

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/CS/HB 811 Foreign Investments

SPONSOR(S): Appropriations Committee; Government Operations Subcommittee; Hager

TIED BILLS: **IDEN./SIM. BILLS:** CS/CS/SB 948

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Government Operations Subcommittee	9 Y, 1 N, As CS	Harrington	Williamson
2) Appropriations Committee	27 Y, 0 N, As CS	Delaney	Leznoff

SUMMARY ANALYSIS

The State Board of Administration (SBA) has responsibility for oversight of the Florida Retirement System (FRS) Pension Plan investments and FRS Investment Plan, which represents approximately \$152 billion, or 85 percent, of the \$177 billion in assets which are managed by the SBA. The SBA's ability to invest the FRS assets is governed by a "legal list" of the types of investments and the total percentage of funds that may be invested in each type.

The Protecting Florida's Investment Act (PFIA) requires the SBA to identify and divest from assets in foreign companies doing business in Iran and Sudan. The PFIA requires the SBA to assemble and publish a list of "Scrutinized Companies" that have prohibited business operations in Sudan and Iran. Once placed on the list, the SBA and its investment managers are prohibited from acquiring those companies' securities and are required to divest those securities if the companies on the list do not cease the prohibited activities or take certain compensating actions involving petroleum or energy, oil or mineral extraction, power production, or military support activities.

The bill modifies the PFIA to provide that SBA investments in exchange-traded funds will not be subject to divestiture requirements. It also makes terminology changes to reflect that South Sudan is now an independent nation.

The bill requires a domestic insurer to report to the Office of Insurance Regulation, on an annual basis, a list of investments the insurer has in companies included on the SBA's Scrutinized Companies list.

The bill has no fiscal impact.

The effective date of the bill is July 1, 2014

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Florida State Pension Funds and Annuities

State Board of Administration

The State Board of Administration (SBA or board) is created in s. 4(e), Art. IV of the State Constitution. The Governor, the Chief Financial Officer, and the Attorney General are the trustees. The SBA derives its powers to oversee state funds from s. 9, Art. XII of the State Constitution.

The SBA has responsibility for oversight of the Florida Retirement System (FRS) Pension Plan investments and FRS Investment Plan,¹ which represents approximately \$152 billion, or 85 percent, of the \$177 billion in assets which are managed by the SBA.² The SBA also manages over 30 other investment portfolios, with combined assets of \$25 billion, including the Florida Hurricane Catastrophe Fund, the Florida Lottery Fund, the Florida Pre-Paid College Plan, and various debt-service accounts for state bond issues.³

Investments

Investment decisions for the pension plan are made by fiduciaries hired by the state. Under Florida law, an SBA fiduciary charged with an investment decision must act as a prudent expert would under similar circumstances, taking into account all relevant substantive factors. A nine-member Investment Advisory Council provides recommendations on investment policy, strategy, and procedures.⁴

The SBA's ability to invest the FRS assets is governed by s. 215.47, F.S., which provides a "legal list" of the types of investments and the total percentage that may be invested in each type. Some "legal list" guidelines specific to the pension plan provide:

- No more than 80 percent of assets should be invested in domestic common stocks.
- No more than 75 percent of assets should be invested in internally managed common stocks.
- No more than 3 percent of equity assets should be invested in the equity securities of any one corporation, except to the extent a higher percentage of the same issue is included in a nationally recognized market index, based on market values, or except upon a specific finding by the board that such higher percentage is in the best interest of the fund.
- No more than 25 percent of assets should be invested in notes issued by FHA-insured or VA-guaranteed first mortgages on real property, or foreign government general obligations.
- No more than 35 percent of assets should be invested in foreign corporate or commercial securities or obligations.
- No more than 20 percent of assets should be invested in alternative investments.

Exchange-Traded Funds

Exchange-traded funds (ETFs) are a type of investment product. ETFs offer investors a way to pool their money in a fund that makes investments in stocks, bonds, or other assets and, in return, to receive an interest in that investment pool. Unlike mutual funds, ETF shares are traded on a national

¹ Members in the FRS may elect to participate in the pension plan, which is a defined benefit plan, or the investment plan, which is a defined contribution plan.

