VERMONT LEGISLATIVE
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Fiscal Note
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S.42 – An act relating to divestment of State pension funds of investments in the fossil fuel industry

As Recommended by the Senate Committee on Appropriations[1]

Bill Summary

This bill, as recommended by the Senate Committee on Appropriations, would require the Vermont Pension Investment Commission (VPIC) to review the extent to which the assets of Vermont's three statewide pension systems are invested in stocks, securities, or other obligations of fossil fuel companies, and develop a plan to divest such holdings on or before December 31, 2030. While private investments and de minimis exposure (less than two percent of total invested assets) to fossil fuels are exempt from the 2030 divestment time frame, the bill also contains legislative intent to divest *all* pension holdings from fossil fuels by December 31, 2040.

S.42 has an expected $100,000 cost in FY 2024 to fund an asset review and divestment plan by VPIC.

S.42, as recommended, contains a $127,000 appropriation to VPIC in FY 2024 from pension fund assets to establish one additional position to meet the review, planning, and reporting requirements of the bill.

Fiscal Impact

S.42, as recommended:

- Includes a $127,000 FY 2024 appropriation to VPIC, paid proportionally from the three retirement systems, to fund one new staff position.
- Authorizes two legislative committees to meet up to one time each when the General Assembly is not in session to review the divestment plan, which could result in a cost of up to $4,000 to the legislative budget in FY 2025.

As introduced, S.42 included a $100,000 General Fund appropriation in FY 2024 to VPIC to develop the asset review, divestment plan, and initial report required by the bill. The report of the Senate Committee on Appropriations proposes to remove this appropriation from the bill.[2]

[1]As recommended by the Senate Committee on Appropriations: https://legislature.vermont.gov/Documents/2024/WorkGroups/Senate%20Appropriations/Bills/S.42/Drafts,%20Amendments,%20and%20Legal%20Documents/S.42~Rebecca%20Wasserman~%20Draft%201.1,%203-23-2023%20-%20Senate%20Appropriations%20Amendment%20~3-23-2023.pdf
Link to bill: https://legislature.vermont.gov/bill/status/2024/S.42
Link to Report of Senate Committee on Government Operations: https://legislature.vermont.gov/Documents/2024/WorkGroups/Senate%20Appropriations/Bills/S.42/Drafts,%20Amendments,%20and%20Legal%20Documents/S.42~Rebecca%20Wasserman~%20Draft%201.7,%203-17-2023~3-22-2023.pdf
[2] Proposed one-time appropriations are often amended out of specific bills so they can instead be reflected in the appropriations bill ("Big Bill").

Background and Details

VPIC is an independent, 9-member commission responsible for investing the assets of Vermont's three major statewide pension systems – the State Employees' Retirement System (VSERS), State Teachers' Retirement System (VSTRS), and Municipal Employees' Retirement System (VMERS).[3] At the end of FY 2022, the market value of these assets totaled $5.462 billion.

VPIC members have a fiduciary responsibility to the retirement system participants. Statute requires VPIC to "strive to maximize total return on investment, within acceptable levels of risk for public retirement systems, in accordance with the standards of care established by the prudent investor rule under 14A V.S.A. § 902."[4]

The General Assembly's stated legislative intent in S.42 (as recommended) is for VPIC, consistent with sound fiduciary practice and subject to any exceptions, to:

- Divest the holdings of Vermont's three statewide retirement systems from the fossil fuel industry.
- Establish 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 VPIC determines that such divestment is consistent with sound fiduciary practice*. The report of the Senate Committee on Appropriations would further articulate the legislative intent that VPIC include consideration of any expected increased funding requirements for the actuarially determined employer contribution (ADEC) and administrative costs as part of its divestment plans.

Asset Review and Divestment Plan

S.42 would require VPIC (in consultation with the State Treasurer) to:

- On or before December 15, 2023, **review the carbon footprint** of the holdings of the three retirement systems and submit a report on this review to relevant legislative committees by February 15, 2024.[5]
    - "Carbon footprint" is defined in Section 1 as "the extent to which holdings are invested in stocks securities, or other obligations of any fossil fuel company or any subsidiary, affiliate, or parent of any fossil fuel company."

Exemptions: Until such time as VPIC deems divestment to be prudent and consistent with sound fiduciary practice, S.42, as recommended, exempts from the plan to divest by December 31, 2030:

- De minimis exposure to the stocks, securities, or other obligations of any fossil fuel company or any subsidiary, affiliate, or parent of any fossil fuel company. *De minimis exposure* is defined in Section 1 as "the aggregate amount of all fossil fuel company holdings in the portfolio amounting to less than two percent of the aggregate amount of all funds invested."

