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Testimony for House Bill 533
State Government – Prevention of Genocide and Crimes Against Humanity and the Commission on
Genocide Prevention
House Health and Government Operations Committee
February 17, 2021
1:30 P.M.

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Chief Investment Officer
State Retirement Agency

The Board of Trustees for the State Retirement and Pension System (System) wishes to express its support, with amendments, to House Bill 533, State Government – Prevention of Genocide and Crimes Against Humanity and the Commission on Genocide Prevention.

House Bill 533 would require the Board of Trustees (Board) to direct the Investment Committee to vote in favor of shareholder resolutions that ask companies in which the System holds shares to adopt a policy of refusing to do business with governments engaged in genocide or crimes against humanity. The Investment Committee is also required to report, annually, to the Board and the State Treasurer regarding the use of shareholder advocacy with companies in which the State invests to persuade those companies to adopt and implement a policy of refusing to do business with governments engaged in genocide or crimes against humanity. This proposed legislation also establishes a Commission of members including the Governor, one State senator, one State delegate, the Attorney General, the State Treasurer, and two members of the public. In part, the Commission is charged with researching governments that are committing genocide or crimes against humanity and holding periodic hearings on the Board's implementation of the provisions of this legislation. The Board is concerned that in its current posture, House Bill 533 conflicts with the fiduciary duties applicable to the Board and other System fiduciaries under State and federal law.

In accordance with § 21-203 of the State Personnel and Pensions Article, the members of the Board and Investment Committee are fiduciaries of the System, and as such are required to discharge their duties "solely in the interest of the participants" and "for the exclusive purposes of providing benefits to the participants." This provision is very similar to provisions governing fiduciary standards for ERISA plans. Consequently, the Department of Labor (DOL) interpretations of ERISA provide useful guidance to the System with regard to issues addressing fiduciary standards. The DOL has issued regulations specifying that with respect to shares of stock, the fiduciary duty to manage plan assets includes the management of shareholder rights applicable to those shares, such as the right to vote proxies. *See* 29 C.F.R. §2550.404a-1(e). The DOL regulations provide that when deciding whether to vote proxies, fiduciaries must carry out their duties prudently and solely in the interests of the participants, for the exclusive purpose of providing benefits to participants and defraying the reasonable expenses of administering the plan. Moreover, fiduciaries may not subordinate the interest of participants in their retirement income to unrelated

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objectives. Among other requirements, the DOL regulations provide that when deciding whether to exercise shareholder rights and when exercising them, ERISA plan fiduciaries must: (1) act solely in accordance with the economic interest of the plan and its participants; (2) consider any costs involved; (3) not subordinate the participants' economic interests in their retirement income to non-pecuniary objectives; and (4) evaluate material facts that form the basis for any particular proxy vote. Therefore, "the focus of plan fiduciaries on the plan's financial returns and risk to beneficiaries must be paramount."

We believe that because provisions of House Bill 533 *require* the Board to direct its Investment Committee to ensure that any shares held by the System are voted in favor of shareholder resolutions that ask the company to adopt a policy of refusing to do business with governments engaged in genocide or crimes of humanity, this could present situations where the Board would be acting in a manner inconsistent with the exclusive benefit rule and the fiduciary duties applicable to the System's fiduciaries. Such actions would conflict with State law, as well as federal law applicable to the System as a qualified pension plan under 401(a) and 414(d) of the IRC.

Members of the Health and Government Operations Committee should understand that the provisions of the State Personnel and Pensions Article and federal law that address the fiduciary duties of the Board would not preclude it from voting in favor of the types of shareholder resolutions described in House Bill 533, so long as voting in favor of any such resolutions is consistent with and does not violate the Board's fiduciary duty. Accordingly, we would recommend amending House Bill 533 to include language that the Board shall act in good faith and consistent with its fiduciary duties when carrying out the provisions of the bill, and shall not act unless the Board determines in good faith that the action is consistent with its fiduciary duties. Additionally, we would recommend adding language that would provide that the Board, or any other fiduciaries of the several systems, may not be held liable for any actions taken or decisions made in good faith for the purposes of complying with the provisions of the bill.

This issue of fiduciary duty has been addressed in the past through several bills passed by the legislature. Chapter 342 of the Acts of 2008 requires the Board to notify any company whose shares are held in an actively traded separate account in its portfolio that is doing business in either Iran or Sudan that the Board will divest all holdings in the company unless the company releases a plan to cease its business with Iran or Sudan within one year. Chapter 342 specifically requires the Board to act in good faith and in a manner consistent with its fiduciary responsibilities in carrying out the bill's divestment requirement. Provisions of the Chapter 342 also provide that the Board is inured against liability associated with actions made in good faith to comply with the Act. Chapter 459 of the Acts of 2016 authorizes the Board to enter into an agreement with the Maryland Technology Development Corporation or another entity to make and manage investments on behalf of the Board in private equity and venture capital in the State, provided the investments are consistent with, and do not compromise or conflict with, the Board's fiduciary duties. Most recently, Chapter 769 of the Acts of 2018 requires the Board, consistent with its fiduciary duties, to adopt policies regarding the management of risk, including climate risks, in the investment of system assets.

House Bill 533 also establishes a Commission on Genocide Prevention, that is comprised of: (1) the Governor, or the Governor's designee; (2) one member of the Senate of Maryland; (3) one member of the House of Delegates; (4) the Attorney General, or the Attorney General's designee; (5) the State Treasurer, or the State Treasurer's designee; and (6) two members appointed by the Governor. One of the duties of the Commission prescribed under the provisions of the bill would be to hold periodic hearings on the implementation of provisions of the bill that relate to the Board and the System. Beyond this, the bill is silent with regard to what the hearings would entail and what authority, if any, the Commission would

have to direct the Board to take certain actions when implementing the provisions of House Bill 533. There is a concern that if the Commission were to seek to direct the Board to take certain actions, it would not be doing so in a capacity as a fiduciary to the System. Because of this, we would recommend removing this provision from the bill. In its place, we would recommend amending the bill to direct the Chief Investment Officer to report annually to the Joint Committee on Pensions the Board's use of shareholder advocacy with companies in which the Board invests to persuade those companies to adopt and implement a policy of refusing to do business with governments engaging in genocide or crimes against humanity.

Finally, we would recommend two additional technical amendments. The Committee should be aware that the Board currently has a proxy voting policy included in its investment policy manual. This policy was recommended to the Board by the Investment Committee. In light of this, we would recommend amending the bill to provide that instead of the Board directing the Investment Committee to take certain actions to comply with the provisions of the bill, the Board, based on the recommendations of the Investment Committee, shall adopt and implement a policy within its investment policy manual that would amend its current proxy voting policy and explicitly address the concerns of the bill. The second technical amendment we would recommend addresses the types of proxy ballots that the Board votes. Specifically, the Board only votes proxy ballots for shares held in separate accounts; it does not vote proxies for shares held in commingled accounts. Accordingly, we would recommend adding a definition that provides that for purposes of the provisions addressing the System in House Bill 533, "shares" shall only include publicly traded shares of investments that are held in separate accounts by the System.

We appreciate being given the opportunity to support House Bill 533 with amendments. We also wish to thank the sponsor of the bill for working with the State Retirement Agency to address the issues we have raised in our testimony. The Board of Trustees and the Agency stand ready to provide any further information or services the Committee may need.