





RETIREMENT BOARD CALENDAR SHEET
Retirement Board Meeting of September 14, 2016

Date: September 14, 2016

To: Retirement Board

Through: Jay Huish 
Executive Director

From: Robert L. Shaw, CFA 
Managing Director, Public Markets

Subject: Consideration of Divestment of Firearms and Ammunitions Manufacturing Companies and Retailers under the SFERS Social Investment Policies and Procedures

Background:

On June 28, 2016, the San Francisco Board of Supervisors passed the attached resolution urging SFERS and the Retirement Board to divest from its holdings in firearm and ammunition manufacturing companies (Exhibit A). The Board of Supervisors passed a similar resolution in early 2013 following the shooting massacre at Sandy Hook Elementary School in Newtown, Connecticut in December 2012. The Retirement Board considered divestment from firearms and ammunitions manufacturing firms at its March 13, 2013 Board meeting; however, no action was taken by the Retirement Board at that time. For the Retirement Board's consideration, staff is providing information related to the business and investment risk posed by firearms and ammunitions manufacturers against the attached SFERS Social Investment Policy and Procedures (Exhibit B).

At its July 13, 2016 meeting, the Retirement Board continued this item to the September 14, 2016 Retirement Board meeting.

Business Risk:

Investments in firearms and ammunitions put SFERS' portfolio at greater risk than comparable investments in companies whose products do not pose such a threat to public health and safety. The firms that make these firearms and ammunitions are subject to considerable litigation and regulatory risk. The growing support for stricter gun control laws makes this risk more than mere speculation. Additionally, while certain firearms may be legal, they have the ability to cause significant social harm as was evidenced by the tragic events at Dallas Texas, Orlando Florida, Charleston South Carolina, Newtown Connecticut, Aurora Colorado, and Tucson Arizona.

From 2002 through 2014, gun-related deaths in the United States, including homicides, suicides and unintentional or undetermined cause deaths have averaged over 30,000 per year, with a total of 33,599 gun deaths reported in the United States in 2014.¹

Federal law requires a license for firearms manufacturing and as of 2014 there were approximately 10,000 (a near 2x increase from the 5,400 reported in 2011). Using the most recent data (2014), domestic firms produced 9.1 million small arms - including handguns (4.4 million), rifles (3.4 million) and shotguns (0.9 million). An additional 3.6 million small arms were imported.²

With much of the firearms industry in private ownership, revenue and profit statistics are limited. However, IBISWorld estimates \$13.5 billion in revenues and \$1.5 billion in profits from the manufacturing of guns and ammunition.³

Investment Risk

Retirement staff has identified the following six publicly traded firearms manufacturing companies:

Name	Domicile	Market Capitalization (\$Millions)	Benchmark Weight	SFERS Ownership (\$)	% of Public Equities	% Revenue from Firearms	% of Sales to Safety / Military
Orbital ATK	US	\$ 4,416.97	0.010%	\$ 428,141	0.004%	<30%	<40%
Olin Corporation	US	3,574.15	0.008%	-	0.000%	<30%	<2%
Vista Outdoor	US	2,402.53	0.006%	193,764	0.002%	>60%	13%
Smith & Wesson	US	1,580.68	0.004%	119,103	0.001%	>90%	<9%
Sturm Ruger & Co	US	1,162.79	0.003%	-	0.000%	>90%	Not Available
Forjas Taurus SA	BZ	36.69	0.000%	-	0.000%	>90%	Not Available
Totals		<u>\$ 13,173.80</u>	<u>0.031%</u>	<u>\$ 741,008</u>	<u>0.007%</u>		

Notes:

1. Market Capitalization is in \$millions – as of August 31, 2016;
2. SFERS Ownership (\$) is based upon holdings in SFERS' separate account public equity holdings;
3. Vista Outdoors (Federal Premium) and Olin Corporation (Winchester) have subsidiaries that manufacture ammunition that is sold in the civilian, military and police market segments; and
4. Vista Outdoor was created through a spin-off from Orbital ATK (in 2015).

