

Legislative Commission on Pensions and Retirement

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TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Chad Burkitt, Analyst

DATE: March 18, 2019

RE: H.F. 2329 (Long); S.F. 2276 (Pappas): State Board of Investment; Mandating a report on the effect of climate change on investments.

Summary of H.F. 2329 (Long); S.F. 2276 (Pappas)

H.F. 2329 (Long); S.F. 2276 (Pappas) is a session law consisting of two new subdivisions. Subdivision 1 is a statement of legislative findings and purpose describing the effects of climate change, some of the potential risks associated with climate change, and the purpose for the report required by the bill. Subdivision 2 mandates the State Board of Investment (SBI) prepare a report describing the risk posed to the pension funds by current investments in companies engaged in the exploration for or the extraction of fossil fuels. The bill outlines the required contents of the report which can be categorized as:

- description of the status quo;
- assessment of the risks posed by fossil fuel investments to the portfolio; and
- description of methodologies available to mitigate said risks.

The SBI is required to deliver the report to the LCPR by February 1, 2020.

Background Information

Climate change is a politically divisive issue with various groups taking differing positions on the causes of climate change, the long-term effects, and the potential solutions. In recent years, some advocacy groups have raised concerns that climate change and the reaction to climate change may cause unforeseen volatility in the fossil fuel industry. These concerns have led to many organizations conducting assessments of their own exposure to climate change-related volatility.

Under statute, the SBI, its staff, and executive director are charged with the responsibility of prudently investing pension assets to maximize the total rate of return without incurring undue risk. See Minn. Stat. §§ 11A.01 and 11A.09. They are assisted by the Investment Advisory Council. Investment decisions are made pursuant to statute and the investment policies set by the SBI.

The SBI invests pension assets on behalf of the three statewide pension systems in the combined funds. As of July 1, 2018, the combined funds held assets valued at \$68 billion. Besides cash, those assets are held in a variety of securities in four broad categories:

- 41% (\$28 billion) – domestic public equity;

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- 19% (\$13 billion) – international public equity;
- 24% (\$17 billion) – fixed income securities; and
- 14% (\$9 billion) – alternative investments and private equity.

Each of those four categories include an interest in companies that primarily explore or extract fossil fuels. The SBI does not produce any estimate of their total exposure to fossil fuel companies. However, analysis produced by a local advocacy group, Divest-Invest Minnesota, shows that the SBI holds at least \$2.3 billion worth of securities of 200 companies with the largest fossil fuel reserves.

Discussion and Analysis

1. Appropriateness of legislation to obtain information. To obtain information on a topic, the LCPR can:
 - request information from an agency under Minn. Stat. § 3.85 Subd. 6;
 - direct LCPR staff through a resolution to research and report on an issue; or
 - obtain legislation mandating a report from an agency or workgroup.

In the past, the LCPR has used legislation to require reports to learn more about a particularly complex issue that requires significant time or resources not otherwise available to the commission.

The available information from the SBI provides very little insight on this topic. The annual reports and asset listings published by the SBI do not provide any breakdown of assets by industry or economic sector. In addition, the number of securities held by the SBI (approximately 10,500 different types of securities in the combined pension funds) make any attempt at comprehensive research a time intensive task. Furthermore, the LCPR staff lack expertise in the fossil fuel industry and in assessing climate change risk. Therefore, a resolution or information request will likely result in incomplete or irrelevant information. It is likely that the only method of obtaining the information required by the bill is through legislation mandating a report.

2. Relevance of the issue. Whether climate change and fossil fuel investments pose a risk to pension investments is a relevant question for the commission to consider. The statewide pension systems rely on returns generated by investments in the combined pension funds to fund the benefits they pay. In fiscal year 2018, the three largest statewide plans received \$2 billion in contributions but earned \$5.5 billion from investments. As a result, they are sensitive to changes in the long-term returns. For example, the 2018 Omnibus Retirement Bill set the assumed annual rate of return for the statewide pension plans to 7.5% from the previous rate of 8% (8.5% for the Teachers Retirement Association). This change resulted in an increase of approximately \$5 billion in actuarial liabilities.

In addition, the commission has, in the past, approved legislation to modify the SBI's investment authority. For example, the 2012 Omnibus Retirement Bill added "swap contracts marked to market" to a list of authorized securities.

3. Cost. Due to the expertise and time required to provide the information, the SBI will likely need to contract with private consultants to assist in preparing the report. There are two possible sources of money for the SBI to pay consulting fees. First, the SBI could deduct the money from the pension funds. Under current law, the SBI is annually appropriated from the assets of the funds "sums sufficient to pay the costs of all necessary expenses for the administration of the board." The

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amount spent would be subject to approval by the SBI. However, state and federal law require that pension funds be used for the exclusive benefit of the members; their beneficiaries; and “the necessary, reasonable, and direct expenses of maintaining, protecting, and administering the public plan...” See 26 U.S.C. § 401(a); and Minn. Stat. § 356.001. The Commission may feel that the report required by the bill does not meet that requirement.

The second option is a direct appropriation from the general fund. LCPR staff have requested an estimate of the cost to produce the report from the SBI.

4. Date of delivery. The issue is whether February 1, 2020, is sufficient time for the SBI to complete an analysis and write a report.
5. Clarity of reporting requirements. Some of the requirements allow for broad interpretation by the SBI in determining what information must be included in the report. For example, subdivision 2, clause (4), states:

Identification of already available assessments of alternatives to fossil fuel investments, including investment in renewable energy companies and engagement in the governance of those fossil fuel companies that are transitioning to become exclusively renewable energy resource companies

6. Divesting from fossil fuel companies. While the bill does require an assessment of the risk posed by continuing to stay invested in fossil fuel companies, it does not require the SBI to report on the immediate or projected cost of divesting. The Commission may wish to require that the SBI provide that information.

