California Public Employees' Retirement System

Total Fund Investment Policy Sections

~~VIII.~~VII. Divestment

Purpose

This section sets forth the CalPERS policy (Policy) for responding to external and Board-directed~~or internal~~ initiatives that seek to remove or limit specific investments from the CalPERS portfolio or investment universe for any period of time (Divestment Initiatives).~~to cause CalPERS to sell investments or refrain from making additional investments (Divesting) for the purpose of achieving certain goals that do not appear to be primarily investment-related, such as promoting social justice (Divestment Initiatives)~~. Typically, Divestment Initiatives focus on companies (Targeted Companies) that do business in or with a specified country, are engaged in a specified industry, or that engage in specific practices deemed undesirable by one or more constituencies~~federal and state law (*e.g.*, human rights violations) (Targeted Companies)~~.

The Committee believes that investing in broad market indices and segments is consistent with Investment Beliefs #7; that CalPERS will take risk only where we have a strong belief we will be rewarded for it. Many of the portfolio's investments are therefore in broad market indices and segments intended to capture and reflect the overall economic performance of countries and companies over the long term. As such, they do not necessarily signify CalPERS' approval of any particular company's policies, products, or actions. While CalPERS prefers that the companies in which it invests embody the principles articulated in the CalPERS Global Governance Principles as a means of promoting superior long-term investment performance, the Board's fiduciary obligations forbid CalPERS, in the management of its portfolios, from sacrificing potential investment performance or diversification for the purpose of achieving ancillary goals unrelated to the risk-return profile of the portfolio.
~~CalPERS investment in a company does not necessarily signify that it approves of the company's policies, products, or actions. CalPERS, nevertheless, wants companies in which it invests to meet high corporate governance, ethical, and social standards of conduct. The Committee believes that this generally will promote superior long-term investment performance.~~

This approach is aligned with Investment Belief 3 that CalPERS investment decisions may reflect wider stakeholder views provided they are consistent with the fiduciary duties owed its members and beneficiaries, and that engagement is our preferred means of responding to stakeholder issues.

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VII. Divestment (continued)

Purpose (continued)

CalPERS' experience ~~to date~~ has been that divestment tends to harm investment performance and increase transaction costs for the System. Given that experience, and the fact that divestment, by definition, decreases diversification, this Policy discourages divestment as a tool for responding to Divestment Initiatives, and encourages instead the use of constructive engagement to help improve long-term investment performance.

Fiduciary Duty Standard per California Constitution:

The System's assets are trust funds held for the exclusive purposes of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the system. (CA Const. §17(a).) The members of the Board must discharge their duties solely in the interest of, and for the exclusive purposes of (i) providing benefits to participants and their beneficiaries, (ii) minimizing employer contributions, and (iii) defraying reasonable expenses of administering the system. (CA Const. §17(b).)

The above duties of the Board take precedence over any other duty. (CA Const. §17(b).) The Legislature may prohibit certain investments when in the public interest to do so, provided the prohibition satisfies the above standards of fiduciary care and loyalty. (CA Const. §17(g).)
~~CalPERS Board of Administration (Board) and its staff have fiduciary duties of loyalty and prudence, pursuant to the California Constitution, Article XVI, Section 17, and Government Code (GC) Section 20151, to invest "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an enterprise of a like character and with like aims." (GC Section 20151(c).)~~

~~These fiduciary obligations generally forbid CalPERS from sacrificing investment performance for the purpose of achieving goals that do not directly relate to CalPERS operations or benefits. Divesting appears to almost invariably harm investment performance, such as by causing transaction costs (e.g., the cost of selling assets and reinvesting the proceeds) and compromising investment strategies.~~

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VII. Divestment (continued)

Purpose (continued)	~~In addition, there appears to be considerable evidence that Divesting is an ineffective strategy for achieving social or political goals, since the usual consequence is often a mere transfer of ownership of divested assets from one investor to another. Investors that divest lose their ability as shareowners to influence the company to act responsibly.~~ ~~This Policy, therefore, generally prohibits Divesting in response to Divestment Initiatives, but permits CalPERS to use constructive engagement, where consistent with fiduciary duties, to help Divestment Initiatives achieve their goals.~~
~~Statement of Policy~~ **Investment Approaches & Parameters**	CalPERS will undertake constructive engagement with Targeted Companies in support of Divestment Initiatives to the extent the ~~Committee~~ Investment Office determines such engagement to be appropriate or as required by law.~~, but~~ CalPERS will sell and/or refrain from making investments in Targeted Companies in some or all portfolios (a) to the extent investment in the Targeted Company is inconsistent with the Board's fiduciary duties, (b) to the extent divestment is expected to produce superior, risk-adjusted returns on a total fund basis, or (c) as required by law. In so doing, CalPERS recognizes that the prudence of an investment may depend on its purpose within the overall portfolio. For example, divestment of a given security might be prudent within an actively managed portfolio, but imprudent within the context of an indexed portfolio. Similarly, depending upon the economic impact of the particular divestment mandate in question, the Board's fiduciary duty may in some instances permit a prohibition of additional investment in the Targeted Companies at issue but not the divestment of existing holdings. ~~CalPERS will not sell investments in Targeted Companies or refrain from investing in them in response to Divestment Initiatives except as follows:~~ A. ~~CalPERS will sell Targeted Company investments or refrain from making them to the extent investment in the Targeted Company is imprudent and inconsistent with fiduciary duties. CalPERS recognizes that the prudence of an investment may depend on its purpose. For example, it might be imprudent to retain an investment in an actively managed portfolio, but prudent to retain it in an indexed portfolio or as part of a long-short absolute return strategy.~~