¹ www.GunPolicy.org

² Firearms Commerce in the United States 2015 – Bureau of Alcohol, Tobacco, Firearms and Explosives.

³ America's Gun Business, By the Numbers, CNBC, October 2, 2015 (<http://www.cnbc.com/2015/10/02/americas-gun-business-by-the-numbers.html>)

Investment performance – Through August 31, 2016

Performance Through August 31, 2016

Company	Year to Date	Fiscal Year to Date	1 Year	3 Years	5 Years
Orbital ATK	-14.98%	-11.40%	0.64%	19.94%	22.14%
Olin Corporation	29.32%	-12.08%	12.82%	1.23%	5.30%
Vista Outdoor	-10.54%	-16.57%	-14.80%	No Data	No Data
Smith & Wesson	28.07%	3.57%	55.51%	36.95%	53.74%
Sturm Ruger & Co	4.93%	-3.48%	-0.70%	8.12%	18.39%
Forjas Taurus SA	86.73%	35.26%	78.53%	-56.18%	-36.10%
Benchmarks:					
S&P 500	7.82%	3.83%	12.54%	12.26%	14.64%
Russell 3000	7.99%	4.23%	11.38%	11.69%	14.43%
MSCI ACWI IMI	6.63%	1.41%	7.97%	7.43%	9.06%

Notes:

1. Vista Outdoor, a spin-off from Orbital ATK, began trading in February 2015.
2. Performance results are sourced from Bloomberg and Northern Trust.

SFERS Social Investment Policy and Procedures

As set forth in the California Constitution, the SFERS Retirement Board and staff are required to discharge their fiduciary duties solely in the interest of the participants and beneficiaries [as a whole] for the exclusive purpose of providing benefits to members and their beneficiaries. [California Constitution, Article 16, Section 17.] These requirements are also mandated by the Internal Revenue Code of 1954 as amended in order for SFERS to maintain its status as a qualified plan. [Code Section 401(a)(2).]

The SFERS Retirement Board and staff are also required to invest the SFERS Trust "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims. [California Constitution, Article 16, Section 17.] The prudence requirements are generally satisfied if, in the analysis, the Retirement Board and staff are guided principally by economic and business factors. Whether an investment benefits a social goal may be a secondary consideration.

The SFERS Social Investment Policy and Procedures does not apply to segments of the portfolio that track market indices, as SFERS Policies and contractual mandates require those segments to invest in all companies included in an index. Additionally, the policy does not apply to investments in a Limited Partnership due to SFERS' legal position of limited liability as a Limited Partner rather than a General Partner or comingled funds due to SFERS contractual relationship with other investors in such funds.

The SFERS Social Investment Policy and Procedures provide that the Retirement Board, as fiduciaries to the beneficiaries of the SFERS Trust, must give adequate recognition to the social consequences of corporate actions and investment decisions to achieve maximum long term investment return from Trust assets while ensuring that, in no event, will the tenets of the policy take precedent over the fiduciary responsibility of producing investment returns for the exclusive benefit of the members and

beneficiaries. Social concerns address through the policy will follow the order of action outlined in the policy except where the Retirement Board determines that action contemplated in an earlier step has been initiated prior to consideration of action under the policy and found to be ineffective or non-relevant.

The SFERS Social Investment Policy and Procedures outline three levels of action that the Retirement Board can direct staff to implement to engage companies on social issues of concern:

Level I – Shareholder Voting: SFERS’ shareholder voting rights will be exercised reflecting specific Board social investment considerations and directions or by authorization under procedures which reflect the Retirement Board’s directions on social issues.

Level II – Engagement: SFERS will proactively promote social interests individually or in concert with other shareholders to assure proper recognition of social interests with the goal of influencing corporate activities or policies. Activities at this level may include direct communication with the company and/or initiation of shareholder resolutions, individually or in concert with other shareholders.

Level III – Investment Restrictions: In the event that Level I and Level II engagement has not provided the Retirement Board’s desired results and alternatives to the restricted holdings are available which do not compromise investment return and risk, the Retirement Board may direct staff to restrict investment activities in specific areas to promote the interest of the SFERS Trust beneficiaries. Under Level III engagement, Retirement staff would provide directions to the investment manager that would include restricting purchase of additional shares of the targeted securities and directing the manager to research alternative securities to replace the targeted holdings that would provide comparable investment return with comparable risk.

