

SESSION OF 2023

SUPPLEMENTAL NOTE ON HOUSE BILL NO. 2436

As Amended by House Committee on Financial
Institutions and Pensions

Brief*

HB 2436, as amended, would create the Kansas Public Investments and Contracts Protection Act and would amend law governing the Kansas Public Employees Retirement Fund (Trust Fund) and investment standards to prohibit state agencies and other political subdivisions and instrumentalities from giving preferential treatment to or discriminating against companies based on environmental, social, or governance (ESG) criteria in the procuring or letting contracts; require fiduciaries of the Kansas Public Employees Retirement System (KPERs or System) to act solely in the interest of participants and beneficiaries of the System; and indemnify KPERs with respect to actions taken in compliance with this act.

***Kansas Public Investments and Contracts Protection Act
(New Sections 1-6)***

The bill would designate the provisions of sections 1-6 of the bill as the Kansas Public Investments and Contracts Protection Act (Act).

Definitions (New Section 1)

The bill would create several definitions for terminology associated with the Act. Among these terms, the bill would define:

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

- “Board” would mean the Board of Trustees of KPERS;
 - “System” would mean KPERS;
- “Environmental, social, and governance criteria” would mean a preferential treatment or a discrimination evaluation conducted by the State, any agency of the State, any political subdivision of the State, or any instrumentality thereof, that considers whether a company meets or fails to meet one or more of the following criteria:
 - Engaging in the exploration, production, utilization, transportation, sale, or manufacturing of:
 - Fossil fuel-based energy;
 - Nuclear energy; or
 - Any other natural resource;
 - Engaging in the production of agriculture;
 - Engaging in the production of lumber;
 - Engaging in mining;
 - Emitting greenhouse gases or not disclosing or offsetting such greenhouse gas emissions;
 - Engaging in the manufacturing, distribution, or sale of firearms, firearms accessories, ammunition, or ammunition components;
 - Having a governing corporate board or other officers whose race, ethnicity, sex, or sexual orientation meets or does not meet any criterion;
 - Facilitating or assisting or not facilitating or assisting employees in obtaining abortions or gender reassignment services; and
 - Doing business with any company described in the above-listed criteria;

- “Fiduciary” would mean any person acting on behalf of the board or System as an investment manager, proxy advisor, or contractor, including the System’s Board of Trustees;
 - The bill would further specify that a fiduciary may reasonably be determined to have taken an action or considered a factor with a purpose to further social, political, or ideological interests based upon evidence indicating such a purpose, including, but not limited to, any fiduciary commitment to further, through portfolio company engagement, board, or shareholder votes or otherwise as a fiduciary, any of the following beyond what controlling federal or state law requires, specifically on assets managed on behalf of the System:
 - Eliminating, reducing, offsetting, or disclosing greenhouse gas emissions;
 - Instituting or assessing corporate board, employment, composition, compensation, or disclosure criteria that incorporates characteristics protected under state law;
 - Divesting from, limiting investment in, or limiting the activities or investments of any company for failing or not committing to meet environmental standards or disclosures;
 - Accessing abortion, sex or gender change, or transgender surgery; or
 - Divesting from, limiting investment in, or limiting the activities or investments of any company that engages in, facilitates, or supports the manufacture, import, distribution, marketing, advertising, sale, or lawful uses of firearms, ammunition,

or component parts and accessories of firearms or ammunition.

- “Fossil fuels” would mean coal, natural gas, petroleum, or oil formed by natural processes through decomposition of dead organisms.

The bill would also define the terms “Act,” “company,” “fiduciary commitment,” “financial,” and “natural resources.”

State Contracts—No Preferential Treatment or Discrimination Against Based on ESG Criteria (New Section 2)

The bill would require the State and its agencies (including the Pooled Money Investment Board) and subdivisions, when engaged in procuring or letting contracts for any propose, to ensure that bidders, offerors, contractors, or subcontractors are not given preferential treatment or discriminated against based solely on ESG criteria.

The bill would further prohibit the State and its agencies and subdivisions from adopting any procurement regulation or policy that causes any bidder, offeror, contractor, or subcontractor to be given preferential treatment or subjected to discrimination based solely on ESG criteria, except as otherwise specifically permitted or required by law.

Investments by the Retirement System and Duties of the System, Investment Managers, and Other Advisors (New Section 3)

Discharge of duties. The bill would require the System and any investment manager, proxy advisor, or contractor, when making and supervising investments of the System, to discharge its duties solely in the financial interest of the participants and beneficiaries for the exclusive purposes of providing financial benefits to participants and their beneficiaries and defraying reasonable expenses of administering the System.

The bill would further subject investment managers, proxy advisors, or contractors retained by the System to the same fiduciary duties as the System's Board of Trustees. The bill would also state that a fiduciary shall consider only financial factors when discharging such fiduciary's duties with respect to the System.

