LEGISLATIVE FISCAL ESTIMATE

[First Reprint]

SENATE, No. 416

STATE OF NEW JERSEY
220th LEGISLATURE

DATED: JANUARY 23, 2023

SUMMARY

Synopsis:	Prohibits investment by State of pension and annuity funds in, and requires divestment from, 200 largest publicly traded fossil fuel companies.
Type of Impact:	Potential expenditure decrease or increase to the State and local government units.
Agencies Affected:	Department of the Treasury and local government units.

Office of Legislative Services Estimate

Fiscal Impact	**Fiscal Year 2023 & Thereafter**
State and Local Employer Contributions	Potential Decrease or Increase Depending on Investment Performance
State Cost	Indeterminate Increase – Dependent on Costs Related to Implementation

- The Office of Legislative Services (OLS) cannot reliably assess the ramifications on State and local government finances of prohibiting investment of pension and annuity funds in any of the top 200 companies that hold the largest carbon content fossil fuel reserves. The bill has the potential to directly alter pension and annuity investment fund returns either positively or negatively. If the bill does alter investment returns, it could indirectly affect the amount of actuarially determined employer contributions to the funds made by the State and local governments.

- On four grounds, the OLS cannot determine the difference between future pension and annuity fund investment returns with and without the bill's prohibition. First, for reasons stated below, it is unclear to what extent pension and annuity funds are currently placed in investments prohibited by the bill. Second, it is unclear when the Division of Investment in the Department of the Treasury would sell any prohibited holdings, as the bill requires divestment from companies engaged in the mining, extraction, or production of coal within 24 months of the bill's effective date and from all other fossil fuel companies within one year. Third, it would be highly speculative for the OLS to make assumptions on future changes in financial markets and the department's future investment decisions with and without the bill's prohibition. Fourth, it is unclear whether the bill would be fully implemented as it permits the cessation of divestment or reinvestment in previously divested companies under certain circumstances.

- The State will incur additional, indeterminate costs related to implementation of the bill and annual reporting requirements. These may include amounts paid to an outside entity to prepare the report, and any internal costs to the Department of the Treasury.

BILL DESCRIPTION

The bill prohibits the State from investing any assets of any pension or annuity fund under the management of the Division of Investment in the Department of the Treasury in any of the top 200 companies that hold the largest carbon content fossil fuel reserves.

Under the bill, divestment from coal companies is required to be completed within two years, and from all other fossil fuel companies within one year. The bill authorizes the department to cease divestment, or reinvest in previously divested companies, if the department demonstrates that as a direct result of the divestment, the State retirement funds have or will become equal to or less than 99.5 percent of their hypothetical value had no divestment occurred. Finally, the bill requires the State Investment Council and the division to report on the divestment efforts required by the bill within 120 days of the bill's effective date and annually thereafter.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS cannot reliably assess the ramifications on State and local government finances of prohibiting investment of pension and annuity funds in any of the top 200 companies that hold the largest carbon content fossil fuel reserves. The bill has the potential to directly alter pension and annuity fund investment returns either positively or negatively. If the bill does alter investment returns, it could indirectly affect the amount of actuarially determined employer contributions to the funds by the State and local governments.

Conceptual Considerations: The bill's fiscal impact will equal the difference in the pension and annuity funds' future investment performance with and without the bill's prohibition on investments in the top 200 companies that hold the largest carbon content fossil fuel reserves.

The bill will have no impact if investment returns remain identical with and without the bill's prohibition. This scenario might materialize, for example, if the department never intended to invest pension and annuity funds in any of the top 200 companies that hold the largest carbon content fossil fuel reserves with or without the bill's prohibition.

The bill will generate a gain to the pension and annuity funds, and potentially a reduction in State and local government employer contributions thereto, if investment returns were greater with the bill's prohibition than without it. This scenario would materialize if, absent this bill, the department were to invest pension and annuity fund resources in any of the top 200 companies that hold the largest carbon content fossil fuel reserves and if the ensuing returns were inferior to the returns of other investments the department would make with the prohibition in effect.

