



Senate Fiscal Agency
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BILL ANALYSIS

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Senate Bills 846, 848, 849, and 850 (as enacted)
Senate Bill 852 (as enacted)
Senate Bills 853 and 856 (as enacted)
House Bill 4854 (as enacted)
House Bill 4903 (as enacted)

Sponsor: Senator Cameron S. Brown (S.B. 846)
Senator John Pappageorge (S.B. 848)
Senator Randy Richardville (S.B. 849)
Senator Dennis Olshove (S.B. 850)
Senator Valde Garcia (S.B. 852)
Senator Hansen Clarke (S.B. 853)
Senator Mark C. Jansen (S.B. 856)
Representative Alma Wheeler Smith (H.B. 4854)
Representative Marty Knollenberg (H.B. 4903)

Senate Committee: Homeland Security and Emerging Technologies
House Committee: Government Operations

Date Completed: 8-20-08

RATIONALE

Growing concern about terrorism around the world and genocide in Sudan has led a number of states to enact or consider measures that prohibit or discourage the investment of public funds in companies doing business with countries that are considered "state sponsors of terrorism". Other measures require or encourage the divestment of funds from such companies. "State sponsors of terrorism" are countries determined by the U.S. Secretary of State to have repeatedly provided support for acts of international terrorism, such as Iran and Sudan. This designation results in sanctions at the Federal level, including restrictions on U.S. foreign aid, a ban on defense exports and sales, and certain controls over exports of dual use items (products that have both commercial and military uses).

Many people believe that limiting investments in businesses associated with state sponsors of terrorism will motivate the companies to sever their ties with nations that provide resources and safe haven to terrorist organizations, ultimately reducing those activities. Many also believe that it is

PUBLIC ACTS 234-237 of 2008
PUBLIC ACT 256 of 2008
PUBLIC ACTS 238 & 239 of 2008
PUBLIC ACT 233 of 2008
PUBLIC ACT 232 of 2008

inappropriate for public funds to be invested in these enterprises. It was suggested that Michigan should take steps to require the divestment of public funds from companies that do business with state sponsors of terrorism, and to prevent new investment in those companies.

CONTENT

Senate Bill 846 created the "Divestment from Terror Act" to do the following:

- **Require a fiduciary (e.g., the State Treasurer with respect to various funds and retirement systems, or a community college board) to make its best efforts to identify all companies in which it has holdings that do business with a "state sponsor of terror", i.e., "scrutinized companies", and create a list of those companies.**
- **Within nine months of a company's most recent appearance on a fiduciary's list, require the fiduciary to sell, redeem, divest, or withdraw**

50% of the securities of the company if it continues to have scrutinized active "business operations" (engages in commerce with a state sponsor of terror).

- Within 15 months of a company's most recent appearance on a fiduciary's list, require the fiduciary to sell, redeem, divest, or withdraw 100% of the securities of the company if it continues to have scrutinized active business operations.
- Except for indirect holdings in actively managed investment funds, prohibit a fiduciary from acquiring securities of companies on its list that have active business operations.
- Require a fiduciary to perform due diligence to prevent investment in any private equity fund in violation of the Act.
- If the manager of a publicly traded, actively managed fund in a fiduciary's portfolio creates a similar fund not associated with scrutinized active business operations, encourage the fiduciary to replace its existing investments with investments in the new fund.
- Require the Department of Treasury to collect and publish on its website information regarding investments under the Act, as well as the progress made in preventing new investment in scrutinized companies with active business operations in a state sponsor of terror and replacing existing investments.
- Exempt a fiduciary from any statutory or common law obligation that conflicts with the Act.
- Provide immunity from liability for actions taken to comply with the Act.
- Require a fiduciary to follow divestment criteria in the Public Employee Retirement System Investment Act if a scrutinized company does business with the government of Sudan or Iran.

House Bills 4854 and 4903 amended the Public Employee Retirement System Investment Act to add divestment requirements pertaining to Sudan and Iran, respectively, similar to the requirements in the Divestment from Terror Act.

Senate Bills 848, 849, 850, 852, 853, and 856 amended various statutes to require the applicable investment fiduciary to comply with the Divestment from Terror Act in making investments.

