

Spokane Employees' Retirement System (SERS)
Board Meeting, 1:30 p.m. April 25, 2018
City Hall – Conference Room 5A

AGENDA

1. Bill Dowd and Bill Reid, SageView Consulting – Actuarial Valuation Report
 - Information
2. Ad-hoc
 - Motion
3. Minutes of the March 28, 2018 Meeting
 - Motion
4. Director's Report
 - a. Retirements
 - Motion
 - b. Withdrawals
 - Motion
 - c. Vesting
 - Information
 - d. Deaths
 - Information
 - e. Expenditure Summary Report – March 2018
 - Motion
 - f. Schedule of Investments – March 2018
 - Information
 - g. Cash Reconciliation – March 2018
 - Information
 - h. Other Business
5. Berens Consent Agreement
 - Motion
6. Environmental, Social, and Governance (ESG) Overview
 - Information
7. GASB 75 OPEB Expenses
 - Information
8. Other Business
9. Next Meeting - **Wednesday, May 30, 2018 at 12:00 p.m.**

**Spokane Employees' Retirement System (SERS)
Board Meeting Minutes
March 28, 2018**

The regular monthly meeting was called to order at 1:31 p.m. in the 5th Floor Conference Room at City Hall.

Present: Mike Coster, Mike Cavanaugh, Candace Mumm, Brian Brill, Dean Kiefer, and J.D. Morscheck

Absent: Jim Tieken

Staff: Phill Tencick, Christine Shisler, and Tim Szambelan

Guests: Jim Bradshaw (Bridge City), Joe Cavanaugh, Joan Hamilton, Bob Olsen, Dave Hanshaw, Natalie Hilderbrand, Richard Czernik, and John Bjork.

Bridge City Presentation

Jim Bradshaw presented an overview of Bridge City Capital. Bridge City has been SERS' small cap growth manager since December 2011 and currently manages \$6.3M of SERS assets. Mr. Bradshaw provided an overview of the firm, the team, the investment process and the current portfolio.

Minutes of the February 28, 2018 Meeting

Mike Cavanaugh moved and Candace Mumm seconded the motion to approve the minutes of the February 28, 2018 meeting as presented.

Director's Report

Service Retirements

<i>Name</i>	<i>Age</i>	<i>Retirement Date</i>	<i>Years of Service</i>	<i>Option</i>
Ned Pauling	62	04/04/2018	23.0	E
Joseph G. Blazek	57	05/02/2018	28.0	E
Gregory J. Butz	62	05/09/2018	10.6	E

Dean Kiefer moved and Candace Mumm seconded the motion to approve the service retirements as amended on the March Retirement Transaction Report. The motion passed unanimously.

Withdrawals for March 2018

<i>Name</i>	<i>Years of Service</i>	<i>Termination Date</i>
Gregory E. Chute	0.8	08/17/2017

Jacqueline M. Smithley	2.1	08/25/2017
Crystal D. Kranz	0.8	09/08/2017
Kelly J. Doty	6.6	02/02/2018

Mike Cavanaugh moved and Dean Kiefer seconded the motion to approve the requests for withdrawal as presented on the March Retirement Transaction Report. The motion passed unanimously.

Expenditure Summary Report – February 2018

The Expenditure Summary Report was presented to the Board and discussed.

J.D. Morscheck moved and Mike Cavanaugh seconded the motion to approve the February 2018 Expenditure Summary Report. The motion passed unanimously.

Schedule of Investments – February 2018

The monthly investment report was presented to the Board for review. The estimated market value of the SERS portfolio on February 28, 2018 was \$307.7 million with an estimated monthly rate of return of -1.9%.

Monthly Cash Reconciliation

The monthly cash reconciliation report for March 2018 was presented to provide the Board with additional insight into the ongoing liquidity and cash position of the plan.

Other Business

There being no other business, the meeting adjourned at 2:28 p.m.

