

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

Item Number: **7**

SUBJECT: Assault Weapons Engagement Plan

CONSENT: _____

ATTACHMENT(S): 4

ACTION: X

DATE OF MEETING: May 9, 2018 / 45 mins.

INFORMATION: _____

PRESENTER: Christopher Ailman

POLICY

[Engagement](#) and the corporate governance work plan fall under the [Corporate Governance \(CG\) Policy](#) and the [Corporate Governance Principles](#). The Corporate Governance policy, like all of the CalSTRS investment portfolios, is governed by the [CalSTRS Investment Policy and Management Plan](#) (IPMP) Teachers' Retirement Board Policy Manual, Section 1000, page A-1.

HISTORY OF THE ITEM

Following the shooting at Sandy Hook Elementary School in 2013, the CalSTRS Investment Committee invoked its [Divestment Policy](#) and voted unanimously to [divest of all firearm manufacturers](#) that manufacture weapons for sale to the public which are illegal in the State of California, such as the assault-type weapons used in the Sandy Hook shooting. CalSTRS sold all publicly traded companies that met this criterion and was able to exit from its exposure in a private partnership. On an ongoing basis, CalSTRS staff monitors publicly traded companies and will divest from companies that meet this criteria. For new private partnerships, provisions are included within the contract that excludes firearm companies from purchase subject to the divestment criteria.

After the September 2017 Las Vegas shooting, [State Treasurer John Chiang wrote a letter](#) to the Chair of the Investment Committee urging [CalSTRS to divest](#) from retailers of assault weapons and 'bump stocks'. At the February 2018 Investment Committee meeting, the Chair, with the assent of the Committee, directed staff to place an item on the May agenda regarding retailers and manufacturers of assault-type weapons.

PURPOSE

The purpose of this agenda item is to discuss:

1. Engagement of [Assault-type weapon](#) retailers and manufacturers within the 2018 Corporate Governance work plan and assign a priority, in addition to evaluating resource needs to the effort and reporting requirements;
2. Utilize the enormous social awareness around this issue to create a customized public engagement strategy.
3. Lastly, initiating the Divestment policy if engagement fails to achieve an acceptable outcome.

BACKGROUND

CalSTRS has a long history, dating back to the 1970's, of considering the investment risk from material, environmental and social risks. The Investment Committee developed an [Environmental, Social, and Governance - 21-Risk Factor Policy](#), in the IPMP in July 2008.

In 2017, the Investment Committee adopted an [Investment Belief statement](#), number 7.

Responsible corporate governance, including the management of environmental, social and governance (ESG) factors, can benefit long-term investors like CalSTRS.

CalSTRS believes that, in addition to traditional financial metrics, timely consideration of material environmental, social, and governance (ESG), factors in the investment process for every asset class, has the potential, over the long-term, to positively impact investment returns and help to better manage risks.

Proxy rights attached to shareholder interests in public companies are additional “plan assets” of the system. As a largely long-term investor, CalSTRS can enhance the value of its plan assets by taking a leadership role by voting proxies.

As stated in the Belief, CalSTRS believes it can better manage our investment risks by consideration of material ESG factors and can enhance the value of the Fund by taking a leadership role in voting proxies and direct engagement with companies.

DISCUSSION

After the February Investment Committee meeting discussion on firearms retailers, the Chair and Vice-Chair of the Investment Committee, following up on direction of the Committee, consulted with the general investment consultants and staff regarding the investment and legal risks to the CalSTRS portfolio of owning assault-type weapon manufacturers and retailers. This agenda item provides the research gathered by staff on these companies and suggests an engagement action plan to address risks to the Fund.

Since the February discussion, a shooting occurred at the Marjory Stoneman Douglas High School in Florida, further escalating the risk. Subsequently, both institutional and retail investors across the country have begun factoring in the reputational and investment risk of assault-type weapons exposure in their portfolios. BlackRock, the world's largest money manager, issued a [press release](#) outlining their decision to approach and engage companies that manufacture and distribute firearms.