² *Quarterly Performance Report to the Trustees*, December 31, 2013, State Board of Administration. A copy of the report can be found online at: <http://www.sbafla.com/fsb/PerformanceReports/2013QuarterlyReporttoTrustees/tabid/1481/Default.aspx> (last visited March 15, 2014).

³ *Monthly Performance Report to the Trustees, Performance through November 30, 2013*, State Board of Administration, issued January 13, 2014. A copy of the report can be found online at:

<http://www.sbafla.com/fsb/PerformanceReports/2013MonthlyReporttoTrustees/tabid/1480/Default.aspx> (last visited March 15, 2014).

⁴ Section 215.444, F.S.

stock exchange and at market prices that may or may not be the same as the net asset value of the shares.⁵

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 Act, the Arms Export Control Act, and the Foreign Assistance Act.⁶ 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.

The four countries currently designated by the U.S. Secretary of State as “State Sponsors of Terrorism” are Cuba, Iran, Sudan, and Syria.⁷

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 and diplomatic and military activities. Alternatively, divestment may be used as a protective device if a particular investment carries a high level of risk to the performance of the fund.

Federal Divestment Laws

The Sudan Accountability and Divestment Act of 2007 (SADA) authorizes states to divest – within specified boundaries – from companies that do business in Sudan. SADA provides in pertinent part:

Authority to Divest—Notwithstanding any other provision of law, a State or local government may adopt and enforce measures that meet the requirements of subsection (e) to divest the assets of the State or local government from, or prohibit investment of the assets of the State or local government in, persons that the State or local government determines, using credible information available to the public, are conducting or have direct investments in business operations described in subsection (d).

The authority of states to divest is limited to companies with business operations in Sudan and to companies with operations in four specified industries: power production activities, mineral extraction activities, oil-related activities, or the production of military equipment. SADA contains other limitations on the divestment of state funds.⁸ Additionally, the authority to divest ends 30 days after the President certifies that Sudan has met certain conditions assuring peace and safety for civilian populations.

Similar divestment policy is found in the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA). Title II of CISADA pertains to the divestment from certain companies that invest in Iran. Identical authority for states to divest state funds, as found in SADA, is found in s. 202(b). CISADA prohibits investments in Iran relating to specified amounts invested in the energy sector, including oil and natural gas production. CISADA requires the state or local government to provide notice and opportunity for a hearing.

State Divestment Laws

The state has practiced divestment three times 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. In 2007, the Legislature unanimously passed the Protecting Florida’s Investment Act

⁵ More information about ETFs can be found online at: <http://www.nasdaq.com/investing/etfs/what-are-ETFs.aspx> (last visited March 15, 2014).

⁶ U.S. Department of State, Diplomacy in Action can be found online at: <http://www.state.gov/j/ct/list/c14151.htm> (last visited March 15, 2014).

⁷ *Id.*

⁸ See SADA s. 3(d)(2), (e), and (f).

(PFIA), which required the SBA to divest of companies with certain business operations in the countries of Sudan or Iran. The PFIA requires the SBA to assemble and publish a list of “Scrutinized Companies”⁹ that have prohibited business operations in Sudan and Iran. Once placed on the list, the SBA and its investment managers are prohibited from acquiring those companies’ securities and are required to divest those securities if the companies on the list do not cease the prohibited activities or take certain compensating actions involving petroleum or energy, oil or mineral extraction, power production, or military support activities.

Sudan and South Sudan

Sudan was engaged in a civil war between north and south Sudan until 2005 when a Comprehensive Peace Agreement was signed. Southern Sudan was granted a six-year period of autonomy to be followed by a referendum on independence. That referendum was held in January 2011, and resulted in a vote in favor of succession from Sudan. The southern region attained independence on July 9, 2011.¹⁰ As a result, the PFIA contains references to Sudan that are now inaccurate.

