

LEGISLATIVE FISCAL ESTIMATE
SENATE, No. 857
STATE OF NEW JERSEY
219th LEGISLATURE

DATED: MARCH 16, 2020

SUMMARY

- Synopsis:** Subjects domestic equity investments of the Division of Investment to certain requirements, imposes requirements related to selection of external managers and protection of public sector jobs.
- Type of Impact:** Potential annual expenditure impact to State and local governments.
- Agencies Affected:** Department of the Treasury;
Local subdivisions of State Government.

Office of Legislative Services Estimate

Fiscal Impact	<u>FY 2021 and Thereafter</u>
Annual State Expenditures	Indeterminate Impact
Annual Local Expenditures	Indeterminate Impact

- The Office of Legislative Services (OLS) cannot reliably assess the impact on State and local government finances of requiring pension and annuity fund investments to adhere to the requirements prescribed in the bill.
- The bill does allow for the Director of the Division of Investment and the State Investment Council to take appropriate action to divest from any investment held in violation of the provisions of the bill when efforts to cure the violation are unsuccessful, but the director is not required to divest.
- Therefore, any fiscal impact would depend on future investment decisions by the division and conditions prevailing in financial markets, which the OLS cannot anticipate. In general, any financial gain or loss to the pension funds could ultimately affect the amount of actuarially determined employer contributions to the funds by the State and local governments.

BILL DESCRIPTION

This bill imposes conditions on domestic equity investments in the private real estate, private equity, and private infrastructure asset classes in which the Division of Investment has more than

a 50 percent interest. The bill also imposes requirements related to the protection of public sector jobs and the selection of external managers.

With respect to construction-related activity financed by the division's investments, operators of such activity must use good faith efforts to ensure that responsible contractors are included in the bidding and selection of contractors and subcontractors. A responsible contractor is one which, among other requirements, submits to the property or external manager a responsible contractor self-certification form; provides the Director of the Division of Investment and the external manager with responsible contractor documentation; and pays workers fair wages and fair benefits including employer-supported family health care coverage, pension benefits and apprenticeship training programs.

With respect to long-term operations financed by the division's investments, operators must make a good faith effort to secure an agreement with a bona fide labor organization requesting to enter in to such an agreement solely with respect to such operations in which the labor organization agrees not to strike, picket, boycott, or take economic action against the operations for the duration of the investment.

For similar investments in which the division has a 50 percent or less interest, the bill requires the division to encourage external managers to follow the above mentioned practices and shall give preference in the selection of external managers and placement of additional investments to those which provide the best level of return at an acceptable level of risk and follow such practices.

The bill also prohibits the division from approving any investment that has the potential to eliminate public sector jobs, would pose a reputational risk to the State-administered retirement systems, or could bring public or regulatory scrutiny to the retirement systems.

The bill further requires the director to exercise due diligence in the selection of external managers and requires those managers to be of good character. The managers are to be evaluated for their record of compliance with the policies, including any responsible contractor policies of public pension plans for which they serve or have served as external managers and are required to disclose any instances of non-compliance with such policies and to certify that they and their portfolio companies are not out of compliance with any such policies at the time of any proposed investment by the division. External managers must demonstrate a past practice of, and capacity for, managing risks, including, without limitation, investment risks, interest rate risks, compliance risks, the risk of labor disputes, and the risk of malfeasance or ineptitude on the part of contractors, subcontractors, or operators. Whenever possible, external managers are to be chosen by competitive bidding and evaluated on their likelihood of producing competitive, risk-adjusted rates of return.

Finally, the bill requires the division to annually report on investments held in violation of the requirements of this bill.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS cannot reliably assess the impact on State and local government finances of requiring pension and annuity fund investments to adhere to the requirements prescribed in the bill. The bill does allow for the director and the State Investment Council to take appropriate action to divest

from any investment held in violation of the provisions of the bill when efforts to cure the violation are unsuccessful, but the director is not required to divest. Therefore, any fiscal impact would depend on future investment decisions by the division and conditions prevailing in financial markets, which the OLS cannot anticipate. In general, any financial gain or loss to the pension funds could ultimately affect the amount of actuarially determined employer contributions to the funds by the State and local governments.

The provisions in the bill mostly require external managers to make good faith efforts to ensure responsible contractors are included in the bidding process and to secure an agreement with a bona fide labor organization. These requirements are not expected to significantly affect future investment decisions by the division, since an external manager can make a good faith effort without producing the intended outcome of those requirements. However, the bill does include certain requirements that may directly influence the division's future investment decisions. Specifically, the bill requires external managers to exclude certain contractors and senior officials from bidding on certain contracts if those parties have been disbarred within the last 36 months by a governmental authority for failure to adhere to laws regarding prevailing wage or benefits, restricts the director and the State Investment Council from approving an investment that has the potential to eliminate public sector jobs, pose a reputational risk to the State-administered retirement systems, or bring public or regulatory scrutiny to the retirement systems, and requires prospective external managers to be of good character and demonstrate certain past practices. Those provisions will likely shrink the pool of eligible contractors, external managers, and investments the division can consider.

The bill's ultimate fiscal impact on State and local government expenditures will depend on the difference in the pension and annuity funds' future investment performance with and without the rules and regulations that the bill requires the Division of Investment to adopt. If investment returns to the funds are greater or smaller with the regulations in place, there could potentially be a decrease or increase, respectively, in the State and local government employer contributions made thereto. However, it would be highly speculative for the OLS to make assumptions on the division's future investment decisions and future gyrations in financial markets with and without provisions of the bill in effect. Irrespective of the vagaries of future asset allocations and investment returns, the bill will not compel the divestment of any current domestic equity investments in the private real estate, private equity, and private infrastructure asset classes.

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.).