

**HOUSE OF REPRESENTATIVES STAFF ANALYSIS**

**BILL #:** PCB SAC 24-05 Foreign Investments by the State Board of Administration

**SPONSOR(S):** State Affairs Committee

**TIED BILLS:** **IDEN./SIM. BILLS:** SB 7060

<b>REFERENCE</b>	<b>ACTION</b>	<b>ANALYST</b>	<b>STAFF DIRECTOR or BUDGET/POLICY CHIEF</b>
Orig. Comm.: State Affairs Committee	18 Y, 0 N	Villa	Williamson

**SUMMARY ANALYSIS**

The State Board of Administration (SBA) has responsibility for investing the assets of the Florida Retirement System (FRS) Pension Plan and administering the FRS Investment Plan, which represent approximately \$190.8 billion (84.4 percent) of the \$225.4 billion in assets managed by the SBA. SBA fiduciaries charged with investment decisions must maintain a diversified portfolio and act as a prudent expert would under similar circumstances. The SBA's ability to invest the FRS assets is governed by an authorized list of investments established in law. In addition, the SBA is prohibited from investing in, and is required to divest from, companies engaging in certain business operations with Cuba, Venezuela, Iran, and Sudan or engaged in an economic boycott against Israel. Typically, the SBA must invest based only on pecuniary factors without regard to the furtherance of social, political, or ideological interests. However, the SBA is exempt from such requirement when divesting pursuant to law.

China has been the subject of various United States sanctions due to its human rights abuses, illicit narcotics trafficking, cyber-attacks, weapons proliferation, and corruption. In March 2022, the SBA completed an analysis and reported the FRS's total exposure in China was relatively low at approximately 2.8 percent of the FRS Trust Fund and announced it would cease funding new investment strategies in China due to the continued economic risk and global uncertainty. Currently, the FRS's total exposure to Chinese companies is estimated around \$277 million or 0.16 percent of the FRS Trust Fund.

The bill prohibits the SBA from acquiring, on behalf of the FRS Trust Fund, direct holdings in a Chinese company. In addition, by June 1, 2024, the SBA must initiate a review of all current direct holdings to determine which, if any, include securities of a Chinese company.

The bill requires the SBA to develop a divestment plan for all direct holdings in Chinese companies by September 1, 2024. The divestment plan must be developed and implemented consistent with the fiduciary standards of the SBA. The bill requires the SBA to complete divestment no later than September 1, 2025, or at such later time if necessary for the SBA to implement the divestment plan consistent with its fiduciary standards.

The bill specifies that the SBA is exempt from its typical fiduciary duty to only invest based on pecuniary factors when divesting from Chinese companies pursuant to the bill.

All actions taken pursuant to the bill must be adopted and incorporated into the FRS Trust Fund investment policy statement.

The bill will likely have an indeterminate fiscal impact on state and local governments. See Fiscal Comments.

# FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

### A. EFFECT OF PROPOSED CHANGES:

#### Background

##### State Board of Administration

The State Board of Administration (SBA) is established by Art. IV, s. 4(e) of the Florida Constitution, and is composed of the Governor as Chair, the Chief Financial Officer, and the Attorney General, commonly referred to as the Board of Trustees.<sup>1</sup> The Board of Trustees delegates operational authority to an executive director and chief investment officer, who oversee about 200 employees.<sup>2</sup>

The SBA has responsibility for investing the assets of the Florida Retirement System (FRS) Pension Plan<sup>3</sup> and administering the FRS Investment Plan,<sup>4</sup> which combined represent approximately \$190.8 billion, or approximately 84.4 percent, of the \$225.4 billion in assets managed by the SBA as of October 31, 2023.<sup>5</sup> The SBA also manages over 25 other investment portfolios, with combined assets of approximately \$34.6 billion, including the Florida Hurricane Catastrophe Fund, the Florida Lottery Fund, the Florida Prepaid College Plan, and Florida PRIME.<sup>6</sup>

Investment decisions for the pension plan are made by fiduciaries hired by the state.<sup>7</sup> Under Florida law, SBA fiduciaries charged with investment decisions must maintain a diversified portfolio and act as a prudent expert would under similar circumstances, considering all relevant substantive factors. Investment decisions must be based on pecuniary factors<sup>8</sup> and fiduciaries may not sacrifice investment return or undertake additional risk to promote any nonpecuniary factor.<sup>9</sup> A nine-member Investment Advisory Council (IAC) provides recommendations to the SBA on investment policy, strategy, and procedures and serves as a resource to the Board of Trustees.<sup>10</sup>

The SBA's authority to invest the funds, including FRS assets, is governed by an authorized list of investments established in law, known as the legal list.<sup>11</sup> The legal list specifies the permitted types of investments, as well as the total percentage that may be invested in each type of investment, and provides that:

- No more than 80 percent of any fund may be invested in domestic equity securities.
- No more than 75 percent of any fund may be invested in internally managed equity securities.
- No more than 3 percent of equity assets may be invested in the equity securities of any one issuing entity, except to the extent a higher percentage of the same issue is included in a nationally recognized market index, based on market values, or except upon a specific finding by the SBA that such higher percentage is in the best interest of the fund.