Highlighting the reputational risks to shareholders are actions by citizens and students across the country who are mounting a growing wave of social attention and pressure on the issue of firearms. As one example, on March 14, 2018, students and teachers across the USA participated in a national walkout to protest gun violence and demand school safety.

In response to this powerful social pressure, numerous retailers announced significant changes to the inventory and sale of firearms, specifically assault rifles. Most firms announced they would stop selling ‘assault-type rifles’ and raise the purchase age to 21 years. While many of the major retailers all quickly made these changes, some of the hunting and fishing specialty stores have been slow to respond or even silent on the subject.

Attachment 1 is the list of the retailers in the CalSTRS investment portfolio that sold firearms prior to February 2018. (Please note that this list is broad and not specific to assault weapons, as the industry definition is unclear. With the 2013 divestment, CalSTRS chose to define firearms by those illegal in the State of California.) Also listed are any subsequent changes with regards to whether the firm changed any of its firearm sales policies. It should be noted that in many cases, firearms comprise a very small percentage of the company’s annual sales. In other cases, the retailers have multiple store lines that may or may not include hunting and fishing specialty stores who sell firearms. MSCI [Investor Responses to Gun Violence in the U.S.](#) has information on firearm manufacturers and retailers while Attachment 4 provides an Executive Summary.

At the November 2017 Investment Committee meeting, the Committee adopted the 2018 Corporate Governance Engagement Plan. Based on recent events and the increased material risks to the Fund, the Chair and Vice-Chair of the Investment Committee requested an updated engagement plan to include companies that sell assault-type weapons.

Unlike other CalSTRS engagements, where staff generally prefers a quiet engagement approach, this engagement may be more effective with a customized public engagement strategy. To date, the element of social pressure has proven far more effective, as evidenced by the companies’ responses to the social attention. Therefore, in addition to our usual engagement strategies, staff proposes an engagement to leverage that wave and develop a public communication plan to highlight areas of firearm concern and applaud responsive companies. The Investment Branch will work with CalSTRS Communications staff to develop a comprehensive plan. In addition, Investment staff will work with other institutional investors to engage with companies on this issue.

Staff estimates that additional resources, including two new positions, will be required to implement this engagement effort. The estimated additional cost of an engagement staff is approximately \$160,000 per year. Consistent with Board’s statutory authority, this specific position can be established and funded within the Corporate Governance Continuous Appropriation. To assist in this public engagement effort, an additional position will be required within our Communications division costing approximately \$120,000 per year. Positions within the Communications division are funded through the Support Appropriation and, if approved, would be filled through diversion of an existing vacancy or an administratively established position. Given the direct linkage of the Communications position to the engagement effort, staff is researching whether or not the Support Appropriation is the correct funding source of this activity. Based on the findings of this research, staff may recommend an alternative funding source.

Given the higher profile nature of this engagement effort, regular reports will be added to the Investment Committee agenda. Additionally, timely updates on the status of engagements will be sent to the Investment Committee. The first report would be added to the September Investment Committee agenda.

Lastly, as identified in the [Divestment Policy](#), only after all the engagement tools are exhausted and there remains risks, then staff would return to the Investment Committee with a

recommendation to consider divestment as a means to mitigate the risks consistent with their fiduciary duty.

RECOMMENDATION

The Chair and Vice Chair, with the support of the Investment Consultants and staff, recommend the Investment Committee consider the following:

- 1) Revise the 2018 Corporate Governance Engagement Plan to add engagement of companies that manufacture and sell firearms illegal in the State of California and place it as the top priority.
- 2) Develop and execute a communication plan to make this engagement public.
- 3) Through the continuous appropriations, authorize the creation of an additional position to Corporate Governance to lead the engagement and approve an appropriated budgeted position for Communications to support the public engagement strategy.
- 4) Direct staff to report back to the Investment Committee the progress on the engagement and provide timely updates on the status and effectiveness of the engagements.
- 5) As part of the engagement, if staff feels a company is not making an adequate effort to engage or being responsive to CalSTRS requests, the Investment Committee encourages staff to vote against the entire Board of Directors. Upon consultation with the Investment Committee, staff may utilize all governance and communication tools to reinforce active engagement.
- 6) In accordance with the Divestment Policy, if staff believes the engagement efforts are unsuccessful, the staff will report and the Investment Committee may consider divestment or customized indices that exclude retailers who sell firearms illegal in the State of California and/or bump stocks.

