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**STATE OF VERMONT**  
**OFFICE OF THE STATE TREASURER**

**TO:** Senator Jeanette White, Chair, Senate Committee on Government Operations  
Representative Donna Sweaney, Chair, House Committee on Government Operations

**FROM:** Beth Pearce, Vermont State Treasurer

**RE:** Vermont Pension Investment Committee (VPIC) Sub-Committee process update

**DATE:** May 3, 2016

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In response to the letter from three members of the Senate Committee on Government Operations sent on March 16, 2016, as well as H.R. 13 as passed by the House, I would like to give an update on the status of our review and analysis of the Vermont Pension Investment Committee's exposure to coal and fossil fuel holdings. The House resolution dealt with the issue of divestment from coal and ExxonMobil while the Senate letter also asked us to investigate divestment from fossil fuels, if consistent with our fiduciary responsibilities.

In response, a Sub-Committee has been formed to review, analyze and make recommendations to the full VPIC. The following individuals were appointed to the Sub-Committee by the VPIC Chair:

Tom Golonka (VPIC Chair)  
Beth Pearce (VPIC Vice Chair)  
Linda Deliduka (VPIC Alternate)  
Karen Paul (VPIC Member)  
Roger Dumas (VSERS Chair)  
Jon Harris (VSTRS Chair)  
Peter Amons (VMERS Chair)

Below is a summary of our activities to date and planned next steps.

The Treasurer's Office and the Sub-Committee view this as a collaborative process bringing together stakeholders (employee groups, members of the system, employer groups, and Pension Board Trustees) along with interested parties. Prior to the formation of a Sub-Committee VPIC chair Tom Golonka and I convened a planning meeting on March 18, 2016 to discuss parameters for what a review would encompass. The following stakeholders and interested parties were invited:

350VT, Sierra Club - Vermont Chapter, Vermont Public Interest Research Group, National Wildlife Federation, Vermont Natural Resources Council, Vermont Businesses for Social Responsibility, Vermont Conservation Voters, Vermont State Employees' Association, Vermont State Employees' Association Retirees' Chapter, Vermont Retired State Employees Association, Vermont National Education Association, Vermont League Of Cities And Towns, Professional Firefighters of Vermont, Vermont Troopers' Association, A Representative for corporate clients, AFSCME Council 93, A

Representative for the American Petroleum Institute, Vermont State Labor Council—AFL-CIO, Institute for Energy and the Environment at Vermont Law School, Vermont Retired Teachers' Association.

Over 30 individuals participated in the planning meeting. In addition, Treasurer's Office staff met separately with various groups to obtain input.

An audio of the planning meeting, as well as all subsequent Sub-Committee meetings, have been posted to the Treasurer's Web site, along with any meeting materials. I think you will find that the Sub-Committee has engaged all stakeholders and interested parties in the process.

The first formal meeting of the Sub-Committee was held on April 13<sup>th</sup>. The Sub-Committee elected Tom Golonka as chair. The Sub-Committee also decided, based on materials provided through the planning meeting and dialogue with interested parties, to pursue three tracks of review: The ExxonMobil holding; coal holdings (various definitions); and the larger case of fossil fuels in general. A series of subjects for the Sub-Committee to cover over the course of its review was also outlined. A chart detailing these is attached.

The April 13<sup>th</sup> meeting also included an overview of the investment portfolio provided by Matt Considine, the Director of Investments in the Treasurer's Office, as a context for our discussions. The Sub-Committee decided that the next meeting should include an overview of fiduciary responsibilities as they relate to pension investments and opted to create an expert panel to address this at the next meeting. Eric Becker of Clean Yield Asset Management supplied the names of two experts and the Treasurer's Office and VPIC chair identified two participants. The panel was held at the second subcommittee meeting on April 26, 2016. I encourage you to review the minutes, audio recordings, and all attachments from that meeting on our website at:

<http://www.vermonttreasurer.gov/retirement/vpic>. There was consensus that Environmental, Social, and Governance (ESG) factors can be appropriate investment considerations as a part of the fiduciary duty process when considering risk and return of competing investment choices. As a result of the panel discussion, several recommendations were provided as they relate to the (ESG) Policy. These recommendations will be further developed and discussed at a subsequent Sub-Committee meeting.

