

SUBJECT: Restricting Permanent University Fund investments in Sudan

COMMITTEE: Pensions, Investments and Financial Services — favorable, without amendment

VOTE: 5 ayes — Truitt, Flynn, Hernandez, Hopson, Parker
0 nays
4 absent — Anchia, Anderson, Veasey, Woolley

WITNESSES: For — Keaton Anderson, Jason Meschin, Kara Miller, White Rose Society; (*Registered, but did not testify:* Maggie McCloud, White Rose Society)
Against — None
On — David Mattax, Office of Attorney General; Pranav Merchant; Jerry Turner, Bruce Zimmerman, University of Texas Investment Management Company (UTIMCO)

BACKGROUND: The 80th Legislature in 2007 enacted SB 247 by Ellis (Government Code, ch. 806) to establish a targeted divestment process by which the Teacher Retirement System and the Employees Retirement System must sell, redeem, divest or withdraw all publicly traded securities of “scrutinized businesses” with operations in Sudan.

Government Code, ch. 806 defines the Government of Sudan as the government in Khartoum, Sudan, which is 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 does not include the regional government of southern Sudan.

Education Code, ch. 66, subch. A outlines provisions for the composition, investment, and use of the Permanent University Fund (PUF). The PUF is a public endowment contributing to the support of most institutions in the University of Texas System and Texas A&M University systems, and

since 1996 has been managed for the UT Board of Regents by The University of Texas Investment Management Company (UTIMCO), a 501(c)(3) corporation.

DIGEST:

HB 801 would apply provisions in Government Code, ch. 806 relating to prohibition on investments in Sudan to the University of Texas System's Board Of Regents and to any entity acting on behalf of the board, including a non-profit corporation with investment authority over the PUF.

Scrutinized companies. The comptroller would have to prepare and update annually a list of all "scrutinized companies" that had engaged in scrutinized business operations or had been complicit in the Darfur genocide during any preceding 20-month period as soon as practicable after September 1, 2009, but before January 1, 2010. The Board of Regents would be subject to existing provisions regarding investment prohibition in Sudan when it received the initial list from the comptroller.

A complicit company would be one that took actions to support directly 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.

A company would be considered to have engaged in "scrutinized business operations" if it had had business operations that involved contacts 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 project or consortium, 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.

A company would have taken “substantial action” if it:

- adopted, publicized, and implemented a formal plan to cease scrutinized business operations within one year and to refrain from any such new business operations;
- had undertaken significant humanitarian efforts on behalf of one or more marginalized populations of Sudan; or
- through engagement with the Government of Sudan, had materially improved conditions for the genocidally victimized population in Darfur.

Required activities. Within 14 days of receiving the comptroller’s list of scrutinized companies, the Board of Regents, or the nonprofit corporation acting on its behalf, would have to notify the comptroller of listed companies in which the Permanent University Fund had direct or indirect holds and would have to send a written notice informing each company of its listed status along with a warning that it could become subject to divestment.

In this written notice, the Board of Regents, or the nonprofit corporation acting on its behalf, would have to encourage the company to either cease its scrutinized businesses or convert such operations to inactive business operations within 90 days. If the company did so, its name would be removed from the list of scrutinized companies. Inactive business operations would be the continued holding or renewal of rights to property previously operated to generate revenue but not presently deployed to generate revenue.

If a notified company continued to have scrutinized active business operations after this 90-day period, the Board of Regents, or the nonprofit

corporation acting on its behalf, 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.

The Board of Regents, or the nonprofit corporation acting on its behalf, could stop divesting from or reinvest in a listed company only if it 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.

The Board of Regents, or the nonprofit corporation acting on its behalf, would not be required 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 consider removing those companies from the fund or create a similar actively managed fund with indirect holdings devoid of listed companies. If the manager created a similar fund with substantially the same fees and risk level, the Board of Regents, or the nonprofit corporation acting on its behalf, would have to replace all applicable investments with investments in the similar fund in an expedited time frame consistent with prudent fiduciary standards.

Indemnification of UT board of regents and related entities and employees. HB 801 would provide that in a cause of action based on an action, inaction, decision, divestment, investment, company communication, report, or other determination made or taken in connection with prohibitions on investments in Sudan, the state would, without regard to whether the person was compensation for performance, indemnify and hold harmless for actual damages, court costs, and attorney's fees adjudged against, and defend:

- an employee or member of the Board of Regents;
- an employee or officer of any entity acting on behalf of the board, including a non-profit corporation with investment authority of the Permanent University Fund;
- a contractor of the board;
- a former board employee, a former board member, or former employee or officer of a non-profit corporation who was serving in that capacity when the act or omission on which the damages were based occurred; and
- a former contractor of the board who was a contractor when the act or omission on which the damages were based occurred.