Senate Bill 848 amended Public Act 9 of the Extra Session of 1946, which governs the Veterans' Trust Fund. Senate Bill 849 amended the Natural Resources and Environmental Protection Act with regard to the Environmental Protection Fund. Senate Bill 850 amended the Community College Act. Senate Bill 852 amended the Michigan Trust Fund Act with regard to the 21st Century Jobs Trust Fund. Senate Bill 853 amended Public Act 249 of 1982, which governs the Children's Trust Fund. Senate Bill 856 amended the Michigan Education Trust Act. (Under these statutes, the State Treasurer is responsible for investing the assets of the Veterans' Trust Fund, the Environmental Protection Fund, the 21st Century Jobs Trust Fund, and the Children's Trust Fund. Investments under the Community College Act are made by a board of trustees, chief executive officer, or treasurer of a community college district. The board of the Michigan Education Trust invests assets of the Trust.)

All of the bills, except Senate Bill 852, took effect on July 17, 2008. Senate Bill 852 took effect on August 4, 2008.

The House bills and all of the other Senate bills were tie-barred to Senate Bill 846, which was tie-barred to the House bills.

Senate Bill 846 and House Bills 4854 and 4903 are described in detail below.

Senate Bill 846

Identification of Scrutinized Companies

Within 90 days after the Act's effective date, a fiduciary must make its best efforts to identify all scrutinized companies in which the fiduciary has direct or indirect holdings or has a current option to have such holdings in the future. The efforts may include one or more of the following:

- Reviewing and relying, as appropriate in the fiduciary's judgment, on publicly available information regarding companies with business operations in a state sponsor of terror, including information provided by nonprofit organizations, research firms,

international organizations, and government entities.

- Contacting asset managers contracted by the fiduciary that invest in companies with business operations in a state sponsor of terror.
- Contacting other institutional investors that have divested from or engaged with companies that have business operations in a state sponsor of terror.
- Reviewing the laws of the United States regarding the levels of business activity that would cause sanctions to be applied against companies conducting business or investing in countries that are designated state sponsors of terror.

"State sponsor of terror" means any country that the U.S. Secretary of State determines to have repeatedly provided support for acts of international terrorism, subject to provisions regarding applicability of the Act (described below).

"Fiduciary" means any of the following:

- The Michigan Legislative Retirement System board of trustees for the Tier 1 retirement plan available under the Michigan Legislative Retirement System Act.
- The State Treasurer for the State Police Retirement System, the Tier 1 retirement plans available under the Judges Retirement Act and the State Employees Retirement Act, and the Public School Employees Retirement System.
- The board of trustees of a community college.
- The board of directors of the Michigan Education Trust.
- The board of the Michigan Strategic Fund.

The term also includes the State Treasurer in connection with his or her duties under any of the following:

- The Veterans' Trust Fund law
- Public Act 105 of 1855 (which governs surplus State funds).
- The Children's Trust Fund.
- The Lottery Act.
- Section 503b of the Natural Resources and Environmental Protection Act (which Senate Bill 849 added in relation to the Environmental Protection Fund).

"Scrutinized company" means any company that has business operations that involve contracts with or provision of supplies or

services to a state sponsor of terror; a company in which a state sponsor of terror has any direct or indirect equity share, consortiums, or projects commissioned by a state sponsor of terror; or a company involved in consortiums and projects commissioned by a state sponsor of terror and one or both of the following apply:

- More than 10% of the company's total revenue or assets are directly invested in or earned from or significantly contributed to a state sponsor of terror and the company has failed to take "substantial action" (i.e., adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within one year and to refrain from any new business operations).
- The company has, with actual knowledge, made an investment of at least \$20.0 million, or any combination of investments of at least \$10.0 million each, that in the aggregate equal or exceed \$20.0 million in any 12-month period, and that contributes directly or significantly to a state sponsor of terror, and the company has failed to take substantial action.

"Scrutinized company" does not include a social development company or a company that only meets the definition's criteria because an independently owned franchise of that company is a scrutinized company. "Social development company" means a company licensed by the U.S. Department of Treasury pursuant to the Federal Trade Sanction Reform and Export Enhancement Act, or a company operating lawfully under the laws of another country, whose primary purpose in a state sponsor of terror is to provide humanitarian goods and services including food, other agricultural products, supplies or infrastructure, clothing, shelter, medicine or medical equipment, educational opportunities, journalism-related activities, information or information materials, spiritual-related activities, general consumer goods, or services of a purely clerical or reporting nature, to aid the inhabitants of a state sponsor of terror.

