*SESSION OF 2024*

# SUPPLEMENTAL NOTE ON HOUSE SUBSTITUTE FOR SENATE BILL NO. 37

As Recommended by House Committee on Financial Institutions and Pensions

## Brief*

House Sub. for SB 37 would create the Countries of Concern Divestment and Procurement Protection Act. The Act would require state-managed funds' divestment from investments with countries of concern and prohibit investments and deposits with a bank or company domiciled in a country of concern, prohibit state agencies from procuring final or finished goods or services from a foreign principal, and indemnify state-managed funds with respect to actions taken in compliance with the Act.

The provisions of this act would expire on July 1, 2029.

### *Designation of Act and Definitions (Sections 1-2)*

The bill would establish several definitions under the Act, including:

- "Company" would mean any:
  - For-profit corporation, partnership, limited partnership, limited liability partnership, limited liability company, joint venture, trust, association, sole proprietorship, or other organization, including any:

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*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at http://www.kslegislature.org

- Subsidiary of such company, a majority ownership interest of which is held by such company;
- Parent company that holds a majority ownership of such company; and
- Other affiliate or business association of such company whose primary purpose is to make a profit; or

○ Nonprofit organization;

● "Country of concern" would mean the following:

○ People's Republic of China, including the Hong Kong special administrative region;

○ Republic of Cuba;

○ Islamic Republic of Iran;

○ Democratic People's Republic of Korea;

○ Russian Federation; and

○ Bolivarian Republic of Venezuela.

The bill would specify that "country of concern" does not include the Republic of China (Taiwan).

● "Covered transaction" would be defined the same as in 31 C.F.R. § 800.213, as in effect on July 1, 2024 [*Note:* 31 C.F.R. Part 800 includes regulations pertaining to certain investments in the United States by foreign persons; it was promulgated by the U.S. Department of the Treasury, Office of Investment Security.]

○ "Covered transaction" as defined in the federal Code means:

- A covered control transaction;
- A covered investment;
- A change in the rights that a foreign person has with respect to a U.S. business in which the foreign person has an

investment, if that change could result in a covered control transaction or a covered investment; or

- Any other transaction, transfer, agreement, or arrangement, the structure of which is designed or intended to evade or circumvent the application of Section 721 of Title VII of the Defense Production Act of 1950, 50 U.S.C. 4565.

[*Note:* According to summary information published in the *Federal* Register, the final rule (31 C.F.R. Part 802; 85 FR 3112) established regulations to implement the provisions relating to real estate transactions in Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment Risk Review Modernization Act (FIRRMA) of 2018. This rule sets forth the scope of, and process and procedures relating to, the national security review by the Committee on Foreign Investment in the United States (CFIUS) of certain transactions involving the purchase or lease by, or concession to, a foreign person of certain real estate in the United States. FIRRMA also broadened authorities of the President and CFIUS to address national security concerns arising from certain non-controlling investments, including the review of certain transactions.]

- “Covered control transaction” would be defined the same as in 31 C.F.R. § 800.210, as in effect on July 1, 2024;
  - “Covered control transaction” as defined in the Code of Federal Regulations means any transaction that is proposed or pending after August 23, 1988, by or with any foreign person that could result in foreign control of

any U.S. business, including such a transaction carried out through a joint venture;

- “Domicile” would mean the country where:
  - A company is organized;
  - A company completes a substantial portion of its business; or
  - A majority of a company’s ownership interest is held;
- “Foreign principal” would mean:
  - The government or any official of the government of a country of concern;
  - Any political party, subdivision thereof, or any member of a political party of a country of concern;
  - Any corporation, partnership, association, organization, or other combination of persons organized under the laws of or having its principal place of business in a country of concern. “Foreign principal” includes any subsidiary owned or wholly controlled by any such entity;
  - Any agent of or any entity otherwise under the control of a country of concern;
  - Any individual whose residence is in a country of concern and who is not a citizen or lawful permanent resident of the United States; or
  - Any individual, entity, or combination thereof described in the prior provisions within this definition that has a controlling interest in any company formed for the purpose of holding any interest in real property;
- “Person” would mean an individual;

