

**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 Appropriations Subcommittee on General Government

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BILL: SB 7028

INTRODUCER: Governmental Oversight and Accountability Committee

SUBJECT: State Board of Administration

DATE: January 20, 2016

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

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
	<u>Peacock</u>	<u>McVaney</u>		<b>GO Submitted as Committee Bill</b>
1.	<u>McSwain</u>	<u>DeLoach</u>	<u>AGG</u>	<b>Recommend: Favorable</b>
2.	_____	_____	<u>AP</u>	_____

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**I. Summary:**

SB 7028 deletes one of the conditions that trigger the expiration of the State Board of Administration's (SBA) duty to scrutinize companies and to assemble the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List. The SBA will no longer be required to consider declarations from the United States Congress or the President via legislation, executive order, or written certification from the President to Congress, that mandatory divestment of companies with scrutinized business operations in Iran interfere with the conduct of U.S. foreign policy. The State Board of Administration must monitor certain events and report occurrence of these events to its trustees.

The bill clarifies the duties of the State Board of Administration relating to:

- The creation and maintenance of the various lists of scrutinized companies;
- The divestment of certain investments relating to those scrutinized companies; and
- The reporting of the various lists of scrutinized companies and specified criteria of the Florida Retirement System.

The fiscal impact on state government is indeterminate. The bill takes effect on July 1, 2016.

**II. Present Situation:**

**State Board of Administration Investing Duties**

The State Board of Administration (SBA) was created by Article IV, section 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, section 9 of the Florida Constitution and ch. 215, F.S.

The SBA has oversight over the Florida Retirement System (FRS) pension plan and the FRS investment plan, which represent approximately \$157.14 billion, or 87.3 percent, of the \$180 billion in assets managed by the SBA, as of June 30, 2015.<sup>1</sup> 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 \$22.86 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.<sup>2</sup>

### State Sponsors of Terrorism

The United States Department of State maintains a list of countries determined to have repeatedly provided support for acts of international terrorism.<sup>3</sup> The countries are designated "terrorist nations" under requirements in three federal laws: the Export Administration Act<sup>4</sup>; the Arms Export Control Act<sup>5</sup>; and the Foreign Assistance Act<sup>6</sup>. Taken together, the four main categories of sanctions resulting from designation under these authorities include 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.<sup>7</sup>

Currently, the State Department designates three countries under these authorities: Iran, Sudan and Syria.<sup>8</sup> The chart below shows the date each country was designated a terrorist nation.

Country	Designation Date
Iran	January 19, 1984
Sudan	August 12, 1993
Syria	December 29, 1979

Cuba had been designated as a State Sponsor of Terrorism on March 1, 1982. In December 2014, President Obama requested the Secretary of State to review Cuba's designation as a state sponsor of terrorism, and to provide him a report within six months in regards to Cuba's support for international terrorism.<sup>9</sup> On April 8, 2015, the Secretary of State completed his review and recommended to the President that Cuba no longer be designated as a state sponsor of terrorism.<sup>10</sup>

On April 14, 2015, the President submitted this report to Congress indicating the administration's intent to rescind Cuba's state sponsor of terrorism designation, including the certification that Cuba has not provided any support for international terrorism during the

<sup>1</sup> State Board of Administration "Performance Report to the Trustees" dated June 30, 2015, and issued on August 12, 2015.

<sup>2</sup> *Id.*

<sup>3</sup> U.S. Department of State, Diplomacy in Action can be found online at <http://www.state.gov/j/ct/list/c14151.htm> (last visited Sept. 9, 2015).

<sup>4</sup> 50 U.S.C. App 2405(j)

<sup>5</sup> 22 U.S.C. s. 2780

<sup>6</sup> 22 U.S.C. s. 2371

<sup>7</sup> See <http://www.state.gov/s/ct/c14151.htm>.

