

January 31, 2019

SENATE BILL NO. 2663
(First Reprint)

To the Senate:

Pursuant to Article V, Section I, Paragraph 14 of the New Jersey Constitution, I herewith return Senate Bill No. 2663 (First Reprint) without my approval.

This bill would impose conditions on equity investments in the private real estate, private equity and private infrastructure asset classes in which the Division of Investment ("Division") has more than a 50 percent interest. As a condition of the State's investment, developers and operators of construction related activity would be required to use good faith efforts to ensure that responsible contractors are included in the bidding and selection of contractors and subcontractors. Among other things, the bill defines a responsible contractor as a contractor that pays workers fair wages and benefits and offers apprenticeship training programs. Similar investments in which the Division has an equity interest at or below 50 percent would be encouraged, but not required, to follow these responsible contractor practices. The bill also would prohibit the Division and the State Investment Council ("Council") from approving any investment that has the potential to eliminate public sector jobs, pose reputational risks to the retirement systems, or subject the systems to regulatory scrutiny, and would require the Division and Council to consider the labor practices of prospective investment companies when selecting fund managers.

I commend the sponsors for their efforts to ensure that our pension dollars are invested in entities that adhere to responsible labor practices that appropriately protect workers. I certainly agree that a well-trained and fairly compensated workforce contributes to higher quality work products and services that in turn may enhance investment returns.

I am concerned, however, that this bill creates broad proscriptions on the State's investment practices that would be challenging for the Division to implement and could jeopardize the overall health of the systems. The bill's sweeping prohibition against any investments that could pose a "reputational risk" to the State's retirement systems, for example, could be interpreted to apply to a wide range of direct and indirect investments, and may be used to call into question investments that are objectively appropriate.

I have also been advised by Treasury that the bill could undermine certain investment strategies that have been successfully utilized by the Division to reduce fees and increase returns. In recent years, the Division has managed many of the funds' real estate investments through separate accounts, in which the Division holds more than 50 percent of the equity as the sole unaffiliated investor, rather than through a commingled investment vehicle. In one recent example, the use of a separate account is expected to save the Division approximately \$39 million in fees over the life of the \$300 million commitment. This bill could significantly reduce the Division's ability to take advantage of the savings opportunities available through this and similar investment structures.

Moreover, the bill may conflict with the Division's fiduciary responsibilities to manage the investments for the exclusive benefit of the systems' employees and retirees and their beneficiaries. These responsibilities are clearly articulated in State law and the Internal Revenue Code, and failure to adhere to them could jeopardize the systems' tax-exempt status.

While the seriousness of these concerns prevents me from approving this bill, I am confident that the Division and Council can achieve many of the bill's laudable objectives through the

recently adopted Environmental, Social and Governance ("ESG") policy. This policy, adopted by the Council last September, formally incorporates an analysis of a wide variety of factors in the investment and evaluation of the systems' assets. Beyond that, it strikes the delicate balance of enabling the Division and Council to positively influence the behavior of the entities in which the State invests while still adhering to their fiduciary duties. Notably, many of the factors that may be considered under the ESG policy, including workforce diversity, fair trade, working conditions and equitability of compensation, are consistent with the goals of this bill. The ESG policy could be further enhanced by more specifically addressing a responsible contractor policy that is consistent with the Division's fiduciary duties under applicable law. Retirement systems in several states, including New York and California, have recently adopted such policies.

Because the Council's ESG policy already provides a framework for incorporating the types of considerations that are contemplated in this bill, while also driving improved investment returns with reduced risks consistent with our fiduciary responsibilities to the funds' beneficiaries, I herewith return Senate Bill No. 2663 (First Reprint) without my approval.

Respectfully,

/s/ Philip D. Murphy

Governor

[seal]

Attest:

/s/ Matthew J. Platkin

Chief Counsel to the Governor