Phillip Tencick, Retirement Director

SERS Retirement Transaction Report

April 2018

Retirements

	Name	Age	Retirement Date	Years of Service	Department	Option
1	Dann A. Douglas	67	04/12/2018	16.9	Engineering Services	E
2	Victoria L. Nicodemus beneficiary of Ronald E. Nicodemus	60	04/14/2018	36.9	Public Works & Utilities	E
3	Janet M. Worley	62	05/02/2018	31.0	Solid Waste Management	E
4	Donald E. McIntyre	68	05/04/2018	15.6	Parking Meters Advanced	E
5	George M. Eltz	74	05/16/2018	19.0	Wastewater Treatment	ST
6	Jeffrey T. Peer	50	06/01/2018	17.8	Fleet Services	ST
6	Patricia A. Bonner	65	06/16/2018	33.6	Library	ST
7	Thomas C. Kestell	63	07/07/2018	19.0	IT	D
8	John A. Walters	63	07/07/2018	20.0	IT	E
9	John W. Halsey	61	08/02/2018	23.5	Development Services Center	E
	Retirements YTD	23				
	2017 Total Retirements	62				

Withdrawals

	Name	Years of Service	Department	Termination Date
1	Joel B. Williamson	1.0	Council	01/04/2013
2	Lauren M. Bickel	0.2	Library	07/28/2017
3	Sean R. Zubaugh	0.9	Water	10/12/2017
4	Ronald E. Jobe beneficiary of Michael R. Jobe		Lump Sum Payout to Beneficiary	

Vesting

	Name	Department	Years of Service
1	Kenneth C. Gimpel	Solid Waste Disposal	5.3
2	Nicole R. Goes	Civil Service	7.8
3	Michelle D. Szambelan	Municipal Court	18.6

Deaths

	Name	Date Retired	Age	Date of Death	Information
1	Ida M. Cross	05/05/2017	95	04/06/2018	No Further Benefits
2	Wilma C. Beddow	06/08/2013	58	04/08/2018	E Option Continues

SPOKANE EMPLOYEES' RETIREMENT SYSTEM - 6100
 2018 EXPENDITURE SUMMARY REPORT
MARCH 31, 2018

	2017 ACTUAL	2018 BUDGET	MARCH ACTUAL EXPENDITURES	2018 ACTUAL YTD EXPENDITURES	VARIANCE	PERCENTAGE USED
OPERATING EXPENDITURES						
Departmental Salaries	272,809.13	290,564.00	31,660.01	63,580.01	226,983.99	21.9%
Departmental Benefits	78,628.12	86,250.00	8,388.97	20,275.08	65,974.92	23.5%
Reserve for Budget Adjustment	-	10,000.00	-	-	10,000.00	0.0%
Administrative Income	(19,374.47)	(10,000.00)	(6,598.00)	(6,598.00)	(3,402.00)	
Postage/Supplies/Other	4,680.88	9,950.00	42.85	304.53	9,645.47	3.1%
State Audit Charges	10,669.62	15,000.00	234.08	797.25	14,202.75	5.3%
Contractual Services	139,186.91	175,000.00	348.00	348.00	174,652.00	0.2%
Travel	10,968.76	15,000.00	-	81.69	14,918.31	0.5%
Registration/Schooling	15,980.00	15,000.00	7,990.00	7,990.00	7,010.00	53.3%
Other Dues/Subscriptions/Membership	1,886.00	2,500.00	-	160.00	2,340.00	6.4%
Other Miscellaneous Charges	708.66	1,300.00	55.00	169.48	1,130.52	13.0%
OPEB Expense	-	-	-	-	-	
Amortization	17,649.00	-	-	-	-	
TOTAL OPERATING EXPENDITURES	533,792.61	610,564.00	42,120.91	87,108.04	523,455.96	14.3%
INTERFUND EXPENDITURES						
Interfund - Centralized Purchasing	-	378.00	-	94.50	283.50	25.0%
Interfund - Centralized Accounting	2,346.92	2,078.00	-	519.40	1,558.60	25.0%
Interfund - IT Phones	1,514.36	-	-	-	-	
Interfund - Risk Management	760.00	790.00	-	197.50	592.50	25.0%
Interfund - Worker's Compensation	104.00	109.00	-	27.25	81.75	25.0%
Interfund - Reprographics	7,596.07	4,500.00	329.38	1,179.16	3,320.84	26.2%
Interfund - IT	13,756.33	16,171.00	1,353.69	2,706.21	13,464.79	16.7%
Interfund - IT Replacement	2,772.00	2,066.00	172.17	344.34	1,721.66	16.7%
Interfund - My Spokane	435.90	1,532.00	-	-	1,532.00	0.0%
TOTAL INTERFUND EXPENDITURES	29,285.58	27,624.00	1,855.24	5,068.36	22,555.64	18.3%
TOTAL ADMINISTRATIVE EXPENDITURES	563,078.19	638,188.00	43,976.15	92,176.40	546,011.60	14.4%

