



S.F. 131
(Bonoff)

H.F. 111
(Winkler)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): MSRS, PERA, TRA, and Plans Using Supplement Fund
Relevant Provisions of Law: Minnesota Statutes, New Section 11A.244
General Nature of Proposal: State Board of Investment; Requires Divestment of Certain Investments Relating to Iran
Date of Summary: March 2, 2009

Specific Proposed Change(s)

Requires the State Board of Investment (SBI) to identify companies with active business operations in Iran which are subject to liability or sanctions under the Iran and Libya Sanctions Act of 1996, to divest of the securities of those companies unless doing so would be contrary to fiduciary duties, and to provide various reports to the Legislative Commission on Pensions and Retirement and legislative committees with jurisdiction over SBI.

Policy Issues Raised by the Proposed Legislation

1. Issues regarding reporting to the Legislative Commission on Pensions and Retirement.
2. Sufficient impact to justify the administrative burden.
3. Unclear application to passive investments.
4. Lack of inclusion of debt securities.
5. Lack of effective date.
6. Question regarding inclusion in omnibus pension bill.

Potential Amendments

Technical Amendment

S0131-1A adds an effective date to be determined by the Commission by filling in the blank. July 1, 2009, is one of several reasonable dates.

Substantive Amendment

S0131-2A adds debt investments to the investment types included as "direct holdings." This would expand the coverage beyond only equity investments.

Alternative Amendments Dealing With Reporting Issues:

S0131-3A leaves the reporting in the bill unchanged except for including the Commission's executive director in any reporting transmitted to the Commission chair and vice chair.

S0131-4A revises the reporting to have the Commission and its executive director receive all reports, removes the initial report of the list of scrutinized companies in subdivision 9, and does not alter reporting to other legislative committees.

S0131-5A removes all reporting to the Commission, and has all reports sent to the chairs of the legislative committees and divisions in the House and Senate with jurisdiction over the SBI. The amendment also removes the initial report of the list of scrutinized companies in subdivision 9.

S0131-6A requires all reports to be sent to the Commission chair, vice chair, and executive director, and all reports are also sent to the chairs of the legislative committees and divisions in the House and Senate with jurisdiction over the SBI.) The amendment also removes the initial report of the list of scrutinized companies in subdivision 9.

S0131-7A requires all reports to be sent to the Commission and to the chairs of committees with jurisdiction over the SBI. Reports to the Commission will be sent to the Commission's executive director only, not to the Commission chair and vice chair. The amendment also removes the initial report of the list of scrutinized companies.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Ed Burek, Deputy Director **EB**
RE: S.F. 131 (Bonoff); H.F. 111 (Winkler), the First Engrossment: State Board of Investment; Requiring Divestment of Certain Investments Relating to Iran
DATE: March 2, 2009

General Summary of S.F. 131 (Bonoff); H.F. 111 (Winkler), the First Engrossment

S.F. 131 (Bonoff); H.F. 111 (Winkler), the first engrossment, requires the State Board of Investment (SBI) to identify companies with active business operations in Iran which are subject to liability or sanctions under the Iran and Libya Sanctions Act of 1996, to divest of the securities of those companies unless doing so would be contrary to fiduciary duties, and to provide various reports to the Legislative Commission on Pensions and Retirement and legislative committees with jurisdiction over SBI.

Public Law 104-172, Iran and Libya Sanctions Act of 1996

Public Law 104-172, the Iran and Libya Sanctions Act of 1996, states in its declaration of policy section a desire by the United States "to deny Iran the ability to support acts of international terrorism and to fund the development and acquisition of weapons of mass destruction and the means to deliver by limiting the development of Iran's ability to explore for, extract, refine, or transport by pipeline petroleum resources of Iran." Companies that provide equipment, material, or expertise which assists Iran in developing its oil reserves are subject to sanctions under the Iran and Libya Sanctions Act of 1996. Under this act, the President may impose a variety of sanctions against a person or company including prohibiting the Export-Import Bank from providing assistance or approval, prohibiting export of goods or technology, prohibiting banks from providing business loans, and prohibiting the federal government from purchasing goods or services from a sanctioned company.