ATTACHMENTS/POWERPOINT

Attachment 1 – Engagement List – retailers and manufactures of firearms illegal in the State of California

Attachment 2 – PCA Memo

Attachment 3 – STO letter dated October 6, 2017

Attachment 4 – MSCI Executive Summary: Investor Responses to Gun Violence

PowerPoint – None

Name	Description	Location	Sells Bump Stocks	Stopped Selling Assault Rifles	Raised Age Limit	CalSTRS Exposure
Walmart Inc.	Multi-line retailers including Grocery Stores. Large general merchandise stores having Sporting Goods section selling firearms.	Bentonville, AR Over 5000 Stores across the USA in different brand names.	No	Yes	Yes	\$320 million (70% passively held) \$24 million in Bonds
The Kroger Company	Predominately a line of grocery stores, including Ralphs in southern California. Also includes Fred Meyers, a multi-line retailer. Sells guns at 43 of the 133 Fred Meyers, in Alaska, Idaho, Oregon and Washington.	Cincinnati, OH 3,838 stores across the USA in different brand names.	No	Yes ¹	Yes	\$52 million (75% passively held) \$18 million in Bonds
Wal-Mart de Mexico SAB de CV	Wal-Mart de Mexico is a multi-line retailer including Grocery Stores across Mexico. The company sells sports rifles and pistols for sport hunting purposes in a limited number of stores. These firearms are neither automatic nor exceeding 0.22 caliber. The company has reported to CalSTRS that they are "disappearing the department as part of a company decision."	Mexico City, Mexico 845 stores across Mexico.	No	Yes ²	ND ³	\$44 million

¹ Reports the company is going to "responsibly phase out sales of firearms and ammunition."

² Assault rifles cannot be sold by law in the jurisdictions in which the company operates. Furthermore, the company is phasing out the sale of guns and ammunition.

³ The Company operates in Mexico. Staff has not determined legal age requirements in the country or engaged the company on gun sale procedures.

Name	Description	Location	Sells Bump Stocks	Stopped Selling Assault Rifles	Raised Age Limit	CalSTRS Exposure
Dick's Sporting Goods, Inc.	Dick's Sporting Goods retails semi-automatic rifles, shotguns, and ammunition for hunting and target shooting. The company quit selling assault rifles in their Dick's branded stores in 2005, but continued to retail them in their Field and Stream stores until 2018.	Pittsburgh, PA 845 Stores across the USA in different brand names.	No	Yes	Yes	\$4 million (87% passively held)
XXL ASA	XXL ASA is a Scandinavian sporting goods retailer. They retail rifles and ammunition for hunting.	Oslo, Norway 75 Stores across Scandinavia.	No	ND ⁴	ND ⁵	\$2 million
Academy Ltd.	Academy Limited retails firearms including assault rifles in their Academy Sports + Outdoor stores.	Katy, TX 290 Stores across the South East USA	No	No	No	\$1 million in Bonds
Big 5 Sporting Goods Corp.	Big 5 is a sporting goods retailer. The company sells semi-automatic shotguns, rifles, and ammunition for hunting. The company stopped selling assault rifles in 2016.	San Diego, CA 435 Stores across the West and Midwest USA	No	Yes	No	\$579 thousand (43% passively held)
Sportsman's Warehouse Holdings, Inc.	Sportsman's Warehouse retails semi-automatic rifles, shotguns and ammunition for hunting and target shooting.	Salt Lake City, UT 87 stores across the West and southeastern USA.	No	No	No	\$377 thousand (100% passively held)

ND = Not Determined

⁴ The Company operates in Scandinavian countries with strict gun laws. Staff has not engaged the company on what firearms are permitted in various jurisdictions, and whether or not the company sells them. However, the company website does not list assault rifles as available products.