SPOKANE EMPLOYEES' RETIREMENT SYSTEM - 6100
 2018 EXPENDITURE SUMMARY REPORT
MARCH 31, 2018

	2017 ACTUAL	2018 BUDGET	MARCH ACTUAL EXPENDITURES	2018 ACTUAL YTD EXPENDITURES	VARIANCE	PERCENTAGE USED
PENSIONS						
Pensions-Annuity Benefit Payments	24,852,639.62	27,000,000.00	2,133,570.96	6,391,334.72	20,608,665.28	23.7%
Pensions-Disability Payments	125,328.48	140,000.00	10,444.04	31,332.12	108,667.88	22.4%
Pensions-Survivor Annuity Benefits Payments	1,913,816.49	2,100,000.00	157,169.13	470,400.35	1,629,599.65	22.4%
TOTAL PENSIONS	<u>26,891,784.59</u>	<u>29,240,000.00</u>	<u>2,301,184.13</u>	<u>6,893,067.19</u>	<u>22,346,932.81</u>	23.6%
Refunds	551,908.36	1,000,000.00	40,825.32	70,330.29	929,669.71	7.0%
TOTAL EXPENSES	<u><u>28,006,771.14</u></u>	<u><u>30,878,188.00</u></u>	<u><u>2,385,985.60</u></u>	<u><u>7,055,573.88</u></u>	<u><u>23,822,614.12</u></u>	22.8%
INVESTMENT EXPENSE*						
Advisory Technical Service	449,836.97	500,000.00	4,747.68	44,846.48	455,153.52	9.0%

* investment expenses are netted against investment income in the statement of changes of plan net assets to arrive at a net investment income amount.

