

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 2068H.011
 Bill No.: HB 977
 Subject: Retirement Systems and Benefits - General; Retirement - State; Retirement - Local Government; Retirement - Schools; State Employees; Business and Commerce
 Type: Original
 Date: February 5, 2025

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 2026	FY 2027	FY 2028
General Revenue*	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
Total Estimated Net Effect on General Revenue	\$0	\$0 or (Unknown, could be substantial)	\$0 or (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 2026	FY 2027	FY 2028
State Road Fund*	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
Various Other State Funds*	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
Total Estimated Net Effect on <u>Other</u> State Funds	\$0	\$0 or (Unknown, could be substantial)	\$0 or (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 2026	FY 2027	FY 2028
Federal Funds*	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
Total Estimated Net Effect on <u>All</u> Federal Funds	\$0	\$0 or (Unknown, could be substantial)	\$0 or (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 2026	FY 2027	FY 2028
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 2026	FY 2027	FY 2028
Local Government	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)

*Oversight assumes the potential loss of investment returns and increased costs could result in an increase in employer contributions for local political subdivisions.

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Joint Committee on Public Employee Retirement (JCPER)** state the proposal has no direct fiscal impact to the JCPER. According to actuarial information provided by the retirement system, this proposal would constitute a “**substantial proposed change**” in future plan benefits as defined in section 105.660(10). Pursuant to section 105.670, an actuarial cost statement must be filed with the Chief Clerk of the House of Representatives, the Secretary of the Senate, and the Joint Committee on Public Employee Retirement as public information for at least five legislative days prior to final passage.

Officials from **Missouri State Employee's Retirement System (MOSERS)** state under this proposed legislation adding new Section 105.693, a state or local public retirement system would be:

- (a) prohibited from knowingly investing in a restricted entity or restricted investment product, as defined in the bill, starting August 28, 2025;
- (b) required annually, starting by December 1, 2025, to identify its investments in any restricted entities or restricted investment products;
- (c) required to divest any such identified investment by August 28, 2026, but must be divested no later than August 28, 2028 if the board finds that divestment would result in the system incurring aggregate transaction costs in excess of \$500,000, the selling of the global public equity would result in a loss on secondary markets, or the divestment would otherwise fail to comply with federal or state law or other legal obligations;
- (d) required annually, starting by December 31, 2025, to report to the General Assembly regarding restricted entities that shall include: a copy of the restricted entity list; all publicly traded securities sold, redeemed, divested, or withdrawn in compliance with the proposed legislation; all commingled funds exempt from divestment as provided under subsections 5, 6, or 10 of new Section 105.693; and any progress made regarding whether to cease or defer divestment as a result of the change in status of any restricted entity or restricted investment product to non-restricted; and
- (e) required to prudently exchange investment in any excepted investment in an indirect holding in an actively managed investment fund to a similar actively managed investment fund, absent the restricted entities, created by the manager or investment fiduciary.

MOSERS make the following assumptions and clarifications in providing this fiscal impact estimate:

- (1) The proposed prohibitions on Chinese investments extend beyond the scope of current federal law. However, MOSERS is in the course of implementing the Board's December 2024 China policy prohibiting investment in, and requiring divestment of, Chinese global public equity investments. Their current expectation is that they will complete that implementation by the end of March 2025, in advance of the bill's potential deadline

(August 28, 2026). Therefore, this bill would not have any fiscal impact attributable to it with respect to public equity market prohibited investments.

- (2) For the remainder of the prohibitions, the proposed legislation is consistent with federal investment restrictions and related practices, and it will not require any divestment of MOSERS's current investments.
- (3) Private market funds are not defined in the proposal. For purposes of this fiscal note MOSERS assumes the term to encompass investments such as hedge funds, private equity, private real estate/private real assets, and private credit.

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

In the event that MOSERS needs to hire an independent research firm, as provided for in subsection 3 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, they estimate this to be an annual cost between \$100,000 to \$200,000.

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

Most of the mandates to be implemented in this bill 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. Investments referred to in section 105.693.1(c) require extensive research because those investments do not appear in a list managed by a governmental source.

The fiscal impact of this legislation is indeterminable. As a general rule, any time the opportunity set of investments is reduced, return expectations are correspondingly reduced. MPERS' current exposure to Chinese public equities is approximately \$54 million.

In addition, the board may require the use of an independent research firm to assist in identifying restricted entities and restricted investment products in which the system holds an investment. To this end, MPERS anticipates the independent research cost to be at least \$100,000, recurring annually.

Officials from the **County Employees' Retirement Fund (CERF)** have reviewed this proposal. CERF's response is based, in part, on the interpretation of subdivision (2) of subsection 10, which provides: "Notwithstanding any provision of law to the contrary, the provisions of this

section do not apply to indirect holdings in actively managed investment funds.” CERF interprets this subdivision to exempt indirect holdings in actively managed investment funds from the other requirements in this bill. Assuming that this interpretation is accurate, this proposal would have no fiscal impact to CERF.

