



STATE OF VERMONT
VERMONT PENSION INVESTMENT COMMISSION

To: House Committee on Government Operations and Military Affairs
From: Eric Henry, Chief Investment Officer
Re: VPIC Opposition to S.42
Date: April 15, 2024

The Vermont Pension Investment Commission (VPIC) shares the legislature's goals of reducing CO2 and other greenhouse emissions, slowing climate change, and expediting the transition to a low-carbon economy but is opposed to S.42 because it will lower investment returns, increase investment expenses, increase VPIC operating expenses, statutorily restrict VPIC's investment opportunities, and expose Commissioners and staff to litigation over future investment and divestment decisions. The basis for this opposition is outlined below:

1. S.42 will restrict access to top-tier private market investment opportunities that have historically provided over 1,000 basis points of excess return over public markets.

Section 1 (a) (3) specifically tasks VPIC with establishing "a long-term goal to divest from any private investments that contain assets in the fossil fuel industry on or before December 31, 2040 if the Commission determines that such divestment is consistent with sound fiduciary practice." While such planning is premised on it being consistent with sound fiduciary practice, we are concerned that legal counsel for the private market partnerships in which we seek to invest would conclude that this language would limit their ability to make future investments in the fossil fuel industry. As a small investor, VPIC does not have the ability to set terms for these private market investments and we are concerned that the general partners would exclude us from their funds and, instead, admit investors that are not subject to such restrictions. Assuring compliance by 2040 would impact 2025 commitments as these funds typically have lives of 12-15 years. If we are unable to access top-tier private market funds, our exposure will gradually amortize over the coming 15 years. As that exposure declines, so too will our expected returns and our ability to support a 7.0% actuarial assumed rate of return (AROR). Our estimates indicate S. 42 as currently drafted would cause a reduction of at least 50 basis points to VPIC's AROR; that equates to an increase in the state's actuarially determined employer contribution to the Vermont State Employees' Retirement System and the Vermont State Teachers' Retirement System of at least \$50 million each year. The Vermont Municipal Employees' Retirement System would see proportionally increased contribution rates.

2. The 2.5% de minimus exemption is large enough to prohibit any immediate forced divestment but would limit future investment opportunities in the energy transition if successful companies prosper. The energy transition is a major investment opportunity

and VPIC has been successful in its early investment therein. Global energy trends such as the proliferation of artificial intelligence, emerging markets transitioning into developed markets, and a continued adoption of electric vehicles present compelling investment opportunities. A broad limit on exposure to fossil fuel companies is likely to limit investments in companies that transition effectively and generate outsized returns.

- 3. Enactment of S.42 would increase VPIC staffing, technology, and custody costs.** We estimate the need for 2-3 additional analysts to monitor the Carbon 200 fossil fuel companies and others for exposure to the fossil fuel industry and prepare necessary legislative reporting. Each analyst would require a Bloomberg terminal to conduct such research and access to our custody systems to assure that the right CUSIP numbers are tracked for statutory compliance. This would increase VPIC operating expenses by \$337,160 and 490,740 per year as outlined below and would be funded ultimately from the three statewide pension plans. Only \$127,000 in additional funding is included in S.42 at this time.

Per person compensation and benefits	\$127,000
Bloomberg terminal	26,580
Annual cost per analyst	\$153,580
Annual cost for two analysts	\$307,160
Annual cost for three analysts	\$460,740
Increased compliance monitoring costs	\$30,000

It is our view that these costs are material to three statewide pension plans.

- 4. Enactment of S.42 would increase VPIC’s investment management expenses by \$1.5 million per year, as outlined below.** Implementation of S.42 would entail movement of \$1.7 billion from the ACWI IMI index to the more expensive Low Carbon Transition index and, similarly, \$254 million from the S&P Equal Weight index. These moves would increase investment management expenses for two funds from \$220,000 to \$1.8 million, a sevenfold increase.

Cost of ACWI IMI index	1 basis point
Cost of S&P Equal Weight index	2 basis points
Cost of Low Carbon Transition index	9 basis points

- 5. The indemnification language of section of Section 3 provides insufficient litigation protection to Commissioners and staff.** VPIC submitted language for consideration but it

is not included in the current draft of S.42. Further information can be seen in the attached analysis by VPIC legal consultant Robert Klausner. We suggest deleting Section 3 and amending Section 4 to read as follows: *This act does not create a private cause of action, at law or equity, against any person, natural or corporate, or against VPIC by any individual, corporation, or governmental entity for violations of this act, including but not limited to breach of fiduciary duty, for declaratory or injunctive relief, or for a violation of any constitutional, statutory, or regulatory requirement in connection with any action, inaction, decision, divestment, investment, financial company communication, any official communication, report or other determination made or taken in connection with this act. The courts of Vermont shall have no jurisdiction to consider any such claims. A person or entity who files any claim prohibited by this section shall be liable for attorney fees and costs.*

- 6. It is VPIC's view that we cannot successfully engage with companies and divest of them at the same time.** A witness at last week's S.42 hearing indicated that VPIC testified in 2023 that we could successfully engage with companies and divest of them at the same time. This is simply not true. While it is true that holding only a few shares of a company could allow an investor to engage, companies take material institutional investors more seriously than those holding only a few shares. We have a very strong track record of successful engagements and are considered leaders in the industry. We have worked very hard to develop a reputation for being a reasonable, outcome-driven institutional investor. Attempting to engage with only a few shares would damage our reputation and hinder our ability to successfully engage.