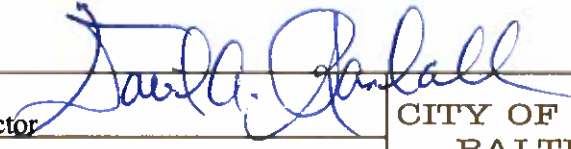



FROM	NAME & TITLE	David A. Randall, Executive Director 	CITY OF BALTIMORE MEMO	
	AGENCY NAME & ADDRESS	Employees' Retirement Systems 7 E. Redwood Street, 12 th Floor		
	SUBJECT	City Council Bill 21-0066		

DATE: May 20, 2021

TO

Honorable President and Members of the
Baltimore City Council
Attn: Natawna Austin, Executive Secretary
Room 409, City Hall
100 N. Holiday Street
Baltimore, Maryland 21202

**Re: City Council Bill 21-0066- Retirement Systems
Precluded Investment and Divestment of Fossil Fuel Companies**

Dear Mr. President and City Council Members:

City Council Bill 21-0066 has been introduced to amend certain provisions of the Employees' Retirement System (ERS), Elected Officials' Retirement System (EOS), Fire and Police Employees' Retirement System (F&P) law to (1) prohibit new actively- managed investment of ERS, EOS and F&P retirement funds in certain fossil fuel companies on after January 1, 2022 and (2) require actively-managed investment funds to gradually divest from fossil fuel companies, at the rate of 20% per year, within a 5-year timeframe beginning July 1, 2022 and ending June 30, 2026.

LEGISLATIVE SUMMARY

This Legislation Summary is in agreement with the F&P position and is mirrored here in our agency documentation.

Fossil Fuel Company Defined

The Bill would prohibit new investment in, and require divestment from, any company listed in the 200 publicly traded coal, oil, and gas companies that hold reported fossil fuel reserves with the largest potential carbon emissions, as ranked and updated annually in the Fossil Free Indexes US ("FFIUS") or any successor index.

Actively-Managed Investment Prohibited

Only ERS, EOS, or F&P assets that are actively-managed and held in a separate account would be subject to the Bill's prohibition on new investment and the requirement to divest. The Bill defines "Actively Managed Separate Account" to not include the following accounts: (1) an indexed fund; (2) a private equity fund; (3) a hedge fund; (4) a real estate fund; or (5) any other commingled or passively ERS, EOS or F&P managed fund.

Reporting Requirement

The Bill would require the ERS and F&P Boards of Trustees (Trustees) to file with the Mayor and the City Council, on or before June 30th of each year, an annual report detailing any new investment in, and any divestment from, fossil fuel companies during the past fiscal year, and a calculation of the administrative cost of compliance with fossil fuel divestment. Any decision to delay divestment during the fiscal year would also have to be described.

Divestment Notice to Fossil Fuel Companies

The Bill provides that no ERS, EOS, or F&P divestment action may be taken until Trustees provides written notice and an opportunity to respond to each company subject to a proposed divestment action and waits 90 days from the written notice. If the subject company demonstrates to the Trustees that it is exempt from divestment, no divestment action may be taken. A subject company will be exempted from divestment if it can demonstrate that it: (1) has stopped exploring for new hydrocarbons; (2) contractually agrees not to develop or sell 80% of its current proven fossil fuel reserves; and (3) has ceased lobbying or attempting to influence city, state, or federal government officials to preserve fossil fuel subsidies, tax breaks, or the company's competitive advantage with respect to clean, renewable energy.

Fiduciary Duty

Trustees need not take any divestment action under the Bill if it is determined in good faith by either Board of Trustees that divestment would be inconsistent with that Board's fiduciary responsibilities. If a Board of Trustees determines that its fiduciary duties require that it delay a divestment action, it must report that determination to the Mayor, City Council and Board of Estimates, along with an estimated timeline for resuming divestment.