"Scrutinized company" also does not include a company that the U.S. government has excluded from any present Federal sanctions regime relating to a state sponsor of terror, or that has obtained from the U.S. government an applicable license or

approval to conduct a transaction with a state sponsor of terror.

"Business operations" means engaging in commerce in any form with a state sponsor of terror, including by acquiring, developing, maintaining, owning, selling, possessing, leasing, or operating equipment, facilities, personnel, products, services, personal property, real property, or any other apparatus of business or commerce.

Scrutinized Companies List

At the end of the 90-day period after the Act's effective date, or by the first meeting of a fiduciary following that period, the fiduciary must assemble all scrutinized companies identified into a scrutinized companies list. The fiduciary must update the list on a quarterly basis based on evolving information from, among other sources, those used to identify scrutinized companies (described above). If a fiduciary receives credible information showing that a scrutinized company was wrongfully identified as such, the fiduciary must immediately modify the list to remove the name of the company.

The fiduciary must determine immediately the companies on the scrutinized companies list that the fiduciary oversees pursuant to its responsibilities in the definition of "fiduciary".

For each identified company with only inactive business operations, the fiduciary must send a written notice informing the company of these provisions of the Act. The fiduciary also must encourage the company to continue to refrain from initiating active business operations in a state sponsor of terror until it can avoid scrutinized business operations, and to engage in substantial humanitarian operations in the country. The fiduciary must continue this correspondence on a semiannual basis.

For each identified company with active business operations, the fiduciary must send a written notice informing the company of its scrutinized company status and that it may become subject to divestment by the fiduciary. The notice must give the company the opportunity to clarify its state sponsor of terror-related activities. The notice also must encourage the company, within 90 days, either to cease its scrutinized business operations or convert

them to inactive business operations in order to avoid qualifying for divestment.

If a company ceases scrutinized business operations within 90 days after the fiduciary's first engagement with the company, it must be removed from the list and the Act will cease to apply to the company unless it resumes scrutinized business operations. If, within nine months following the fiduciary's first engagement with a company, the company converts its scrutinized active business operations to inactive business operations, the company will not be subject to the Act.

("Active business operations" means all business operations that are not inactive. The term does not include the activities of any business, legal, or governmental entity or institution that provides humanitarian aid to the people of any state sponsors of terror. "Inactive business operations" means the mere continued holding or renewal of rights to property previously operated for the purpose of generating revenue but not presently deployed for that purpose.)

Divestment; New Investment

If a company has not developed and announced a plan to convert its active business operations to inactive business operations after 90 days following a fiduciary's first engagement with the company, and only while the company continues to have scrutinized active business operations, the fiduciary must sell, redeem, divest, or withdraw all of the company's publicly traded securities, according to the following schedule:

- At least 50% of the assets must be removed from the fiduciary's assets under management within nine months after the company's most recent appearance on the scrutinized companies list.
- 100% of the assets must be removed from the fiduciary's assets under management within 15 months after the company's most recent appearance on the list.

Except as provided below, at no time may the fiduciary acquire securities of companies on the scrutinized companies list that have active business operations.

This prohibition and the divestment requirement do not apply to indirect holdings in actively managed investment funds. For this purpose, actively managed investment funds include private equity funds and publicly traded funds. ("Indirect holdings" of a company are all securities of that company held in an account or fund, including a mutual fund or other commingled fund, managed by one or more people not employed by the fiduciary, in which the fiduciary owns shares or interests together with other investors not subject to the Act.)

Before the fiduciary invests in a new private equity fund that was not in its portfolio on the Act's effective date, the fiduciary must perform due diligence to prevent investment in any private equity fund in violation of the Act. The fiduciary is not required to identify holdings in private equity funds or submit engagement letters to them. If the manager of a publicly traded, actively managed fund that was in the fiduciary's portfolio when the Act took effect creates a similar publicly traded, actively managed fund with indirect holdings devoid of identified scrutinized companies with scrutinized active business operations, the fiduciary is not required, but is strongly encouraged, to replace all applicable investments with investments in the similar fund in an expedited time frame consistent with prudent investment standards.

Schedule of Application; Recommendations

If a state sponsor of terror is either of the following countries, the provisions of the Act will begin to apply on the following dates:

- Syria, January 1, 2010.
- Cuba, January 1, 2011.

If a state sponsor of terror is any other country, the Act will begin to apply 12 months following the determination by the U.S. Secretary of State.

