COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4486H.01I
Bill No.: HB 1869
Subject: Retirement Systems And Benefits - General; Retirement - State; Retirement - Local Government; Retirement - Schools; State Employees; Business And Commerce
Type: Original
Date: February 20, 2024

Bill Summary: This proposal modifies provisions relating to investments of public employee retirement and pension systems, requiring divestment of fund holdings in certain Chinese entities or products.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2025	FY 2026	FY 2027
General Revenue*	$0	(Unknown, could be substantial)	(Unknown, could be substantial)
Total Estimated Net Effect on General Revenue	**$0**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**

*Oversight assumes the potential loss of investment returns and increased costs could result in an increase in employer contributions for state agencies that could exceed $250,000.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2025	FY 2026	FY 2027
State Road Fund*	$0	(Unknown, could be substantial)	(Unknown, could be substantial)
Various Other State Funds*	$0	(Unknown, could be substantial)	(Unknown, could be substantial)
Total Estimated Net Effect on Other State Funds	**$0**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**

*Oversight assumes the potential loss of investment returns and increased costs could result in an increase in employer contributions for state agencies that could exceed $250,000.
Numbers within parentheses: () indicate costs or losses.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2025	FY 2026	FY 2027
Federal Funds*	$0	(Unknown, could be substantial)	(Unknown, could be substantial)
Total Estimated Net Effect on All Federal Funds	**$0**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**

*Oversight assumes the potential loss of investment returns and increased costs could result in an increase in employer contributions for state agencies that could exceed $250,000.

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2025	FY 2026	FY 2027
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☒ Estimated Net Effect (expenditures or reduced revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

☐ Estimated Net Effect (savings or increased revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2025	FY 2026	FY 2027
Local Government	**$0**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Joint Committee on Public Employee Retirement (JCPER)** state the bill has no direct fiscal impact to the JCPER. The JCPER's review of this legislation indicates it will not affect retirement plan benefits as defined in Section 105.660(9).

In response to a similar proposal, HB 2143 (2024), officials from the **Office of the State Treasurer** assumed the proposal would have no fiscal impact on their organization.

Officials from **Missouri State Employee's Retirement System (MOSERS)** state they make the following assumptions and clarifications in providing this fiscal impact estimate:

1. The proposed legislation will not require any divestment of MOSERS's investments in restricted entities or restricted investment products with private market managers in place upon the bill's effective date but will apply to any new such investments following that date.
2. The proposed legislation will apply to current MOSERS investments in restricted entities and restricted investment products in hedge funds and any future such investments.
3. The proposed legislation requires each board to compile and provide the restricted entity list annually for reporting to the General Assembly.
4. The proposed legislation will require MOSERS to include, in any contract for an investment in an asset class that could otherwise potentially result in an investment in a restricted entity or restricted investment product, a provision requiring the manager to waive its discretion to make such prohibited investments.
5. The MOSERS Board of Trustees adopted the following on December 12, 2023, and MOSERS is in the process of implementing this policy:
   MOSERS staff shall act with all deliberate speed to divest from all Global Public Equity investments in China:
   - During a period that shall not exceed twelve months from the date of this motion;
   - Staff may exceed the twelve-month deadline, but shall not exceed thirty-six months without Board approval:
   - to avoid incurring aggregate transaction costs in excess of $500,000;
   - to avoid selling Global Public Equity interests at a loss on secondary markets;
   - or to otherwise comply with legal requirements; and
   - Prior to divesting any commingled fund for which divestment is necessitated and would result in a realized loss, staff are required to notify the Board. If, within two business days, four Trustees object, no further action shall be taken until a special or regular meeting of the Board; and

- No additional Global Public Equity investments in China shall be made after the adoption of this motion by the Board, meaning that the Emerging Markets portfolio shall be constructed "ex China" from this point forward and Taiwan shall be excluded from the definition of China for purposes of implementing this motion.