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<sup>1</sup> See also Art. XII, s. 9, FLA. CONST.

<sup>2</sup> See s. 215.44(2)(b), F.S. See also SBA, *Summary Overview of the State Board of Administration of Florida*, available at [https://www.sbafla.com/fsb/Portals/FSB/Content/Topics/SBAOverview\\_20211025.pdf?ver=2021-10-28-120954-217](https://www.sbafla.com/fsb/Portals/FSB/Content/Topics/SBAOverview_20211025.pdf?ver=2021-10-28-120954-217) (last visited February 9, 2024).

<sup>3</sup> S. 121.151, F.S.

<sup>4</sup> S. 121.4501(8), F.S. See also, R. 19-13.001, F.A.C.

<sup>5</sup> State Board of Administration, *Performance Report Month Ending: October 31, 2023*, available at <https://www.sbafla.com/fsb/Portals/FSB/Content/Performance/Trustees/2023/October%202023%20Monthly%20Trustee%20Report.pdf?ver=2023-12-22-140235-787> (last visited February 9, 2024).

<sup>6</sup> *Id.*

<sup>7</sup> The SBA does not directly manage investments for the Investment Plan. Instead, the Investment Plan offers a diverse selection of primary investment funds from which members can choose to allocate their funds. These investment funds are managed by private providers such as Fidelity, BlackRock, Stephens, T Rowe Price, and others. MyFRS, *Investment Plan – Investment Fund Summary January 2024*, available at [https://www.myfrs.com/pdf/forms/invest\\_fund\\_summary.pdf](https://www.myfrs.com/pdf/forms/invest_fund_summary.pdf) (last visited February 8, 2024). See also s. 121.4501(9), F.S.

<sup>8</sup> "Pecuniary factor" means a factor that the SBA prudently determines is expected to have a material effect on the risk or returns of an investment based on appropriate investment horizons consistent with applicable investment objectives and funding policy. The term does not include the consideration of the furtherance of any social, political, or ideological interests. S. 215.47(10)(a), F.S.

<sup>9</sup> S. 215.47(10), F.S.

<sup>10</sup> S. 215.444(1), F.S.

<sup>11</sup> S. 215.47, F.S.

- No more than 25 percent of any fund may be invested in specific instruments, such as certain bonds or other obligations of other states or of municipalities or other political subdivisions, notes secured by first mortgages insured or guaranteed by the Federal Housing Administration or the United States Department of Veterans Affairs, investment-grade group annuity contracts of the pension investment type, certain interests in real property, certain bonds or instruments issued by the government of Israel, foreign government general obligations, or other asset-backed securities.
- No more than 50 percent of any fund may be invested in foreign corporate or commercial securities or obligations.
- No more than 30 percent of any fund may be invested in alternative investments.<sup>12,13</sup>

In addition, the SBA may invest up to 5 percent of any fund as it deems appropriate. However, before making such investment, the SBA must present a proposed plan for such investment to the IAC. The proposed plan must include a detailed analysis of the investment, the expected benefits and potential risks, and methods for monitoring and measuring performance.<sup>14</sup>

To diversify its investments, the SBA invests in multiple asset classes: global equities, fixed income, real estate, cash equivalents, strategic investments, and private equity.<sup>15</sup> As of June 30, 2023, the total market value of the FRS Pension Plan's foreign equity investments was \$31.7 billion.<sup>16</sup>

#### *Investment Policy Statement*

The SBA must maintain an investment policy statement (IPS) for the FRS Pension Plan and may only invest in conformance with the IPS. By law, the IPS must clearly state its investment objectives, identify the types of securities in which the plan may invest, and the evaluation criteria used to measure fund performance.<sup>17</sup>

The executive director of the SBA is authorized to present recommended changes to the IPS to the Board of Trustees for approval; however, prior to presenting any changes to the Board of Trustees, the executive director must submit the recommendations to the IAC for review. The IAC must then present its findings and recommendations to the Board of Trustees before the final approval of any changes to the IPS.<sup>18</sup>

#### Divestment of Securities

Divestment of securities is one method of applying economic pressure to companies, groups, or countries whose practices are not condoned by shareholders. Divestment may be used in conjunction with or in lieu of other sanctioning methods, such as economic embargoes and diplomatic and military activities. Alternatively, divestment may be used as a protective device if a particular investment carries a high level of risk to the performance of a fund.