SERS Schedule of Cash and Investments
March 31, 2018

4/19/2018

				Allocation		
				Target	Current	Diff.
		Type				
Cash Held by Treasurer	Cash		\$ 52,986			
US Bank	Short-term Inv		(519,602)			
	Total Cash		(466,616)	0.0%	-0.2%	-0.2%
Sterling Capital	Total Return		24,171,993			
	Total Total Return		24,171,993	10.0%	7.9%	-2.1%
Hotchkis & Wiley	High Yield - Mutual Fund		23,155,545			
	Total High Yield		23,155,545	5.0%	7.6%	2.6%
Polar	LLC		6,686,242			
American Beacon	Mutual Fund		2,266,596			
Castine Capital I	Ltd Partnership		7,917,414			
Post Limited Term High Yield	Ltd Partnership		5,980,053			
Rimrock Low Volatility	Ltd Partnership		9,775,030			
	Total Absolute Return		32,625,335	8.0%	10.7%	2.7%
Total Capital Preservation			79,486,257	23.0%	26.1%	3.1%
Hotchkis & Wiley	LC Value - Mutual Fund		15,411,928			
Jackson Square	LC Growth - Mutual Fund		16,096,474			
MFS Heritage	LC Core		17,810,974			
Vanguard S&P 500 Index	LC Core - Mutual Fund		10,296,304			
	Total US Large Cap		59,615,680	21.0%	19.6%	-1.4%
Sterling	MC Value		6,103,226			
Vanguard MC Growth	MC Growth - Mutual Fund		4,634,609			
Vanguard MC Index	MC Core - Mutual Fund		3,932,765			
Champlain	SC Core		5,778,530			
Phocas	SC Value - Mutual Fund		3,989,799			
Bridge City	SC Growth		6,229,183			
Vanguard SC Index	SC Core - Mutual Fund		858,893			
	Total US Small/Mid Cap		31,527,005	11.0%	10.3%	-0.7%
Total US Equities			91,142,685	32.0%	29.9%	-2.1%
Artisan	SMID Value - Mutual Fund		21,929,699			
Euro Pacific	LC Blend - Mutual Fund		22,315,891			
Vanguard International	LC Index - Mutual Fund		-			
	Total International Large Cap		44,245,590	15.0%	14.5%	-0.5%
Trivalent	SC Value - Mutual Fund		12,872,708			
	Total International Small/Mid		12,872,708	4.0%	4.2%	0.2%
Berens	Ltd Partnership		10,084,713			
	Total Emerging Markets		10,084,713	3.0%	3.3%	0.3%
Total International Equities			67,203,011	22.0%	22.0%	0.0%
Weatherlow Offshore	Ltd Partnership		15,766,270			
Royalty Opportunities I	Ltd Partnership		2,669,586			
Royalty Opportunities II	Ltd Partnership		2,555,125			
	Total Long Biased		20,990,981	7.0%	6.9%	-0.1%
Metropolitan Real Estate Partners	Ltd Partnership		223,118			
Morrison Street Fund IV	LLC		389,261			
Morrison Street Fund V	LLC		4,171,797			
Morrison Street Debt Opportunties	LP		4,096,610			
Principal (REITs)	REITs		9,613,258			
Morgan Stanley Prime	LLC		7,052,396			
	Total Real Estate		25,546,440	9.0%	8.4%	-0.6%
Beach Point	Ltd Partnership		10,377,444			
	Total Opportunistic Credit		10,377,444	7.0%	3.4%	-3.6%
OrbiMed II	Ltd Partnership		10,084,807			
	Total Special Opportunities		10,084,807	0.0%	3.3%	3.3%
Total Cash and Investments			\$ 304,831,625	100.0%	100.0%	0.0%
		Monthly Pension	\$ (2,342,009)			
		As of February 28, 2018	\$ 307,726,661			
		Estimated Rate of Return	-0.2%			
Abs. Return and Total Return FI	Thesis 2017.1		56,797,328	18.0%	18.6%	0.6%
High Yield and Opp Credit	Thesis 2017.2		33,532,989	12.0%	11.0%	-1.0%
Equity and Special Situations	Thesis 2017.3		168,430,503	54.0%	55.3%	1.3%

Cash Recon - Apr 18

Date	Transactions	Sources	Uses	Balance
3/21/2018	Beginning Balance			857,599.09
3/23/2018	Distribution - Morrison Street V	850,112.05		1,707,711.14
3/28/2018	Distribution - OrbiMed Royalty Opps II	16,620.34		1,724,331.48
3/29/2018	Distribution - Morgan Stanley Prime RE	69,526.46		1,793,857.94
3/30/2018	Pension Payments		(2,314,114.68)	(520,256.74)
4/2/2018	Sale - American Beacon	650,000.00		129,743.26
4/2/2018	Wire -		(27,894.77)	101,848.49
4/2/2018	Payroll Contributions	688,205.90		790,054.39
4/2/2018	Interest	654.74		790,709.13
4/6/2018	Purchase - Hotchkis & Wiley High Yield		(750,000.00)	40,709.13
4/9/2018	Cash Sweep	0.04		40,709.17
4/13/2018	Distribution - Morrison Street IV	9,456.27		50,165.40
4/16/2018	Payroll Contributions	692,728.54		733,437.71
4/18/2018	Ending Balance	2,977,304.34	(3,092,009.45)	742,893.98
	<u>Upcoming</u>			
4/20/2018	Sale		700,000.00	
4/30/2018	April Pension Payments		(2,368,352.23)	

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) OVERVIEW

April 25, 2018

SERS

Spokane Employees'
Retirement System

Fiduciary Duty

1) Duty of Loyalty

- Act solely in the interests of plan participants and their beneficiaries with the exclusive purpose of providing benefits to them
- Every action for the benefit of the members, not:
 - Self
 - Plan Sponsor
 - Citizens

2) Duty of Prudence

- Acting with care, skill, knowledge, prudence, and diligence

3) Duty to Diversify

- Diversify investments to reduce risk to the Plan
 - Reduce risk of a large loss
 - Consider how each investment fits in to the entire portfolio

Fiduciary Duty (cont'd)