Up to two times, the State Treasurer may extend any of these dates for one year if he or she determines either or both of the following:

- The constitutionality of the Act's divestment provisions conflict with Federal law.
- The Department of Treasury is not able to gather sufficient information to prepare an accurate scrutinized companies list.

By October 1 of 2010 and 2011, and within nine months immediately following the determination of another country as a state sponsor of terror, the Department must make recommendations to each house of the Legislature and to the standing committees of the House of Representatives and the Senate with jurisdiction over issues pertaining to divestment of State funds, on what statutory changes are needed to improve the Act's effectiveness, and whether the Department has extended or will extend any of the dates and the reason for the extension.

Treasury Website

Within one year after the Act's effective date, the Department of Treasury must collect and publish the following information on its internet website:

- All investments sold, redeemed, divested, or withdrawn in compliance with the Act.
- All prohibited investments made under the Act.
- Any progress made in preventing new investment in private equity funds invested in scrutinized companies with active business operations in a state sponsor of terror, and replacing existing investments in publicly traded, actively managed funds.

The Department must update the information at reasonable intervals.

Fiduciary Immunity

With respect to actions taken in compliance with the Act, including all good faith determinations regarding companies, a fiduciary is exempt from any conflicting statutory or common law obligations, including any obligations with respect to choice of asset managers, investment funds, or investments for the fiduciary's securities portfolios.

A fiduciary, members of an investment advisory committee and any person with decision-making authority with regard to investments of the fiduciary may not be held liable for any action undertaken for the purpose of complying with or executing the mandates of the Act.

Sudan & Iran Divestment Criteria

If a scrutinized company does business with the government of Sudan or the government of Iran, and the fiduciary is subject to the divestment provisions of Section 13c or Section 13d of the Public Employee Retirement System Investment Act, for that period of time the fiduciary must follow the divestment criteria contained in Section 13c or 13d, and not the divestment provisions of the Divestment from Terror Act. (House Bills 4854 and 4903 added Sections 13c and 13d, respectively, to the Public Employee Retirement System Investment Act.)

Severability

If any provision, section, subsection, sentence, clause, phrase, or word of the Divestment from Terror Act or its application to any person or circumstance is found to be invalid, illegal, unenforceable, or unconstitutional, it is declared to be severable and the balance of the legislation will remain effective and functional notwithstanding the invalidity, illegality, unenforceability, or unconstitutionality.

House Bills 4854 and 4903

The Public Employee Retirement System Investment Act applies to public employee retirement systems created by this State or any political subdivision of the State. The Act governs the investment of the assets of such a retirement system. House Bills 4854 and 4903 amended the Act in regard to the investment of assets in companies doing business with Sudan or Iran, respectively. The following description applies to each bill, except as otherwise provided.

Identification of Scrutinized Companies

Within 90 days after the bill's effective date, the fiduciary must to make its best efforts to identify all scrutinized companies in which it has direct or indirect holdings or possibly could have such holdings in the future. The efforts must include one or more of the following:

- Reviewing and relying, as appropriate in the fiduciary's judgment, on publicly available information regarding companies with business operations in Sudan or Iran (as applicable), including information provided by nonprofit organizations, research firms,

international organizations, and government entities.

- Contacting asset managers contracted by the fiduciary that invest in companies with business operations in Sudan or Iran.
- Contacting other institutional investors that have divested from or engaged with companies that have business operations in Sudan or Iran.

Under House Bill 4903, these efforts also may include reviewing the laws of the United States regarding the levels of business activity that would cause application of sanctions against companies conducting business or investing in countries that are designated state sponsors of terror.

Each bill defines "fiduciary" as the Michigan Legislative Retirement System board of trustees for the Tier 1 plan for the Michigan Legislative Retirement System; and the State Treasurer for the retirement system created under the State Police Retirement Act, tier 1 retirement plan available under the Judge's Retirement Act, the tier 1 retirement plan available under the State Employees Retirement Act, and the Public School Employees Retirement Act.

House Bill 4854 defines "scrutinized company" as mean any company, except a social development company that is not complicit in the Darfur genocide, that has business operations that involve contracts with or provision of supplies or services to any of the following: the government of Sudan; companies in which the government of Sudan has any direct or indirect equity share; consortia or projects commissioned by the government of Sudan; or companies involved in consortia and projects commissioned by the Sudanese government to which one or both of the following apply:

- More than 10% of the company's total revenue or assets linked to Sudan involve oil-related activities or mineral extraction activities, less than 75% of the company's revenue 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".

