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BILL ANALYSIS

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Senate Bill 846 (Substitute S-2 as passed by the Senate)
Senate Bill 847 (Substitute S-2 as passed by the Senate)
Senate Bills 848 and 849 (as passed by the Senate)
Senate Bill 850 (Substitute S-1 as passed by the Senate)
Senate Bills 851 through 856 (as passed by the Senate)
Senate Joint Resolution J (as passed by the Senate)
Sponsor: Senator Cameron S. Brown (S.B. 846 & 847)
Senator John Pappageorge (S.B. 848)
Senator Randy Richardville (S.B. 849)
Senator Dennis Olshove (S.B. 850)
Senator Valde Garcia (S.B. 851 & 852)
Senator Hansen Clarke (S.B. 853)
Senator Tupac A. Hunter (S.B. 854)
Senator Buzz Thomas (S.B. 855)
Senator Mark C. Jansen (S.B. 856)
Committee: Homeland Security and Emerging Technologies

Date Completed: 2-20-08

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. The current list of state sponsors of terrorism consists of Cuba, Iran, North Korea, Sudan, and Syria. 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 inappropriate for public funds to be invested in these enterprises. It has been 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 (S-2) would create 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 had holdings that did business with or were located in a "state sponsor of terror", i.e., "scrutinized companies", and create a list of those companies.**
-- **Within 15 months after a company most recently appeared on a fiduciary's list, require the fiduciary**

to sell, redeem, divest, or withdraw all of the securities of the company if it continued to have scrutinized active "business operations" (engaging in commerce with a state sponsor of terror).

- **Except for indirect holdings in actively managed investment funds, prohibit a fiduciary from acquiring securities of companies on its list that had active business operations.**
- **Require a fiduciary to perform due diligence to prevent investment in any private equity fund invested in a scrutinized company with active business operations in a state sponsor of terror.**
- **If the manager of a publicly traded, actively managed fund in a fiduciary's portfolio created 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 proposed 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 conflicted with the proposed Act.**
- **Provide immunity from liability for actions taken to comply with the proposed Act.**
- **Require a fiduciary to follow proposed divestment criteria in the Public Employee Retirement System Investment Act if a scrutinized company did business with the government of Sudan or Iran.**

<u>Senate Joint Resolution J</u> would amend the State Constitution to prohibit public bodies from investing in entities engaged in business with known state sponsors of terror; and require public bodies to dispose of assets invested in such entities.

<u>Senate Bill 847 (S-2)</u> would amend the Public Employee Retirement System Investment Act to require an investment fiduciary of any of the following to comply with the proposed Divestment from Terror Act in making investments: the Tier 1 retirement plan available under the State Employees' Retirement Act; the Tier 1 retirement plan available under the Judges Retirement Act; the State Police Retirement System created under the State Police Retirement Act; or the Public School Employees Retirement System created under the Public School Employees Retirement Act.

<u>Senate Bills 848 through 856</u> would amend various statutes to require the applicable investment fiduciary to comply with the proposed Divestment from Terror Act in making investments. Senate Bill 848 would amend Public Act 9 of the Extra Session of 1946, which governs the Veterans' Trust Fund. Senate Bill 849 would amend the Natural Resources and Environmental Protection Act with regard to the Environmental Protection Fund. Senate Bill 850 (S-1) would amend the Community Colleges Act. Senate Bill 851 would amend the Michigan Strategic Fund Act. Senate Bill 852 would amend the Michigan Trust Fund Act with regard to the 21st Century Jobs Trust Fund. Senate Bill 853 would amend Public Act 249 of 1982, which governs the Children's Trust Fund. Senate Bill 854 would amend Public Act 105 of 1855, which governs the use and investment of surplus funds in the State Treasury. Senate Bill 855 would amend the Lottery Act with regard to the State Lottery Fund. Senate Bill 856 would amend the Michigan Education Trust Act.

Senate Bills 847 (S-2) through 856 are tie-barred to Senate Bill 846. Senate Bill 846 (S-2) is tie-barred to House Bills 4854 and 4903, which would amend the Public Employee Retirement System Investment Act to add divestment requirements pertaining to Sudan and Iran.

Senate Bill 846 (S-2) and Senate Joint Resolution J are described in detail below.