6. For purposes of this fiscal impact estimate, any short- and long-term fiscal impact that MOSERS has incurred or would incur from the December 2023 policy has been excluded from this estimate even though MOSERS has not yet fully implemented the policy and, if this proposed legislation were enacted, such fiscal impact might be equally attributable to this legislation.
7. The value of the MOSERS portfolio as stated in its 2023 Annual Comprehensive Financial Report was $8.75 billion ($8,748,232,863).
8. The proposed legislation would require divestment of any MOSERS investments in restricted entities or restricted investment products in the public market that were: (a) actively managed commingled funds; and (b) passively managed commingled funds, unless the estimated cost of divestment were greater than 10 percent of the total value of the restricted entities held in the passively managed commingled fund. However, absent a change to the MOSERS Board of Trustees' December 2023 policy, the proposed legislation will not affect MOSERS in that: (a) the policy already requires divestment in actively managed commingled funds; and (b) MOSERS does not have any passively managed commingled funds – all of its funds are actively managed.

<u>To the extent any of its assumptions prove incorrect, MOSERS reserves the right to revise this fiscal impact estimate accordingly.</u>

As with other institutional investors, MOSERS hires external managers that invest across different asset classes, such as private equity, hedge funds, private credit, etc., as these asset classes cannot be directly implemented by MOSERS staff. These managers are investment fiduciaries who act on behalf of the fund(s) they manage, which typically hold investments for multiple investors in addition to MOSERS.

MOSERS anticipates that most or all top-tier investment managers will be unwilling to agree contractually to waive their discretion to make investments in restricted entities or restricted investment products as would be prohibited by this legislation, even if a manager had no intention to make such an investment. Thus, the legislation will indirectly shrink MOSERS's investment opportunity set by eliminating, or at minimum severely limiting, MOSERS's ability to invest in Global Private Equities, Direct Hedge Funds, and Alternative Beta asset classes. These asset classes combined make up 30% of the portfolio.

<u>Private Markets</u>
For private market investments, predicting the fiscal impact with certainty is challenging for several reasons. First, the size and diversity of the private equity universe make it impossible to state reliably what investment opportunities might exist when the bill would be effected, but they believe MOSERS's ability to hire quality private market managers will be greatly diminished.

Second, they do not know future actual returns for any investment type. Despite these unknowns, to the best of MOSERS's ability, MOSERS has estimated a potential outcome for reallocating the 15% of the MOSERS portfolio currently invested in Global Private Equities.

If MOSERS cannot invest in Global Private Equities at all as a result of managers' unwillingness to forgo their discretion, MOSERS instead would likely invest those dollars ($1.31 billion) in Global Public Equities. According to Verus Advisory's capital market assumptions, as of December 2023, public equity is expected to earn at least 2.1% less per year than private equity (estimated 9.0% return for private equities compared to 6.9% for public equities) each year for the next 10 years. Therefore, they expect the future impact on investment in Global Private Equities to have an estimated annual cost of at least $27.56 million per year resulting from its investments currently in Global Private Equities being reallocated to comply with this legislative proposal ($8.75 billion × 15% × 2.1%). This result is more conservative than some estimates of the private equity premium available over time.

<u>Direct Hedge Funds and Alternative Beta</u>
If MOSERS cannot invest in the Direct Hedge Funds and Alternative Beta asset classes as a result of managers' unwillingness to forgo their discretion, MOSERS would have to restructure its portfolio to eliminate both, which together make up 15% of MOSERS's overall investment allocation. Their elimination would result in a long-term diminished rate of return following the short-term costs of divestment to the portfolio.

For the past 5 years, Direct Hedge Funds and Alternative Beta asset classes have been a primary driver of MOSERS's excess return, or its out performance. Replacing these out-performing asset classes with assets with a similar risk profile would require substituting and over-allocating to other asset classes, which they believe would result in a portfolio with overall lower returns than with a full opportunity set of managers, funds, and investments.

Hence, they expect that the future prohibition on investment in Direct Hedge Funds and Alternative Beta would have an estimated annual cost ranging from $35.00 million to $65.00 million. This is based on their collective investment experience and knowledge as well as the historical and expected returns of these investments compared with other permitted investments with similar risks.

<u>Summary</u>
Based on the foregoing, they estimate that the annual cost to MOSERS from the proposed legislation would be $77.56 million ($27.56 million (relating to moving assets from Global Private Equities to Global Public Equities) + $50.00 million (the median estimated loss for moving assets from Direct Hedge Funds and Alternative Beta)). Using the 10-year time frame for the private equity over public equity estimated returns, the estimated cumulative loss in value to the portfolio from the proposed legislation during that time frame would be $1.07 billion.