A full copy of the Iran and Libya Sanctions Act of 1996 is attached.

Discussion and Analysis

S.F. 131 (Bonoff); H.F. 111 (Winkler), the first engrossment, requires the SBI to identify companies with active business operations in Iran which are subject to sanctions under the Iran and Libya Sanctions Act of 1996, to divest of the securities of those companies unless doing so would be contrary to fiduciary duties, and to make various reports to the Legislative Commission on Pensions and Retirement and the legislative committees with jurisdiction over SBI.

The proposed legislation raises several pension and related public policy issues for Commission consideration and potential discussion, as follows:

1. Issues Regarding Reporting to the Legislative Commission on Pensions and Retirement. There are three issues regarding reporting to the Legislative Commission on Pensions and Retirement.
 - a. Should there be any reporting to the Commission?
 - b. If there should be reporting to the Commission, which reports should be transmitted? As drafted, the Commission receives some but not all of the reports.
 - c. If the Commission is to receive any reports, a copy should also be sent to the Commission's executive director. As drafted, any reports to the Commission are sent to the chair and vice chair only.

Given the bill's drafting, two reports are sent to the Commission. One seems to be a one-time event. Page 4.31 to 4.33 requires the SBI to report to the chair and vice chair of the Commission the list of companies identified as a scrutinized company (a company with activities subject to or potentially subject to sanctions under the Iran and Libya Sanctions Act of 1996). Only the first list of these companies compiled by SBI is to be transmitted to the Commission. Later reports (see page 4.34) indicating the most recent list of scrutinized companies and actions taken by SBI regarding these companies are to be transmitted to the legislative committees with jurisdiction over the SBI, but not to the Commission. It is not clear what purpose is served by that one-time reporting to the Commission. If the Commission should receive any of these reports, presumably it should receive each annual report. This proposal, in its structure, bears some similarity to an investment in Sudan provision added to SBI law in 2007 (Minnesota Statutes, Section 11A.243). That provision requires reporting to

the committees with jurisdiction, but no reports are to be sent to the Commission. It is unclear why the current proposal differs from the procedures of the section added to SBI statute in 2007.

If the Commission receives any reports, it would be appropriate to include the Commission's executive director. As drafted, any reports sent to the Commission are transmitted to the chair and vice chair only.

The proposal also requires another set of reports (page 4.4 to 4.14). These reports are to be provided quarterly to the Commission chair and vice chair, and are to provide information regarding any decision by the SBI not to divest shares of a scrutinized company, because doing so would conflict with fiduciary duties. If that remains in the bill, it would be appropriate to include the Commission's executive director. Also, as drafted these reports are not sent to the policy committees. That may be a drafting omission requiring an amendment. No commission or committee receives all the reports, leaving each with an incomplete picture.

