

**State Employees' Retirement System
Senate State Government Committee
Hearing on
H.B. 2447 (Russia Divestiture)
June 14, 2022**

Information Packet Contents:

- **Introductory Comments:** Joseph A. Torta, SERS Executive Director
- **Final SERS Board Motion (2022-13):** "Divestment of Russia-Related and Belarus-Related Assets," March 4, 2022
- **SERS News Release Announcing Board Decision to Divest from Russia and Belarus,** March 4, 2022
- **SERS Response to IFO Request for H.B. 2447-Related Information Regarding Investment Holdings and Estimated Costs of Compliance/Reporting,** March 25, 2022
- **SERS Investment Office Memo to Board re: SERS' Exposure to Russian Assets,** June 2, 2022

State Employees' Retirement System
Joseph A. Torta, Executive Director - Introductory Comments
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Chairman Argall, esteemed members of the committee – we thank you for this opportunity to testify and provide information regarding the actions and approach that the SERS Board and the system took earlier this year in regard to divesting investments in Russia and Belarus.

As you may know, following the Russian invasion of Ukraine on February 24, 2022, the SERS Board took action at its next scheduled meeting, on March 4th.

After what I would call a spirited debate among the trustees, the Board moved to divest from all Russia-related and Belarus-related assets and investments held by SERS in a fiduciarily prudent manner and within a reasonable time.

The following business day, SERS directed its investment managers, consultants and other investment partners to cease making further Russia-related and Belarus-related investments until such time as the Board, after receiving the advice of internal staff and outside investment consultants and advisors, concludes that it is fiduciarily prudent to again to so.

As a matter of course, SERS Board and staff have a fiduciary obligation to protect the assets and interests of our approximately 238,000 members and participants. And it was based on this fiduciary responsibility that the SERS Board took action.

Unquestionably, the Russian invasion of Ukraine brought a heightened level of volatility, risk and potential for losses resulting from exposure to Russia-related investments.

I should note that SERS' exposure to Russia was and is fairly limited. Out of roughly \$40 billion in assets as of December 31, 2021, Russian investments amounted to less than zero-point-one-five percent. So we're talking about a potential impact that is relatively small. At the same time, we had zero investments in Belarus.

Following this Board action, SERS staff, along with our colleagues at PSERS and PMRS, were called upon to provide technical input, advice and insights to the drafters of House Bill 2447.

Just so you know – and this is a little sales pitch – this is the kind of opportunity we welcome. While our official function is the administration of the State Employees' Retirement System, we are also well-positioned to provide technical assistance to members of the General Assembly and their staff in regard to legislation that impacts pensions and the retirement systems. After all, we're the ones that deal on a day-to-day basis with the Retirement Code and pension law - topics that can often be somewhat arcane. Our goal is to help you draft legislation that helps you accomplish your goals and also avoid any pitfalls that can crop up.

During the course of the drafting of H.B. 2447, we worked closely with legislative staff to make sure that what was intended could be accomplished, providing observations and technical advice on matters such as the structure of the legislation, terms and definitions, and other technical details and nuances identified by our team – consisting of legal, investment, governance and finance specialists, as well as our colleagues at PSERS and PMRS.

Again, we were happy to be of service to the General Assembly on this piece of legislation, and will continue to do our best to serve the interests of our members and participants – and the taxpayers of Pennsylvania.

With that, and with your permission, Mr. Chairman, my team and I will be happy to answer your questions.

DIVESTMENT OF RUSSIA-RELATED AND BELARUS-RELATED ASSETS

MOTION: 2022-13

By motion that was moved, seconded, and approved by board members, it was

RESOLVED: That the board, in response to Russia's invasion of Ukraine, the SERS administrative staff, investment office staff and the board's investment consultants are to begin immediately to take all actions necessary to divest SERS of all Russia-related and Belarus-related assets and investments held by SERS in a fiducially prudent manner and within a reasonable time;

AND FURTHER, the administrative and investment office staff of SERS shall direct the investment managers, consultants, and other investment partners of SERS to cease making further Russia-related and Belarus-related investments until such time as the board, after receiving the advice of internal staff and outside investment consultants and advisors, concludes that it is fiducially prudent to again do so.

Glenn E. Becker ABSENT

John M. DiSanto YES

David R. Fillman YES

Dan B. Frankel YES

Stacy Garrity YES

Vincent J. Hughes Designee Matt Lindsay YES

Gregory K. Jordan YES

Paul Schemel YES

Mary A. Soderberg YES

Gregory C. Thall YES

Richard Vague Designee Alan Flannigan YES

March 4, 2022

**Penn SERS Board Calls for Divestment of Russia-Related Investments
Announces 17.24% Return on Investments in 2021,
Approves \$400 Million in New Investments**

HARRISBURG – The Pennsylvania State Employees’ Retirement System Board, meeting by video conference today, directed staff and hired managers and consultants to take all actions necessary to divest SERS of all Russia-related assets in a prudent manner and within a reasonable time.