- Private investments that contain fossil fuel company stocks, securities, or other obligations of any fossil fuel company or any subsidiary, affiliate, or parent of any fossil fuel company.

As recommended, S.42 does *not* create an explicit exemption for index funds that contain fossil fuel company stocks, securities, or other obligations. However, it is possible that some level of exposure through index funds may fall within the de minimis exemption.

[3] See 3 V.S.A. Ch. 17 and http://vpic.vermont.gov

[4] 3 V.S.A. § 523.

[5] The reporting requirements in S.42 direct reports to the House Committee on Government Operations and Military Affairs, Senate Committee on Government Operations, and Joint Pension Oversight Committee.

- As recommended, S.42 does not explicitly define "fossil fuel company."[6]

- In accordance with sound investment criteria and consistent with fiduciary obligations, **develop a plan to divest any holdings identified in the review on or before December 31, 2030**. VPIC shall submit a report on this divestment plan to relevant legislative committees on or before September 1, 2024. VPIC shall include in the plan consideration of the State's long-term goal of divestment from any investments that are exempt from the plan on or before December 31, 2040.

- As part of the divestment plan, VPIC shall include a definition for "fossil fuel company" and a method for determining the metric of the portfolio's carbon footprint that allows for an exemption of private investments for the purpose of determining the de minimis exposure. The report of the Senate Committee on Appropriations would further articulate that VPIC include consideration of any expected increased funding requirements for the actuarially determined employer contribution (ADEC) and administrative costs as part of its divestment plans.

S.42 authorizes the House Committee on Government Operations and Military Affairs and Senate Committee on Government Operations, with approval of the Speaker of the House and President Pro Tempore of the Senate, to each meet up to one time when the General Assembly is not in session to evaluate this divestment plan that is due on or before September 1, 2024. While not explicitly mentioned in this language, the Joint Pension Oversight Committee may also meet at the call of the chair during the off session under its existing authority per 2 V.S.A. § 1001.

Annual Reporting Requirements

Beginning on January 15, 2025, S.42 would require annual reports to relevant legislative committees on the progress of divestment. These reports shall include updates on the composition and percentage of exposure of any investments exempt from the divestment plan, and a summary of the fee impacts and any instance of excessive charges or demands related to the rebalancing of the funds consistent with the implementation of the bill. These annual reports would cease to be required after January 15, 2040.

VPIC would be required to make a final report to the relevant legislative committees on or before January 15, 2041, on the completion of divestment.

Absent supplemental appropriations, any future incremental costs associated with generating these reports would be paid from the VPIC budget, which is supported proportionally by the retirement assets it manages. It is not clear what, if any, additional costs may result from these reporting requirements.

Fiscal Impact

Direct Impacts

As introduced, S.42 contained a $100,000 General Fund appropriation to VPIC in FY 2024 to develop the asset review, divestment plan, and initial report required in the bill. The report of the Senate Committee on Appropriations proposes to remove this appropriation from the bill.

As recommended, S.42 contains a $127,000 appropriation to VPIC in FY 2024 to fund one new staff position to support improvements and efficiencies in the administration of VPIC and to meet the review, planning, and reporting requirements of S.42. This cost would be shared by the three retirement systems in proportion

[6] As introduced, S.42 defined "fossil fuel company" as any company that is among the 200 publicly traded companies with the largest fossil fuel reserves in the world; is among the 30 largest public company owners in the world of coal-fired power plants; has at its core business the construction or operation of fossil fuel infrastructure; has at its core business the exploration, extraction, refining, processing, or distribution of fossil fuels, or; receives more than 50 percent of its gross revenue from companies that meet the criteria listed above. As recommended by the Senate Committee on Government Operations, VPIC is directed to define "fossil fuel company" as part of the required divestment plan.

to the current value of their assets within the VPIC portfolio – 40.86% by VSERS, 44.01% by VSTRS, and 15.13% by VMERS. The cost of supporting this position in future years would be built into the VPIC budget moving forward, with costs similarly shared among the three retirement systems proportionally.

If the two legislative committees each meet once when the General Assembly is not in session to evaluate the divestment plan required to be submitted by September 1, 2024, this would result in a cost to the General Assembly budget of up to $4,000 for per diem, mileage, and meal expenses. This cost would likely occur during FY 2025.

Additional Considerations

As recommended, S.42 would not preclude de minimis exposure (less than two percent of total pension investments) to fossil fuel company investments after 2030. Testimony from VPIC in February 2023 indicated that direct fossil fuel holdings totaled approximately $40 million, or 0.7 percent of all pension investments.[7] This provision would limit VPIC's direct investments in fossil fuel companies while allowing it to continue its shareholder engagement efforts in the near term, which are aimed at getting companies to reduce their carbon emissions.

