

Legislative Analysis



PUBLIC RETIREMENT SYSTEMS: DIVESTITURE OF INVESTMENTS RELATED TO SUDAN AND IRAN

Mitchell Bean, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 4854 (H-3) as passed by the House
Sponsor: Rep. Alma Wheeler Smith

House Bill 4903 (H-3) as passed by the House
Sponsor: Rep. Marty Knollenberg
Committee: Government Operations

Complete to 8-27-07

A SUMMARY OF HOUSE BILLS 4854 & 4903 AS PASSED BY THE HOUSE ON 7-24-07

The bills would amend the Public Employee Retirement System Investment Act (MCL 38.1133c and 1133d) to require a retirement system to engage in a number of activities related to assets invested in companies with certain kinds of business relationships with Sudan and Iran. These companies are referred to as "scrutinized companies." House Bill 4854 deals with Sudan. House Bill 4903 deals with Iran.

The bill ultimately could, under certain conditions, require a retirement system to sell, redeem, divest, or withdraw all publicly traded securities of a company actively involved with the Sudan or Iran over a 15-month period.

Further, under the bill, at no time could a retirement system acquire securities of companies on its scrutinized companies list that have active business operations in Sudan or Iran.

Retirement Systems. The bill would apply to retirement systems under the Michigan Legislative Retirement Act, the State Police Retirement Act, the Judges Retirement Act, the State Employees Retirement Act, and the Public School Employees Retirement Act. The state treasurer is the fiduciary for all of those systems except the Legislative Retirement System, which has a board of trustees as its fiduciary.

Scrutinized Companies. Scrutinized companies are those that have business operations that involve contracts with or the provision of supplies or services to the governments of Sudan or Iran, companies in which the governments of Sudan or Iran have a direct or indirect equity share, and consortia or projects commissioned by the governments of Sudan or Iran.

Scrutinized companies also include, for Sudan-related investments, companies involved in government of Sudan-commissioned consortia and projects if (1) 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 failed to take "substantial action;" or (2) more than 10 percent of the company's revenues and assets linked to Sudan involve power production activities, less than 75 percent 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." The term also includes companies that are complicit in the Darfur genocide or that supply military equipment within Sudan (unless a company can show the equipment cannot be used for offensive military actions or the company implements rigorous and verifiable safeguards to prevent use of the equipment by forces participating in armed conflict).

For Iran-related investments, scrutinized companies also include companies involved in consortia and projects commissioned by the government of Iran where (1) more than 10 percent of the company's total revenues or assets are linked to Iran, involve oil-related activities or mineral-extraction activities, and the company has failed to take "substantial action;" or (2) 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 \$10 million each aggregating \$20 million in a 12-month period, that directly or significantly contributes to the enhancement of Iran's ability to develop petroleum resources.

Substantial Action. The term "substantial action" as used above is defined somewhat differently in the two bills. For Iran, it refers to adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within one year and to refrain from any new business operations.

For Sudan, it includes those activities but in addition includes (1) undertaking significant humanitarian efforts in conjunction with an international organization, the government of Sudan, the regional government of Southern Sudan, or a nonprofit entity and certified by an independent third party to be substantial in relationship to the company's Sudan business operations and of benefit to one or more marginalized populations of Sudan, or (2) through engagement with the government of Sudan, materially improving conditions for the genocidally victimized population in Darfur.

Exempt Companies. Under House Bill 4854, dealing with Sudan, the divestiture and investment provisions would not apply to a "social development company," which is defined as a company whose primary purpose in Sudan is to provide humanitarian goods or services, including medicine or medical equipment, agricultural supplies or infrastructure, educational opportunities, journalism-related activities, information materials, spiritual-related activities, or food, clothing, or general consumer goods that are unrelated to oil-related activities, mineral extraction activities, or power production activities.

Further, under both House Bill 4854 and 4903, the divestiture and investment provisions would not apply to a company that the United States government affirmatively declares to be excluded from its present or future federal sanctions regime related to Sudan or Iran. Those provisions would also not apply to indirect holdings in actively managed investment funds (e.g., mutual funds). Before the fiduciary invests in a new private equity fund that is not in the fiduciary portfolio, the fiduciary must perform due diligence

to prevent investment in any private entity fund where the offering memorandum identifies the purpose of that fund as investing in scrutinized companies in active business operations with Sudan or Iran. The fiduciary would not be required to identify holdings in private equity funds or submit engagement letters to those funds.

If the manager of a publicly traded, actively managed fund in the fiduciary portfolio creates a similar publicly traded actively managed fund with indirect holdings devoid of identified scrutinized companies with scrutinized active business operations, the fiduciary would be required to replace all applicable investments with investments in similar fund in an expedited time frame consistent with prudent investment standards.

Scrutinized Companies List. Within 90 days after the effective date of the bills, a fiduciary would have to make its best efforts to identify all scrutinized companies in which it has direct or indirect holdings or could have in the future. Such efforts would have to include one or more of the following: reviewing and relying on publicly available information (from nonprofits, research firms, and government entities); contacting contracted asset managers that invest in companies with business operations in Sudan or Iran; and contacting other institutional investors that have divested from or engaged with companies that have business operations in Sudan or Iran. (Under House Bill 4903, efforts could also include reviewing federal laws regarding the levels of business activity that would cause the application of sanctions against companies conducting business or investing in countries designated as "state sponsors of terror.")