LAW AND ANALYSIS

ERS through their research and analysis with the following statement of legal analysis put forth by F&P and supports the following in case law. ERS also supports the case law analysis in the enclosed paragraphs contained in the letter addressed to the Council (see et seq.) but not fully quoted, hereof:

****In *Board of Trustees of Employees' Retirement System of Baltimore, et al. v. Mayor and City Council of Baltimore, et al.*, 317 Md. 72, 562 A.2d 720 (1989) (the South Africa case), the Maryland Court of Appeals upheld a City Council ordinance prohibiting retirement system investment in, and requiring divestment from, companies doing business in South Africa. The court defended the law against numerous challenges posed by the retirement systems Boards of Trustees. See, also, 93 Md. Op. Atty. Gen. 168 (2008) (law requiring State retirement system to divest from companies doing business in Iran or Sudan not in conflict with Trustees' fiduciary duties conflict and may be implemented.**

However, it was found that divestment from a system must receive fair market value return and costs of divestment must be de minis as compared to total fund assets. Also, substitute investments must be available that will yield competitive returns at a comparable level of risk.

COST

In analyzing these factors, the Bill's provisions have been reviewed by Marquette Associates, the agency's investment advisor. Included is the attachment. The current investments in fossil fuels in the chart shows 35% of portfolio assets of ERS and 29 % of OPEB Trust that would be subject to impact of the bill. With the pension funds spread to four different investment managers that are presently making money above our target for the fund, the table enclosed shows the amount of investment at stake and required for divestment. This is a meaningful exposure to our holding that should not be required in such a short notice. Our Board exercises fiduciary duties and principles regarding the timing and manner of divestment in order to avoid imprudent transactions. Our Board has a fiduciary duty with prudent judgment to act upon expert analysis when acting for the benefit of the pension plan. The Board must be able to investigate alternatives, and diversify accordingly. The structure of this bill will not allow them to function in that capacity.

The bill creates a potential for less return in the marketplace when the Board is not allowed to divest at the best time, at the best execution to sell and receive fair market value in return. The opportunity costs of divestment are unknown. It cannot be predicted that substitute investments will yield competitive return for ERS. There has to be room for a gradual time for development of renewable energy and environmental responsibility; however, the bill does not give the Board that time sequence.

While ERS believes in the social concerns of investors, divestment legislation is ill-advised at this time. ERS prefers to implement investment guidelines in line with our mission statement (see enclosed) favoring renewable and alternative energy investment. Our mission would be to divest from fossil fuel companies in a timely manner based upon our investment managers' recommendations to the Board. Prudently, the likelihood that fossil fuel divestment will result in a measurable financial cost is not predictable, given unknown future determinants and adequate available substitute investments which are still to be determined.

The proposed council Bill 21-006 will result in cost to ERS and OPEB Trust if divestiture is handled within the time frame presented by this Bill. The ERS Board balances ESG investing with its fiduciary responsibilities and feels the request should not be law but policy.

However, the ERS Board respectfully believes that the Bill is feasible but asks for consideration of the following amendments.

AMENDMENTS

Reporting but not Mandating Divestment

The ERS Board supports prudent and gradual divestment staged over time pursuant to internal guidelines and our mission statement.

Therefore, delete all provisions of the Bill mandating divestment and retain only the definitions set forth on page 2, lines 1-29 and page 5, lines 1-30 and reporting sections set forth on page 4, lines 17-27 and page 7, line 22-32.

Definition of Fossil Fuel Company

ERS through their research has discovered that the reference by the Bill to “Fossil Free Indexes US (FFIUS)” as referring to the index of the 200 listed companies with the largest carbon potential carbon emissions is outdated. Also, the current and commonly referred-to fossil fuel company index is known as “Carbon Underground 200 (CU200)”.

Accordingly, ERS agrees with F&P that on page 2, line 28 and page 5, line 29, “Fossil Free Indexes US (FFIUS)” should be changed to “Carbon Underground 200 (CU200)”.

Divestment Timeframe with Annual Goals

The ERS Board with its mission statement can be shown in favor of divesting from fossil fuel but would like to do so in a manner which provides flexibility to reduce the cost of divestment and maximize the retirement systems’ ability to find alternative investments. Therefore, the ERS Board suggests that in lieu the proposed plan, the divestment time frame should be a 10 year plan with elimination of annual goals. This would provide the Board the ability to time the divestment without the potential of loss in an unpredictable market.