- More than 10% of the company's revenue or assets linked to Sudan involve power production activities, less than 75% of the company's power production activities include projects intended to provide power or electricity to the marginalized populations of Sudan, and the company has failed to take substantial action.

Additionally, under House Bill 4854, "scrutinized company" mean any company, except a social development company that is not complicit in the Darfur genocide, that supplies military equipment within Sudan, unless the fiduciary finds that the equipment will not be used to facilitate offensive military actions in Sudan or finds that the company implements rigorous and verifiable safeguards to prevent use of the equipment by forces participating actively in armed combat. The term also includes any company that is complicit in the Darfur genocide.

"Government of Sudan" means the government in Khartoum, Sudan, that is led by the National Congress Party or any successor government formed on or after October 13, 2006. The term does not include the regional government of southern Sudan.

"Substantial action" means adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within one year and to refrain from any new business operations, 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 evaluated 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 through engagement with the government of Sudan, materially improving conditions for the genocidally victimized population in Darfur.

"Complicit" means taking actions during any preceding 20-month period that have directly supported or promoted the genocidal campaign in Darfur, including preventing Darfur's victimized population from communicating with each other; encouraging Sudanese citizens to speak out against an internationally approved security force in Darfur; working actively to deny,

cover up, or alter the record on human rights abuses in Darfur; or other similar actions.

"Marginalized populations of Sudan" includes all of the following:

- The portion of the population in the Darfur region that has been genocidally victimized.
- The portion of the population of southern Sudan victimized by Sudan's north-south civil war.
- The Beja, Rashidiya, and other similarly underserved groups of eastern Sudan.
- The Nubian and other similarly underserved groups in Sudan's Abeyi, Southern Blue Nile, and Nuba Mountain regions.
- The Amri, Hamadab, Manasir, and other similarly underserved groups of northern Sudan.

"Social development company" means 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 or information materials, spiritual-related activities, services of a purely clerical or reporting nature, food, clothing, or general consumer goods that are unrelated to oil-related activities, mineral extraction activities, or power production activities.

House Bill 4903 defines "scrutinized company" as any company that has business operations that involve contracts with or provision of supplies or services to the government of Iran; a company in which the government of Iran has any direct or indirect equity share, consortiums, or projects commissioned by the Iranian government; or a company involved in consortiums and projects commissioned by the Iranian government and one or both of the following apply:

- More than 10% of the company's total revenue or assets are linked to Iran, and involve oil-related activities or mineral extraction activities, and the company has failed to take "substantial action" (i.e., adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within one year and to refrain from any new business operations).

-- The company, with actual knowledge, on or after August 5, 1996, made an investment of at least \$20.0 million, or any combination of investments of at least \$10.0 million each, that in the aggregate equals or exceeds \$20.0 million in any 12-month period, and that contributes directly or significantly to the enhancement of Iran's ability to develop petroleum resources (i.e., petroleum or natural gas).

House Bills 4854 and 4903 contain the same definitions of "oil-related activities", "mineral extraction activities", "power production activities", and "business operations".

"Oil-related activities" means owning rights to oil blocks; exporting, extracting, producing, refining, processing, exploring for, transporting, selling, or trading of oil; constructing, maintaining, or operating a pipeline, refinery, or other oil-field infrastructure; and facilitating such activities, including by providing supplies or services in support of them. The mere retail sale of gasoline and related consumer products are not considered oil-related activities.

"Mineral extraction activities" includes exploring, extracting, processing, transporting, or wholesale selling or trading of elemental minerals or associated metal alloys or oxides, including gold, copper, chromium, chromite, diamonds, iron, iron ore, silver, tungsten, uranium, and zinc, as well as facilitating such activities, including by providing supplies or services in support of them.

"Power production activities" means any business operation that involves a project commissioned by the National Electricity Corporation of Sudan or other similar government of Sudan entity, or the government of Iran, whose purpose is to facilitate power generation and delivery, including establishing power-generating plants or hydroelectric dams, selling or installing components for the project, providing service contracts related to the installation or maintenance of the project, and facilitating such activities, including by providing supplies or services in support of them.

