



EXECUTIVE CHAMBERS

HONOLULU

NEIL ABERCROMBIE
GOVERNOR

February 5, 2014

The Honorable Donna Mercado Kim,
President
and Members of the Senate
Twenty-Seventh State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

The Honorable Joseph M. Souki, Speaker,
and Members of the House of
Representatives
Twenty-Seventh State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear President Mercado Kim, Speaker Souki, and Members of the Legislature:

For your information and consideration, as required by Act 192, section 5, I am transmitting a copy of the Employees' Retirement System (ERS) report on Direct Holdings in Sudan Scrutinized Companies. In accordance with Section 93-16, Hawaii Revised Statutes, I am also informing you that the report may be viewed electronically via the ERS website at <http://ers.ehawaii.gov/wp-content/uploads/2014/01/Sudan-2013.pdf>.

Sincerely,

/s/

NEIL ABERCROMBIE
Governor, State of Hawaii

Enclosures

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII
DIRECT HOLDINGS IN SUDAN SCRUTINIZED COMPANIES
2013

Act 192, Session Laws of Hawaii 2007, expresses the State's desire to not participate in ownership of companies that provide significant practical support for genocide activities being conducted by the Sudanese government in the Darfur region.

The Board of Trustees of the Employees' Retirement System recognizes the intent of Act 192 and will abide by its requirements. The Board, however, must also apply a decision framework to act for the exclusive benefit of ERS Plan participants. In this respect, the Board recognized that divestment activities could potentially increase the portfolio's idiosyncratic investment risk. Divestment guidelines and procedures, codified in the ERS' *Sudan Investment Policy* ("Policy"), were therefore developed to minimize the impact of the Sudan divestment policy upon the investment results of the ERS portfolio. The Sudan divestment policy is intended to also avoid:

- Discriminating against companies whose Sudan-related business activities are supported by the U.S. government;
- Discriminating against companies whose Sudan-related business activities do not support genocide activities;
- Unnecessarily harming U.S. companies and jobs; and
- Compromising the Board of Trustees' duties to the beneficiaries of the ERS.

The ERS was required to make its best efforts to identify all of its direct holdings in scrutinized companies within 180 days after July 1, 2007. Those efforts were to include:

- Reviewing publicly available information regarding companies with business operations in Sudan provided by nonprofit organizations and other appropriate parties;
- Contacting ERS' asset managers with investments in scrutinized companies; and
- Contacting other institutional investors that have divested from or engaged with companies that have business operations in Sudan.

Each year thereafter, Act 192 requires the ERS to provide to the legislature a publicly-available report that includes activity under section 4, to include: 1) A summary or correspondence with companies engaged by the public fund; 2) All investments sold, redeemed, divested, or withdrawn; 3) All prohibited investments; and, 4) Any progress made. The ERS respectfully reports all pertinent activity in 2013 related to Sudan Scrutinized Companies as outlined in Act 192:

Summary of correspondence with companies engaged by public fund:

The ERS relied on the *Sudan Company Report* prepared by the Conflict Risk Network (CRN) to determine “scrutinized companies,” that certain business activities in Sudan may determine their status as a “highest offender.” Highest offenders are subject to possible divestment in accordance with the Policy.

Before taking any action against the company, the ERS Board considers any additional information they may provide. The ERS will send a letter to the scrutinized company to inform them of their Sudan-related activities, and encourage them to cease their scrutinized active business operations within 90 days. If the company continues to have scrutinized active business operations after ninety days following the first engagement by ERS, the Board will consider divestment or other corrective actions to the extent possible with due consideration from among other things, return on investment, diversification, and the ERS’ other legal obligations. Failure to respond to the ERS letter may lead to divestment action.

Two highest offender security positions (Glencore Holdings and Reliance Industries Limited) were held in the ERS portfolio at some point in 2013. The Glencore Holdings positions were acquired by two investment managers prior to the securities becoming restricted. Originally, Xstrata, a diversified natural resources company, issued several securities that were held by two ERS investment managers. On May, 2, 2013, Xstrata merged with Glencore, causing the securities to fall within the “scrutinized companies” framework. The violations were first reported to the Investment Committee in May and June, respectively. The full episode was accounted to the ERS Board of Trustees in August 2013. The Reliance Industries position was traded into the ERS portfolio in error and removed from the portfolio shortly after discovery and notification made to the investment manager. The violation was reported to the ERS Board of Trustees informally in January and then at a Board Meeting in February 2013.

The investment managers informed the ERS Chief Investment Officer (CIO) of the suspected violation due to the company merger on May 6 and 17, 2013. The CIO consulted with CRN as early as May 6th, but due to delays did not receive clear guidance until late June. However, the managers were informed of the likelihood of divestiture on June 14, 2013. After consulting with CRN, the ERS general consultant, and the managers, it was determined that the violation was legitimate and required divestment. On July 5, 2013, the ERS CIO instructed the manager to divest of the holdings and to provide summary reports on the episode.

Reliance Industries Limited (“Reliance”) was classified as *scrutinized* company on the CRN report of February 29, 2012. ERS staff discovered the restricted security in the investment manager’s portfolio on January 9, 2013, and immediately informed the manager of the violation. The manager decided to sell the position upon learning of the error and to make the ERS whole for any losses incurred. The trade resulted in a net loss of USD equivalent of \$9,428.93, for which the ERS was reimbursed. Accordingly, no letters were sent to officials at the firm. The ERS investment manager no longer holds Reliance.

Of further note, CRN merged with another group, and rebranded itself the EIRIS Conflict Risk Network. Additionally, while the ERS enjoyed fee waivers to use the service in the past, a new EIRIS policy created an annual subscription fee based on size of the institution and assets under management. ERS staff is taking steps to renew its subscription to the service, but will survey other providers in accordance with procedure before renewing the service.

I All Investment Sold, Redeemed, Divested or Withdrawn

<u>Action</u>	<u>Company Divested</u>	<u>Market Value</u> ¹
Sold: January 9, 2013	Reliance Industries ²	(\$9,428.93)
Sold: July 8, 2013	Glencore/Xstrata	(\$67,682.33)
Sold: July 29, 2013	Glencore/Xstrata	\$6,745.76

¹ Net Market Value in US Dollars at time of divestment

² Security was traded into the ERS portfolio in error on January 8, 2013.

II All Prohibited Investments

Companies held in the 2013 calendar year

Glencore Holdings

Reliance Industries Limited

III Any Progress Made

<u>Company</u>	<u>Status</u>
Glencore Holdings	Two investment managers holding Xstrata issued bonds on the date of the merger with Glencore on May 2, 2013. After consultation with advisers, the managers were directed to divest the holdings in early July 2013. Both managers sold the holdings by the end of July 2013.
Reliance Industries	Investment made in error of policy and guidelines, and was reversed upon notification on January 9, 2013.