<sup>12</sup> "Alternative investment" means an investment by the SBA in a private equity fund, venture fund, hedge fund, or distress fund or a direct investment in a portfolio company through an investment manager. S. 215.4401(3)(a), F.S.

<sup>13</sup> S. 215.47, F.S.

<sup>14</sup> S. 215.47(6), F.S.

<sup>15</sup> The SBA categorizes their investments in the asset classes in the following manner:

- Global equity: primarily consists of equities in companies located in the United States and abroad.
- Fixed income: primarily consists of investment grade bonds.
- Real estate: primarily consists of directly owned real properties, real estate-based joint ventures, open-end and closed-end funds, and publicly traded real estate securities.
- Cash equivalents: primarily consists of short-term securities that have a high credit quality and liquidity.
- Strategic investments: contains investments not suitable for inclusion in the other asset classes, such as hedge funds, private debt, infrastructure, and timberland.
- Private equity: primarily consists of equity investments in non-publicly traded entities through limited partnerships.

SBA, *Summary Overview of the State Board of Administration of Florida*, available at [https://www.sbafla.com/fsb/Portals/FSB/Content/Topics/SBAOverview\\_20211025.pdf?ver=2021-10-28-120954-217](https://www.sbafla.com/fsb/Portals/FSB/Content/Topics/SBAOverview_20211025.pdf?ver=2021-10-28-120954-217) (last visited February 9, 2024).

<sup>16</sup> SBA, *Annual Investment Report*, available at <https://www.sbafla.com/fsb/Portals/FSB/Content/Performance/Annual/2022-2023%20AIR.pdf?ver=2023-12-22-100527-123> (last visited February 8, 2024).

<sup>17</sup> S. 215.475(1), F.S. See also R. 19-4.0035, F.A.C.

<sup>18</sup> S. 215.475(1) and (2), F.S.

### State Divestment Laws

The state has practiced divestment several times in modern history. From 1986 to 1994, the Legislature prohibited the SBA from investing in companies doing business with South Africa.<sup>19</sup> From 1988 to 2015, the Legislature placed restrictions on investments in any institution or company doing business in or with Northern Ireland.<sup>20</sup> From 1993 to the present, the Legislature required the SBA to divest from companies doing business in or with Cuba and prohibited state agencies from investing in companies engaging in certain business activities with Cuba.<sup>21</sup> From 1997 until 2001, the Board of Trustees decided to divest from 16 tobacco stocks due to pending litigation involving the state and those companies.<sup>22</sup> From 2007 to the present, the Legislature directed the SBA to divest funds from companies that are providing certain business opportunities with Iran and Sudan.<sup>23</sup> From 2016 to the present, the Legislature prohibited the SBA from investing in companies that engage in an economic boycott against Israel,<sup>24</sup> and in 2023, required the SBA to divest from such companies.<sup>25</sup> From 2018 to the present, the Legislature required the SBA to divest from companies doing business in or with Venezuela and prohibited state agencies from investing in companies engaging in certain business activities with Venezuela.<sup>26</sup>

When divesting pursuant to law, the SBA is exempted from its typical fiduciary duty to only invest based on pecuniary factors.<sup>27</sup>

### FRS – Investments in China

In December 2021, the Board of Trustees directed the completion of an analysis of all FRS investments to determine how many assets the state has invested in China.<sup>28</sup> In March 2022, the SBA completed the analysis and reported the FRS's total exposure in China was relatively low at approximately 2.8 percent of the FRS Trust Fund. Also, in March 2022, the SBA announced it would cease funding new investment strategies in China due to the continued economic risk and global uncertainty surrounding China.<sup>29</sup> Currently, the FRS's total exposure to Chinese state owned entities is estimated around \$277 million or 0.16 percent of the FRS Trust Fund. The table below shows these holdings:<sup>30</sup>

<b>Chinese Company</b>	<b>Value of Holding</b>
Bank of China Limited Class H	\$13.0 m
Baoshan Iron & Steel, Ltd. Class A	\$22.5 m
China Construction Bank Corp Class H	\$53.6 m
China Longyuan Power Group Corporation Ltd Class H	\$5.6 m
China Railway Group Limited Class H	\$7.3 m
China Yangtze Power Co., Ltd Class A	\$9.9 m
Chinese Universe Publishing & Media Group Co., Ltd. Class A	\$6.2 m

<sup>19</sup> See chs. 86-236, s. 3, and 94-264, s. 2, Laws of Fla.

