April 26, 2016

TESTIMONY OF ROBERT D. KLAUSNER TO THE VERMONT PENSION INVESTMENT COMMITTEE ON THE QUESTION OF DIVESTMENT

Members of the VPIC, it is my privilege to appear here today on the pending question of fossil fuel divestment. Based on the projected adverse economic effect on the pension systems and the loss of a seat at the table for Vermont in the important question of climate control initiatives, it is my view that divestment is not consistent with the fiduciary duty of the VPIC as articulated in 14A V.S.A. 902.

I have reviewed the July 23, 2015 memorandum from the Treasurer urging Vermont not to abandon its considerable engagement efforts on behalf of improved environmental performance by energy and utility companies; the July 28, 2016 memorandum from the Chief Investment Officer outlining the substantial adverse effects on the portfolio of divestment and the absence of a meaningful universe of alternatives; as well as the scholarly material, pro and con, concerning divestment.

Engagement in climate control is more than aspirational, it is potentially existential. That is precisely the reason why institutional investors have banded together to move the energy industry into green alternatives and cleaner carbon products.

The VPIC has a fiduciary to invest the assets of the pension systems for the highest and best return at a reasonable rate of risk. Divestment of fossil fuels will, according to the CIO result in a foregone return of $9M annually and a loss of $4-$10M in transactional costs which can never be recovered. In relatively small Fund of $4B, that is a material, adverse effect on any objective measure.

It is precisely for this reason that divestment, for non-economic reasons, is a disfavored strategy. Other larger state funds have chosen, as has Vermont to date, to vigorously engage the energy industry through proxy voting to act in a more ecologically sound fashion. And there have been measurable results.

Vermont has a vigorous ESG program. Studies have shown that the “G” - governance - has been the most effective tool in effecting climate change goals and other laudable advancements such as sustainable industry and work place equity. Divestment says to the energy and utility sectors that, as well as your fellow pension systems, that you are willing to place your fate in the hands of others. By divesting, you simply have no voice.

CalPERS, the largest public retirement system in the country also has a vigorous ESG program and substantial corporate engagement. In very recent comments to the United Nations, it was observed that a trillion dollars of new investments are earmarked for green initiatives under the Paris Accord. Those developments can only be achieved by engagement.

Divestment has a real cost which can only be made up, in the final analysis by a greater burden on the pension plan sponsors. Maintaining well-funded meaningful retirement benefits has proven the best tool to attract and retain a talented public sector workforce. Divestment, and particularly the projected multi-million cost to Vermont, threatens the security of those programs and also further strains the public fisc.

If divestment is being made primarily for social principles, but is not equally rooted in sound economics for the pension trust, there is no principled way to stop every divestment until there is nothing left to invest in. This view is shared by New York Comptroller, the sole trustee of that state's retirement funds and as well as noted economists at Harvard and Yeshiva universities. They have collectively observed that divestment is a futile act by which one surrenders the most effective voice for climate change. Further, divestment would have the undesirable effect of lowering the very source of capital that will drive clean energy.

I have no doubt that proponents of divestment hold a sincere belief that by holding energy investments Vermont is contributing to global climate change in unfavorable way. The success of global engagement, however, has clearly proven the value of "staying in the game." More importantly, divestment would leave the Fund at the mercy of others. In that fashion, it is an abdication of fiduciary duty rather than its exercise.

The U.S. Bureau of the Census maintains detailed records on the role of investment return in offsetting the cost of retirement plans. Fully two thirds of the cost of the plans are borne by investment return. Given the analysis of the effect of divestment on the Fund, and the absence of readily suitable alternatives shifts that burden directly to the contributing employers.

As noted earlier, divestment has a real cost. In 2000, CalPERS divested from tobacco based on the belief that pending litigation against Big Tobacco would eventually drive it out of business. Besides the obvious morality to dispensing with investment in a health threat, the decision to divest had what is always required for an ESG decision; a sound basis in economics. As it has turned out, tobacco did not disappear and CalPERS losses from that divestment have reached approximately $3B. Assuming a $9M loss annually in the Vermont portfolio from energy divestment over the same period (15 years), Vermont could face a loss in excess of $130M, or nearly 3% of the current portfolio.

Committee members, I live at sea level, dividing my time between South Florida and New Orleans. These are two places that are on the razor's edge of the effects of climate change and rising seas. But I remain convinced, based on nearly 40 years as an advisor to committees such as this, that engagement from within is a far more effective instrument of positive change than shouting from outside the walls of the corporate castle.

I commend the VPIC on its commitment to ESG principles as well as your treasurer and investment staff for providing you an unblinking look at the economic effect of divestment. As I stated at the outset, best practices disfavor divestment and so should you in the exercise of fiduciary duty to members and beneficiaries of your pension funds. As an aside, your continued engagement will have a positive influence on the energy industry while at the same time allowing you to retain a robust investment program.

Thank you. I would be pleased to address any questions.