Also, at the April 13<sup>th</sup> meeting, the group discussed employing outside consultants to perform the formal study of the proposed three tracks of interest. The Sub-Committee recommended a collaborative consensus study rather than competing studies. The Sub-Committee determined that its current advisor, NEPC LLC, would participate in partnership with a second firm. The second firm would be selected from a list produced by divestment advocates. We expect a collaborative approach and anticipate joint recommendations.

The Treasurer's Office has identified \$40,000 of non-pension funds within its FY16 budget to contribute to fund the study and the activities of the Sub-Committee.

While the scope of the study will encompass three tracks, recent market developments have prompted the Treasurer's Office to propose to the Sub-Committee that it fast track a review of the coal sector.

In testimony provided in February to the Senate Committee on Government Operations, both the Director of Investments and I stated that coal was likely to be removed from the portfolio over time. Specifically, my testimony stated:

“It is probable that the market will address this (*coal*)... Through rebalancing, our index funds stay in sync with the characteristics of the appropriate index. As the market cap of thermal coal companies declines, their weighting in the index will become smaller. The index eventually removes stocks that no longer meet minimum market cap requirements. I suspect that thermal coal may be removed completely from the index in the near future[...].”

The attached graphs illustrate this trend and it is evident in the VPIC portfolio. As of the beginning of May, the separately managed equity strategies within the VPIC portfolio no longer have coal positions (using the California/thermal coal definition as well as the broader GIC definition). VPIC strategies have incorporated these market trends noted above.

Due to this development, the joint study should give first priority to the analysis of coal as it relates to separately managed accounts. This would encompass the feasibility, incorporating due considerations of cost to the portfolio, of various alternative strategies to minimize the likelihood or eliminate coal from the separately managed stocks on a go-forward basis. The Sub-Committee will look to see what strategies could be employed to accomplish this, consistent with VPIC's obligations to the members and beneficiaries of the participating retirement systems and with the standard of care established by the prudent investor rule, and at the same time consistent with Vermont values.

The Sub-Committee will, of course, also continue to review the remaining tracks (ExxonMobil and fossil-fuels), and issues surrounding our comingled investment vehicles for all tracks, with the same due diligence and thorough study, and with care and duty to the members of the system.

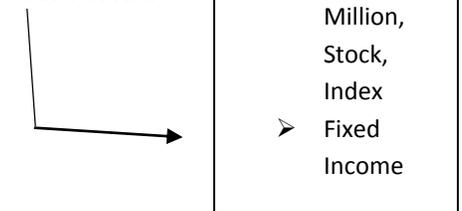
At this time, I and the Chair expect to meet with interested parties and stakeholders to further define the scope of a study prior to the next Sub-Committee meeting, to be scheduled in May. Once we have hired a supplemental advisor to work with NEPC we will better be able to estimate a timeline for completion of a study.

When this process started I committed to a thoughtful, thorough, and transparent approach that was consistent with our fiduciary responsibilities to the 50,000 active, vested, and retired members of the retirement systems. I believe we have fulfilled our promise and will continue to do so. VPIC and the Treasurer's Office remain committed to an engaged process that places the financial integrity of the system and its responsibility to its members and taxpayers as our first priority.

March 18, 2016

VPIC Subcommittee Planning Meeting – Suggestions from the meeting

<u>Subjects</u>
ESG/ Constructive Engagement
Indexing
Comingled vs. Separate
Fees
Fiduciary
Constructive Engagement
Review of studies NEPC, Treasurer’s Office, other states/municipalities, & third party
Slippery Slope, or are they opportunities → <i>(incremental)</i>
Alternatives to divestment
Alternative vehicles <ul style="list-style-type: none"> <li>➤ Substitute classes</li> <li>➤ Cost/Benefit</li> <li>➤ Sector</li> </ul> <div style="display: inline-block; border: 1px solid black; padding: 5px; margin-left: 100px;">Risk</div>
Timeframe—investments

<u>Scope</u>
Coal Definition <i>(Carbon Tracker, California, or GIC)</i> > California 
<div style="border: 1px solid black; padding: 5px; display: inline-block;"> <ul style="list-style-type: none"> <li>➤ Carbon Tracker</li> <li>➤ \$600, Index</li> <li>➤ \$1.1 Million, Stock, Index</li> <li>➤ Fixed Income</li> </ul> </div>
ExxonMobil
Fossil Fuels—Carbon Tracker
Secondary uses?
<ol style="list-style-type: none"> <li>1. Do they pose financial risk to pension?</li> <li>2. Concurrent by subject</li> <li>3. Risk adjusted return</li> <li>4. Status quo/ Future</li> <li>5. Other definition(s) of risk</li> <li>6. Assess benefit + beneficiaries</li> <li>7. Exxon vs. rest of industry/market</li> <li>8. Unintended consequences</li> </ol>

