

Chester J. Culver
GOVERNOR
Patty Judge
LT. GOVERNOR



Donna M. Mueller
CHIEF EXECUTIVE OFFICER

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SEP 29 2010

HOUSE OF REPRESENTATIVES

September 28, 2010

Honorable Mike Marshall,
Secretary of the Senate
Honorable Mark Brandsgard,
Chief Clerk of the House
General Assembly of the State of Iowa
Des Moines, IA 50319

Dear Messrs. Marshall and Brandsgard:

Enclosed is the Iowa Public Employees' Retirement System's report for the fiscal year ended June 30, 2010, on divestment activities related to companies doing business in the Sudan. This annual report is required by section 12F.5 of the Code of Iowa.

The report describes IPERS' implementation of the Sudan divestment program in its initial year, and provides information on divestment activities and costs. The report also includes a list of prohibited companies as of June 30, 2010.

Sincerely,

A handwritten signature in cursive script that reads "Donna M. Mueller".

Donna M. Mueller
Chief Executive Officer

Enclosure

IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
ANNUAL REPORT
ON SUDAN DIVESTMENT
For the Fiscal Year Ended June 30, 2010

Iowa Code chapter 12F requires the Iowa Public Employees' Retirement System (IPERS) to scrutinize companies with business operations in the Sudan, and under certain circumstances, to restrict its purchases of, and/or divest of, holdings of any company determined to have active business operations in the Sudan. Chapter 12F specifies certain procedures to be followed in engaging companies doing business in the Sudan, and requires IPERS to annually report to the General Assembly on its activities concerning the Sudan divestment law.

Implementation

IPERS develops a list of scrutinized companies using the research and findings of the Conflict Resolution Network (CRN). The CRN, which was formerly known as the Sudan Divestment Task Force, is an organization that helped develop the legislation and is considered to be an authoritative source of information in this area. IPERS considers all companies characterized by the CRN as "Highest Offenders" to be companies with active business operations in the Sudan.

IPERS sends a letter to each company with active business operations asking them to discontinue their operations in the Sudan. Companies are given the opportunity to provide evidence that contradicts the CRN's findings. The letter also notifies the company that IPERS will prohibit further investment and divest of its holdings in the company's securities if the company does not meet the requirements of the law. If the company does not respond, or fails to provide convincing evidence within the time period established by law, then IPERS places the company on its prohibited companies list. The prohibited companies list is updated quarterly, and is provided to the public on IPERS' Web site at www.ipers.org.

IPERS' investment managers are prohibited from purchasing securities issued by companies on the prohibited companies list. Investment managers that have any existing direct holdings¹ of a prohibited company must sell (divest) the position within 18 months of the date the company was first notified. An investment manager has the discretion to decide when to sell its holdings within the 18 month period.

¹ It is important to note that chapter 12F makes a distinction between direct holdings and indirect holdings. *Direct holdings* are securities directly owned and held in IPERS' name. *Indirect holdings* refer to situations where IPERS may indirectly own an interest in a security because of its ownership of shares in a commingled investment vehicle, such as a mutual fund. The General Assembly recognized that it may not be possible to efficiently divest of prohibited companies held in a commingled fund, and exempted indirect holdings from many provisions of chapter 12F. IPERS is required to analyze the prudence of moving its indirect holdings to Sudan-free commingled funds if such an option exists. See section on Indirect Holdings.

Chapter 12F requires IPERS to engage only those scrutinized companies in which it has direct holdings. However, IPERS has opted to send letters to all scrutinized companies, and will place a scrutinized company on the prohibited companies list if warranted, regardless of whether or not IPERS has any direct holdings in the company. This is done because IPERS prefers to engage a company and determine whether it is a prohibited company before an investment manager purchases any securities of such company. The investment manager wants to know if a company is prohibited before buying it, not afterwards.

Chapter 12F also requires IPERS to contact companies that have inactive business operations in the Sudan. However, the purpose of such letter is to encourage them to keep their business activities inactive until the genocide stops in the Sudan. IPERS uses information from CRN to determine which companies have inactive business operations in the Sudan.

Fiscal Year 2010 Engagement Activity

The following chart summarizes the numbers of companies contacted by IPERS in fiscal year 2010 pursuant to chapter 12F.

| Time Period | Number |
|--------------------|---------------|
| Sept. 30, 2009 | 1 |
| Dec. 31, 2009 | 3 |
| Mar. 31, 2010 | 1 |
| June 30, 2010 | 9 |

In total, letters were sent to 14 companies under scrutiny for active business operations. IPERS received responses from only 2 companies, and none of them offered credible evidence to refute the CRN's findings. Based on the CRN's Sudan Company Report, it appears that CRN is having some success in getting scrutinized companies to at least engage in dialogue on the issue.

IPERS updates and publishes its prohibited companies list on a quarterly basis. During fiscal year 2010, 9 companies were added to the prohibited companies list, and 12 companies were removed. The companies were removed because the CRN no longer considered them to be Highest Offenders. IPERS' prohibited companies list as of June 30, 2010 is included as Appendix A to this report.

Fiscal Year 2010 Divestment Activity

There was no divestment activity in fiscal year 2010, because IPERS had no direct holdings in prohibited companies during the fiscal year.

Indirect Holdings

As noted earlier, chapter 12F makes a distinction between direct and indirect holdings. IPERS' had indirect holdings in three companies listed on the prohibited companies list on June 30, 2010 that were valued at \$1,048,780, which was less than one one-hundredths of the total IPERS Fund value. While indirect holdings are generally exempt from most of the provisions of the law, IPERS is required to evaluate the potential costs associated with moving its indirect investments to funds that will comply with chapter 12F, if it is prudent to do so.

