



STATE OF VERMONT
VERMONT PENSION INVESTMENT COMMISSION

To: Representative Michael McCarthy, Chair
House Committee on Government Operations and Military Affairs

From: Thomas J. Golonka, VPIC Chair
Kimberly Gleason, VPIC Vice-Chair

Re: VPIC Comments on S.42

Date: April 7, 2023

We are writing to express the Vermont Pension Investment Commission's (VPIC's) opposition to S.42, as passed by the Senate, regarding the divestment of State pension funds of investments in the fossil fuel industry as it risks reduced investment returns, increases the State's annual actuarially determined employer contribution (ADEC), increases contribution rates for the Vermont Municipal Employees Retirement System (VMERS), and creates exposure to a breach of fiduciary duty claims.

Section 1 (c) of S.42 calls for VPIC to study its carbon footprint and we support that idea. Absent any legislative mandate, VPIC has for many years now aggressively acted to reduce CO2 emissions. We intend to continue to support and participate in all strategies that address the universal problem of climate change while still meeting our paramount goal of providing fiduciary security for our retirees, the state and local governments, and their employees. We provided written and oral testimony on our many successes in direct engagement through our proxy votes to reduce emissions and promote responsible corporate behavior, while simultaneously maximizing returns and managing risk, complexity, liquidity, and costs to taxpayers. Through our proxy votes, we have negotiated reductions in carbon emissions at some of the largest public oil and gas companies held in the VPIC portfolio. Further, we have seeded a \$200 million low-carbon transition readiness global index fund and committed \$15 million to seed a net zero infrastructure fund. S.42 would silence our voice with these companies and limit our ability to influence climate change—ultimately reducing VPIC's impact on climate work.

S.42 requires VPIC to divest all fossil fuel companies and sets an abrupt timeframe for doing so without a full understanding of the issues and opportunity costs. We support conducting a comprehensive study that helps develop a thoughtful plan forward to reduce VPIC's carbon footprint but also quantifies shareholder engagement impacts and the financial impacts of divesting from fossil fuels. VPIC opposes setting specific divestment mandates and timelines in the absence of the findings of a comprehensive study.

We have been clear that prohibiting any investments in fossil fuel companies would preclude future commitments from private infrastructure, private credit, and top-performing private equity funds which in turn would mandate a reduction in the actuarially assumed rate of return of 50

basis points or more. Segal, the pension plans' actuary, has indicated that each 50-basis point reduction will increase the State's actuarially determined employer contribution (ADEC) by \$50 million or more per year and increase VMERS' contribution rates for both employees and employers.

S.42 is contradictory in its divestment mandate. Sections of S.42 mandate a full divestment of fossil fuel companies while simultaneously allowing VPIC to ignore the divestment mandate if not deemed consistent with fiduciary duty. VPIC is concerned that this contradiction will inevitably bring future legal challenges to our investment decisions and undermine our fiduciary obligations to the pension beneficiaries.

VPIC's external legal consultant and advisor shares the Commission's concerns over future challenges of breach of fiduciary duty as outlined in his recent memo to VPIC. "The defense [of a challenge] will be complicated by the fact that pursuit of an investment practice other than in the best interests of the participant is the classic definition of breach of fiduciary duty...To follow the Prudent Investor Act, VPIC would have to violate S.42. If it follows S.42, it violates the Prudent Investor Act. To expect staff or commissioners to take that risk with uncertain legal protection should give a prudent person pause for thought...In Texas Government Code Chapter 809, pension funds are directed to divest companies that boycott fossil fuels. To protect the pension funds, Chapter 809 expressly prohibits causes of action against any entity or person for following the statute and guarantees absolute immunity for trustees and staff. Lastly, it provides that in the case of conflict with the Texas Uniform Prudent Investor Act (which is the same as Vermont's and found in Chapter 117, Texas Property Code) the entity's non-compliance with the divestment will be excused. None of these protections are found in S.42."

VPIC respectfully suggests the following adjustments to S.42:

1. Clearly exempt all private market investments until completion of the study. Doing so will allow the three statewide pension plans to continue to capture the illiquidity premium and avoid significant increases of more than \$50 million annually in the State's ADEC payments and VMERS' contribution rates.
2. Maintain the de minimus standard indefinitely. Doing so will avoid significant cost increases in VPIC's public market investments by allowing our indexing strategies to continue. VPIC can report annually on the investment thesis to hold the positions as part of the de minimus standard.
3. Insert language to clearly protect VPIC members from breach of fiduciary duty challenges similar to language used in Texas's divestment bill.
4. Develop through a comprehensive study a plan for the portfolio to reach net zero, using divestment and other means, with science-based timelines and targets. Doing so would allow for the Commissioners to meet their fiduciary duty to participants in consideration of the costs and complexities involved in a just transition to a low carbon economy.
5. Clearly exempt holdings in companies with which we are engaging. Doing so allows VPIC to continue its successful track record in fostering responsible corporate behavior and reducing CO2 emissions.