

Virginia Retirement System 2012 Fiscal Impact Statement

1. Bill Number: HB386

House of Origin X Introduced Substitute Engrossed
Second House In Committee Substitute Enrolled

2. Patron: Gilbert

3. Committee: Appropriations

4. Title: **Virginia Retirement System; investments related to Iran.**

5. Summary: Virginia Retirement System; investments related to Iran. Requires the Virginia Retirement System, under certain circumstances, to divest of holdings in companies meeting certain criteria gauged to be related to support of the current regime in Iran.

6. Fiscal Impact Estimates: The bill would preclude VRS from investing in at least 158 investments domiciled in U.S., Europe and Asia. At least \$1.8 billion in stocks or about 7.5% percent of the VRS public equity portfolio would be subject to divestment. The transaction costs for selling these scrutinized companies and buying replacements is estimated to be \$14.3 million. VRS is unable to estimate the possible loss in future earnings that could result from a substantially reduced set of investment opportunities.

Note: There are no pre-established screening criteria or industry lists that fully comply with this bill's language (the "complicit" definition is particularly challenging to implement). The development of a customized analysis was not possible within the timelines established for this impact statement's completion, so VRS used a pre-existing list of companies with Iranian ties with exceptions for humanitarian providers. Accordingly, additional companies could meet the parameters set forth in this bill.

The reporting requirements in the bill would require substantial investment staff time that would otherwise be allocated to other investment-related activities.

7. Budget Amendment Necessary: No

8. Fiscal Implications: See "Other Comments" below.

9. Specific Agency or Political Subdivisions Affected: VRS

10. Technical Amendment Necessary: No

11. Other Comments:

The VRS Board of Trustees has a number of concerns about divestment legislation:

Fiduciary/Constitutional Concern – Article 11 of the *Virginia Constitution* sets out an important fiduciary standard that requires VRS trust funds to be “invested and administered solely in the interests of the members and beneficiaries thereof.” Divestment is contrary to this principle as it requires the Board to consider interests other than the sole interest of members. While well intended, the Board opposes divestment legislation as it would create a precedent for the use of VRS trust funds as an instrument of foreign policy for the purpose of influencing the behavior of foreign governments.

Adverse Impact on the Investment Program – The bill would require VRS to sell potentially profitable investments and restrict future investment opportunities. Some of the largest companies from most of the developed economies in the world would be placed off limits to the VRS investment program.

Unintended Consequences – Some of the firms subject to divestment operate in Virginia, pay Virginia taxes, and employ Virginia citizens. Companies such as Canon, Volvo, Ford, General Motors, Toyota, Honda, and Maersk conduct business operations in Virginia and employ Virginia citizens who are subject to Virginia taxation. As such they support the VRS trust fund.

VRS Engagement Policy Has Operated for Two Years

In June 2009, pursuant to a request from the Chairman of the House Appropriations Committee, the Virginia Retirement System’s Board of Trustees adopted an engagement policy for companies doing business in Iran. Under the policy, a company is targeted for scrutiny if it (1) has made an investment of \$20 million or more in Iran’s oil and natural gas sector, (2) actively conducts business activities subject or liable to sanctions under the Iran Sanctions Act of 1996, and (3) has business activities that directly or significantly contribute to the enhancement of Iran’s ability to develop its petroleum resources.

Finally, VRS has modified its proxy voting standards to support well-written shareholder proposals that call for scrutinized companies to terminate business operations in Iran. VRS also instructed its proxy voting service provider to refer all such shareholder proposals to VRS.

Engagement requires VRS to contact each scrutinized company asking officials to: (1) provide more information about its Iran-related activities, (2) explain how it is using its influence with the Iranian government to advocate against objectionable activities, and (3) identify any associated shareholder risks. The policy also requires VRS to annually request external investment managers with exposure to scrutinized companies to articulate their investment case for holding their securities. As long as VRS holds direct investments in securities issued by a scrutinized company valued at one-tenth of one percent of the total fund, VRS will continue engagement activities with the subject company.

Two such companies, Royal Dutch Shell and Petroleo Brasileiro (Petrobras), had holdings exceeding the 0.1 percent total fund threshold. VRS requested that its investment managers holding assets in these two companies make a case for these investments and defend the risks associated with them. The managers contacted by VRS staff were AllianceBernstein, Arrowstreet, BlackRock, T. Rowe Price, and The Boston Company.

VRS staff also contacted Royal Dutch Shell and Petrobras to obtain more information on their ties to Iran. Petrobras responded that it had a service contract with the National Iranian Oil Company (NIOC) to explore in the Persian Gulf. The contract expired in July 2009, and at this time Petrobras has no additional activities or further plans in Iran. Accordingly, engagement with Petrobras was terminated.

Royal Dutch Shell withdrew from its largest project in Iran (South Pars) in July 2008. However, given the time horizon for projects which deliver hydrocarbon resources to customers, Royal Dutch Shell responded that it made sense for international energy companies to prepare a portfolio of possible new energy projects in a variety of different locations and leave the final investment decision on whether to proceed to the last practicable moment. Based on these responses, VRS continued engagement with Royal Dutch Shell.

In fiscal year 2011 VRS performed its screening criteria again for scrutinized companies exceeding the 0.1 percent total fund threshold. As before, Royal Dutch Shell was selected for engagement. Again VRS requested that its investment managers holding assets in the company make a case defending its holdings and justifying the risks associated with them. The managers contacted by VRS staff were Acadian, AllianceBernstein, Arrowstreet, and BlackRock.

VRS staff also contacted Royal Dutch Shell directly to obtain more information on its ties to Iran. Officials from Royal Dutch Shell responded that the company had ceased all sanctionable activities as defined under the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA). VRS also received a letter from the Deputy Secretary of State confirming Shell's actions. Accordingly VRS no longer considers Royal Dutch Shell to be subject to its Iran Engagement Policy.

Date: 1/26/2012

Document: HB386.DOC

Company Name	Market Value As Of 1/20/12
ABB LTD-REG	15,690,761
AFG ARBONIA-FORSTER HOLD-REG	1,521,211
AIR FRANCE-KLM	187,660
AIR LIQUIDE SA	10,482,940
AISIN SEIKI CO LTD	6,700,309
AKER SOLUTIONS ASA	425,348
ALCATEL-LUCENT	1,376,884
ALLIANZ SE-REG	36,276,379
ALSTOM	1,676,275
AP MOELLER-MAERSK A/S-A	935,514
AP MOELLER-MAERSK A/S-B	2,606,794
ARCELORMITTAL	4,892,056
ATLAS COPCO AB-A SHS	7,217,646
ATLAS COPCO AB-B SHS	6,710,963
BANCO BILBAO VIZCAYA ARGENTA	10,354,852
BANCO DE SABADELL SA	894,416
BASF SE	32,066,461
BNP PARIBAS	19,508,909
BP PLC	43,844,796
CAMERON INTERNATIONAL CORP	262,822
CANON INC	17,494,458
CARLSBERG AS-B	4,572,373
CASIO COMPUTER CO LTD	303,412

CHINA PETROLEUM & CHEM-ADR	3,091,354
CHINA PETROLEUM & CHEMICAL-H	23,202,148
CHIYODA CORP	371,345
CNOOC LTD	23,851,992
COMMERZBANK AG	1,910,651
COMPASS GROUP PLC	15,654,739
CONTINENTAL AG	5,143,544
CORE LABORATORIES N.V.	4,281,970
COSMO OIL COMPANY LTD	3,053,302
CREDIT AGRICOLE SA	5,894,739
CUMMINS INC	3,666,957
DAIMLER AG-REGISTERED SHARES	15,140,887
DEUTSCHE BANK AG-REGISTERED	18,366,212
DEUTSCHE LUFTHANSA-REG	7,685,238
DEUTSCHE POST AG-REG	7,937,082
DEVRO PLC	636,832
E.ON AG	29,712,927
EADS NV	2,874,684
ENI SPA	40,044,255
ERICSSON LM-B SHS	6,549,687
ESSAR ENERGY PLC	145,218
FIAT SPA	6,422,926
FINMECCANICA SPA	928,222
FISCHER (GEORG)-REG	2,102,963
FLOWERVE CORP	120,645

FORBO HOLDING AG-REG	1,249,578
FORD MOTOR CO	4,997,009
GAZPROM OAO-SPON ADR	89,069,005
GDF SUEZ	11,399,033
GEA GROUP AG	1,262,877
GENERAL MOTORS CO	17,171,659
GIVAUDAN-REG	1,664,037
HEINEKEN NV	2,550,910
HENKEL AG & CO KGAA	2,174,158
HENKEL AG & CO KGAA VORZUG	6,125,042
HOLCIM LTD-REG	3,061,233
HONDA MOTOR CO LTD	17,283,256
HSBC HOLDINGS PLC	55,987,135
HYUNDAI ENGINEERING & CONST	8,046,522
ING GROEP NV-CVA	33,858,277
INGERSOLL-RAND PLC	8,969,165
INTESA SANPAOLO	6,843,246
INTESA SANPAOLO-RSP	1,232,683
ITOCHU CORP	17,939,331
JAPAN PETROLEUM EXPLORATION	502,690
JAPAN TOBACCO INC	37,991,112
JGC CORP	1,155,487
KANEMATSU CORP	498,272
KAWASAKI HEAVY INDUSTRIES	869,305
KEPPEL CORP LTD	3,564,272

KIA MOTORS CORPORATION	21,033,859
LG ELECTRONICS INC	13,749,769
LYONDELLBASELL INDU-CL A	42,003,341
MAN SE	3,331,106
MARUBENI CORP	7,658,535
MAZDA MOTOR CORP	709,829
MEDIOBANCA SPA	703,490
MITSUBISHI MOTORS CORP	967,255
MITSUBISHI UFJ FINANCIAL GRO	17,827,036
mitsui & co ltd	8,212,007
mitsui engineer & shipbuild	263,312
NEC CORP	1,184,204
NIPPON SHEET GLASS CO LTD	387,172
NISSAN MOTOR CO LTD	27,282,298
NOKIA CORP-SPON ADR	(1,118,910)
NOKIA OYJ	15,168,549
NORDEA BANK AB	8,977,871
OIL & NATURAL GAS CORP LTD	2,781,032
OMV AG	6,887,669
PANASONIC CORP	4,017,573
PETROCHINA CO LTD -ADR	4,971,878
PETROCHINA CO LTD-H	27,519,602
PETROFAC LTD	4,046,711
PETROLEO BRASILEIRO S.A.-ADR	62,226,582
PETROLEO BRASILEIRO-SPON ADR	64,840,128

PEUGEOT SA	7,577,996
POLSKIE GORNICTWO NAFTOWE I	701,458
POSCO	10,945,591
POSCO-ADR	1,064,334
POSTNL NV	318,562
PROTON HOLDINGS BHD	831,115
RENAULT SA	22,125,602
REPSOL YPF SA	27,707,345
REPSOL YPF SA -SPONSORED ADR	2,909,171
ROLAND CORP	477,143
ROYAL DUTCH SHELL PLC-A SHS	54,541,452
ROYAL DUTCH SHELL PLC-B SHS	35,348,200
SAIPEM SPA	4,510,782
SAMSUNG ELECTRONICS CO LTD	132,965,233
SANDEN CORP	444,281
SASOL LTD	6,638,371
SASOL LTD-SPONSORED ADR	3,217,177
SCANIA AB-B SHS	1,809,294
SCHLUMBERGER LTD	34,154,459
SCHNEIDER ELECTRIC SA	17,515,672
SGS SA-REG	2,949,357
SHIMANO INC	1,400,088
SIEMENS AG-REG	36,290,625
SINOPEC SHANGHAI PETROCHEM-H	654,593
SKF AB-B SHARES	1,924,829

SNAM SPA	5,416,326
SNC-LAVALIN GROUP INC	1,708,590
SOJITZ CORP	6,928,273
STATOIL ASA	12,999,311
STATOIL FUEL & RETAIL AS	771,444
STRAUMANN HOLDING AG-REG	832,823
STRYKER CORP	2,887,826
SULZER AG-REG	632,307
SUMITOMO CORP	9,771,390
SUMITOMO MITSUI FINANCIAL GR	20,971,180
SUNPOWER CORP	88,576
SUZUKI MOTOR CORP	1,517,646
SYNGENTA AG-REG	9,431,342
TATA STEEL LTD	6,932,344
TECHNIP SA	8,492,341
THALES SA	699,546
THYSSENKRUPP AG	1,992,608
TOTAL SA	73,796,983
TOTAL SA-SPON ADR	5,537,351
TOYOTA MOTOR CORP	30,158,996
TUPRAS-TURKIYE PETROL RAFINE	684,459
UNICREDIT SPA	33,818,601
UNILEVER NV-CVA	17,690,234
UTI WORLDWIDE INC	2,428,850
VALEO SA	17,753,571

VESTAS WIND SYSTEMS A/S	499,013
VOLKSWAGEN AG	1,670,091
VOLKSWAGEN AG-PFD	16,276,436
VOLVO AB-B SHS	7,212,217
WARTSILA OYJ ABP	4,067,533
WEATHERFORD INTL LTD	4,191,444
WEIR GROUP PLC/THE	2,271,168
WELSPUN CORP LTD	98,626
XEROX CORP	244,667
YAMAHA CORP	372,398