

**CONFERENCE COMMITTEE REPORT BRIEF
HOUSE BILL NO. 2100**

As Agreed to April 6, 2023

Brief*

HB 2100 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 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; restrict state agencies from adopting ESG criteria or requiring any person or business to operate in accordance with such criteria; provide for enforcement of this act by the Attorney General; 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:

- “Board” would mean the Board of Trustees of KPERS;
 - “System” would mean KPERS;
 - “System” would not include participant-directed individual account plans;
- “Environmental, social, and governance criteria” would mean any criterion that gives preferential treatment or discriminates based on 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:

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- Fossil fuel-based energy;
- Nuclear energy; or
- Any other natural resource;
- Engaging in the production of agriculture;
- Engaging in the production or 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; and
- “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 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 be subject to discrimination based 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 (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 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.

Conference Committee Action

The second Conference Committee agreed to remove the contents of HB 2100, as amended by the Senate Committee on Financial Institutions and Insurance, and insert the contents of SB 291, as further amended by the Senate Committee on Federal and State Affairs.

[Note: HB 2100, as introduced and passed the Senate, pertained to risk-based capital instructions in the Insurance Code. A companion bill, SB 14, has been inserted into the Conference Committee Report for SB 119.]

Background

The bill, as agreed to by the Conference Committee, contains the provisions of SB 291 (pertaining to ESG criteria).

SB 291 (Kansas Public Investments and Contracts Protection Act; ESG Criteria)

SB 291 was introduced by the Senate Committee on Federal and State Affairs at the request of Senator Thompson. [Note: Provisions of the bill are similar to those of HB 2436.]

Senate Committee on Federal and State Affairs

In the Senate Committee hearing on March 7 and 8, 2023, **proponent** testimony was provided by Representative Murphy, the Attorney General, the State Treasurer, a representative of Berexco, LLC, and a private citizen. The Attorney General stated financial returns should be the top priority for KPERS and suggested an amendment to the bill that would require registered investment advisers to obtain written consent from clients prior to investing client moneys in investments using ESG criteria. The State Treasurer addressed the operational role of a fiduciary, which must act solely in its client's best interest and whose advice would be intended to maximize the return on the client's investment funds. The primary goal of any legislation addressing ESG in Kansas, the State Treasurer stated, should be to ensure the free market continues to operate unimpeded by the insertion of subjective, politically driven goals. Representative Murphy expressed concerns about the performance of ESG funds.

The other proponents generally stated the bill would address concerns about ESG negatively impacting Kansas oil and gas producers and fossil fuel production and use.

Written-only proponent testimony was provided by representatives of the Kansas Independent Oil and Gas Association, Opportunity Solutions Project, and WallBuilders ProFamily Legislative Network, and a private citizen.

Opponent testimony was provided by representatives of the KPERS Board of Trustees, Kansas Coalition of Public Retirees and Kansas Association of Retired School Personnel, Kansas National Education Association, and Kansas Sierra Club. 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.) 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.

The Executive Director noted 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. The other opponent conferees expressed concerns regarding the impact on KPERS investments and divestment, government interference with private business, and the potential of losses or extra costs.

Written-only opponent testimony was provided by representatives of the City of Overland Park and League of Kansas Municipalities.

Neutral testimony was provided by representatives of the Kansas Bankers Association, Kansas Chamber of Commerce, and Kansas Credit Union Association. The financial institutions' representatives requested cautious consideration of ESG proposals with stated concerns regarding the requirement to obtain written consent, any increase on the 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.

Written-only neutral testimony was provided by representatives of the American Council of Engineering Companies of Kansas, American Property Casualty Insurance Association, and Kansas Interfaith Action.

The Senate 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 [*Note: The Conference Committee retained this amendment.*];
- 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 [*Note: The Conference Committee retained this amendment.*];
- 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 [*Note: The Conference Committee retained this amendment.*];
- 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 [*Note: The Conference Committee retained this amendment.*]; and
- Add a requirement that registered investment advisers must obtain written consent from clients prior to investing client moneys in investments using ESG criteria that may be enforced by the Attorney General. [*Note: The Conference Committee did not retain this amendment.*]

On March 21, 2023, the bill was withdrawn from the Senate Calendar and referred to the Senate Committee on Federal and State Affairs.

On March 22, 2023, following discussion on the bill, the Senate Committee further amended the bill to remove the requirement that registered investment advisers must obtain written consent from clients prior to investing client moneys in investments using ESG criteria, remove the provision related to the Attorney General enforcing the requirement to obtain written consent, and clarify the definition of "System." [*Note: The Conference Committee retained these amendments.*]

Senate Committee of the Whole

The Senate Committee of the Whole amended the bill to add provisions concerning foreign adversaries and certain prohibited investments and requirements on the Board. Definitions for the terms “entity,” “foreign adversary,” “person,” and “person owned by, controlled by or subject to the jurisdiction or direction of a foreign adversary” were also added by the amendment. [*Note:* The Conference Committee did not retain this amendment.]

Fiscal Information

According to the fiscal note prepared by the Division of the Budget on SB 291, 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. Both the cost of the additional FTE position and the contract for the proxy voting vendor would be ongoing costs. [*Note:* This fiscal note is applicable to the bill, as agreed to by the Conference Committee.]

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

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