⁵ The Company operates in Scandinavian countries. Staff has not determined legal age requirements in the countries in which the company operates, or engaged the company on gun sale procedures.

Date: April 12, 2018

To: CalSTRS Investment Committee

From: Allan Emkin and Sarah Bernstein – Pension Consulting Alliance, LLC (PCA)

RE: PCA Opinion: CalSTRS Assault Weapons Engagement Plan

Opinion: In PCA's opinion, CalSTRS' proposed Assault Weapons Engagement Plan offers a timely approach to CalSTRS' potential material reputational and investment risks associated with its exposure to assault-type weapons producers and retailers. In general, we believe CalSTRS' approach to this issue should be consistent with CalSTRS' overall corporate governance and divestment policy, which emphasizes engagement and calls for all engagement options to be used prior to any divestment. We believe the proposed public engagement approach offers potentially more timely results than CalSTRS' traditional engagement process and is superior to divestment of assault-type weapons retailers.

Background: There is widespread evidence that the easy availability of assault weapons in the U.S. compared to other countries, contributes significantly to the epidemic of gun violence and mass shootings with automatic weapons in the United States today. The escalation in shootings during the few last years and consequent growing social protests against gun violence across the country by students, teachers, and citizens have materially increased the reputational and investment risks to shareholders of producers and retailers of assault-type weapons.

CalSTRS' divestment from manufacturers of all firearms that are illegal for sale or possession by the public in the State of California, following the 2013 massacre at Sandy Hook Elementary school, continues as an actively managed exclusion policy. In our opinion, the CalSTRS Assault Weapons Engagement Plan, as a complement to the firearm producer exclusion policy, has the potential to have a greater impact on reducing CalSTRS' reputational and investment risks of exposure to current assault-type gun retailers and greater potential to contribute to the reduction in the sales of assault-type weapons in the U.S. than CalSTRS' traditional engagement approach or divestment of gun retailers.

Two key aspects of this issue highlight the potential benefits of the more public engagement approach to gun violence. First, unlike a quiet engagement approach, or divestment, the proposed public engagement can more effectively leverage, and support, today's broad social movement and awareness of gun violence issues. The public outcry has successfully propelled some retailers to adopt more restrictive gun sales policies than current federal law requires. Some retailers have increased the age limit to purchase a gun to 21, even though that age is not at this point required by federal law, and some have quit selling assault-type weapons due to the extensive public discontent. Second, several of the largest gun sellers are large cap retailers for whom firearms sales represent a very small percent of total sales for the companies. For example, the two companies in which CalSTRS has the largest investment exposure, and therefore the largest investment risk, are Walmart and The Kroger Company. Walmart is one of the largest gun sellers; however, Walmart's total revenues from all firearms account for approximately 0.99% of total Walmart revenues. Similarly, the Kroger Company's gun sales account for only 0.1% of total revenues. In our opinion, such household names for non-gun sales exemplify, in today's climate, the value of a more public engagement process on this issue. As noted in Item 7, Appendix I, The Kroger Company now reports that the company is going to "responsibly phase out sales of firearms and ammunition," and both companies have already raised the age limit for gun purchases.

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JOHN CHIANG
TREASURER
STATE OF CALIFORNIA

October 6, 2017

Mr. Harry Keiley
Chair, Investment Committee
Teachers' Retirement Board
California State Teachers' Retirement System
100 Waterfront Place
West Sacramento, CA 95605

Dear Mr. Keiley:

Most Americans are shocked and deeply saddened by the massacre that killed at least 58 concert goers and injured hundreds of others in Las Vegas. But shock and sympathy provide little consolation to the families who must now bury a child, a sibling, a spouse, or a loved one. Let us leave our platitudes and rituals of grief at the door and focus on what can be done to deny weapons of mass carnage to the next loon.

