

March 7, 2023

The Honorable Mike Thompson, Chairperson  
Senate Committee on Federal and State Affairs  
300 SW 10th Avenue, Room 144-S  
Topeka, Kansas 66612

Dear Senator Thompson:

**SUBJECT:** Fiscal Note for SB 224 by Senate Committee on Federal and State Affairs

In accordance with KSA 75-3715a, the following fiscal note concerning SB 224 is respectfully submitted to your committee.

SB 224 would enact the Kansas Protection of Pensions and Businesses Against Ideological Interference Act. The bill would require the State Treasurer to prepare, maintain, and provide to the KPERS Board of Trustees a list of all financial companies that engage in ideological boycotts. The State Treasurer may rely on publicly available information regarding financial companies and request written verification from a financial company that the company does not engage in ideological boycotts. A financial company that fails to provide to the State Treasurer a written verification before day 31 of receiving the request would be presumed to be engaged in an ideological boycott.

For any financial company that the State Treasurer determines is engaged in an ideological boycott, the State Treasurer would be required to send a written notice at least 45 days before including the company on the list. The bill would outline the requirements of the notice. The State Treasurer would be required to update the list annually, or more often as deemed necessary, but not more often than quarterly.

Not later than the 30th day after the date that the KPERS Board of Directors would receive the list from the State Treasurer, the Board would notify the State Treasurer of the listed financial companies that KPERS owns holdings, either directly or indirectly. The bill would provide a procedure for the Board to notify a financial company that it is on the list, along with a warning that it may become subject to divestment by the Board. Not later than the 90th day after it receives a notice, the financial company would be required to cease engaging in ideological boycotts to avoid divestment by the Board. The bill would provide a procedure to remove the financial company to be removed from the list maintained by the State Treasurer.

If the financial company would continue to engage in ideological boycotts, the Board would be required to divest all publicly traded securities of the financial company, with certain exceptions. The Board would be required to divest at least 50.0 percent of the assets no later than the 180th day after the date the financial company receives notice by the Board, unless the Board determines that a later date would be more prudent. In addition, the Board would be required to divest in 100.0 percent of assets no later than the 360th day after the notice by the Board. The Board may delay the schedule of divestment, only to the extent that a good faith judgement that the divestment from the financial company would likely result in a loss in value or a benchmark deviation. If the Board would delay the schedule for divestment, the bill would require the Board to make a report to the State Treasurer, the Legislature, and the Attorney General.

The Board would be required to divest from any indirect holdings in actively or passively managed investment funds or private equity funds containing listed financial companies. The Board would be required to submit letters to the managers of each investment fund containing listed financial companies requesting that they remove the financial companies from the fund or create a similar actively or passively managed fund with indirect holdings without any listed financial companies. If a manager would create a similar fund with substantially the same management fees and substantially the same level of investment risk and anticipated return, the Board may replace all applicable investments with investments in the similar fund in a time frame consistent with prudent fiduciary standards but not later than the 450th day after the date the fund is created. If a manager does not create a similar fund, the Board would be required to divest from the indirect holdings in actively or passively managed investment funds or private equity funds.

The Board may cease divesting from one or more listed financial companies only if clear and convincing evidence shows that: (1) the system has suffered or will suffer a greater than 25.0 percent loss in hypothetical value of all assets under management by the KPERS system as a result of the divestment; or (2) an individual portfolio that uses a benchmark-aware strategy would be subject to an aggregate expected deviation from its benchmark of greater than 25.0 percent as a result of the divestment. Before ceasing divestment, the Board would be required to provide a written report to the State Treasurer, the Legislature, and the Attorney General.

On or before the first day of each regular legislative session, the Board would be required to file a report with the Treasurer, the Legislature, and the Attorney General that contains a list of all securities divested in compliance with the bill, as well as all prohibited investments, and any indirect investment changes made. The Attorney General may bring any action necessary to enforce the provisions of the bill and to investigate any potential violations.

In addition, the Board could not designate a bank to receive deposit of state funds in operating accounts or investment accounts if the bank has been listed by the State Treasurer as a restricted financial institution. Any agreement awarding the deposit of state moneys in operating accounts or investment accounts on or after July 1, 2024, would be required to comply with the provisions of the bill.

