COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 5181-02
Bill No.: HCS for HB 2357
Subject: Retirement Systems and Benefits - General; Terrorism
Type: Original
Date: April 1, 2010

Bill Summary: Prohibits Missouri public retirement plans from investing funds with foreign companies located in countries that sponsor terrorism.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on General Revenue Fund	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 7 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☐ Estimated Total Net Effect on All funds expected to exceed $100,000 savings or (cost).

☐ Estimated Net Effect on General Revenue Fund expected to exceed $100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

The **Joint Committee on Public Employee Retirement (JCPER)** has reviewed this proposal and has determined an actuarial study is not needed under the provisions of section 105.660, subdivision (5).

Officials from the **Department of Conservation** assume there will be no fiscal impact to their agencies.

Officials from the **Missouri State Employees' Retirement System (MOSERS)** assume the proposed legislation described in Fiscal Note No. 5181-01N (HB 2357) 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 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.

MOSERS Anti-Terrorism Policy
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

ASSUMPTION (continued)

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.

Cost
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 44 asset managers that currently or may potentially invest in international equities of publicly-traded foreign companies. In addition, there are 155 individual hedge fund managers in our fund of funds portfolios that currently or may potentially invest in international equities of publicly-traded foreign companies. We also internally manage one real assets portfolio that could potentially invest in international equities of publicly-traded foreign companies, and would be required obtain the services of a specialty firm to cover that internally managed portfolio.

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 (200 x $15,000 = $3,000,000).

ASSUMPTION (continued)

In the past, MOSERS retained the services of independent research providers to further scrutinize the MOSERS investment portfolio. It has been our experience that research providers do not take responsibility for their information when it is being used as a divestment recommendation. In March 2009, the additional screening service was reviewed and the contract discontinued.

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 **MoDOT & Patrol Employees' Retirement System (MPERS)** assume this proposal adds Section 105.676 to the statutes, and would require any asset manager to any retirement system (plan) established by the state of Missouri or an political subdivision or instrumentality of the state to certify to the plan that they do 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 Iran, North Korea, Sudan, and Syria that are non-humanitarian in nature.

The effect of this law would be to require asset managers desiring to maintain a relationship with Missouri public pension systems to divest of the identified investments – linked to countries identified as state sponsors of terrorism. Or, alternatively would require the asset managers and the corresponding plans to sever such relationships. The bill contains a mandate that purports to trump the fiduciary duties of the trustees of the various public retirement systems. Access to the list required to screen companies is private. MPERS does not have access to this list.

MPERS's investment staff reviewed this legislation and compared investment returns of certain indexes over a three-year period (mid 2006 to mid 2009) to MPERS international portfolio. As the screening list is private, MPERS used the MIT Terror Free Fund run by the State of Missouri and the MSCI EAFE (Morgan Stanley Capital International - Europe Australia Far East) for comparative purposes. This analysis indicated that the terror free fund underperformed MPERS' actual performance and also significantly underperformed the passive international index. The estimated adverse negative fiscal impact for MPERS, if projected forward would be about $4 million dollars on an annual basis.

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

ASSUMPTION (continued)

Officials from the **Public School Retirement System (PSRS)** assume PSRS/PEERS will incur recurring hard dollar expenses (at minimum $125,000 annually) related to this bill long-term. Additionally, the bill may limit the Systems' ability to invest in certain investment strategies longer term. This could result in lower investment income.

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 **County Employees' Retirement Fund (CERF)** assume it is possible for this proposal to have an effect on costs for the CERF. However, it is impossible to quantify these costs in advance. For example, their fund managers may have to charge an additional fee to monitor the requirements of the proposal.

FISCAL IMPACT - State Government	FY 2011 (10 Mo.)	FY 2012	FY 2013
	$0	**$0**	**$0**

FISCAL IMPACT - Local Government	FY 2011 (10 Mo.)	FY 2012	FY 2013
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

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

FISCAL DESCRIPTION

This bill requires any asset manager who invests in international equities of publicly-traded foreign companies on behalf of any retirement system established by the State of Missouri or any political subdivision to attest semiannually in a written statement to the respective retirement board 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 Iran, North Korea, Sudan, or Syria that are nonhumanitarian in nature.

VL:LR:OD (12/02)

DESCRIPTION (continued)

The provisions of the bill will expire if the President of the United States affirmatively and unambiguously states by means of, but not limited to, enacted legislation, executive order, or written certification that the United States Department of State no longer recognizes Iran, North Korea, Sudan, or Syria individually as a state sponsor of terrorism.

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
Missouri State Employees' Retirement System
MoDOT & Patrol Employees' Retirement System
Department of Conservation
Public School Retirement System
County Employees' Retirement Fund

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April 1, 2010