"Business operations" means engaging in commerce in any form in Sudan or Iran, as applicable, including by acquiring,

developing, maintaining, owning, selling, possessing, leasing, or operating equipment, facilities, personnel, products, services, personal property, real property, or any other apparatus of business or commerce.

In addition, under both bills, "scrutinized company" does not include a company that the U.S. government has affirmatively excluded from Federal sanctions for business the company conducts relating to Sudan or Iran, as applicable, or that has consistently obtained applicable licenses or approvals to conduct transactions with Sudan or Iran. If the fiduciary becomes aware at any time that a company that has not been affirmatively excluded from Federal sanctions for business it conducts with Sudan or Iran and has not received from the U.S. government applicable licenses or approvals to conduct transactions with Sudan or Iran, that company is immediately subject to the bills' requirements regarding companies on the scrutinized companies list.

Scrutinized Companies List; Notice

At the end of the 90-day period after each bill's effective date or by the first meeting of a fiduciary following that period, the fiduciary must assemble all identified scrutinized companies into a list. The fiduciary must update the list on a quarterly basis based on evolving information from, among other sources, those specified in the bill for the identification of scrutinized companies. The fiduciary must make the list freely available to the fiduciaries of other public retirement systems in Michigan if doing so does not violate any agreements with third parties or reveal a third party's proprietary information.

The fiduciary immediately must determine the companies on the list that the fiduciary oversees pursuant to its responsibilities.

For each identified company with only inactive business operations, the fiduciary must send a written notice informing the company of the bill's requirements and encourage it to continue to refrain from initiating active business operations in Sudan or Iran until it is able to avoid scrutinized business operations. Under House Bill 4854, the fiduciary also must encourage the company to engage in substantial humanitarian operations in Sudan. Under each bill, the fiduciary must

continue the correspondence on a semiannual basis.

For each company newly identified with active business operations, the fiduciary must send a written notice informing the company of its scrutinized company status and that it may become subject to divestment by the fiduciary. The notice must offer the company the opportunity to clarify its Sudan- or Iran-related activities and must encourage the company, within 90 days, either to cease its scrutinized business operations (through substantial action, under House Bill 4903) or to convert them to inactive business operations in order to avoid qualifying for divestment.

(Under House Bill 4903, these notices must be sent within 60 days after a company is identified or newly identified.)

If, within 90 days following the fiduciary's first engagement with a company, the company ceases scrutinized business operations under House Bill 4854, or announces a plan of substantial action under House Bill 4903, the company must be removed from the list and the bill's provisions will not apply to it unless it resumes those operations or fails to implement the plan of substantial action within the designated time frame, as applicable. If the company converts its active business operations to inactive business operations, within 90 days after the fiduciary's first engagement, the company will be subject to the bill.

The bills define "inactive business operations" as the mere continued holding or renewal of rights to property operated previously for the purpose of generating revenue but not deployed presently for that purpose. "Active business operations" means all business operations that are not inactive.

Divestment

Under each bill, if a company continues to have active business operations 90 days after a fiduciary's first engagement with the company, and only while it continues to have active business operations, the fiduciary must sell, redeem, divest, or withdraw all publicly traded securities of the company, according to the following schedule:

- Within nine months after the company's most recent appearance on the scrutinized companies list, at least 50% of the assets must be removed from the fiduciary's assets under management.
- Within 15 months after the company's most recent appearance on the list, 100% of the assets must be removed from the fiduciary's assets under management.

Except as provided below, at no time may the fiduciary acquire securities of companies on the list that have active business operations.

No company that the U.S. government declares affirmatively to be excluded from its present or any future Federal sanctions regime relating to Sudan or Iran is subject to the divestment requirement or the investment prohibition.

The schedule and the prohibition do not apply to indirect holdings in actively managed investment funds. For this purpose, actively managed investment funds include private equity funds and publicly traded funds. Before investing in a new private equity fund (or publicly traded fund, under House Bill 4903) that was not in its portfolio on the bill's effective date, the fiduciary must perform due diligence to prevent investment in any private equity fund (or publicly traded fund) where the offering memorandum or prospectus identifies a purpose of the fund as investing in scrutinized companies with active business operations in Sudan or Iran. The fiduciary is not required to identify holdings in private equity funds or submit engagement letters to them. If the manager of a publicly traded, actively managed fund that was in the fiduciary's portfolio on the bill's effective date creates a similar fund with indirect holdings devoid of identified scrutinized companies with scrutinized active business operations, the fiduciary must replace all applicable investments with investments in the similar fund in an expedited time frame consistent with prudent investment standards.

