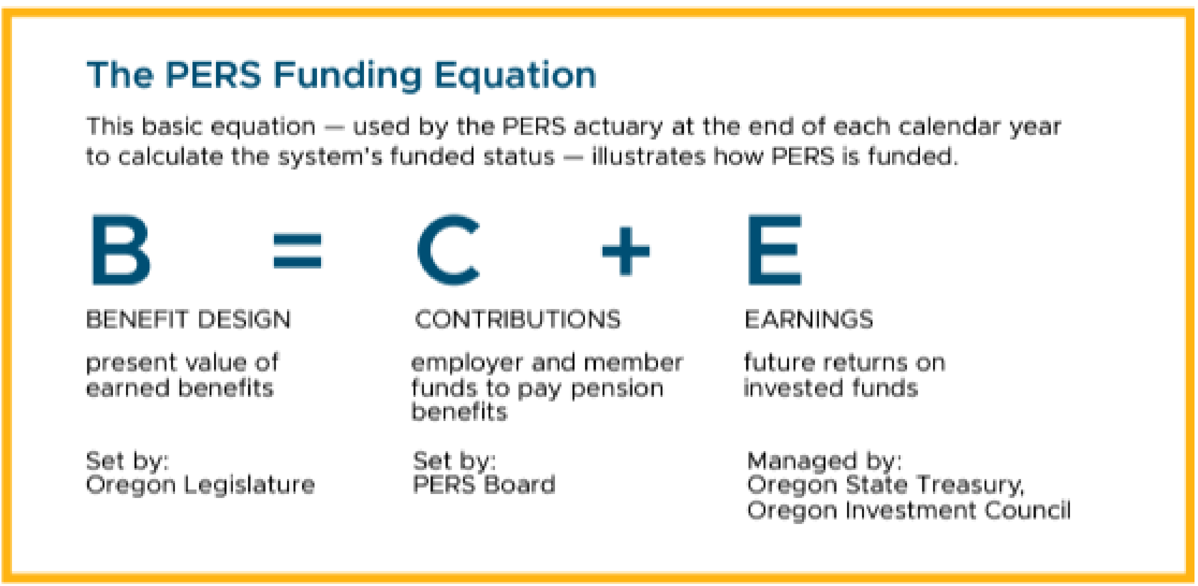
PRELIMINARY ANALYSIS

<u>What the Measure Does</u>: **HB 2601 as introduced** requires the State Treasurer to divest and ensure that no carbon-intensive investments are acquired for any investment fund upon specific dates, subject to fiduciary duties. Additionally, bill provisions require extensive constituent engagement, reporting, and disclosure of Treasury plans relating to implementation of the bill, disclosure of investments, and governance and information related to holdings.

<u>How the Measure Impacts the Oregon State Treasury (OST)</u>: **HB 2601's** provisions would require Treasury to divest fossil fuel related securities and make new disclosures related to Private Equity investments.

Among the many fiduciary concerns and impacts on the fund, the definitions within the Bill are overly broad and would limit OST's investable universe. Given the broad definitions within the Bill, and reliance on proprietary lists, Treasury attempted to estimate the annual cost to OPERF by eliminating the energy sector as a proxy (**we believe this is in line with the spirit of the bill, we believe a strict interpretation of the bill would be far more expansive**). Treasury believes the divestment and loss of opportunity set from our very limited proxy (energy sector alone) could cost OPERF around 10bps (0.10%) a year. The cost is likely larger. This cost is not trivial as it's an annual cost that accumulates each year and compounds at the assumed rate of return for the fund (currently 6.9%). Since the plan design is set in statute and the expected earnings are expected to decline, the PERS board would very likely need to raise contribution rates to balance the funding equation. OST recognizes there is a range of possibilities for performance after divestment, but under a principle of conservatism managed to protect downside risk.



How PERS is funded

Based on the simplest valuation model, a 10bps reduction in earnings on the OPERF $90 billion portfolio translates to $90 million in estimated lost revenue a year. Based on the most recent "Valuation Methods and Assumptions" review by OPERF actuary Milliman, this $90 million would require contribution rates to increase by from 0.7% to 0.8% of payroll [1] and increase the unfunded liability by $1 billion[2].

