Public Act 95-616 ("Iran Act")

Annual Report

January 1, 2016

Illinois State Board of Investment
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Introduction


With respect to actions taken in compliance with the Act, including good faith determinations regarding companies as prescribed by the Act, the Illinois State Board of Investment (the “Board”) is exempt from any conflicting statutory or common law obligations, including any fiduciary duties under Article 1 and any obligations with respect to choice of asset managers, investment funds, or investments for the Board’s securities portfolios. (40 ILCS 5/1-110.10(j)). The Board has developed the Iran Divestment Policy to serve as a guide for implementation of the Act’s specific requirements. This Policy is attached as Exhibit A.

In accordance with the Act, the Board is required to file this annual report with the Public Pension Division, which shall be made available to the public and includes the following:

1. A list of scrutinized companies that have active business operations in Iran.
2. A summary of correspondence between the Board and scrutinized companies.
3. A summary of all investments sold, redeemed, divested, or withdrawn as a result of scrutinized companies continuing to have scrutinized active business operations.
4. A summary of correspondence with private market funds with scrutinized active business operations.
The Board's Scrutinized Companies Identification Methodology

The Board took the following actions to identify all scrutinized companies:

1. Following the Act’s passage, Staff contacted the Florida State Board of Administration (“FSBA”) to assess how the FSBA responded to the Protecting Florida’s Investments Act, an act that restricts the FSBA’s investments in scrutinized companies with ties to Sudan and Iran, and reviewed the FSBA’s quarterly report, which includes a list of scrutinized companies and details the methodology for FSBA’s compliance with the Florida Act.

2. Staff contacted other Illinois state public funds to exchange ideas and receive feedback regarding compilation of the list of scrutinized companies.

3. Staff contacted the American Israel Public Affairs Committee (“AIPAC”) to obtain AIPAC’s list of companies investing in Iran’s energy sector and to discuss the methodology associated with compiling the list of scrutinized companies.

4. Staff contacted Risk Metrics Group (“RMG”), Conflict Securities Advisory Group and Corporate Library, all independent research firms, to request detailed information regarding how the firms could (i) identify scrutinized companies (by tracking the definition of scrutinized company in the Act) and (ii) identify which scrutinized companies have active or inactive business operations. RMG and Conflict Securities Advisory Group submitted proposals to provide the list of scrutinized companies.

5. After evaluation of all resources, the Board chose to retain RMG to provide the list of scrutinized companies.

6. At its July 2009 Board Meeting, the Board authorized Staff to issue a request for competitive proposal (“RFP”) for proxy voting advisory and related socially responsible investment (“SRI”) services. SRI services include providing the Board with its list of scrutinized companies. Staff carefully reviewed the proposals for content, quality and compliance with proposal document requirements. On December 18, 2009, the Board approved to maintain RMG for proxy voting advisory and related SRI services. RMG’s experience and expertise satisfied the scope of work requirements outlined in the RFP and the firm’s fee proposal was the most cost effective in relation to the services being provided. On June 1, 2010, RMG was acquired by MSCI Inc. (“MSCI”), a leading global provider of investment decision support tools, including indices and portfolio risk and performance analytics.

7. On January 17, 2014, the Board issued an RFP for proxy voting and/or SRI advisory services. As a result of the RFP, on June 27, 2014, the Board voted to retain IW Financial for its SRI services, replacing MSCI. IW Financial is a leading provider of SRI research, consulting and portfolio management solutions; the firm provides custom Sudan and Iran data feeds to several of the largest U.S. public pension funds and was the most competitively priced option.
On July 11, 2008, the Board adopted an official list of scrutinized companies in accordance with the Act and the Board’s Iran Divestment Policy. In accordance with the Act, the Board has continued to review the list on an annual basis. Effective January 1, 2016, Public Act 099-0128 amends the previously adopted investment restrictions and prohibits retirement systems from investing in companies that boycott Israel, and those that have business operations in Iran and Sudan. Under 40 ICLS 5/1-110.16, a newly formed Illinois Investment Policy Board (the “Policy Board”) will assemble a list of companies identified as Iran-restricted, Sudan-restricted, and companies that boycott Israel and will distribute this list to each retirement system by April 1, 2016. This will be the process going forward. As a result of this legislation, the Board did not adopt a new list at its September 2015 meeting.
Summary of Correspondence with Scrutinized Companies

In accordance with Section 1-110.10 of the Act, the Board determined the companies on the scrutinized companies list in which the Board owns direct or indirect holdings.