Actions taken by Other Public Plans:

Divestment proposals have been an ongoing topic with a large number of SFERS’ public fund peers. Following is a review of the actions taken by several funds:

- **CalPERS** - In January 2013, CalPERS, following a request from Board Member and State Treasurer, Bill Lockyer, undertook an evaluation of their holdings of manufacturers of assault weapons. Following the fund’s divestment policies, staff identified holdings valued at approximately \$5 million. On February 19, 2013, the CalPERS Board of Administration voted to divest from Smith & Wesson and Sturm Ruger;
- **CalSTRS** - In January 2013, the CalSTRS Board indicated that they would follow the fund’s divestment policy, which requires staff to meet and discuss the specific issue with the effected companies ahead of any action. On February 22, 2013, CalSTRS voted to divest approximately \$5 million in Smith & Wesson and Sturm Ruger; and
- **NYC Teachers** - On February 15, 2013, the NYC Teachers’ Pension Fund Board of Trustees voted to divest from the five firms indicated in the table above. This action was taken after staff had determined that the action would be consistent with the fund’s fiduciary standards and investment process.

- **NYC Employees' Retirement System.** In May 2013, the NYC Employees' Retirement System voted to divest from the five firms indicated in the table above. This action was taken after staff had determined that the action would be consistent with the fund's fiduciary standards and investment process.

In July 2016, the NYC Employees' Retirement System voted to divest from three retailers (Dick's Sporting Goods, Cabela's and Big 5 Sporting Goods) that sell firearms and ammunitions.

SFERS currently owns each of these three companies – Totaling \$829,214 and each is a member of SFERS' public equity benchmark (MSCI – ACWI IMI).

- **NYC Police, Fire and Board of Education.** In January 2016, NYC mayor, Bill de Blasio submitted a resolution to the NYC Police Pension Fund (one of five NYC public pension systems) to analyze gun divestment. Specifically, the resolution requests that the Board of Asset Management and the fund's general consultant conduct an analysis identifying investments in companies that manufacture assault weapons and high-capacity ammunition magazines, such Smith and Wesson. Similar resolutions have also been submitted to Uniformed Fire Pensions and the Board of Education Retirement System.

Recommendation:

As the decision whether to engage the firearms and ammunitions manufacturing companies and retailers through the SFERS Social Investment Policies and Procedures is a policy decision solely in the purview of the Retirement Board, Retirement staff does not provide a recommendation regarding the prudence of directing divestment or engagement under the policy.

Should the Retirement Board determine that divestment or engagement of the firearms and ammunitions manufacturing companies and/or retailers through its policy is prudent, Retirement staff recommends that the Retirement Board direct staff to:

- a) provide an implementation plan and timeline for engaging with or divesting from its current public markets holdings in these firearms and ammunitions manufacturing companies as well as the other firearms and ammunitions manufacturing firms listed above in which SFERS is not currently invested; and/or
- b) provide an implementation plan and timeline for engaging with or divesting from its current public markets holdings in these firearms and ammunitions retailers – Dick's Sporting Goods, Cabela's and Big 5 Sporting Goods.

Retirement staff will provide regular reports to the Retirement Board on the results of its engagement or divestment as directed by the Retirement Board.

Exhibit A

1 [Urging the San Francisco Employees' Retirement System and Retirement Board to Divest
2 from Firearm and Ammunition Manufacturers]

3 **Resolution urging the San Francisco Employees' Retirement System and Retirement**
4 **Board to divest from firearm and ammunition manufacturers.**

5
6 WHEREAS, San Francisco and cities across the United States continue to be affected
7 by senseless gun violence and easy access to guns and ammunition; and

8 WHEREAS, The senseless gun violence and tragedies committed in Orlando, Sandy
9 Hook, Charleston, Tucson, Aurora, and Virginia Tech show that current gun control
10 regulations are simply not enough to protect the public from senseless gun violence; and