Therefore, on page 3, beginning with line 8, delete the entirety of sub-subparagraphs 1 through 4; on line 20, delete the number “5”, replace “2026” with “2031”, after “divest”, delete “at least 100%” and replace with “all”; and delete the rest of the line. Make the same amendments to subparagraph (IV) on page 6.

90 Day Notice Period

The ERS Board will exercise due diligence prior to divestment to ensure that each fossil fuel company subject to divestment is resolute in desiring to continue to engage in exploration, development, or sale of fossil fuels or lobbying to preserve governmental advantages for fossil fuels. However, the ERS Board is in agreement with the F&P Board in opposing the imposition of a 90-day period to accommodate communication with a subject fossil fuel company. Having any time frame imposed by law could potentially interfere with an advantageous sell strategy and execution.

Accordingly, on page 4, line 1, and on page 7, line 6, delete in its entirety sub-subparagraph 2.

RESOLUTION

At their meeting of May 20, 2021, the ERS Board of Trustees resolved that the Bill is feasible with the aforementioned recommended amendments for consideration.

I will be available to provide testimony at the hearing scheduled for CC Bill 21-0066. Please call me at 443-984-3180 if you would like additional information.

DAR/EC/dsb

Enclosures

CC: Henry Raymond, Board Chair

Deborah Moore-Carter, Board Vice-Chair

Nichelle Lashley, Deputy Director

Nina Themelis



To: City Council Bill 21-0066 – Retirement Systems –Precluded Investment and Divestment – Fossil Fuel Companies

From: Marquette Associates, Inc. ("Marquette")

Date: May 14, 2021

Re: Investment Consultant Response

Topic

The purpose of this client memorandum is to provide the investment consultant response to the implementation of City Council Bill 21-0066.

Investment Portfolio Impact

As the current investment consultant to the City of Baltimore Employee's Retirement System ("ERS"), City of Baltimore Elected Official's Retirement System ("EOS"), and the City of Baltimore Retirement Trust ("OPEB"), Marquette Associates, Inc. has reviewed the proposed City Council Bill 21-0066 (the "Bill") and evaluated the Bill's impact to the investment portfolios of ERS, EOS, and OPEB. Marquette consulted with the ERS, EOS, and OPEB investment managers that may be subject to the divestment as outlined in the Bill. The table below details investment managers that have a meaningful exposure to holdings that would require divestment under the terms of the Bill:

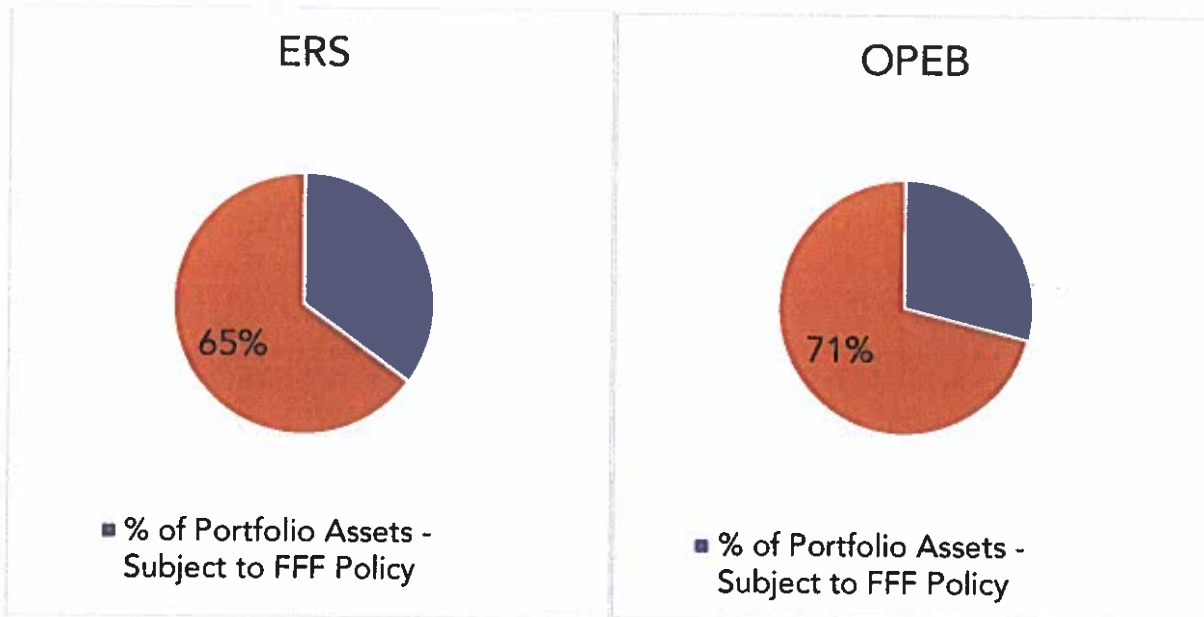
Investment Manager	Asset Class	Plan	% of Portfolio Required for Divestment	Value of Assets Required for Divestment (\$)
Edgar Lomax	U.S. Large Cap Value Equity	ERS	9%	\$9.7 million
Rothschild	U.S. Small Cap Value Equity	ERS	4%	\$4.5 million
Baird Advisors	Core Fixed Income	OPEB Trust	4%	\$2.4 million
Edgar Lomax	U.S. Large Cap Value Equity	OPEB Trust	9%	\$6.0 million

