thirty-one additional Sudanese companies subject to the asset freeze strictures of Executive Orders 13067, 13400, and 13412. We imposed sanctions against three individuals and

one company because of their role in the ongoing violence in Darfur. We designated Ahmad Muhammed Harun, Sudan's State Minister for Humanitarian Affairs, and Awad Ibn Auf, Sudan's head of Military Intelligence and Security, who are among Khartoum's senior leadership and have acted as liaisons between the Sudanese government and the Government-supported Janjaweed militias. We also designated Khalil Ibrahim, leader of the Justice and Equality Movement (JEM), a rebel group that has been responsible for a number of violent incidents, and the Azza Air Transport company, which had been conveying artillery, small arms, and ammunition to Sudanese government forces and Janjaweed militia in Darfur for their activities in Darfur.

Simultaneously, we targeted 30 additional companies owned or controlled by the Government of Sudan, thereby subjecting them to the asset freeze imposed on the Government by Executive Order 13067 and 13412. These targeted companies included five petrochemical companies, Sudan's national telecommunications company, and an entity that has supplied armored vehicles to the Sudanese Government for military operations in Darfur.

In addition to these actions to strengthen our financial measures against Sudan, we have stepped up enforcement of our Sudan sanctions, and have made such enforcement a top priority within OFAC. While I cannot comment on specific open enforcement cases, I can tell you that we are aggressively pursuing a number of violators to expose and penalize those who are violating our sanctions and deter those who might think of doing so.

In this regard, I would like to thank the Chairman and this Committee for its support in passing S. 1612, the International Emergency Economic Powers Enhancement Act, which provides for increased civil penalties for violations of IEEPA – the statute pursuant to which our sanctions against Sudan are imposed. We have sought these increased penalties in no small part because we faced impediments to obtaining meaningful enforcement of our sanctions against Sudan. The passage of this bill will provide a strong tool to make our sanctions effective.

It can be notoriously difficult to measure and attribute the impact of sanctions, when the ultimate objective is a change in regime behavior. It is certainly true that our sanctions were watched very carefully in Khartoum and taken seriously. Immediately after the sanctions were announced, the Sudanese Government took steps to sell off Government assets that we had identified and its Central Bank imposed broad restrictions on the movement of foreign currency. And, most importantly, we believe that the new U.S. sanctions – and the threat of international sanctions along similar lines – played a role in President Bashir's announcement in early June that Sudan would allow the deployment of a joint African Union-United Nations peacekeeping force in Darfur.

In addition to ensuring that our sanctions have the maximum possible effect on the Government of Sudan (GOS), we are also taking steps to protect the Government of Southern Sudan (GOSS) and humanitarian aid efforts in Darfur and elsewhere. We have prepared regulations that will help clarify the scope of sanctions with respect to South

Sudan, Darfur and other exempt areas, and hope that those regulations will spur interest in investment and economic development in the South. And to facilitate the vital assistance activities of our State Department and USAID colleagues and those in the NGO community, we are licensing humanitarian work. Since January, 2006, we have issued approximately 87 licenses and registered approximately 48 NGOs to conduct this critical assistance work.

Pending Legislation Concerning Sudan

We appreciate and share the concerns that animate the various pieces of Sudan-related legislation pending before Congress. Let there be no mistake – these concerns are deeply shared by the Treasury Department and the entire Administration

A Government-Generated List

In imposing economic sanctions or other measures against Sudan – or any other regime – we must always keep in mind the ultimate goals of those sanctions. While the Department shares the Committee's and the Congress' goal of increasing pressure on the Sudanese government to end the violence in Darfur, we have several concerns with the various legislative proposals that have been introduced and discussed in the Congress

Of particular concern are the various proposals that would require either the President or the Secretary of the Treasury to prepare a list of all companies engaged in specified business activities in Sudan. The preparation and publication of such a list raise

a series of significant concerns for the Department, and may not add much value, given that non-governmental organizations have produced such lists for purposes of divestment.

A primary concern with the creation of such a list is the impact it is likely to have on our ability to maintain multilateral pressure on the regime in Khartoum. Because of the United States' broad sanctions against Sudan, no U.S. companies are likely to be included on such a list, as investment by such companies in Sudan is generally prohibited absent a license from OFAC. Consequently, the list would consist of foreign companies whose activities in Sudan are most likely legal in their home countries. Such a list likely will be viewed by our allies as a U.S. Government "blacklist" – not of Sudanese government entities – but of other companies based in their nations, and, therefore, as an unwelcome effort by the United States to expand the scope of our sanctions. As a result, such a list seriously risks alienating the very countries whose assistance we need to maintain and increase international pressure on the Bashir regime. These third countries hold important leverage that may be needed to threaten and ultimately impose additional measures against the Bashir regime, should it fail to follow through on its commitments. The promulgation of what will likely be perceived as a U.S. Government blacklist targeted at the lawful conduct of non-GOS companies based in these allied nations, however, risks shifting the focus of the debate from the Bashir government's compliance to the propriety of U.S. actions, and thus jeopardizes the international coalition that has helped bring about the recent positive developments in Sudan. Particularly in light of the current track of negotiations, including upcoming peace talks in Libya later this month, we strongly believe that requiring the promulgation of such a list is unwise.

In addition, creation of such a list raises a host of practical concerns. Any such list created by the U.S. Government will necessarily be incomplete. It would not identify those companies whose involvement in Sudan is not sufficiently established or is known only through classified information. The resultant list would be limited to publicly available information. Such a list would attempt to duplicate similar lists already compiled by non-governmental organizations based on public information but it would likely be less inclusive in light of the government's inability to rely on certain sources of information.

Further, the agency tasked with creating such a list would face difficult issues in determining what type and amount of evidence would suffice to include a company on the list. And, the inclusion or exclusion of certain companies from the list could subject the agency to legal challenges under the Administrative Procedure Act.

Creation of a list would also impose an ongoing, burdensome requirement on the agency tasked with its creation, especially a list that would need to be updated continually or on a regular basis as called for by some legislative proposals. These demands will necessarily divert resources from other important government functions. Indeed, those on my staff who have the most familiarity with Sudan are currently working to target companies and individuals for additional sanctions.

With relevant lists already available from non-governmental sources, all of the above costs would seem to greatly outweigh what incremental benefit a new government-generated list might provide.

Other Policy Proposals

Many legislative proposals would encourage and affirmatively authorize State and local government action. As noted by my State Department colleague, the Administration opposes proposals to authorize divestment by state and local governments, which impair the ability of the president to act on behalf of the nation as a whole and risk creating a multiplicity of foreign policies.

I understand that the Committee is considering alternative proposals to a government-generated list. We look forward to continuing to work with you and your staffs as you consider the costs and benefits of such proposals, and would look forward to answering the Committee's questions regarding these issues.

Conclusion

We all share the same objective when it comes to Darfur: a negotiated settlement that will bring a stable and lasting peace to Darfur. We remain committed to continuing the constructive dialogue we have had with your staffs on these important issues, as we very much want to ensure that the U.S. Government has all appropriate tools at its disposal to address this situation. Thank you again for the opportunity to testify today about this important issue.

The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott*

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Abstract

Governments and vocal institutional shareholders have been exerting pressure on companies they deem to have objectionable operations (such as tobacco or chemical producers). This paper studies the effect of the most important legislative and shareholder boycott to date, the boycott of South Africa's Apartheid regime. We find that corporate involvement with South Africa was so small that the announcement of legislative/shareholder pressure of voluntary divestment from South Africa had little discernible effect either on the valuation of banks and corporations with South African operations or on the South African financial markets. There is weak evidence that institutional shareholdings increased when corporations divested. In sum, despite the public significance of the boycott and the multitude of divesting companies, political pressure had little visible effect on the financial markets.

*The paper benefited from comments from Jonathan Berk, Robert Dammon (the WFA discussant), David Hirshleifer, Donald Siegel, Phillip Stocken, and University of Michigan and WFA seminar participants. We thank David Hoopes, Duke Bristow, and Troy Janes for research assistance, and Toby Moskowitz for data.

IX Summary

This paper has presented a *post mortem* analysis of an unusual historic event. It investigated the effect of the most important legislative and shareholder boycott to-date: the boycott of South Africa's Apartheid regime. Despite heated public debate over divestment, there has been little formal empirical evidence brought on this issue. We find no support for the common perception—and often vehement rhetoric in the financial media—that the anti-Apartheid shareholder and legislative boycotts affected the financial sector adversely: the announcement of legislative or shareholder pressure had *no* discernible effect on the valuation of banks and corporations with South African operations or on the South African financial markets. There is weak evidence that institutional shareholdings increased when corporations divested, i.e., that divesting firms' investor clienteles changed, and that divesting firms with more returning institutional shareholders received a perhaps slightly more positive but insignificant valuation response. One explanation may be that the boycott primarily reallocated shares and operations from "socially responsible" to more indifferent investors and countries. Our findings are consistent with the view that demand curves for stocks are highly elastic and so have little downward slope.