"Indirect holdings" in a company means all securities of that company held in an account or fund, such as a mutual fund or other commingled fund, managed by one or more people not employed by the fiduciary, in which the fiduciary owns shares or

interests together with other investors not subject to the Act.

Reports

Each bill requires the fiduciary to file a publicly available report to the Legislature that includes the scrutinized companies list within 30 days after the list is created. Annually, the fiduciary must file a publicly available report to the Legislature that includes all of the following:

- A summary of correspondence with companies engaged by the fiduciary under the bill.
- All investments sold, redeemed, divested, or withdrawn in compliance with the bill.
- All prohibited investments made under the bill.
- Any progress made in replacing existing investments with similar investments in publicly traded, actively managed funds.

Under House Bill 4854, the fiduciary must send a copy of this report to the U.S. Presidential Special Envoy to Sudan.

Discontinuation

The provisions of House Bill 4854 will no longer be effective when one or more of the following occur:

- The U.S. Congress or President declares that the Darfur genocide had been halted for at least 12 months.
- The U.S. revokes all sanctions imposed against the government of Sudan.
- The Congress or President declares that 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 for deliveries of humanitarian assistance, and allow for the safe and voluntary return of refugees and internally displaced people.
- The Congress or President declares, through legislation or executive order, that mandatory divestment of the type provided for in the bill interferes with the conduct of U.S. foreign policy.

The provisions of House Bill 4903 will no longer be effective when any of the following occur:

- The U.S. Congress or President states affirmatively and unambiguously, 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.

- The U.S. revokes all sanctions imposed against the government of Iran.
- The Congress or President states affirmatively and unambiguously, through legislation, executive order, or written certification from the President to Congress, that mandatory divestment of the type provided for in the bill interferes with the conduct of U.S. foreign policy.

Exemption from Liability

With respect to actions taken in compliance with either bill, including all good faith determinations regarding companies as required, the fiduciary is exempt from any conflicting statutory or common law obligations, including any obligations with respect to choice of asset managers, investment funds, or investments for the fiduciary's securities portfolio.

The fiduciary, members of an investment advisory committee, and any person with decision-making authority with regard to the fiduciary's investments may not be held liable for any action undertaken for the purpose of complying with or executing the mandates of the bill.

Severability

If any provision, section, subsection, sentence, clause, phrase, or word of either bill or its application to any person or circumstances is found to be invalid, illegal, unenforceable, or unconstitutional, it is declared to be severable and the balance of the bill will remain effective and functional notwithstanding the invalidity, illegality, unenforceability, or unconstitutionality.

MCL 129.291-129.301 (S.B. 846)
35.605 (S.B. 848)
324.503b (S.B. 849)
389.124 & 389.142 (S.B. 850)
12.257 (S.B. 852)
21.171 (S.B. 853)
390.1429 & 390.1431 (S.B. 856)
38.1133c (H.B. 4854)
38.1133d (H.B. 4903)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The designation of "state sponsor of terrorism" and the imposition of Federal sanctions serve as a mechanism to isolate these nations, encourage them to renounce terrorism, and ultimately make it difficult for terrorists to obtain the funds, weapons, equipment, and secure areas they need to plan and conduct operations. Reducing commerce with these countries is another approach to combating terrorism. Divestment laws send the message that a company's reputation and share value will be at stake unless it stops doing business in or with a terrorist-sponsoring nation. When this occurs, the company withdraws money that otherwise could be used to purchase weapons and supplies for terrorist organizations. At the same time, the need to protect its economy may motivate the country itself to discontinue activities that support terrorism—activities that can range from directly engaging in warfare to providing a safe haven for terrorists.

A similar movement took place in the late 1980s when states enacted divestiture legislation in regard to South Africa, which promoted white supremacy through its laws and social structure. Michigan's five-year program for implementing divestiture was discontinued after the third year, as apartheid had ended and investment in South Africa again was encouraged. This nationwide movement, which involved both public and private investments, arguably contributed to the end of apartheid.

Like the earlier measures, these bills use the "power of the purse" to exert pressure on companies doing business with countries that allow or promote terrorist or genocidal activities. The legislation will affect companies that have significant investments in state sponsors of terror, that contract with or provide services or supplies to state sponsors of terror, or in which state sponsors of terror have an equity share. The time frames will give scrutinized companies an opportunity to discontinue their business operations with state sponsors of terror before divestment is required or fully implemented; once a company no longer has active business

operations with a state sponsor of terror, divestment no longer will be required.

