Department of Legislative Services

Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
Third Reader

House Bill 740 (Delegate Lierman)(Chair, Joint Committee on Pensions)
Appropriations Budget and Taxation

State Retirement and Pension System - Investment Climate Risk - Fiduciary Duties

This bill requires a fiduciary of the State Retirement and Pension System (SRPS), when managing assets of the system and in accordance with statutory fiduciary responsibilities, to consider the potential systemic risks of the impact of climate change on the system's assets. It further specifies requirements for an existing climate risk assessment, the duties of the Chief Investment Officer (CIO), and changes to policies of the SRPS Board of Trustees to address and mitigate climate risk in the system's investment program. **The bill takes effect June 1, 2022.**

Fiscal Summary

State Effect: No effect in FY 2022. Nonbudgeted expenditures increase by $409,300 in FY 2023 for staffing and consulting services to implement the bill; out-year costs reflect ongoing costs and inflation. No material effect on State pension liabilities or contribution rates. No effect on revenues.

(in dollars)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
Revenues	$0	$0	$0	$0	$0
NonBud Exp.	409,300	392,400	398,800	405,000	411,400
Net Effect	($409,300)	($392,400)	($398,800)	($405,000)	($411,400)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: No material effect on pension liabilities or contribution rates for participating governmental units. No effect on local revenues.

Small Business Effect: Minimal.

Analysis

Bill Summary: Consideration of the potential risks of the impact of climate risk by a fiduciary of SRPS includes monitoring net-zero aligned investments and climate solutions to ensure a path to a long-term sustainable portfolio.

The bill incorporates its requirements into existing investment procedures and reporting requirements. A climate risk assessment required by current law must, under the bill, include:

- a review of the total investment portfolio to determine the level of climate risk across industry sectors and asset classes that prioritize high-impact sectors responsible for greenhouse gas emissions;
- identifying investment opportunities in (1) emerging technologies in renewable energy and (2) transitioning, reducing, and eliminating carbon-emitting technology;
- establishing a process for regular reassessment of the potential systemic risks of the impact of climate change on the system's assets; and
- utilization of the best data and practices available in current science, investment strategies, and climate risk analysis.

Based on the information in the climate risk assessment, the CIO must review and manage the system's assets and may choose to invest or divest funds. The CIO must also:

- identify environmentally sustainable investment opportunities to support a low-carbon economy;
- develop transition assessments relating to investments in high-impact sectors;
- evaluate whether internal and external investment managers are taking steps to transition to a more sustainable business model; and
- work with specified investment professionals to identify, analyze, define, and prioritize asset-class specific metrics and minimum standards to evaluate transition readiness and resiliency for companies in high-impact sectors.

The policies of the SRPS board must address and mitigate climate risk through (1) direct engagement with managers, brokers, or other entities; (2) proxy voting; (3) a periodic review and assessment of the effectiveness of procedures used for direct engagement and proxy voting; and (4) to the extent practicable, the establishment of a specified panel of experts.

The SRPS board or any other fiduciary may not be held liable for any actions taken or decisions made in good faith to comply with the bill's requirements. Nothing in the bill requires the SRPS board or any other fiduciary to take actions unless they determine, in good faith, that the action is consistent with their fiduciary responsibilities.

Current Law:

Fiduciary Duties

A fiduciary of the SRPS system is defined as (1) a member of the Board of Trustees; (2) a member of the Investment Committee or other specified committees; or (3) an employee of the State Retirement Agency (SRA) who exercises any discretionary authority or control over the management of the system or its assets.

A fiduciary must discharge his or her duties solely in the interest of the participants and:

- for the exclusive purposes of providing benefits to the participants and for reasonable expenses;
- with the care, skill, prudence, and diligence under circumstances, then prevailing, that a prudent person acting in a like capacity and familiar with such matters would use;
- by diversifying investments so as to minimize the risk of large losses, unless it is clearly prudent not to do so; and
- in accordance with the laws, documents, and instruments governing the system.

Climate Risk Assessment

Consistent with its fiduciary duties, the SRPS board must include policies in the investment policy manual regarding risk management, including climate risks, in the investment of system assets. The policies must address (1) investment principles, guidelines, and policies that govern the selection and retention of investments, including proxy voting and engagement guidelines and (2) a policy that proxy votes and sample due diligence questionnaires for prospective managers be published on SRA’s website.

Also consistent with its fiduciary duties, by January 31 of each year, the SRPS board must submit a report on the risk assessment, including climate risk, to the General Assembly. SRA must post a report about the risk assessment on its website.

Investment Division

Chapters 727 and 728 of 2018 gave the SRPS board independent authority to create positions for SRA’s Investment Division and to set compensation for employees of the division. It also made all expenses of the division nonbudgeted (paid out of the pension trust fund instead of SRA's operating budget).

State Expenditures: SRA advises that it intends to hire a managing director for environmental, social, and governance (ESG) standards and a corporate governance analyst to help implement the bill's requirements. However, SRA further advises that only a portion of their time will be devoted to the bill, with the remainder dedicated to other related responsibilities. In addition, SRA requires additional consulting and data analytics services to comply with the bill's requirements. Therefore, nonbudgeted expenditures by SRA increase by $409,301 in fiscal 2023, which accounts for a 30-day start-up delay from the bill's June 1, 2022 effective date. This estimate reflects the cost of hiring an ESG managing director (one-third time) and a corporate governance analyst (half-time) as well as consulting and data analytics services needed to implement the bill. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Part-time Positions	2
Salaries and Fringe Benefits	$195,325
Consulting and Analytics	200,000
Other Operating Expenses	13,976
Total FY 2023 State Expenditures	**$409,301**

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

These nonbudgeted expenditures are paid from the pension trust fund and, therefore, reduce the system's total assets. However, a reduction of this limited magnitude does not have a material effect on the system's unfunded liabilities (currently approximately $20 billion) and, therefore, does not have a measurable effect on State pension contributions.

Additional Information

Prior Introductions: None.

Designated Cross File: SB 566 (Senator Elfreth)(Chair, Joint Committee on Pensions) - Budget and Taxation.

Information Source(s): State Retirement Agency; Office of the State Treasurer; Department of Legislative Services

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