In all, the evidence from both individual and legislative actions, taken together, suggests that the South African boycott had little valuation impact on the financial sector. Despite the prominence and publicity of the boycott and the multitude of divesting companies, the financial markets valuations of targeted companies or even the South Africa financial markets themselves were not easily visibly impacted. The sanctions may have been effective in raising the public moral standards or public awareness of South African repression, but it appears that financial markets managed to avoid the brunt of the sanctions. This may be an important point for future activists who are considering using the tools of the boycott for other causes.

Assistant Secretary of State for African Affairs
Jendayi E. Frazer
Testimony before the Senate Committee on Banking, Housing and Urban Affairs
October 3, 2007

Mr. Chairman, Ranking Member Shelby, members of the Committee, thank you for the opportunity to testify on the Administration's Sudan policy and specifically our efforts to peacefully end the tragic humanitarian situation in Darfur. Sudan is a top priority for the Administration. We appreciate the generous support of Congress as we work to resolve the situation in Darfur which, among many things, has helped us sustain the African Union (AU) peacekeepers in Darfur and most recently, achieve United Nations (UN) Security Council Resolution 1769 authorizing the deployment of 26,000 UN peacekeepers. But, as demonstrated by the tragic events of September 29 with the attack on the AU Mission in Sudan (AMIS) camp in Darfur that resulted in the death of at least 10 AU peacekeepers, there is still a long way to go to achieve peace in Darfur. I look forward to our continued close relationship with Congress as we work together to bring peace to the region.

Critical Juncture on Darfur

Mr. Chairman, we are at a critical point in our efforts in Sudan. The large, robust peacekeeping force for Darfur that we have all worked for over the last few years is finally on the verge of deployment – its first elements are slated to go in before the end of the year. The renewed talks that aim to achieve a lasting political solution in Darfur are expected to begin on October 27 in Libya. This progress, while long in coming, is due in large part to increased international pressure on Sudan, led by the United States. At the UN General Assembly last week, President Bush stated that "America has responded [to the suffering in Darfur] with tough sanctions against those responsible for the violence."

The new sanctions he imposed on May 29 targeted 30 Sudanese Government-owned or-controlled companies and three individuals, including two Government officials and one rebel leader. These new sanctions, and stepped up enforcement of existing sanctions on Sudan, are working. To move forward from here, we are working closely with the UN and AU to implement the agreements, even as we continue to closely monitor the actions of all parties.

We appreciate the efforts of some groups to seek additional ways to increase pressure on Khartoum. We are confident that our May 29th sanctions have and are working. We are at a critical moment and it is important to avoid any action – including legislative measures – that might set back the progress we have made thus far. In considering our position, we also have to bear in mind that the Government of Sudan has accepted UNAMID and the need to negotiate a peace deal. At the moment, the main issue is whether rebel factions will be an obstacle to a peaceful negotiated settlement. We are also concerned that some initiatives to increase economic pressure on Sudan will damage our relationship with our key partners rather than increase pressure in Khartoum, and may further complicate efforts to carry out our substantial assistance programs. A welcome and useful initiative at this juncture would be for Congress and other concerned groups to issue statements calling for the rapid deployment of the UN/AU hybrid force and calling on all parties to participate in the political process.

Situation in Darfur and between North-South

Today, I will review the present situation in Darfur, our efforts to achieve full implementation of the Comprehensive Peace Agreement (CPA) which ended more than 21 years of warfare between North and South Sudan, and what further steps are needed to

realize our goals. Efforts to end the violence in Darfur and implement the CPA must go hand-in-hand, and we must be willing to exercise pressure to achieve success on both fronts. At the same time, we must also be wary of initiatives that advance peace in one part of the country at the expense of another.

Let me first turn to Darfur. The situation on the ground is chaotic. Tribal conflict, survival-motivated violence, Janjaweed attacks, clashes between rebel and government forces, and rebel attacks on AMIS continue. Since the beginning of 2007, nearly 248,000 people have been newly displaced from the fighting. This is in addition to the over two million people currently living in camps or settlements for the displaced, and the over 235,000 refugees in neighboring Chad. On September 29 and 30, the 7,000-strong African Union Mission in Sudan suffered its greatest loss since its initial deployment in 2004. Armed men from rebel factions viciously attacked the African Union base camp in Haskanita, killing 10 peacekeepers, looting supplies and vehicles, and destroying the buildings. The 150 or so primarily Nigerian peacekeepers fought back, repulsing the first wave of attackers, but in the end were overpowered and forced to evacuate in the early morning hours. We honor the service of those peacekeepers that lost their lives and our hearts go out to their families. We express our outrage and call upon all parties to adhere to a ceasefire and cease hostilities immediately. Military action will only weaken the position of the party responsible.

The tragedy of this attack highlights the urgency to deploy the UN's heavy support package (HSP) and the UN/AU Hybrid peacekeeping mission (UNAMID) to Darfur as soon as possible. The United States has been leading this effort. We have been working with the United Nations to recruit the necessary troop contributors, and with a

few exceptions, the UN has received an abundance of offers. We are also expanding seven of the African Union's base camps to hold two additional battalions that will serve as protection for the UN's HSP units. Among other units, the HSP includes engineers from China that will help prepare the infrastructure for larger deployments of peacekeepers early next year. We are also providing training and equipment to African battalions that will deploy as part of the UN mission.

Again, the Sudanese Government has publicly accepted UN Security Council Resolution 1769 and has pledged cooperation with its deployment. We will hold them to this pledge. The key leaders of UNAMID are already on the ground. The UN/AU Joint Special Representative, Rodolphe Adada, and UN/AU Force Commander General Martin Agwai are already in place. We have warned the Government of Sudan that we are watching closely, and that we insist on nothing less than full cooperation, from flight and customs clearances for UN equipment, to the rapid provision of entry visas for deploying personnel.

The heart of the solution in Darfur is an inclusive political agreement, and the United States is sustaining its efforts to achieve that end. There can be no military solution. I was present in Abuja, Nigeria when the Government of Sudan and Minni Minawi, leader of the Sudan Liberation Movement (SLM), signed the Darfur Peace Agreement (DPA) on May 5, 2006. The DPA is a fair agreement which addresses the core grievances of the people of Darfur. Unfortunately, at the eleventh hour, some parties became intransigent and refused to sign. We have all learned from that process.

The United Nations and African Union are providing renewed leadership and their efforts are making headway. New talks are scheduled to begin on October 27 in

Libya. The UN and AU have incorporated the regional countries into the process, and are formulating a mechanism to formally include civil society, tribal leaders, and representatives of the internally displaced persons. The first order of business in Libya should be the strengthening of the ceasefire monitoring mechanism.

As I noted, at the moment, the splintered rebel factions are creating obstacles to a peaceful negotiated settlement. Several of the rebel factions have refused to attend peace conferences, citing untenable conditions, and others are wary of the process. Rebel factions that remain outside of the process are not acting in the interests of the people of Darfur they claim to represent. We are working with our international partners to press all the rebels to attend.

We have reached a sensitive time in our diplomatic engagement to achieve a restarted political process in Libya. The Sudanese government and the rebel factions must both be pressed to attend the talks, and we have been sending messages to that end. We will apply sanctions on any party that obstructs the peace process.

Let me now discuss the Comprehensive Peace Agreement, which is central to our efforts to achieve the peaceful, democratic transformation of Sudan and resolution of the crisis in Darfur. The elections called for at every level in 2009, if implemented freely and fairly, can dramatically change the political landscape in Sudan and Darfur and the direction of Sudan's future. We must ensure that our efforts do not undermine the potential of this agreement.

While much has been accomplished during the nearly three years since its signing, the progress of the CPA has faltered in areas related to flashpoint issues along the North-South border, including Abyei, oil revenue sharing, and redeployment of

forces. The United States is leading international efforts to address these challenges and put CPA implementation back on track. We are sending a message to all parties, including those in Darfur, that the international community will stand fully behind the peace agreements it witnesses. Special Envoy Natsios is on the ground in Southern Sudan pressing this point. We have asked the Intergovernmental Authority on Development (IGAD), to host a high-level meeting through its Partners' Forum to call the parties to the CPA to account for progress on implementation. The recent appointment of Ashraf Jehangir Qazi as UN Special Representative for Sudan will also bring renewed focus to CPA implementation.