11 WHEREAS, Currently, on average every day 297 people are shot and an average of
12 89 people die from gun violence each day in America; and

13 WHEREAS, San Francisco and the State of California have been national leaders in
14 enacting common sense gun safety policies all aimed at stopping senseless gun violence,
15 saving lives, and enhancing public safety; and

16 WHEREAS, The San Francisco Employee's Retirement System (SFERS) administers
17 two benefit programs from active and retired members; and

18 WHEREAS, Under the direction of the Retirement Board, the Executive Director and
19 senior staff of SFERS manage the day-to-day activities of the system including investments;
20 and

21 WHEREAS, In the wake of mass gun violence a number of municipal retirement funds,
22 including the California State Teachers' Retirement System (CalSTRS) and the country's
23 largest pension fund, the California Public Employees' Retirement System (CalPERS) have
24 voted to divest from investments in firearm and ammunition manufacturers; and
25

1 WHEREAS, The Retirement Board's Social Investment Policy states, that "The
2 relationship of the corporation to the communities in which it operates shall be maintained as
3 a good corporate citizen through observing proper environmental standards, supporting the
4 local economic, social and cultural climate, conducting acquisitions and reorganizations to
5 minimize adverse effects;" and

6 WHEREAS, Currently, SFERS has just over one million dollars invested in three
7 different companies that are in the firearm and ammunition manufacturing businesses; and

8 WHEREAS, On February 12, 2013, the Board of Supervisors unanimously adopted a
9 resolution urging the Retirement Board of the Employees' Retirement System to divest from
10 publicly traded firearm and ammunition manufacturers, on file with the Clerk of the Board of
11 Supervisors in File No. 130125, which is hereby declared to be a part of this resolution as if
12 set forth fully herein; and

13 WHEREAS, The Retirement Board has hosted one hearing on divesting from firearm
14 and ammunition manufacturers, but has not taken any divestment action since that hearing;
15 and

16 WHEREAS, Divesting from firearm and ammunition manufactures would be consistent
17 with the Retirement Board's Social Investment Policy, would match San Francisco values and
18 priorities, and would be a powerful, meaningful act for the City; now, therefore, be it

19 RESOLVED, That the Board of Supervisors urges the Retirement Board to not make
20 any new investments in firearm and ammunition manufacturers; and, be it

21 FURTHER RESOLVED, That the Board of Supervisors urges the Retirement Board to
22 host a hearing on divesting from investments in firearm and ammunition manufacturers as
23 soon as possible; and, be it

24 FURTHER RESOLVED, That the Board of Supervisors urges the Retirement Board to
25 divest all the City's investments in Orbital ATK, Vista Outdoor, and Sturm, Ruger & Co. in

1 order to be consistent with San Francisco values that promote common sense gun safety
2 policies.

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

Exhibit B

CITY AND COUNTY OF SAN FRANCISCO
EMPLOYEES' RETIREMENT SYSTEM
RETIREMENT BOARD POLICY

THE SOCIAL INVESTMENT PROCEDURES

The Retirement Board adopted the attached list of Social Investment Policies at the Retirement Board Meeting of September 27, 1988.

CITY AND COUNTY OF SAN FRANCISCO
EMPLOYEES' RETIREMENT SYSTEM

THE SOCIAL INVESTMENT PROCEDURES

Since it is necessary for adequate recognition to be given to the social consequences of corporate actions and security and portfolio investment decisions to achieve maximum long term investment returns from System assets, and since the individual decisions of Staff, Managers, Consultants, and other System fiduciaries have to be made within a framework that reflects the particular social situation and concerns of the participants and the System, the following policies shall be followed when investing, managing, or reviewing System assets. Social concerns to be addressed through investment policy shall follow the order of action as outlined in I, II, and III except where the Board has determined that action contemplated in an earlier step has been initiated prior to the adoption of these policies and found to be ineffective or non-relevant. In no event shall these policies take precedent over the fiduciary responsibility of producing investment returns for the exclusive benefit of the participants.

