EXECUTIVE CHAMBERS

HONOLULU

DAVID Y. IGE
GOVERNOR

January 30, 2015

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

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

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

For your information and consideration, I am transmitting a copy of the Employees' Retirement System report on Direct Holdings in Sudan Scrutinized Companies, as required by section 5 of Act 192, Session Laws of Hawaii 2007. In accordance with section 93-16, Hawaii Revised Statutes, I am also informing you that the report may be viewed electronically at http://ers.ehawaii.gov/resources/reports-to-legislature.

Sincerely,

/s/

DAVID Y. IGE
Governor, State of Hawaii

Enclosure

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII
DIRECT HOLDINGS IN SUDAN SCRUTINIZED COMPANIES
2014

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 (Board) of the Employees' Retirement System (ERS) 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 2014 related to Sudan Scrutinized Companies as outlined in Act 192.

The ERS relied on the *Sudan Company Report* prepared by the EIRIS 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.

The scrutinized company, Caterpillar Inc., was temporarily held in a "transition" account by the ERS for several days in 2014. The security was held in a passive comingled account that the ERS has not direct control. When the security was transferred in-kind to the transition account, the ERS/BNYM compliance immediately flagged the violation. Staff consulted with BNY Mellon (the custodial bank) and Pension Consulting Alliance (the general consultant) on how to respond. As it was determined that the security came from an account not covered by the ERS policy and would only be held temporarily, no action was necessary.

It should be noted that the target manager for the funds also exercises a partial passive strategy that previously held the Caterpillar; however, because the ERS owns the account in a separate account arrangement, in 2012 the ERS required the manager to comply with ERS policy and had it divest of the scrutinized company, thus avoiding the possible violation in 2014.

Of further note, CRN rebranded itself the EIRIS Conflict Risk Network after the two firms merged. 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. The ERS renewed its subscription to the service despite the additional cost.

I All Investment Sold, Redeemed, Divested or Withdrawn

Action	Company Divested	Market Value [1]
Sold: May 28 and 29, 2014	Caterpillar Inc. [2]	($10,819.73)

[1] Net Market Value in US Dollars at time of divestment .

[2] Security was traded into the ERS portfolio as part of a transition rebalancing trade on May 21, 2014.

II All Prohibited Investments

Companies held in the 2014 calendar year
Caterpillar Inc.

III Any Progress Made

Company	Status
Caterpillar Inc.	The scrutinized company was held in a passive strategy that ended up in a temporary transition account through an in-kind transfer of stock, which was intended to be held for a short period of time. The target portfolio for the trade did not receive the stock thus bringing the portfolio holdings into compliance. The trade was passive, temporary, and non-material in nature. It should be noted that passive comingled fund accounts are not covered by ERS policy related to Act 292, and therefore, no action would be required.