Office of Insurance Regulation

The Financial Services Commission (commission) is created within the Department of Financial Services, and is comprised of the Governor, the Attorney General, the Chief Financial Officer, and the Commissioner of Agriculture. The Office of Insurance Regulation, within the commission, is responsible for all activities concerning insurers and other risk bearing entities, including licensing, rates, policy forms, market conduct, claims, issuance of certificates of authority, solvency, viatical settlements, premium financing, and administrative supervision.¹¹ Chapter 625, F.S., governs accounting, investments, and deposits by insurers and specifies the assets that are allowed and not allowed for purposes of determining the financial condition of an insurer. Insurer is defined as “every person engaged as indemnitor, surety, or contractor in the business of entering into contracts of insurance or of annuity.”¹²

Chapter 625, F.S., provides for the calculation of assets to determine the financial condition of an insurer. Section 625.012, F.S., provides for certain allowable assets, which include cash, investments,

⁹ Section 215.473(1)(t), F.S., defines “Scrutinized Company” as any 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 share, consortiums or projects commissioned by the government of Sudan, or companies involved in consortiums or projects commissioned by the government of Sudan , and:

a. 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-extracting 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 action; or

b. More than 10 percent of the company’s revenues or assets linked to Sudan involve power-production activities; less than 75 percent of the company’s power-production activities 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.

2. The company is complicit in the Darfur genocide.

3. The company supplies military equipment within Sudan, unless it clearly shows that the military equipment cannot be used to facilitate offensive military actions in Sudan or the company implements rigorous and verifiable safeguards to prevent use of that equipment by forces actively participating in armed conflict. Examples of safeguards include post-sale tracking of such equipment by the company, certification from a reputable and objective third party that such equipment is not being used by a party participating in armed conflict in Sudan, or sale of such equipment solely to the regional government of southern Sudan or any internationally recognized peacekeeping force or humanitarian organization.

4. The company has business operations that involve contracts with or provision of supplies or services to the government of Iran, companies in which the government of Iran has any direct or indirect equity share, consortiums, or projects commissioned by the government of Iran, or companies involved in consortiums or projects commissioned by the government of Iran and:

a. More than 10 percent of the company’s total revenues or assets are linked to Iran and involve oil-related activities or mineral-extraction activities; and the company has failed to take substantial action; or

b. The company has, with actual knowledge, on or after August 5, 1996, made an investment of \$20 million or more, or any combination of investments of at least \$10 million each, which in the aggregate equals or exceeds \$20 million in any 12-month period, and which directly or significantly contributes to the enhancement of Iran’s ability to develop the petroleum resources of Iran.

¹⁰ More information can be found on the CIA World Factbook, located online at: <https://www.cia.gov/library/publications/the-world-factbook/geos/od.html> (last visited March 13, 2014).

¹¹ Section 20.121(3)(a), F.S.

¹² Section 624.03, F.S.

interest, and premiums due. Section 625.031, F.S., provides a list of assets that are not allowed, including trade names, patents, advances to officers or employees, and furniture and fixtures.

Effect of Proposed Changes

The bill changes references to Sudan to reflect Sudan and South Sudan.

The bill provides that SBA investments in exchange-traded funds are not subject to the divestiture requirements.

The bill creates s. 624.449, F.S., relating to insurers invested in companies doing business in Sudan and Iran. It requires a domestic insurer to report a list of investments that the insurer has in companies included on the Scrutinized Companies with Activities in Sudan List or Scrutinized Companies with Activities in Iran Petroleum Energy Sector List. The list must be reported annually to the Office of Insurance Regulation.

The bill provides that the invalidation of any one provision of the act does not affect other provisions that could still be given legal effect.

B. SECTION DIRECTORY:

Section 1. amends s. 215.473, F.S., revising and providing definitions with respect to requirements that the board divest securities in which public moneys are invested in certain companies doing specified types of businesses in or with Sudan or Iran; revising exclusions from the divestment requirements; conforming cross-references.

Section 2. creates s. 624.449, F.S., requiring domestic insurers to report annually on specified investments to the Office of Insurance Regulation.

Section 3. provides severability.

Section 4. provides an effective date of July 1, 2014.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill requires domestic insurers to file annual reports to the Office of Insurance Regulation on certain investments will impose limited administrative burden on those companies.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to affect county or municipal governments.

2. Other:

Federal Preemption

While federal and state governments have their respective spheres of sovereignty, the United States Constitution, and laws made pursuant to it, is the supreme law of the United States.¹³ State law may be expressly preempted if federal law explicitly prohibits any state action on a matter. State law also may be preempted by implication if either the federal government has expressed intent to restrict regulation of a certain field to the federal level, or if a state law conflicts with a federal law.¹⁴

In *American Insurance Ass'n v. Garamendi*, the Supreme Court invalidated a Holocaust Victim Insurance Relief Act in California, which required insurers to disclose information about all policies sold in Europe between certain years as a violation of Presidential preemption.¹⁵ The court reasoned that executive power includes the power to conduct foreign affairs on behalf of the nation and applied a two-prong test to justify preemption: whether an express federal law was in place at the time state law was enacted, and whether the conflict between the two was sufficient to permit preemption of the state law.

