

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 Governmental Oversight and Accountability Committee

BILL: SB 1144

INTRODUCER: Senator Garcia

SUBJECT: Scrutinized Companies

DATE: January 27, 2012

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	McKay	Roberts	GO	Pre-meeting
2.			BC	
3.				
4.				
5.				
6.				

I. Summary:

The bill would prohibit the State Board of Administration from investing in companies that have specified business relationships with Cuba and Syria.

This bill amends sections 215.473 and 287.135 of the Florida Statutes.

II. Present Situation:

The State Board of Administration

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 \$128 billion, or 86 percent, of the \$149 billion in assets managed by the SBA, as of October 31, 2011. The Pension Plan is a defined benefit plan and the Investment Plan is a defined contribution plan that employees choose in lieu of the Pension Plan. The SBA also manages 33 other investment portfolios, with combined assets of \$21 billion, including the Florida Hurricane Catastrophe Fund (CAT Fund), the Florida Lottery Fund, the Florida Pre-Paid College Plan, and various debt-service accounts for state bond issues.¹

¹ State Board of Administration “Monthly Performance Report to the Trustees” as of October 31, 2011, issued November 30, 2011.

Divestiture from Cuba

Section 215.471, F.S., enacted in 1993, prohibits the SBA from investing in stocks, securities, or other obligations of:

- Any institution or company domiciled in the United States that does business of any kind with Cuba, in violation of federal law.
- Any institution or company domiciled outside of the United States if the President of the United States has applied sanctions against the foreign country in which the institution or company is domiciled, pursuant to s. 4 of the Cuban Democracy Act of 1992.

Section 215.472, F.S., prohibits each state agency from investing in:

- Any financial institution or company domiciled in the United States, or foreign subsidiary of a company domiciled in the United States, which directly or through a United States or foreign subsidiary, makes any loan, extends credit of any kind or character, advances funds in any manner, or purchases or trades any goods or services with Cuba, the government of Cuba, or any company doing business in or with Cuba in violation of federal law.
- Any financial institution or company domiciled outside of the United States if the President of the United States has applied sanctions against the foreign country in which the institution or company is domiciled pursuant to s. 4 of the Cuban Democracy Act of 1992.

According to information provided by staff of the SBA, in order to comply with this legislation, the Cuban Affairs Section at the U.S. State Department or the Treasury Department's Office of Foreign Assets Control (OFAC) are contacted periodically to confirm that no sanctions have been implemented. Since the Act's inception, sanctions have never been issued against any country.

The Protecting Florida's Investments Act

In 2007, the Legislature enacted² 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 and are required to divest those securities if the companies 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.

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

² Chapter 2007-88, L.O.F.; Senate Bill 2142.

- 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, 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 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.³ 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;

³ Section 215.473(4)(b), F.S.

- 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 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.

Section 121.4501(7), F.S., enacted in 2009, requires the SBA to identify and offer, by March 1, 2010, at least one terror-free investment product for the FRS Investment Plan.⁴ The product must allocate its funds among securities not subject to divestiture, as provided in the PFIA.

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 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.

⁴ Section 1 of Ch. 2009-97, L.O.F.; Senate Bill 538.

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:

The bill adds Syria and Cuba as nations subject to the Protecting Florida’s Investments Act in s. 215.473, F.S., requiring investing prohibitions and potential divestiture by the SBA.

The bill expands the definition of “scrutinized countries” to include the following:

- The company has business operations that involve contracts with or provision of supplies or services to the government of Cuba, companies in which the government of Cuba has any direct or indirect equity share, consortiums or projects commissioned by the government of Cuba, or companies involved in consortiums or projects commissioned by the government of Cuba and:
 - More than 10 percent of the company’s total revenues or assets are linked to Cuba, and the company has failed to take substantial action; or
 - The company has, with actual knowledge, on or after January 1, 1959, 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.
- The company supplies military equipment within Cuba, unless it clearly shows that the military equipment cannot be used to facilitate offensive military actions in Cuba 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 Cuba, or sale of such equipment solely to any internationally recognized peacekeeping force or humanitarian organization.

- The company has business operations that involve contracts with or provision of supplies or services to the government of Syria, companies in which the government of Syria has any direct or indirect equity share, consortiums or projects commissioned by the government of Syria, or companies involved in consortiums or projects commissioned by the government of Syria and:
 - More than 10 percent of the company's total revenues or assets are linked to Syria and involve oil-related activities, and the company has failed to take substantial action; or
 - The company has, with actual knowledge, on or after March 8, 1963, 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 Syria's ability to develop the petroleum resources of Syria.
- The company supplies military equipment within Syria, unless it clearly shows that the military equipment cannot be used to facilitate offensive military actions in Syria 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 Syria, or sale of such equipment solely to any internationally recognized peacekeeping force or humanitarian organization.

The bill requires the SBA to create a "Scrutinized Companies with Activities in Cuba List" and a "Scrutinized Companies with Activities in Syria List," and use those lists consistent with the duties in the PFIA.

The bill provides that if any of the following occur, the SBA may no longer scrutinize the affected companies, no longer produce the Scrutinized Companies list, and cease divestment and investment prohibitions:

- 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 Cuba or Syria has ceased to acquire weapons of mass destruction and support international terrorism;
- The United States revokes all sanctions imposed against the government of Cuba or Syria; 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 the type provided for in this act interferes with the conduct of United States foreign policy.

The bill amends s. 287.135, F.S., to provide that a contract with an agency or local government, after July 1, 2012, must include a provision allowing for termination if the company is found to have submitted a false certification or been placed on a Scrutinized Companies list.

The bill takes effect July 1, 2012.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

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:

The SBA would be prohibited from investing in those companies placed on a Scrutinized Companies list. Staff of the SBA advises that as proposed, the bill could potentially affect up to 13 foreign companies with business operations in Syria, 194 foreign companies with business operations in Cuba, and 33 U.S. companies with business operations in Cuba.

C. Government Sector Impact:

Staff of the SBA advises that as proposed, the bill could require the SBA to sell securities valued at approximately \$10.2 billion, with direct and indirect costs of \$20 million to \$40 million. Roughly 8 percent of U.S stocks, and 21 percent of international stocks, would be prohibited for investment by the SBA.

VI. Technical Deficiencies:

On line 831, the word “Cuba” should be changed to “Syria.”

VII. Related Issues:

None.

VIII. 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.

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