

The Florida Senate
PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Governmental Operations Committee

BILL: CS/SB 2142

INTRODUCER: Governmental Operations Committee, Senator Deutch and others

SUBJECT: Economic Sanctions/Sudan

DATE: April 18, 2007

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Pardue/Skelton	Skelton	MS	Favorable
2.	Wilson	Wilson	GO	Fav/CS
3.			JU	
4.			GA	
5.				
6.				

I. Summary:

The bill provides a series of legislative findings relative to current conditions in the Republic of Sudan. It describes, in detail, declarations by the U.S. Congress, U.S Secretary of State, and the U.S. President regarding the ongoing genocide and atrocities against citizens of regions of Sudan. The bill recognizes that Sudan is designated as a State Sponsor of Terror by the U.S. Department of State and that the U.S. government applies trade sanctions against Sudan for its ongoing actions. The findings include information regarding universities, municipalities, states and private pension plans that have chosen to divest of securities with equity ties to companies doing business with the Government of Sudan.

Further, the bill finds that it is the responsibility of the State of Florida to decide how, where and by whom financial resources in its control should be invested and it is the prerogative of the state not to participate in ownership or capital-providing capacity with entities that provide significant practical support for genocide, including certain non-U.S. companies presently doing business in Sudan. It finds that divestment should only be used sparingly and judiciously and that a Congressional and Presidential declaration of genocide satisfies this high threshold. The bill finds that the act should remain in effect only if it continues to be consistent with and does not unduly interfere with the foreign policy of the United States.

The bill requires the State Board of Administration (SBA) to perform certain tasks related to the "Public Fund." The Public Fund is defined as all funds, assets, trustees, and other designates under the State Board of Administration.

The SBA is required to make its best efforts to identify all "scrutinized companies" in which the Public Fund has direct or indirect holdings or could possibly have such holdings in the future.

Companies designated as “social-development company” that are not complicit in the Darfur genocide are not considered scrutinized companies.

The SBA is required to assemble a list of “scrutinized companies.” The list shall be updated quarterly.

The Public Fund is required to actively engage any company on the list to encourage the company to refrain from active business operations with the Government of Sudan.

For a company which is newly identified on the list as having active business operations, the Public Fund is required to send the company a written notice of its status as a scrutinized company and the possibility that it may become subject to divestment by the Public Fund.

If a company on the “Scrutinized Companies List” fails to take action within 90 days after engagement through written notice, the Public Fund is required to sell, redeem, divest, or withdraw all publicly traded securities of the company according to the following schedule:

- At least 50 percent of such assets shall be removed from the Public Fund’s assets under management by 9 months after the most recent appearance of the company on the Scrutinized Companies List and
- 100 percent of those assets must be removed within 15 months of the company’s most recent appearance on the list.
- A company that the U.S. government affirmatively declares to be excluded from federal sanctions is exempt from such divestment.

If a company resumes active business operations in Sudan, it is to be added back to the Scrutinized Companies List immediately.

The Public Fund is prohibited from acquiring securities of any companies on the list which have active business operations in Sudan.

The divestment provisions do not apply to indirect holdings in actively managed investment funds. The Public Fund is required to send letters to the managers of such funds requesting that they consider removing those companies from the fund or create an alternative fund. If an alternate fund is created, the Public Fund is required to replace all applicable funds with the new fund.

The Public Fund must file a report to the Governor, the Attorney General, the Senate President and House Speaker which includes the Scrutinized Countries List within 30 days of the creation of the list. A further report is required annually. In addition to the above, the annual report is to be sent to the U.S. Presidential Special Envoy to Sudan. The annual report is to include a summary of all correspondence with companies; all investments sold, redeemed, divested; or withdrawn; all prohibited investments; and any progress made in engagement of actively managed investment funds.

The act expires only if certain conditions are met.

With respect to this act, the Public Fund is exempt from any conflicting statutory or common law obligations, including any obligations with respect to choice of asset managers, investment funds or investments for the Public Fund's security portfolios.

The Public Fund may cease divesting, or reinvest, in certain scrutinized companies if the value of all assets under management by the Public Fund becomes equal to or less than 99.50 percent, or 50 basis points, of the hypothetical value of all assets under management. Such activities require an additional report to the SBA, Senate and House.

The bill requires the Attorney General to enforce the provisions of the act and allows the Attorney General to bring any necessary actions in court.

The act includes a severability clause.

The bill takes effect becoming law and remains in effect until certain conditions are met at the federal government level.

The bill will have an unknown fiscal impact on the Public Fund.

This bill creates an unnumbered section of the Florida Statutes.

II. Present Situation:

History of the Conflict in the Republic of the Sudan and Darfur¹

According to the U. S. Department of State, Sudan is the largest country in Africa comprising an area almost the size of the continental United States east of the Mississippi River. Sudan's population is one of the most diverse on the African continent. The country has two distinct major cultures, "Arab" and "black African" that include hundreds of ethnic and tribal subdivisions and language groups.