State Board of Investment Fossil Fuel Holdings

OIL AND GAS COMPANIES	AMOUNT	OIL AND GAS COMPANIES	AMOUNT
ROSNEFT	\$22,710,468	SASOL	\$10,890,749
EXXON MOBIL	\$375,370,362	CALIFORNIA RESOURCES	\$144,486
BP	\$73,572,038	CRESCENT POINT ENERGY	\$1,891,904
ROYAL DUTCH SHELL	\$151,565,676	RICE ENERGY	\$4,325,937
CHEVRON	\$221,387,425	NEWFIELD EXPLORATION	\$5,599,932
PETROBRAS	\$12,391,077	LUNDIN	\$4,312,225
NOVATEK	\$9,985,673	CIMAREX ENERGY	\$11,712,988
TOTAL	\$67,166,716	EP ENERGY	\$502,522
TATNEFT	\$2,680,583	MAERSK	\$12,717,311
ENI	\$4,865,104	SANTOS	\$2,212,809
CONOCO PHILLIPS	\$70,061,030	ULTRA PETROLEUM	\$2,159,899
STATOIL	\$15,841,258	OIL SEARCH	\$3,154,651
CNOOC	\$14,210,845	SM ENERGY	\$3,112,731
INPEX	\$7,985,315	ENGIE	\$3,914,456
CANADIAN NATURAL RESOURCES	\$25,219,213	WPX ENERGY	\$5,256,846
OCCIDENTAL	\$60,848,755	ARC RESOURCES	\$3,351,804
EOG RESOURCES	\$63,554,454	GULFPORT ENERGY	\$2,415,298
REPSOL	\$10,406,199	OASIS PETROLEUM	\$3,767,682
ANTERO RESOURCES	\$4,641,525	PDC ENERGY	\$3,596,624
SUNCOR ENERGY	\$35,454,279	ENERGEN	\$4,509,110
EQT	\$12,589,350	MOL	\$5,074,396
IMPERIAL OIL	\$3,784,628	GALP ENERGIA	\$4,932,909
RANGE RESOURCES	\$13,695,882	DENBURY RESOURCES	\$235,002
MARATHON OIL	\$40,931,393	NATIONAL FUEL GAS CO	\$4,191,183
ECOPETROL	\$4,342,669	CENTRICA	\$9,215,767
ANADARKO PETROLEUM	\$34,192,798		
DEVON ENERGY	\$24,999,101	TOTAL OIL & GAS	\$1,760,954,408
BASF	\$57,250,685		
CHESAPEAKE ENERGY	\$4,456,341	COAL COMPANIES	AMOUNT
NOBLE	\$14,657,068	COAL INDIA	\$1,002,099
APACHE	\$21,405,229	CHINA SHENHUA ENERGY	\$5,541,420
CONTINENTAL RESOURCES	\$7,791,530	YANZHOU COAL MINING	\$616,926
CABOT OIL & GAS	\$15,964,992	CHINA COAL ENERGY	\$643,522
HESS	\$12,391,740	EXXARO RESOURCES	\$500,032
OMV	\$11,915,280	GLENCORE	\$37,405,792
CENOVUS ENERGY	\$3,236,009	PEABODY ENERGY	\$1,024,577
WOODSIDE PETROLEUM	\$12,492,879	BHP BILLITON	\$51,890,237
CONSOL ENERGY	\$3,804,904	MITSUBISHI CORP	\$21,340,064
SOUTHWESTERN ENERGY	\$3,294,503	ARCH COAL	\$740,714
ENCANA	\$3,740,691	ANGLO AMERICAN	\$8,431,683
CONCHO RESOURCES	\$21,023,596	EVRAZ	\$124,881
HUSKY ENERGY	\$2,516,738	VALE	\$7,288,242
SEVEN GENERATIONS ENERGY	\$1,849,995	RIO TINTO	\$48,158,960
PIONEER NATURAL RESOURCES	\$32,993,325	SEVERSTAL	\$1,069,556
TOURMALINE OIL	\$2,173,640	TATA STEEL	\$628,880
SK INNOVATIONS	\$4,333,243	WESTMORELAND COAL	\$160,437
QEP RESOURCES	\$2,317,637	JASTRZĘBSKA SPÓŁKA	
PTT	\$15,130,166	WĘGLOWA	\$290,331
MURPHY OIL	\$4,131,889	TECK RESOURCES	\$9,394,449
WHITING PETROLEUM	\$4,429,291	ADARO ENERGY	\$644,934
		AGL ENERGY	\$8,390,420

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COAL COMPANIES	AMOUNT
CONSOL ENERGY	\$3,804,904
SOUTH 32	\$12,141,444
NACCO INDUSTRIES	\$691,638
ITOCHU	\$14,531,708
NOVOLIPETSK STEEL	\$886,068
MITSUI	\$535,353
BANPU	\$16,028,908
WESFARMERS	\$4,811,018
ALLETE	\$8,505,934
ARCELORMITTAL	\$1,312,809
VEDANTA	\$8,466,086
CLP HOLDINGS	\$6,920,735
BLACK HILLS	\$15,949,937
FIRSTENERGY	\$10,890,749
SASOL	\$327,348
TATA POWER	\$311,092,793
TOTAL COAL	\$311,092,793

TOTAL COAL INVESTMENTS	\$311,092,793
TOTAL OIL & GAS	\$1,760,954,408
TOTAL FOSSIL FUELS	\$2,072,047,200
TOTAL 2016 FOSSIL FUELS LOST SINCE 2016	-\$2,296,892,296 -\$224,845,095