

Kim Reynolds
GOVERNOR

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LT. GOVERNOR



Donna M. Mueller
CHIEF EXECUTIVE OFFICER

September 29, 2017

Honorable W. Charles Smithson,
Secretary of the Senate
Honorable Carmine Boal,
Chief Clerk of the House
General Assembly of the State of Iowa
Des Moines, IA 50319

Dear Mr. Smithson and Ms. Boal:

Enclosed is the Iowa Public Employees' Retirement System's report for the fiscal year ended June 30, 2017, on divestment activities related to companies doing business in Iran. This annual report is required by Iowa Code section 12H.5.

The report describes IPERS' implementation of the Iran divestment program and provides information on IPERS divestment activities and costs. The report also includes the list of prohibited companies that was in effect as of June 30, 2017.

Sincerely,

A handwritten signature in blue ink that reads "Donna M. Mueller".

Donna M. Mueller
Chief Executive Officer

Enclosure

**IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
ANNUAL REPORT
ON IRAN DIVESTMENT
For the Fiscal Year Ended June 30, 2017**

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

Implementation

IPERS develops its list of scrutinized companies using the research and findings of IW Financial (IWF). IWF is a research firm that specializes in researching and monitoring the activities of companies against various types of environmental, social and governance screens. IWF uses the criteria established in Chapter 12H to screen various sources of publicly available information in order to provide IPERS with a list of scrutinized companies. IWF also assists IPERS in evaluating any follow-up responses from scrutinized companies.

IPERS sends a letter to each company believed to have active business operations in Iran and asks them to discontinue their operations in Iran. Companies are given the opportunity to provide evidence that contradicts IWF's findings. The letter also notifies the company that IPERS will prohibit further investment and/or 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 12H 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 12H. IPERS is required to analyze the prudence of moving its indirect holdings to Iran-free commingled funds if such an option exists. See section on Indirect Holdings.

Chapter 12H 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 pursuant to the law's criteria before an investment manager purchases any securities of such company. IPERS' investment managers want to know if a company is prohibited before buying it - not afterwards.

Chapter 12H also requires IPERS to contact companies that have inactive business operations in Iran. However, the purpose of such letter is to encourage them to keep their business activities inactive until state-sponsored terrorism stops in Iran. IPERS uses information from IWF to determine which companies may have inactive business operations in the Iran. Currently, no companies have inactive business operations in Iran as defined in Chapter 12H.

Fiscal Year 2017 Engagement Activity

The following chart summarizes the numbers of companies contacted by IPERS in fiscal year 2017 pursuant to chapter 12H.

Time Period	Number
Sept. 30, 2016	9
Dec. 31, 2016	10
Mar. 31, 2017	2
June 30, 2017	4

Letters were sent to twenty-five companies under scrutiny for active business operations. IPERS received responses from two of these companies. During fiscal year 2017, twenty-two companies were added to the prohibited companies list, and seven companies were removed. The companies were removed because IPERS, with the assistance of IWF, concluded that they no longer met the criteria established in Chapter 12H. IPERS' prohibited companies list in effect as of June 30, 2017 is included as Appendix A to this report.

Chapter 12H also requires IPERS to send reminder letters to companies on the prohibited companies list and encourage them to transform their operations to inactive operations. This task was completed in September 2017 for the fifty-three companies on IPERS' prohibited companies list on July 31, 2017.

Fiscal Year 2017 Divestment Activity

Bonds of Lukoil Oil Co. that IPERS already directly owned in two accounts became a prohibited security on April 22, 2016. Subsequently, on July 28, 2016 one manager sold their entire position in this bond. The other manager sold their remaining position on June 7, 2017. The bonds of Hyundai Motor and Siemens AG also became prohibited securities during the year. The managers have until April 20, 2018 and January 21, 2018, respectively, to sell these securities. Regarding stocks, Bouygues SA, Siemens AG, and Hyundai Mobis became prohibited securities during fiscal year 2017. The positions in Bouygues SA were sold by June 30, 2017. The managers have until April 20, 2018 and January 21, 2018 to sell these securities of Hyundai Mobis and Siemens AG, respectively.

