November 1, 2024

To: Public Pension Fund Fiduciaries
From: State Financial Officers
Subject: Fiduciary Rationale for Divesting from China-Based Investments

Today, we join with the Federal Retirement Thrift Investment Board and many other state officials in concluding that investments in China are no longer prudent investments. Trustees of state funds have a duty to investigate investments and a duty to monitor investments and divest from imprudent investments, in order to ensure that those funds grow and are protected for future beneficiaries. The time has come to divest from China.

Investments in China increasingly present red flags, including:

1. The Chinese Communist Party (CCP) has cracked down on firms providing due diligence, and financial audits have been found to be unreliable;

2. The CCP interferes with Chinese stock and bond markets, including recent actions to conceal the historic outflow of foreign investments and to stop market participants from selling shares;

3. The CCP exerts control over China-based companies, including by placing intelligence and military operatives within companies; and

4. The CCP keeps the legal status of Variable Interest Entities (VIEs) in a state of uncertainty. VIEs are offshore shell companies that appear to be illegal under

Chinese law, yet are the most common type of Chinese investment available to U.S. investors. As the SEC has warned, the CCP could declare VIEs illegal "at any time and without notice."

5. There is a significant risk that China may invade Taiwan in the near future, as it has repeatedly stated its intent to annex Taiwan even if by force, and is conducting military exercises in the area;

6. The U.S. government is likely to impose further restrictions on investing in China with or without an invasion, similar to restrictions imposed on every other country on the U.S. government's "foreign adversaries" list—(Cuba, Iran, North Korea, Russia, the Maduro regime in Venezuela);

7. Foreign investment in China is rapidly declining, producing net outflows from Chinese markets;

8. Similar fiduciaries are divesting from or avoiding China-based investments, including the Federal Thrift Savings Plan and state systems in Florida, Indiana, Kansas, Missouri, Nebraska, Oklahoma, Pennsylvania, Tennessee, and West Virginia;

Many fiduciaries, including state pension plans, failed to recognize similar warning signs before Russia's invasion of Ukraine in 2022. As a result, states lost billions of dollars in value that was held in trust for retirees. Pension boards should learn from the past, or they will be doomed to repeat it.

As state financial officers, we urge public pension boards to analyze these issues, to identify China-based investments, and to divest from those investments in line with their fiduciary duties.

Sincerely,

J. andrew Sorrell

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