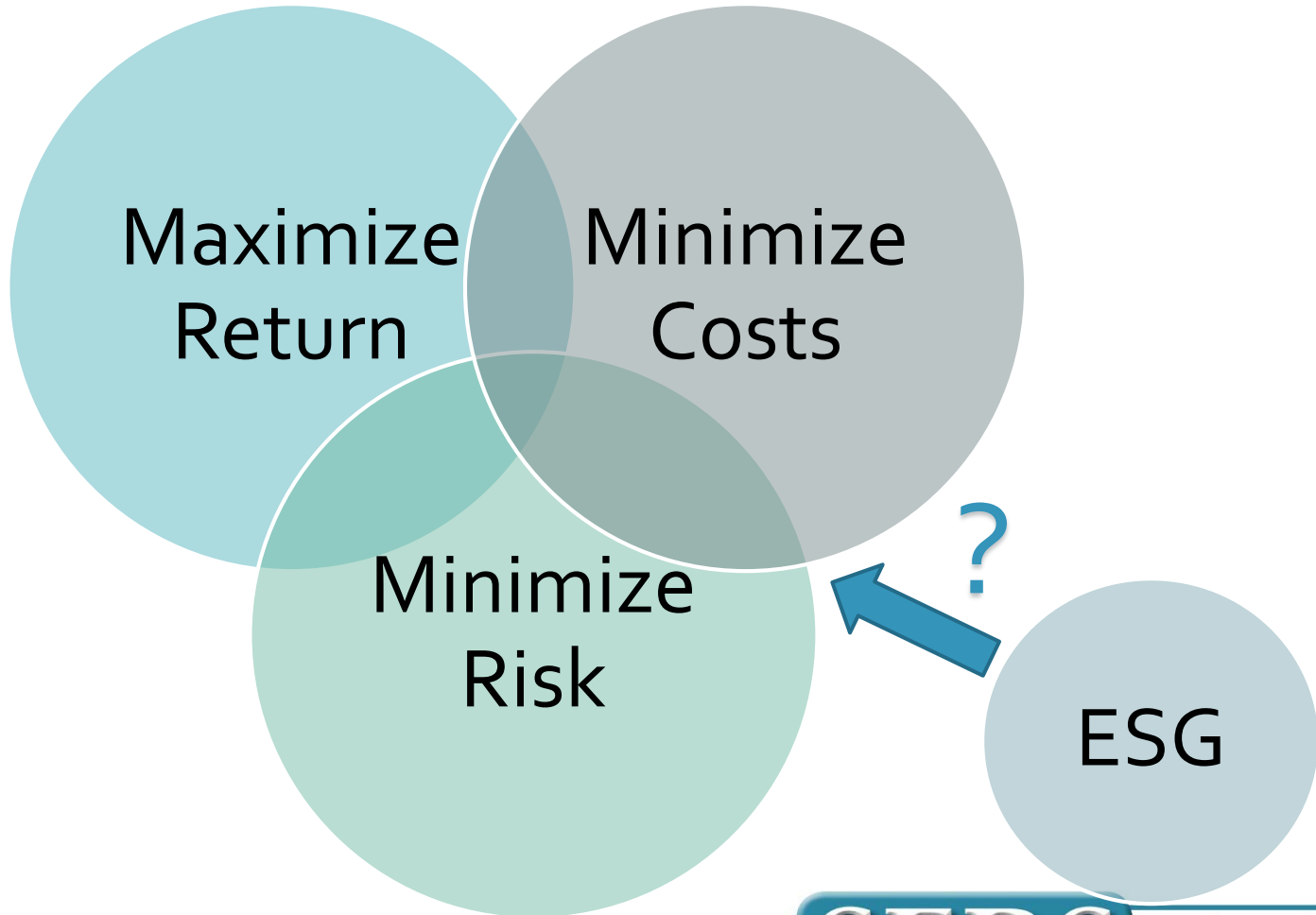
4) Duty to Adhere

- Document plan policies and processes
- Adhere to the documented policies and processes

5) Duty of Reasonableness

- Pay only reasonable plan expenses
 - Reducing expenses retains more assets for the benefit of plan participants
 - When in doubt, erring on the side of lower fees is generally safe

Where does ESG fit as a fiduciary?