“The board was briefed by its staff and outside consultants on the heightened volatility, risk, and potential for losses resulting from exposure to Russia-related investments,” said SERS Board Chairman David R. Fillman. “The board directed staff to cease making any Russia-related investments, including Belarus-related investments, and to divest all Russia-related investments currently in the portfolio, as prudent and within a reasonable time, with the goal of reducing risk and possibility of loss to the portfolio and ultimately SERS members.

“Our thoughts are with the Ukrainian people who have been enduring the deplorable bombing of their country and are fighting to preserve democracy for their families,” Fillman added.

As of 03/03/2022, the SERS fund had approximately \$7 million (or 0.02% of SERS’ total fund value) invested in Russia-related investments.

2021 Investment Returns

The board received a report on the investment returns generated by the State Employees’ Retirement Fund. The fund earned a 17.24% return, net of fees, for the Defined Benefit Plan, adding nearly \$5.4 billion to the fund for pension benefits.

Returns by asset class for the fourth quarter and calendar year 2021, were:

Asset Class	4 th Quarter 2021	Calendar Year 2021
U.S. Equity	8.10%	24.62%
Private Equity	6.71	52.83
Real Estate	6.35	18.04
Private Credit	4.15	19.12
International Developed Markets Equity	3.77	14.48
Inflation Protection (TIPS)	2.25	5.16
Fixed Income	0.28	(0.75)
Cash	0.01	0.06
Emerging Mkts Equity	(0.34)	(0.45)
Total Fund	4.65%	17.24%

All returns are reported net of fees. Both private equity and real estate returns are reported on a quarter lag and are adjusted for cash flows. Additional information, including benchmark data, is listed in the quarterly investment performance reports at [SERS.pa.gov/Investments.html](https://www.sers.pa.gov/Investments.html).

- more -

New Investments

The board approved six new follow-on investments within the Private Equity asset class, totaling \$400 million:

- Up to \$100 million to **Francisco Partners VII**, L.P.
- Up to \$50 million to Francisco Partners Agility III, L.P.
- Up to \$50 million to a sidecar vehicle that will co-invest alongside Francisco Partners VII, L.P. and/or Francisco Partners Agility III, L.P.

- Up to \$100 million to **Thoma Bravo Fund XV**, L.P.
- Up to \$50 million to Thoma Bravo Discover Fund IV, L.P.
- Up to \$50 million to a sidecar vehicle that will co-invest alongside Thoma Bravo Fund XV, L.P. and/or Thoma Bravo Discover Fund IV, L.P.

Other Business

Following the board's December 2021 approval of an aggregate pay increase budget for investment professional staff in 2022, the Board Governance and Personnel Committee approved annual salary adjustments for 12 investment professional staffers within the Office of Financial Management and Investment Office, and the Chief Financial Officer, and the board approved a salary increase for the Chief Investment Officer.

The board also approved work plans for each board committee, a board educational training plan, and amendments to the Audit, Risk, and Compliance Committee and Board Governance and Personnel Committee charters.

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Pennsylvania State Employees' Retirement System

Established in 1923, SERS is one of the nation's oldest and largest retirement plans for public employees, with approximately 238,000 members. As of Dec. 31, 2021, SERS' Defined Benefit Plan had assets of nearly \$39.9 billion and the Defined Contribution Plan, which launched on Jan. 1, 2019, had approximately \$75.1 million. SERS also administers a voluntary supplemental Deferred Compensation Plan with nearly 57,600 participants and assets of approximately \$4.8 billion as of Dec. 31, 2021. A wealth of information is available at www.SERS.pa.gov.

For more information: Pamela Hile | phile@pa.gov

March 25, 2022

Mathieu Taylor
Fiscal Analyst II
Independent Fiscal Office
Rachel Carson State Office Building
400 Market Street
Harrisburg, PA 17105

RE: H.B. 2447, P.N. PN 2869

Dear Mathieu,

I am writing in response to your email message of March 23, 2022, asking for information from SERS concerning the possible impact of H.B. 2447 on the system.

House Bill 2447, Printer's Number 2869

House Bill 2447, P.N. 2869, requires the State Treasurer as custodian of Commonwealth funds, the State Employees' Retirement System, the Public School Employees' Retirement System, and the Pennsylvania Municipal Retirement Fund to divest all direct and indirect investment holdings and alternative investments of companies that are sanctioned Russian companies, sanctioned Belarusian companies, and scrutinized companies, including the government of Russia, the government of Belarus, and their respective subdivisions.

HB 2447's divestiture rules and definitions do not apply to SERS' defined contribution plan, created under Act 2017-5, or the Commonwealth's Deferred Compensation Plan created under 72 P.S. §4521.2.

SERS' leadership team has reviewed the bill and determined that we have no major technical or implementation objections or concerns to the bill as currently written, although we understand that there may be additional technical correction amendments by the sponsor. We have no comments on the substantive public policy position of the bill.