The Board did not have investments in scrutinized companies with inactive business operations.

This section of the Report is not applicable. The Board did not adopt a new list at its September 2015 meeting due to the new legislation. One newly identified scrutinized company responded before the new legislation became effective and the company’s response is summarized below.

As of July 11, 2015, ISBI has incurred a gain of $4,109,353.82 due to Iran divestments; which includes a gain of $4,311,007.32 between July 12, 2014 and July 11, 2015. The total amount divested since July 11, 2009 is $29,202,072.60; which includes the divestment amount of $22,117,461.01 between July 12, 2014 and July 11, 2015.

Table 2: Summary of Responses from Scrutinized Companies

<table>
<thead>
<tr>
<th>Company</th>
<th>Response</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total S.A.</td>
<td>According to the company, Total S.A. has no exploration and production activities in Iran. The company provided evidence that it no longer has any investment in Iran.</td>
<td>As a result of a review of the evidence by Staff and IW Financial, the company has been removed from the list.</td>
</tr>
</tbody>
</table>

Summary of Correspondence with Private Market Funds

This is not applicable. The Board did not adopt a new list at its September 2015 meeting due to the new legislation. The new legislation, 40 ILCS 5/1-110.16, does not apply to indirect holdings or private market funds, as defined in the statute.

Summary of Investments Sold, Redeemed, Divested, or Withdrawn

On July 11, 2008, the Board sent letters to all external investment managers notifying them of the Act and informing them of the newly adopted list of scrutinized companies.

Beginning in November 2008, the Board informed all affected managers to sell, redeem, divest, or withdraw all publicly traded securities of active scrutinized companies no later than July 11, 2009. The scrutinized companies affected by this direction failed to convert their active scrutinized business operations to inactive.

Specifically, the Board sent letters to Templeton Investment Counsel (Account # NHEB), Fort Washington (NHFS), State Street Global Advisors- ACWI (NHHJ), State Street Global Advisors- EAFE (NHHI), and Vontobel Asset Management (NHHP), stating that the Board
must divest itself of all holdings of any scrutinized companies within 12 months of the companies’ original appearance on the prohibited investment list. Therefore, complete divestitures of scrutinized companies (on the original July 11, 2008 list) must be made no later than July 11, 2009. The letters sent to these affected managers also requested that the managers provide the Board with all specific transaction details, including the date of the transaction, the number of shares, total share value and the amount of gain or loss.

Since July 11, 2008, there has been no increase in holdings of scrutinized companies. External managers are contractually responsible for administering investments in accordance with the investment manager guidelines and restrictions set forth by the Board, including the prohibited investments list of the Act.

As of July 11, 2015, ISBI has incurred a gain of $3,942,018.25 due to Iran divestments; which includes a gain of $4,311,007.32 between July 12, 2014 and July 11, 2015. The total amount divested since July 11, 2009 is $4,607,668.41; which includes the divestment amount of $4,311,007.32 between July 12, 2014 and July 11, 2015. The table below presents a summary of all sales of all scrutinized companies between July 12, 2014 and July 11, 2015.

**Table 3: Summary of Sales of all Prohibited Investments**

<table>
<thead>
<tr>
<th>Transaction Type</th>
<th>Fund</th>
<th>Security Name</th>
<th>Share/Par Value</th>
<th>Base Security Gain/Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>SELL</td>
<td>NHEZ</td>
<td>MCGRAW HILL FINANCIAL</td>
<td>87.529399</td>
<td>1,192,871.50</td>
</tr>
<tr>
<td>SELL</td>
<td>NHEZ</td>
<td>MCGRAW HILL FINANCIAL</td>
<td>86.500000</td>
<td>61,713.50</td>
</tr>
<tr>
<td>SELL</td>
<td>NHDM</td>
<td>MCGRAW HILL FINANCIAL</td>
<td>95.327200</td>
<td>42,615.20</td>
</tr>
</tbody>
</table>
**Exhibit A**

**IMPLEMENTATION OF PUBLIC ACT 95-616**

**IRAN DIVESTMENT POLICY**


With respect to actions taken in compliance with the Act, including good faith determinations regarding companies as prescribed by the Act, the Board is exempt from any conflicting statutory or common law obligations, including any fiduciary duties under Article 1 and any obligations with respect to choice of asset managers, investment funds, or investments for the Board’s securities portfolios. (40 ILCS 5/1-110.10(j)).

