FISCAL NOTE TO

# ASSEMBLY, No. 2050

# STATE OF NEW JERSEY

DATED: SEPTEMBER 24, 1996

Assembly Bill No. 2050 of 1996 prohibits the investment of any pension or annuity fund assets under the jurisdiction of the State Division of Investment in the Department of Treasury in stocks, securities or other obligations of a corporation or other entity engaging in the manufacture or wholesale distribution of tobacco products. The State Investment Council and the Director of the Division of Investment are directed to sell, redeem, divest or withdraw any investment held in violation of the bill and must do so within three years following the effective date of the bill. The Director of the Division of Investment is required to file periodic reports with the Legislature describing the progress made in divesting these assets and analyzing the fiscal impact on the pension and annuity funds.

The Department of Treasury states that it cannot provide an estimate of the fiscal impact of divesture upon the total value and return on investments in the pension and annuity funds. Certainly, there would be additional incidental transaction costs in accomplishing the divesture. However, an estimate on a net realized portfolio loss or gain cannot be made at this time. With three years to comply with the provisions of the bill, an estimate of the fiscal impact of this action on the funds would be purely speculative at this time, according to the department.

The department expresses its concern with introducing this type of non-financial factor into the State's investment program and notes tobacco company stocks have provided substantial returns for the pension fund portfolios. Pension fund holdings of tobacco stocks have provided a market gain of $333 million over their cost of $118 million at current prices. In addition, tobacco stocks have materially outperformed the general stock market over the last 10 years. A mandatory divestment would remove an area of investment, which could result in opportunity costs for the pension funds. Over the last 10 years, the stocks of Philip Morris and UST, for example, have outperformed the stock market by 63 percent and 140 percent, respectively. If these stocks were to continue at this level of performance for the next 10 years, and if the general market provided a 10 percent annual benchmark return, then the cumulative opportunity loss (future earnings) to the funds would be $1.05 billion.
over the 10 year- period, based on the current holdings of these stocks.

The department has provided information on the value of securities

currently held in pension and employee savings funds that would have to be sold, redeemed, divested or withdrawn in accordance with the provisions of this bill.

| **Stocks** | | |
|---|---|---|
| Company | Shares | 6/30/95 Market Value (000) |
| DiMon Inc. | 320,000 | $ 5,760 |
| Philip Morris Cos. Inc. | 4,162,000 | 413,599 |
| UST Inc. | 936,000 | 30,888 |
| Total Stocks | | $ 450,247 |
| **Fixed Income** | | |
| Company | Description | Par Value (000) |
| Philip Morris Cos. Inc. | 8 3/4% notes due '98 | $ 22,000 |
| | 7 3/4% notes due '03 | 20,000 |
| Total Fixed Income | | $ 42,000 |
| Total-All Tobacco-related Securities | | $492,247 |

The Office of Legislative Services (OLS) cannot agree or disagree with the information provided by the department on the value of current holdings since the OLS does not have an opportunity to analyze the portfolio of the pension and annuity funds maintained by the Division of Investment. However, the OLS does concur with the department's statement that a specific dollar value of the cost or gain associated with the divestiture cannot be estimated at this time. OLS believes that while a potential exists for a portfolio loss from divesture, the magnitude or even the certainty cannot be estimated. Any such figure would be speculative, given the dynamic nature of market conditions and the many variables governing the suitability of alternative investments. The three year divesture period would allow the division to select the most opportune "time window" for the sale of holdings and the purchase of new holdings.

This fiscal note has been prepared pursuant to P.L.1980, c.67.