On or before July 1, 2024, the State Treasurer would be required to prepare and maintain a list of financial institutions that have assets of \$20.0 billion or greater and that are engaged in ideological boycott on the agency's website, as well as submit a copy of the list to the Governor, the Attorney General, and the Legislature. The bill would outline the procedure for providing a

written notice to affected financial institutions, as well as a procedure for removing an institution from the list. A financial institution on the list would be ineligible to enter into or renew any banking contracts with the state on or after July 1, 2024.

For contracts with a value of \$100,000 or more that is wholly or partially paid with public funds that involve a governmental entity and a company with ten or more full-time employees, a contract could not be entered unless the company has written verification that it does not engage in ideological boycotts and will not engage in ideological boycotts during the term of the contract. The bill would provide certain exceptions to this requirement. The provisions would apply to all contracts on or after July 1, 2023.

A fiduciary would be required to discharge the fiduciary's duties with respect to a governmental retirement plan solely in the financial interest of the participants and beneficiaries of the governmental retirement plan for the exclusive purpose of providing financial benefit to the participants and beneficiaries, defraying reasonable expenses of administering any governmental plan for retirement benefits. A fiduciary could only consider pecuniary (monetary) factors when evaluating an investment or discharging a fiduciary's duties with respect to a governmental retirement plan. A fiduciary could not consider any nonpecuniary factors when evaluating an investment or discharging a fiduciary's duties with respect to a governmental retirement plan. A fiduciary may reasonably be determined to have considered nonpecuniary factors based upon evidence indicating an intent to further an ideological boycott through portfolio company engagement, board, or shareholder votes or otherwise as a fiduciary.

A Kansas governmental entity that establishes, maintains, or manages a governmental retirement plan could not grant proxy voting authority to any person who is not a part of the governmental entity, unless the person follows guidelines consistent with the governmental entity's obligation to consider only pecuniary factors.

Any shares held directly or indirectly by a governmental retirement plan must be voted only in the financial interest of the governmental plan. Shares could not be voted to further nonpecuniary factors. No governmental retirement plan assets could be entrusted to any fiduciary that engages with companies or commits voting shares based upon nonpecuniary factors.

A fiduciary or governmental entity administering a governmental retirement plan could not adopt a practice of following the recommendations of a proxy advisory firm or other service provider unless the proxy advisory firm's or the service provider's voting guidelines are consistent with the fiduciary's or governmental entity's obligation to act only on pecuniary factors. Unless no economically practicable alternative is available, governmental plan public retirement system assets could not be entrusted to a fiduciary, unless that fiduciary has a practice of, and in writing commits to match the governmental entity's obligation to act solely upon pecuniary factors. All proxy votes must be tabulated and reported annually to the governmental entity's retirement board. The reports must be posted on the governmental entity's retirement system website for review by the public.

The Attorney General may enforce and investigate any possible violations against a governmental entity. In addition to any other remedies available, a company who serves as a fiduciary and who violates the provisions of the bill would be obligated to pay damages to the

governmental entity in an amount equal to three times all funds paid to the company by the governmental entity for the company's services.

To provide fair access to financial services, a financial services company could not:

1. Discriminate in the provision of financial services against a person based on the person's social credit score, including by refusing to provide a person new or ongoing financial services of any kind, refraining from continuing to provide a person existing financial services, terminating a person's existing financial services or refusing to make each financial service a financial services company offers to all persons in the geographic market served by the financial services company on a nondiscriminatory basis;
2. Agree, conspire or coordinate, directly or indirectly, including through any intermediary or third party, with another company or group of companies, to discriminate in the provision of financial services against a person based on the person's social credit score, including by refusing to provide a person new or ongoing financial services of any kind, refraining from continuing to provide a person existing financial services, terminating a person's existing financial services, or deny any person a financial service such financial services company offers except to the extent justified by such person's documented failure to meet quantitative, impartial risk-based financial standards established in advance by such financial services company;
3. Deny any person a financial service when the effect of the denial is to prevent, limit, or otherwise disadvantage the person from entering or competing in a market or business segment; or in a way that benefits another person or business activity in which the financial services company has a financial interest; and
4. Deny, in coordination with others, any person a financial service that the financial services company offers.