The United States has and will continue to lead the world in responding to the situation in Sudan. We have provided over \$4 billion in assistance to Sudan since 2005. While we are successfully increasing pressure on the Government of Sudan, we must also recognize that these efforts and any future efforts may impact the Government of Southern Sudan (GOSS). As part of the CPA, the GOSS receives tens of millions of dollars in oil revenue each month from the central government in Khartoum. This influx of resources is unprecedented in a post-conflict situation, and has allowed the GOSS to participate with the international community in the development and reconstruction of Southern Sudan.

We share the frustration of Congress and the American people who want to see an end to the suffering of the Darfur people. We, together with Congress' ongoing support, will continue to exert all our efforts until the crisis in Darfur is ended, and all the people of Sudan can live in peace.

Thank you, Mr. Chairman. I will be pleased to answer any questions you may have.



Testimony of Acting A/S Elizabeth Dibble, Bureau of Economic, Energy
and Business Affairs

Senate Committee on Banking, Housing and Urban Affairs

October 3, 2007

“Combating Genocide in Darfur: The Role of Dives ent and Other Policy
Tools”

Chairman Dodd, Ranking member Shelby, and members of the committee, thank you for the opportunity to appear before you today to discuss some aspects of possible sanctions measures concerning Sudan. Sanctions seek to change behavior. To be effective, they must be carefully calibrated and coordinated. Naturally, timing and messaging are essential components of this process. The Administration and Congress need to maintain a unified message on Sudan policy to maximize U.S. influence on the peace process. This is particularly true since the Administration and Congress fully share the same objectives in Sudan, in particular our common desire to end the violence in Darfur.

In recent years, the Administration, with the support of the Congress, has imposed extensive sanctions against Sudan. There can be no doubt regarding the determination of the United States to see effective change in Sudan.

But sanctions are only one part of the approach, which also has to rely upon multilateral diplomacy and, eventually, changed behavior by the Khartoum regime itself. We have to ensure that our desire to send a strong message via sanctions does not counteract or even overwhelm progress on those political fronts. As Assistant Secretary Frazer indicated, we have serious concerns about attempts to apply new sanctions on the Government of Sudan (GOS) at this moment. It would send the wrong message to the regime at a time when it is actually being helpful with peace talks and with the AU/UN peace keeping force. It would also send the wrong message to rebel movements, one of which just attacked an African Union peacekeeping base and killed 11 Nigerian peace-keepers. The rebels need to join the peace process rather than targeting international forces.

Legislative proposals can serve as a useful reminder of what might occur if progress does not continue, but we are concerned about the negative impact of an actual new law at this delicate juncture.

Our most recent action on Sudan sanctions, announced by President Bush on May 29, was carefully targeted and came at a time when the GOS was resisting deployment of UN peace-keepers, undermining the political process, and continuing to carry out a bombing campaign in Darfur. The USG designated 30 companies owned or controlled by the Government of Sudan under Executive Orders 13067 and 13412. These included five petrochemical companies and Sudan's national telecommunications company. These designations got the attention of GOS officials without undermining our multinational coalition on Sudan, and as Assistant Secretary Frazer has stated, it was this increased pressure that helped bring us to where we are today.

In addition to the problem of timing, certain aspects of pending Sudan bills raise broader concerns about unintended consequences. We need to take into account the potential impacts on Southern Sudan as well as reactions by key international partners. A/S Frazer has noted the millions of dollars of taxpayer money that we have invested in trying to help develop Southern Sudan; our sanctions regime already is so broad that it inevitably has negative consequences for the South as well as for its intended target in the North. The Government of Southern Sudan recently sent a high-level delegation to DC to explore ways to mitigate the unintended harm our current sanctions appear to have had in the South. New measures may well compound the South's difficulties in attracting U.S. and foreign investors or even interfere with development assistance projects, if they are not carefully calibrated.

Required divestment will be seen by our allies as a U.S. government action targeting their companies and could affect our ability to obtain cooperation on mutual action with respect to Sudan. Some of these key allies will be providing troops and equipment for the AU/UN Hybrid peacekeeping force.

In a broader spillover effect, such Sudan measures could also jeopardize the cooperation of these key partners on other countries of concern such as Iran, North Korea, and Burma. We need to look carefully at each of the Sudan bills and consider all aspects of their likely impacts, including on Southern Sudan and our multinational coalitions. We need a multilateral coalition that includes the Chinese, the Arab world, the Europeans, and the African Union to build peace in Sudan.

We recognize that individuals and particular funds may want to divest certain holdings for a variety of reasons. In fact, we do not take a position on private independent action by individual investors based on private-sector research and analysis. The message sent by millions of individuals voting with their dollars can be powerful; especially if it is not influenced by U.S. government action. However, the Administration is opposed to affirmative federal legislation that explicitly authorizes divestment campaigns at the state and local level. Sanctions policy needs to respond quickly to rapidly evolving events. Having one unified foreign policy gives us the flexibility to do this. State and local divestment efforts risk creating the appearance of a multiplicity of foreign policies, undercutting our policy flexibility and the clarity of the messages we send foreign governments. They also undermine the President's Constitutional responsibilities to conduct foreign affairs for the Nation. Moreover, such provisions could serve as an undesirable model for other countries to adopt their own legislation, encouraging divestment from companies (including American ones) doing business in other particular countries.

The Department knows that this is not the intent of the concerned citizens, groups, and representatives who back Sudan divestment initiatives, but it is a real concern. We share their desire to stop the violence in Darfur and applaud the way so many have come together to keep the focus on change in Sudan.

Other general concerns about divestment include the prospect that encouraging divestment could be challenged by foreign governments as a secondary boycott. It could also invite such secondary boycotts or other similar action against U.S. firms, or against companies engaged in activities, or doing business in countries, that we strongly support. Politicizing our capital markets also carries longer-term risks to our economy, if it deters foreign investors from using our markets. The Administration has consistently opposed, as a matter of policy, legislative provisions that politicize capital markets.

Other provisions of concern which are in some bills remove essential legal protections for workers' retirement security. The Employee Retirement Income Security Act of 1974 (ERISA) requires fiduciaries of private-sector employee benefit plans to act prudently and solely in the interest of the plan's participants and beneficiaries. Bills with "safe harbor" provisions, including for private investment companies, could exempt fiduciaries from

their duties of prudence and loyalty and from prohibitions on self-dealing when divesting the plan from investments or avoiding investing plan assets in blacklisted companies. By removing these essential protections, such a measure could harm workers, retirees and their families, allowing them no recourse for their losses.

The Sudan bills currently under consideration all seek ways to use U.S. economic leverage to have an indirect impact on Sudan's leaders by pressuring foreign companies that do business in Sudan. The primary approach in certain bills would have the USG create a "blacklist." This is the most troubling approach. Another concept in play is a new SEC disclosure process. A third concept is an as yet unarticulated U.S. government contracting certification procedure and a procurement bar on prospective contractors who cannot certify that they either have no specified business activities in Sudan or, if they do, that they meet certain humanitarian criteria. These latter two proposals also pose concerns but we remain open to exploring them further as alternatives.

The Administration has consistently opposed all requirements that the President or Treasury or any other U.S. government entity affirmatively prepare a "blacklist" periodically of companies doing business in Sudan -- such a list would target our allies, impairing multilateral efforts to aid the peace process. The high evidentiary standard that the U.S. government compiler of such a list would need to apply also means that the list would be narrower than ones already developed by NGO's and the private sector.

In summary, sanctions are an important policy tool, but need to be managed with maximum flexibility. Timing is everything, and we believe it imperative to preserve the President's flexibility to decide when and how to calibrate the application of sanctions, so they can work to the maximum advantage. We look forward to our continued dialogue with the Congress to ensure that sanctions are applied at the appropriate time and in ways that do not undermine the multilateral efforts which are essential to achieve our policy objectives for Sudan, including ending the violence in Darfur.

Updated

LEGISLATIVE RESEARCH REPORT

JANUARY 28, 2008



REPORT NUMBER 08.112

DIVESTMENT OF QUALIFYING COMPANIES OPERATING IN SUDAN FROM ALASKA PUBLIC FUNDS

PREPARED FOR REPRESENTATIVE LES GARA

BY DANIEL LESH, LEGISLATIVE ANALYST

You asked about state economic sanctions against the government of Sudan via the divestment of public assets in qualifying companies. Specifically, you asked for a review of relevant U.S. state laws and an analysis of the potential effects of a "targeted divestment" law on the State of Alaska with respect to the Alaska Permanent Fund, the Alaska Retirement Management Board's funds, and other Alaska state funds.