The federal government has expressed foreign policy concerning Iran and Sudan through CISADA and SADA, which authorizes states to divest in certain circumstances. A reviewing court may find that the bill is preempted under the United States Constitution if it finds the requirement that domestic insurers report on specified assets conflicts with the federal policy, or if the court determines the federal policies are intended to regulate the field of sanctions against Iran and Sudan.

¹³ Article VI, cl. 2, U.S. Constitution.

¹⁴ *State v. Harden*, 938 So.2d 480, 485 (Fla. 2006) (stating that “[u]nder the Supremacy Clause, a federal law may expressly or impliedly preempt state law. A state cannot assert jurisdiction where Congress clearly intended to preempt a field of law.”) citing *Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311 (1981).

¹⁵ 539 U.S. 396 (2003).

Dormant Foreign Affairs Doctrine

The United States Constitution grants the federal government various powers related to foreign affairs, such as the power to declare war,¹⁶ maintain a military,¹⁷ enter into treaties and other international agreements,¹⁸ regulate foreign commerce,¹⁹ and to hear cases involving foreign states and citizens.²⁰ These grants of power have been interpreted to grant the federal government the exclusive power to act in the area of foreign affairs.²¹ The federal government's exclusive authority to act in the area of foreign affairs is known as the dormant foreign affairs doctrine.

When a state law operates in the field of foreign affairs without federal authorization, a reviewing court might find the state law to be invalid as a violation of the dormant foreign affairs doctrine.²² If the purpose of the bill is to impact foreign affairs,²³ or if the effects of the bill have a sufficiently serious impact on foreign policy,²⁴ the bill may be found in violation of the dormant foreign affairs doctrine.²⁵

Case law indicates that in the absence of federal authority authorizing a restriction on foreign commerce, state laws may be preempted by the dormant federal foreign affairs powers. In 2000, the United States Supreme Court unanimously held in *Crosby v. National Foreign Trade Council* that a Massachusetts law restricting state transactions with firms doing business in Burma was preempted by a federal Burma statute.²⁶ The Court noted that the state law penalized private action differently than the federal law, which results in an “unyielding application” that compromises the President's authority over foreign affairs. Without control, the “President has less to offer and less economic and diplomatic leverage” when utilizing the coercive powers of the national economy.²⁷

The federal government has expressly given state and local governments the authority to divest from companies directly invested in certain Sudanese and Iranian sectors. A reviewing court may determine that requiring domestic insurers to report on specified foreign assets may be preempting foreign affairs policy. “Courts have consistently struck down state laws which purport to regulate an area of traditional state competence, but in fact, affect foreign affairs.”²⁸

Dormant Foreign Commerce Clause

¹⁶ Section 8, Art. I, U.S. Constitution.

¹⁷ *Id.*

¹⁸ Section 2, Art. II, U.S. Constitution.

¹⁹ Section 8, Art. I, U.S. Constitution.

²⁰ Section 2, Art. III, U.S. Constitution.

²¹ *Hines v. Davidowitz*, 312 U.S. 52, 63 (1941) (stating that the “Federal Government, representing as it does the collective interests of the forty-eight states, is entrusted with full and exclusive responsibility for the conduct of affairs with foreign sovereignties.”).

²² *Zschernig v. Miller*, 389 U.S. 429 (1968); *American Ins. Ass'n v. Garamendi*, 539 U.S. 396 (2003).

²³ *Crosby v. National Foreign Trade Council*, 530 U.S. 363, 381 (2000) (pointing out that a congressional invocation of exclusively national powers with respect to addressing human rights violations in Burma precluded Massachusetts from restricting its agencies from purchasing goods or services from companies that did business with Burma; the case, however, was decided on the basis that a federal law preempted the state law.).

²⁴ *Clark v. Allen*, 331 U.S. 503, 517-518 (1947) (finding a state law that addressed the disposition of personal property of alien decedents valid, in spite of noting that the law would “have some incidental or indirect effect in foreign countries.”); *Zschernig v. Miller*, 389 U.S. 429 (1968).

