STATE ARMOR

November 14, 2024

To Governors, State Legislatures, State Fiscal Officers, and Fund Managers allocating state pensions, endowments, and other public funds:

State and local investments in China-based companies and their related shell companies may violate your state pension laws and put pensioners at risk. Under these laws, fiduciaries responsible for managing state pension funds owe pensioners a duty of care, and they must continually monitor and investigate whether their investments are prudent.

Geopolitical warning signs indicate that Chinese investments are no longer prudent. Many states failed to heed similar signs before Russia invaded Ukraine in 2022, and consequently states lost billions of dollars in pensions and other funds. The warning signs ahead of Russia's invasion of Ukraine occurred on a relatively compressed timeline compared to the warning signs of an invasion of Taiwan by China. Indeed, on October 14, 2024, China's People's Liberation Army conducted a massive, simulated blockade and invasion of Taiwan, including a record 125 aircraft along with scores of ships, including China's aircraft carriers. This exercise was China's third such simulated blockade and invasion of Taiwan over the last two years.

To avoid losses in Chinese investments, to which state pension funds generally bear much greater exposure than they did to Russian investments, fiduciaries responsible for managing state pension funds need to change their approach.

First, states did not prepare for the likelihood of investment restrictions with Russia in 2022 based on its clear intention to invade Ukraine. Today, China-based investments are likely to be subject to similar restrictions because American military intelligence reports a significant likelihood of China invading Taiwan. Furthermore, even without an invasion, the United States government is likely to continue to increase investment restrictions with China because China is on its foreign adversary list (along with Russia, Cuba, Iran, North Korea, and the Maduro regime in Venezuela).

On October 28, President Biden's Department of Treasury issued a final rule restricting outbound investments in Chinese national security technologies and products. Congressional leaders have signaled near-term interest in more comprehensive restrictions on outbound investments to China. Furthermore, President-elect Trump campaigned on a policy of imposing 60% tariffs on imports from China. Foreign investment in China has precipitously declined the past few years. Fiduciaries responsible for managing state pension funds have a duty to monitor these risks and, subsequently, to divest from imprudent investments.

In addition, the Chinese Communist Party's (CCP's) extensive control over companies prevents fiduciaries from accurately assessing China-based investments. Indeed, the CCP has taken steps to prohibit accurate audits, and prevent firms from conducting due diligence. The CCP has repeatedly interfered with its stock and bond markets, and places CCP and militia cells within companies. And the VIE structure used for many China-based investments does not provide investors with an equity stake or basic legal protections. Without accurate information, fiduciaries cannot uphold their duty of care to pensioners.

Notably, similar fiduciaries have recognized these risks and are divesting. The Federal Retirement Thrift Investment Board voted unanimously to use funds that exclude China and Hong Kong. Several states have also begun working to divest some or all state funds from China-based investments including—Missouri, West Virginia, Florida, Indiana, Nebraska, Oklahoma, Pennsylvania, Kansas, Idaho, South Dakota, Mississippi, Iowa, Texas, and Tennessee. Twenty state financial officers representing 17 states recently issued a joint statement concluding that "investments in China are no longer prudent investments" and that the "time has come to divest from China."[1] Several of Sweden's state pension funds have also chosen to divest from China-based investments.

Your states should also consider taking actions to reduce your exposure to China-based investments. To ensure your state fiduciaries and their counsel are fully informed, we have prepared a legal memorandum on the extensive risks of continuing to invest in China-based companies along with analysis from national security experts with a career-long focus on financial matters. We are glad to provide additional information that may assist this analysis with the ultimate goal of helping states secure their financial positions by divesting from China-based investments.

Sincerely,

Michael Lucci
Founder and CEO of State Armor

[1] https://sfof.com/wp-content/uploads/2024/11/China-Divestment-Letter11-4.pdf