The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

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

Prepared By: The Professional Staff of the Committee on Appropriations

BILL: CS/CS/CS/SB 948

INTRODUCER: Appropriations Committee; Banking and Insurance Committee; Governmental Oversight and Accountability Committee; and Senator Ring

SUBJECT: Foreign Investments

DATE: April 24, 2014 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	McKay	McVaney	GO	**Fav/CS**
2.	Matiyow	Knudson	BI	**Fav/CS**
3.	McSwain	Kynoch	AP	**Fav/CS**
4.			RC	

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/CS/CS/SB 948 modifies the Protecting Florida's Investments Act (PFIA), which requires the State Board of Administration (SBA) to identify and divest assets in foreign companies doing business in Iran and Sudan, by providing that SBA investment in exchange-traded funds will not be subject to the divestiture requirements. The bill also makes terminology changes to reflect that South Sudan is now an independent nation.

The bill allows the SBA to invest up to 50 percent of any of its funds in foreign corporate securities and obligations, an increase from the current maximum of 35 percent.

The bill also provides that a domestic insurer with investments in a company included on the Iran and Sudan scrutinized company lists must report such investments quarterly to the Office of Insurance Regulation.

The fiscal impact of the bill is indeterminate.

II. Present Situation:

State Board of Administration Investing Duties

The State Board of Administration (SBA) is created in Article IV, s. 4(e) of the Florida 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, s. 9 of the Florida Constitution.

The SBA has responsibility for oversight of the Florida Retirement System (FRS) Pension Plan and the FRS Investment Plan, which represent approximately $151 billion, or 88 percent, of the $173 billion in assets managed by the SBA, as of November 30, 2013. The Pension Plan is a defined benefit plan and the Investment Plan is a defined contribution plan that employees may choose in lieu of the Pension Plan. The SBA also manages over 30 other investment portfolios, with combined assets of $22 billion, including the Florida Hurricane Catastrophe Fund, the Florida Lottery Fund, the Florida Prepaid College Plan, and various debt-service accounts for state bond issues.[1]

In investing assets, the SBA follows the Florida Statutes' fiduciary standards of care, subject to certain limitations.[2] Pursuant to s. 215.444, F.S., a nine-member Investment Advisory Council provides recommendations on investment policy, strategy, and procedures. The SBA's ability to invest the FRS assets is governed by s. 215.47, F.S., which provides for a "legal list" of the types of investments and for how much of the total fund may be invested in each investment type. Some of the key guidelines in the "legal list" specific to the investment of FRS Pension Plan assets include:

- No more than 80 percent of assets may be invested in domestic common stocks.
- No more than 75 percent of assets may be invested in internally managed common stocks.
- No more than 3 percent of equity assets may be invested in the equity securities of any one corporation, except when the securities of that corporation are included in any broad equity index or with approval of the Board; and in such case, no more than 10 percent of equity assets may be invested in the equity securities of any one corporation.
- No more than 80 percent of assets may be placed in corporate fixed income securities.
- No more than 25 percent of assets may be invested in notes secured by FHA-insured or VA-guaranteed first mortgages on Florida real property, or foreign government general obligations with a 25-year default-free history.
- No more than 35 percent of assets may be invested in foreign corporate or commercial securities or obligations[3].

[1] State Board of Administration "Monthly Performance Report to the Trustees" as of November 30, 2013, issued January 13, 2014.

[2] Section 215.44, F.S.

[3] This provision in s. 215.47(20), F.S., permitting the SBA to invest up to 35 percent of any fund in foreign securities or bonds is an SBA-specific exception to the general requirement in s. 215.47(5), F.S., that no more than 25 percent of any fund may be invested in foreign securities or bonds. The SBA exception is located in s. 215.47(20), F.S., because s. 112.661(5)(a), F.S., subjects local retirement systems and plans to the limitations in s. 215.47(5), F.S.

- No more than 10 percent[4] of assets may be invested in alternative investments,[5] alternative investment vehicles,[6] and other non-publicly-traded investments.

Exchange-Traded Funds

Exchange-traded funds (ETFs) are a type of exchange-traded investment product. Investors use ETFs as 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, however, ETF shares are traded on a national stock exchange and at market prices that may or may not be the same as the net asset value of the shares. ETFs were initially designed to track the performance of specific U.S. equity indexes; those types of index-based ETFs continue to be the predominant type of ETF offered and sold in the United States. Newer ETFs, however, also seek to track indexes of fixed-income instruments and foreign securities.[7]

The SBA does not currently invest in ETFs, and ch. 215, F.S., does not address the use of ETFs by the SBA.