The MOSERS Board of Trustees sets its portfolio asset allocation in consultation with external investment consultants. From the asset allocation analysis, along with MOSERS's actuarial professionals, the Board also adopts actuarial assumptions including the assumed investment rate of return (currently 6.95%). The Board would likely need to modify the asset allocation significantly to achieve the expected 6.95%, lower the investment return assumption, or both, should this proposal become law.

A reduction of this investment return assumption would increase the actuarial accrued liabilities, causing an increase in the actuarially determined employer contribution and a decrease in the funded ratio of the system, ultimately resulting in an increased cost to employers to fill a larger gap between obligations and funding. At its September 2023 meeting, the Board adopted a 28.75% employer contribution rate for FY2025, but long term diminished returns would cause the Board to increase its rates.

Information supplied by MOSERS's external actuarial professionals indicates a 1% reduction in MOSERS's assumed portfolio valuation would increase the actuarial accrued liabilities by an estimated $1.85 billion for FY2025. As a result, the employer contribution rate and employer contribution dollars are projected as follows:

	Employer Contribution Rate	Employer Contribution Dollars
Baseline - 6.95% - FY25	28.75%	$684,161,428
Reduced - 5.95% - FY25	35.57%	$846,456,417
INCREASE	**6.82%**	**$162,294,989**
Baseline - 6.95% - FY26	30.25%	$733,091,749
Reduced - 5.95% - FY26	35.79%	$867,350,535
INCREASE	**5.54%**	**$134,258,786**
Baseline - 6.95% - FY27	32.00%	$790,719,979
Reduced - 5.95% - FY27	35.51%	$877,452,076
INCREASE	**3.51%**	**$86,732,097**
Total Estimated 3-Year Increase		**$383,285,872**
Total Estimated 10-Year Increase		**$926,003,600**
Projections are based on the June 30, 2023 actuarial valuation and assume that all assumptions are met in the future.		

In addition, they estimate an annual cost between $100,000 to $200,000 for an independent research firm as provided for in subsections 3 and 6 in new Section 105.693 to create a restricted entity list and to identify restricted entities and restricted investment products in which the system holds an investment.

Officials from **MoDOT & Patrol Employees' Retirement System (MPERS)** state, the proposal, if enacted, would modify provisions related to public pension funds' investment activity in China. Specifically, the proposal would require the divestment from Chinese companies in public market funds and the restriction from investing in the future in public and private market funds. The divestment would take place on a timeline over several years.

Many of the mandates to be implemented in the proposal are in existing law, regulation, or order from the federal government. MPERS complies with all federal prohibitions on investments in or business dealings with prohibited entities, including China. The primary mechanism for compliance is through their banking relationships in the United States. Banks, through the Department of Treasury, Office of Foreign Asset Control (OFAC), comply with all prohibitions in federal law, by regulation, or by order. For the aspects of the bill that rely on existing foreign asset control processes, there is no additional cost.

There are other aspects of this bill that will create significant oversight burdens, require additional resource expenditures, and create the potential for lower returns. The most substantial implementation challenges result from the provisions that mandate divestment (or exclusion from divestment) based on international treaties or Chinese national proclamations and successor documents. These provisions will require additional staff to monitor the evolution of these documents as well as the retention of a niche advisory service, of which there are few, if any, competitive options. These costs could range between $100,000 and $1,000,000.

To comply with this bill, MPERS would have to sell, at a minimum, all public and private holdings in China and Hong Kong. MPERS currently owns approximately $48 million in Chinese public equities, $40 million in Hong Kong public equities, and $19 million in Chinese private equity. MPERS estimates lost profit of $4 million annually from selling public market equities. This cost estimate takes the projected return of MCSI ACWI with China relative to the MCSI ACWI without China. Foregoing investment in Chinese private equity would result in an additional estimated loss of $800,000 per year. In total, the lost profit is estimated to be $4.8 million per year.

Officials from the **University of Missouri System** state the legislation could have a significant fiscal impact, but it is not possible to determine the amount.

Officials from the **Public Schools and Education Employee Retirement Systems (PSRS/PEERS)** state this legislation, as currently drafted, is expected to impact the Public School Retirement System of Missouri (PSRS) and the Public Education Employee Retirement System (PEERS), by adding additional investment transaction costs and reducing the long-term investment earnings of the Systems in total. PSRS/PEERS have included their understanding of the proposed changes and the overall analysis by the Systems' actuaries, PricewaterhouseCoopers US, in the discussion below.