- "Person owned or controlled by or subject to the jurisdiction or direction of a country of concern" would mean any:
  - Person, wherever located, who is a citizen of a nation-state controlled by a country of concern, unless such person is a lawful permanent resident of the United States; or
  - Corporation, partnership, association, or other organization organized under the laws of a nation-state controlled by a country of concern;
- "State agency" would mean any department, authority, bureau, division, office, or other governmental agency of this state; and
- "State-managed fund" would mean:
  - The Kansas Public Employees Retirement Fund managed by the Board of Trustees of the Kansas Public Employees Retirement System (KPERS) in accordance with provisions governing the management and investment of the fund; and
  - The Pooled Money Investment Portfolio managed by the Pooled Money Investment Board in accordance with Article 42 of Chapter 75 of the *Kansas Statutes Annotated* (addresses state moneys); and
  - Any other fund that is sponsored or managed by a state agency.

***State-managed Fund—Sale, Redemption, Divestment, or Withdrawal of Publicly Traded Securities (Section 3)***

The bill would require, notwithstanding the provisions of law governing the Kansas Public Employees Retirement Fund and management and investment of this Trust Fund designated to the KPERS Board of Trustees (KSA 74-4921) or any other statute to the contrary, a state-managed fund to sell, redeem, divest, or withdraw all publicly traded securities of any country of concern or person owned or controlled by or subject to the jurisdiction or direction of a country of concern in accordance with this schedule:

- At least 50 percent of such assets must be removed from the state-managed fund's assets under management not later than July 1, 2025, or one year from the date the definition of "country of concern" is amended to include such country of concern if amended after July 1, 2024, unless the state-managed fund determines that a later date is more prudent based on a good faith exercise of the state-managed fund's fiduciary discretion and subject to the requirements created pursuant to the January 1, 2026, deadline (described below); and

- 100 percent of such assets must be removed from the state-managed fund's assets under management not later than January 1, 2026, or one year from the date the definition section of the Act is amended to include such country of country if amended after July 1, 2024.

*Removal of Assets with Prohibition; Prohibited Acquiring of Securities and Investing or Making a Deposit in a Bank*

If a country of concern takes action to prohibit or restrict the selling, redeeming, divesting, or withdrawing of publicly traded securities of any country of concern or person owned or controlled by or subject to the jurisdiction or direction of a country of concern beyond the scheduled removal dates provided in the bill, the bill would require the state-managed fund to remove 100 percent of those assets from the state-managed fund's assets not later than one year from the date that such action is ended by such country of concern.

The bill would prohibit a state-managed fund from knowingly acquiring securities of any country of concern or person owned or controlled by or subject to the jurisdiction or direction of a country of concern. State-managed funds would also be prohibited from investing or making a deposit in any bank that is domiciled in a country of concern.

### *State-managed Fund—Divestiture (Section 4)*

The bill would require, notwithstanding the provisions of law governing KPERS and directing management and investment of this Trust Fund by the KPERS Board of Trustees or any other statute to the contrary, state-managed funds to divest from any indirect holdings in actively or passively managed investment funds containing publicly traded securities of any country of concern or person owned or controlled by or subject to the jurisdiction of a country of concern. The state-managed fund would be permitted to submit letters to the managers of each investment fund containing publicly traded securities of any country of concern requesting that they remove such publicly traded securities from the fund or create a similar actively or passively managed fund with indirect holding devoid of any such publicly traded securities. If a manager creates a similar fund with substantially the same management fees and same level of investment risk and anticipated return, the bill would authorize the state-managed fund to replace all applicable investments with investments in the similar fund in a time frame consistent with prudent fiduciary standards but not later than the 450th day after the fund is created. If a manager does not create a similar fund, the bill would require the state-managed fund to divest from its indirect holding in actively or passively managed investment funds.