Conversely, the bill would produce a loss to the pension and annuity funds, and potentially an increase in State and local government employer contributions thereto, if investment returns were smaller with the bill's prohibition than without it. This scenario would materialize if absent this bill the department were to invest pension fund resources in any of the top 200 companies that hold the largest carbon content fossil fuel reserves and if the resultant returns were superior to the returns of other investments the department would make with the prohibition in effect.

Impediments: Four unknown variables preclude the OLS from quantifying the difference between future pension and annuity fund investment returns with and without the bill's prohibition.

First, it is unclear to what extent pension and annuity fund resources are currently placed in investments prohibited by the bill. It may be difficult for the State to identify all investments in prohibited companies with absolute certainty. This is so because of the uncertainty of investing in hedge funds and private equity firms, which generally treat their investments and investment strategies as proprietary information that they do not share with investors. It is therefore possible for the department to have inadvertently placed pension and annuity fund moneys in some of the top 200 companies that hold the largest carbon content fossil fuel reserves through its hedge funds and private equity holdings.

Maine is currently the only state that has enacted legislation requiring its pension system to divest from fossil fuel companies. Maine is required to divest from any company that: (1) is among the 200 publicly traded companies with the largest fossil fuel reserves in the world; (2) is among the 30 largest public company owners in the world of coal-fired power plants; (3) has as its core business the construction or operation of fossil fuel infrastructure; (4) has as its core business the exploration, extraction, refining, processing, or distribution of fossil fuels; or (5) receives more than 50 percent of its gross revenue from companies that satisfy any of the aforementioned requirements. Information on the fiscal impact of this legislation on the Maine Public Employment Retirement System is unavailable at this time. Maine's law requires the divestment to be completed by January 1, 2026. In a news report published in December 2022, the retirement system indicated that about eight percent of its $18 billion portfolio would have to be reallocated to comply with the law. (See https://www.wmtw.com/article/fact-checking-maines-first-in-the-nation-fossil-fuel-divestment-law/42133676).

Second, it is unclear when the department would divest from any prohibited holdings, as the bill requires divestment from companies engaged in the mining, extraction, or production of coal within 24 months of the bill's effective date and from all other fossil fuel companies within one year.

Third, it is unclear whether the bill would be fully implemented, as it permits the department to cease divestment or to reinvest in previously divested companies if the department demonstrates that as a direct result of the divestment, the State's retirement funds have or will become equal to or less than 99.5 percent of their hypothetical value had no divestment occurred.

Fourth, it would be highly speculative for the OLS to make assumptions on future changes in financial markets and the department's future investment decisions with and without the bill's prohibition.

Implementation & Reporting: The bill requires the State Investment Council and the Division of investment to take actions to effectuate the divestments required by the bill. Other statutes establishing investment prohibitions require the retention of an independent research firm to identify companies from which divestment is required in accordance with those laws. While not specifically mandated by the bill, it is conceivable that the department will be required to engage an outside entity to identify all companies from which divestment is required.

Current law prohibits the department from investing the assets of any pension or annuity fund with an equity tie to the governments of Sudan or Iran, and from investing in companies that boycott the products of Israel. In response to a Fiscal Year 2019 OLS Discussion Point, the Department of the Treasury estimated that the total costs of complying with those statutes was about $24.3 million. This included $250,000 in fees paid to consulting firms to identify companies prohibited from investment in accordance with those statutes, and $23.9 million for commissions and market impact costs related to the sale of prohibited securities and the reinvestment of the sale proceeds.

Finally, the bill requires the Division of Investment in the Department of the Treasury and the State Investment Council to submit to the Governor, Legislature, and Attorney General an annual report identifying all investments sold, redeemed, divested, or withdrawn in compliance with the bill, and all prohibited investments from which divestment has not occurred. The bill also mandates the reporting of any cessation of divestment. These reporting requirements are similar to other mandates established in statute for other investment prohibitions. The State will incur ongoing costs related to these reporting requirements. These may include amounts paid to an outside entity to prepare the report, and any internal costs to the department, such as the amount of staff time spent reviewing the report before it is published. Internal costs are generally unquantifiable and may be absorbed into the department's existing budget.

Section: *Revenue, Finance, and Appropriations*

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This legislative fiscal estimate has been produced by the Office of Legislative Services due to the failure of the Executive Branch to respond to our request for a fiscal note.

This fiscal estimate has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).