Preliminary Effect of Changes – Uncollared 2023-2025 Rates

- Estimated impact on uncollared system-average advisory pension rates for 2023-2025 based on preliminary valuation work
  - Results do not reflect any adjustment for already known 2021 asset returns

	Assumed Return 7.2%		Assumed Return 7.0%		Assumed Return 6.9%		Assumed Return 6.8%	
	UAL	Normal Cost	UAL	Normal Cost	UAL	Normal Cost	UAL	Normal Cost
Salary/sick lv/vaca	0.2%	0.4%	0.2%	0.4%	0.2%	0.4%	0.2%	0.4%
Other assumptions	(0.1%)	0.0%	(0.1%)	0.0%	(0.1%)	0.0%	(0.1%)	0.0%
Assumed return	0.0%	0.0%	0.9%	0.6%	1.4%	0.8%	1.9%	1.1%
Total	**0.1%**	**0.4%**	**1.0%**	**0.9%**	**1.5%**	**1.2%**	**1.9%**	**1.5%**
Combined Total	**0.4%**		**1.9%**		**2.7%**		**3.4%**	

Changes shown are stated as a percent of payroll, reflect a 3.40% payroll growth assumption, and exclude changes for the RHIA & RHIPA programs. Numbers may not add due to rounding.

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In addition to the losses above, OST believes the Bill would severely limit the Real Assets investment universe and the disclosure requirements would likely make Private Equity an uninvestable asset class. Removing these high-returning and diversifying assets would materially lower the OST's achievable returns. The effect can be seen in Meketa's (OIC investment consultant) most recent OPERF ALM study report estimating the assumed investment return would fall from 7.6% to 6.5% without private equity.[3] Since the achievable returns would be below the Actuarial Assumed Rate of return of 6.9% the OPERF board would likely feel compelled to lower the Actuarial Assumed Rate. As a rough estimate from the Milliman presentation each 10bps decrease in assumed return would increase unfunded liabilities by $1 billion and increase contributions by 75bps. In total, Staff believes the bill will increase the OPERF unfunded liability by $5 billion requiring contribution rates to increase by 3.75% or more.[4]

Lastly, a large increase in the Pension plans unfunded liability could have follow on effects on Oregon's credit rating. **If the adjusted actuarial liabilities contributed to a rating change, funding costs for <u>all</u> Oregon general obligations could increase.**

OIC recognizes that there are a range of possible outcomes and losses are not guaranteed.

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[1] https://www.oregon.gov/pers/Documents/Board-Meetings/2021/PERS-Board-Packet-7-23-21.pdf page 171.

[2] 20 years of $90 million annual losses discounted at a 6.5% assumed rate of return.

[3] www.oregon.gov/treasury/invested-for-oregon/Documents/Invested-for-OR-47OIC-Agenda-and-Minutes/2022/12.07.22-Public-Book.pdf page 14. (Note: OIC Adopted Option 2A)

[4] This does not incorporate an estimate of runoff of current private assets or interaction effect of concentrating the portfolio in the public markets with a reduced (ex-Fossil Fuels) universe.

<u>Strategy and Funding for Implementing Measure Requirements</u>: HB 2601's provisions, as currently written, require extensive data collection, contracting with mandated service providers, reporting, engagement, and OIC meetings. These additional requirements will require significant amounts of staff and council time, software systems, and other resources not funded by the bill.

Furthermore, the bill does not allocate funds to cover losses from the reallocation of holdings which will include transition costs and potentially forced sale losses. Forced sale losses could be incurred as managers of comingled products with fossil fuel holdings would have to be exited as they cannot implement fossil fuel divestment for just OST under their fiduciary requirements. All holdings in the OST account (not only fossil fuel holdings) could be subject to liquidation at unfavorable prices. Alternatively, OST could change from a comingled product to a separately managed account without fossil fuel exposure but would incur substantial costs for operational, transition, and management fees.

Timing mandated by the bill could also increase losses as illiquid securities (particularly emerging markets oil and gas) will not be sellable quickly without taking significant losses.

As the bill does not allocate funds for implementation or potential losses, the costs of the bill would be reflected in the portfolio value and likely passed on to plan participants through higher contribution rates.