

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 6075-01
Bill No.: HB 2459
Subject: Retirement - State; Retirement - Local Government; Retirement Systems and Benefits - General; Terrorism
Type: Original
Date: April 18, 2016

Bill Summary: This proposal prohibits any public retirement plan from investing funds with foreign companies that have active ties to any country designated as a state sponsor of terrorism.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Total Estimated Net Effect on General Revenue	\$0	\$0	\$0

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Total Estimated Net Effect on <u>Other</u> State Funds	\$0	\$0	\$0

Numbers within parentheses: () indicate costs or losses.
This fiscal note contains 8 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Total Estimated Net Effect on <u>All</u> Federal Funds	\$0	\$0	\$0

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Total Estimated Net Effect on FTE	0	0	0

Estimated Net Effect (expenditures or reduced revenues) expected to exceed \$100,000 in any of the three fiscal years after implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Local Government	\$0	\$0	\$0

FISCAL ANALYSIS

ASSUMPTION

Oversight was unable to receive some of the agency responses in a timely manner due to the short fiscal note request time. Oversight has presented this fiscal note on the best current information that we have or on prior year information regarding a similar bill. Upon the receipt of agency responses, Oversight will review to determine if an updated fiscal note should be prepared and seek the necessary approval of the chairperson of the Joint Committee on Legislative Research to publish a new fiscal note.

Officials from the **Missouri State Employees' Retirement System (MOSERS)** assume the proposed legislation would, if enacted, affect all public employee retirement plans covered by Chapter 105, RSMo. The proposal would require any asset manager that invests in international equities of publicly traded foreign companies on behalf of the such plans, including the Missouri State Employees Retirement System (MOSERS), to attest semi-annually in a written statement to the board that they do not hold on behalf of the plan any stock of any foreign company that, according to a reputable independent research provider specializing in global security risk assessment, has active business ties to Iran, North Korea, Sudan and Syria that are non-humanitarian in nature.

The proposal would expire with respect to each individual country, irrespective of the countries that still remain prohibited, at such time that the President of the United States affirmatively and unambiguously states by means of, but not limited to, enacted legislation executive order or written certification from the President to Congress and the Department of State that no longer recognizes Iran, North Korea, Sudan or Syria as state sponsors of terrorism.

The proposal outlines timing of selling of such stock that has been held for at least one year and would cause the plan to experience a loss of at least five percent to allow plan to hold stock until a time when the sale would not cause the plan to experience a loss greater than five percent.

The legislation also contains provisions that would exempt the plan and board from any conflicting statutory obligations, including any such obligations with respect to choice of asset managers, investment funds, or investments for the plan's securities portfolios with respect to actions taken to be in compliance with, and including all good faith determinations regarding companies, as required by the legislation.

ASSUMPTION (continued)

Under MOSERS' anti-terrorism governance policy, staff is required, at least annually, to contact the Department of Homeland Security, the State Department, the Commerce Department, the Justice Department, the Treasury Department, the Securities and Exchange Commission, and any other federal agency deemed to have useful information in accurately identifying companies that are supporting terrorism. Specifically, staff is required to request guidance from these agencies on countries and more specifically companies that are believed to be supporting terrorism. If any such information is received, staff is to compare that information with the list of companies in our current holdings. In the event that MOSERS is a holder of one of these companies, staff must immediately contact the manager of the specific investment account to bring the situation to their attention and discuss appropriate actions for divesting from the company. In addition, staff is to forward all information received from any of these federal government agencies to our investment managers so they can avoid making initial investments or divest of existing investments in companies that are identified as supporting terrorist activities. In addition, the portfolio is regularly screened by our custodian bank for any holdings that are prohibited by the Office of Foreign Asset Control within the U.S. Treasury Department. Finally, staff provides a report to the board on an annual basis that identifies any investment actions taken due to links to terrorist activities.

This policy is intended to avoid 1) punishing companies whose activities abroad are supported by the U.S. government; 2) punishing companies whose activities abroad do not further terrorism, 3) unnecessarily harming U.S. companies and jobs; and 4) compromising the board's fiduciary duties to the beneficiaries of the system. Recognizing the dynamic nature of this issue, staff is required to annually evaluate this policy to determine if changes need to be made to reflect recent developments. In the event that staff believes changes to this policy are warranted, they will bring the issue to the attention of the Board for consideration.

The proposed legislation would mandate the hiring an "independent research provider" by each of our external money managers. For purposes of determining the fiscal impact, we assume that each asset manager will incur a cost of at least \$15,000 for purchasing a list of scrutinized companies from a reputable service provider that specializes in global security risk assessment based on our previous experiences with such service providers. Such lists are proprietary and may not be shared among managers. MOSERS has over 49 asset managers that currently or may potentially invest in international equities of publicly-traded foreign companies. In addition, there are 160 individual hedge fund managers in our fund of funds portfolios that currently or may potentially invest in international equities of publicly-traded foreign companies.

ASSUMPTION (continued)

Based on the assumption that each asset manager would pass on the cost of the service provider to MOSERS through increased management fees, the fiscal impact of this legislation is estimated to be approximately \$3,000,000 per year ($209 \times \$15,000 = \$3,135,000$).