²⁵ Matthew Shaefer, *Constraints on State-Level Foreign Policy: (Re) Justifying, Refining, and Distinguishing the Dormant Foreign Affairs Doctrine*, 41 SETON HALL L. REV. 201, 237-239 (2011).

²⁶ 530 U.S. 363 (2003). *But see Faculty Senate of Fla. Int'l Univ. v. Winn*, 616 F.3d 1206 (11th Cir. 2010) (upholding a Florida law that prohibited state and nonstate university funding to be used on activities related to travel to a “terrorist state” as designated by the United States Department of State. The 11th Circuit distinguished the case from *Crosby* by stating that the travel act did not name a specific country and did not penalize or prohibit anyone from traveling to any place. Instead, the Florida law established how funds would be used to facilitate university travel.).

²⁷ *Crosby*, at 377.

²⁸ *Movsesian v. Versicherung AG*, 670 F.3d 1067, 1074 (9th Cir. 2012); quoting *Von Saher v. Norton Simon Museum of Art at Pasadena*, 592 F.3d 954, 964 (9th Cir. 2010); see also *American Insurance Association v. Garamendi*, 539 U.S. 396 (2003); *Crosby v. National Foreign Affairs Trade Council*, 530 U.S. 363, 373 (2000); *Zschernig v. Miller*, 389 U.S. 429, 437-38 (1968).

The Commerce Clause authorizes Congress to regulate foreign and interstate commerce. Under judicial construction, it also has dormant or negative aspects that limit state interference with foreign and interstate commerce even in the absence of Congressional action.

The U.S. District of the Northern District of Illinois, Eastern Division, ruled that Illinois legislation that required broad divestment in the banking sector, as well as prohibitions in state and local pension funds, was unconstitutional in violation of the foreign commerce clause of the United States Constitution.²⁹ The court denied the defendant's assertion that the state was merely acting as a market participant because the divestment policy impacted more than just the state.

Single Subject

Article III, s. 6 of the State Constitution provides that "[e]very law shall embrace but one subject and matter properly connected therewith, and the subject shall be briefly expressed in the title." The single subject clause contains three requirements: that each law embrace only one subject, that the law may include any matter that is properly connected with the subject, and that the subject be briefly expressed in the title.³⁰ The single subject must be derived from the short title. "A connection between a provision [in the act] and the subject is proper (1) if the connection is natural or logical, or (2) if there is a reasonable explanation for how the provision is (a) necessary to the subject or (b) tends to make effective or promote the objects and purposes of legislation included in the subject."³¹

The short title of this bill is "[a]n act relating to foreign investments," and the bill contains provisions relating to the proportion of funds that the SBA may invest in foreign securities, provisions pertaining to the divestment of SBA funds in ETFs, and regulatory requirements for insurers with investments in scrutinized companies. If the bill was challenged as a violation of the single subject provision of the State Constitution, a court would apply a highly deferential standard of review.³²

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On March 18, 2014, the Government Operations Subcommittee adopted a strike-all amendment and reported the bill favorably with committee substitute. The amendment:

- Maintained current law definitions for "business operations" and "company;"
- Required a domestic insurer to report only certain investments to the Office of Insurance Regulation; and
- Removed the requirement that the domestic insurer divest of such investments within a specified period of time.

On April 10, 2014, the Appropriations Committee adopted two amendments and reported the bill favorably with committee substitute. The committee substitute:

- Removed language authorizing an increase in the SBA's allowed asset allocation from 35 to 50 percent; and
- Decreased the frequency of the reports from domestic insurers related to certain investments from quarterly to annually.

²⁹ *National Foreign Trade Council, Inc. v. Giannoulis*, 523 F.Supp.2d 731 (N.D. Ill 2007). The court noted that even though the state law appeared to have good motives, the law violated federal constitutional provisions, which preclude states from taking action that may interfere with the President's authority over foreign affairs and commerce with foreign countries.

³⁰ *Franklin v. State*, 887 So.2d 1063, 1072 (Fla. 2004).

³¹ *Id.* at 1078.

³² *Id.* at 1073.

This analysis is drafted to the committee substitute as approved by the Appropriations Committee.