This Iran Divestment Policy shall serve as a guide for implementation of the Act’s specific requirements.

In accordance with the Act, the following actions shall be taken:

**I.** The Board shall use best efforts to identify all scrutinized companies in which it has direct holdings or indirect holdings by March 30, 2008 (90 days after January 1, 2008, the effective date of the Act). In order to identify the scrutinized companies, the Board has discretion to use any of the following efforts: A) reviewing and relying on publicly available information regarding companies having business operations in Iran, including information provided by nonprofit organizations, research firms, international organizations, and government entities; B) contacting asset managers contracted by the Board that invest in companies having business operations in Iran; C) contacting other institutional investors that have divested from or engaged with companies that have business operations in Iran; or D) retaining an independent research firm to identify scrutinized companies in which the Board has direct or indirect holdings.

**II.** The Board shall assemble and adopt an official list of scrutinized companies at the June 2008 Board Meeting. The Board shall file the scrutinized companies list with the Public Pension Division (Division) of the Department of Financial and Professional Regulation within 30 days of its adoption. The Division shall make the Board’s scrutinized companies list available to the public. Staff shall supplement the scrutinized companies list on an annual basis.

**III.** In respect of companies on the scrutinized companies list, the Board shall adhere to the following procedures:

A) The Board must determine which companies on the scrutinized companies list are direct or indirect holdings;

B) In respect of a scrutinized company with inactive business operations, the Board, on a semi-annual basis, must send a written notice informing the company of the Act and encouraging the company to refrain from initiating active business operations in Iran until it is able
to avoid scrutinized business operations. This requirement applies to companies that are direct and indirect holdings.

C) In respect of a scrutinized company that has active business operations, the Board shall send a written notice informing the company that it is considered a scrutinized company under the Act and that it may become subject to divestment by the Board, due to such status. Further, the notice shall inform the company of its opportunity to clarify its Iran-related activities and encourage the company, within 90 days, to cease its scrutinized business operations or convert such operations to inactive business operations, in order to avoid qualifying for divestment by the Board.

1) If the company ceases scrutinized business operations within 90 days of the Board’s first engagement, the Board shall remove the company from the scrutinized companies list.

2) If the company converts its active scrutinized business operations to inactive business operations within 90 days of the Board’s first engagement, the company shall receive letters from the Board, as described above in III (B).

3) If the company continues to have active scrutinized business operations following the 90 day period, the Board shall sell, redeem, divest or withdraw all publicly traded securities of the company within 12 months after the company’s most recent appearance on the scrutinized companies list. This requirement does not apply to indirect holdings in a private market fund. Please note that companies that the U.S. Government affirmatively declares are excluded from present and future federal sanctions relating to Iran are not subject to divestment.

IV. Subsequent to the Board’s adoption of the scrutinized companies list, the Board shall not acquire securities of companies on the scrutinized companies list that have active business operations. This requirement does not apply to indirect holdings in a private market fund. However, please note that the Board may acquire a company that the U.S. Government has affirmatively declared to be excluded from its present or any future federal sanctions relating to Iran. Staff will arrange for the Board’s investment managers to have access to the scrutinized companies list and provide this Iran Divestment Policy to guide the investment managers’ investment of fund assets. If the Board purchases the scrutinized companies list from an independent research provider, each of the Board’s investment managers will reimburse the Board for their pro rata share of the list’s cost.

V. In respect of the Board’s indirect holdings in scrutinized companies with active business operations existing within the Board’s private market funds, the Board shall submit letters to the general partners of the applicable private market funds, requesting that the general partner consider removing the companies from the fund or create a similar actively managed fund having indirect holdings devoid of the companies. If the general partner creates such a fund, the Board shall replace all applicable investments with investments in the similar fund in an expedited time frame consistent with prudent investment standards.

VI. The Board shall file an annual report with the Division, which shall be made available to the public, discussing the following information: A) a summary of correspondence with scrutinized companies engaged by the Board; B) all investments sold,
redeemed, divested or withdrawn in compliance with the Act; C) all prohibited investments (companies on the scrutinized company list that have active business operations); and D) a summary of correspondence with private market funds.