Under S.42, as recommended by the Senate Committee on Appropriations, VPIC shall consider any expected impacts to ADEC funding requirements and administrative costs as part of its divestment decision-making. While S.42 expresses legislative intent for VPIC to fully divest itself of all fossil fuel holdings (including those that fall within the de minimis exposure and private investment exemptions) by December 31, 2040, VPIC is not *required* to do so if it determines that such divestment is inconsistent with sound fiduciary practice.

Illustration of Possible Impact to Retirement Systems in Response to S.42

While this Fiscal Note does not presume that divestment or S.42 will inherently lead to worse investment performance or a decline in the assumed rate of return, *Tables 1 and 2* are intended to provide context as to how the retirement systems may be impacted in response to investment decisions VPIC *could* face to comply with the stated intent of S.42.

Table 1 provides context for the range of possible actuarial impacts to the two retirement systems funded by the State if the assumed rate of return were to be reduced from 7.0 percent to 6.5 percent in response to higher overall management costs and/or more limited future investment expectations.

Table 1: **Examples of Fiscal Impacts from Lowering the Assumed Rate of Return**

$ millions	**FY 2022 Baseline (7.0%)**	**FY 2022 If 6.5%**	**Change**
VSERS – State Employees			
Actuarial Accrued Liability	$3,444.1	$3,653.7	+$209.6
Funded Percentage (AVA basis)	69.9%	65.8%	-4.1%
Total Normal Cost	$74.1	$83.1	+$9.0
FY 2024 ADEC*	$121.9	$147.1	+$25.2
VSTRS - Teachers			
Actuarial Accrued Liability	$4,289.8	$4,548.3	+ $258.5
Funded Percentage (AVA basis)	57.3%	54.0%	-3.3%
Total Normal Cost	$79.7	$90.7	+$11.0
FY 2024 ADEC*	$194.3	$223.5	+$29.2

(*) ADEC impact would recur annually, growing in 3% future increments through FY 2038. Estimates from Segal as reported in Golonka testimony, February 16, 2023.

[7] This estimate is based on a point in time and is subject to further revision upon the completion of the investment review required in Section 1. See testimony of Tom Golonka, VPIC Chair, to the Senate Committee on Government Operations. February 16, 2023.
https://legislature.vermont.gov/Documents/2024/WorkGroups/Senate%20Government%20Operations/Bills/S.42/Witness%20Documents/S.42~Thomas%20Golonka~Vermont%20Pension%20Investment%20Commission%20Climate%20Change%20Analysis~2-16-2023.pdf

Lowering the assumed rate of return by 50 basis points would be expected to increase the actuarially determined employer contributions (ADEC) by $25.2 million for VSERS and $29.2 million for VSTRS.[8]

Table 2 illustrates how deviation in investment performance impacts the actuarially determined employer contribution (ADEC). If actual yearly investment returns were to deviate from the 7.0 percent actuarial assumption by 1.0 percent, the ADEC would be impacted by approximately $4.3 million, total, for VSERS and VSTRS.[9]

Table 2: **Examples of Fiscal Impacts from Investment Risk**

$ millions	**VSERS (State Employees)**	**VSTRS (Teachers)**
Impact of 1% Difference in Actual Yearly Investment Return on ADEC* (% of payroll)	0.34%	0.29%
Assumed Covered Payroll (FY 2023)	$604.11	$735.72
Assumed Covered Payroll (FY 2024)	$625.26 (3.5%/year growth)	$757.80 (3%/year growth)
Example of Impact of 1% Deviation on FY 2024 ADEC**	$2.13	$2.20

(*) Disregards impacts of five-year smoothing of investment gains and losses.
(**) ADEC impact would recur annually, growing in 3% future increments through FY 2038. Unfunded liability portion of ADEC would be impacted.
Data on investment return risk from actuarial valuations for FY 2022.

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[8] While an increase in the assumed rate of return is possible, it would run counter to recent trends of most major public pension systems lowering their rates in recent years. In 2020, Vermont lowered its assumed rate of return from 7.5% to 7.0%. According to NASRA, as of November 2022 the median rate of return nationally is 7.0 percent, and the average is 6.93 percent. https://www.nasra.org/latestreturnassumptions

[9] The ADEC for VSERS is paid proportionally by the funds that employ the active members (approximately 40% paid from the General Fund). The VSTRS ADEC (unfunded liability portion) is paid primarily by the General Fund. The VMERS ADEC is paid by participating members and employers, not by the funds of state government.