This proposal would amend Chapter 105 of the Revised Statutes of the State of Missouri ("RSMo") by adding a new subsection to be known as section 105.693. This bill modifies provisions relating to investments of public employee retirement and pension systems, inclusive of PSRS and PEERS, requiring divestment of holdings in certain Chinese entities and products. The bill specifies, after August 28, 2024, the Systems shall not knowingly invest in a restricted entity or a restricted investment product, as these terms are defined in the bill, and shall divest any investment that the system has on behalf of a fund, defined in the bill, including particular investments publicly confirmed to be controlled by the People's Republic of China or the Chinese Communist Party. Divestment is not required in limited circumstances including, but not limited to, current private market funds and identified holdings in passively managed commingled funds that include a restricted entity and the estimated cost of divestment of the commingled fund is greater than ten percent of the total value of the restricted entities held in the commingled fund. New investments are prohibited in direct public holdings, private market funds and passively managed commingled funds.

The bill further indicates that before December 1, 2024, the Systems are required to make a good faith effort to identify all restricted entities and restricted investment products in which the System holds an investment and divest accordingly to the schedules included in the bill. If the Systems determine investments are held in a restricted entity or a restricted investment product, the Systems shall establish a plan to divest the investment and complete the divestment as soon as financially prudent. However, the investment (public securities) shall be divested no later than the following:

(1) At least fifty percent of the investment shall be removed from a fund's assets within three years after the board determines that the investment is in a restricted entity or restricted investment product, which would be no later than December 31, 2027;
(2) At least seventy-five percent of the investment shall be removed from a fund's assets within four years after the board determines that the investment is in a restricted entity or restricted investment product, which would be no later than December 31, 2028; and
(3) One hundred percent of the Investment shall be removed from a fund's assets within five years after the board determines that the investment is in a restricted entity or restricted investment product, which would be no later than December 31, 2029.

In addition, annually on or before December 31st of each subsequent year, the Systems are required to submit a report to the General Assembly including the information that is specified in the bill.

The bill grants immunity from civil liability to the State and any political subdivision; its officers, agents, and employees; and the board and employees of a system for any act or omission related to the removal of an asset from a fund and indemnifies the system for all losses, costs, and expenses as detailed in the bill.

The proposed legislation would significantly alter the Systems' ability to set a prudent asset allocation. The proposed legislation would prohibit PSRS/PEERS from working with top-tier investment managers in all asset classes, inclusive of private risk markets.

PSRS/PEERS has long had an Investment Policy reviewed and approved by the Board of Trustees that governs how the Systems' funds shall be invested. For nearly twenty years, this Investment Policy has included an Anti-Terrorism and Economic Sanctions Policy. The Anti-Terrorism and Economic Sanctions Policy requires Staff to provide a full report to the Board on an annual basis that identifies compliance with the Policy and any action taken due to economic sanctions and terrorist activities. The Systems monitor their active holdings on a monthly basis. The Systems utilize guidance from the U.S. Department of Commerce and the Office of Foreign Assets Control, including the Specially Designated Nationals and Blocked Persons List, Foreign Sanctions Evaders List and Sectoral Sanctions List. Additionally, the Systems contractually require their investment managers and global custodian to do the same.

The Board-approved Investment Policy and asset allocation has performed extremely well in supporting retirement for Missouri educators. The Systems' investment returns for the 10-year time period ended June 30, 2023 exceeded the return of a passive portfolio of 60% global stocks and 40% bonds by 2.2% per year, resulting in added value above a traditional portfolio of $11.9 billion, while internal investment staff and external investment managers added value above the policy benchmark of almost $7.0 billion over the same time period. This outperformance was due to portfolio construction as well as active management on the part of external managers.

This proposal is expected to have a fiscal impact on the Systems. The initial fiscal impact is the one-time transaction and operational costs of divestment of any identified public market portfolio holdings which are expected to range from $9.8 million to $10.6 million. Additionally, the Systems would incur immediate 'investment fee' impact as it transitions away from legacy portfolios. This impact is estimated at an additional recurring cost of $11.8 million annually. Finally, as a global institutional investor, the Systems' asset allocation and overall performance is directly impacted by the ability to invest in the broadest available opportunity set in the world economy. That opportunity set is then viewed through the lens of the Board-approved Investment Policies.