SUMMARY

As of January 28th, 2008, at least 41 states have adopted or are considering implementing policies to divest state assets from Sudan, where the U.S. Congress has declared that genocide is taking place. Twenty-one of these states have enacted divestment policies. By our calculation, as of December 31st, 2007, investments within the Alaska Permanent Fund totaling roughly \$22 million, or about 0.06% of the fund's total market value, would be subject to divestment under legislation currently introduced in Alaska (HB 287, SB 227). If this legislation became law, divestment of these assets would be accomplished over an 18-month period and would incur additional administrative costs. The direct impacts of divestment on the state's investment earnings, as well as on targeted companies, are debatable, but in both cases would likely be minimal.

STATUS OF STATE DIVESTMENT LEGISLATION

As of January 28th, 2008, at least 41 states have adopted or are considering implementing policies to divest state assets from Sudan, where the U.S. Congress has declared that genocide is taking place.¹ Lawmakers in 16 states have enacted laws that require state funds to divest

¹ Data on state legislation are from LexisNexis and the Sudan Divestment Task Force's report "State of Sudan Divestment" (Attachment A) and chart of "Divestment Statistics" (Attachment B).

holdings in some or all companies operating in Sudan. Five additional states have adopted similar policies through their executive branches. Legislatures in Louisiana and Maryland, respectively, have passed weaker laws that encourage and allow divestment or encourage divestment and prohibit future investments. Lawmakers in another eighteen states are considering measures that address divestment from Sudan. In Table 1, we detail the status of state legislation related to divestment of public assets from Sudan.

The laws and pending legislation listed in Table 1 generally follow one of two models. Of the 41 divestment policies, 26—including that proposed in Alaska—follow a targeted approach that is applicable only to specific types of foreign companies operating in Sudan.² A targeted approach relies on the creation and maintenance of lists of companies that are deemed to be supporting the genocide in Sudan. Most of the targeted companies participate in Sudan's oil industry and pay taxes and royalties that fund the Sudanese government. States that do not follow a targeted divestment approach prohibit investment in any company operating in Sudan, though generally with an exception for humanitarian and various other types of organizations. A number of states (Colorado, Florida, Georgia, Kentucky, Louisiana, and Missouri) have also included other countries, such as Iran, North Korea, and Syria, in their divestment policies.

On December 31st, 2007, President Bush signed the Sudan Accountability and Divestment Act authorizing—but not requiring—state and local governments to disassociate from companies operating in Sudan and prohibiting the granting of new federal contracts to such companies.

As you may know, no domestic companies are affected by state divestment laws, because U.S. companies are prohibited from operating in Sudan by federal executive orders dating from 1997.³

² Targeted divestment is advocated by the Sudan Divestment Task Force (SDTF), the leading advocacy organization on this issue. We include their model legislation as Attachment C and apply its provisions—which are substantially the same as those introduced in Alaska—in this report. According to the SDTF, 15 states have adopted versions of its model legislation on targeted divestment; however, we put Maryland in a different category and Table 1 lists 14 such states.

³ Executive Orders 13067 (1997), 13400 (2006), and 13412 (2006).

Table 1: Status of State Legislation Related to Divestment of Public Funds from Sudan

Cal. Gov. Code § 7513.6 (2007)	
Colo. Rev. Stat. § 24-54.8 (2007)	
Fla. Stat. § 215.473 (2007)	
Act No. 192, Session Law 2007	
Ind. Code. Ann. § 5-10.2-9	
Chapter 10a, Session Law 2007	
Kan. Stat. Ann. § 74-4923 and 74-4960 (2007)	
Minn. Stat. § 11A.243 (2007)	
Executive Branch Policy	
Executive Branch Policy	
Session Law 2007-486	
Chapter 93, Session Law 2007	
Tex. Govt Code Ann. § 806.001 (2007)	
Executive Branch Policy	
	HB 287, SB 227
	SB 0555, HB 4854
	LB 992
	HJ 1516
	SB 161
	HB 3058, SB 2146
	HB 729
	HB 2951, SB 3161
	HB 138
	HB 556, SB 87
	AB 124, SB 57
	HB 4096
Public Act No. 95-521, Session Law 2007	
Me. Rev. Stat. Ann. tit. 5, § 1956 (2007)	
Mass. Gen. Laws Ann. ch. 32, § 23 (2006)	
N.J. Stat. Ann. § 52:18A-89.9 (2007)	
ORS § 203.811-817 (2006)	
	SB 9
	HB 256, SB 199
	HB 25
SCR 20 & Executive Branch Policy	
Conn. Gen. Stat. § 3-21e (2007) & Executive Branch Policy	
La. Rev. Stat. Ann. § 11:312 (2007)	
Executive Branch Policy	
Md. Code Ann. § 21-123.1 (2007)	
	HCR 32
	HB 245

NOTES: Pending legislation in some states may not have been captured by our search and this list should not be treated as exhaustive. (a) New York state and New Mexico pension funds have adopted a targeted divestment policy. (b) Vermont's pension fund has enacted a targeted divestment from Sudan. (c) Illinois' 2007 legislation replaced the state's 2005 law, which was found unconstitutional. (d) Arkansas and laws in Connecticut are non-binding, but the states have divested significant assets. (e) Nevada's governor and legislative leaders urged the adoption of a targeted divestment policy, but no action has been taken. (f) Maryland law encourages divestment and prohibits future investments in all companies with operations in Sudan. **SOURCES:** Lexis.com; Sudan Divestment Task Force's "State of Sudan Divestment" report (Attachment A); Sudan Divestment Task Force's "Divestment Statistics" chart (Attachment B).

TARGETED DIVESTMENT OF ALASKA STATE FUNDS

By our calculation, as of December 31st, 2007, the balances of all state invested assets totaled approximately \$70 billion.⁴ Of these investments, a very small portion would be subject to divestment under a targeted approach.⁵ Of the \$39.8 billion in the Alaska Permanent Fund, we calculate that, as of December 31st, 2007, a maximum of about \$22 million (about 0.06%) would require divestment using the Sudan Divestment Task Force's list of targeted companies (see Table 2). We found no targeted holdings in other state funds, including all state assets under the investment authority of the Alaska Retirement Management Board and the Department of Revenue.

Table 2: Alaska Permanent Fund Stock Holdings Subject to Divestment

CHINA PETROLEUM (SINOPEC)	\$ 10,455,130	China
ALSTOM	\$ 9,268,789	France
PETROFAC LTD	\$ 1,331,983	UK
WARTSILA	\$ 867,531	Finland
LUNDIN PETROLEUM AB	\$ 67,705	Sweden
CNPC HONG KONG LIMITED	\$ 25,600	Bermuda
TOTAL	\$ 22,016,736	

NOTES: Holdings subject to divestment determined using the Sudan Divestment Task Force's (SDTF) divestment lists. Some of the stocks listed above may be indirect holdings in actively managed investment funds, which are exempt from divestment under the SDTF targeted divestment model applied in this report.

SOURCES: Stock information current as of December 31, 2007 and available on the Alaska Permanent Fund Corporation's website at <http://www.apfc.org/investments/stocks.cfm?us=show&int=show>.

Under the targeted divestment legislation currently under consideration in Alaska (HB 287, SB 227), divestment of the assets described in Table 2 would occur over an 18-month period following the effective date of the legislation. In the first step of the process, fund directors would be allowed 90 days to compile and adopt a "scrutinized companies list" based on criteria and sources outlined in the legislation. Following adoption of the list, the fund would be required to

⁴ These funds include the Alaska Permanent Fund (\$39.8 billion); funds under the fiduciary responsibilities of the Commissioner of Revenue, which include Alaska Retirement Management Board funds (\$19.5 billion; including the Public Employees' Retirement System, Teachers' Retirement System, Judicial Retirement System, National Guard/Naval Militia Retirement System, Alaska Supplemental Annuity Plan, Alaska Deferred Compensation Plan, Alaska Defined Contribution Plan), General Fund and other Non-segregated Investments (GeFONSI; \$5.5 billion), Constitutional Budget Reserve Fund (\$3.1 billion), and other funds (\$1.6 billion; including the Public School Trust Fund, Alaska Children's Trust, Investment Loss Trust Fund, Supplemental Benefits Trust Fund, General Obligation Bond Fund, International Airports Fund, International Airports Construction Fund, Retiree Health Insurance Fund, Power Cost Equalization Endowment Fund, Mine Reclamation Fund, and Alaska Sport Fish Construction Fund); and state funds outside the fiduciary responsibility of the Commissioner of Revenue (\$0.4 billion; including the University of Alaska Trust Fund, Alaska Student Loan Corporation Fund, Exxon Valdez Oil Spill Investment Fund, and Mental Health Trust Reserve Fund). Information on state funds obtained from Pam Green, state comptroller, Alaska Department of Revenue, (907) 465-3751.

