
MAINEPERS

LEGISLATIVE MEMORANDUM

TO: SENATOR RAFFERTY, REPRESENTATIVE SYLVESTER AND MEMBERS OF THE JOINT STANDING COMMITTEE ON LABOR AND HOUSING

FROM: SANDY MATHESON, MAINEPERS EXECUTIVE DIRECTOR

SUBJECT: LD 99 SUPPLEMENTAL INFORMATION

DATE: FEBRUARY 19, 2021

Thank you for the opportunity to provide information and answer questions regarding the February 10, 2021 hearing on LD 99, An Act to Require the State to Divest Itself of Assets Invested in the Fossil Fuel Industry. This memorandum provides additional information and more complete answers to some of the questions raised during the hearing. This memo also provides a possible path forward based on the concerns raised and building on the steps MainePERS has already taken regarding climate action.

HOW DOES MAINEPERS INVEST?

The Board of Trustees adopts and updates an Investment Policy Statement that governs the investment program. This policy sets an asset allocation based on a prudent level of risk.

Public Securities – companies issue shares and sell bonds to the public to finance business activities and expansion. Issuance is regulated by the Securities and Exchange Commission. Once issued, securities are traded on secondary markets such as the NASDAQ. This trading occurs between investors and does not provide the company with additional capital. MainePERS does not seek to participate in initial security offerings.

MainePERS Target Asset Allocation		
Public Securities (45%)		
	US Equities	15%
	Non-US Equities	15%
	Fixed Income	15%
Private Markets (45%)		
	Private Equity	15%
	Credit	5%
	Real Estate	10%
	Infrastructure	10%
	Natural Resources	5%
	Risk Diversifiers	10%

MainePERS uses a passive approach to investing in public securities, enabling participation in public market gains while holding a very well diversified portfolio and incurring minimal expenses. In the domestic equity market, for example, we hold a portfolio of stocks corresponding to the Russell 3000 index, representing essentially all US stocks. We directly hold the shares of the largest 1,000 companies, comprising around 90% of the index by value. The

remaining 2,000 smaller companies are held in a commingled fund, where we own shares of the fund rather than directly owning company shares.

While holding the entire market does mean some of our holdings will drop in value, we are also guaranteed to be invested in top performers. History has proven that this approach works – an investment of \$1 in the US market 5 years ago has doubled in value, as the performance of winners has more than offset poorly performing stocks, and this outcome is unchanged over longer periods.

As a shareholder of the largest 1,000 firms, MainePERS keeps a say in company governance and can work with other investors to influence corporate behavior. For example, MainePERS voted in opposition to management and in favor of 3 shareholder proposals at Exxon Mobil regarding separating the role of CEO and Board Chair, and increasing disclosure concerning Gulf Coast risks and lobbying. While these proposals failed, our proxy voting and direct engagement, along with that of other institutional investors, are valuable tools for effecting change on important issues impacting the values of our investments.

The alternative to passive investing is active trading, where we would hire experts to identify and buy winners and avoid poor performers. In our prior experience, such managers in aggregate underperform passive investments in broad market indexes over time. Our experience is not unique – active trading is difficult and expensive and requires great skill to outperform the market on a long-term basis. In fact, recent statistics from Standard & Poor's (S&P) show that 87% of active managers have failed to outperform their benchmark index over the last 15 years. Not surprisingly, passive investing tied to broad market indexes has become widely accepted by institutional investors like MainePERS.

Finally, the buying and selling of publicly traded shares by investors, whether active or passive, is separate from corporate operating decisions. Such decisions are typically driven by product market factors as companies seek to meet consumer demands. For example, selling fossil fuel stocks does not change the demand or use of fossil fuels in the same way that selling Apple does not change the use or increase sales of iPhones.

Private Market Investments - MainePERS investments in private market funds offer private businesses a way to finance activities and expansion other than issuing shares to the public. There has been a marked trend over the last few decades, for many reasons, for companies to choose private financing over public. One often-cited reason is the complexity of SEC regulations associated with raising capital in the public markets, and whether public financing is worth the effort. Otherwise, public and private companies follow the same operating laws and regulations.

MainePERS invests in private assets by committing money to funds structured as private partnerships. These funds are raised and managed by an investment manager, who serves as

the partnership's General Partner (GP). The GP has full discretion in the management of the fund's investments, within the bounds of the partnership agreement. In order to limit liability, MainePERS participates in these funds as a Limited Partner (LP). LPs have no role in the selection or management of the fund's investments, and potential losses are limited to the amount invested. Funds are generally closed-ended, with a 10-year life, and capital is returned to LPs only as individual investments within the fund are liquidated. MainePERS generally represents a very small share of the capital raised by these funds.

These private market investments are best categorized as active investing. In a typical year MainePERS makes 20 or so private market commitments, each following a process involving months of due diligence and analysis in order to select a single fund from a dozen or more candidates. The goal of this due diligence, which we have generally achieved, is to select managers able to achieve returns 2-3% higher than those available in public markets while simultaneously limiting risk. Our in-depth due diligence process is where we consider return, traditional risk, and the manager's knowledge and integration of environmental, social and governance (ESG) factors. Our ESG reports explain our ESG policies and the outcomes of our approach.

WHO IS OUR INVESTMENT TEAM?