At the end of the 90-day period or by the first meeting of the fiduciary after the 90-day period, the fiduciary would have to assemble all scrutinized companies identified into a scrutinized companies list. The fiduciary would be required to update the list on a quarterly basis based on evolving information.

Procedure in Dealing with Scrutinized Companies. A fiduciary would have to adhere to all the following procedures for scrutinized companies on the list:

**** Immediately determine the companies in which the retirement system owns direct or indirect holdings.**

**** For each company identified with only inactive business operations, send a written notice informing the company of the new act and encouraging it to refrain from initiating active business operations in Sudan or Iran until it is able to avoid scrutinized business operations (and, in the case of Sudan, engage in substantial humanitarian operations). The fiduciary would continue the correspondence on a semiannual basis.**

**** For each company newly identified with active business operations, send a written notice informing the company of its scrutinized company status and that it could become subject to divestment by the fiduciary. The notice would offer the company the opportunity to clarify its Sudan- or Iran-related activities and would encourage it, within 90 days, to either cease its scrutinized business operations or convert such operations to inactive business operations in order to avoid qualifying for divestment.**

** If, within 90 days following the fiduciary's first engagement with a company, it ceases scrutinized business operations, then the company would be removed from the list and the bills would not apply to it unless the company resumed scrutinized business operations. If, within 90 days following the fiduciary's first engagement, the company converts its scrutinized active business operations to inactive business operations, it would also be removed from the list.

** If, after 90 days following the fiduciary's first engagement with the company it continues to have scrutinized active business operations, and only while it continues to have active business operations, the fiduciary could sell, redeem, divest, or withdraw all publicly traded securities of the company as follows: 50 percent of the assets would be removed from the fiduciary's assets under management within nine months after the company's most recent appearance on the list and 100 percent would be removed from the retirement system's assets under management within 15 months after the company's most recent appearance on the list.

** The fiduciary would also have to submit letters to the managers of actively managed investment funds containing companies with scrutinized active business operations requesting they consider removing identified companies from the fund or create a similar actively managed fund with indirect holdings devoid of identified companies. If the manager creates a similar fund, the fiduciary would replace all applicable investment with investments in the similar fund in an expedited time frame consistent with prudent investing standards.

Report to the Legislature. The fiduciary would have to file a publicly available report to the Legislature 30 days after the list is created that includes the scrutinized companies. Annually thereafter, the fiduciary would have to file a publicly available report with the Legislature and send a copy to the United States Presidential Special Envoy to either Sudan or Iran that includes a summary of correspondence with companies engaged by the fiduciary; all investments sold, redeemed, divested, or withdrawn; all prohibited investments; and any progress made with actively managed investment funds.

Effectiveness Terminated. The provisions of House Bill 4845 would be in effect until the first occurrence of one or more the following:

(1) the United States Congress or the President of the United States declares that the Darfur genocide has been halted for at least twelve months; (2) the U.S. revokes all sanctions imposed against the government of Sudan; (3) the Congress or President declares the government of Sudan has honored its commitments to cease attacks on civilians, demobilize and demilitarize the Janjaweed and associated militias, grant free and unfettered access to deliveries of humanitarian assistance, and allow for the safe and voluntary return of refugees and internally displaced persons; or (4) the Congress or President declares, through legislation or executive order, that mandatory divestment (as provided in the act) interferes with the conduct of U.S. foreign policy.

The provisions of House Bill 4903 would remain in effect until the first occurrence of one or more of the following:

(1) the Congress or President affirmatively and unambiguously states through 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; (2) the U.S. revokes all sanctions imposed against the government of Iran; and (3) the Congress or President affirmatively state through legislation, executive order or written certification that mandatory divestment interferes with the conduct of United States foreign policy.

Exemption from Obligations for Compliance with Bills. A fiduciary, with respect to actions taken in compliance with the bills, would be exempt from any conflicting statutory or common law obligations, including any obligations in respect to choice of asset managers, investment funds, or investments for the retirement system's securities portfolios.

Waiver of Liability. With regard to investments, the fiduciary, members of an investment advisory committee, and any person with decision-making authority would not be held liable for any action undertaken for the purpose of complying with or executing the mandates required in the act.

Severability. The bills contain a severability clause that says: "If any provision, section, subsection, sentence, clause, phrase, or word of this legislation or its application to any person or circumstance is found to be invalid, illegal, unenforceable, or unconstitutional, the same is hereby declared to be severable and the balance of this legislation shall remain effective and functional notwithstanding such invalidity, illegality, unenforceability, or unconstitutionality."

FISCAL IMPACT:

The fiscal impact of the bills is indeterminate due to a lack of data on the effect on state investments.

POSITIONS

The following indicated support for House Bill 4854 at the Government Operations meeting on 7-24-07: the Department of Treasury; the Sudan Divestment Task Force; Nine 4 Peace; MSU STAND (Spartans Taking Action Now: Darfur); the Michigan Darfur Coalition; the Michigan Jewish Conference; and the Jewish Community Relations Council.

The following indicated support for House Bill 4903 on 7-24-07: The Department of Treasury and the Michigan Jewish Conference;

Legislative Analyst: E. Best
Fiscal Analyst: Al Valenzio

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.