

SUBJECT: Restricting ERS and TRS pension fund investments in Sudan

COMMITTEE: Pensions and Investments — favorable, without amendment

VOTE: 7 ayes — Truitt, Villarreal, McClendon, Burnam, Keffer, Macias, Rodriguez  
0 nays

SENATE VOTE: On final passage, March 20 — 29-0

WITNESSES: For — Colin Lowenberg, The White Rose Society, Student Anti-Genocide Coalition; Paul H. Schwartz, Sudan Divestment Task Force; Jan Soifer, Anti-Defamation League, National Council of Jewish Women, Jewish Community Association of Austin; Adam Sterling, Genocide Intervention Network, and seven others (*Registered, but did not testify*: Elizabeth Brenner)  
  
Against — None  
  
On — David Mattax, Office of the Attorney General

DIGEST: SB 247 would establish a “targeted divestment” process by which the Employees Retirement System (ERS) and the Teacher Retirement System (TRS), after a series of notifications outlined in the bill, would have to sell, redeem, divest or withdraw all publicly traded securities of certain “scrutinized businesses” with operations in Sudan.  
  
The bill would define the “Government of Sudan” as the government in Khartoum, Sudan, led by the National Congress Party, formerly known as the National Islamic Front, or any successor government formed on or after October 13, 2006, including the coalition National Unity Government agreed upon in the Comprehensive Peace Agreement for Sudan. The term would not include the regional government of southern Sudan.  
  
**Scrutinized businesses.** A company would be considered to have engaged in “scrutinized business operations” if it had business operations that involved contracts with or provided supplies or services to the

Government of Sudan, if that government had any direct or indirect equity share in the company, or if the company was a consortium or project commissioned by the Government of Sudan or was involved in such a consortium or project, and:

- more than 10 percent of its revenues or assets linked to Sudan involved oil-related or mineral extraction, less than 75 percent of the company's revenue or assets linked to Sudan involved contracts with or a provision of oil-related or mineral extracting products or services to the regional government of southern Sudan or a project or consortium created exclusively by that government, and the company had failed to take substantial action; or
- more than 10 percent of its revenues or assets linked to Sudan involved power production activities, less than 75 percent of its operations provide power or electricity to the marginalized populations of Sudan, and the company had failed to take substantial action; or
- the company supplied military equipment to Sudan, unless it showed that the equipment could not be used to facilitate offensive military actions in Sudan and implemented rigorous and verifiable safeguards to prevent the use of that equipment by forces actively involved in armed conflict.

“Substantial action” would mean adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within one year and to refrain from any new such business operations. It also would mean undertaking significant humanitarian efforts on behalf of one or more marginalized populations of Sudan, or, through engagement with the Government of Sudan, materially improving conditions for the genocidally victimized population in Darfur.

The bill would define a “social development company” as one whose primary purpose is providing humanitarian goods or other services listed in the bill. A social development company that was not complicit in the Darfur genocide would not be considered to be a scrutinized company. Companies excluded from federal sanctions would not be subject to divestment or investment prohibitions.

**Identification and notification.** The Comptroller's Office would have to prepare and annually update a list of all “scrutinized companies” — companies that had engaged in scrutinized business operations or had been

“complicit” in the Darfur genocide during any preceding 20-month period. A “complicit” company would be defined as one that took actions to directly support or promote the genocidal campaign in Darfur, including preventing members of Darfur’s victimized population from communicating with each other, encouraging Sudanese citizens to speak out against an internationally approved security force for Darfur, or actively working to deny, cover up, or alter the record on human rights abuses in Darfur.

The Comptroller’s Office would have to provide this list to ERS and TRS. No later than 30 days after the list was provided or updated, the comptroller would have to file the list with the presiding officer of each house of the Legislature and the attorney general.

Within 14 days, ERS and TRS would have to notify the comptroller of listed companies in which the pension funds had direct or indirect holdings and would have to send a written notice informing each company of its listed status along with a warning that the company could become subject to divestment.

In this written notice, ERS or TRS would have to encourage the company to either cease its scrutinized businesses or convert such operations to inactive businesses within 90 days. If the company did so, its name would have to be removed from the list of scrutinized companies.

If a notified company continued to have scrutinized active business operations after this 90-day period, ERS or TRS would have to remove at least 50 percent of investments in that company from its assets by the 270th day and 100 percent of assets by the 450th day after the company received its original notice. A company that resumed active business after being removed from listed status would be subject to the same timeline.

ERS or TRS could stop divesting from or reinvest in a listed company only if the agencies determined in good faith that divestment would result in a loss such that the value of all assets in the fund equaled 99.7 percent of what the value would have been if the agency had not divested from those companies. The agencies could maintain investments in these companies only to the extent necessary to ensure that the overall value of the fund did not fall below 99.7 percent of what it would have been without divestment. In these situations, the agency would have to notify in writing the presiding officers of both houses of the Legislature and the

attorney general providing clear and convincing evidence of their decision and would have to update the report semiannually.

ERS and TRS would not have to divest from any indirect holdings in actively managed investment funds or private equity funds, but would have to submit letters to the managers of investment funds containing listed companies requesting that they remove these companies from the fund or create a similar actively managed fund devoid of holdings of listed company. If a manager created such a fund with substantially similar fees and risk, ERS and TRS would have to transfer to these funds in an expedited time frame consistent with prudent fiduciary standards.