No private cause for action. A person could not sue or pursue a private cause of action against identified individuals, the state, or the Board of Regents for any claim or cause of action, including breach of fiduciary duty, or for violation of any constitutional, statutory, or regulatory requirement in connection with any action, inaction, decision, divestment, investment, company communication, report, or other determination made or taken regarding prohibition of investments in Sudan. A person who filed suit against the state on grounds of violating the Sudan investment prohibition, the Board of Regents, or identified individual would be liable for paying the costs of attorney's fees of a person sued. The attorney general could bring an enforcement action in this area.

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

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

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2009.

SUPPORTERS
SAY:

HB 801 simply would extend to the Permanent University Fund's investments the same divestment policies in certain companies in Sudan as currently are required for the Teacher Retirement System and Employees

Retirement System pension funds. This would strengthen the message from Texas about corporate responsibility in the face of mass murder and human rights atrocities by requiring the largest public school endowment in the United States to divest in companies that do business actively 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 the University of Texas Investment Management Company (UTIMCO) to divest from 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 require UTMICO to adopt a targeted divestment strategy for the Permanent University Fund 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. The bill would set limits to ensure that the fund did not face significant losses as a result of divestment.

As ERS and TRS already are carrying out divestment plans for state pension funds, there is no reason why UTIMCO could not carry out similar action. While UTIMCO has taken action to end its investments in separate investment accounts in the comptroller’s “worst offenders” list, it still has several million dollars invested in these companies through index and commingled funds.

In addition to obvious moral reasons, there are financial reasons for this divestment. According to a 2008 Sudan peer performance analysis, the “worst offenders” in Sudan underperformed their peer group average by

over 22 percent over a three-year period and over 45 percent over one year. This period corresponds with the rise of the Sudan divestment movement and shows that it indeed works. By adopting as policy the provisions outlined in HB 801, Texas would join the 26 other states and 61 universities that have enacted Sudan divestment policies. Lastly, there is clear precedence for such action, as the Permanent University Fund's investment policy was restricted from making investments in securities of the South African government or related firms under anti-apartheid activity.

OPPONENTS
SAY:

Although the human rights abuses occurring in Sudan are reprehensible, HB 801 would represent an unnecessary intrusion into the fiduciary standards and management policy of UTIMCO. The policy of the Board of Regents, which has authorized UTIMCO to manage the Permanent University Fund (PUF), states that the investment strategy of the PUF is to have returns to the fund that are stable and predictable for annual distribution and to preserve the fund's purchasing power. This investment policy is outlined clearly in the Texas Constitution, Art. 7, sec. 18(e) and does not include that social issues should be considered in managing the fund. As such, inserting one social issue — however tragic — potentially would set a precedent of considering any and all social issues. Such consideration, while worthy, could distract the PUF from its stated purpose of supporting the institutions in the UT and the Texas A&M System. Imposing any additional investment objective could impact negatively the fund's performance.

Additionally, Texas Constitution, Art. 7, sec. 11(b) provides the UT Board of Regents exclusive authority to manage the Permanent University Fund. As such, regardless of the issue or type of investment, the Legislature has no authority to infringe of the board's sole and exclusive right. Under constitutional provisions for the state retirement system outlined in Texas Constitution, Art. 16, sec. 67, ERS and TRS cannot claim this exclusive right.

In practice, UTIMCO already is addressing this issue. As of April 2008, UTIMCO had roughly seven million dollars in three companies on the comptroller's list of companies doing business with Sudan out of billions invested — a very small percentage of its overall assets. Unlike ERS and TRS, UTIMCO does not invest directly in stocks, but makes allocation decisions and hires managers to execute its policy. While some of these allocations go through index funds that may include companies on the

comptroller's list, UTIMCO can manage this situation by making clear to its managers the risks involved in types of investments.

Further, any sale of investments could clash with the prudent investor rule in Texas Constitution, Art. 7, sec. 11(a) and 11(b), 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." As such, the Legislature should not direct trustees to violate their fiduciary duty by divesting certain stocks or other securities for reasons unrelated to prudent investing.

NOTES:

The companion bill, SB 602 by Ellis, has been referred to the Senate Finance Committee.