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March 7, 2023

The Honorable Nick Hoheisel, Chairperson
House Committee on Financial Institutions and Pensions
300 SW 10th Avenue, Room 582-N
Topeka, Kansas 66612

Dear Representative Hoheisel:

SUBJECT: Fiscal Note for HB 2436 by House Committee on Appropriations

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2436 is respectfully submitted to your committee.

HB 2436 would prohibit any state agency, including the Pooled Money Investment Board (PMIB), or any instrumentality of the state from adopting any procurement regulation that would cause a bidder or contactor to be given preferential treatment or be subject to discrimination based on environmental, social and governance (ESG) criteria, unless allowed by law.

The bill would specify that all KPERS investment personnel, including contractors, would be subject to the same fiduciary duties as the KPERS Board of Trustees. A fiduciary could only consider financial factors when discharging duties of the position. All shares held directly or indirectly by KPERS could only be voted in the financial interest of KPERS beneficiaries. Unless no economically practicable alternative would be available, KPERS would be required to:

1. Not grant proxy voting authority to any person who is not part of KPERS, unless the person commits in writing to follow guidelines that match KPERS obligation to act solely upon financial factors;
2. Give preference to a proxy advisor service that commits in writing to engage in voting shares and make recommendations in a strictly fiduciary manner, without consideration of policy objectives that are not the express policy objectives of KPERS;
3. Not entrust assets to a fiduciary, unless the fiduciary commits in writing to following KPERS guidelines when engaging with portfolio companies to act solely upon financial factors and not policy considerations that are not the express policy objectives of KPERS;

4. Have no investment manager or contractor adopt a practice of following the recommendations of a proxy advisor unless the advisor or proxy service provider commits in writing to follow KPERS obligation to act solely upon financial factors; and

5. Tabulate and report annually all proxy votes to the Legislative Coordinating Council, including a vote caption, the KPERS vote, the recommendation of any proxy advisor recommendation which would be posted on the KPERS website for review by the public.

No state agency could share or publish information, adopt policies, rules or regulations, or issue guidelines for ESG criteria that would restrict the ability of any industry to offer products or services. No state agency could require any person or business to adopt or operate in accordance with ESG criteria. The Attorney General would enforce any infractions of the provisions of the bill. In addition to any other remedies available, an investment manager or contractor of KPERS that services as a fiduciary and violates provisions of the bill would be obligated to pay damages to the state in the amount equal to three times all funds paid to the investment manager or contactor by KPERS.

Under current law, no KPERS funds can be invested or reinvested if the sole or primary investment objective is for economic development or social purposes or objectives. HB 2436 would prohibit any funds being invested or reinvested if an investment objective is for economic development or social purposes or objectives.

The enactment of HB 2436 would require additional oversight of investment managers and additional reporting requirements. The agency would need to hire an additional 1.00 FTE Investment Officer for these additional duties at a cost of $165,000 in FY 2024 (including fringe benefits) from the KPERS Fund. In addition, the agency reports that KPERS utilizes more than 99,000 proxy votes each year. To manage these votes, the agency would need to utilize a proxy voting vendor, at an estimated annual cost of approximately $750,000 from the KPERS Fund. Both the cost of the additional FTE position and the contract for the proxy voting vendor would be ongoing annual costs.

KPERS reports that the bill could have an actuarial cost to the retirement system from how the divestment requirements would affect the KPERS assets and future expected investment returns. The agency indicates that the KPERS investment portfolio would have to be restructured because the current investment managers would be disqualified as fiduciaries and replaced by alternative investment managers that would meet the bill's requirements. The initial divestment in private markets is estimated to cost KPERS approximately $1.14 billion from early divestment and could lower the system's funded ratio by 4.0 percent.

In addition, a theoretical restructured investment portfolio of 60.0 percent equities and 40.0 percent bonds would lower expected investment returns by 0.85 percent. This lowered investment return would increase the liabilities of the system, which would increase the unfunded actuarial liability and require increased employer contribution rates. The KPERS actuary estimates for the State/School Group, lowering the expected return by 0.85 percent would increase the unfunded actuarial liability by $2.4 billion and reduce the funded ratio by 6.5 percent. With this scenario, the actuarial required employer contribution rate would increase in FY 2025 from 12.42 percent to 17.61 percent, or 5.19 percentage points. This increase would trigger the statutory cap on annual employer contributions and would limit the increase to 1.2 percentage points, or approximately $62.0 million for the State/School Group.

The cumulative theoretical actuarial effect on KPERS would be a decrease of approximately 10.0 percent to the system's funded ratio, which would be approximately the same as in the system's 2013 actuarial valuation. However, the actual long-term cost to KPERS would depend on the extent of the required divestment and restructuring of the investment portfolio. With a reduction in expected returns of 0.85 percent, the KPERS general investment consultant projects that the investment portfolio returns would reduce by $3.6 billion over the next ten years when compared to the current investment portfolio.

The Department of Administration, Office of Procurement and Contracts indicates that the enactment of the bill would have no fiscal effect. The Office of the Attorney General states that it is unable to estimate a fiscal effect for the agency. The Office of Judicial Administration indicates that the enactment of the bill would have a negligible fiscal effect. The Pooled Money Investment Board reports that the bill would have no fiscal effect. Any fiscal effect associated with HB 2436 is not reflected in *The FY 2024 Governor's Budget Report*.

The League of Kansas Municipalities and the Kansas Association of Counites report that the bill would have no fiscal effect on local governments.

Sincerely,

Adam Proffitt
Director of the Budget

cc: Jarod Waltner, KPERS
Tamara Emery, Department of Administration
Wendi Stark, League of Kansas Municipalities
Jay Hall, Kansas Association of Counties
Scott Miller, Pooled Money Investment Board
John Milburn, Office of the Attorney General
Vicki Jacobsen, Judiciary