<u>Senate Bill 846 (S-2)</u>

<u>Identification of Scrutinized Companies</u>

Within 90 days after the proposed Act took effect, a fiduciary would have to make its best efforts to identify all scrutinized companies in which the fiduciary had direct or indirect holdings or could possibly have such holdings in the future. The efforts could 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 invested in companies with business operations in a state sponsor of terror.
-- Contacting other institutional investors that had divested from or engaged with companies that had business operations in a state sponsor of terror.
-- 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 were designated state sponsors of terror.

"State sponsor of terror" would mean any country that the U.S. Secretary of State determined to have repeatedly provided support for acts of international terrorism, subject to criteria regarding applicability of the proposed Act (described below).

"Fiduciary" would mean 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 plan available under the Judges Retirement Act, the Tier 1 retirement plan available under 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 would include 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.
-- The Children's Trust Fund.
-- The Lottery Act.
-- Section 503b of the Natural Resources and Environmental Protection Act (which Senate Bill 849 would add in relation to the Environmental Protection Fund).

"Scrutinized company" would mean 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, to which 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" would not include a social development company or a company that only met the definition's criteria because an independently owned franchise of that company was a scrutinized company. "Social development company" would mean 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.

"Business operations" would mean 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 proposed Act took effect, or by the first meeting of a fiduciary following that period, the fiduciary would have to assemble all scrutinized companies identified into a scrutinized companies list. The fiduciary would have to 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 received credible information that showed that a scrutinized company was wrongfully identified as such, the fiduciary immediately would have to modify the list to remove the name of the company.

The fiduciary immediately would have to determine the companies on the scrutinized companies list that the fiduciary oversaw pursuant to its responsibilities in the definition of "fiduciary". If, within 90 days following the fiduciary's first engagement with a company, that company ceased scrutinized business operations, it would have to be removed from the list and the proposed Act would cease to apply to the company unless it resumed scrutinized business operations.

If, within nine months following the fiduciary's first engagement, the company converted its scrutinized active business operations to inactive business operations, the company would not be subject to the Act. ("Active business operations" would mean all business operations that are not inactive. The term would 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" would mean 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

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

-- At least 50% of the assets would have to 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 would have to 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 could the fiduciary acquire securities of companies on the scrutinized companies list that had active business operations.

This prohibition and the divestment requirement would not apply to indirect holdings in actively managed investment funds. For purposes of this provision, actively managed investment funds would include private equity funds and publicly traded funds. ("Indirect holdings" of a company would mean 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 proposed Act.)

Before a fiduciary invested in a new private equity fund that was not in its portfolio as of the proposed Act's effective date, the fiduciary would have to perform due diligence to prevent investment in any private equity fund in violation of the Act.

The fiduciary would not be 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 created a similar publicly traded, actively managed fund with indirect holdings devoid of identified scrutinized companies with scrutinized active business operations, the fiduciary would not be required, but would be strongly encouraged, to replace all applicable investments with investments in the similar fund in an expedited time frame consistent with prudent investment standards.

Treasury Website; Recommendations

Within one year after the proposed Act took effect, the Department of Treasury would have to 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.

Periodically, the Department would have to update the information at reasonable intervals.

By October 1 of 2010, 2011, and 2012, and within nine months immediately following the determination of another country as a state sponsor of terror, the Department would have to 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 were needed to improve the proposed Act's effectiveness.

Fiduciary Immunity

With respect to actions taken in compliance with the proposed Act, including all good faith determinations regarding companies, a fiduciary would be 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 could not be held liable for any action undertaken for the purpose of complying with or executing the mandates of the proposed Act.

Schedule of Application

If a state sponsor of terror were any of the following countries, the provisions of the proposed Act would begin to apply on the following dates:

-- Syria, January 1, 2010.
-- North Korea, January 1, 2011.
-- Cuba, January 1, 2012.

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

Sudan & Iran Divestment Criteria

If a scrutinized company did business with the government of Sudan or the government of Iran, and the fiduciary were 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 would have to follow the divestment criteria contained in Section 13c or 13d, and not the divestment provisions of the proposed Divestment from Terror Act. (House Bills 4854 and 4903 would add Sections 13c and 13d, respectively, to the Public Employee Retirement System Investment Act, to establish divestment criteria concerning companies that had business operations involving the government of Sudan or Iran.)

Severability

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

Senate Joint Resolution J

Article IX, Section 19 of the State Constitution prohibits the State from investing in stock, subject to exceptions. The joint resolution would amend Article IX, Section 19 to prohibit a public body from investing or depositing any public funds in any business, legal, or governmental entity or institution that was engaged in business with known state sponsors of terror or that had facilities or conducted business in any state sponsor of terror. For the purposes of this provision, an independent franchise of a business entity would not be considered part of that business entity. This prohibition would not apply to the activities of any business, legal, or governmental entity or institution providing humanitarian aid to the people of any state sponsors of terror through a governmental agency or department or through a nongovernmental organization.

