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Maine Public Employee Retirement System
P.O. Box 349
Augusta, ME 04332
via electronic mail to: comment@mainepers.org

RE: Implementation of Fossil Fuel Divestment

Dear Dr. Wyke, Chairman Noyes, and Members of the Board,

We write in response to your request for public comments on implementation of divestment from fossil fuel companies as required by LD 99. We hope these comments assist with the hiring process for the investment consultant(s) you plan to retain.

Divestment from fossil fuel companies has been repeatedly found to be consistent with the fiduciary duties of care, prudence, and loyalty.[1] There is little doubt that Maine PERS can accomplish the legislative goals of the statute while fulfilling your fiduciary duties and maintaining sound investment criteria. Although technical hurdles may arise during the process, the effort is benefited by the clear policy directive articulated in the statute.

To date, the State Treasurer has elected to fulfill the goals of the statute by undertaking a shift in the investment vehicles for several trusts under his authority.[2, 3] The trusts are now invested in a mix of Vanguard ESG index funds that track indices provided by FTSE Russell.[4] The indices have been screened for companies that fail to meet environmental, social, and governance (ESG) standards. The funds largely exclude fossil fuel investments and are a responsible first step toward compliance with the statute.

Observations on Divestment from Fossil Fuel Companies

1. There is an investment trend with increasing numbers of institutional investment funds (pensions, universities, private endowments, and public and private trusts) divesting some

[1] New York State Senate Committee on Finance. Testimony of Bevis Longstreth. April 30, 2019. The comments were written for the New York Legislature to further its deliberations. Mr. Longstreth's observation that the state comptroller would likely divest without the need for the legislation was borne out. The comptroller decided to divest consistent with his fiduciary duty.
[2] Office of the State Treasurer. Trust Fund Management.
[3] Office of the State Treasurer. Investment Policy Statement for State Held Trusts. August 24, 2021.
[4] According to documents provided by the Office of the State Treasurer, the several trusts are invested in the Vanguard FTSE Social Index Admiral Shares, Vanguard ESG US Stock ETF, and Vanguard ESG International Stock ETF, as well as several bond funds and money market accounts.

or all of their current fossil fuel holdings. Institutional funds have adopted divestment strategies for three major reasons: 1) Fossil fuel companies are not prepared to address the risks associated with the economy's transition to a sustainable, low-carbon economy; 2) The physical risks associated with climate change that portfolios face are mounting, and 3) Over the last 10 years, fossil fuel stocks have lagged the market and confront a largely negative long-term outlook. In addition to extreme weather and changes to the world's physical environment, climate change constitutes a financial risk.

When several New York City pension funds were considering how to divest from fossil fuels and continue to fulfill their fiduciary duties, the New York City Comptroller's Office retained two investment advisors on their behalf.[5] The advisors, BlackRock Sustainable Investing and Meketa Investments Group, provided the city with a substantive analysis that supported its divestment decision. The firms' studies gave an affirmative answer to the fundamental question: Can an institutional fund divest its fossil fuel assets and continue to meet its investment targets? Among the findings: 1) No fund that has divested has experienced negative financial outcomes, and 2) Divestment actions were initially adopted by small funds but are now increasingly finding support with large, prominent institutional funds.[6]

2. The question of the private equity portfolio and other alternative asset classes is another important trend that may be of importance to Maine PERS as it develops its strategic program to comply with the statute. Private equity investments do not typically have the transparency or liquidity of a common stock or bond. The consultant should identify how much of the funds' investments in private equity and other alternative asset classes are in fossil fuels.

   How PERS decides to comply with divesting the private equity portfolio must be different from how it divests from stocks and bonds. Because it will take more time and planning, it would be prudent for Maine PERS to soon adopt a policy that it will no longer participate in private equity portfolios that invest in fossil fuels.

3. Care and diligence must be exercised beyond the initial transactions that eliminate fossil fuel holdings from the portfolio. Ongoing compliance monitoring is necessary and can be achieved without undue administrative burdens as markets evolve and the pension system's funds are rebalanced. By and large, this service can be obtained from any of the index fund managers as a matter of course. Monitoring duties by Maine PERS staff should include an ongoing relationship with the index fund managers to ensure normal internal controls that are associated with any contract administered by the fund. In addition, Maine PERS has the option to align itself with a growing number of formal and informal shareholders of varying sizes that are involved with the execution of climate change investment strategies.

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[5] New York City Office of the Mayor. Mayor de Blasio, Comptroller Stringer, and Pension Fund Trustees Announce Significant Next Step to Divest Pension Funds From Fossil Fuel Reserve Companies. December 18, 2018.

[6] IEEFA. Major investment advisors BlackRock and Meketa provide a fiduciary path through the energy transition. March 22, 2021. Redacted versions of the studies are available.

There are a number of questions that the ideal investment consultant would provide ready answers to:

1. How can PERS divest from fossil fuels and continue to meet its investment targets?

2. What has been the experience of other funds that have divested?
   - What was the scope of the divestment programs they adopted? Can you conduct a survey to find out?
   - What was the effect on returns?
   - How long did it take?
   - Were there any unexpected occurrences, good or bad?
   - What costs were incurred to divest? How did these compare to a typical portfolio rebalancing?

3. What is best way to understand the risks of holding fossil fuels in the future?
   a. What are the transition risks?
   b. What are the physical risks?
   c. Are there any surprise costs?

4. Have you worked with other funds that have decided to divest?
   a. What did you learn from that experience? How is Maine PERS similar and how is it different from other funds you have worked with?
   b. How does your approach differ from Meketa Investments Group and BlackRock, whose research work for New York City was publicly released?[7] Are you familiar with other advisors and how they approach the issues?

5. How would you treat the private equity sector of the portfolio?

6. How have other funds created an on-ramp for companies who adopt sound transition strategies and are candidates for reinvestment?

Our organization stands ready to assist Maine PERS in this effort in any way we can. Please do not hesitate to get in touch.

Sincerely,

/s/ Tom Sanzillo
Tom Sanzillo, Director of Financial Analysis (bio)

/s/ Dan Cohn
Dan Cohn, Global Energy Transition Researcher

[7] Direct links to reports: BlackRock Phase 1, Phase 2, Phase 3; Meketa Phase 1, Phase 2, Phase 3.