I. Shareholder Voting

The ownership of equity interests in many corporations as an investment of System assets includes the right to vote on the initiation, approval, or denial of major company policies and actions. These voting rights shall be exercised only by specific Board considerations and directions or by authorization under procedures which reflect Board decisions on popular issues.

- A. Issues likely to come before shareholders in a proxy "season" will be reviewed prior to the "season" to allow the sense of the Board to be obtained on generic issues to be voted by Staff when received.
- B. Issues of non-generic nature will be specifically reviewed by Staff and recommended to the Board for action. Counsel of the external managers shall be sought on issues of immediate investment concern for securities held in the manager's portfolio; i.e., mergers, acquisitions, buy-outs, etc.
- C. Determination of the social concerns that should be addressed through exercise of voting rights and subsequent implementation of the balance of these procedures will be made by the Board in full consideration of their responsibilities as fiduciaries of the System and only after Staff review of the

investment and social implications. Additional information from external managers and other outside sources will be sought when necessary.

II. Promoting Social Rights and Interests

The ownership of equity interests, and to some extent of fixed income interests, in many corporations provides an opportunity to act individually or in concert with other shareholders to assure proper recognition of social interests. Social interests shall be promoted only if in the interest of the participants, the community and the corporation as expressed in the preceding section on shareholder voting.

- A. Shareholder resolutions will be initiated upon review of previous shareholder votes, discussion with the corporation, and Board determination that the proposed resolution is a reasonable vehicle to influence corporate activities.
- B. Other interested shareholders may be actively sought to express common concerns, join in resolutions, and solicit proxy votes.
- C. Specific investment programs that benefit the Participants while aiding other persons or entities may be considered provided that expected investment returns are at least equivalent to available alternatives of similar risk.

III. Investment Restrictions

When social concerns have not been or cannot be addressed adequately through discussion, exercising shareholder voting rights, promotion of shareholder initiatives, or participation in active investment programs, it may be necessary to restrict System investment activities in specific areas to promote the interests of the participants. In general, restrictions will be adopted in the following manner:

- A. Restrictions will not take precedent over investment considerations but will be used to set standards when dealing with essentially equivalent investment choices.
- B. Recognizing that substantial investment flexibility is necessary to maximize returns at an acceptable level of risk, restrictions will be adopted only when exercising voting rights and promoting investment initiatives have not been or would not be successful and alternatives to the restricted securities are available which do not compromise potential investment return.

- C. Restrictions will be applied at the lowest possible investment level, either specific issuers or securities, to protect against adverse investment effects and facilitate amendment in response to corporate action or changes in investment or social climate.
- D. Restrictions will be analyzed periodically for social and financial consequences and amended or repealed as appropriate.
- E. Restrictions will be applied only upon specific decision of the Board based on available information as evaluated by Staff, and after full consideration of the investment ramifications.

CITY AND COUNTY OF SAN FRANCISCO
EMPLOYEES' RETIREMENT SYSTEM
RETIREMENT BOARD POLICY

THE SOCIAL INVESTMENT POLICIES

The Retirement Board adopted the attached list of Social Investment Policies at the Retirement Board Meeting of September 27, 1988. As new policies are developed and adopted, they will be added to this document.

- | | | |
|--|---------|---------|
| 1. Corporate activities of companies whose securities are owned by the System shall be conducted in compliance with all applicable laws and regulations. | Level I | 9/27/88 |
| 2. <u>Employment Standards</u>
Active measures shall be taken to assure that the corporation meets fair employment standards including non-discrimination in hiring, transfer, pay and promotion, decent working facilities and conditions, and the recognition of all legal employee rights of organization and political expression. | Level I | 9/27/88 |
| 3. <u>Community Relations</u>
The relationship of the corporation to the communities in which it operates shall be maintained as a good corporate citizen through observing proper environmental standards, supporting the local economic, social and cultural climate, conducting acquisitions and reorganizations to minimize adverse effects and not discriminate in making loans or writing insurance. | Level I | 9/27/88 |
| 4. <u>Corporate Governance and Internal Affairs</u>
The Bylaws of the corporation shall be maintained to permit full expression of shareholder voting rights in corporate affairs and to prevent entrenchment of management. Executive compensation shall be fair and reasonable. Reports and data shall be made available to shareholders concerning social issues to the extent possible without jeopardizing business interests. | Level I | 9/27/88 |