SERS Russian and Belarus Investment Holdings

As of March 10, 2022, SERS estimated the fund had \$0 (zero) of direct exposure and approximately \$5 million of indirect exposure of Russian public equity through SERS public equity commingled funds and approximately \$1 million of Russia exposure through private equity funds. Of the \$6 million of indirect Russia exposure, there is approximately \$2 million of exposure to sanctioned companies. Furthermore, SERS has \$0 (zero) exposure to Belarus (direct and indirect).

On March 4, 2022, SERS Board of Trustees passed Motion 2022-13, which states:

That the board, in response to Russia's invasion of Ukraine, the SERS administrative staff, investment office staff and the board's investment consultants are to begin immediately to take all actions necessary to divest SERS of all Russia-related and Belarus-related assets and investments held by SERS in a fiduciarily prudent manner and within a reasonable time;

AND FURTHER, the administrative and investment office staff of SERS shall direct the investment managers, consultants, and other investment partners of SERS to cease making further Russia-related and Belarus-related investments until such time as the board, after receiving the advice of internal staff and outside investment consultants and advisors, concludes that it is fiduciarily prudent to again do so.

In accordance with the above motion, all staff, hired managers, and consultants were directed to take all actions necessary to divest SERS of all Russia-related and Belarus-related assets and investments in a prudent manner and within a reasonable time. In addition, they were instructed to make no purchases on behalf of SERS of any securities of Russia-related or Belarus-related investments until further notice.

Since that time, the amount of SERS' investment holdings in Russia has declined due in part to indexes rebalancing through the removal of Russian exposure. That decline is expected to continue.

Given the volatility of the markets, and ongoing uncertainty in how long it could take to divest SERS' Russia-related assets and investments in a fiduciarily prudent manner, total projected losses are indeterminable at this time.

Estimated Administrative Costs of Compliance / Reporting

In addition to potential losses identified above, costs and expenses likely to be incurred by SERS as a result of compliance with HB 2447 are anticipated to be minimal. Administrative expenses, including salaries of staff related to various compliance activities such as report preparation and communication with managers, are also expected to be minimal.

I trust this provides you with the information you need to assess H.B. 2447, P.N. 2869, and its potential impact on SERS.

Please feel free to reach out if you have any questions or concerns.

Very truly yours,



Thomas Derr
Director, Communications & Policy

Memo

To: SERS' Board Members
 From: James G. Nolan, Chief Investment Officer
 Date: 6/2/2022
 Re: **SERS' Exposure to Russian Assets**

Background:

On February 24th, 2022, Russia began the invasion of the sovereign nation Ukraine. As a result, governments and businesses around the globe began restricting business ties to Russia. To prevent financial collapse, the Russian Central Bank closed the Moscow Stock Exchange on February 28, 2022, effectively freezing all market transactions.

At the next available SERS Board meeting, which took place on March 4, 2022, The SERS Board directed staff to immediately cease all Russian, and Russian sympathizer Belarus, based investments and to divest all Russian and Belarusian assets prudently and in a reasonable amount of time.

Timeline of Events:

Date	Event
2/24/2022	Russia invades Ukraine
2/28/2022	Russian Central Bank closes Moscow Stock Exchange
3/2/ 2022	MSCI Inc. announces removal of Russia from their Emerging Markets Index
3/4/2022	SERS Board votes 10 affirmative (1 absentee) to cease all Russian and Belarusian investments and to begin divesting in a fiduciarily prudent manner
3/24/ 2022	Russian Central Bank partially reopens stock exchange but barred foreign investors from selling stocks
6/1/2022	Russian foreigners are still prohibited from selling Russian stock

Staff and Manager Action:

In preparation for the March Board Meeting, the Investment Office reached out to both private and public market managers to confirm how much Russian and Belarussian based assets were held and how easily they could be liquidated. On March 2, MSCI Inc. announced that it was removing Russia from its flagship Emerging Market Index, clearing the way for SERS' emerging markets manager Blackrock to begin liquidation of Russian Assets. Other public market managers Macquarie and Leading Edge also began divesture while Martin Currie possesses only de-minimis exposure after liquidating most of their Russian exposure during January 2022.

After nearly a one month close, the Russian Central bank reopened the Moscow stock exchange on March 24, 2022, however all short selling was banned, and all foreign investors were prohibited from selling Russian stocks. Despite an initial proposal that all stocks would resume trading on April 1, 2022, foreign investors are still banned from selling Russian stocks as of the date of this memo.

SERS Past and Current Russian Exposure (Estimated as the Russian market remains closed):

**PORTFOLIO LEVEL EXPOSURES
(CONFIDENTIAL BOARD USE ONLY)**

Portfolio	Market Value (As of 12/31/21, \$ in Millions)	Change in Market Value	Market Value (As of 3/31/22, \$ in Millions)	Market Value (As of 5/25/22, \$ in Millions)
% of Total Fund Value	0.14%		0.01%	0.01%

* As of 9/30/2021

** As of 12/31/2021

Result:

SERS' investment office continues to actively monitor this volatile situation and will continue to work with our managers to divest from Russian and Belarussian assets in a prompt, but prudent, manner.