In 2013, this board responsibly reacted to the shootings at Sandy Hook Elementary School by divesting from companies that manufacture firearms and ammunition that are illegal for sale or possession in California. While it was a complicated, two-year divestment process that left me and the nearly 880,000 teachers served by the California State Teachers' Retirement System sometimes frustrated by its sluggish pace, we emerged from 2015 free of any investment holdings in companies that manufacture banned firearms and ammunition.

Today, I urge you to go further.

I respectfully call upon this board to refrain from allocating even a penny of our \$213 billion in investable assets to the benefit of wholesale or retail sellers of these banned weapons. Neither taxpayer funds nor the pension contributions of any public school educator – such as the three California teachers slain in Las Vegas – should be invested in the purveyors of banned military-style assault weapons.

I also strongly believe CalSTRS should not have any investments – direct or indirect – in any company which manufactures or sells bump stocks, slide-fire devices, and other accessories that can accelerate a semi-automatic rifle's rate of fire. These relatively easy-to-buy and inexpensive aftermarket products allow semi-automatic weapons to simulate automatic fire. A

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Harry Keiley
October 6, 2017
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rifle that may normally fire at a rate of 45 to 60 rounds per minute can be altered to release a torrent of devastation at 400 to 800 rounds per minute.

The deadly efficiency of these senseless products was on display this past Monday as 58 were killed and more than 500 wounded in the span of ten minutes. According to the Bureau of Alcohol, Tobacco and Firearms, twelve bump-fire stocks were found on weapons recovered from the murderer's hotel room.

This issue is of enduring importance to me. It would be recklessly inconsistent for anyone who supports California's assault weapons ban to believe that investing in companies making or selling these weapons or ancillary devices ensures teachers' retirement security.

Divestment in such companies would be faithful to CalSTRS' existing investment policy and uphold the Board's fiduciary duty to the pension system's members. Current policy requires us to view our investment decisions through a number of prisms, one of which is risk of investing in companies making products detrimental to public health and safety. It would be difficult to argue that battlefield assault weapons and aftermarket accessories which are designed to rain down bullets do not fall into this category.

I am eager to discuss this with CalSTRS staff and my colleagues on the Board. So that we can have an informed discussion, I respectfully ask you to assign staff to develop a comprehensive accounting of CalSTRS' exposure to companies which manufacture or sell the products mentioned in this letter.

Should you have any questions or concerns, please contact me or Deputy Treasurer Jeree Glasser-Hedrick.

Sincerely,



JOHN CHIANG
California State Treasurer

cc: Members, CalSTRS Investment Committee
Jack Ehnes, CEO, CalSTRS
Christopher Ailman, CIO, CalSTRS



EXECUTIVE SUMMARY: **INVESTOR RESPONSES TO GUN VIOLENCE**

MARCH 2018

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INV37



EXECUTIVE SUMMARY: INVESTOR RESPONSES TO GUN VIOLENCE

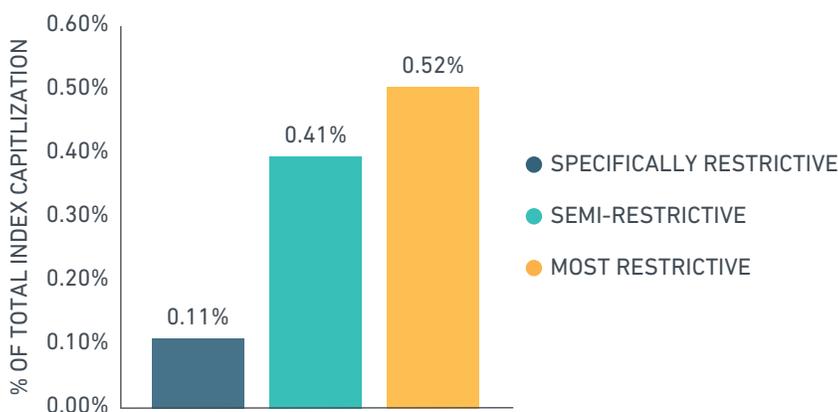
Gun control has long been a contentious issue in American political discourse, repeatedly brought back to the fore in the aftermath of mass shootings. Recent mass shooting events have led to the United States gun industry facing increased pressure. This new wave of activism is targeting both the manufacturers and retailers of firearms as well financial institutions that invest in or help to fund these companies' operations.

