

**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.)

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Prepared By: The Professional Staff of the Committee on Governmental Oversight and Accountability

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BILL: SB 948

INTRODUCER: Senator Ring

SUBJECT: Foreign Investments

DATE: March 3, 2014

REVISED: \_\_\_\_\_

|    | ANALYST | STAFF DIRECTOR | REFERENCE | ACTION             |
|----|---------|----------------|-----------|--------------------|
| 1. | McKay   | McVaney        | GO        | <b>Pre-meeting</b> |
| 2. |         |                | AP        |                    |
| 3. |         |                | RC        |                    |

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**I. Summary:**

SB 948 modifies the Protecting Florida's Investments Act (PFIA), which requires the State Board of Administration (SBA) to identify and divest from assets in foreign companies doing business in Iran and Sudan. The bill changes the definition of companies subject to the PFIA to exclude subsidiaries and affiliates, and provides 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 investments by a domestic insurer in a company included on the Iran and Sudan scrutinized company lists must be treated as nonadmitted assets under the Florida Insurance Code. Such investments must be reported to the Office of Insurance Regulation and must be divested.

**II. Present Situation:**

**State Board of Administration Investing Duties**

The State Board of Administration (SBA) is created in Art. IV, s. 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 Art. XII, s. 9 of the State 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 Pre-Paid College Plan, and various debt-service accounts for state bond issues<sup>1</sup>.

In investing assets, the SBA follows the Florida Statutes' fiduciary standards of care, subject to certain limitations.<sup>2</sup> 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 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 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 can be invested in the equity securities of any one corporation.
- No more than 80 percent of assets should be placed in corporate fixed income securities.
- No more than 25 percent of assets should 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 should be invested in foreign corporate or commercial securities or obligations<sup>3</sup>.
- No more than 10 percent<sup>4</sup> of assets should be invested in alternative investments,<sup>5</sup> alternative investment vehicles,<sup>6</sup> and other non publicly-traded investments.

### **Exchange-Traded Funds**

Exchange-traded funds (ETFs) are a type of exchange-traded 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, however, ETF shares are traded on a national stock exchange and at market prices that may or

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<sup>1</sup> State Board of Administration "Monthly Performance Report to the Trustees" as of November 30, 2013, issued January 13, 2014.

<sup>2</sup> Section 215.44, F.S.

<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> 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."

<sup>6</sup> 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."

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.<sup>7</sup>

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<sup>8</sup> 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<sup>9</sup> and are required to divest those securities if the companies<sup>10</sup> 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, including:

- 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<sup>11</sup>, 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.

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<sup>7</sup> 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 February 25, 2014.

<sup>8</sup> Chapter 2007-88, L.O.F.; Senate Bill 2142.

<sup>9</sup> Section 215.473(3)(c), F.S.

<sup>10</sup> Section 215.473(3)(b), F.S.

<sup>11</sup> The quarterly reports are available at

<http://www.sbafla.com/fsb/FundsWeManage/FRSPensionPlan/PFIA/2013QuarterlyReports/tabid/1483/Default.aspx>

- 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 of the following 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.<sup>12</sup> 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.
- 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

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<sup>12</sup> Section 215.473(4)(b), F.S.

- 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.<sup>13</sup>

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 “company” for purposes of the PFIA, by deleting from the definition “all wholly owned subsidiaries, majority owned subsidiaries, parent companies, or affiliates of such entities or business associations.” Deleting this language means that a company with an affiliate or wholly owned subsidiary doing business in Sudan or Iran would not subject the parent company to being named as a scrutinized company.

The bill amends the definition of “indirect holdings” to clarify that the securities included are held in a comingled fund or other collective instrument, whether managed by an SBA employee or not.

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<sup>13</sup> Information from the CIA World Factbook, located at <https://www.cia.gov/library/publications/the-world-factbook/geos/od.html>, last visited on February 25, 2014.

The bill 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. Section 624.449(1), F.S., makes legislative findings with respect to foreign companies doing business in Iran and Sudan, which are currently subject to sanctions. The findings note that shares in such companies may be held in the portfolio of insurance policies issued in Florida.

Subsection (2) provides a series of definitions to be used in 629.449, F.S., though the definitions are probably not needed, and many of the definitions are not subsequently used. The definitions sometimes differ from the definitions used in the PFIA in s. 215.47, F.S.

Subsection (3) provides that investments by a domestic insurer which are included on the SBA's "Scrutinized Companies with Activities in Sudan List" and "Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List" must be treated as nonadmitted assets. By June 30, 2014, and quarterly thereafter, the insurer must determine what investments it has in companies included on those lists.

Subsection (4) requires the insurer to provide to the Office of Insurance Regulation, quarterly, 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.

Subsection (5) provides that within 36 months after a company's appearance on the list created in subsection (3), the insurer must sell, redeem, divest, or withdraw all of the investments in the company.

Subsection (6) provides a series of conditions by which the bill section would not apply to assets of Iran or Sudan.

For assets of Iran:

- Iran is removed from the United States Department of State's list of countries that have been determined to repeatedly provide support for acts of international terrorism; and
- Pursuant to federal law, the President of the United States determines and certifies to the United States Congress that Iran has ceased its efforts to design, develop, manufacture, or acquire a nuclear explosive device or related materials and technology.

For assets of Sudan, s. 624.449, F.S., would cease to apply if the government of Sudan is removed from the United States Department of State's list of countries that have been determined to repeatedly provide support for acts of international terrorism.

These expiration provisions are different than the expiration provisions that exist in the PFIA in s. 215.473(5), F.S.

#### **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, Section 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.<sup>14</sup> The single subject of an act is to be derived from the short title.<sup>15</sup> “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 subject or (b) tends to make effective or promote the objects and purposes of legislation included in the subject.”<sup>16</sup>

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.<sup>17</sup>

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<sup>14</sup> *Franklin v. State*, 887 So.2d 1063, 1072, (Fla. 2004)

<sup>15</sup> *Id.* at 1075.

<sup>16</sup> *Id.* at 1078.

<sup>17</sup> *Id.* at 1073.

**V. Fiscal Impact Statement:****A. Tax/Fee Issues:**

None.

**B. Private Sector Impact:**

The bill requires insurers with investments on the “Scrutinized Companies with Activities in Sudan List” and “Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List” to divest themselves of those holdings.

**C. Government Sector Impact:**

Indeterminate.

**VI. Technical Deficiencies:**

The word “list” on line 411 and 414 should be “lists,” to reflect the fact that the SBA produces two lists of scrutinized companies.

**VII. Related Issues:**

The new definition and expiration provisions in section 3 of the bill are different than the current definition and expiration provisions in the PFIA. Since the insurer divestiture provisions use the scrutinized company lists generated by the SBA pursuant to the PFIA, the definition and expiration provisions in section 3 should be deleted to avoid interpretive conflicts that could thwart implementation.

The legislative findings section contains facts which are subject to change. Since the section does not contain substantive law, the section could be eliminated without affecting the implementation of the legislation.

The bill creates the insurer scrutinized company divestiture provision in Ch. 624, F.S., relating to the Insurance Code: Administration and General Provisions. Chapter 625, F.S., relates to Accounting, Investments, and Deposits by Insurers. More specifically, s. 625.031, F.S., specifies assets not allowed in any determination of the financial condition of an insurer. It is unclear whether the new divestiture provision in this bill ought to be referenced in s. 625.031, F.S.



**VIII. Statutes Affected:**

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

This bill creates section 624.449 of the Florida Statutes.

**IX. Additional Information:**

**A. Committee Substitute – Statement of Changes:**

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

None.

**B. Amendments:**

None.

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

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