Sudan was a collection of small, independent kingdoms until 1820-21 when Egypt conquered and unified the northern portion of the country. A nationalist revolt led by religious leader Muhammad ibn Abdalla resulted in a brief period of independence beginning in 1885. In 1898, an invading force led by Lord Kitchner established a period of Anglo-Egyptian rule that lasted until Sudan achieved independence on January 1, 1956.

Independent Sudan was established under a provisional constitution that was silent on two issues that were considered crucial for southern Sudanese leaders—the secular or Islamic character of the state and its federal or unitary structure. Due to the failure of the Arab-led government in Khartoum to create a federal system as promised, southern army officers led a mutiny that resulted in 17 years of civil war (1955 – 1972). Sudan has been at war with itself for more than three quarters of its existence since 1956.

In 1972, an agreement was signed in Addis Ababa granting the south a measure of autonomy. The western regions of Darfur and Kordofan then sought similar privileges but were denied.

¹ U. S. Department of State, Background Note: Sudan, February 2007.

Political maneuvering continued until 1979 when Chevron discovered oil in the south. Northern pressure began to build to abrogate those provisions of the peace treaty granting the south financial autonomy. Ultimately in 1983, the southern region was abolished, Arabic was declared the official language, traditional Islamic punishments derived from Shari'a (Islamic Law) were incorporated into the penal code, and control of the southern armed forces was transferred to the central government. The second Sudan civil war effectively began in January 1983.

The 1990's saw a succession of regional efforts to broker an end to the Sudanese civil war. In July 2002, an agreement was reached on the role of the state and religion and the right of southern Sudan to self-determination. This was followed by an agreement in November 2004 committing to a final comprehensive peace agreement and a United Nations Security Council Resolution 1574 calling for an end to the violence in Darfur. The Comprehensive Peace Agreement (CPA) was formally signed on January 9, 2005. The CPA established a new Sudanese Government of National Unity and the interim Government of Southern Sudan with a call for wealth and power sharing, a ceasefire, withdrawal of troops from southern Sudan, and security arrangements between the two parties.

In 2003, while the historic north-south conflict was on its way to resolution, increasing reports of attacks on civilians especially aimed at non-Arab tribes began to surface. A rebellion broke out in Darfur, in the extremely marginalized western Sudan, led by two rebel groups – the Sudan Liberation Movement/Army (SLM/A) and the Justice and Equality Movement (JEM). These groups represented agrarian farmers who are mostly non-Arabized black African Muslims. In seeking to defeat the rebel movements, the Government of Sudan increased arms and support to local tribal and other militias, which have come to be known as the Janjaweed.

Attacks on the civilian population by the Janjaweed, often with the direct support of Government of Sudan forces, have resulted in the deaths of tens of thousands of persons and the displacement of approximately 2.5 million people.²

On September 9, 2004, Secretary of State Colin Powell told the Senate Foreign Relations Committee, "genocide has been committed in Darfur and that the Government of Sudan and the Janjaweed bear responsibility—and that the genocide may still be occurring." President Bush echoed this in July 2005, when he stated that the situation in Darfur was "clearly genocide."

In March 2005, United Nations Security Council Resolution 1590 established a UN mission in Sudan, with up to 10,000 African Union military personnel, in order to foster peace in Darfur. Security Council Resolution 1591 subsequently criticized the Government of Sudan and rebels in Darfur for failing to comply with several previous resolutions, for ceasefire violations, and for human rights abuses.

On May 5, 2006, the Government of Sudan and a faction of the SLM/A signed the Darfur Peace Agreement. Shortly thereafter, the conflict in Darfur intensified, led by rebel groups who refused to sign the agreement. After government forces began a major offensive on rebel areas in Northern Darfur in late August 2006, Security Council Resolution 1706 authorized the transition

² Note: The United Nations estimates that more than 200,000 have died in the conflict in Darfur.

of the African Union mission to a more robust UN peacekeeping operation. The Government of Sudan has resisted the establishment of such an UN operation.

On November 16, 2006, UN Secretary General Kofi Annan announced in Addis Ababa, Ethiopia that further agreement on peacekeeping forces had been reached. However, recent reports indicate that Sudanese President Omar Hassan al-Bashir has refused to accept the plan.

In an attempt to document the atrocities in Darfur, the U. S. State Department characterized the situation in 2004 as a humanitarian crisis. At that time, 405 villages in Darfur had been completely destroyed and another 123 substantially destroyed. Approximately 200,000 persons had sought refuge in eastern Chad and the UN reported an estimated 1.2 million internally displaced persons remained in western Sudan.³

Since that assessment, the situation has become worse. As previously stated, the current estimate of displaced persons is approximately 2.5 million. Humanitarian relief efforts for displaced persons camps have been blocked and aid workers have been forced to leave. Day to day life in and around the camps is dangerous with an ever present threat of rape, torture, or murder.

Currently, efforts by the United Nations and the international community are continuing in order to arrive at peace in Darfur.