Oversight assumes the cost of the retirement plans reflects potential current operating expenses and may or may not be reflected in actuarial determinations.

Officials from the **Joint Committee on Public Employee Retirement** assume this proposal would not affect retirement plan benefits as defined in Section 105.660.

Officials from the **Office of the State Treasurer** assume the current proposal would not fiscally impact their agency.

Officials from the **Sheriff's Retirement System** and the **Police Retirement System of St. Louis** each assume the current proposal would not fiscally impact their respective organizations.

Officials from the **Public School and Education Employee Retirement Systems of Missouri (PSRS)** state their system has an existing policy regarding terror-free investing that has been in place for nearly ten years (since May 2005). Current practice requires our PSRS Investment Staff to, at minimum, annually contact the Department of Homeland Security, the State Department, the Commerce Department, the Justice Department, the Treasury Department, the Securities and Exchange Commission, and any other federal agency deemed to have useful information in accurately identifying companies that are supporting terrorism.

PSRS's staff then requests guidance from these agencies on countries and more specifically companies that are believed to be supporting terrorism. Once the information is received, we compare their list of companies with current holdings. In the event that PSRS is a holder of one of these companies, we will immediately contact the manager of the specific investment account to bring the situation to their attention and discuss appropriate actions for divesting from the company.

Additionally, we forward all information received from any of these federal government agencies to the Systems' investment managers so they can avoid making initial investments or divest of existing investments in companies that are identified as supporting terrorist activities. Finally, we provide a report to our Board on an annual basis that identifies any investment actions taken due to links to terrorist activities. The Systems have not identified any terrorist-related investments since the inception of the PSRS policy in 2005.

ASSUMPTION (continued)

The proposed legislation, as it relates to the PSRS, requires any asset manager who invests in international equities of publicly-traded foreign companies to attest semiannually in a written statement to the Board of Trustees that the manager does not hold on behalf of the plan the stock of any foreign company that, according to a reputable independent research provider specializing in global security risk assessment, has active business ties to any country designated by the United States Department of State as a state sponsor of terrorism that is non-humanitarian in nature.

Subsection 3 does allow the Systems some flexibility with existing contracts or investments. Those foreign investments that have ties to state sponsors of terrorist must be sold if such stock has been held for a period of less than a year. Any of those stocks that are held more than a year and would cause the plan to experience a percent loss if sold, can be held until a time when the sale of such stock would not cause the plan to experience a loss greater than five percent.

PSRS have over 143 separate relationships with external money managers within our overall investment portfolio. Of those investment relationships, PSRS has approximately 31 external money managers and hedge fund managers that currently or potentially could invest in international equities of publicly-traded foreign companies. At this point, PSRS/PEERS does not invest in any company or companies that have active business operations in countries designated as "state sponsors of terrorism" by the United States Department of State.

Subsection 2 seems to require our international managers to attest to the Board of Trustees in writing that it doesn't hold stock in a publicly traded foreign company that "has active business ties to any state sponsor of terrorism." It appears that "reputable independent research providers" that file the required affidavit with the Treasurer's office would create a list of offending publicly traded international companies that could be compared to our manager's holdings. The manager would need to compare its holdings with the companies on the list and either attest to the Board it doesn't hold any of those companies' stock or divest per subsection 3. There is no explanation as to who pays for the services of the "reputable independent research provider." Normally, there is a substantial cost for this type of service.

The total direct fiscal impact on PSRS regarding the proposed legislation is estimated to be approximately \$250,000 annually, which are a result of increased monitoring and screening of existing and future investments that could be required to comply with this legislation.

This legislation could also potentially impact the ability of PSRS to invest in certain investment vehicles. The total assets of PSRS are approximately \$38 billion.

ASSUMPTION (continued)

Thus, even a 0.01% change in investment earnings (due to investment restrictions) could result in lost revenue of \$3.8 million. Additionally, the Systems could incur transactions costs associated with potential divestment which is not captured in the above cost. It is our position that the proposed legislation could cost our members and school districts in terms of reduced investment earnings with no material improvement in additional safeguards or precautions regarding terror-free investing.

It is our position that the PSRS existing Anti-Terrorism Policy already addresses the issue of terror-free investing. New legislation could increase the costs to the retirement systems and potentially impact their investment strategy with no improvement in policy.

Oversight assumes the cost of the retirement plans reflects potential current operating expenses and may or may not be reflected in actuarial determinations.

<u>FISCAL IMPACT - State Government</u>	FY 2017 (10 Mo.)	FY 2018	FY 2019
	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

<u>FISCAL IMPACT - Local Government</u>	FY 2017 (10 Mo.)	FY 2018	FY 2019
	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

FISCAL IMPACT - Small Business

No direct fiscal impact to small businesses would be expected as a result of this proposal.

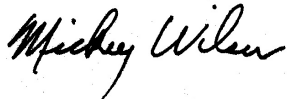
FISCAL DESCRIPTION

The proposed legislation appears to have no direct fiscal impact.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Joint Committee on Public Employee Retirement
Office of the State Treasurer
Missouri State Employees Retirement System
Public School and Education Employees Retirement System
Sheriff's Retirement System
Police Retirement System of St. Louis



Mickey Wilson, CPA
Director
April 18, 2016

Ross Strobe
Assistant Director
April 18, 2016