#### *Exception and Prohibition, Real Estate or Private Equity Investment Commitments*

The bill would state that the provisions of this act do not apply to any real estate or private equity investment commitment made by a state-managed fund prior to July 1, 2024, or to a real estate or private equity investment commitment made by a state-managed fund prior to the date either established by the bill or later amended to include a country of concern. The bill would also prohibit, on and after July 1, 2024, a state-managed fund from making any new real estate or private equity investment commitment in a person owned or controlled by or subject to the jurisdiction of a country of concern.

***Reporting to the Legislature, KPERS, Joint Committee (Section 5)***

The bill would require, no later than the first day of the regular session of the Legislature, each state-managed fund to file an annual report with the Legislature. KPERS would also be required to file a report with the Joint Committee on Pensions, Investments and Benefits that:

- Identifies all securities sold, redeemed, divested, or withdrawn in compliance with requirements of the bill;
- Identifies amendments to the definitions section created under this bill to add or remove a country of concern after the later of July 1, 2024, or the last date such information was reported; and
- Summarizes any changes made under provisions pertaining to state-managed fund divestiture from any direct or indirect holdings in actively or passively managed funds containing publicly traded securities of any country of concern (as provided in section 4).

***Procurement of Goods and Services (Section 6)***

The bill would prohibit state agencies from entering into a contract or agreement to procure final or finished goods or services from a foreign principal except as described below.

The bill would permit a state agency to enter into a contract or agreement to procure final or finished goods or services from a foreign principal if such foreign principal:

- Previously received a determination that there are no unresolved national security concerns and action under 50 U.S.C. § 4565, as in effect on July 1, 2024, has concluded with respect to a covered transaction, provided that such foreign principal has not undergone a change in control constituting a covered control transaction, since such determination to conclude action; or

- Has a national security agreement in effect on July 1, 2024, with CFIUS, or the U.S. Department of Defense, under 50 U.S.C. § 4565, as in effect on July 1, 2024, and maintains such national security agreement.

The bill would specify this prohibition would not apply to any contract or agreement entered into prior to July 1, 2024.

### *Cause of Action (Section 7)*

The bill would provide that in a cause of action based on action, inaction, decision, divestment, report, or other determination made or taken in compliance with the Act, without regard to whether the person performed services for compensation, the State shall:

- Indemnify and hold harmless for actual damages, court costs, and attorney fees adjudged against members of a state-managed fund or any other of its officers related to the act or omission on which the damages are based; and

- Defend the state-managed fund and any of its current and former employees.

### *Expiration of the Act (Section 8)*

The provisions of the Act would expire on July 1, 2029.

On or after July 1, 2028, but prior to July 15, 2028, KPERS would be required to notify the Speaker of the House of Representatives, the President of the Senate, and the chairperson of the Joint Committee on Pensions, Investments and Benefits that this act is scheduled to expire on July 1, 2029.

## Background

The House Committee on Financial Institutions and Pensions recommended a substitute bill incorporating provisions that would create the Countries of Concern Divestment and Procurement Protection Act (HB 2739). The House Committee removed the contents of SB 37, pertaining to amendments to the Kansas Housing Investor Tax Credit Act and expansion of the transferability of tax credits issued under that act. [*Note:* The original contents of SB 37, as amended by the Senate Committee on Financial Institutions and Insurance, were included in SB 34, as amended by the House Committee on Financial Institutions and Pensions. The contents of SB 34, as amended by House Committee and modified by the Conference Committee, were enacted in the 2023 Conference Committee Report for SB 17.]

### *HB 2739 (Countries of Concern Divestment and Procurement Protection Act)*

HB 2739 was introduced by the House Committee on Financial Institutions and Pensions at the request of Representative Hoheisel.

On February 14, 2024, the bill was withdrawn from the House Committee on Financial Institutions and Pensions and referred to the House Committee on Appropriations. On

February 15, 2024, the bill was then withdrawn from the House Committee on Appropriations and re-referred to the House Committee on Financial Institutions and Pensions.