"Public body" would mean the State or a city, village, township, county, school district, public college or university, public community or junior college, or other governmental department, governmental agency, or political subdivision of this State. "State sponsor of terror" would mean any country that the U.S. Secretary of State determined to have repeatedly provided support for acts of international terrorism.

Within nine months after the joint resolution became part of the Constitution, a public body would have to dispose of or withdraw at least 50% of its assets or money invested or deposited in a business, legal, or governmental entity engaged in business in or with a state sponsor of terror. Within 15 months after the joint resolution became part of the Constitution, a public body would have to dispose of or withdraw all of those assets or money.

The governing body of each public body annually would have to give the Department of Treasury any information concerning its compliance with Article IX, Section 19 that was required by law.

The joint resolution also would amend Article VIII, which provides for the University of Michigan board of regents, the Michigan State University board of trustees, and the Wayne State University board of governors, and requires that other institutions of higher education established by law having authority to grant baccalaureate degrees also be governed by a board of control.

Each board has general supervision of the institution and the control and direction of all expenditures from the institution's funds. Under the joint resolution, this provision would apply except as provided in Article IX, Section 19.

The joint resolution would have to be submitted to voters at the next general election, if two-thirds of the members elected to and serving in each house of the Legislature approved it.

MCL 38.1333 (S.B. 847)
MCL 35.605 (S.B. 848)
Proposed MCL 324.503b (S.B. 849)
MCL 389.124 & 389.142 (S.B. 850)
Proposed MCL 125.2007a (S.B. 851)
MCL 12.257 (S.B. 852)
MCL 21.171 (S.B. 853)
Proposed MCL 21.145 (S.B. 854)
MCL 432.41 (S.B. 855)
MCL 390.1429 & 390.1431 (S.B. 856)

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 abandoned after the third year, as apartheid had ended and investment in South Africa again was encouraged. This nationwide movement, which included both public and private investments, arguably contributed to the end of apartheid.

Like the earlier measures, these proposals would use the "power of the purse" to exert pressure on companies doing business with countries that allow or promote terrorist or genocidal activities. This legislation would 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 joint resolution also would affect companies that conduct business in a state sponsor of terror. The proposed time frames would give scrutinized companies an opportunity to discontinue their business operations with state sponsors of terror before divestment would be required or fully implemented; once a company no longer had active business operations with a state sponsor of terror, divestment no longer would 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 these proposals. It is possible that divestment could have a negative impact on the portfolios of the affected funds, and developing a list of "scrutinized companies" could be expensive. Although there already are lists of companies doing business with Iran or Sudan, similar lists do not exist for Cuba, North Korea, or Syria, and creating a list in 90 days might not be feasible. In addition, the definition of "business operations" is very broad, and it would be difficult to measure whether a company's assets or revenue "significantly contributed" to a state sponsor of terror.

Also, although exceptions would be made for companies that provide humanitarian aid, divestment from other businesses could 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 proposed 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 *Giannoulias, 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, the restrictions also affected municipal pension funds, making the exception unavailable to the state. Although the proposed Michigan bills would apply to State-controlled funds, Senate Joint Resolution J would apply to a "public body", including a local unit of government.

In addition, compliance could 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 simply 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

Senate Bills 846 (S-2) through 856 and Senate Joint Resolution J would have an indeterminate fiscal impact on State and local units of government. The Department of Treasury has explored the impact of these proposals with respect to its investments, which would not include all of the entities in the bills and the resolution. For the Department's investments alone, Treasury has estimated that it would cost approximately $30,000 per year per country to ensure compliance with the proposed restrictions. That amount would cover the cost of hiring a private company to monitor compliance, and would be ongoing. There also could be additional up-front transaction costs to comply with these restrictions. The amount of those costs could 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, North Korea, 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 would depend on the amount each entity has invested in relevant companies. The joint resolution also would require that each public body report to the Department annually.

While the resolution does not specify the Department's responsibility, if the Department of Treasury were charged with establishing a list of companies for each country and assisting public bodies with compliance, the Department would incur significant additional costs.

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

As of September 30, 2006, the State Employees' Retirement System, Public School Employees' Retirement System, State Police Retirement System, and Judges Retirement System had combined total assets of approximately $64 billion.

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