This bill would diminish the Systems' opportunity set within the world economy; specifically, access to private markets. The impact of the diminished opportunity set is currently unknown, but considered significant. The enclosed analysis reflects the impacts of a 1.0% decrease in the overall return on assets in the Systems' portfolio. The Systems acknowledge the impact will vary from this amount; however the 1.0% sensitivity is consistent with the sensitivity analysis required by Government Accounting Standards Board Statement No. 67, Financial Reporting for Pension Plans.

The asset allocation shifts that would be required by this legislation would greatly diminish the Systems' returns. A 1.0% decrease in the Systems' assumed rate of return, increases PSRS' unfunded liability by $7.2 billion and increases the actuarially determined contribution rate

(ADC) to 40.10% from 28.78%. The impact for PEERS is an increase in the unfunded liability of $0.9 billion and the ADC would increase to 18.04% from 13.67%

Officials from the **County Employees' Retirement Fund (CERF)** state CERF's response is based, in part, on the interpretation of the definition of "restricted investment product," as described below.

CERF assumes that the definition of "restricted investment product" in subdivision (8) of subsection 1 only applies to investments directly held by a retirement system and would not apply to investments indirectly held by a retirement system in a mutual fund. Assuming that this interpretation of "restricted investment product" is accurate, HB 1869 would have no fiscal impact to CERF.

However, if the definition of "restricted investment product" would include or apply to investments indirectly held by a retirement system in a mutual fund, then HB 1869 would likely require CERF to terminate relationships with two investment managers and would likely have a negative fiscal impact to CERF.

CERF's investment portfolio includes two international equity funds. These funds are actively managed. CERF's third-party investment consultant has identified whether any restricted entities, as defined in HB 1869, are present in these international equity funds.

The investment consultant has determined that these two international equity funds hold investments in companies that would be considered "restricted entities," as defined in HB 1869. As of the end of the third quarter 2023, these investments comprise 0.31% of the total CERF investment portfolio. Because these investment vehicles are structured as commingled investment funds, CERF would be unable to divest these particular companies; instead, HB 1869 would require CERF to terminate its relationship with the investment managers. CERF notes that it has worked with these two investment managers on a long-term basis since 1998 and 2012.

Terminating these two investment managers would likely have a negative fiscal impact to CERF. First, terminating the investment managers would require CERF to incur transaction costs and would increase administrative work to CERF, its investment consultant, its investment custodian, and the investment managers. Second, CERF would need to perform a manager search for different international equity funds that would not invest in any restricted entities, as defined in the act. Given that the definition of "restricted entity" includes any investment that is domiciled, issued, incorporated, or listed in the People's Republic of China, and China is the world's second largest economy, it may be difficult to identify two similar actively managed international equity funds in terms of risk/return profile and fee structure that do not have investments in China; this may result in a lower investment return. Third, the divestment and transition process may cause CERF to lose out on investment return as assets would be sold and transferred to different investment managers.

Officials from the **City of Kansas City** state this proposal will have a negative fiscal impact of an indeterminate amount.

Officials from the **Police Retirement System of Kansas City** and the **Civilian Employees' Retirement System of the Police Department of Kansas City** state the proposal could result in unknown revenue losses. Divesting from investments in Chinese Entities or products may have negative economic consequences. The Police Retirement System of Kansas City and the Civilian Employees' Retirement System of the Police Department of Kansas City invest in diverse portfolios to maximize returns and optimize benefits for present and future retirees.

This proposal could result in cost increases of more than $250,000. Identifying and monitoring investments related to Chinese Entities or products requires a sophisticated and constantly updated system. Implementing and maintaining such a system would be resource-intensive and may create economic challenges for the Retirement Systems. Engaging a third-party independent research firm to identify companies that fit the criteria would incur additional costs, which cannot be determined at this time.

Officials from the **Kansas City Public School Retirement System** state some fiscal impact is expected in additional staff time and in potential loss of investment opportunities. Placing investment restrictions on an investment manager may hinder investment opportunities.

Officials from the **Missouri Sheriffs' Retirement System** state this proposal may have a negative impact if this legislation passes. The Retirement System hires investment managers to invest its assets based on the investment policy. Setting constraints on investment guidelines has a potential of limiting investment earnings used to finance the retirement system. At the time the negative impact is unknown.