Protecting Florida Investments Act

In 2007, the Legislature enacted[8] the Protecting Florida's Investments Act (PFIA). The PFIA requires the SBA, acting on behalf of the Florida Retirement System Trust Fund (FRSTF), to assemble and publish a list of "Scrutinized Companies" that have prohibited business operations in Sudan and Iran. Once placed on the list of Scrutinized Companies, the SBA and its investment managers are prohibited from acquiring those companies' securities[9] and are required to divest those securities if the companies[10] do not cease the prohibited activities or take certain compensating actions. The implementation of the PFIA by the SBA does not affect any FRSTF investments in U.S. companies; the PFIA affects foreign companies with certain business operations in Sudan and Iran involving the petroleum or energy sector, oil or mineral extraction, power production, or military support activities.

The definition of "company" for purposes of the PFIA includes all wholly-owned subsidiaries, majority-owned subsidiaries, parent companies, or affiliates of entities or business associations.

According to staff of the SBA, the PFIA imposes the following reporting, engagement, and investment requirements on the SBA:

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[4] The cap on alternative investments was last changed in 2008, when it was raised from 5% to 10% by Ch. 2008-31, L.O.F.
[5] An "alternative investment" is defined in s. 215.4401(3)(a)1., F.S., as "an investment by the State Board of Administration in a private equity fund, venture fund, hedge fund, or distress fund or a direct investment in a portfolio company through an investment manager."
[6] An "alternative investment vehicle" is defined in s. 215.4401(3)(a)2., F.S., as the "limited partnership, limited liability company, or similar legal structure or investment manager through which the State Board of Administration invests in a portfolio company."
[7] All of the information in this paragraph is from a Securities and Exchange Commission Investor Bulletin available at: https://www.sec.gov/investor/alerts/etfs.pdf, last visited on March 26, 2014.
[8] Chapter 2007-88, L.O.F.; Senate Bill 2142.
[9] Section 215.473(3)(c), F.S.
[10] Section 215.473(3)(b), F.S.

- Quarterly reporting to the Board of Trustees of every equity security in which the SBA has invested for the quarter, along with its industry category. This report is posted on the SBA website.
- Quarterly presentation to the Trustees of a “Scrutinized Companies" list for both Sudan and Iran for their approval. Scrutinized Company lists are available on the SBA’s website[11], along with information on the FRSTF direct and indirect holdings of Scrutinized Companies.
- Written notice to external investment managers of all PFIA requirements. Letters request that the managers of actively managed commingled vehicles (i.e., those with FRSTF and other clients’ assets) consider removing Scrutinized Companies from the product or create a similar actively managed product that excludes such companies. Similar written requests must be provided to relevant investment managers within the Investment Plan.
- Written notice to any company with inactive business operations in Sudan or Iran, informing the company of the PFIA and encouraging it to continue to refrain from reinitiating active business operations. Such correspondence continues semiannually.
- Written notice to any Scrutinized Company with active business operations, informing the company of its Scrutinized Company status and that it may become subject to divestment. The written notice must inform the company of the opportunity to clarify its Sudan-related or Iran-related activities and encourage the company, within 90 days, to cease its scrutinized business operations or convert such operations to inactive status.
- A prohibition on further investment on behalf of the FRSTF in any Scrutinized Company once the Sudan and Iran scrutinized lists have been approved by the Trustees. All publicly traded securities of Scrutinized Companies must be divested within 12 months after the company’s initial (and continued) appearance on the Scrutinized Companies list. Divestment does not apply to indirect holdings in actively managed commingled investment funds—i.e., where the SBA is not the sole investor in the fund. Private equity funds are considered to be actively managed.
- Reporting to each member of the Board of Trustees, President of the Senate, and the Speaker of the House of Representatives of Scrutinized Company lists within 30 days of creation, and public disclosure of each list.
- Quarterly reporting to each member of the Board of Trustees, the President of the Senate, the Speaker of the House of Representatives, the United States Presidential Special Envoy to Sudan, and the United States Presidential Special Envoy to Iran.[12] The report must include the following:
    - A summary of correspondence with engaged companies;
    - A listing of all investments sold, redeemed, divested, or withdrawn;
    - A listing of all prohibited investments;
    - A description of any progress related to external managers offering PFIA compliant funds; and
    - A list of all publicly traded securities held directly by the state.
- Adoption and incorporation into the FRSTF Investment Policy Statement (IPS) of SBA actions taken in accordance with the PFIA. Changes to the IPS are reviewed by the Investment Advisory Council (IAC) and approved by the Trustees.

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[11] The quarterly reports are available at http://www.sbafla.com/fsb/FundsWeManage/FRSPensionPlan/PFIA/2013QuarterlyReports/tabid/1483/Default.aspx

[12] Section 215.473(4)(b), F.S.