Proxy voting authority and practice. The bill would also provide the following conditions regarding proxy votes (voting of shares):

- All shares held directly or indirectly by or on behalf of the System or the participants and their beneficiaries must be voted solely in the financial interest of the system participants and their beneficiaries;
- Unless no economically practicable alternative is available, the System cannot grant proxy voting authority to any person who is not part of the System, unless that person has a practice of, and in writing commits to, follow guidelines that match the system's obligation to act solely upon financial factors, in which case the System may grant proxy voting authority to such person;
- Unless no economically practicable alternative is available, in the selection of the proxy advisor, the System must give practice to a proxy advisor service that commits in writing to engage in voting shares and making recommendations in a strictly fiduciary manner, and without consideration of policy objectives that are not the express policy objectives of the System, in which case the System may engage a proxy voting advisor;
- Unless no economically practicable alternative is available, system assets cannot be entrusted to a fiduciary, unless the fiduciary has a practice of, and in writing commits to, following guidelines, when

engaging with portfolio companies and voting shares or proxies, that follow the system's obligation to act solely upon financial factors and not upon policy considerations that are not the express policy objectives of the System, in which case the System may entrust engagement and share voting to a fiduciary;

- Unless no economically practicable alternative is available, an investment manager or contractor cannot adopt a practice of following the recommendations of a proxy advisor or other service provider, unless the advisor or service provider has a practice of, and in writing commits to, following proxy voting guidelines that follow the system's obligations to act solely upon financial factors, in which case the investment manager or contractor may follow the recommendations of a proxy or other service advisor; and
- All proxy votes must be tabulated and reported annually to the System's Board of Trustees and to the Joint Committee on Pensions, Investments and Benefits. The reports must be posted on the system's website for review by the public; and
 - The reports will be required to contain, for each vote: a vote caption, the system's vote, the recommendation of company management, and, if applicable, the proxy advisor's recommendation.

The bill would further state that provisions relating to proxy voting authority, selection of proxy advisors, voting shares and guidelines, and reporting shall apply only to assets managed on behalf of the System and shall not apply to alternative or real estate investments as defined in the law governing the Trust Fund and investment standards delegated to the System's Board of Trustees (KSA 74-4921(5)).

*State Agencies, Prohibition on ESG Requirements on
Persons or Businesses (New Section 4)*

The bill would prohibit state agencies from sharing or publishing information, adopting policies, adopting rules and regulations, or issuing guidelines for the purposes of ESG criteria that restrict the ability of any industry to offer products or services. Under the bill, a state agency could not require any person or business to adopt or operate in accordance with ESG criteria. The bill would define “state agency” for its use in this section as “an office, board, commission, department, council, bureau, governmental entity, or other agency of state government having authority to adopt or enforce rules and regulations.”

*Enforcement of the Act, Contracts Subject to the Act
(New Section 5)*

The bill would provide that the Act or any contract subject to the Act may be enforced by the Attorney General. The bill would further state if the Attorney General has reasonable cause to believe that a person has engaged in, is engaging in, or is about to engage in a violation of the Act, the Attorney General may require:

- The person to file on such forms as the Attorney General may prescribe a statement of report in writing, under oath, as to all the facts and circumstances concerning the violation; and
- The filing of other data and information as deemed necessary.

Damages. The bill would also provide that, in addition to any other remedies available at law or equity, a system investment manager or contractor that serves as a fiduciary and violates the provisions of section 3 (duties of the System, investment managers, other advisors) will be obligated to pay damages to the State in an amount equal to three times all moneys paid to the investment manager or contractor by the

System for the services of such investment manager or contractor.

Compliance with Act; Indemnification for System and its Representatives, Board of Trustees (New Section 6)

The bill would provide that in a cause of action based on action, inaction, decision, divestment, investment, report, or other determination made or taken in compliance with the Act, without regard to whether the person performed services for compensation, the State must indemnify and hold harmless for actual damages, courts costs, and attorney fees adjudged against and defend the System and any of its current and former employees, members of the Board, or any other officers of the System related to the Act or omission on which the damages are based.

Kansas Public Employees Retirement Fund and Investment Objective Delegated to the Board of Trustees (Section 7)

The bill would also amend law governing the Trust Fund and investment standards to modify an existing prohibition on the investment and reinvestment of the trust fund to state that no moneys in the fund shall be invested or reinvested if an investment objective is for economic development or social purposes or objectives. [Note: The law currently states these moneys could not be invested or reinvested if the sole or primary investment objective is for economic development or social purposes or objectives.]

The bill would also make technical updates to the trust fund provisions by updating organization and removing obsolete language.

Background

The bill was introduced by the House Committee on Appropriations at the request of Representative Waymaster.

The bill was referred to the House Committee on Financial Institutions and Pensions on February 22, 2023. [Note: A similar bill has been introduced in the Senate. SB 291, as amended by Senate Committee on Federal and State Affairs, contains additional disclosure provisions regarding investment advisers that are not contained in HB 2436.]

House Committee on Financial Institutions and Pensions

In the House Committee hearing on March 8, 2023, the State Treasurer and a representative of Opportunity Solutions Projects (OSP) provided **proponent** testimony. The State Treasurer addressed the operational role of a fiduciary, which must act solely in its client's best interest and whose advise would be intended to maximize the return on the client's investment funds. The primary goal of any legislation addressing ESG in Kansas, the Treasurer stated, should be to ensure the free market continues to operate unimpeded by the insertion of subjective, politically driven goals.