Officials from the **St. Louis Employees Retirement System** state they utilize many commingled investment vehicles for international investments because they are less cumbersome and less expensive to administer and the managers of these funds are experts in international investment opportunities and the processes for administering those assets. This legislation would prevent or hamper those investment opportunities. The Board believes that Missouri public pension investment fiduciaries should not be required to consider a standard other than the normal prudent investor standard currently imposed on Missouri public pension investment fiduciaries lest the System miss out on excellent investment opportunities.

Officials from the Public School Retirement System of the City of St. Louis ("PSRSSTL" or "System") state this proposal adds a new Section 105.693 to the Missouri Revised Statutes which generally prohibits public retirement systems in Missouri (such as the PSRSSTL) from investing in Chinese investments.

The mission of the PSRSSTL is to enhance the well-being and financial security of its Members, Retirees and Beneficiaries through benefit programs and services that are soundly financed and prudently administered in an effective and efficient manner. To accomplish this mission, the

System's Trustees, Staff, and investment professionals operate as fiduciaries with exclusive loyalty to act in the best interests of the System's Members and Beneficiaries and maintain the duty to invest assets according to prudent investor standards.

In evaluating this proposal and the provisions relating to divesting from China, the Trustees, Staff, and investment professionals of the System believe that complying with the proposal may result in the System violating its fiduciary duties owed to its Members. Furthermore, in reviewing other pending legislation pertaining to the State's Pension Systems, the proposal is in direct conflict with HB 1937, HB 1700, SB 815, SB 827 and SB 1113, all of which serve to prohibit non-pecuniary Environmental, Social and Governance issues as a basis for investing assets and voting proxies.

The System's Trustees, Staff, and Investment professionals must consider the needs of, or impact on the System's Members and Beneficiaries, the financial benefits or risks related to divestment, or any investment processes or policies in making the decisions. The following are potential impacts of divestment that may result in a breach of fiduciary duty and operating in a manner contrary to the best interests of Members and Beneficiaries:

- Regional divestment may limit the System's ability to participate in the full market opportunity set resulting in potential risks from less-than-optimal diversification and concentration to other regions, companies, and economic factors. In certain time periods this lack of diversification may result in tracking/error, relative performance differentials, and adverse risk-adjusted results versus market benchmarks.

- China remains a key player in the global economy with participation in the technology, manufacturing, and finance sectors. Divesting may result in missed opportunities as China continues to be a major driver of global economic growth. Interconnected global supply chains and market dynamics also translate to bigger risks for countries and companies with interrelated exposures that will be impacted by divestment.

- In addition to the potential return and risk costs, there are short-term trading costs (commissions) and market impact factors that accompany this type of legislation. If a short time window is presented to divest, the market will experience a negative impact from high-volume selling; essentially all required divestors will be forced to sell into declining markets and losses could be amplified.

    - The System's combined separate account managers have approximately $1.5 million of exposure to China that would need to be divested and would need to be addressed in the Investment Policy Statement and Manager Guidelines. If such legislation were to pass, the System would need to work in a measured and systematic pace, within the time frame prescribed, to allow managers to divest and to minimize potential negative cost and market impacts.

- Based on the current language in HB 1869, ANY mutual fund, collective investment trust ("CIT") or partnership with exposure to China, however minimal, would need to be divested by the System. Currently the System has approximately $220 million (30% of total assets) in exposure to such vehicles. Even though the underlying exposure to China in each investment vehicle may be minimal, the way HB 1869 is worded, the PSRSSTL may nonetheless still be obligated to divest from these diversified investment vehicles. Note that by policy, mutual funds, CITs and partnerships are bound by their prospectus guidelines, which may differ from guidelines that the System prescribes for separate account managers. The System does not have the ability to require mutual funds, CITs or partnerships to divest from specific companies. If the intent of the legislation is to view these exposures on a look-through basis, then all the System's investments in these types of vehicles would need to be fully divested and replaced by specific mutual funds that have this exclusion, even though the amount of holdings in Chinese investments in each vehicle may be minimal. While such strategies exist, the approved list of institutional-quality, prudently diversified and reasonably priced investment options is limited, and risk-adjusted and peer-relative performance results may not support prudent investment standards. Furthermore, based on the sizable amount of assets, an orderly liquidation and replacement would result in excessive transactions costs, potential negative market impacts, and the potential for asset allocation policy deviations that could impact performance relative to policy benchmarks.