As of November 2007, according to the National Conference of State Legislatures, 16 states had enacted legislation to require or encourage the divestment of public funds in Sudan, Iran, other state sponsors of terror, or companies doing business with those nations, or to prohibit or discourage new investments in those countries or firms. In an additional 16 states, besides Michigan, such legislation was introduced in 2007. The combined efforts of the states could have a significant impact on decisions made by companies that do business with state sponsors of terror, leading them to sever those ties and, ultimately, leading the countries to denounce terrorism.

Response: Various concerns have been raised about this legislation. It is possible that divestment will have a negative impact on the portfolios of the affected funds, and developing a list of "scrutinized companies" might be expensive. Although there already are lists of companies doing business with Iran or Sudan, similar lists do not exist for other countries, and creating a list in 90 days might not be feasible. In addition, the definition of "business operations" is very broad, and it will be difficult to measure whether a company's assets or revenue "significantly contribute" to a state sponsor of terror.

Also, although exceptions are made for companies that provide humanitarian aid, divestment from other businesses might harm innocent citizens by taking away their jobs or jeopardizing their country's economy. In addition, destabilizing a nation's political system can have unforeseen and undesirable consequences.

Another concern involves the constitutionality of the legislation. In February 2007, a U.S. District Court in Illinois permanently enjoined enforcement of an Illinois statute that imposed various restrictions on the deposit of state funds in financial institutions whose customers have certain types of connections with Sudan, and on the investment of public pension funds in Sudan-connected entities (*National Foreign Trade Council, Inc., et al. v Giannoulis, et al.*, Case No. 06 C 4251). Regarding the pension fund restrictions, in particular, the Court found that the amendments to the state's Pension Code violated the Foreign Commerce Clause of the U.S. Constitution,

which gives Congress the power to regulate commerce with foreign nations (although those amendments might have been constitutional on the basis of a "market participant" exception if they had applied only to state-controlled pension funds).

In addition, compliance may be difficult as countries are added to or removed from the list of state sponsors of terrorism, or if Federal sanctions are lifted for portions of a designated country. As the U.S. District Court pointed out in *National Foreign Trade Council*, the Federal sanctions no longer applied to specific regions of Sudan, but the Illinois statute did not make this distinction.

Supporting Argument

It is inappropriate and unacceptable for public dollars to be invested in companies that help promote terrorism or genocide by engaging in business with state sponsors of terror. It also is not acceptable for public funds to profit from such companies' activities. Just as a racially discriminatory political system could not be tolerated in South Africa, governments that commit atrocities against their own citizens, harbor known terrorists, or provide money, supplies, or weapons to terrorist organizations should not be supported in any way.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bills will have an indeterminate fiscal impact on State and local units of government. The Department of Treasury has explored the impact of these measures with respect to its investments, which do not include all of the entities in the bills. For the Department's investments alone, Treasury has estimated that it will cost approximately \$30,000 per year per country to ensure compliance with the new restrictions. That amount will cover the cost of hiring a private company to monitor compliance, and will be ongoing. There also might be additional up-front transaction costs to comply with these restrictions. The amount of those costs may be slightly lower for countries where the State has comparatively smaller investments. The Department has identified several countries that qualify as state sponsors of terror, including Sudan, Iran, Syria, and Cuba, though that list is subject to change.

The fiscal impact on universities, community colleges, local units of government, and other public bodies is difficult to determine, as it will depend on the amount each entity has invested in relevant companies.

Although it is difficult to quantify the precise fiscal impact of these bills on State and local government and other public bodies, it might be substantial. The Department of Treasury has indicated that not only will there be immediate transaction costs involved in the divestiture, there also will be compliance costs going forward. According to the Department, transaction costs may be considerable, particularly because the affected funds often invest in indices and mutual funds that contain many companies, which will make singling out individual companies difficult. In addition to these more measurable costs, the Department predicts that the lost opportunity costs of prohibited investments might be high as well, thereby affecting the overall value of State investments; however, these potential costs or gains can only be determined retrospectively.

As of September 30, 2007, the State Employees' Retirement System, Public School Employees' Retirement System, State Police Retirement System, and Judges Retirement System had combined total assets of approximately \$76.5 billion.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.