Sudan's Economy

Sudan had a gross domestic product of \$22.75 billion in 2005 with a per capita income of \$2,100. Sudan has modest reserves of oil, natural gas, gold, iron ore, copper, and other industrial metals. Its primary resources are agricultural with products including cotton, peanuts, sorghum, sesame seeds, gum Arabic, sugarcane, millet, and livestock. However, oil production and export has taken on increasing importance since October 2000 when oil began to be exported. There are indications of significant potential reserves of oil and natural gas in southern Sudan, the Kordofan region and the Red Sea province.

Sudan's major markets include Egypt, the Persian Gulf states, Saudi Arabia, Malaysia, China, and South Korea. Sudan's major suppliers include the European Union, China, Malaysia, Canada, the United Kingdom, Italy, Germany, Saudi Arabia, Egypt, the Persian Gulf states, and surrounding East African nations.

Sudan has an estimated population of approximately 41 million people. Of these, approximately 22 million live in the northern region including most of the urban centers. Six million live in the southern region. The remaining population is located in the eastern and western regions.

State Sponsors of Terrorism

Countries which are determined by the United States Secretary of State to have repeatedly provided support for acts of international terrorism are designated as "State Sponsors of Terrorism" and are subject to sanctions under the Export Administration Act⁴, the Arms Export

³ U. S. State Department, State Publication 11182, Documenting Atrocities in Darfur, September 2004.

⁴ Section 6(j), U.S. Export Administration Act.

Control Act⁵ and the Foreign Assistance Act⁶. The four main categories of sanctions resulting from designations under these acts are: restrictions on U.S. foreign assistance, a ban on defense exports and sales, certain controls over exports of dual use items, and miscellaneous financial and other restrictions.⁷ Some of the miscellaneous restrictions include opposition to loans by the World Bank and other financial institutions, removing diplomatic immunity to allow victims of terrorism to file civil lawsuits, denial of tax credits to companies and individuals for income earned in named countries, authority to prohibit U.S. citizens from engaging in transactions without a Treasury Department license, and prohibition of Department of Defense contracts above \$100,000 with companies controlled by terrorist-list states.⁸

The five countries currently designated by the U.S. Secretary of State as “State Sponsors of Terrorism” are Cuba, Iran, North Korea, Sudan and Syria.⁹

The Republic of the Sudan was recognized as a State Sponsor of Terrorism on August 12, 1993, and has retained that designation continuously since that time. While terrorist activity appears to have subsided in recent years, concerns remain. In the April 2006 “Country Reports on Terrorism” released by the Office of the Coordinator for Counterterrorism for the U.S. Department of State, Sudan is cited for its continued cooperation against known and suspected international terrorist elements believed to be operating in and out of Sudanese territory. The report cited Sudan’s cooperation with the international community in calling for strong condemnation of terrorism. However, the report cautions that Sudan’s history of hosting al-Qaida leader Usama bin Ladin in the 1990s continues to reflect heavily on any assessment of Sudan’s role in international terrorism. While there is considerable international concern about Sudan’s handling of internal rebel movements, the report indicates that there is no current data indicating that international terrorists operate in Darfur. The flow of weapons into and out of Sudan has weakened international efforts to stabilize the region. There is continued concern that Sudanese fighters are among the insurgents in Iraq. There is evidence of their presence, and of the Sudanese government’s attempts to curb this activity.

The U.S. government attributes progress made in working with Sudan to reduce terrorism to diplomatic actions and economic pressure applied by sanctions, both U.S. and international.

Current U.S. Sanctions Against Sudan¹⁰

The United States has imposed trade sanctions on the Government of Sudan since November 1997. Executive Order No. 13067, its successor orders and associated regulations, have remained in effect continuously. The sanctions are imposed for several reasons. Continued support for international terrorism, ongoing efforts to destabilize neighboring governments, and the prevalence of human rights violations including slavery and the denial of religious freedoms are cited.

⁵ Section 40, U.S. Arms Export Control Act.

⁶ Section 620A, U.S. Foreign Assistance Act.

⁷ U.S. Department of State website, <http://www.state.gov/s/ct/c14151.htm>, Office of Coordinator for Counterterrorism, “State Sponsors of Terrorism.”

⁸ U.S. Department of State website, <http://www.state.gov/s/ct>, “Country Reports on Terrorism.”

⁹ See Footnote 4 above.

¹⁰ U.S. Department of the Treasury, Office of Foreign Assets Control, “What You Need To Know about U.S. Sanctions – Sudan.”

In addition to U.S. sanctions, the United Nations Security Council issued Resolution 1591 and Resolution 1672 condemning the actions of the Government of Sudan and calling on member nations to take certain measures against persons responsible for continuing conflicts.

In response to UNSC Resolution 1672, President Bush issued a new Executive Order expanding on the original sanctions of E.O. No. 13067. The expanded order specifically names persons subject to its provisions and authorizes the Department of Treasury and Department of State to designate additional persons, as needed.