2. Sufficient Impact to Justify the Administrative Burden. The issue is whether the proposal will have sufficient impact to justify the administrative cost of implementing it. If the intention is to further punish companies subject to Iran and Libya Sanctions Act of 1996 sanctions, the proposal may have little if any impact. If the SBI divests of the company, others will purchase those shares. The end result may be little more than a different distribution of ownership with little or no impact on the value of the assets. Also, there may be no SBI divestment. Subdivision 7, Exemptions, on page 4.4, allows the SBI to not divest if the SBI concludes that divesting of the specified asset or assets is inconsistent with fiduciary responsibilities. Regarding administration, the SBI will need to devote time and resources to the reviews, company notifications, and reports required under this proposal. The Commission may wish to have Howard Bicker, Executive Director of the State Board of Investment, testify on the administrative burden this provision may cause, and from the bill's supporters regarding the intended impact or purpose for the proposal.
3. Lack of Clarity Regarding Applicable Securities, Investment Forms. The bill is not clear regarding the scope of investment arrangements to which the requirements of this provision will apply. The Commission may wish to hear from Mr. Bicker about whether he interprets this bill as applying to both actively managed assets and assets in passive portfolios. The majority of SBI assets are in passively managed portfolios. If these restrictions could impact passive portfolios (indexed investments), the Commission may wish to have Mr. Bicker comment on whether this will have a material impact on the indexed portfolios, including but not limited to requiring the use of a different index or target. Comments on the extent to which the SBI may decide that divestment is not appropriate due to conflict with fiduciary duty would also be helpful. The SBI may decide that no changes should be made in indexed portfolios to avoid harm to the fund and a breach of fiduciary duties. Similar arguments could be made about actively managed portfolios, or semi-passive portfolios. The Commission may also seek comments from Mr. Bicker regarding the impact the bill might have on investments in Supplemental Fund, which include some volunteer fire assets and the assets of the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), and deferred compensation accounts.
4. Scope of Investments Covered. The issue is whether this bill is intended to apply only to equity investments, or to both fixed income and equity investments. The definition of "direct holdings" (page 1.16 to 1.18) refers only to equity investments. An issue for the Commission is whether to revise the bill to also include debt investments.
5. Lack of Effective Date. The bill does not have an effective date. The Commission may wish to consider adding one.
6. Question Regarding Inclusion in Omnibus Pension Bill. If the Commission does recommend the bill to pass, either as introduced or with amendments, an issue is whether to recommend inclusion in an omnibus pension bill or whether to refer the bill separately as a freestanding bill. The Commission may need to consider what other committees or divisions may need to review and consider this bill.

Amendments for Consideration

The Commission may wish to consider the following amendments:

- **Amendment S0131-1A** adds an effective date to be determined by the Commission by filling in the blank. July 1, 2009, is one of several reasonable dates.
- **Amendment S0131-2A** adds debt investments to the investment types included as "direct holdings." This would expand the coverage beyond only equity investments.

The following are all alternative amendments dealing with reporting issues. They differ in who receives the reports and which reports are sent to the various entities.

- **Amendment S0131-3A** leaves the reporting in the bill unchanged except for including the Commission's executive director in any reporting transmitted to the Commission chair and vice chair.
- **Amendment S0131-4A** revises the reporting to have the Commission and its executive director receive all reports, removes the initial report of the list of scrutinized companies in subdivision 9 on page 4.31 to 4.33, and does not alter reporting to other legislative committees.
- **Amendment S0131-5A** removes all reporting to the Commission, and has all reports sent to the chairs of the legislative committees and divisions in the House and Senate with jurisdiction over the SBI. The amendment also removes the initial report of the list of scrutinized companies in subdivision 9 on page 4.31 to 4.33.
- **Amendment S0131-6A** requires all reports to be sent to the Commission chair, vice chair, and executive director, and all reports are also sent to the chairs of the legislative committees and divisions in the House and Senate with jurisdiction over the SBI.) The amendment also removes the initial report of the list of scrutinized companies in subdivision 9 on page 4.31 to 4.33.
- **Amendment S0131-7A** requires all reports to be sent to the Commission and to the chairs of committees with jurisdiction over the SBI. Reports to the Commission will be sent to the Commission's executive director only, not to the Commission chair and vice chair. The amendment also removes the initial report of the list of scrutinized companies in subdivision 9 on page 4.31 to 4.33.

Minnesota Statutes, Section 11A.243, INVESTMENT IN SUDAN.

Subdivision 1. **Definitions.** (a) For the purposes of this section, the following items have the meanings given them in this subdivision.

(b) "Active business operations" means all business operations that are not inactive business operations.

(c) "Business operations" means engaging in commerce in any form in Sudan, 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.

(d) "Company" means any sole proprietorship, organization, association, corporation, partnership, joint venture, limited partnership, limited liability partnership, limited liability company, or other entity or business association, including all wholly owned subsidiaries, majority-owned subsidiaries, parent companies, or affiliates of such entities or business associations, that exists for profit-making purposes.