Written-only proponent testimony was submitted by the Attorney General. The testimony indicated financial returns should be the top priority for KPERS' investment strategies.

Neutral testimony was provided by representatives of the Kansas Bankers Association, the Kansas Credit Union Association, and the Kansas Chamber. The financial institutions' representatives requested cautious consideration of ESG proposals with a stated concern regarding any increase on regulatory burden on local financial institutions or any other unintended consequences. The Kansas Chamber representative encouraged the avoidance of penalties on private businesses and the placement of the State in a neutral position with investments and contracts.

Neutral written-only testimony was submitted by the American Council of Engineering Companies of Kansas and the American Property Casualty Insurance Association.

Representatives of the KPERS Board of Trustees, Kansas Coalition of Public Retirees (KCPR) and Kansas

Association of Retired School Personnel, and the Kansas Sierra Club provided **opponent** testimony.

The KPERS Executive Director, appearing on behalf of the Board, stated that all investment decisions are made for the sole purpose of providing promised benefits and cited language addressing the issue of social investing enacted by the 1992 Legislature. The Executive Director indicated the Board believes all current investment managers would be disqualified under the definitions created in the bill, as introduced (e.g., fiduciary, fiduciary commitment, and financial.)

The KPERS Executive Director noted that if the bill disqualifies the current investment managers, the Board would have to divest the existing positions with those managers, review what similar investment managers and funds are available to meet the bill's new fiduciary requirements, and restructure the portfolio based on the investment options available. This divestment would incur asset losses of approximately \$1.14 billion and reduce future investment returns by 0.85 percent based on a restructured investment portfolio.

The testimony further indicated over the next ten years, the restructured portfolio is estimated to earn \$3.6 billion less than the existing investment portfolio. The Executive Director also addressed proxy voting requirements in the bill and indicated a proxy advisor would be needed to comply with the bill. The Executive Director requested consideration of amendments addressing indemnity for the Board and KPERS personnel complying with the requirements of the bill.

Opponent written-only testimony was submitted by the City of Overland Park and the League of Kansas Municipalities. The testimony generally addressed concerns about the inclusion of local governments within the scope of the bill and the ability to exercise local control when contracting.

The House Committee amended the bill to:

- Add indemnification provisions for the System and its officers and employees, as well as the Board, for services provided in compliance with the Act;
- Modify criteria within certain definitions to clarify the referenced fiduciary duties and proxy voting conditions would apply specifically to the assets managed by the System;
- Add clarification to proxy voting authority and practices to include instances when the System may grant proxy voting authority, assign engagement and share voting to a fiduciary, and follow recommendations of a proxy or other advisor;
- Revise a proxy voting reporting requirement to change one of the entities receiving annual reporting from the Legislative Coordinating Council to the Joint Committee on Pensions, Investments and Benefits; and
- Modify language pertaining to procurement and letting of certain contracts to add “solely” as that term applies to preferential treatment or discrimination based on ESG criteria.

[*Note:* In the House Committee meeting on March 15, 2023, the KPERS Executive Director indicated the projected \$3.6 billion reduction in investment portfolio earnings stated in the original fiscal note would no longer apply.]

Fiscal Information

According to the fiscal note prepared by the Division of the Budget on the bill, as introduced, KPERS indicates enactment of the bill would require additional oversight of investment managers and additional reporting requirements. The agency would need to hire an additional 1.0 FTE Investment Officer for these additional duties at a cost of

\$165,000 in FY 2024 (including fringe benefits) from the KPERS Trust Fund. In addition, the agency reports that KPERS utilizes more than 99,000 proxy votes each year. To manage these votes, KPERS would need to utilize a proxy voting vendor, at an estimated cost of approximately \$750,000 from the KPERS Trust Fund. The cost of the FTE position and the contract for the proxy voting vendor would be ongoing costs.

[*Note:* During House Committee action on the bill, KPERS confirmed the above-referenced fiscal note for administrative costs, including proxy voting services. The fiscal note regarding the broader actuarial costs and projected impacts of the bill, as introduced, on the investment portfolio, funded ratio, and employer contribution rates would no longer be applicable in the bill, as amended.]

The Department of Administration, Office of Procurement and Contracts, indicates that enactment of the bill would have no fiscal effect. The Office of the Attorney General states it is unable to estimate a fiscal effect for the agency. The Office of Judicial Administration indicates that enactment of the bill would have a negligible fiscal effect. The Pooled Money Investment Board reports the bill would have no fiscal effect. Any fiscal effect associated with the bill is not reflected in *The FY 2024 Governor's Budget Report*.

The League of Kansas Municipalities and the Kansas Association of Counties report that the bill would have no fiscal effect on local governments.

Pensions; KPERS or Retirement System; KPERS Board of Trustees; Kansas Public Investments and Contracts Protection Act; state agencies; political subdivisions; proxy votes; reporting; Joint Committee on Pensions, Investments and Benefits