Persons named as, or doing business with persons named as “Specially Designated Nationals” of Sudan face the following sanctions:

- U.S. persons are prohibited from transacting business with these individuals and entities and all of their property in the United States or in the possession or control of a U.S. person is blocked.
- Any U.S. individual or organization engaging in transactions with foreign nationals must take reasonable care to make certain such foreign nationals are not owned, controlled by, or acting on behalf of Sudan.
- U.S. individuals or organizations that violate the regulations may be subject to civil or criminal prosecution.

Goods or services of Sudanese origin may not be imported into the United States, either directly or indirectly without a license. Except for certain exempted goods (information, donated articles to relieve human suffering, and licensed export of agricultural, medicine and medical devices), no goods, technology or services may be exported from the U.S. to Sudan. No U.S. bank may do business with Sudanese customers or customers doing business with the Sudanese government.

All property and interest in property of the Government of Sudan in U.S. possession or control is frozen and may only be released with approval of the Office of Foreign Asset Control. All unspecified transactions with Sudan are prohibited. U.S. persons are prohibited from facilitating trade with Sudan.

Florida State Pension Funds and Annuities

The State Board of Administration is created in Article IV, Section 4 (e) of the State Constitution. Its members are the Governor, the Chief Financial Officer and the Attorney General. The Board derives its powers to oversee state funds from Article XII, Section 9 of the Constitution.

The State Board of Administration (SBA) has responsibility for oversight of the Florida Retirement System (FRS) Pension Plan and the FRS Investment Plan, which represent approximately \$129 billion or 73 percent of the \$177 billion in assets managed by the SBA (as of December 31, 2006.) The Pension Plan is a defined benefit plan and the Investment Plan is a defined contribution plan that employees choose in lieu of the Pension Plan.¹¹ The FRS receives employer contributions from approximately 950 employers (local government entities). The state

¹¹ SBA Staff Analysis of HB 703, February 9, 2007.

share of the FRS totals approximately 25 percent of total annual contributions with the remainder coming from other government sources.¹²

Investment decisions for the pension plan are made by fiduciaries hired for that purpose by the state. Investment decisions for the investment plan are made by individual employees who may design their own portfolios based on participating offering companies.

The State of Florida has adopted federal fiduciary standards for management of the FRS funds. The Employee Retirement Income Security Act of 1974 (ERISA) is regulated by the U.S. Department of the Treasury and is the Florida standard for management of public funds.¹³ The Trustees of the SBA and all fiduciaries who manage Florida funds are bound by law to follow the standards established in ERISA.

The SBA investment managers are contractually bound to follow all federal and state laws in performance of their services to the state. The SBA does not invest in the securities of any company domiciled in countries on the U.S. State Department list of State Sponsors of Terrorism.¹⁴

Divestment of Securities

Divestment of securities is one method of applying economic pressures to companies, groups or countries whose practices are not condoned by shareholders. Divestment may be used in conjunction with or in lieu of other sanctioning methods such as economic embargoes, diplomatic and military activities. Alternatively, divestment may be used as protective device if a particular investment carries a high level of risk to the performance of a fund.

Several tools are available to fund managers, and their trustees, to protect funds against harm. The federal government has established the Office of Global Security Risk within the Securities and Exchange Commission to provide information to funds managers about potential risks of securities becoming unstable or losing value due to risk conditions, either political, or economic, that might exist in certain circumstances or locations around the world. Since fiduciaries are required to divest using prudent expert standards, they must have valid economic reasons for making decisions related to investment, divestment or repositioning in any particular security. The purpose of the Office of Global Security Risk is to provide fund managers with the information needed to make those decisions, however, the SEC does not take a position about investing in individual companies.¹⁵ There is no known definitive federal list of companies that have equity ties to, or do business with, Sudan. Several organizations provide lists of companies suspected of doing business in or with these countries, but none are definitive. The Department of Treasury does keep a list of “Specially Designated Nationals” (SDN) made up of companies or individuals who are not authorized to do business with the United States or its citizens. These SDN lists are either specific to a particular country designated as a State Sponsor of Terrorism or generic to the Global War on Terrorism.¹⁶

¹² Ibid.

¹³ Section 112.63(f), Florida Statutes.

¹⁴ SBA Staff Analysis of HB 703, February 9, 2007.

¹⁵ Phone conversation with Cecelia Blye, Chief of the Office of Global Security Risk, Division of Corporate Finance, Securities and Exchange Commission; cited in SBA Staff Analysis of HB 703, February 9, 2007.

¹⁶ <http://www.treasury.gov/offices/enforcement/ofac/sdn/index.shtml>

“Engagement” is a tool that fund managers can use to attempt to change the behavior of a company that appears to be at high risk of exposure to losses. This process involves a direct conversation with a company by stockholders to express concerns about the high risk activity of the company. Companies may be asked to change their behavior to reduce investment risk. Engagement has been credited with changing the investment strategies of several large companies over time. Recently, ABB (Swiss power engineering group) and Siemens AG (German electronics and electrical engineering company) have suspended business operations in Sudan as a result of the engagement process which included the possibility of divestment.¹⁷

If the engagement process fails, or if it is not used, the next tool available to fund managers is to divest of a security. Generally, this practice is only used in the most dire circumstances.¹⁸ Divestment, or “Targeted Divestment,” may be used to illustrate to an offending country that the actions of its government are causing companies that do business with the country to lose money. Divestment on a large scale may apply enough economic or political pressure to change the behavior of a country.