⁵ Only the portions of funds with publicly-traded equity in targeted companies would be affected, which for these funds is typically a small proportion of total investments. Furthermore, the targeted approach we apply here includes an exception for indirect holdings in actively managed, commingled investment funds—the most difficult and expensive type of fund to customize.

contact all scrutinized companies in which they have holdings and allow them 90 days to change their offending operations before becoming subject to divestment. Within nine months of the adoption of the "scrutinized companies list," the fund would be required to complete the divestment of 50 percent of holdings in scrutinized companies. Within 15 months, 100 percent of holdings in scrutinized companies would be required to be divested. Funds would not be required to divest indirect, actively managed holdings. This timeframe is within that described by Alaska funds as reasonable.⁶ Lastly, ongoing reporting requirements and the screening of future investments would be required.

The Alaska Permanent Fund and the Alaska Retirement Management Board expressed reservations about the wisdom of divestment, citing increased administrative costs and possible declines in fund performance.⁷ We note, however, that recent divestment research we reviewed, which ultimately argues against divestment, concludes that fund performance changes are usually "negligible, and in most cases zero."⁸

Due to the nature of the global investment marketplace, it is debatable, but unlikely, that the divestment of Alaska public funds from targeted companies would have a direct, negative economic impact on those companies. Clearly, however, divestment laws have drawn considerable press attention and are a prominent factor in the ongoing debate regarding public response to the genocide occurring in Sudan.

I hope you find this information to be useful. Please do not hesitate to contact us if you have questions or need additional information.

⁶ Personal correspondence with Laura Achee, research and communications liaison, Alaska Permanent Fund Corporation, (907) 796-1522. Ms. Achee stated that most of the assets could be divested in several weeks. However, managers of two accounts that do not allow customization would have to be replaced, a process which generally requires several months. Gary Bader, chief investment officer, Alaska Department of Revenue, (907) 465-4399, described a similar process, including the necessity to review contracts with seven asset account managers hired by the Alaska Retirement Management Board.

⁷ Ms. Achee, research and communications liaison, Alaska Permanent Fund Corporation, expressed concern that new manager searches could yield managers that do not perform as well as current managers. Overall, in her view, divestment "would have a dampening effect on the Permanent Fund to some degree, without any guarantee that the actions would bring about the desired result in the targeted country." Gary Bader, chief investment officer, Alaska Department of Revenue, expressed his belief that Alaska funds would likely perform substantially worse after divestment.

⁸ See page 6 of "Should Public Plans Engage in Social Investing?," a publication of the Center for Retirement Research at Boston College (Attachment D), for a description of empirical research on the impacts of divestment on fund performance.

Attachment A

Sudan Divestment Task Force

"State of Sudan Divestment"

http://www.sudandivestment.org/docs/state_of_sudan_divestment.pdf



SUDAN DIVESTMENT

— TASK FORCE —

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The State of Sudan Divestment:

An Overview of States, Cities, Universities, Companies, and Private Pensions
Currently Working on Sudan Divestment

December 24, 2005 (UPDATED *October 26, 2007*)

A Report by
The Sudan Divestment Task Force

SUDAN DIVESTMENT TASK FORCE

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SUDAN DIVESTMENT TASK FORCE

I. Introduction

This State of Sudan Divestment report provides details on the progress of numerous states, cities, universities, and companies that have active divestment campaigns as well as the status of ex-Sudan investment offerings by asset managers and private pension plans. The report serves as a resource for various individuals and organizations examining the issue of divestment from companies that support the Government of Sudan as it commits genocide in the Darfur region of Sudan. To our knowledge, the current status of Sudan divestment as of August 2007 is as follows (please also see www.sudandivestment.org/home.asp#map):

The states of California, Colorado, Florida, Hawaii, Indiana, Iowa, Kansas, Minnesota, New York, Rhode Island, Texas, and Vermont have all adopted the Sudan Divestment Task Force model of targeted Sudan divestment. While the states of New Jersey, Illinois, Oregon, Maine, Connecticut, Maryland and Arkansas have all approved divestment plans. Finally, over a dozen states have active divestment movements with varying levels of involvement from state officials. Religious and international campaigns have also gathered steam; several religious organizations have divested or restricted future investments, including the Evangelical Covenant Church, National Ministries and Unitarian Universalist Church. Internationally, Canadian universities and provinces have initiated divestment campaigns and over half a dozen European countries have active divestment campaigns. Cities have contributed to the divestment movement as well: San Francisco, CA; Providence, RI; New Haven, CT; Philadelphia, PA; Denver, CO; Los Angeles, CA; Pittsburgh, PA and Miami Beach, FL have passed measures prohibiting certain Sudan investments while the fiduciaries of Buffalo, NY; Newton, MA, and other smaller cities are considering the issue. At the university level, over fifty institutions have enacted restrictions on Sudan investments. There are emerging or active Sudan divestment campaigns at over two dozen other colleges and universities. At the asset manager level, a grassroots campaign targeting Fidelity Investments and Warren Buffet's holding company, Berkshire Hathaway, has been initiated. Berkshire Hathaway holds roughly \$3 billion in PetroChina, one of the primary offending companies in Sudan, making it the largest single shareholder in the company. At the private pension fund level, there is an active divestment campaign for TIAA-CREF, the nation's largest such fund. Finally, the investment community has begun to respond to investors demands for Sudan free investment opportunities. A limited number of ex-Sudan investment vehicles have been developed or are being developed by asset managers such as Northern Trust, Barclays Global Investors, State Street Global Advisors as well as several socially responsible investing firms. Third party research firms have begun to develop list of companies that meet the targeted divestment criteria. A number of Sudan-free mutual

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funds have also been recently introduced.

Below, we provide more detail and contact information on many of the campaigns mentioned above, as well as others not mentioned in this introduction. However, we acknowledge that other individuals and groups may be organizing without our knowledge. If you do have information on other campaigns, please e-mail us at info@sudandivestment.org so we can update this report.

II. State of Divestment: State Legislatures

The State of Sudan Divestment report provides a historical account of the divestiture movements in each state. This document does not address the specifics of each piece of legislation. Despite passing the Sudan Divestment Task Force model of targeted Sudan divestment legislation, each state labeled 'Divested: Task Force Model' will have unique legislation, subject to the amendment process in each respective legislature. These amendments do not compromise the integrity of the legislation. Rather, the amendments often deal with the specifics of implementation and reporting. Details on the nuances of each bill are available by email info@sudandivestment.org.

The overwhelming majority of Sudan divestment legislation is passed as a stand alone item. However, in some cases, bills have included multiple premises. These instances are noted and details are available by contacting us by email, info@sudandivestment.org.

Alabama (Campaign Initiated)

Legislative Status:

A targeted Sudan divestment campaign has been initiated.

Website and Articles:

<http://www.sudandivestment.org/alabama>

Contact:

Max Croes
Advocacy Associate, Sudan Divestment Task Force
alabama@sudandivestment.org

Alaska (Campaign Initiated)

Legislative Status:

A targeted Sudan divestment campaign has been initiated.

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Website and Articles:

<http://www.sudandivestment.org/alaska>

Contact:

Max Croes
Advocacy Associate, Sudan Divestment Task Force
alaska@sudandivestment.org

Arizona (Campaign Initiated)

Legislative Status:

In the 2007 legislative session, Senator Paula Aboud and Representative Phil Lopes attempted to pass an amendment requiring divestment from Sudan, but this amendment was stripped in conference committee.

Representative Kyrsten Sinema has agreed to introduce legislation based off of the Sudan Divestment Task Force's targeted divestment model in the 2008 legislative session. The Arizona Education Association has endorsed targeted Sudan divestment.

Website and Articles:

<http://www.sudandivestment.org/arizona>

Contact:

Scott Wisor
Senior National Field Organizer, Sudan Divestment Task Force
arizona@sudandivestment.org

Arkansas (Divested: Other Model)

Legislative Status:

In March 2007, the Arkansas General Assembly passed SCR20 which was sponsored by Senator Sue Madison. The resolution passed both houses of the Assembly and received the signature of Governor Beebe. SCR20 encourages Arkansas State Retirement Systems to identify their investments in companies operating in Sudan and then divest from these companies until the genocide in Darfur has ended.

The Arkansas Teachers Retirement System (ATRS), which oversees \$11 billion in assets,

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voted to adopt a Sudan divestment policy. ATRS has no direct holdings in any of the worst offending companies as identified by the Sudan Divestment Task Force. ATRS has written to their fund managers requesting that they implement Sudan divestment policies. ATRS has acquired both the broader and more restrictive KLD list of companies and voted to adopt Sudan divestment based on the KLD list based off of Sudan Divestment Task Force criteria of targeted Sudan divestment.