ESG Issues

Environmental	Social	Governance
Climate change	"Sin" products	Board composition
Carbon emissions	Data protection & privacy	Bribery and corruption
Resource usage	Gender and diversity	Executive compensation
Biodiversity	Employee relations	Lobbying
Deforestation	Community relations	External causes
Energy efficiency	Human rights	Whistleblower schemes
Waste management	Labor standards	Regulatory oversight

Implementation Challenges

- Policy Creation
 - Inclusion/Exclusion
 - Industry vs. Company
 - Absolute vs. Relative
 - Investment vs. Investor
 - How to draw the lines?
 - Evaluation Criteria
 - Legal standards
 - Ethical standards
 - How to measure?
 - How much is allowed?
 - Benchmarking

Implementation Challenges (cont'd)

- Available Strategies and Vehicles
 - Subset of broader market
 - Comingled vehicles must meet policy
 - Separate account availability
- Costs
 - Active management only
 - Monitoring
 - Opportunity cost

Where does ESG fit as a fiduciary?

- **First, do no harm**
 - Can't decrease returns
 - Can't increase risk
 - Can't increase net costs
 - May serve as tie-breaker if all else equal
- **Demonstrate ESG adds value**
 - Premium for firms with high ESG scores?
 - ESG risks not correctly priced?
 - Early adopter premium?



EMPLOYEE BENEFITS LAW

PRIVILEGED & CONFIDENTIAL

THIS DOCUMENT IS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE.

MEMORANDUM

To: Board of Administration
Seattle City Employees' Retirement System

From: Michael Monaco

Date: July 13, 2017

Re: Legal Permissibility of Environmental, Social and Governance ("ESG") Investment Proposals

INTRODUCTION

In accordance with the directions of the Board at its meeting on April 13, 2017, we have conducted a comprehensive reexamination of whether there has been any expansion or change in the legal rules determining the legality of ESG investment proposals. Following a review of relevant legal authorities in Washington State, throughout the United States, and internationally, we conclude that there has been no change in the legal standards that SCERS must follow in considering ESG proposals. Indeed, the ESG legal standards relevant to SCERS have only been reaffirmed by relevant court decisions, legal articles and treaties, model laws, and opinions by other law firms regarding the fiduciary responsibility standards governing retirement plans.

Thus, proposals to SCERS for ESG investments remain subject to the legal standards outlined in the Board's Policy and Procedure for Consideration of Environmental, Social and Governance Investment Proposals, and there is no reasonable prospect of a change in those standards in the foreseeable future.

DETAILED LEGAL ANALYSIS

A. Long-Standing Elements of Fiduciary Responsibility and Legally-Required Analysis of ESG Investment Proposals

The ESG policy that SCERS adopted in 2013 and updated in 2016 follows the well-established legal approach to consideration of ESG investments. That policy states:

The Board's fiduciary obligations to the members of SCERS are paramount. Investment actions that promote an ESG goal such as rewarding workplace

diversity, promoting local industry, or protecting the environment may be considered if the proposed action does not adversely affect investment risk and/or return for SCERS and if the resulting expected return on investment and related risk for the proposed action are economically equivalent to other available investments in the same category. While the Board may give serious consideration to environmental, social and governance issues, the Board must follow its fiduciary obligations and Investment Policy and an investment cannot be selected, rejected, or divested from based solely on those considerations. In addition, where an ESG consideration has a direct relationship to the economic value of an investment, that factor is a proper component of the Board's fiduciary analysis of the economic merit of the investment decision.

....

The Board will give preference to an Investment Manager that advances its ESG goals if the selection results in an expected return on investment and related risk that it is at least economically equivalent to other available Investment Managers in the same category.

These ESG policies have been developed and applied to SCERS because the retirement system's assets are held in trust solely for the benefit of members and their beneficiaries, and because SCERS is subject to strict requirements of fiduciary responsibility under Washington state law.

Seattle Municipal Code (SMC) 4.36.605A states:

The retirement fund shall be a trust fund for the exclusive benefit of the members of the City Employees' Retirement System and their beneficiaries. No part of the corpus or income of the retirement fund shall be used for or diverted to, purposes other than for the exclusive benefit of the members of the system or their beneficiaries and the payment of fees and expenses of maintaining and administering the system.

