HOUSE OF REPRESENTATIVES
FINAL BILL ANALYSIS

BILL #:	CS/CS/HB 811	**FINAL HOUSE FLOOR ACTION:**	
SPONSOR(S):	Appropriations Committee; Government Operations Subcommittee; Hager and others	118 **Y's**	0 **N's**
COMPANION BILLS:	CS/CS/CS/SB 948	**GOVERNOR'S ACTION:**	Approved

SUMMARY ANALYSIS

CS/CS/HB 811 passed the House on April 25, 2014, and subsequently passed the Senate on May 1, 2014. The bill modifies the Protecting Florida's Investment Act (PFIA), revises provisions governing investments by the State Board of Administration (SBA), and requires domestic insurers to report on specified information concerning scrutinized companies.

The 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 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. Currently, the SBA may invest up to 35 percent of any of its funds in foreign corporate securities and obligations.

The 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 allows the SBA to invest up to 50 percent of any of its funds in foreign corporate securities and obligations.

The bill modifies the PFIA to provide that SBA investments in exchange-traded funds are not 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 on state or local government.

The bill was approved by the Governor on June 13, 2014, ch. 2014-134, L.O.F., and will become effective on July 1, 2014.

I. SUBSTANTIVE INFORMATION

A. EFFECT OF CHANGES:

Background

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 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

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[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

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[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).

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 (PFIA), which requires 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

[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.

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, 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 amends current law to allow the SBA to invest up to 50 percent of any of its funds in foreign corporate securities and obligations, which is an increase from the current maximum of 35 percent.

For purposes of the PFIA, the bill changes references to Sudan to reflect Sudan and South Sudan. It also 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.

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:

[12] Section 624.03, F.S.

The bill requires domestic insurers to file annual reports with the Office of Insurance Regulation regarding certain investments; such reporting requirements will impose a limited administrative burden on those companies.

D. FISCAL COMMENTS:

None.