The Arkansas State Employees Retirement System, which oversees \$5 billion in assets, has written to their fund managers requesting that they comply with Senate Resolution 20, but have publicly stated that they do not intend to purchase or maintain a list of companies that operate in Sudan.

Bill Text:

<http://www.arkleg.state.ar.us/2007/scripts/ablr/bills/bills.asp?billno=SCR20>

Website and Articles:

<http://www.sudandivestment.org/arkansas>

Contact:

Sudan Divestment Task Force
arkansas@sudandivestment.org

California (Divested: Task Force Model)

Legislative Status:

On September 25, 2006, California Governor Arnold Schwarzenegger was joined by actors George Clooney and Don Cheadle, former Secretary of State George Shultz, executive members of the Sudan Divestment Task Force, and other community leaders at a public signing for AB 2941, adopting a targeted divestment policy for the California Public Employees Retirement System (CalPERS) and California State Teachers Retirement System (CalSTRS) and indemnifying the boards of both funds.

History:

In August 2005, the California legislature adopted Assembly Concurrent Resolution #11 (ACR11) which urges CalPERS and CalSTRS to encourage their portfolio companies doing business in Sudan "to act responsibly and not take actions that promote or otherwise enable human rights violations in the Sudan."¹

Separately, in a letter dated August 8, 2005, CalPERS Board Members Willie Brown, Jr.

¹ http://www.leginfo.ca.gov/pub/bill/asm/ab_0001-0050/acr_11_bill_20050830_chaptered.html

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and California Treasurer Phil Angelides requested that CalPERS ensure that the pension fund's investments in companies doing business in the Sudan are not contributing to genocide and human suffering in the Darfur region of that country. Specifically, the Treasurer and Member Brown's letter requested that staff provide to the Board a report identifying any companies that have business operations in the Sudan and the exact nature of those business activities. Secondly, they requested that CalPERS take all necessary steps to ensure that companies are not engaged in any business activities that in any way support genocide in Darfur, including directly engaging with each company.²

CalPERS followed up on Angelides' and Browns' request by:

- (1) Building a coalition with four other public pension plans to establish an engagement process with companies doing business in Sudan.
- (2) Building a second coalition of 50 pension funds that engaged the U.S. Department of Commerce, U.S. Department of State, U.S. Department of the Treasury, and the U.S. Securities and Exchange Commission.
- (3) Engaging 46 external investment managers and 1,869 portfolio companies in an effort to identify companies that may be operating in Sudan.
- (4) Identifying, through its coalition with four other public pension plans, five companies in the CalPERS portfolio to directly engage regarding business activities in the Sudan: ABB, Siemens, Alcatel, Total SA, and Royal Dutch Shell.
- (5) Engaging those five companies to determine their relationship to the Sudanese government and the Darfur genocide.³

On December 12, 2005, CalPERS reported the results of its ongoing research and engagement process. Specifically, it noted that of the five initial companies it had investigated, ABB, Alcatel and Siemens all had business relationships with the Sudanese government or government-controlled entities. CalPERS staff reported that the other two companies, Total SA and Royal Dutch Shell, had operations in Sudan but no clear business affiliation with the Sudanese government.⁴

Based on CalPERS' findings, Treasurer Angelides recommended that CalPERS continue to monitor the Sudanese business activities of Total SA and Royal Dutch Shell while proposing that CalPERS "use the power of the funds' \$200 billion investment portfolio to demand that... ABB, Ltd., Alcatel, and Siemens AG cease their business ties with the Sudanese government and all government-controlled entities." The CalPERS Board approved the Treasurer's proposal in a 9 to 2 vote on December 12, 2005.⁵ The CalPERS staff also plans to continue its research and engagement process, reporting back to the CalPERS' Committee on Investments on a regular basis.

Also in December, Treasurer Angelides urged CalSTRS to divest from its PetroChina holdings following the fiasco and cover-up of the Nov. 13 PetroChina chemical spill in China. Angelides noted that the combination of PetroChina's negligent behavior at home and troubling relationship with the government of Sudan indicated that investment in the

² CalPERS Agenda Item 8a: Committee on Investments Meeting; September 19, 2005. <http://www.calpers.ca.gov/eip-docs/about/board-cal-agenda/agendas/invest/200509/item8a-00.pdf>

³ *Id.*

⁴ California State Treasurer News Release. December 12, 2005. http://www.treasurer.ca.gov/news/releases/2005/20051212_sudan.pdf

⁵ *Id.*

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company was too risky for CalSTRS. As is widely known, Angelides pointed out that PetroChina's parent company, the Chinese-government oil company China National Petroleum Corp., holds a 40% stake in the Sudanese-government created Greater Nile Petroleum Operating Company, which provides revenue to the Sudanese government.⁶

CalPERS subsequently sent letters of concern to Siemens, Alcatel, and ABB urging them to halt their business ties to Sudan. The companies' responded in the negative in the middle of February 2006.

CalSTRS researchers investigated divestment from multiple Sudan-related companies, including PetroChina. While letters were sent to these companies, CalSTRS staff research, at the time, determined that South African divestment by CalSTRS did not fulfill the prudent investor rule and that the fund would be vulnerable to liability if it were to divest from Sudan, no matter how few companies were under consideration. CalSTRS Trustee Roger Kozberg noted at the time, "Short of thermonuclear war, this [divestment] is a direction we ought not take."

Assembly Bill 2941, introduced by Assemblymember Paul Koretz, passed out of the Assembly by a bipartisan vote of 72-4 in May 2006 and passed out of the California Senate by a bipartisan vote of 29-7.

Independent Actions taken by the Pension Systems:

As follow-up to the April 2006 meeting of the CalSTRS Board (when they indicated their intent to divest and instructed staff to develop a financially prudent plan), CalSTRS agreed to the following Sudan policy in early June: CalSTRS "will actively engage management of companies with ties to the Sudanese government. If portfolio companies fail to comply with the fund's 20 risk factors [a set of social, moral, and economic risk factors that determines whether CalSTRS will invest in a company], CalSTRS will direct its active managers to find suitable alternate investments that wouldn't impair returns or add risk to the portfolio. CalSTRS' passive portfolios will stop buying shares of companies that violate pension fund policy." The California divestment bill, AB2941, would require CalSTRS to divest from passive holdings.

On May 15, 2006, CalPERS agreed to disinvest from the same nine companies from which the University of California had divested. While CalPERS had no current holdings in the nine companies, the Sacramento Bee noted, "Some CalPERS money managers include Bharat and Oil & Natural Gas as part of a benchmark used to measure their investment performance. Now, they will be specifically precluded from investing in the two Indian companies." This action was taken independently of AB 2941.

Bill Text:

http://www.leginfo.ca.gov/pub/bill/asm/ab_2901-

⁶ California State Treasurer News Release, December 2, 2005.
http://www.treasurer.ca.gov/news/releases/2005/20051202_petrochina.pdf

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[2950/ab_2941_bill_20060925_chaptered.html](#)

Website and Articles:

<http://www.sudandivestment.org/california>

Contact:

Adam Sterling
Director, Sudan Divestment Task Force
asterling@sudandivestment.org

Colorado (Divested: Task Force Model)

Legislative Status:

On April 19, 2007, Colorado Governor Bill Ritter signed House Bill 1184, Colorado's targeted Sudan divestment bill, into law.

Speaker of the House Andrew Romanoff and Senate President Pro-Tempore Peter Groff sponsored HB 1184, a bill based on the Sudan Divestment Task Force model of targeted divestment.

Additionally, HB 1184 was endorsed by the Public Employees' Retirement Association of Colorado (PERA).

Bill Text:

http://www.leg.state.co.us/Clics/Clics2007A/csl.nsf/fsbillcont3/C67D12670D14F9E787257251007B243B?Open&file=1184_ren.pdf

Website and Articles:

<http://www.sudandivestment.org/colorado>

Contact:

Scott Wisor
Senior National Field Organizer, Sudan Divestment Task Force
Colorado@sudandivestment.org

Connecticut (Divested: Other Model)

Legislative Status:

A non-binding divestment resolution passed the Connecticut legislature and was signed by the governor on May 8, 2006. The non-binding resolution was requested by Treasurer

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Denise Nappier, principal fiduciary of the \$24 billion Connecticut Retirement Plans and Trust Funds (CRPTF), to affirm her statutory authority to divest from companies that her office identifies as offending. The legislation goes into extensive detail on what qualities a company may demonstrate to be offending. The legislation also gives significant leeway to Treasurer Nappier to decide what factors are important in determining if a particular company should be targeted. Nappier has emphasized that divestment would occur at the end of an engagement process with companies identified as offending.