Continued engagement with global economic partners and diplomacy can promote near- and long-term benefits relative to a strategy of divestment. Maintaining investments and economic ties with major global economic participants can be a more effective lever for positive change and cooperation all while supporting the ability of large retirement systems to operate according to prudent fiduciary standards that place the interests of Members and Beneficiaries above all else.

Officials from the **Metropolitan St. Louis Sewer District Employees Pension Plan**, **Northwest Missouri State University** and the **University of Central Missouri** each assume the proposal will have no fiscal impact on their respective organizations.

Based on the responses received, **Oversight** assumes there could be costs and investment losses to retirement systems as a result of this proposal which would result in an increase the actuarial accrued liability and a subsequent increase in the actuarially determined employer contribution rates. Based upon the responses provide, Oversight will reflect the fiscal impact as (Unknown, could be substantial) to the state, universities and local political subdivisions.

Oversight assumes "the board shall establish a plan to divest the investment and complete the divestment as soon as financially prudent." Therefore, Oversight assumes this could impact employer contribution rates as soon as FY 2026.

FISCAL IMPACT – State Government	FY 2025 (10 Mo.)	FY 2026	FY 2027
GENERAL REVENUE			
Costs – increase in employer contribution rates	$0	(Unknown, could be substantial)	(Unknown, could be substantial)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**$0**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**
STATE ROAD FUND			
Costs – increase in employer contribution rates	$0	(Unknown, could be substantial)	(Unknown, could be substantial)
ESTIMATED NET EFFECT ON STATE ROAD FUND	**$0**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**
VARIOUS OTHER STATE FUNDS			
Costs – increase in employer contribution rates	$0	(Unknown, could be substantial)	(Unknown, could be substantial)
ESTIMATED NET EFFECT ON VARIOUS OTHER STATE FUNDS	**$0**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**
FEDERAL FUNDS			
Costs – increase in employer contribution rates	$0	(Unknown, could be substantial)	(Unknown, could be substantial)

FISCAL IMPACT – State Government	FY 2025 (10 Mo.)	FY 2026	FY 2027
ESTIMATED NET EFFECT ON FEDERAL FUNDS	**$0**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**

FISCAL IMPACT – Local Government	FY 2025 (10 Mo.)	FY 2026	FY 2027
LOCAL POLITICAL SUBDIVISIONS			
Costs – increase in employer contribution rates	$0	(Unknown, could be substantial)	(Unknown, could be substantial)
ESTIMATED NET EFFECT ON LOCAL POLITICAL SUBDIVISIONS	**$0**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**

FISCAL IMPACT – Small Business

No direct fiscal impact to small businesses would be expected as a result of this proposal.

FISCAL DESCRIPTION

As specified in the bill, after August 28, 2024, the public retirement and benefit systems shall not knowingly invest in a restricted entity or a restricted investment product, as these terms are defined in the bill, and shall divest any investment that the system has on behalf of a fund, defined in the bill, including particular investments publicly confirmed to be controlled by the People's Republic of China or the Chinese Communist Party.

Before December 1, 2024, and annually on or before December first of each subsequent year, the board is required to make a good faith effort to identify all restricted entities and restricted investment products in which the system holds an investment. The bill sets forth the time period and the percentages of the divestments in a restricted entity or a restricted investment product that the board determines needs to be removed from the fund.

On or before December 31, 2024, and annually on or before December 31st of each subsequent year, the board is required to submit a report to the General Assembly including the information that is specified in the bill.

The bill grants immunity from civil liability to the State and any political subdivision; its officers, agents, and employees; and the board and employees of a system for any act or omission related to the removal of an asset from a fund and indemnifies the system for all losses, costs, and expenses as detailed in the bill.

The divestment requirements included in the bill do not apply to private market funds as detailed in the bill.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Joint Committee on Public Employee Retirement
Office of the State Treasurer
Missouri State Employee's Retirement System
MoDOT & Patrol Employees' Retirement System
University of Missouri System
City of Kansas City
County Employees Retirement Fund
Kansas City Civilian Police Employees' Retirement
Kansas City Police Retirement System
Kansas City Public School Retirement System
Metropolitan St. Louis Sewer District Employees Pension Plan
Public Schools and Education Employee Retirement Systems
Sheriff's Retirement System
St. Louis Employees Retirement System
St. Louis Public School Retirement System
Northwest Missouri State University
University of Central Missouri

Julie Morff
Director
February 20, 2024

Ross Strope
Assistant Director
February 20, 2024

JLH:LR:OD