<sup>20</sup> See chs. 88-406, s. 1, and 2015-75, s. 1, Laws of Fla.

<sup>21</sup> Ss. 215.471(1)(a) and (b) and 215.472(1) and (2), F.S.

<sup>22</sup> See the Cabinet State of Florida, *Cabinet Meeting Transcript*, (June 12, 2001), available at <https://www.myflorida.com/myflorida/cabinet/agenda01/0612/trans.html> (last visited February 9, 2024).

<sup>23</sup> S. 215.473, F.S.

<sup>24</sup> S. 215.4725, F.S. "Boycott Israel" or "boycott of Israel" means refusing to deal, terminating business activities, or taking other actions to limit commercial relations with Israel, or persons or entities doing business in Israel or in Israeli-controlled territories, in a discriminatory manner. A statement by a company that it is participating in a boycott of Israel, or that it has initiated a boycott in response to a request for a boycott of Israel or in compliance with, or in furtherance of, calls for a boycott of Israel, may be considered by the SBA to be evidence that a company is participating in a boycott of Israel. The term includes taking adverse action, including changes to published commercial financial ratings, risk ratings, and controversy ratings based on nonpecuniary factors, to inflict economic harm on Israel or persons or entities doing business in Israel or in Israeli-controlled territories. The term includes trade practices prohibited by federal regulations issued in compliance with 50 U.S.C. s. 4842 and does not include trade practices preempted by federal law. S. 215.4725(1)(a), F.S.

<sup>25</sup> Ch. 2023-111, s. 4, Laws of Fla.

<sup>26</sup> Ss. 215.471(1)(c) and 215.472(3), F.S.

<sup>27</sup> S. 215.47(10)(b), F.S.

<sup>28</sup> SBA Meeting Transcript (December 20, 2021), available at <https://www.myflorida.com/myflorida/cabinet/agenda21/1220/Transcript.pdf> (last visited February 8, 2024).

<sup>29</sup> Florida Cabinet Meeting Transcript (March 29, 2022), available at <https://www.myflorida.com/myflorida/cabinet/Meeting%20of%20the%20Governor%20and%20Cabinet%20032922%20-%20Transcript.pdf> (last visited February 8, 2024).

<sup>30</sup> Email from Lamar Taylor, Interim Executive Director and Chief Investment Officer, SBA, RE: Book1.xlsx, (January 29, 2024).

Chinese Company	Value of Holding
Huaneng Lancang River Hydropower Co Ltd Class A	\$10.6 m
Kweichow Moutai Co., Ltd Class A	\$36.3 m
Kweichow Moutai Co., Ltd Class A	\$10.1 m
PICC Property & Casualty Co., Ltd. Class H	\$5.3 m
Sinotruk Hong Kong Ltd	\$6.9 m
Wuliangye Yibin Co., Class A	\$21.1 m
198 Other Holdings (each less than \$5 million)	\$68.7 m
<b>TOTAL</b>	<b>\$277.1 m</b>

### Federal Sanctions on China

The United States has implemented multiple sanctions on the People's Republic of China (PRC) based on its human rights abuses, illicit narcotics trafficking, cyber-attacks, and corruption; weapons proliferation; failure to comply with multilateral sanctions on North Korean and Iran; and policy regarding Hong Kong.<sup>31</sup> The United States also has imposed sanctions on China in response to its utilization of United States capital to fuel the advancement and modernization of its military, intelligence, and security capabilities that pose an ongoing and direct threat to the United States.<sup>32</sup> This prohibits the purchase or sale of any publicly traded securities, or any derivative thereof, from any person determined by the Office of Foreign Assets Control<sup>33</sup> to:

- Operate or have operated in the defense and related material sector or the surveillance technology sector of the economy of the PRC; or
- Own or control, directly or indirectly, an individual or entity who operates or has operated in any prohibited sector.