Treasurer Nappier announced on May 9, 2007 that she is directing investment managers who invest the funds of the CRPTF to divest from Sinopec. As of April 30, the CRPTF held 12,439,950 shares with a market value of \$11,085,867.72 in Sinopec. In addition, Nappier announced that she is prohibiting direct investment in the following 5 companies: Bharat Heavy Electricals Ltd., Nam Fatt Corp., Oil and Natural Gas Corp. (ONGC), PECD Group and Sudan Telecom (Sudatel). In addition to the above companies, investment in PetroChina has been prohibited since its initial public offering in 2000.

Staff of the Treasurer's office has initiated a dialogue with approximately 25 companies, and it is anticipated that additional companies will be contacted in the near future. According to the Treasurer's office, dialogue is ongoing with eight companies in which CRPTF's holdings are valued at approximately \$100,000,000.

Full Text:

<http://www.state.ct.us/ott/pressreleases/press2006/pr022306legislation.pdf>

Website and Articles:

<http://www.sudandivestment.org/connecticut>

Contact:

Sudan Divestment Task Force
connecticut@sudandivestment.org

Delaware (Campaign Initiated)

In June 2007 the Delaware House of Representatives passed a non-binding resolution calling for targeted Sudan divestment.

Targeted Sudan divestment legislation will be introduced in 2008 by Senator Harris McDowell.

Website and Articles:

<http://www.sudandivestment.org/delaware>

SUDAN DIVESTMENT TASK FORCE

Contact:

Max Croes
Advocacy Associate, Sudan Divestment Task Force
delaware@sudandivestment.org

Florida (Divested: Task Force Model)

On June 8, 2007 Governor Charlie Crist signed legislation containing targeted Sudan divestment language.

Senate Bill 2142 was introduced by State Senator Ted Deutch, the bill language had multiple premises aside from Sudan divestment.

Bill Text:

<http://www.flhouse.gov/Sections/Documents/loadDoc.aspx?FileName=s2142er.html&DocumentType=Bill&BillNumber=2142&Session=2007>

Website and Articles:

<http://www.sudandivestment.org/florida>

Contact:

Daniel Millenson
National Advocacy Director, Sudan Divestment Task Force
dmillenson@sudandivestment.org

Georgia (Campaign Initiated)

Legislative Status:

A targeted Sudan divestment campaign has been initiated.

Website and Articles:

<http://www.sudandivestment.org/georgia>

Contact:

Daniel Millenson
National Advocacy Director, Sudan Divestment Task Force
georgia@sudandivestment.org

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Hawaii (Campaign Initiated)

Legislative Status:

On June 18th, 2007 Lieutenant Governor Duke Aiona signed House Bill 34, based on the Sudan Divestment Task Force model of targeted Sudan divestment.

House Bill 34 was introduced by State Representative Roy Takumi.

Bill Text:

HB 34: [http://www.capitol.hawaii.gov/sessioncurrent/Bills/HB34 .htm](http://www.capitol.hawaii.gov/sessioncurrent/Bills/HB34.htm)

Website and Articles:

<http://www.sudandivestment.org/hawaii>

Contact:

Sudan Divestment Task Force
Hawaii@sudandivestment.org

Idaho (Campaign Initiated)

Legislative Status:

In 2007, a targeted Sudan divestment bill was voted down in committee.

In September, 2007, the Public Employee Retirement System of Idaho began offering Sudan Free fund options for beneficiaries investing into defined contribution plans (401(k) plans). This is the first such offering of public fund in the United States.

Acknowledging that a majority of Sudan Related Investments are in defined benefit plans, Idahoans are actively pursuing binding targeted Sudan divestment legislation for the 2008 session.

Website and Articles:

<http://www.sudandivestment.org/idaho>

Contact:

John Sullivan
idahodivestment@hotmail.com

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Illinois (Divested: Other Model)

Legislative Status:

In June 2005, the Illinois state legislature passed into law a blanket Sudan divestment plan that affected the entire Illinois pensions system. The Illinois statute targeted all companies with ties to Sudan, and mandated divestment on all of the states investment vehicles.

In late February 2007, U.S. District Judge Matthew F. Kennelly ruled Illinois' blanket Sudan divestment statute to be unconstitutional. However, instead of striking down divestment per se as unconstitutional, Judge Kennelly defined certain limits to Sudan divestment statutes and ruled that Illinois had crossed those certain limits.

In response, Illinois Senator Jacqueline Collins has filed Senate Bill 1169, legislation intended to amend the law to bring it in line with constitutional requirements outlined by Judge Kennelly. The bill awaits approval from the Governor.

Bill Text:

<http://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=094-0079> (original statute)
<http://www.ilga.gov/legislation/95/SB/09500SB1169sam002.htm> (amended legislation)

Website and Articles:

<http://www.sudandivestment.org/illinois>

Contact:

Sudan Divestment Task Force
info@sudandivestment.org

Indiana (Divested: Task Force Model)

Legislative Status:

On May 3, 2007, Indiana Governor Mitch Daniels signed House Bill 1067, Indiana's targeted Sudan divestment bill, into law. The law is based on the Sudan Divestment Task Force Model of targeted Sudan divestment, this language does not stand alone.

House Bill 1067 was based on legislation originally introduced by Indiana Representatives Matt Pierce and Cindy Noe and Senators John Broden and Gary Dillon.

Bill Text:

<http://www.in.gov/legislative/bills/2007/HB/HB1484.1.html>

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Website and Articles:

<http://www.sudandivestment.org/indiana>

Contact:

Sudan Divestment Task Force
Indiana@sudandivestment.org

Iowa (Divested: Task Force Model)

Legislative Status:

On April 5, 2007 Iowa Governor Chet Culver signed Senate File 361; Iowa's targeted Sudan divestment legislation. The law is based on the Sudan Divestment Task Force Model of targeted Sudan divestment.

In addition to divesting Iowa's state pension plan from Sudan, the legislation also mandates targeted divestment from Sudan by the University of Iowa, Iowa State University, and the University of Northern Iowa.

State Representative Dawn Pettengill (D-39) had introduced House File 807 and Senator Michael Connolly (D-14) had introduced Senate File 361.

Bill Text:

<http://coolice.legis.state.ia.us/Cool-ICE/default.asp?category=billinfo&service=Billbook&hbill=HF2241&menu=text>

Website and Articles:

<http://www.sudandivestment.org/iowa>

Contact:

Sudan Divestment Task Force
Iowa@sudandivestment.org

Kansas (Divested: Task Force Model)

Legislative Status:

On May 11, 2007, Kansas Governor Kathleen Sebelius signed House Bill 2457, Kansas' targeted Sudan divestment bill, into law. The law is based on the Sudan Divestment Task Force Model of targeted Sudan divestment, the language does not stand alone.

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House Bill 2457 was based on legislation originally introduced by Kansas Senator Donald Betts Jr.

Bill Text:

HB 2457: <http://www.kslegislature.org/legsrv-bills/showBill.do?id=164697>

Website and Articles:

<http://www.sudandivestment.org/kansas>

Contact:

Matthew Vines
Kansas@sudandivestment.org

Kentucky (Campaign Initiated)

In December 2006, the Board of Trustees of the Kentucky State Teacher's Retirement unanimously voted to adopt a non-binding policy of engagement with certain companies operating in Sudan.

A targeted Sudan divestment campaign seeking binding legislation has been initiated.

Website and Articles:

<http://www.sudandivestment.org/kentucky>

Contact:

Katie Savin
College Divestment Coordinator, Sudan Divestment Task Force
info@sudandivestment.org

Maine (Divested: Other Model)

Legislative Status:

In April 2006, Maine adopted a Sudan divestment statute, LD 1758, for all active investments in separately managed accounts held by the Maine State Retirement System (MSRS). Index funds and all commingled funds are excluded from the bill. The law requires divestment, "in accordance with sound investment criteria and consistent with the board's fiduciary obligations." MSRS utilizes information from the Sudan Divestment Task Force, direct correspondence from companies, and other data sources to develop and maintain their own divestment and engagement lists.

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Separately, in January 2006, State Treasurer David Lemoine ordered the sale of all direct holdings in Schlumberger Ltd. stock held by Maine's \$24 million State Held Trusts.

Bill Text:

<http://janus.state.me.us/legis/LawMakerWeb/externalsiteframe.asp?ID=280019872&LD=1758&Type=1&SessionID=6>

Website and Articles:

<http://www.sudandivestment.org/maine>

Contact:

Sudan Divestment Task Force
Maine@sudandivestment.org

Maryland (Divested: Other Model)

Legislative Status:

On April 10, 2007, Maryland Governor Martin O'Malley signed Senate Bill 543, a Sudan divestment bill, into law. The statute urges the Maryland State Retirement and Pension System to divest from any company with operations in Sudan and prohibits future investment in those companies.