(e) "Complicit" means taking actions during any preceding 20-month period that have directly supported or promoted the genocidal campaign in Darfur, including, but not limited to, preventing Darfur's victimized population from communicating with each other, encouraging Sudanese citizens to speak out against an internationally approved security force for Darfur, actively working to deny, cover up, or alter the record on human rights abuses in Darfur, or other similar actions.

(f) "Direct holdings" in a company means all securities of that company held directly by the State Board of Investment or in an account or fund in which the State Board of Investment owns all shares or interests.

(g) "Government of Sudan" means the government in Khartoum, Sudan, which is led by the national congress party (formerly known as the national Islamic front) or any successor government formed on or after October 13, 2006, including the coalition national unity government agreed upon in the comprehensive peace agreement for Sudan, and does not include the regional government of southern Sudan.

(h) "Inactive business operations" means the mere continued holding or renewal of rights to property previously operated for the purpose of generating revenues but not presently deployed for such purpose.

(i) "Indirect holdings" in a company means all securities of that company held in an account or fund, such as a mutual fund, managed by one or more persons not employed by the State Board of Investment, in which the State Board of Investment owns shares or interests together with other investors not subject to the provisions of this section.

(j) "Marginalized populations of Sudan" include, but are not limited to, 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 Abyei, Southern Blue Nile, and Nuba Mountain regions; and the Amri, Hamadab, Manasir, and other similarly underserved groups of northern Sudan.

(k) "Military equipment" means weapons, arms, military supplies, and equipment that readily may be used for military purposes, including, but not limited to, radar systems or military-grade transport vehicles, or supplies or services sold or provided directly or indirectly to any force actively participating in armed conflict in Sudan.

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

(m) "Oil-related activities" include, but are not limited to, 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 the provision of supplies or services in support of such activities, provided that the mere retail sale of gasoline and related consumer products shall not be considered oil-related activities.

(n) "Power production activities" means any business operation that involves a project commissioned by the National Electricity Corporation (NEC) of Sudan or other similar government of Sudan entity whose purpose is to facilitate power generation and delivery, including, but not limited to, 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, as well as facilitating such activities, including the provision of supplies or services in support of such activities.

(o) "Scrutinized company" means any company that meets the criteria in clause (1), (2), or (3):

(1) the company has business operations that involve contracts with or provision of supplies or services to:

(i) the government of Sudan;

(ii) companies in which the government of Sudan has any direct or indirect equity share;

(iii) government of Sudan-commissioned consortiums or projects; or

(iv) companies involved in government of Sudan-commissioned consortiums or projects; and

(A) more than ten percent of the company's revenues or assets linked to Sudan involve oil-related activities or mineral extraction activities; less than 75 percent of the company's revenues or assets linked to Sudan involve contracts with or provision of oil-related or mineral extracting products or services to the regional government of southern Sudan or a project or consortium created exclusively by that regional government; and the company has failed to take substantial action; or

(B) more than ten percent of the company's revenues or assets linked to Sudan involve power production activities; less than 75 percent of the company's power production activities include projects whose intent is to provide power or electricity to the marginalized populations of Sudan; and the company has failed to take substantial action;

(2) the company is complicit in the Darfur genocide; or

(3) the company supplies military equipment within Sudan, unless it clearly shows that the military equipment cannot be used to facilitate offensive military actions in Sudan or the company implements rigorous and verifiable safeguards to prevent use of that equipment by forces actively participating in armed conflict, for example, through postsale tracking of such equipment by the company, certification from a reputable and objective third party that such equipment is not being used by a party participating in armed conflict in Sudan, or sale of such equipment solely to the regional government of southern Sudan or any internationally recognized peacekeeping force or humanitarian organization.

Notwithstanding any other provision to the contrary in this section, a social development company that is not complicit in the Darfur genocide shall not be considered a scrutinized company.

(p) "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.

(q) "Substantial action" means adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within one year and to refrain from any such 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 that has been evaluated and certified by an independent third party to be in substantial 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.

