JOHN CHIANG
TREASURER
STATE OF CALIFORNIA

Henry Jones
Chair, Investment Committee
CalPERS Board of Administration
PO Box 942701
Sacramento, CA 94229-2701

December 13, 2016

Dear Mr. Jones:

I continue to believe that investing in tobacco-related securities is a bad economic decision for CalPERS beneficiaries, for the state in general and for the world as a whole, whether we invest directly or through others. I will be voting for the expansion of tobacco divestment to include external active investment managers.

It is time to end the charade that somehow CalPERS stopped investing in tobacco companies more than a decade ago. Our external managers currently have plowed a sizable $547 million into tobacco-related funds, according to the latest CalPERS staff estimates. We need to pull those funds and soon.

Such ongoing investments are linked directly to addiction, disease and death. They raise serious public policy questions that cannot be mitigated by supposed higher returns. CalPERS should not put money into an industry that is so harmful to people's health and so costly to the state when rising health care costs are factored into the balance sheet.

For that reason, I asked the board last April to continue its prohibition against direct tobacco investment.

This month, staff will present the results of this study to the Investment Committee, providing members with an economic/risk analysis on the tobacco industry with suggested options for the Committee to consider going forward.

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These options include:
(1) Affirming the existing policy by continuing to divest tobacco-related securities in CalPERS' internally-managed funds;
(2) Expanding the divestment to include approximately $547 million in PERF-held external active investment managers and an unknown amount in Affiliate Fund-held external funds; or
(3) Removing the restriction on tobacco investments altogether, thus allowing CalPERS to resume investments in tobacco-related securities.

In determining what the responsible fiduciary action should be, we cannot separate the benefits to the fund of investment in tobacco from the health care costs of tobacco that CalPERS incurs. Wilshire Consulting indicated that CalPERS' tobacco exclusion cost the fund in excess of $3 billion in foregone investment returns between 2001 and 2014 and projected a future annual loss of potential returns of between $112 million and $172 million.

However, this analysis did not take into account the health care costs and lost productivity borne by health insurers, taxpayers, and employers due to tobacco use. Conservative estimates indicate that these combined costs amount to $27 billion annually in California alone. That means over the same 14 year period, tobacco use cost the state approximately $378 billion. The State of California, being one of the largest employers in the state, bears an inordinate proportion of these costs and, as part of my fiduciary duty as a Board member, I must take that into account.

Let me speak for a moment to the notion that tobacco investing represents a lucrative return. Educational and regulatory efforts continue to erode tobacco consumption use throughout the world. Proposition 56, for example, which recently increased the tax on tobacco products and tripled funding for tobacco control programs, will further reduce the tobacco consumption rate in California. Moreover, the Centers for Disease Control has found that between 2005 and 2014, the prevalence of cigarette smoking among US adults has declined from 20.9% to 16.8%. Smoking rates similarly leveled off or declined in the rest of the developed world so tobacco is increasingly relying on heavy use in developing countries, where regulation is extremely low, and on new smokers to sustain the industry.

Past performance is not an indicator of future results, and tobacco is no exception. The reported $3 billion in lost return due to the exclusion is not an indicator of future performance. The reported $112 million to $127 million in projected annual future impact from excluding tobacco investments pales in comparison to the costs CalPERS bears to care for tobacco-related diseases in its beneficiaries as well as in lost productivity for state employees. I believe that tobacco is literally a dying industry and that CalPERS must divest itself of **all** tobacco-related investments. Removing the restriction on tobacco investments would irreparably damage CalPERS' reputation as a leader in sustainable investments and send a terrible message to other pension funds. I urge my fellow Board members to join me in voting to continue our divestment policy and expand it to our external managers.

Sincerely,

JOHN CHIANG
California State Treasurer

cc: CalPERS Board
Marcie Frost, Chief Executive Officer, CalPERS
Ted Eliopoulos, Chief Investment Officer, CalPERS

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