As reported in last year's annual report, IPERS investment staff collected information concerning the potential cost of moving its indirect holdings to Sudan-free alternatives in Fall 2007 and presented such information to the IPERS Investment Board at its December 6, 2007 meeting. The Investment Board agreed with staff that it was not prudent to incur the trading costs to eliminate such small indirect exposures to prohibited companies. The size of IPERS' indirect holdings has not materially changed since that time, so it is believed that transaction costs associated with moving to Sudan-free alternatives would continue to be cost prohibitive for the removal of such small exposures.

Fiscal Year 2010 Program Costs

The cost to implement the Sudan monitoring and divestment program have been very low so far. IPERS has been able to avoid payment of any staff overtime costs during the implementation phase of the program, and IPERS has not incurred any third party costs for research or other services by using the information made available by CRN. IPERS incurred no fees or commission costs in fiscal year 2010 because there was no divestment activity during the fiscal year.

Conclusion

The impact of the law on the situation in the Sudan is unknown. IPERS cannot point to any definitive study or conclusive research that indicates that conditions in the Sudan have improved, or that a change in the political regime in the Sudan is imminent. However, we can say that the Sudan divestment law has been implemented by IPERS at relatively little cost to the System so far.

For More Information

See IPERS' Web site at www.ipers.org/investments/restrictions.html for quarterly updates throughout the year. We can be reached by e-mail at investments@ipers.org or by telephone at 515-281-0030.

Appendix A

Iowa Public Employees' Retirement System's Prohibited Companies List

July 1, 2010

| | <u>Divestment Date *</u> |
|--|--------------------------|
| » Alstom | |
| » Alstom Projects India | September 30, 2010 |
| » AREF Energy Holding Company | December 31, 2010 |
| » AviChina Industry & Technology Ltd. | |
| » Bongaigaon Refinery & Petrochemicals Limited (BRPL) | |
| » Chennai Petroleum Corporation Limited (CPCL) | |
| » China Hydraulic and Hydroelectric Construction Group Corporation (Sinohydro) | September 30, 2010 |
| » China National Petroleum Corporation (CNPC) | |
| » China North Industries Group Corporation (CNGC/NORINCO) | September 30, 2010 |
| » China North Industries Corporation (NORINCO) | September 30, 2010 |
| » CNPC Hong Kong | |
| » Daqing Huake Group Co. Ltd. | September 30, 2010 |
| » Egyptian Kuwaiti Holding Company | |
| » Electricity Generating Public Company Limited (EGCO) | |
| » Favelle Favco Bhd | September 30, 2010 |
| » Gas District Cooling PutraJaya Sdn Bhd | September 30, 2010 |
| » Hafei Aviation Industry | |
| » Harbin Dongan Auto Engine Co. | June 30, 2010 |
| » Indian Oil Corporation Ltd. (IOCL) | |
| » Jiangxi Changhe Automobile Co. | |
| » Jiangxi Hongdu Aviation (Hongdu Aviation) | |
| » Jinan Diesel Engine Co. Ltd. | December 31, 2010 |
| » Khanom Electricity Generating Co. Ltd. | |
| » Kingdream PLC | June 30, 2010 |
| » KLCC Property Holdings Bhd | September 30, 2010 |
| » KMCOB Capital Berhad | |
| » Lanka IOC Limited | |
| » Managem | September 30, 2010 |
| » Mangalore Refinery and Petrochemicals Ltd. | |
| » Mercator Lines Limited | March 31, 2011 |
| » Midciti Resources Sdn Berhad | |
| » MISC Berhad (Malaysia International Shipping Company) | |
| » MISC Capital | September 30, 2010 |
| » Nippon Oil Corporation | September 30, 2011 |
| » NORINCO International Cooperation Ltd. | September 30, 2010 |
| » Oil and Natural Gas Corp. Ltd. (ONGC) | |
| » Oil India Limited | June 30, 2011 |
| » ONA S.A. | September 30, 2010 |
| » PetroChina | |
| » Petroliam Nasional Berhad (Petronas) | |
| » Petronas Capital Limited | |
| » Petronas Dagangan | |
| » Petronas Gas | |
| » PTT Public Company Ltd. (PTT) | June 30, 2011 |
| » Ranhill Berhad | |
| » Ranhill Labuan Ltd | September 30, 2010 |
| » Ranhill Powertron Sdn | September 30, 2010 |
| » Scomi Engineering Berhad | |
| » Scomi Group Berhad | |
| » Seadrill Ltd. | June 30, 2011 |
| » Sinopec Corporation (China Petroleum and Chemical Corporation) | |
| » Sinopec Finance | June 30, 2010 |
| » Sinopec Group (China Petrochemical Corporation) | |
| » Sinopec Kanton Holdings | |
| » Sinopec Shanghai Petrochemical Co. Ltd. | |
| » Sinopec Yizheng Chemical Fibre Co. Ltd. | June 30, 2010 |
| » Societe Metallurgique D'imiter | September 30, 2010 |
| » Wuhan Boiler Company | |

» Denotes wholly- or majority-owned subsidiaries, parent companies, or affiliates of companies that have the most problematic operations in Sudan according to the Sudan Divestment Task Force model of targeted divestment.

* Denotes deadline for divesting of security.