Senate Bill 543 was introduced by State Senator Verna Jones.

Bill Text:

<http://mlis.state.md.us/2007RS/billfile/sb0543.htm>

Website and Articles:

<http://www.sudandivestment.org/maryland>

Contact:

Maggie Tiernan
Senior National Field Organizer, Sudan Divestment Task Force
Maryland@sudandivestment.org

Massachusetts (Campaign Initiated)

Legislative Status:

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In early 2007, State Senator Harriette Chandler, Senator Edward Augustus and Representative Jay Kaufman introduced S2255, based off the Sudan Divestment Task Force targeted divestment model.

In June 2007, S2255 passed the Massachusetts State Senate. Subsequently, the Massachusetts House of Representatives passed S2255 in September.

Currently, S2255 awaits the signature of Governor Deval Patrick. The Governor has already publicly endorsed the legislation.

Bill Text:

S2255: <http://www.mass.gov/legis/bills/senate/185/st02/st02255.htm>

Website and Articles:

<http://www.sudandivestment.org/massachusetts>

Contact:

Daniel Millenson
National Advocacy Director, Sudan Divestment Task Force
Massachusetts@sudandivestment.org

Michigan (Campaign Initiated)

Legislative Status:

State Senator Hansen Clarke has introduced Senate Bill 0555, based off the Sudan Divestment Task Force model of targeted Sudan divestment. Senate Bill 0555 has been referred to the Senate Appropriations committee.

Companion House legislation, House Bill 4854, has been introduced by Representative Alma Wheeler Smith. House Bill 4854 has been referred to the Government Operations Committee.

Website and Articles:

<http://www.sudandivestment.org/michigan>

Bill Text:

SB 0555:
[http://www.legislature.mi.gov/\(S\(1hts0p45adyonk450o141d55\)\)/mileg.aspx?page=getobject&objectname=2007-SB-0555&quervid=18337355](http://www.legislature.mi.gov/(S(1hts0p45adyonk450o141d55))/mileg.aspx?page=getobject&objectname=2007-SB-0555&quervid=18337355)

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HB 4854:

[http://www.legislature.mi.gov/\(S\(gxwbw4bh4gmqw5ahstnl1nn4\)\)/mileg.aspx?page=Bills&tatus&objectname=2007-HB-4854](http://www.legislature.mi.gov/(S(gxwbw4bh4gmqw5ahstnl1nn4))/mileg.aspx?page=Bills&tatus&objectname=2007-HB-4854)

Contact:

Scott Wisor

Senior National Field Organizer, Sudan Divestment Task Force

swisor@sudandivestment.org

Minnesota (Divested: Task Force Model)

Legislative Status:

In May 2007, Governor Tim Pawlenty signed Senate File 1075, based on the Sudan Divestment Task Force model of targeted divestment.

Senate File 1075 was introduced by State Senator Sandra Pappas. Companion legislation, House File 1332, was introduced by State Representative Karen Clark.

Website and Articles:

<http://www.sudandivestment.org/minnesota>

Bill Text:

SF 1075:

<http://www.revisor.leg.state.mn.us/bin/bldbill.php?bill=S1075.1.html&session=1s85>

HF 1332:

<http://www.revisor.leg.state.mn.us/bin/bldbill.php?bill=H1332.0.html&session=1s85>

Contact:

Scott Wisor

Senior National Field Organizer, Sudan Divestment Task Force

swisor@sudandivestment.org

Missouri (Campaign Initiated)

Legislative Status:

In late 2005 a state-owned equity portfolio, the Missouri Investment Trust (MIT), put out a request for proposals to manage a \$5 million international portfolio "terror-free."

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Despite the requirement that the entire portfolio, including any commingled or index funds, be terror-free and the portfolio was a mere \$5 million, MIT received four bids, two of which were from leading Wall Street managers. In June 2006, MIT selected a State Street Global Advisors enhanced index fund to handle the \$5 million investment. According to the state treasurer, State Street will subcontract with Conflict Securities Advisory Group to provide the list of identified stocks. Furthermore, the treasurer has stated that, "historical net return analysis shows no negative impact."

In 2007 Missouri House of Representative, Minority Leader Jeff Harris introduced a blanket Sudan divestment amendment which was stripped in conference committee.

A targeted Sudan divestment campaign has been initiated for the 2008 legislative session.

Website and Articles:

<http://www.sudandivestment.org/missouri>

Press Release:

<http://www.treasurer.missouri.gov/pressroom/MITFund.html>

Contact:

Scott Wisor
Senior National Field Organizer, Sudan Divestment Task Force
Missouri@sudandivestment.org

Nebraska (Campaign Initiated)

Legislative Status:

A targeted Sudan divestment campaign has been initiated.

Website and Articles:

<http://www.sudandivestment.org/nebraska>

Contact:

Scott Wisor
Senior National Field Organizer, Sudan Divestment Task Force
Nebraska@sudandivestment.org

Nevada (Campaign Initiated)

Legislative Status:

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In June 2007 Governor Jim Gibbons joined with Senate Majority Leader William Raggio and Assembly Speaker Barbara Buckley, to encourage the Public Employees Retirement System of Nevada (PERS) to adopt a targeted Sudan divestment policy. PERS has not taken any subsequent action.

Website and Articles:

<http://www.sudandivestment.org/nevada>

Contact:

Nevada@sudandivestment.org

New Hampshire (Campaign Initiated)

Legislative Status:

State Representative Jeff Fontas has agreed to introduce targeted Sudan divestment legislation for the 2008 legislative session.

Website and Articles:

<http://www.sudandivestment.org/newhampshire>

Contact:

Daniel Millenson
National Advocacy Director, Sudan Divestment Task Force
info@sudandivestment.org

New Jersey (Divested: Other Model)

Legislative Status:

Since adopting a blanket divestment statute in July 2005, the state of New Jersey completed divestment of \$2.16 billion from 17 companies identified as having an equity tie to the government of Sudan. The divestment's completion comes two years before the statute's mandatory deadline.

Website and Articles:

<http://www.sudandivestment.org/newjersey>

Bill Text:

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http://www.njleg.state.nj.us/2004/Bills/AL05/162_.PDF

Contact:

Sudan Divestment Task Force
info@sudandivestment.org

New Mexico (Campaign Initiated)

Legislative Status:

A targeted Sudan divestment campaign has been initiated.

Website and Articles:

<http://www.sudandivestment.org/newmexico>

Contact:

Sudan Divestment Task Force
newmexico@sudandivestment.org

New York (Divested: Task Force Model)

Legislative Status:

On June 11, 2007, New York State Comptroller Thomas P. DiNapoli announced that the New York State Common Retirement Fund, one of the largest pension funds in the country, will develop and implement a policy designed to place pressure on the Sudanese government to end the genocide currently taking place in Darfur. The Comptroller's policy will follow the Sudan Divestment Task Force's targeted Sudan divestment model.

The New York State Teachers' Retirement Fund has yet to make divestment commitments.

Press Release and Policy:

<http://www.osc.state.ny.us/press/releases/june07/061107.htm>

Website and Articles:

<http://www.sudandivestment.org/newyork>

Contact:

SUDAN DIVESTMENT TASK FORCE

Sudan Divestment Task Force
NewYork@sudandivestment.org

North Carolina (Divested: Task Force Model)

Legislative Status:

State Representative Paul Luebke has introduced House Bill 291, targeted Sudan divestment legislation based on the Sudan Divestment Task Force's model in the 2007 legislative session.

In April 2007, House Bill 291 passed the house unanimously.

On July 27th, 2007, House Bill 291 received unanimous approval in the Senate.

On August 31st, 2007, Governor Mike Easley signed House Bill 291.

Additionally, on November 1, 2006 North Carolina Treasurer Richard Moore announced his decision to divest the North Carolina Retirement System (NCRS), the state's pension fund, from nine companies he identified as providing monetary or military support to the Sudanese government. The initial decision affected NCRS's assets in Bharat Heavy Metals, China Petroleum and Chemical Corp., Nam Fatt, Oil & Natural Gas Company, PECD Berhad, PetroChina Company, Sudan Telecom Company, Tatneft OAO and Videocor Industries Limited, assets totaling \$24 million of the pension fund's \$70 billion. The decision affects offending assets held in all of NCRS' applicable asset classes.

Website and Articles:

<http://www.sudandivestment.org/northcarolina>

Bill Text:

HB 291: <http://www.ncga.state.nc.us/Sessions/2007/Bills/House/PDF/H291v2.pdf>

SB 516: <http://www.ncga.state.nc.us/Sessions/2007/Bills/Senate/PDF/S516v1.pdf>

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Ohio (Campaign Initiated)

Legislative Status: