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BOARD OF INVESTMENT

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TO: Members, State Board of Investment
Governor Rudy Perpich
State Auditor Arne H. Carlson
State Treasurer Robert W. Mattson
Secretary of State Joan Anderson Growe
Attorney General Hubert H. Humphrey III

FROM: Members, South Africa Task Force

Jay Kiedrowski Commissioner of Finance	Governor's Representative
Fred Krohn Deputy State Auditor	State Auditor's Representative
Michael Lucas Senior Vice President Norwest Bank	Private Sector Representative
Mike Miles Assistant Attorney General	Attorney General's Representative
Rick Scott AFSME	Public Employee Representative
Harvey Schmidt Teachers Retirement Assoc.	Retirement Fund Representative
Representative Randy Staten MN House of Representatives	State Treasurer's Representative
Elaine Voss Deputy Secretary of State	Secretary of State's Representative

SUBJECT: SBI policy on companies that do business in South Africa.

The State Board of Investment South Africa Task Force held three meetings from September 20 to September 27, 1985 to review the Board's policy on companies that do business in South Africa. The Committee discussed six alternatives available to the Board, and reviewed the pertinent available data on the financial, legal, and social impact of the proposed courses of action. The alternatives examined by the Committee were:

1. The immediate sale of securities of all companies doing business in South Africa.

2. The sale of all companies that do business in South Africa over a set time period (e.g., 6 months to 3 years).

3. The sale of companies that do not meet specific Board-established criteria governing corporate conduct in South Africa.

4. No future investment in securities of all companies doing business in South Africa.

5. Initiation of shareholder resolutions by the State Board of Investment to affect changes in the policies of companies doing business in South Africa.

6. A phased-in plan to sell the securities of companies whose corporate behavior in South Africa does not meet the standards established by the State Board of Investment. This phased divestiture would be combined with Board-sponsored resolutions to effect change in corporate policies before impending divestiture action.

7. No change in current policy.

After considerable discussion, the Task Force focused its attention on three policy alternatives: 1) Board initation of shareholder resolutions at corporate annual meetings; 2) no future investments in any company doing business in South Africa; and 3) phased divestiture combined with shareholder resolutions.

Initiate Shareholder Resolutions

The Board would become a sponsor of shareholder resolutions at corporate annual meetings to affect changes in corporate policies in South Africa.

PROS

- On-going pressure on corporations to positively change their policies
- Provides a forum for the Board to express its views
- Is timely for upcoming proxy season
- Has no negative impact on investment performance

CONS

- Political message not as strong as total divestiture
- Will take time to affect change

No future investment in companies that do business in South Africa

The Task Force also discussed at length the proposal that the Board not make any future investment in any company that does business in South Africa. This proposal would not entail the divestiture of any securities, but would prohibit the purchase or, once sold, repurchase of securities in companies doing business in South Africa.

PROS

- makes a political statement
- eliminates high one time transaction costs associated with total divestiture (estimates range from $33 million to $132 million)
- delays total financial impact on the portfolio

CONS

- increases portfolio volatility
- decreased investment flexibility
- increases on-going portfolio costs as the companies owned by the fund become smaller and less liquid
- potentialy violates the Board's fiduciary obligations resulting in possible lawsuits against the Board

Phased Divestiture/Shareholder Resolutions

The Task Force focused most of its discussion on the resolution adopted by trustees of the New York City Employees Retirement System (NYCERS) in August, 1984. Under the resolution, unless companies take certain actions to combat apartheid, NYCERS will divest all holdings in companies that do business in South Africa or Namibia and banks that lend to the South African government over a five-year period. Divestiture will be carried out in the following four phases:

-- Phase One, to be completed within 15 months, will cover equity securities of those businesses that operate in a manner that either directly supports apartheid, or are not signatories of the Sullivan principles or a comparable corporate policy. A company will be considered to be directly supporting apartheid if it provides goods or services to the South African military and police, provides technology such as energy producing plants that make South Africa less dependent on international trade, or provides financial services to the government.

-- Phase Two, to be completed within two years, will cover companies that have signed the Sullivan principles but do not report on their progress to the monitoring firm of Arthur D. Little Inc. or another independent monitoring organization satisfactory to the trustees.

-- Phase Three, to be completed within three years, will affect companies that do not receive a performance rating in the top category of Sullivan signatories or an equivalent.

-- Phase Four, to be completed within five years, will apply to all other companies with operations in South Africa.

The proposed sale of any security under this policy will be reviewed and a recommendation made by independent financial and legal counsel to assure that the Board is meeting its fiduciary obligations. Under NYCERS resolution, the retirement system has become an active initiator of shareholder resolutions to encourage companies to improve their corporate policies in South Africa.

The Task Force concurred that the following amendments should be offered to the New York Program if adopted in Minnesota:

- The appointment of an on-going Task Force to oversee the implementation of the plan;
- the retention of a consultant to assist the Task Force and staff in sponsoring shareholder resolutions;
- the retention of financial counsel to review any divestment activity considered by the Board to determine whether it fulfills the Board's fiduciary obligations; and
- the review by legal counsel of any divestment activity considered by the Board to determine whether it fulfills the Board's fiduciary obligations.

<u>PROS</u>

- on-going pressure on corporations
- potentially results in positive change in corporate policies
- financial impact on the pension fund is reviewed at each phase to ensure that the Board is fulfilling its fiduciary obligations
- provides a forum for the Board to express its views
- has the strong political message without the sizable financial costs associated with total divestment

<u>CONS</u>

- political message is not as strong as immediate divestment
- because divestment is likely to occur, it still generates costs to the pension funds
- will take time to affect change
- divestiture will have been completed within 5 years

Any of the three proposals will involve additional budgetary expense and considerable staff time.

Summary

Although the Task Force chose not to adopt formally one of the three alternatives, a majority of members expressed support of the phased divestiture/shareholder resolution proposal over the other options.