Chief Investment Officer Jim Bennett leads a team of eight professionals, six of whom hold advanced degrees. All have earned the CAIA (Chartered Alternative Investment Analyst) designation, and four also hold the CFA (Chartered Financial Analyst) designation. The Investment Team works closely with and are supported by both general investment and specialized asset-class consultants.

MAINEPERS FOSSIL FUEL INVESTMENTS

MainePERS' testimony provided estimates of our fossil fuel investments based on the definition provided in LD 99. Broadening this definition results in larger estimates, which are more comparable to those provided by other stakeholders. The attachment to this memo shows how we arrived at these numbers.

PRIOR DIVESTMENT LAWS

Maine has enacted two divestment laws in the past. In 1988 a law was passed requiring divestment from South Africa-related investments. We do not have information showing that fiduciary duty issues were considered, but note that this was before Maine started to take its obligations to fund public pensions very seriously. In the 1980s the State-Teacher plan was less than 20% funded, one of the worst in the nation. Today, because of State of Maine funding

commitments made starting in the early-1990s, the plan is one of the better funded plans at 82% funded.

The second law was enacted in 2006 and concerned divestment from Sudan-related investments. After MainePERS raised concerns that the original bill would violate our fiduciary responsibility to members, the law as passed conditioned divestment on consistency with the Board's fiduciary obligations and exempted commingled investments and index funds.

IDEAS FOR MOVING FORWARD

We are suggesting two ways to move forward on LD 99 that are consistent with both our duty to members and the sponsors' and stakeholders' concerns. We would be happy to discuss both at your LD 99 work session.

Priorities - Our first suggestion is based on Representative Sylvester's questions on prioritizing environmentally friendly opportunities when these opportunities have the same risk and expected return as other opportunities. MainePERS can consider this preference when evaluating energy-related funds in our private market investments. As stated earlier, while we do not participate in the management of a fund, we do pick and choose the funds into which we invest. Opportunities to make environmentally friendly investments with attractive returns are likely to become more common as the transition to more sustainable energy grows.

We suggest this preference apply only to our private market investments, where we are equipped to make active investment decisions. Our public shareholdings are not only passively held for reasons described earlier, but divesting stocks already on the open market is costly and has no effect on the climate.

Engagement - Our second suggestion is for the Committee to express support for MainePERS to continue and grow our long-standing ESG program. This is a positive effort where we are already making a difference as we described earlier in our proxy voting. Engagement also includes direct dialogue with corporations to encourage transparency and awareness of their effect on critical issues that affect long-term value such as those brought forward by stakeholders. The reason engagement works is that corporations listen to our voice, along with other institutional investors, in evaluating how they operate. For example, this type of engagement is likely partially responsible for a corporation like Shell transforming itself into a broadly diversified energy company, rather than strictly a fossil fuel producer.

Attachment 1 – MainePERS Fossil Fuel Related Holdings

The table below contains estimates of MainePERS holdings of companies belonging to fossil fuel-related industries. Our smaller prior estimates were consistent with the definition of fossil fuels in LD 99. The below estimates below are similar to the figures provided by various stakeholders during in the hearing. Companies are assigned to industries by service providers such as Dun and Bradstreet based on their largest product lines. This means that some companies with fossil fuel related business are not counted below, such as Berkshire Hathaway – a financial company that has an energy business. Similarly, many fossil fuel companies counted below have significant business lines unrelated to fossil fuels, such as Shell – an energy company with growing businesses in renewables, hydrogen, and EV charging stations. Also missing from this table are the \$230m in private market renewable energy investments held at the end of 2020.

Utilities and pipelines account for 75% of our 2020 fossil fuel exposures reported in the table. This is a reflection of the current role of fossil fuels in providing the energy for today's economy. The International Energy Association projects that while the use of renewables will grow rapidly, the global demand for oil will rise from the pre-Covid level of 97m barrels per day to around 104m by 2030, and remain at that level through 2040. We realize that no one is able to accurately predict the future, and so we take into account a wide variety of viewpoints and forecasts such as this when making allocation decisions.

Table 1 – MainePERS Energy and Utilities Sector Holdings

Energy	12-31-2019	12-31-2020
Oil & Gas Equipment & Services	\$34,893,786	\$25,247,878
Oil & Gas Refining & Marketing	35,667,272	28,507,141
Oil & Gas Storage & Transportation	521,008,401	486,025,492
*Coal & Consumable Fuels	13,771,351	15,373,549
*Oil & Gas Drilling	22,863,957	16,755,275
*Oil & Gas Exploration & Production	185,288,557	120,617,853
*Integrated Oil & Gas	167,045,448	103,633,980
Total Energy	\$980,538,773	\$796,161,167
Utilities		
Electric Utilities	204,482,615	269,826,891
Gas Utilities	62,081,381	51,726,477
Independent Power Producers & Energy Traders	92,195,441	91,320,272
Multi-Utilities	71,238,553	68,239,602
Total Utilities	\$429,997,990	\$481,113,242
Total Fossil Fuels	\$1,410,253,764	\$1,272,274,408
Total Public Fossil Fuels	\$530,644,123	\$396,251,098
Total Private Fossil Fuels	\$879,892,641	\$881,023,310
Total Fund Value	\$15,391,285,219	\$16,540,086,228
% of Total Fund	9.2%	7.7%

* Included in MainePERS testimony 2-10-2021

This table does not include numerous industries whose current product lines are dependent on the use of fossil fuels such as automobile manufacturers and airlines.