A financial services company could not utilize standards or guidelines based on nonfinancial or ideological criteria, including the criteria constituting an ideological boycott in determining whether or not to provide any financial service to a person or company. A financial services company must disclose to any person or company denied a financial service with the specific data, information, criteria, and standard used to support the denial. The disclosure must be provided in writing in bold 14-point font.

A financial services company that would violate provisions of the bill would be subject to enforcement by the Attorney General. A credit union that would violate provisions of the bill would be subject to civil enforcement by the Credit Union Administrator. An insurance company that would violate provisions of the bill would be subject to the penalties under the Insurance Commissioner. The State Bank Commissioner, the Commissioner of Insurance, and the Credit Union Administrator would be required to adopt rules and regulations for the enforcement of the applicable provisions of the bill before July 1, 2024.

A registered investment adviser would be required to disclose to a registered investment adviser's client, prior to the investment of any funds owned by the client in or through any mutual fund, actively or passively managed equity fund, company or financial institution that is engaged

in ideological boycotts, is a listed financial company or is on the restricted financial institutions list prepared, maintained, and published by the State Treasurer. The disclosure would include that ideological boycotts may limit the client's return on investment. Prior to the investment of a client's funds, a registered investment adviser must obtain written consent from a registered investment adviser's client stating that the client is fully aware of and consents to the investment of funds owned by the client or through any mutual fund, actively or passively managed equity fund, company or financial institution that is engaged in ideological boycotts.

According to KPERS, the enactment of SB 224 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 cost 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, including 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 percent. This increase would trigger the statutory cap on annual employer contributions and would limit the increase to 1.2 percent, 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 effect 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 State Treasurer estimates that the bill would require 3.00 FTE positions, including a director-level position, a deputy director, and a supporting staff member in FY 2024. The agency would note that the director-level position would need to have the expertise to evaluate financial

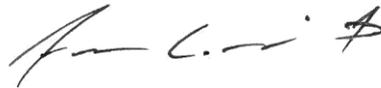
statements and other information to make boycott determinations, as required by the bill. The total cost for these 3.00 FTE positions would be approximately \$300,000 (including fringe benefits). In addition, these positions would require computer equipment and software licensing. Also, the agency indicates that it would require additional subscriptions to financial and investment publications to conduct research and to monitor financial institutions engaging in ideological boycotts. The cost for the 3.00 FTE positions, as well as the other operating expenditures, would be ongoing. The Division of the Budget notes that although the agency did not provide a cost estimate for these other operating expenditures, the funding required for the 3.00 FTE positions and any other operating expenditures would be from the State General Fund.

The Office of the State Bank Commissioner estimates the bill likely would not have a fiscal effect for the agency. The agency notes that the agency has not tracked when a bank rejects a banking relationship from the factors listed in the bill. The agency would ensure that during its examination process that the provisions of the bill would be followed, and no new employees would be required.

The Department of Credit Unions indicates the enactment of the bill would require an additional review area for each credit union during the agency's examination. The agency estimates that additional expenditures totaling \$6,500 from the agency's fee fund in FY 2024 and in each subsequent fiscal year would be required for these additional responsibilities, or an equivalent of 0.20 FTE position. The Pooled Money Investment Board reports that the enactment of the bill would have no fiscal effect on its agency.

The Division of the Budget requested fiscal note responses from the Insurance Department and the Attorney General. The Division will issue a revised fiscal note when this information is received. Any fiscal effect associated with SB 224 is not reflected in *The FY 2024 Governor's Budget Report*.

Sincerely,

A handwritten signature in black ink, appearing to read "Adam Proffitt", followed by a stylized flourish or symbol.

Adam Proffitt  
Director of the Budget

cc: Jarod Waltner, KPERS  
Scott Miller, Pooled Money Investment Board  
Julie Murray, Department of Credit Unions  
John Hedges, Office of the State Treasurer  
Bobbi Mariani, Insurance Department  
John Milburn, Office of the Attorney General