Earnest Capital	International Large Cap Equity	OPEB Trust	4%	\$1.1 million
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The pie chart below indicates the percent of total assets and the dollar value of assets that would require divestment under the current Bill:

Plan	% of Portfolio Required for Divestment	Value of Assets Required for Divestment (\$)
ERS	0.69%	\$15.0 million
OPEB	1.14%	\$9.6 million

The pie chart below indicates the percent of total assets that would be subject to the Bill:



Summary

The current Bill as proposed would impact the investment portfolios highlighted in the information provided. The impact to the portfolios as highlighted above would be meaningful. Marquette believes a reasonable divestment timeline in line with industry standards would be a ten-year projected divestment. The ten-year timeline would ensure a thoughtful and efficient transition of investment portfolios. It would also allow for the implementation of a compliance

process of all service providers and City of Baltimore staff to ensure adherence to the new provisions.

PREPARED BY MARQUETTE ASSOCIATES

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CHICAGO BALTIMORE MILWAUKEE PHILADELPHIA ST LOUIS WEB MarquetteAssociates.com

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The sources of information used in this report are believed to be reliable. Marquette Associates, Inc. has not independently verified all of the information and its accuracy cannot be guaranteed. Opinions, estimates, projections and comments on financial market trends constitute our judgment and are subject to change without notice. References to specific securities are for illustrative purposes only and do not constitute recommendations. Past performance does not guarantee future results.

About Marquette Associates

Marquette Associates is an independent investment consulting firm that guides institutional investment programs with a focused three-point approach and careful research. For more than 30 years Marquette has served this mission in close collaboration with clients – enabling institutions to be more effective investment stewards. Marquette is a completely independent and 100% employee-owned consultancy founded with the sole purpose of advising institutions. For more information, please visit www.marquetteassociates.com.



Employees' and Elected Officials' Retirement System

Mission Statement

The System is committed to protecting and prudently investing member assets and providing accurate and timely retirement benefits with quality service to members and beneficiaries. ERS will continually apply the principles of responsible investing and strive to balance social responsibility with its fiduciary duty to provide strong long-term investment results to the System.

Standards of Conduct

As Trustees and Staff, we are committed to:

Safeguard the members' assets.

Strive for continuous improvement.

Maintain confidentiality as appropriate.

Effectively communicate accurate information.

Provide accountable and proactive leadership.

Conduct all business in a fair and respectful manner.

Foster an atmosphere of cooperation and teamwork.

Value members as clients and advocate on their behalf.

Comply with the System's plan provisions, policies and guidelines.

Work efficiently, simplify procedures, and minimize bureaucratic hurdles.

Form alliances and partnerships to benefit the membership and the System.

Balance Environmental, Social and Governance (ESG) investing with fiduciary duty to obtain strong long-term investment results.

We expect all who interact with us to adhere to these standards of conduct.