

COMMISSION ON GOVERNMENT FORECASTING AND ACCOUNTABILITY

PENSION IMPACT NOTE

95TH GENERAL ASSEMBLY

BILL NO: **SB 1621, as amended by HA#1 and HA #2** June 8, 2007
SPONSOR (S): Schoenberg – Silverstein, et al. (Lang – Watson, et al.)
SYSTEM(S): General Provisions Article
 (Applicable only to SERS, TRS, SURS, JRS, GARS)

FISCAL IMPACT: The fiscal impact of SB 1621, as amended by HA #1 and #2, may have a fiscal impact, but the impact cannot be determined. If Illinois public pension funds and retirement systems have to divest certain assets and reinvest the proceeds in other assets, there may be a fiscal impact due to a change in asset allocation. Asset allocation affects a system's or fund's long-term investment returns. If asset allocation must change significantly, the impact of SB 1621, as amended by HA #1 and #2, may be significant.

SUBJECT MATTER: SB 1621, as amended by HA #1 and #2, amends the General Provisions Article of the Illinois Pension Code to add certain prohibited transactions relating to the investment in or deposit of funds in entities or companies doing business in or with the government of Iran. This bill also requires the retirement system to update the scrutinized company list annually, rather than quarterly, and makes changes in provisions concerning ceasing divestiture.

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COMMENT:

Definition of "Retirement Systems"

SB 1621, as amended by HA#1 and #2, amends the definition of "retirement systems" so that the provisions of this bill apply only to the State Employees' Retirement System of Illinois, the Judges Retirement System of Illinois, the General Assembly Retirement

System, the State Universities Retirement System, and the Teachers' Retirement System of the State of Illinois, excluding all others.

Prohibited Transactions with Scrutinized Companies

Currently, the General Provisions Article of the Pension Code contains a list of prohibited transactions for the Boards of Trustees of each public pension fund and retirement system. Most of these prohibited transactions are aimed at preventing Board members from misusing the assets of the fund or system.

SB 1621, as amended by HA#1 and HA #2 defines "scrutinized company" as a business operation that involves contracts with or provision of supplies or services to the Government of Iran, companies in which the Government of Iran has any direct or indirect equity share, consortiums or projects commissioned by the Government of Iran and:

- (1) more than 10% of the company's revenues produced in or assets located in Iran involve oil-related activities or mineral-extraction activities;
- (2) less than 75% of the company's revenues produced in or assets located in Iran involve contracts with or provision of oil-related or mineral extraction products or services to the Government of Iran; an the company has failed to take substantial action; or
- (3) the company has, on or after August 5, 1996, made an investment of \$20 million or more, or investments of at least \$10 million each in the aggregate equals or exceeds \$20 million in any 12-month period that directly or significantly contributes to the enhancement of Iran's ability to develop petroleum resources of Iran.

Substantial Action to Cease Scrutinized Business Operations

SB 1621, as amended by HA#1 and HA #2, defines "substantial action" as adopting, publicizing, and implementing a formal plan to cease scrutinized business operations within one year and to refrain from any such new business operations. This bill provides that within 90 days of the effective date of this Act, a retirement system shall make its best efforts to identify all scrutinized companies in which the retirement system has direct or indirect holdings or could possibly have such holdings in the future. These efforts shall include the following, as appropriate in the retirement system's judgment:

- (1) reviewing and relying on publicly available information regarding companies having business operations in Iran, including information provided by nonprofit organizations, research firms, international organizations, and government entities;
- (2) contacting asset managers contracted by the retirement systems that invest in companies having business operations in Iran;
- (3) contacting other institutional investors that have divested from or engaged with companies that have business operations in Iran.

By the first meeting of the retirement system following the 90-day period after the effective date of this Act, the retirement system shall assemble all scrutinized companies identified into a scrutinized companies list.

Procedures for Companies on the Scrutinized Companies List

In the context of the foregoing section on scrutinized companies, SB 1621, as amended by HA #1 and HA #2, retirement systems are required to update and adhere to the following procedures for companies on the scrutinized companies list:

- (1) the retirement system shall determine the companies on the scrutinized companies list in which the retirement system owns direct or indirect holdings.
- (2) for each company identified that has only inactive business operations, the retirement system shall send a written notice informing the company and encouraging it to continue to refrain from initiating active business operations in Iran until it is able to avoid scrutinized business operations. The retirement system shall continue such correspondence semiannually.
- (3) for each company newly identified that has active business operations, the retirement system shall send a written notice informing the company of its scrutinized company status and that it may become subject to divestment by the retirement system.
- (4) if, within 90 days after the retirement system's first engagement with a company, that company ceases scrutinized business operations, the company shall be removed from the scrutinized companies list and the provisions shall cease to apply to it unless it resumes scrutinized business operations.

If, after 90 days following the retirement system's first engagement with a company and the company continues to have scrutinized active business operations, the retirement system shall sell, redeem, divest, or withdraw all publicly traded securities of the company from the retirement system's assets under management within 12 months after the company's most recent appearance on the scrutinized companies list. SB 1621, as amended by HA #1 and HA #2, stipulates that the retirement system may not acquire securities of companies on the scrutinized companies list, unless the United States Government declares the company to be excluded from federal sanctions against Iran.

Divestiture Reporting Requirements

SB 1621, as amended by HA #1 and HA #2, requires the retirement system to file a report with the Public Pension Division of the Department of Financial and Professional Regulation Division within 30 days of the creation of the scrutinized companies list, which shall include the following:

- (1) a summary correspondence with companies engaged by the retirement system that has active and inactive business operations.
- (2) all investments sold, redeemed, divested, or withdrawn in compliance with the company continuing to have scrutinized active business operations
- (3) all prohibited investments on the scrutinized companies list that have active business operations.
- (4) a summary of correspondence with private market funds requesting that companies that have scrutinized active business operations consider removing the companies from the fund or creating an actively managed fund with indirect holdings devoid of the companies.

Requirements for Private Market Funds

SB 1621, as amended by HA #1 and HA #2, exempts the following requirements towards indirect holdings in a private market fund: (1) selling, redeeming, divesting, or withdrawing all publicly traded securities of the company by the retirement system, and (2) the retirement system may not acquire securities of companies on the scrutinized companies list that have active business operations. However, the retirement system shall submit letters to the managers of those investment funds containing companies that have scrutinized active business operations requesting that they consider removing the companies from the fund or create a similar actively managed fund having indirect holdings devoid of the companies. If the manager creates a similar fund, the retirement system shall replace all applicable investments with investments in the similar fund in an expedited timeframe consistent with prudent investing standards. SB 1621, as amended by HA #1 and HA #2, defines “private market fund” as any private equity fund, private equity fund of funds, venture capital fund, hedge fund, hedge fund of funds, real estate fund, or other investment vehicles that are not publicly traded.

Conditions for Cessation of Divestiture

SB 1621, as amended by HA #1 and HA #2, provides that the retirement system may cease divesting or reinvesting from certain scrutinized companies if clear and convincing evidence shows that the value of all assets under management by the retirement system becomes equal to or less than 99.50%, or 50 basis points, of the hypothetical value of all assets assuming no divestment for any company had occurred. This bill provides that the retirement system shall provide a written report to the Public Pension Division in advance of initial reinvestment, updated semiannually, supported by clear and convincing evidence, for its decisions to cease divestment, reinvest, or remain invested in companies having scrutinized active business operations. This does not apply to reinvestment in companies on the grounds that they have ceased to have scrutinized active business operations.

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