VII. The Board may cease divesting from scrutinized companies or reinvest in scrutinized companies, if clear and convincing evidence shows that the value of investments in scrutinized companies with active scrutinized business operations becomes equal to or less than 0.5 % of the market value of all assets under management by the Board. If the Board decides to cease divestment, reinvest, or remain invested in companies having active scrutinized business operations, the Board must provide a written report to the Division in advance of the action and update the report semiannually thereafter, identifying the reasons and justification (supported by clear and convincing evidence) for the Board’s decision to cease divestment, reinvest, or remain invested in the applicable companies.

This Iran Divestment Policy shall expire upon the occurrence of any of the following events: A) the U.S. revoking all sanctions imposed against the Government of Iran; B) the Congress or President declaring that the Government of Iran has ceased to acquire weapons of mass destruction and has ceased to support international terrorism; or C) the Congress or the President declaring that mandatory divestment of the type provided for in the Act interferes with the conduct of U.S. foreign policy.

ADOPTED: December 14, 2007

DEFINITIONS:

"Active business operations" means all business operations that are not inactive business operations.

"Business operations" means engaging in commerce in any form in Iran, including, but not limited to, acquiring, developing, maintaining, owning, selling, possessing, leasing, or operating equipment, facilities, personnel, products, services, personal property, real property, or any other apparatus of business or commerce.

"Company" means any sole proprietorship, organization, association, corporation, partnership, joint venture, limited partnership, limited liability partnership, limited liability company, or other entity or business association, including all wholly owned subsidiaries, majority-owned subsidiaries, parent companies, or affiliates of those entities or business associations, that exists for the purpose of making profit.

"Direct holdings" in a company means all securities of that
company that are held directly by the retirement system or in an account or fund in which the retirement system owns all shares or interests.

"Inactive business operations" means the mere continued holding or renewal of rights to property previously operated for the purpose of generating revenues but not presently deployed for that purpose.

"Indirect holdings" in a company means all securities of that company which are held in an account or fund, such as a mutual fund, managed by one or more persons not employed by the retirement system, in which the retirement system owns shares or interests together with other investors not subject to the provisions of this Section.

"Mineral-extraction activities" include exploring, extracting, processing, transporting, or wholesale selling or trading of elemental minerals or associated metal alloys or oxides (ore), including gold, copper, chromium, chromite, diamonds, iron, iron ore, silver, tungsten, uranium, and zinc.

"Oil-related activities" include, but are not limited to, owning rights to oil blocks; exporting, extracting, producing, refining, processing, exploring for, transporting, selling, or trading of oil; and constructing, maintaining, or operating a pipeline, refinery, or other oil-field infrastructure. The mere retail sale of gasoline and related consumer products is not considered an oil-related activity.

"Petroleum resources" means petroleum, petroleum byproducts, or natural gas.

"Private market fund" means any private equity fund, private equity fund of funds, venture capital fund, hedge fund, hedge fund of funds, real estate fund, or other investment vehicle that is not publicly traded.

"Retirement system" means the State Employees' Retirement System of Illinois, the Judges Retirement System of Illinois,
the General Assembly Retirement System, the State Universities Retirement System, and the Teachers' Retirement System of the State of Illinois.

"Scrutinized business operations" means business operations that have caused a company to become a scrutinized company.

"Scrutinized company" means the company has business operations that involve contracts with or provision of supplies or services to the Government of Iran, companies in which the Government of Iran has any direct or indirect equity share, consortiums or projects commissioned by the Government of Iran, or companies involved in consortiums or projects commissioned by the Government of Iran and:

(1) more than 10% of the company's revenues produced in or assets located in Iran involve oil-related activities or mineral-extraction activities; less than 75% of the company's revenues produced in or assets located in Iran involve contracts with or provision of oil-related or mineral-extraction products or services to the Government of Iran or a project or consortium created exclusively by that government; and the company has failed to take substantial action; or

(2) the company has, on or after August 5, 1996, made an investment of $20 million or more, or any combination of investments of at least $10 million each that in the aggregate equals or exceeds $20 million in any 12-month period, that directly or significantly contributes to the enhancement of Iran's ability to develop petroleum resources of Iran.
For more information, please contact:

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