Indirect Holdings

As noted earlier, chapter 12H makes a distinction between direct and indirect holdings. IPERS held twenty-five indirect holdings in the stock of companies listed on the prohibited companies list on June 30, 2017. They were valued at \$45,772,053.73. IPERS indirectly held bonds of companies listed on the prohibited companies list at June 30, 2017 worth \$157,793.69. In total, IPERS had \$45,929,847.42 worth of indirect holdings as of June 30, 2017, which comprised approximately 0.15% of the total IPERS fund.

While indirect holdings are generally exempt from most of the provisions of the law, IPERS is required by law to evaluate the prudence and potential costs associated with moving its indirect investments to funds that will comply with chapter 12H, if any such vehicles exist. IPERS investment staff collected information concerning the potential cost of moving its indirect holdings to Iran-free alternatives in the second quarter of 2012 and presented such information to the IPERS Investment Board at its June 21, 2012 meeting. The Investment Board agreed with staff that it was not prudent to incur the trading costs required to eliminate relatively small indirect exposures to prohibited companies.

Fiscal Year 2017 Program Costs

The cost to implement the Iran monitoring and divestment program has been very low so far. IPERS incurred third party costs of \$8,800.00 for research services in fiscal year 2017, and did not incur any staff overtime costs to implement the program.

In 2016-17, IPERS conducted a competitive selection process for a research provider for the Sudan, Iran and anti-BDS Israel divestment programs. IWF (now a subsidiary of ISS-Ethix) was selected to provide research to IPERS for all three divestment programs for \$5,000.00 per year beginning in fiscal year 2018 – a significant cost savings.

For More Information

Updates of IPERS' Iran prohibited list and holdings can be found on IPERS' Web site at <https://www.ipers.org/about-us/investments/iran-investment-restrictions> quarterly throughout the year. IPERS staff 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 Iran Prohibited Companies List

April 18, 2017

	<u>Divestment Date *</u>
» Aban Offshore Ltd.	
» Alstom SA	April 26, 2017
» Arabian Pipes Co	
» Biancamano Spa	January 22, 2018
» Bouygues SA	January 22, 2018
» Chadormalu Mineral & Ind. Co.	
» China Camc Engineering Co. Ltd	April 21, 2018
» China Nonferrous Metal Industry's Foreign Eng. And Const. Co. Ltd.	
» China Oilfield Services	
» China Petroleum & Chemical Corp	
» China Railway Group Ltd	January 22, 2018
» Chiyoda Corporation	April 21, 2018
» Daellm Industrial	April 21, 2018
» Daewoo Engineering & Construction	January 22, 2018
» Danieli & C - Officine Meccaniche Spa	
» DNO ASA	July 18, 2018
» Energy House Holding Company K.S.C.C.	April 21, 2018
» Engineers India Ltd.	
» F.L.Smidth & Co. AS	April 26, 2017
» Gazprom OAO	
» Glencore plc	
» Gruppo Waste Italia SpA	January 22, 2018
» Hyundai Engineering & Construction	April 21, 2018
» Hyundai Mobis	April 21, 2018
» Hyundai Motor	April 21, 2018
» Indian Oil Corporation Ltd.	
» Inpex Corporation	April 26, 2017
» Inter Rao Ues JSC	January 22, 2018
» Japan Drilling Co., Ltd.	April 26, 2017
» Japan Petroleum Exploration Co., Ltd.	April 26, 2017
» Korea Electric Power	January 22, 2018
» Lukoil Oil Co.	July 22, 2017
» Maire Tecnimont S.p.A.	
» Marubeni Corporation	April 21, 2018
» Mitsubishi Materials Corporation	April 26, 2017
» Motor Sich	
» National Aluminium Co. Ltd.	
» Oil & Natural Gas Corporation Ltd.	
» Oil India Ltd	
» OMV AG	April 26, 2017
» PetroChina Co. Ltd.	
» PJSC Tatneft	July 18, 2018
» Polskie Gornictwo Naftowe i Gazownictwo SA	
» Posco	January 22, 2018
» Power Construction Corporation of China, Ltd.	
» Poyry PLC	
» Shipping Corporation of India Ltd.	April 21, 2018
» Siemens AG	January 22, 2018
» Stroytransgaz OAO	
» United Aircraft Corporation	April 21, 2018
» Zio Podolsk Machinery Plant	

» Denotes companies with active business operations. There are no companies with inactive business operations. Note: not all of these companies are held by IPERS.

* Denotes deadline for divesting of security.