<sup>8</sup> *Id.*

<sup>9</sup> U.S. Department of State, Diplomacy in Action, Recession of Cuba as a State Sponsor of Terrorism, at <http://www.state.gov/r/pa/prs/ps/2015/05/242986.htm> (last visited on Sept. 15, 2015).

<sup>10</sup> *Id.*

previous six months and that Cuba has provided assurances that it will not support acts of international terrorism in the future.<sup>11</sup>

After the 45-day Congressional pre-notification period expired, Cuba was officially removed from the list on May 29, 2015.<sup>12</sup>

### **Protecting Florida Investments Act**

In 2007, the Legislature enacted the Protecting Florida's Investments Act (PFIA).<sup>13</sup> 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>14</sup> and are required to divest those securities if the companies<sup>15</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 such entities or business associations.

The term "public fund" is defined as "all funds, assets, trustee, and other designates under the State Board of Administration pursuant to chapter 121."<sup>16</sup> This means those assets of the Florida Retirement System - both the pension plan as well as the investment plan.

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

- 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>17</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

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<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> Chapter 2007-88, Laws of Florida; *also, see* Senate Bill 2142 (reg. session 2007).

<sup>14</sup> Section 215.473(3)(c), F.S.

<sup>15</sup> Section 215.473(3)(b), F.S.

<sup>16</sup> Section 215.473(1)(r), F.S.

<sup>17</sup> The quarterly reports are available at

<http://www.sbafla.com/fsb/Portals/Internet/PFIA/CurrentProhibitedCompaniesList.pdf>

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.<sup>18</sup> Such correspondence continues semiannually.<sup>19</sup>
- 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.<sup>20</sup> 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.<sup>21</sup>
- 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.<sup>22</sup>
- 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.<sup>23</sup> The report must include the following:<sup>24</sup>
  - 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;<sup>25</sup>
  - Sanctions imposed against the Government of Sudan are revoked;<sup>26</sup>

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<sup>18</sup> Section 215.473(3)(a)2., F.S.

<sup>19</sup> *Id.*

<sup>20</sup> Section 215.473(3)(a)3., F.S.

<sup>21</sup> *Id.*

<sup>22</sup> Section 215.473(4)(a), F.S.

<sup>23</sup> Section 215.473(4)(b), F.S.

<sup>24</sup> Section 215.473(4)(b)1.-5., F.S.

<sup>25</sup> Section 215.473(5)(a)1., F.S.

<sup>26</sup> Section 215.473(5)(a)2., F.S.

- 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;<sup>27</sup>
- Government of Iran has ceased to acquire weapons of mass destruction and support international terrorism;<sup>28</sup>
- Sanctions imposed against the government of Iran are revoked;<sup>29</sup> or
- Mandatory divestment of the type provided for by the PFIA interferes with the conduct of U.S. foreign policy.<sup>30</sup>
- 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.<sup>31</sup> 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.<sup>32</sup> Such condition is required to be updated semiannually.<sup>33</sup>

### **Prohibition Against Contracting with Scrutinized Companies and Companies Engaged in Business Operations in Cuba or Syria**

Section 287.135(2), F.S., prohibits a company on the Scrutinized Companies with Activities in Sudan List or on the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List or is engaged in business operations in Cuba or Syria from bidding on, submitting a proposal for, or entering into or renewing a contract with an agency<sup>34</sup> or local governmental entity for goods or services of \$1 million or more. “Local governmental entity,” for the purposes of s. 287.135, F.S., means a county, municipality, special district, or other political subdivision of the state.

Section 287.135(3)(b), F.S., provides that any contract with an agency or local governmental entity for goods or services of \$1 million or more entered into or renewed on or after July 1, 2012, must contain a provision that allows for the termination of such contract at the option of the awarding body if the company is found to have submitted a false certification or has been placed on the Scrutinized Companies with Activities in Sudan List or the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List or have been engaged in business operations in Cuba or Syria.

Section 287.135(4)(a)1., F.S., allows an agency or local governmental entity to make a case-by-case exception to the prohibition for a company on the Scrutinized Companies with Activities in

<sup>27</sup> Section 215.473(5)(a)3., F.S.

