

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 4049 Scrutinized Companies

SPONSOR(S): Combee

TIED BILLS: **IDEN./SIM. BILLS:**

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Government Operations Subcommittee	13 Y, 0 N	Moore	Williamson
2) Appropriations Committee	23 Y, 1 N	Delaney	Leznoff
3) State Affairs Committee	15 Y, 0 N	Moore	Camechis

SUMMARY ANALYSIS

The State Board of Administration (SBA) has responsibility for oversight of the Florida Retirement System (FRS) Pension Plan and FRS Investment Plan, which represents approximately \$153.8 billion, or 87.1 percent, of the \$176.5 billion in assets 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 that may be invested in each type. Currently, the SBA may invest up to 35 percent of any of its funds in foreign corporate securities and obligations.

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 PFIA specifies that the SBA may no longer scrutinize companies with certain business operations in Iran, may no longer assemble the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List, and must cease engagement, investment prohibitions, and divestment with respect to those companies upon the occurrence of certain actions by Congress or the President.

The bill repeals a provision requiring the SBA to cease scrutinizing and divesting of companies with certain business operations in Iran upon the occurrence of Congress or the President affirmatively and unambiguously declaring, by means including, but not limited to, legislation, executive order, or written certification from the President to Congress, that such mandatory divestment interferes with the conduct of United States foreign policy.

The bill does not appear to have a fiscal impact on the state or local governments.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background

State Board of Administration

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

The SBA has responsibility for oversight of the Florida Retirement System (FRS) Pension Plan investments and the FRS Investment Plan,¹ which represent approximately \$153.8 billion, or 87.1 percent, of the \$176.5 billion in assets managed by the SBA, as of October 31, 2015.² The SBA also manages more than 30 other investment portfolios with combined assets of \$22.9 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.

State Sponsors of Terrorism

Countries that 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.⁵ 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.⁶

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 See State Board of Administration, *Performance Report to the Trustees*, October 31, 2015, issued December 15, 2015, p. 5-6, available at https://www.sbafla.com/fsb/Portals/Internet/Reports/20151031_Trustees_Performance_Reportrev.pdf.

³ *Id.*

⁴ Section 215.444, F.S.

⁵ U.S. Department of State, *State Sponsors of Terrorism*, <http://www.state.gov/j/ct/list/c14151.htm> (last visited Jan. 21, 2016).

⁶ *Id.*

The three countries currently designated by the U.S. Secretary of State as "State Sponsors of Terrorism" are 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 a fund.

Federal Divestment Laws

The Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010⁸ (CISADA) authorizes states to divest – within specified boundaries – from companies that invest in Iran. CISADA 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 (d) to divest the assets of the State or local government from, or prohibit investment of the assets of the State or local government in, any person that the State or local government determines, using credible information available to the public, engages in investment activities in Iran described in subsection (c).

Section (c) of CISADA specifies that a person⁹ engages in investment activities in Iran if the person:

- Has an investment of \$20,000,000 or more in the energy sector of Iran, including in a person that provides oil or liquefied natural gas tankers, or products used to construct or maintain pipelines used to transport oil or liquefied natural gas, for the energy sector of Iran; or
- Is a financial institution that extends \$20,000,000 or more in credit to another person, for 45 days or more, if that person will use the credit for investment in the energy sector of Iran.

CISADA specifies that the authorization for a state or local government to divest ends 30 days after the President certifies to Congress that the government of Iran no longer satisfies the requirements for designation as a state sponsor of terrorism and has ceased the pursuit, acquisition, and development of certain weapons.¹⁰

Protecting Florida's Investment Act

In 2007, the Legislature unanimously passed the Protecting Florida's Investment Act (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"¹¹ that have

⁷ *Id.*

⁸ 22 U.S.C. ss. 8501-8551.

⁹ The term "person" includes corporations, companies, associations, firms, partnerships, societies, and joint stock companies, as well as individuals. 1 U.S.C. s. 1.

¹⁰ *See* 22 U.S.C. s. 8551(a).

¹¹ Section 215.473(1)(t), F.S., defines "scrutinized company" 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 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

prohibited business operations in Sudan or Iran. Once a company is placed on the list, the SBA and its investment managers are prohibited from acquiring that company's securities and are required to divest the company's securities if the company does 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 PFIA specifies that the SBA may no longer scrutinize companies with certain business operations in Iran, may no longer assemble the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List, and must cease engagement, investment prohibitions, and divestment with respect to those companies upon the occurrence of any of the following:

- The Congress or President of the United States affirmatively and unambiguously states, by means including, but not limited to, legislation, executive order, or written certification from the President to Congress, that the government of Iran has ceased to acquire weapons of mass destruction and support international terrorism;
- The United States revokes all sanctions imposed against the government of Iran; or
- The Congress or President of the United States affirmatively and unambiguously declares, by means including, but not limited to, legislation, executive order, or written certification from the President to Congress, that mandatory divestment of companies with business operations in Iran interferes with the conduct of United States foreign policy.

Effect of Proposed Changes

The bill repeals the provision requiring the SBA to cease scrutinizing and divesting of companies with certain business operations in Iran upon the occurrence of Congress or the President affirmatively and unambiguously declaring, by means including, but not limited to, legislation, executive order, or written certification from the President to Congress, that such mandatory divestment interferes with the conduct of United States foreign policy.

B. SECTION DIRECTORY:

Section 1 amends s. 215.471, F.S., relating to divesture by the SBA; Sudan; Iran.

Section 2 provides an effective date of July 1, 2016.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

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.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

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:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

None.