The State of Florida has practiced divestment twice in modern history. From 1986 to 1993, the Legislature directed the SBA to divest of companies doing business with South Africa. From 1997 until 2001, the SBA made a decision to divest of 16 tobacco stocks due to pending litigation involving the state and those companies. There are no specific records to quantify the impact of the South Africa divestment by Florida, but the overall boycott campaign was successful in changing the social environment in South Africa.¹⁹ The tobacco divestment was done relative to a court case and was not directed toward a specific social change.

Organized Divestment Movements

Several states, local governments and universities have initiated efforts to practice divestment of their holdings to protest the ongoing genocide and atrocities against humanity in the Darfur region of the Republic of Sudan.²⁰ Some states have used the Sudan Divestment Task Force Model Legislation²¹, while others have drafted legislation or policy that is either more or less restrictive than the model legislation. In addition, there are multiple resolutions and bills filed in the 110th Congress calling for divestment of public funds by federal, state and local government entities to protest the Sudan situation.

The State of Illinois passed a broad divestment bill, which addressed the deposit of certain funds in banks in the state as well as securities which were prohibited. The U.S. District Court for the Northern District of Illinois found the legislation to be unconstitutional, in full and in part.²² A permanent injunction against implementation of the legislation was ordered. In the portion of the

¹⁷ <http://www.sudandivestment.org/divestment.asp#q6>

¹⁸ Ibid.

¹⁹ “The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott,” 1999 Journal of Business.

²⁰ www.SudanDivestment.org

²¹ Ibid.

²² U.S. District Court for the Northern District of Illinois, Eastern Division. Case No. 06C 4251, National Foreign Trade Council, Inc., et.al v. Alexi Giannoulis, et.al.

finding related to the prohibited actions on the part of the state managed pension funds, the Court held that the Illinois law violated the Foreign Commerce Clause of the U.S. Constitution.

III. Effect of Proposed Changes:

The bill provides a series of legislative findings relative to current conditions in the Republic of Sudan. It describes, in detail, declarations by the U.S. Congress, U.S. Secretary of State, and the U.S. President regarding the ongoing genocide and atrocities against citizens of regions of Sudan. The bill recognizes that Sudan is designated as a State Sponsor of Terror by the U.S. Department of State and that the U.S. government applies trade sanctions against Sudan for its ongoing actions. The findings include information regarding universities, municipalities, states and private pension plans that have chosen to divest of securities with equity ties to companies doing business with the Government of Sudan.

Further, the bill finds that it is the responsibility of the State of Florida to decide how, where and by whom financial resources in its control should be invested and it is the prerogative of the state not to participate in ownership or capital-providing capacity with entities that provide significant practical support for genocide, including certain non-U.S. companies presently doing business in Sudan. It finds that divestment should only be used sparingly and judiciously and that a Congressional and Presidential declaration of genocide satisfies this high threshold. The bill finds that the act should remain in effect only if it continues to be consistent with and does not unduly interfere with the foreign policy of the United States.

The bill requires the State Board of Administration (SBA) to perform certain tasks related to the "Public Fund." The Public Fund is defined as all funds, assets, trustees, and other designates under the State Board of Administration.

Within 90 days of the effective date of this bill, the SBA is required to make its best efforts to identify all "scrutinized companies" in which the Public Fund has direct or indirect holdings or could possibly have such holdings in the future. "Scrutinized company" is defined as a company that meets any of the following criteria:

- (1) The company has business operations that involve contracts with or provision of supplies or services to the Government of Sudan, companies in which the Government of Sudan has any direct or indirect equity shares, consortiums or projects commissioned by the Government of Sudan, or companies involved in consortiums or projects commissioned by the Government of Sudan; and: more than 10 percent of the company's revenues or assets linked to Sudan involve oil-related activities or mineral-extraction activities, less than 75 percent of the company's revenues or assets linked to Sudan involve contracts with or provision of oil-related or mineral-extraction products or services to the regional government of southern Sudan or a project or consortium created exclusively by that regional government and the company has failed to take substantial action²³; or more than 10 percent of the company's revenues or assets linked to Sudan involve power production

²³ "Substantial action" is defined as adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within one year and to refrain from any such new business operations, undertaking significant humanitarian efforts on behalf of one or more marginalized populations of Sudan, or, through engagement with the Government of Sudan, materially improving conditions for the genocidally victimized population in Darfur.

- activities; less than 75 percent include projects whose intent is to provide power or electricity to the marginalized populations of Sudan; and the company has failed to take substantial action.²⁴
- (2) The company is complicit in Darfur genocide.
 - (3) The company supplies military equipment within Sudan, unless it is clearly shown that the equipment cannot be used to facilitate offensive military actions or the company implements rigorous and verifiable safeguards to prevent use of the equipment by forces participating in armed conflict.

