

*Roselyn H. Spencer*

<b>FROM</b>	NAME & TITLE	Roselyn H. Spencer, Executive Director
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	SUBJECT	City Council Resolution 09-0099R - Investigative Hearing – F&P and ERS Boards – Investment Policy Guidelines

CITY of  
BALTIMORE  
**MEMO**



**TO** DATE: 2/12/09

The Honorable President and Members of the City Council  
Room 400 City Hall

The Board of Trustees of the Employees' Retirement System (ERS) has reviewed City Council Resolution 09-0099R, which directs the Executive Directors and a representative of the Boards of the ERS and the Fire and Police Employees' Retirement System (F&P) to brief the Council on an overview of the Boards' practices, procedures, and standards for investments, as well as efforts to invest those funds in local, minority, and women business enterprises.

**Background and Current Policies**

*Statutory Authority*

Pursuant to Article 22, §5 of the Baltimore City Code (the "Code"), the ERS Board of Trustees (the "Board") is charged with the general administration and responsibility for the proper operation of the Retirement System. Further, the Board is entrusted with a fiduciary responsibility over the assets of the ERS.

In this capacity, Article 22 authorizes the Board to: (1) enter into custodial and investment management agreements for investment of ERS assets; and (2) contract with qualified persons to serve as investment advisors to the Board. The duties of the investment advisors include the formation of investment policies.

*Investment Policies - General*

The Board directs the investment of ERS assets pursuant to comprehensive investment guidelines and policies that were developed with the ERS investment consultant. The general Statement of Investment Objectives and Policies (the "General Investment Guidelines") is a statement by the Board to its investment managers and the public declaring the Board's fiduciary duties, statutory investment responsibilities, and general investment guidelines. The General Investment Guidelines are included in every Investment Management Agreement between a manager and ERS, and the manager must sign the Guidelines.

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The General Investment Guidelines begin by detailing the risk tolerance, investment strategy and overall asset allocation, portfolio rebalancing strategy, and performance objectives for the ERS portfolio as a whole. This allows the reader to understand how the strategies of individual asset classes fit into the total investment portfolio.

As a statement of policy, the General Investment Guidelines provide that the Board will give “weight and consideration” to investments that involve local, minority and women business enterprises (“MBE” and “WBE”) “where the investments offer quality, return, and safety comparable to other investments...provided such investments confirm to investment guidelines promulgated by the Board.”

In addition to investing with local MBE and WBE firms, the Guidelines provide that in a search, the Board is to give the same “weight and consideration” to local firms that are investment manager candidates, where these firms offer ‘comparable qualifications and competencies.’”

*Investment Policies - Directed Brokerage*

The General Investment Guidelines also address the brokerage policies that must be adhered to by investment managers. These policies discuss electronic crossing networks, soft dollar arrangements, brokerage commission costs, and other associated details.

The section further includes the “Directed Brokerage” policies for investment managers. Consistent with the position taken by the City of Baltimore toward local, minority, and women enterprises (“MBE” and “WBE”), the ERS directed brokerage policy instructs managers to, whenever possible, ensure that first preference for securities trades go to MBE and WBE brokerage houses with local offices. Based on the asset class invested by the manager, the percentage goals are adjusted accordingly (see below):

<b>Asset Class</b>	<b>Directed Brokerage Requirement</b>
Large-Cap Equity	25% majority local, with 10% MBE or WBE
Small- and Mid-Cap Equity	10% local, with 5% MBE or WBE
International Equity	10% MBE or WBE, regardless of location
REIT (real estate securities)	10% MBE or WBE, regardless of location
Fixed Income	25% majority local, with 10% MBE or WBE

Finally, the General Investment Guidelines specify the communication and reporting requirements for investment managers. Each manager must submit detailed monthly, quarterly, and annual reports to the Board. These reports detail not only manager performance, but also compliance with directed brokerage requirements, and most-favored nation contract clauses, among other things. Every manager is required to make an annual presentation at a regular ERS Board meeting, where the manager reviews performance process, organization structure and gives the Board an opportunity to raise questions.

### *Investment Policies – Specific Asset Classes*

There is an investment policy for each asset class in which the ERS has funds.<sup>1</sup> These customized policies detail the risk tolerances, asset allocations, performance objectives and measurement criteria, diversification requirements, and reporting requirements. Along with the General Investment Guidelines, each manager must sign off on the policy associated with their specific asset class.

### *Search Process*

The only way for any investment management firm to be hired by ERS is through a comprehensive search process that is both quantitative and qualitative in nature. The process is coordinated by the Board's investment consultant. The investment consultant will first work with the Board to establish the objectives for the manager, as well as the initial search criteria. After the Board has made these decisions, the Consultant will cull through both in-house and external databases to create a pool of viable candidates.

Once the pool of candidates is established, the Consultant will return to the Board with a report of all firms reviewed, and a recommendation for a group of "finalists". This recommendation is based on established evaluation criteria that can be applied to every candidate firm. These criteria address firm size, assets under management, performance history – both generally and specific to this asset class, minority representation among officers and employees, firm ownership structure, and other issues.

The Board reviews the information provided, and selects a panel of firms to invite for on-site presentations. The finalist is then submitted for Board of Estimates approval.

### **Conclusion**

The Board's highest priority is to meet its fiduciary responsibilities through prudent investment practices solely in the interest of the participants. The Board also believes that it can, *and does*, meet its fiduciary responsibilities while doing business with local and minority and women enterprises. The Board is proud of its record of doing business with local firms, MBEs and WBEs, and accordingly, **SUPPORTS** Council Bill 09-0099R, and welcomes the opportunity to address any questions or concerns that the Council may have.

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<sup>1</sup> Policies are in place for the following classes: Alternative Investments (private equity), Domestic Equity, Fixed Income, Hedge Funds, International Equity, Real Estate, Short-term Investments, Tactical Asset Allocation, and Securities Lending.

cc: Angela Gibson, Mayor's Legislative Liaison to the City Council  
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