

July 23, 2018

SENATE BILL NO. 1208
(First Reprint)

To the Senate:

Pursuant to Article V, Section I, Paragraph 14 of the New Jersey Constitution, I am returning Senate Bill No. 1208 (First Reprint) with my recommendations for reconsideration.

This bill calls for divestiture of all State pension and annuity fund holdings in entities that have been identified as responsible parties for a Superfund site in the State and have filed for bankruptcy. The bill aims to penalize entities that attempt to avoid their Superfund obligations by engaging in the bankruptcy process. These Superfund sites, overseen by the United States Environmental Protection Agency, are critical to ensuring that adequate time and resources are devoted to cleaning the most contaminated areas in our State.

I commend the sponsors for their passionate advocacy on this issue and wholeheartedly support an aggressive response to any company that attempts to evade its Superfund obligations in this manner. However, while I agree that divestiture is an appropriate penalty in certain instances - particularly when the investment at issue is liquid in nature - I do not believe that it should be the only available response when companies in which the State has invested pension funds behave poorly. A more effective and legally defensible approach would provide the State Investment Council ("Council") with a variety of options to identify and correct the offending behavior, when appropriate, prior to divestiture.

I am therefore recommending revisions that would formally institute an Environmental, Social, and Governance ("ESG") policy that will empower the Council to use a number of negotiating tools to influence a company's behavior. An ESG policy will also allow the Council to regularly review the decisions made by the institutions in which it is invested, and consider retaliatory

actions across several channels, including direct engagement, horizontal engagement with fellow shareholders, proxy voting, and divestment, where appropriate. The Council recently took a similar approach with great success, by convincing mortgage lenders to suspend foreclosures of Puerto Rican properties in the wake of Hurricane Maria. Had divestiture been mandated, these lenders might still be foreclosing on devastated families and hindering the island's recovery efforts.

Consideration of ESG factors can also drive wise investment decisions by helping to identify both higher-yielding investment opportunities and those investments that should be avoided due to long-term risks. Several states have already adopted these policies to drive investment decisions, including California, Maine, New York, Florida and North Carolina. In these states, the ESG policy has positively changed business practices and allowed for more robust engagement between the state and the investment community.

At the same time, mandating divestiture exposes the State to significant costs and legal risks. The State has spent more than \$23 million monitoring the divestiture of holdings as a result of recent statutory mandates to divest pension system assets from companies that do business with Iran and companies that boycott Israel and Israeli businesses. At least two companies have threatened legal action following the Council's divestment decisions. ESG is not only wise policy, it also makes financial sense.

In addition to revisions to implement ESG, my suggested changes would also correct language that may inadvertently extend the bill's provisions to foreign countries and their instrumentalities. While I recognize that other countries may exercise significant control over companies within their jurisdictions, in instances where the Council and the Division of Investment have an investor relationship

with a company, that relationship is predicated upon the fact that the company is publicly traded. As a result, it is inappropriate to include foreign countries within the parameters of the bill.

Accordingly, I herewith return Senate Bill No. 1208 (First Reprint) and recommend that it be amended as follows:

- Page 3, Section 2, Line 17: After "invested" insert "by the Director of the Division of Investment"
- Page 3, Section 2, Line 17: Delete ", or country or its"
- Page 3, Section 2, Line 18: Delete "instrumentality,"
- Page 3, Section 2, Line 24: Delete ", country or country's"
- Page 3, Section 2, Line 25: Delete "instrumentalities"
- Page 3, Section 2, Line 25: Delete ", or"
- Page 3, Section 2, Line 26: Delete "county, or county's instrumentality"
- Page 3, Section 2, Line 32: After "State." insert "Such business or business affiliate shall remain ineligible for investment under the provisions of P.L. , c. (C.) (pending before the Legislature as this bill) for as long as the business remains a responsible party and fails to comply with its obligations with respect to Superfund sites located in the State."
- Page 3, Section 2, Line 41: Delete "to" and insert "concerning"
- Page 3, Section 2, Line 42: Delete "sell, redeem, divest or withdraw"
- Page 3, Section 2, Line 43: After "section" insert ", including, but not limited to, the direct engagement with appropriate parties, coordination with fellow shareholders, proxy voting, or the sale, redemption, divestment or withdrawal from an investment"
- Page 3, Section 2, Line 46: After "withdrawal" insert ", where appropriate,"
- Page 4, Section 2, Line 1: Delete ", or country, or country's instrumentality"

Page 4, Section 2, Line 4:

Delete ", or country, or country's"

Page 4, Section 2, Line 5:

Delete "instrumentality"

Page 4, Section 2, Line 5:

Delete "in violation of" and insert "ineligible for investment pursuant to"

Page 4, Section 2, Line 12:

After "all" insert "actions taken related to"

Page 4, Section 2, Line 13:

Delete "year" and insert "quarter"

Page 4, Section 2, Line 14:

Delete "investments sold," and insert "actions related to investments taken in compliance with this section."

Page 4, Section 2, Lines 15-16:

Delete in their entirety

[seal]

Respectfully,

/s/ Philip D. Murphy

Governor

Attest:

/s/ Kate E. McDonnell

Deputy Chief Counsel to the Governor