Companies designated as “social-development company” that are not complicit in the Darfur genocide are not considered scrutinized companies.

By the first meeting of the SBA after the 90 day period, the SBA is required to assemble a list of “scrutinized companies.” The list shall be updated quarterly.

The Public Fund is required to provide written notice to any company on the list with inactive business operations to encourage the company to continue to refrain from initiating active business operations. A new written notice is to be sent semiannually.

For a company which is newly identified on the list as having active business operations, the Public Fund is required to send the company a written notice of its status as a scrutinized company and the possibility that it may become subject to divestment by the Public Fund. The notice is to inform the company of actions it can take to avoid qualifying for divestment. The requirement is that the company must cease active business operations or convert to inactive operations within 90 days.

If a company on the “Scrutinized Companies List” fails to take action within 90 days after engagement through written notice, the Public Fund is required to sell, redeem, divest, or withdraw all publicly traded securities of the company according to the following schedule:

- At least 50 percent of such assets shall be removed from the Public Fund’s assets under management by 9 months after the most recent appearance of the company on the Scrutinized Companies List and
- 100 percent of those assets must be removed within 15 months of the company’s most recent appearance on the list.
- A company that the U.S. government affirmatively declares to be excluded from federal sanctions is exempt from such divestment.

If a company resumes active business operations in Sudan, it is to be added back to the Scrutinized Companies List immediately. The written notice process begins again for that company.

The Public Fund is prohibited from acquiring securities of any companies on the list which have active business operations in Sudan.

²⁴ See footnote 1, above.

The divestment provisions do not apply to indirect holdings in actively managed investment funds. The Public Fund is required to send letters to the managers of such funds requesting that they consider removing those companies from the fund or create an alternative fund. If an alternate fund is created, the Public Fund is required to replace all applicable funds with the new fund. The bill further excludes holdings in managed defined contribution plans.

The Public Fund must file a report to the Governor, the Attorney General, the Senate President and House Speaker which includes the Scrutinized Countries List within 30 days of the creation of the list. The report is a public document. A further report is required annually. In addition to the above, the annual report is to be sent to the U.S. Presidential Special Envoy to Sudan. The annual report is to include a summary of all correspondence with companies; all investments sold, redeemed, divested; or withdrawn; all prohibited investments; and any progress made in engagement of actively managed investment funds.

The act expires only under the following conditions:

- if the Congress or President declares that the Darfur genocide has been halted for at least 12 months,
- the United States revokes all sanctions against the Government of Sudan,
- if the Congress or President declares that Government of Sudan has honored its commitments to cease attacks on civilians, demobilize and demilitarize the Janjaweed and associated militia, grant free and unfettered access for deliveries of humanitarian assistance and allow for the safe and voluntary return of refugees and internally displaced persons, or
- Congress or the President declares that mandatory divestment of the type required in this act interferes with the conduct of U.S. foreign policy.

With respect to this act, the Public Fund is exempt from any conflicting statutory or common law obligations, including any obligations with respect to choice of asset managers, investment funds or investments for the Public Fund's security portfolios.

The Public Fund may cease divesting, or reinvest, in certain scrutinized companies if the value of all assets under management by the Public Fund becomes equal to or less than 99.50 percent, or 50 basis points, of the hypothetical value of all assets under management. Such activities require an additional report to the SBA, Senate and House.

The bill requires the Attorney General to enforce the provisions of the act and allows the Attorney General to bring any necessary actions in court.

The act includes a severability clause.

The bill takes effect upon becoming law and remains in effect until certain conditions are met at the federal government level.

IV. Constitutional Issues:**A. Municipality/County Mandates Restrictions:**

Divestment may result in investment loss which would be passed on to all participating units of government.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

The U.S. District Court of the Northern District of Illinois, Eastern Division, has recently ruled that Illinois legislation which required broad divestment activities in the banking sector, as well as prohibitions in its pension funds, is unconstitutional. The section of the ruling related to the pension funds indicated that state limitations on trade with companies that do business with foreign countries is a violation of the U.S. Constitution.²⁵

The bill appears to have addressed this concern in (6)(d) wherein the law is considered to be expired if either Congress or the President, through legislation or executive order, declares that mandatory divestment interferes with the conduct of United States foreign policy.

It is not clear whether the requirement for the federal government to take definitive action declaring the activity as interference would absolve the immediate concerns cited in the Court's finding in the Illinois case, or whether those findings are applicable to the proposed legislation in Florida.