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VII. Divestment (continued)

Investment Approaches & Parameters (continued)

~~B. To the extent required by law and consistent with fiduciary duties, CalPERS will comply with federal and constitutional California state laws that require Divesting.~~

~~C. This Policy does not require CalPERS to re-examine investment policies and practices in effect when this Policy was adopted to determine whether they were influenced by Divestment Initiatives or have or will result in Divesting.~~

Divestment Loss Mitigation:

Given CalPERS' experience ~~to date~~ that divestment tends to harm investment performance and increase transaction costs for the System, prudent stewardship of the System's assets requires implementation, going forward, of a loss mitigation mechanism for both cost reimbursement and the unwinding of divestment initiatives that exceed certain investment loss thresholds. Accordingly:

If and when;

~~total net portfolio investment losses caused by either~~ (1) any individual Divestment Initiative has produced net portfolio losses that equal or exceed $750 million for 12 or more consecutive quarters, or

(2) the ~~then in-force~~ total universe of past and present Divestment Initiatives has produced net portfolio losses that, cumulatively, equal or exceed $2.5 billion~~as the case may be, equal or exceed the applicable "Divestment Loss Threshold" for a period of one year or longer (three years or longer for "New Divestment Initiatives")~~,

then:

A. Any investments previously sold pursuant to such individual Divestment Initiative (or collectively pursuant to the ~~then in-force~~total universe of Divestment Initiatives, as the case may be) shall be restored to the portfolio,

B. Restrictions on associated new investments shall cease, and

C. Staff may cease all further divestment-related activity with respect to the involved Divestment Initiative(s).

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Investment Approaches & Parameters (continued)

Though Divestment Initiatives that have, individually, produced net gains for the portfolio are to be included in the calculation of net gain or loss for purposes of the cumulative loss threshold described above, steps (A) through (C) above (*i.e.*, the divestment "unwind") shall not apply to any Divestment Initiatives that have, individually, produced net investment gains for the portfolio. The precise timing of ~~the above~~ any unwind transactions~~, and, in the case of a cumulative loss trigger, the identification of which particular divestments to unwind,~~ shall be in staff's discretion in the prudent administration of the portfolio. Before commencing any reinvestment activity, staff shall notify the Committee that the loss threshold(s) have been met, allowing the Committee to consider exceptions to these reinvestment provisions.

For Existing Divestment Initiatives, portfolio losses shall be calculated with reference to the market value of the relevant investments as of July 1, 2016. For New Divestment Initiatives, portfolio losses shall be calculated based upon the usual methodology for calculating portfolio investment loss, *i.e.*, with reference to the actual dates on which the investments in question were sold. Portfolio losses shall take into account both gains and losses on the affected investments, ~~calculated on a per mandate or cumulative basis, as the case may be, and~~ excluding (a) gains or losses on similar investments in any ~~unaffected~~ portfolios not included in the original divestment, and~~or~~ (b) in the case of a decision to prohibit future investments without divesting existing holdings, the gains or losses on any such "grandfathered" investments. The ~~D~~divestment ~~L~~loss ~~T~~thresholds shall be reviewed annually and adjusted as needed.

Cost Reimbursement:

Implementation of any divestment decisions made pursuant to California state statute shall include a request for the up-front reimbursement by the California state legislature (Legislature) of the anticipated one-time costs of implementation, to include trading costs, staff's analysis and review costs, and the cost of any outside advisers.

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VII. Divestment (continued)

Investment Approaches & Parameters (continued)	**Definitions**: ~~"Divestment Loss Threshold" shall mean $750 million with reference to any single Divestment Initiative, and $2.5 billion cumulatively with reference to the existing universe of Divestment Initiatives.~~ "Existing Divestment Initiatives" shall mean Divestment Initiatives previously enacted by the Legislature or already implemented as of July 1, 2016. The Existing Divestment Initiatives are listed in Appendix 8. "New Divestment Initiatives" shall mean Divestment Initiatives that have *not* been enacted or implemented as of July 1, 2016.