- Relevant Sudan or Iran portions of the PFIA are discontinued if the Congress or President of the United States passes legislation, executive order, or other written certification that:
  - Darfur genocide has been halted for at least 12 months;
  - Sanctions imposed against the Government of Sudan are revoked;
  - Government of Sudan honors its commitments to cease attacks on civilians, demobilize and demilitarize the Janjaweed and associated militias, grant free and unfettered access for deliveries of humanitarian assistance, and allow for the safe and voluntary return of refugees and internally displaced persons;
  - Government of Iran has ceased to acquire weapons of mass destruction and support international terrorism;
  - Sanctions imposed against the government of Iran are revoked; or
  - Mandatory divestment of the type provided for by the PFIA interferes with the conduct of U.S. foreign policy.
- Cessation of divestment and/or reinvestment into previously divested companies may occur if the value of all FRSTF assets under management decreases by 50 basis points (0.5 percent) or more as a result of divestment. If cessation of divestment is triggered, the SBA is required to provide a written report to each member of the Board of Trustees, the President of the Senate, and the Speaker of the House of Representatives prior to initial reinvestment. Such condition is required to be updated semiannually.

Sudan and South Sudan

Previous to the enactment of the PFIA in 2007, Sudan had been embroiled in a north-south civil war, until a Comprehensive Peace Agreement was signed in 2005. 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 an overwhelming vote in favor of succession from Sudan. The southern Sudan region attained independence on July 9, 2011, as South Sudan.[13]

The PFIA in s. 215.473, F.S., contains references to Sudan that are now outdated and inaccurate, including details about the government structures of Sudan and the southern Sudan region as they existed in 2007.

III. Effect of Proposed Changes:

SBA Investments in Foreign Securities

Section 1 amends s. 215.47, F.S., to allow the SBA to invest up to 50 percent of any of its funds in foreign corporate securities and obligations, up from the current maximum of 35 percent.

Section 2 amends s. 215.473, F.S., by amending the definition of "indirect holdings" to clarify that the securities included are held in a commingled fund or other collective instrument, whether managed by an SBA employee or not. The bill provides that SBA investment in exchange-traded funds will not be subject to the divestiture requirements.

[13] Information from the CIA World Factbook, located at https://www.cia.gov/library/publications/the-world-factbook/geos/od.html, last visited on March 26, 2014.

The bill also changes references in s. 215.473, F.S., to Sudan and South Sudan, to reflect current geopolitical reality, makes corresponding corrections to cross-references, and makes technical and grammatical changes.

Assets of Insurers

Section 3 creates s. 624.449, F.S., related to assets of insurers invested in companies doing business in Iran and Sudan. The bill provides that a domestic insurer must provide to the Office of Insurance Regulation, annually, a list of all investments that the insurer has in the companies included on the "Scrutinized Companies with Activities in Sudan List" and "Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List." The list must include the name of the issuer of the stock, bond, security, and other evidence of indebtedness.

Severability Clause and Effective Date

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.

The bill takes effect July 1, 2014.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Article III, s. 6 of the Florida 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.[14] The single subject of an act is to be derived from the short title.[15] "A connection between a provision [in an 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

[14] *Franklin v. State*, 887 So.2d 1063, 1072, (Fla. 2004)
[15] *Id.* at 1075.

subject or (b) tends to make effective or promote the objects and purposes of legislation included in the subject."[16]

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 the SBA may invest in foreign securities, restrictions on SBA's ability to invest in scrutinized foreign companies doing business in Iran and Sudan, and regulatory and divestiture requirements for insurers with investments in scrutinized foreign companies. If this bill were challenged under the single subject provision of the constitution, a court would apply a highly deferential standard of review.[17]

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

CS/CS/CS/SB 948 requires insurers with investments in companies on the "Scrutinized Companies with Activities in Sudan List" and "Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List" to report such investments, quarterly, to the Office of Insurance Regulation.

C. Government Sector Impact:

The fiscal impact is indeterminate.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends the following sections of the Florida Statutes: 215.47 and 215.473.

This bill creates section 624.449 of the Florida Statutes.

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[16] *Id.* at 1078.
[17] *Id.* at 1073.

IX. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS/CS/CS by Appropriations on April 22, 2014:
The CS provides that reports of insurers to the Office of Insurance Regulation on all investments the insurer has in companies on the "Scrutinized Companies with activities in Sudan List" and the "Scrutinized Companies with activities in the Iran Petroleum Energy Sector List" must be filed annually, rather than quarterly.

CS/CS by Banking and Insurance on March 25, 2014:
The CS removes the requirement that domestic insurers must, within 36 months, divest any investments in a company that is included on the Iran and Sudan scrutinized company lists.

CS by Governmental Oversight and Accountability on March 6, 2014:
The CS removes a definitional change that allows an affiliate or wholly owned subsidiary doing business in Sudan or Iran to not impact the scrutinized company status of the parent company. Current law will therefore be retained, which requires the actions of affiliates and subsidiaries to impact the parent company's scrutinized company status.

The CS also removes language unnecessary to the implementation of the insurer divestment provisions.

B. Amendments:

None.