***House Committee on Financial Institutions and Pensions***

In the House Committee hearing on March 4, 2024, representatives of American Global Strategies, LLC, and State Armor Action provided **proponent** testimony, generally stating the bill would protect Kansas' and America's security interests by divesting state funds and stopping new procurements by state agencies from countries of concern. The proponents outlined concerns with the countries identified in the bill and the interconnected global economy and threats seen in emerging technologies. Prior to the hearing, Representative Hoheisel commented on the intentions of the bill, indicating the sole policy question is whether it is appropriate to invest the State's financial resources in countries of concern and entities linked to those ruling regimes.

Written-only neutral testimony was submitted by representatives of the American Council of Engineering Companies of Kansas and the Kansas Chamber. Both representatives requested consideration of removal of language pertaining to a "principal place of business" in provisions pertaining to procurement of goods or services.

The Executive Director of KPERS provided **opponent** testimony on behalf of the KPERS Board of Trustees, stating that the Board and its investment members are fiduciaries to its members and all investment decisions are made for the sole purpose of providing promised benefits. The conferee indicated adding statutory restrictions to investments impedes the Board's ability to make investment decisions and manage risk with the sole purpose of funding benefits. The constraints on KPERS investments could also negatively impact the ultimate rate of return. The conferee noted the Board and its managers follow all federal laws regarding international investments and provided information regarding current holdings in counties of concern (only China, including Hong Kong).

The KPERS Board conferee requested consideration of an amendment to replace reference to "companies affiliated with a country of concern" with "a person owned or controlled by, or subject to the jurisdiction or direction of a country of concern."

The House Committee amended the bill to:

- Add definitions for the terms "covered transaction," "covered control transaction," and "foreign principal";
- Provide the sale, redemption, divestiture, or withdrawal requirements placed on state-managed funds (both publicly traded securities and indirect holdings in actively or passively managed fund containing such securities) would be subject to the law governing the Kansas Public Employees Retirement Fund (KPERS) and management and investment of this Trust Fund designated to the KPERS Board of Trustees (KSA 74-4921) or any other statute to the contrary;
- Remove reference to the principal place of business in provisions pertaining to an investment or deposit prohibition for state-managed funds;
- Remove reference to companies affiliated with a country of concern in an real estate or private equity investment prohibition provision to instead reference a person owned or controlled by or subject to the jurisdiction of a country of concern;
- Clarify the prohibition on state agencies contracting or agreeing to procure good or services to include final or finished goods or services and reference a

foreign principal instead of a company domiciled or with a principal place of business in a country of concern; and

- Allow a state agency to enter into a contract or agreement with foreign principals that meet specified criteria regarding national security concerns or agreements.

## Fiscal Information

According to the fiscal note prepared by the Division of the Budget on HB 2739, as introduced, the Pooled Money Investment Board (PMIB) reports that the enactment of the bill would not have a fiscal impact as the PMIB does not have any investments outlined in the bill. The Office of Procurement and Contracts in the Department of Administration indicates that the enactment of the bill would have no fiscal effect.

The State Treasurer reports that any costs associated with the enactment of the bill would be negligible and could be accomplished within the agency's existing budget resources. The agency assumes the bill would not affect the various consumer investment programs sponsored by the agency, including the Kansas 529 Education Plan and Kansas ABLE Savings Plan.

KPERS reports that the enactment of the bill would require the divestment of holdings in China, including Hong Kong, over a two-year period. As of December 31, 2023, KPERS has approximately $256.0 million in public market securities in China, which represents less than 1.0 percent of the total KPERS assets. The agency state the provisions of the bill that would permit a two-year period of divestiture would allow the KPERS Board of Trustees to manage any associated divestiture risks; however, there would be trading costs to liquidate these holdings and reinvestment in other public market securities. The agency estimates these trading costs to be approximately $680,000 over the two-year period of divestiture. KPERS notes that the bill would not be expected to affect the long-term investment return assumptions currently used by the actuary.

Any fiscal effect associated with enactment of the bill is not reflected in *The FY 2025 Governor's Budget Report*.

Retirement; state agencies; country of concern; investments; divestment; procurement; state moneys; foreign principal; national security agreement; Countries of Concern Divestment and Procurement Protection Act