- | | | | |
|----|---|-----------|----------|
| 5. | <u>MacBride Principles</u>
The corporation shall affirm and adhere to the MacBride Principles concerning operations in Northern Ireland. | Level I | 2/25/92 |
| 6. | <u>Tobacco Divestment</u>
Due to the existing litigation, proposed legislation and probable governmental restrictions relating to the Tobacco industry, the System will not invest in the equity and fixed income securities of companies manufacturing tobacco products. (See list) | Level III | 10/13/98 |
| 7. | <u>Sudan Investments</u>
The Retirement Board directed staff to engage in constructive dialogue with companies doing business in Sudan because US Congress and the State Department have found the Sudanese Government to be complicit in genocide in Darfur region. | Level II | 6/13/06 |
| 8. | <u>Sudan Investments</u>
The Retirement Board directed staff to inform companies meeting specified criteria of intention to divest. Companies will have 90 days to respond. Managers will be informed of companies meeting specified criteria and be given an opportunity to explain why they cannot achieve their mandate if required to divest. Reference Sudan – Level 3 Procedures dated 12/26/06. | Level III | 11/14/06 |
| 9. | <u>Fossil Fuel Investments</u>
The Retirement Board directed staff to prepare an implementation plan and timeline regarding engagement with fossil fuel companies with an objective of persuading companies to ameliorate the effect of stranded assets. | Level II | 3/11/15 |

Key: Level I – Shareholder Voting
Level II – Promoting Social Rights and Interests
Level III – Investment Restrictions

**South Africa Policy restriction at Level III was repealed on July 14, 1994.

**LIST OF COMPANIES INVOLVED IN THE PRODUCTION OR
WHOLESALE DISTRIBUTION OF TOBACCO PRODUCTS**

<i>US Tobacco Companies</i>	
ALLIANCE ONE INTERNATIONAL INC	STAR SCIENTIFIC INC
ALTRIA GROUP, INC.	UNIVERSAL CORP.
LORILLARD INC.	VECTOR GROUP LTD.
PHILIP MORRIS INTERNATIONAL INC.	WELLSTONE FILTERS INC
REYNOLDS AMERICAN INC	
SCHWEITZER-MAUDUIT INTERNATIONAL INC.	

Data as of July 1, 2009; Approved by Retirement Board September 8, 2009

Removed UST acquired by Altria

Source: RiskMetric Group

Companies Prohibited From Investment Due to Business Activities in Sudan¹

Alcatel	LaMancha Resources Inc.
Alstom	Lundin Equipment
AMLAK France	Mitsui Engineering & Shipbuilding Co.
AREF Investment Group	Muhibbah Engineering Berhad
Areva Group	Nam Fatt Co. Bhd
AviChina Industry & Technology	Norinco International Co.
Bank of Khartoum	Oil & Natural Gas Corp. Ltd.
Bharat Electronics Ltd.	PECD Berhad
Bharat Heavy Electronics	Petrofac Ltd.
Bollore Group	Petronas
China Petroleum & Chemical Corporation (Sinopec)	Petrochina
CNPC Ltd (China National Petroleum Corp.)	Reliance Industries Ltd.
Dongfeng Motor Group Co. Ltd.	Scomi Group Bhd
Electricity Generating Public Company	Sarawak Enterprise Corp. Bhd.
Emirates Telecommunications Corp.	Sudan Telecommunications Co. (Sudatel)
Harbin Power Equipment	Sudanese Free Zones & Markets Co.
Indian Oil Corporation	Sudanese French Bank
Kejuruteraan Samudra Timur Bhd	Videocon Industries Ltd.
Kencana Petroleum Bhd	The Weir Group

Companies Removed From Investment Restrictions¹

Schlumberger,LTD	Removed July, 2007
CHC Helicopter	Removed February, 2008
White Nile Company	Removed February, 2008

¹ Approved by Retirement Board September 8, 2009