FIREARMS IN THE U.S.

The number of firearms manufactured in the United States has grown almost three-fold over the ten year period ending in 2016. ¹ During this period, MSCI ESG Research has continued to track publically traded companies worldwide that are involved in the production of firearms, as well as gun retailers. In addition to keeping clients abreast of the latest issues and developments, MSCI ESG Research provides data and tools to support investors who wish to identify gun makers and related companies, whether for the purpose of divestment or engagement.

The largest publicly traded US firearms makers have a market value of less than a billion dollars and are classified as "small cap" companies. Overall, 0.52% of the MSCI ACWI Index (as of February 1, 2018) would be screened out by an investor with the most restrictive screen, the vast majority of which would be firearm retailers .

PERCENT ALLOCATION OF MSCI ACWI INDEX BY SCREENING STRATEGY



Source: MSCI ESG Research as of February 1, 2018

INVESTMENT IMPLICATIONS AND OPTIONS:

- Of the 28,000 mutual funds and ETFs in the MSCI ESG Fund Metrics universe, 23.6% had exposure to companies with ties to civilian firearms (including the retail of firearms), while 11.1% had exposure specifically to gun manufacturers.
- Institutional investors may choose to set an investment policy that calls for an engagement approach, a divestment approach, or a combination of the two. Manufacturers are frequently the target of divestment, while investors may more often choose to engage retailers.
- The impact of firearms divestment on an investable universe is relatively limited due to the number and size of the companies involved: as of February 1, 2018, companies with a tie to civilian firearms accounted for only 0.52% of the MSCI ACWI Index by weight.

MSCI ESG Research’s Civilian Firearms screening factors are specifically designed to allow a high degree of flexibility and customization to meet a variety of screening demands. The intention of the Civilian Firearms category is to identify companies that manufacture handguns, pistols, shotguns, rifles, revolvers, and ammunition for civilian (non-military) use. The data extends to cover the percentage of annual revenues derived from this activity and profile notes

outlining a given company’s involvement. MSCI ESG Research also identifies company involvement in the retail or wholesale distribution of civilian firearms, and takes a further step, aiming to capture companies with a majority ownership stake in or a majority owned subsidiary of a company included in the underlying categories. Clients can set thresholds in accordance with their specific policy and access a list of companies that violate their customized definition.

DEFINING THE STRATEGY

To define a divestment approach, there are two key questions investors typically consider:

1. What type of involvement should be restricted? Should it be only makers of specific types of firearms, such as semi-automatic weapons, all firearms manufacturers, or should it extend to retailers? Should companies with a minority equity stake in an involved company be prohibited?

2. Should the restriction be absolute, or should it include minimum revenue criteria? Some investors choose, for example, to exclude all gun manufacturers while excluding retailers only if their firearms related revenue exceeds a set minimum.

TAXONOMY OF RESTRICTIONS

MOST RESTRICTIVE

ANY TIE

SEMI-RESTRICTIVE

CIVILIAN
FIREARMS
PRODUCER

RETAILERS

SPECIFICALLY RESTRICTIVE

AUTOMATIC
FIREARMS

SEMI-
AUTOMATIC
FIREARMS

AMMUNITION

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¹ Based on latest P&I AUM data and MSCI clients as of Sept, 2017

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