However, if this interpretation of subdivision (2) of subsection 10 is not accurate, then this proposal would likely require CERF to terminate relationships with three investment managers. As such, this proposal would likely have a negative fiscal impact to CERF.

CERF’s investment portfolio includes three international equity funds. These funds are actively managed. CERF’s third-party investment consultant has identified whether these international equity funds include any investments in companies in countries prohibited by this proposal. The investment consultant has determined that these three international equity funds hold investments in companies in countries that would be prohibited by this proposal. These investments comprise 0.78% 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, this proposal would require CERF to terminate its relationship with the investment managers. CERF notes that it has worked with these two of these investment managers on a long-term basis since 1998 and 2012.

Terminating these three 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 investments that would not invest in any restricted entity or restricted investment product as defined by this proposal. Given that this proposal’s scope includes investments in the People’s Republic of China, as described in the act, and China is the world’s second largest economy, it may be difficult to identify three 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 **Kansas City Civilian Police Employees’ Retirement** and the **Kansas City Police Retirement System** state that their current exposure to the markets described in the bill is immaterial. Their investment strategy prioritizes fiduciary responsibility and adherence to best practices in asset management, ensuring that the interests of their members and beneficiaries are protected. They remain committed to prudent and sustainable investment practices that align with their overarching mission to deliver long-term retirement security.

Officials from the **Sheriffs’ Retirement System** state they 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 investing or banking guidelines has a potential of limiting investment earnings used to finance the retirement system.

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 **University of Central Missouri** state this would have an indeterminate fiscal impact.

Officials from the **City of Kansas City** assume the proposed legislation has a negative fiscal impact of an indeterminate amount.

Officials from the **Kansas City Public School Retirement System** assume the proposal will have a fiscal impact on their organization.

Officials from **Public Schools and Education Employee Retirement Systems (PSRS/PEERS)** state, as currently drafted, this bill does not appear to have a fiscal and operational impact on PSRS and PEERS of Missouri, as it appears to be in line with the Systems' current practices.

Officials from the **Office of the State Treasurer** and **Northwest Missouri State University** each assume the proposal will have no fiscal impact on their respective organizations. **Oversight** does not have any information to the contrary. Therefore, Oversight will reflect a zero impact in the fiscal note for these agencies.

Based on the responses received, **Oversight** assumes there is some uncertainty regarding the interpretation of this proposal. Due to the uncertainty, Oversight assumes there could be costs and investment losses to retirement systems which could result in an increase in the actuarial accrued liability and a subsequent increase in the actuarially determined employer contribution rates. Oversight will reflect a range of impact of \$0 (no additional divestment required) to an unknown cost that could be substantial to the state, universities and local political subdivisions.

<u>FISCAL IMPACT – State Government</u>	FY 2026 (10 Mo.)	FY 2027	FY 2028
GENERAL REVENUE			
<u>Costs</u> – increase in employer contribution rates if additional divestment required	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
ESTIMATED NET EFFECT ON GENERAL REVENUE	<u>\$0</u>	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
STATE ROAD FUND			
<u>Costs</u> – increase in employer contribution rates if additional divestment required	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
ESTIMATED NET EFFECT ON STATE ROAD FUND	<u>\$0</u>	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
VARIOUS OTHER STATE FUNDS			
<u>Costs</u> – increase in employer contribution rates if additional divestment required	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
ESTIMATED NET EFFECT ON VARIOUS OTHER STATE FUNDS	<u>\$0</u>	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)

<u>FISCAL IMPACT – State Government</u>	FY 2026 (10 Mo.)	FY 2027	FY 2028
FEDERAL FUNDS			
<u>Costs</u> – increase in employer contribution rates if additional divestment required	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
ESTIMATED NET EFFECT ON FEDERAL FUNDS	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)

<u>FISCAL IMPACT – Local Government</u>	FY 2026 (10 Mo.)	FY 2027	FY 2028
LOCAL POLITICAL SUBDIVISIONS			
<u>Costs</u> – increase in employer contribution rates if additional divestment required	\$0	\$0 or (Unknown, could be substantial)	\$0 or (Unknown, could be substantial)
ESTIMATED NET EFFECT ON LOCAL POLITICAL SUBDIVISIONS	\$0	\$0 or (Unknown, could be substantial)	\$0 or (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, 2025, the public retirement and benefit systems must not knowingly invest in a restricted entity or a restricted investment product, as these terms are defined in the bill, and must 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, 2025, 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.

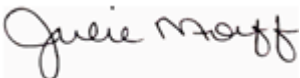
On or before December 31, 2025, and annually on or before December 31st of each subsequent year, the board is required to submit a report to the General Assembly including the information that is specified in the bill.

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
Missouri State Employee's Retirement System
MoDOT & Patrol Employees' Retirement System
University of Missouri System
Public Schools and Education Employee Retirement Systems
County Employees' Retirement Fund
Kansas City Public School Retirement System
Kansas City Civilian Police Employees' Retirement System
Kansas City Police Retirement System
Office of the State Treasurer
City of Kansas City
Sheriffs' Retirement System
University of Central Missouri
Northwest Missouri State University



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