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December 2, 2014

Governor Mark Dayton
State Auditor Rebecca Otto
Secretary of State Mark Ritchie
Secretary of State-Elect Steve Simon
Attorney General Lori Swanson
Executive Director Mansco Perry

Minnesota State Board of Investment
60 Empire Drive, Suite 355
St. Paul, MN 55103

Re: International Investing Guidelines – Country Grouping – Israel

Dear Board members, Secretary of State-Elect Steve Simon and Executive Director Perry:

The Minnesota State Board of Investment is currently in breach of its own administrative rules by failing to timely prepare a periodic review of country groupings pursuant to the Board's International Investing Guidelines and its fiduciary obligations under MN Stat. sec. 356A.04. Periodic reviews are required at least every four years. The last review was prepared in 2005. The purpose of this letter is to request that the Board direct the Administrative Committee to prepare a current, accurate and complete periodic review of Israel's country grouping. Additionally, this letter includes information supporting the re-categorization of Israel from a Group II country to a Group III country.

In September 1992, the State Board of Investment (SBI) established an International Investing Guidelines Task Force led by then State Auditor Dayton. The Task Force was formed in response to human rights and other related concerns raised by Minnesota's two largest labor unions.

The guidelines recommended by the Task Force were adopted by the SBI in December 1992 and have been used by the SBI in the implementation of its international investment

program since that time. Under the guidelines, countries are grouped into three broad categories. Those countries that have legal protections or practices that generally respect internationally recognized worker and human rights are in Group I. Group II countries have legal protections for worker and human rights but violations of these rights have been cited in U.S. State Department reports. Group III countries lack basic protections for worker and human rights and do not appear to be making adequate progress in establishing a legal structure to address these issues.

The SBI has delegated periodic review of country groupings to the SBI Administrative Committee. Over time, the frequency of periodic reviews has fallen off dramatically. The last formal review occurred in 2005. Earlier reviews were conducted in 1994, 1996, and 1998. In 2003, upon the recommendation of the Administrative Committee, the SBI changed the requirements so that periodic reviews would be prepared every four years or at the request of a Board member. Between 2005 and 2013, no effort was made to conduct the required periodic review. Although the Administrative Committee began a periodic review in 2013, it remains unfinished and Israel's country grouping and human rights record have not been examined in nearly a decade, contrary to the Board's own administrative requirements and the intent of the International Investing Guidelines Taskforce.

Assigning a properly researched and current, accurate and complete country grouping to Israel bears a direct relationship to the Board's fiduciary obligations under MN Stat. 356A.04, Subd. 2. Under the Guidelines, Group II countries pose a concern that economic and social disruptions may occur, having an adverse effect on their financial markets. For countries assigned to Group III, the Board recognizes that the potential exists for economic, political and social unrest that could adversely affect the stability of the financial markets within these countries. Thus, the Board requires asset managers who invest in public traded securities in the markets of a Group II or a Group III country to hold a bona fide belief that it would be a breach of fiduciary responsibility not to invest and to notify the SBI of that decision in writing.

As the Board's agents, asset managers who make the statement that they believe it would be a breach of fiduciary duty not to invest are doing so within the scope of the prudent person standard which is defined at sec. 356A.04, Subd. 2. Thus, the Board is attesting, through its agents, that it has acted in good faith in making such a statement, that it has exercised that degree of judgment and care, under the circumstances then prevailing, that persons of prudence, discretion and intelligence would exercise in the management of their own affairs in making such a statement and not for speculation, considering the probable safety of the plan capital as well as the probable investment return to be derived from the assets.

Even though the country grouping and periodic review process is currently limited to informing equity asset managers, the statutory fiduciary obligations that exist in making the decision to invest in the stock of companies domiciled in Group II or Group III countries is based on the same prudent person standard required to be employed by the Board in every transaction, including the purchase of sovereign bonds. Thus, the assignment of a negative country group rating to Israel, although assigned for the purpose of informing equity investment managers, cannot be ignored when purchasing Israel's sovereign bonds. The probable public safety of plan capital invested in sovereign bonds is equally if not more so implicated by the risk presented by actual and potential economic, political and social unrest caused by a sovereign's dismal human rights record.

If the Board lost public funds by purchasing the sovereign bonds of a country periodically falling into turmoil, would the prior categorization of that country as a serious human rights

offender for equity investment purposes also be relevant in a subsequent prudent person examination to show that the Board was on notice that circumstances existed that could likely cause economic, political and social unrest adversely affecting the investment? The answer of course would be yes. The law also forbids the purposeful assignment of an inaccurate country grouping for personal or political reasons (See MN Stat. 356A.05) as it does for any other false statement in the management of the state's fiscal affairs.

In assigning country groupings, the Administrative Committee has traditionally used six human rights criteria derived from the UN's Universal Declaration of Human Rights. They are: 1) Freedom from political or extrajudicial killing or disappearance; 2) Freedom from torture; 3) Right to fair public trial/due process; 4) Freedom of speech and press; 5) Rights of citizens to change laws, officials and government; 6) Freedom from discrimination based on race, religion, sex or social status.

Volunteer members of the Minnesota Break the Bonds Campaign have donated their time to research and compile the following information regarding Israel's egregious human rights record in the six areas used by the Board in assigning past country groupings. With this information in hand, we are hopeful that the Board will now satisfy its own administrative requirements, conduct the required periodic review and more properly assign Israel a category III country grouping. As shown, Israel lacks basic protections for human rights, including a constitution that guarantees equal rights, and does not appear to be making adequate progress in establishing a legal structure to address these issues. Given the current political situation in Israel, including the powerful influence of a right wing pro-settlement block in both the Knesset and the Cabinet given to common expressions of xenophobia and racist hatred toward Arabs, the human rights situation in Israel is getting worse.

Respectfully yours,

Minnesota Break the Bonds Campaign
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