The Florida Retirement System is itself a product of financial stress. Created almost two generations ago, this multi-employer pension plan was the successor to four smaller ones, at least one of which was unable to satisfy the financial demands of its future pensioners. Benefits were promised to those who served in World War II but no employer contributions were made. By the end of the 1960s the first wave of pensioners presented their demands for retirement income and the deficiencies in the financial base soon became apparent. That financial experience caused the Florida Legislature to enact a number of procedural and substantive checks and balances on the preservation of capital within fiduciary funds especially when they involve pension plans. Among them are:

²⁵ U.S. District Court for the Northern District of Illinois, Eastern Division. Case No. 06C 4251, National Foreign Trade Council, Inc., et.al v. Alexi Giannoulis, et. al.

Article X, Section 14, State Constitution

This article placed on the ballot by the 1976 Legislature and approved by the voters effective January 1, 1977, provides that all government pension plans in Florida must be prefunded on a sound actuarial basis. Benefits promised must be concurrently funded.

Part VII of Chapter 112, Florida Statutes

This part implements the above constitutional amendment and also requires adherence to the fiduciary standards in federal law, specifically, the Employee Retirement Income Security Act of 1974, as amended. That federal statute imposes four principal duties on pension plan fiduciaries: Fiduciaries must act with prudence and loyalty for the sole and exclusive benefit of pensioners, for the defraying of the reasonable expenses of administration, and for the diversification of assets consistent with the plan's investment policy statement.

Section 112.661, Florida Statutes

This section and like sections for other units of local government, were enacted in the 1990s in the aftermath of investment irregularities experienced with the demise of brokerage institutions and their marketing of derivative securities to unsophisticated public and private investors. This statute emphasized that public fiduciaries must emphasize diversification and internal controls in their management of fiduciary assets. Seventeen specific standards were established for all pension plans in their execution of investment operations.

Sections 518.11 and 518.12, Florida Statutes

These two sections of Florida law provide the clearest statement of fiduciary duty: to manage as a prudent investor with the knowledge and business expected of one in such circumstance. The prudence standard embodies loyalty and exclusivity of purpose; that is, the achievement of an objective indistinguishable and uncompromisable from that of serving the best interests of the pension plan and its participants while defraying the reasonable costs of administration. The final duty, diversification, requires the fiduciary to not imperil the plan due to its concentration of investment decision-making in narrow choices or limited markets.

Chapters 175, 185, and 121, Florida Statutes

Many of these statements listed above can be found in the organic laws affecting municipal police and firefighter pension plans, as well as the Florida Retirement System itself.

Florida's experience with divestment is limited in part due to the cumulative effect of the above legal standards. While there have been statutes enacted dealing with the Republic of South Africa, Cuba, or Northern Ireland, the circumstances of their operation stands them apart from this bill. The restrictions on South Africa, since repealed, had to do with the direct ownership of government debt. For Cuba the restrictions in Florida law repeat similar restrictions enacted by Congress in federal statute and, therefore, constrain state action. For Northern Ireland, the restrictions required adherence to the Sullivan principals, multi-party aspirational statements of normalized social, economic, and electoral expectations. The literature on the impact of divestment as a precursor event to

the abolition of Apartheid in South Africa is inconclusive at best. One commentator who analyzed its equivocal effects is today a principal with the firm that bears his name and who provides consultant services to the Board of Administration. The challenge for fiduciaries in such divestment situations, particularly when actions are constrained by ERISA, is the avoidance of foreign policy or political considerations or their capture by external interests in either the acquisition or disposal of securities.

The South African experience has been instructive on a number of dimensions. *First*, it did provide an impetus for the development of social activism in the investment community. There are now almost one hundred mutual funds that specialize in ethical, socially responsible, or values-based investing principles. *Second*, it suggested that principles-based investing, tailored at the time to adherence to the Sullivan Principles,²⁶ could be made a complementary duty of institutional investors that, when properly executed, would not antagonize their fiduciary obligations. And, *third*, it emboldened large institutional investors - pension plans, insurance companies, mutual funds, and endowments - to engage in the difficult discussions on the proper role of an investor in a market society, discussions that today can be considered the precursors to contemporary statutes and investor regulations on corporate governance.²⁷

The United States Congress has not seen fit to enact any federal law that would permit states to engage directly in foreign commerce restrictions. Nor has it provided a method under ERISA by which plan fiduciaries may countenance a nation-specific divestment without imperiling their own fiduciary duties. The Illinois case and its related case references do not suggest such divestment actions are unachievable, simply that they must correspond with the plan's own estimation of the risk associated with such actions. This risk assessment practice - whether geo-political, currency, market, credit, or the like - when properly executed and sound from a fiduciary duty standpoint may yield a result consistent with the stated divestment objectives.

The critical distinction appears to be the development of a process that permits fiduciaries, *and not the state legislature*, from conditioning a divestment action. In 1997 the Florida Attorney General opined that the Board of Administration *could* properly discharge its duties and divest the Florida Retirement System of tobacco stocks, notwithstanding their significant income producing and appreciation history. This result was further influenced by a concurrent series of events which saw Florida achieve a large financial settlement from such tobacco companies relative to the documented adverse health effects of their products. The complicating factor which presented itself was that

²⁶ The Sullivan Principles are: (1) Nonsegregation of the races in all eating, comfort, locker rooms and work facilities; (2) Equal and fair employment practices for all employees; (3) Equal pay for all employees doing equal or comparable work for the same period of time; (4) Initiation and development of training programs that will prepare blacks, coloreds and Asians in substantial numbers for supervisory, administrative, clerical and technical jobs; (5) Increasing the number of blacks, coloreds and Asians in management and supervisory positions; (6) Improving the quality of employees' lives outside the work environment in such areas as housing, transportation, schooling, recreation and health facilities.