<sup>28</sup> Section 215.473(5)(b)1., F.S.

<sup>29</sup> Section 215.473(5)(b)2., F.S.

<sup>30</sup> Section 215.473(5)(b)3., F.S.

<sup>31</sup> Section 215.473(7), F.S.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> Agency is defined in s. 287.012(1), F.S., as any of the various state officers, departments, boards, commissions, divisions, bureaus, and councils and any other unit of organization, however designated, of the executive branch of state government. “Agency” does not include the university and college boards of trustees or the state universities and colleges. Also, see s. 287.135(1), F.S. Definitions contained in ss. 287.012 and 215.473, F.S. are incorporated into s. 287.135, F.S.

Sudan List or the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List if:

- The scrutinized business operations<sup>35</sup> were made before July 1, 2011;
- The scrutinized business operations have not been expanded or renewed after July 1, 2011;
- The agency or local governmental entity determines that it is in the best interest of the state or local community to contract with the company;
- The company has adopted, has publicized, and is implementing a formal plan to cease scrutinized business operations and to refrain from engaging in any new scrutinized business operations; *and*
- *One* of the following occurs:
  - The local governmental entity makes a public finding that, absent such an exemption, the local governmental entity would be unable to obtain the goods or services for which the contract is offered.
  - For a contract with an executive agency, the Governor makes a public finding that, absent such an exemption, the agency would be unable to obtain the goods or services for which the contract is offered.
  - For a contract with an office of a state constitutional officer other than the Governor, the state constitutional officer makes a public finding that, absent such an exemption, the office would be unable to obtain the goods or services for which the contract is offered.

Section 287.135(4)(a)2., F.S., allows an agency or local governmental entity to make a case-by-case exception to the prohibition for a company engaged in business operations in Cuba or Syria if:

- The business operations were made before July 1, 2012;
- The business operations have not been expanded or renewed after July 1, 2012;
- The agency or local governmental entity determines that it is in the best interest of the state or local community to contract with the company;
- The company has adopted, has publicized, and is implementing a formal plan to cease business operations and to refrain from engaging in any new business operations; *and*
- *One* of the following occurs:
  - The local governmental entity makes a public finding that, absent such an exemption, the local governmental entity would be unable to obtain the goods or services for which the contract is offered.
  - For a contract with an executive agency, the Governor makes a public finding that, absent such an exemption, the agency would be unable to obtain the goods or services for which the contract is offered.
  - For a contract with an office of a state constitutional officer other than the Governor, the state constitutional officer makes a public finding that, absent such an exemption, the office would be unable to obtain the goods or services for which the contract is offered.

An agency or local governmental entity must require a company that submits a bid or proposal for, or that otherwise proposes to enter into or renew, a contract with the agency or local governmental entity for goods or services of \$1 million or more to certify, at the time a bid or proposal is submitted or before a contract is executed or renewed, that the company is not on the

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<sup>35</sup> Section 215.473(1)(t), F.S., defines “scrutinized business operations” to mean business operations that result in a company becoming a scrutinized company.

Scrutinized Companies with Activities in Sudan List or the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List, or that it does not have business operations in Cuba or Syria.<sup>36</sup>

If an agency or local governmental entity determines that a company has submitted a false certification, it shall provide the company with written notice, and the company will have 90 days to respond in writing to such determination.<sup>37</sup> If the company fails to demonstrate that the determination of false certification was made in error, then the awarding body *must* bring a civil action against the company.<sup>38</sup> If a civil action is brought and the court determines that the company submitted a false certification, the company shall pay all reasonable attorney's fees and costs (including costs for investigations that led to the finding of false certification).<sup>39</sup> Also, a civil penalty equal to the greater of \$2 million or twice the amount of the contract for which the false certification was submitted shall be imposed.<sup>40</sup> The company is ineligible to bid on any contract with an agency or local governmental entity for 3 years after the date the agency or local governmental entity determined that the company submitted a false certification.<sup>41</sup> A civil action to collect the penalties must commence within 3 years after the date the false certification is made.<sup>42</sup>

Section 287.135(6), F.S., specifies that only the awarding body may cause a civil action to be brought, and that the section does not create or authorize a private right of action or enforcement of the provided penalties. An unsuccessful bidder, or any other person other than the awarding body, may not protest the award or contract renewal on the basis of a false certification.