In carrying out the provisions of SB 247, ERS and TRS would be exempt from any conflicting statutory or common law obligations, and employees or contractors would be indemnified in a cause of action based on activities or decisions made in connection with the bill. The bill would prohibit a private cause of action against the state for breach of fiduciary duty in connection with a decision made in connection with the bill.

The provisions of the bill would expire on the earliest of:

- the date the U.S. Congress or the President of the United States declared that the Darfur genocide has been halted for at least 12 months;
- the date the U.S. government revoked its sanctions against the Government of Sudan; or
- the date the U.S. government declared that mandatory divestment interferes with the conduct of U.S. foreign policy.

By December 31 of each year, ERS and TRS would have to file a publicly available report identifying all investments sold, redeemed, divested, or withdrawn and all prohibited investments, and summarize any changes made by investment funds regarding listed companies.

The bill would take effect January 1, 2008, by which date the comptroller would be required to provide a list of scrutinized companies to ERS and TRS.

**SUPPORTERS  
SAY:**

SB 247 would send a powerful message about corporate responsibility in the face of mass murder and human rights atrocities by requiring the state's two largest pension funds to divest in companies that actively do

business in Darfur, Sudan. On September 26, 2006, the United States House of Representatives stated that “an estimated 300,000 to 400,000 people have been killed by the Government of Sudan and its Janjaweed allies since the Darfur crisis began in 2003, more than two million people have been displaced from their homes, and more than 250,000 people from Darfur remain in refugee camps in Chad.” The Darfur crisis represents the first time the United States government has labeled ongoing atrocities a genocide.

The bill would put further pressure on the Government of Sudan, which has been subject to sanctions by the U.S. government since 1997, by requiring ERS and TRS to divest in companies actively doing business with the Sudanese government. This is necessary because under current political and diplomatic pressure, the Sudanese government incurs virtually no cost for continuing its genocide in Darfur. Divestment, however, forces the Sudanese government to pay a price for its refusal to restore peace and security to Darfur.

The bill would establish a “targeted divestment strategy” designed to have the greatest impact by affecting those companies, all of them foreign and mostly in the energy sector, that conduct a significant amount of business with the Government of Sudan while doing little for the country’s underprivileged population.

Under a series of notice requirements specified in the bill, companies would have up to 15 months to cease active business operations that made them subject to divestment. A small fraction of companies in the ERS and TRS portfolios would be affected, and any losses to either pension fund likely would be minimal. The bill would set limits to ensure that neither fund faced significant losses as a result of divestment.

SB 247 would allow Texas to join the growing number of states taking action to stop the genocide through targeted investments. These actions are having an effect. Unlike isolated countries that tend to shrug off sanctions, the Sudanese government is desperately trying to attract foreign investment. Threats to these efforts are taken very seriously by the government in Khartoum.

Texas Constitution, Art. 16, sec. 67(a)(3) specifies that the Legislature by law may further restrict the investment discretion of the board of a statewide benefit system. Clearly, the Legislature has the constitutional

authority to direct or restrict ERS and TRS investments in companies doing business in Sudan.

**OPPONENTS  
SAY:**

Although the human rights abuses occurring in Sudan are reprehensible, it is unlikely that requiring Texas state employee and teacher pension funds to divest would affect the targeted companies or the Government of Sudan. However, such action could violate fiduciary and trust standards and cause these pension funds, neither of which currently is actuarially sound, to lose money, which ultimately would harm the retirees these funds are intended to benefit.

SB 247 could violate Art. 16, sec. 67(a)(1) of the Texas Constitution, which states that “the assets of a system are held in trust for the benefit of members and may not be diverted.” The Constitution is very clear that after state money or member contributions are deposited into a pension system, the Legislature has no authority over that money. Any divestiture bill causing losses to a fund would cause a trustee to violate the fiduciary duties established in the state Constitution.

Further, any sale of investments would clash with Texas Constitution, Art. 16, sec. 67(a)(3), which requires that pension funds be managed in a manner that “persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs.” The same section gives the Legislature the authority to restrict the investment discretion of the board, but this refers to whether trustees are exercising prudent risk in carrying out their responsibilities. For example, the Legislature could direct the board to switch to relatively safe investment-grade debt from riskier junk bonds. The provision does not authorize the Legislature to direct trustees to violate their fiduciary duty by divesting certain stocks or other securities altogether for reasons unrelated to prudent investing.

SB 247 could cause the pension funds to lose money. According to the fiscal note, ERS estimates that its potential loss from divestment in fiscal 2008 could be as high as \$69 million. TRS, meanwhile, would stand to lose \$51 million in fiscal 2008, with ongoing losses in future years. The bill also could raise tax issues because the assets of a pension fund must be exclusively held for the benefit of members in order to be qualified under the federal tax code, which also prohibits diversion of member funds.

Divestment also would be ineffective. While Texas' retirement funds might divest themselves of Darfur-related investments, other investors would be quick to purchase these assets. The Illinois attorney general's office, arguing in defense of a similar Illinois statute, admitted that its law "does not impose any substantive economic pressure on Sudan ... the act is merely moral investment style ... codified into law."

NOTES:

In the fiscal note, the Legislative Budget Board estimates that the provisions of the bill, including added staff costs, would have a negative impact of \$51.1 million to the TRS trust fund and \$12.4 million to the ERS trust fund in fiscal 2008. Annual losses to the TRS fund would reach an estimated \$5.4 million in fiscal 2012, and the ERS fund would lose about \$1.3 million that same year.