²⁷ Two other principles-based statements have attracted considerable interest in the institutional investor community: the CERES principles on the development of sustainable environmental government actions and the Principles for Responsible Investment issued by the United Nations' secretary-general. Both organizations suggest that disclosure, engagement, and the participation in recognized market-based actions, such as proxy-voting, are appropriate means of addressing contemporary corporate governance and social issues.

the logical result of divestiture would imperil the ability of the companies to service the payments they had committed to make under the settlement agreement. A similar divestment strategy deployed today could further imperil the ability to make payments since the underlying financial support of the funded health initiatives in state law are conditioned on the achievement of a certain level of worldwide tobacco sales of these same unhealthy products. An essential element in the tobacco divestiture was the Board's exercise of judgment in picking the proper timing of the securities' disposal. As presently drafted, the bill makes the process virtually automatic once certain statutory thresholds are reached.

On April 18, 2007 the Division of Retirement transmitted a statement dated April 16, 2007 from its consulting actuary assessing the compliance of related divestment legislation, CS/SB 2250, with the pension funding requirements contained in s. 10, Art. X, State Constitution, and Part VII of ch. 112, Florida Statutes. That statement, believed to be similar to one forthcoming on CS/SB 2142, made the following declarations:

. . . This analysis is focused upon impacts on the Florida Retirement System. An actuarial special study is required to determine the fiscal impact resulting from the changes proposed by CS/SB 2250.

. . .

- a. This bill does not comply with the requirements of Article X, Section 14 of the Constitution.*
- b. This bill does not comply with the provisions of Chapter 112, Part VII, Florida Statutes.*

. . .

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The intended impact of the legislation is to reduce the state's participation in companies that have equity ties to Sudan's oil-production or mineral extraction industries. Depending on the size of such holdings in the FRS portfolio, some private companies could suffer losses from divestment.

C. Government Sector Impact:

The SBA will be required to divest of any holdings that have equity ties to Sudan's oil-production or mineral extraction industries. If this activity results in lost investment

income, or administrative costs associated with divestment and replacement of the divested funds, those costs will have to be absorbed by the FRS in the form of a revised investment policy statement or by higher employer payroll contribution rates. The below tables reports what are believed by the named parties to be the scale and scope of the divestitures affected by this bill, assuming that there is no disengagement by the named companies from the Republic of the Sudan or the Islamic Republic of Iran. There is considerable disagreement among the parties as to the scale and scope of the effects including the names of the affected companies. Attempts to narrow the differences are ongoing but there is considerable factual uncertainty since the assumptions of the parties and the data sources used cannot be presently reconciled:

	Sponsor List SB 2142	Sponsor List SB 2250	SBA Estimate SB 2142	SBA Estimate SB 2250	Revised SBA Estimate CS/SB 2142 [CALPERS]	Revised SBA Estimate CS/SB 2250 [NY]
Number of Companies	20	20	45	130	20	15
FRS Costs of Divesting	\$ 3 MM	\$ 7 MM	\$20 MM	\$ 45 MM	N/R	N/R
Upper End Estimated Asset Values	\$ 525 MM	\$ 1 B	\$ 3.5 B	\$ 6 B	\$ 1 B	\$ 600 MM
Historical Performance Results	N/R	N/R	-2 to -38 basis points	+2 to -53 basis points	N/R	N/R

As reported, above, the consulting external actuary to the Division of Retirement concluded that similar legislation violated the two legal standards upon which the Florida Retirement System is based. The actuary further concluded:

A special actuarial study is required to determine the fiscal impact that CS/SB 2250 would have on the system. However, the SBA would first have to identify the impact or ranges of divestiture on the assumed rate of return to be able to perform the required special study.

VI. Technical Deficiencies:

The bill uses the term “Public Fund” to describe what is later referenced to be the Board of Administration.

VII. Related Issues:

It appears that Section 1, subsection (6), entitled “OTHER LEGAL OBLIGATIONS” is an attempt to assert supercession of this legislation over other legislation related to state fund investment. Because the state has adopted by statute the federal ERISA law, it is unclear if this proposed state law could supersede the federal law inherent in the current state law. This is significant in that Part VII of ch. 112, F.S., implements s. 10, Art. 14, State Constitution, and its requirement that pension plans are to be funded in a sound actuarial manner, which the consulting actuary has concluded this bill violates.

This Senate Professional Staff Analysis does not reflect the intent or official position of the bill’s introducer or the Florida Senate.

VIII. Summary of Amendments:

None.

This Senate Professional Staff Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.