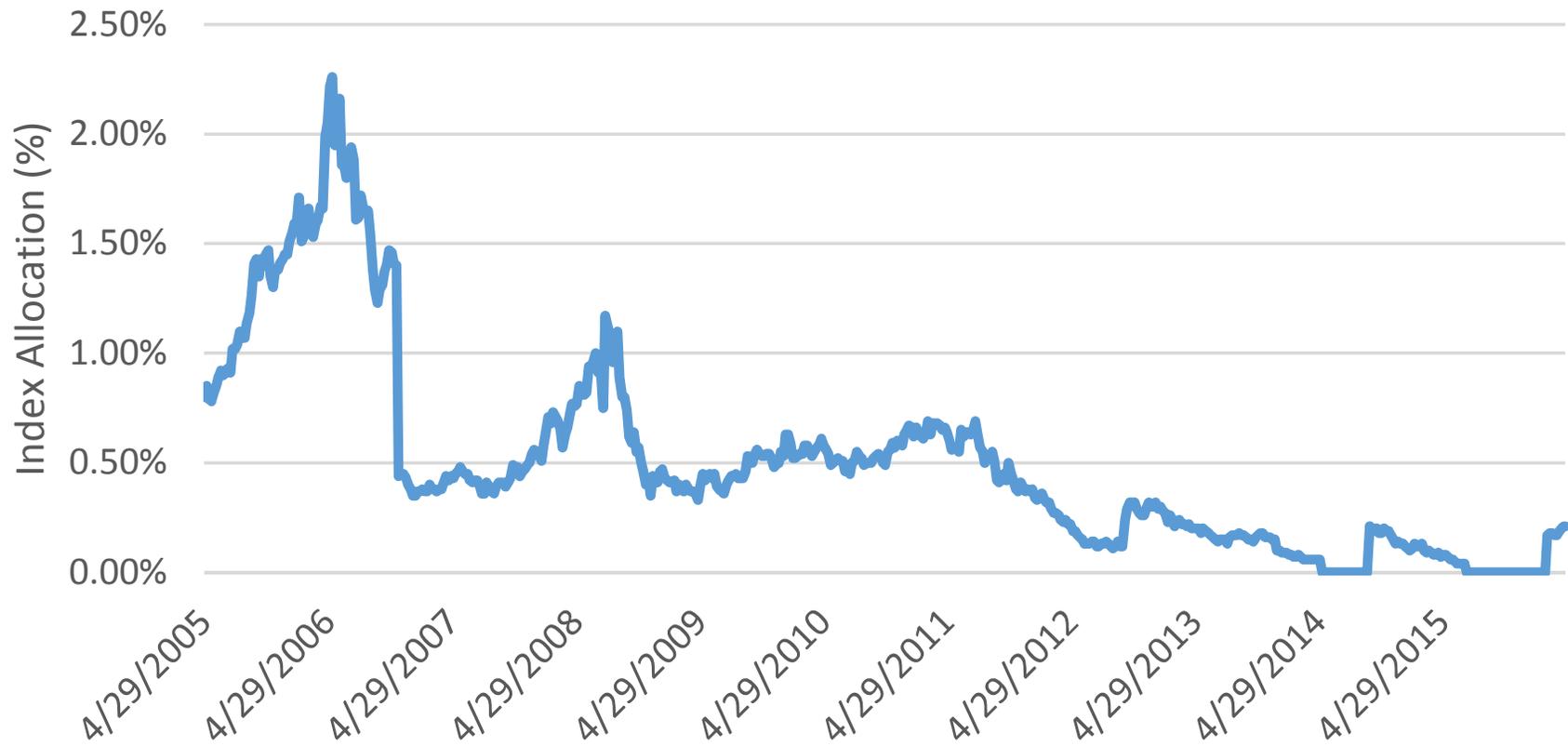
<u>Timeline</u>
Depends on Scope
Cost
Staffing
May 2 <sup>nd</sup> > Status report on process

## S&P 500 COAL&CON FUEL IX



Source: Bloomberg  
Provided to the VPIC Sub-Committee at the April 26, 2016 Meeting

## S&P 400 COAL&CON FUEL IX



Source: Bloomberg

Provided to the VPIC Sub-Committee at the April 26, 2016 Meeting