### **Effect of the Bill**

The bill prohibits the SBA from acquiring, on behalf of the FRS Trust Fund,<sup>34</sup> direct holdings in a Chinese company. The bill defines:

- “China” to mean the government of the PRC, the Chinese Communist Party, the Chinese military, or any instrumentality thereof, or any combination thereof.
- “Chinese company” to mean a company that is publicly known to be majority-owned by China.
- “Company” to mean a sole proprietorship, an organization, an association, a corporation, a partnership, a joint venture, a limited partnership, a limited liability partnership, a limited liability company, or any other entity or business association, including all wholly owned subsidiaries, majority-owned subsidiaries, and parent companies, or an affiliate of such entity or business association which exists for the purpose of making a profit.
- “Direct holdings” in a company to mean all securities of that company which are held directly by the FRS Trust Fund or in an account or fund in which the FRS Trust Fund owns all shares or interests. It does not include indirect holdings in actively managed investment funds, including a private equity fund, or holdings in exchange-traded funds.
- “Indirect holdings” to mean all securities of that company which are held in a commingled fund or other collective investment, such as a mutual fund, in which the FRS Trust Fund owns shares or interests, together with other investors not subject to this section.

<sup>31</sup> Edward Collins-Chase, Congressional Research Service, *U.S. Sanctions: Legislation in the 117th Congress*, (Dec. 20, 2022), available at <https://crsreports.congress.gov/product/pdf/R/R47344> (last visited February 8, 2024).

<sup>32</sup> See Executive Order 14032, *Addressing the Threat from Securities Investments That Finance Certain Companies of the People's Republic of China*, (Jun. 3, 2021), available at <https://ofac.treasury.gov/media/99111/download?inline> (last visited February 8, 2024). See also, Executive Office of the President, *Continuation of the National Emergency with Respect to the Threat from Securities Investments That Finance Certain Companies of the People's Republic of China*, 88 Fed. Reg. 76987-76988 (Nov. 3, 2023), available at <https://www.federalregister.gov/documents/2023/11/07/2023-24776/continuation-of-the-national-emergency-with-respect-to-the-threat-from-securities-investments-that> (last visited February 8, 2024).

<sup>33</sup> The Office of Foreign Assets Control is an agency within the United States Department of the Treasury responsible for administering and enforcing economic and trade sanctions against targeted foreign countries, individuals, entities, and organizations that are involved in activities such as terrorism, narcotics trafficking, proliferation of weapons of mass destruction, or other threats to national security, foreign policy, or economic interests. U.S Department of the Treasury, *Office of Foreign Assets Control*, available at <https://ofac.treasury.gov/> (last visited February 9, 2024).

<sup>34</sup> The bill defines “Florida Retirement System Trust Fund” to mean all assets of the FRS held by the SBA in its capacity as a fiduciary pursuant to part I of ch. 121, F.S.

- “Majority-owned” to mean to own 50.1 percent or more of the outstanding equity interests of a company.

No later than June 1, 2024, the SBA must initiate a review of all current direct holdings to determine which direct holdings, if any, include securities of a Chinese company. No later than September 1, 2024, the SBA must develop a divestment plan for all direct holdings in Chinese companies. The divestment plan must be developed and implemented consistent with the fiduciary standards of the SBA. The bill requires the SBA to complete divestment from direct holdings in Chinese companies included in the divestment plan no later than September 1, 2025, or at such later time if necessary for the SBA to implement the divestment plan consistent with its fiduciary standards.

The bill requires the SBA’s actions taken in compliance with the bill, including all good faith determinations regarding companies, to be adopted and incorporated into the FRS Trust Fund IPS.

The bill specifies that the SBA is exempt from its typical fiduciary duty to only invest based on pecuniary factors when divesting from Chinese companies.

#### B. SECTION DIRECTORY:

Section 1 amends s. 215.47, F.S., relating to investments; authorized securities, loan of securities.

Section 2 creates s. 215.4735, F.S., relating to prohibited foreign investments.

Section 3 provides an effective date of upon becoming a law.

### II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

#### A. FISCAL IMPACT ON STATE GOVERNMENT:

##### 1. Revenues:

None.

##### 2. Expenditures:

See Fiscal Comments.

#### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

##### 1. Revenues:

None.

##### 2. Expenditures:

See Fiscal Comments.

#### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

#### D. FISCAL COMMENTS:

The bill prohibits the SBA from investing in, and requires the SBA to divest from, Chinese companies. The fiscal impact to the FRS Trust Fund as a result of the investment prohibition and divestment requirement is indeterminate at this time. In addition, the SBA may incur costs related to its responsibilities under the bill, including identifying certain holdings and developing a divestment plan; however, any additional costs should be absorbed within existing resources.

### III. COMMENTS

#### A. CONSTITUTIONAL ISSUES:

##### 1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to require counties or municipalities to spend funds or take action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of state tax shared with counties or municipalities.

##### 2. Other:

None.

#### B. RULE-MAKING AUTHORITY:

The bill neither provides for nor requires any additional rulemaking authority.

#### C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

### IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

None.