Section 287.135(7), F.S., specifies that this section preempts any ordinance or rule of any agency or local governmental entity involving public contracts for goods or services of \$1 million or more with a company engaged in scrutinized business operations.

Section 287.135 (8), F.S., provides that this provision becomes inoperative on the date that federal law ceases to authorize the state to adopt and enforce the contracting prohibitions of the type provided for in this section.

### **Fiduciary Standards**

The fiduciary standards for the SBA are specified out as follows in s. 215.47(10), F.S.:

Investments made by the State Board of Administration shall be designed to maximize the financial return to the fund consistent with the risks incumbent in each investment and shall be designed to preserve an appropriate diversification of the portfolio. The board shall discharge its duties with respect to a plan solely in the interest of its participants and beneficiaries. The board in performing the

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<sup>36</sup> Section 287.135(5), F.S.

<sup>37</sup> Section 287.135(5)(a), F.S.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> Section 287.135(5)(a)1., F.S.

<sup>41</sup> Section 287.135(5)(a)2., F.S.

<sup>42</sup> Section 287.135(5)(b), F.S.

above investment duties shall comply with the fiduciary standards set forth in the Employee Retirement Income Security Act of 1974 (ERISA) at 29 U.S.C. s. 1104(a)(1)(A) through (C). In case of conflict with other provisions of law authorizing investments, the investment and fiduciary standards set forth in this subsection shall prevail.

The ERISA standard at 29 U.S.C. s. 1104(a)(1)(A) - (C) provides for the “prudent man standard of care,” requiring a fiduciary to:

discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

- (i) providing benefits to participants and their beneficiaries; and
- (ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so;

### III. Effect of Proposed Changes:

**Section 1** amends s. 215.473, F.S., to define the term “board” as the State Board of Administration. The definition of “public fund” is revised to mean all assets of the Florida Retirement System (FRS) held by the SBA in its capacity as a fiduciary pursuant to chapter 121.

Also, this section clarifies that the SBA must identify all scrutinized companies that have prohibited business operations in Sudan and Iran in which the FRS has direct and indirect holdings or could possibly have such holdings in the future.

Additionally, the bill clarifies that the SBA must maintain a list of Scrutinized Companies with Activities in Sudan and a list of Scrutinized Companies with Activities in the Iran Petroleum Energy Sector.

Further, the bill deletes one of the conditions that trigger the expiration of the SBA’s duty to scrutinize companies and to assemble the Scrutinized Companies with Activities in the Iran Petroleum Energy Sector List. The SBA will no longer be required to consider declarations from Congress or the President via legislation, executive order, or written certification from the President to Congress, that mandatory divestment of companies with scrutinized business operations in Iran interfere with the conduct of U.S. foreign policy. The bill requires the SBA, acting as a fiduciary pursuant to s. 215.47(10), F.S., to monitor events relating to expiration provisions of s. 215.473, F.S., and to report the occurrence and status of such conditions at quarterly meetings of its trustees.

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

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

The mandate restrictions do not apply because the bill does not require counties and municipalities to spend funds, reduce counties' or municipalities' ability to raise revenue, or reduce the percentage of state tax shares with counties and municipalities.

**B. Public Records/Open Meetings Issues:**

None.

**C. Trust Funds Restrictions:**

None.

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

None.

**B. Private Sector Impact:**

None.

**C. Government Sector Impact:**

Indeterminate.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Statutes Affected:**

This bill amends section 215.473 of the Florida Statutes.

**IX. Additional Information:****A. Committee Substitute – Statement of Substantial 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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