Subd. 2. **Identification of companies.** (a) Within 90 days following May 23, 2007, the State Board of Investment shall make its best efforts to identify all scrutinized companies in which the State Board of Investment has direct or indirect holdings or could possibly have such holdings in the future. Such efforts shall include, as appropriate:

(1) reviewing and relying, as appropriate in the State Board of Investment's judgment, on publicly available information regarding companies with business operations in Sudan, including information provided by nonprofit organizations, research firms, international organizations, and government entities;

(2) contacting asset managers contracting with the State Board of Investment who invest in companies with business operations in Sudan; or

(3) contacting other institutional investors that have divested from or engaged with companies that have business operations in Sudan.

(b) At the first meeting of the State Board of Investment after it has completed the requirements of paragraph (a), the State Board of Investment shall assemble a list of scrutinized companies.

(c) The State Board of Investment shall update the scrutinized companies list each quarter based on continuing information, including, but not limited to, information from sources identified in paragraph (a).

Subd. 3. **Engagement of scrutinized companies.** The State Board of Investment shall use the following procedure for companies on the scrutinized companies list:

(a) After completing the list required under subdivision 2, paragraph (a), the State Board of Investment shall immediately identify the companies on the list in which the State Board of Investment owns direct or indirect holdings.

(b) For each company identified in paragraph (a) with only inactive business operations, the State Board of Investment shall send a written notice to the company with information about this section and encourage it to continue to refrain from initiating active business operations in Sudan until it is able to avoid scrutinized business operations. The State Board of Investment shall continue such correspondence on a semiannual basis.

(c) For each company newly identified in paragraph (a) with active business operations, the State Board of Investment shall send a written notice informing the company of its scrutinized company status and that it may become subject to divestment by the State Board of Investment. The notice shall offer the company the opportunity to clarify its Sudan-related activities and shall encourage the company, 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 by the State Board of Investment.

(d) If, within 90 days following the State Board of Investment's first engagement with a company under paragraph (c), that company ceases scrutinized business operations, the company shall be removed from the scrutinized companies list and the provisions of this section shall cease to apply to it unless it resumes scrutinized business operations. If, within 90 days following the State Board of Investment's first engagement, the company converts its scrutinized active business operations to inactive business operations, the company shall be subject to all provisions of this section relating to inactive business operations.

Subd. 4. **Divestment.** (a) If, after 90 days following the State Board of Investment's first engagement with a company under subdivision 3, paragraph (c), the company continues to have scrutinized active business operations, and only while the company continues to have scrutinized active business operations, the State Board of Investment shall sell, redeem, divest, or withdraw all publicly traded securities of the company, except as provided in subdivisions 5 to 11, according to the following schedule:

(1) at least 50 percent of the assets in the company shall be removed from the State Board of Investment's assets under management by nine months after the company's most recent appearance on the scrutinized companies list; and

(2) 100 percent of the assets in the company shall be removed from the State Board of Investment's assets under management within 15 months after the company's most recent appearance on the scrutinized companies list.

(b) If a company that ceased scrutinized active business operations following engagement under subdivision 3, paragraph (c), resumes such operations, paragraph (a) shall immediately apply to the company and the State Board of Investment shall send a written notice to the company. The company shall also be immediately reintroduced onto the scrutinized companies list.

Subd. 5. **Prohibition on acquisition of certain securities.** At no time shall the State Board of Investment acquire securities of companies on the scrutinized companies list that have active business operations, except as provided in this section.

Subd. 6. **Exemption.** If the federal government affirmatively excludes a company from its present or any future federal sanctions regime relating to Sudan, the company is exempt from the divestment and investment requirements of subdivisions 4 and 5.

Subd. 7. **Excluded securities.** Notwithstanding any other provision in this section to the contrary, subdivisions 4 and 5 do not apply to indirect holdings in actively managed investment funds. The State Board of Investment shall submit letters to the managers of investment funds containing companies with scrutinized active business operations requesting the managers to consider removing such companies from the fund or to create a