This structure makes the Board of Administration members function as trustees over SCERS' assets – subject to the duty of loyalty as well as the duty of prudence in SCERS investments. As summarized by the Washington Supreme Court, the duty of loyalty means that the Board “must act with undivided loyalty to the trust beneficiaries, *to the exclusion of all other interests*. . . . It may not sacrifice this goal to pursue other objectives, no matter how laudable those objectives may be.” *Skamania v. State*, 102 Wn.2d 127, 134 (1984) (emphasis added).

Investment and management of SCERS assets is also a matter of fiduciary responsibility under state law. Under state law the Board of Administration must:

act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man or woman acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; shall diversify the investments of the employees' pension system so as

to minimize the risk of large losses; and shall act in accordance with the documents and instruments governing the employees' pension system, insofar as such documents and instruments are consistent with the provisions of this title.

RCW 35.39.060. This is very similar to the fiduciary responsibility of the Washington State Investment Board in investing the state retirement systems' holdings. RCW 43.33A.140.

Because of these directives, it has long been understood by the state, the City of Seattle and SCERS that investment proposals targeted to address environmental, social, and governance issues have to meet the same fiduciary standards of prudent investment as any other investments. For example, addressing proposed divestment from companies doing business in South Africa, in 1985 the Seattle City Attorney's office opined that "[w]hen the return to and the safety of principal from investments are equivalent, trustees may take into account in making trust investments . . . moral, ethical, and social considerations." Opinion 7695 (March 26, 1985). That opinion concluded that the Board of Administration "may not pursue a policy or practice, which reduces the financial return to the pension fund or significantly increases the risk to fund capital in order to further ethical or social considerations." This is consistent with legal opinions throughout the nation regarding public and private retirement fund investments. Exercising its authority to oversee fiduciary responsibility in private pension plans, the U.S. Department of Labor has likewise stated that "in the course of discharging their duties, fiduciaries may never subordinate the economic interests of the plan to unrelated objectives, and may not select investments on the basis of any factor outside the economic interest of the plan," except in the limited circumstance where two or more "investment alternatives . . . are otherwise equal with respect to return and risk over the appropriate time horizon." See U.S. Dept. of Labor Interpretive Bulletins 2008-1 & 2015-1. SCERS's policy for consideration of ESG investment proposals follows these requirements. Of course, where an ESG consideration has a direct relationship to the economic value of an investment, that factor has always been and remains a proper component of fiduciary analysis of the economic merit of the decision.

The Washington State Investment Board's policy regarding Economically Targeted Investments (ETIs) takes the same approach, stating that the WSIB "will consider for investment only those ETIs that are commensurate on a risk-adjusted financial basis to alternatively available investments" and that a "decision to invest in an ETI in consideration of its collateral benefits shall be made only after the opportunity is deemed acceptable exclusively on its economic investment merits."

Fiduciary duty has also long been understood to require that appropriate experts be employed to provide the Board members with the information that they need in order to meet their fiduciary responsibilities. Board members must either become knowledgeable themselves on sophisticated investment issues, or use experts to augment their own expertise in order to make investments consistent with the work of a sophisticated, professional investment team. As one federal appeals court put it: "A pure heart and an empty head are not enough." *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983).

B. Consideration of Changes to the Legal Standards for Permissible ESG Investments

Over the years, the accepted legal standards for consideration of ESG investments have sometimes been questioned or challenged, particularly by proponents of broader acceptability of ESG proposals. These efforts have not produced any changes in Washington law or in the law nationally, and instead the only substantial developments have been to reaffirm the legal principles described above.

1. Continuation of “Tie-Breaker” Legal Standard for ESG Actions

The Washington State Supreme Court’s *Skamania v. State* decision remains in full effect in all state courts and continues to require that the Board of Administration “*act with undivided loyalty to the trust beneficiaries, to the exclusion of all other interests*” and “*may not sacrifice this goal to pursue other objectives, no matter how laudable those objectives may be.*” The court decisions from around the nation analyzing fiduciary responsibility have uniformly required that an ESG action be taken only where it is equivalent to other available investment options. *Associated Students of the University of Oregon v. Oregon Investment Council*, No. 78-7502 (Cir. Ct. Lane Co. Or. Jan. 21, 1985), *rev’d* 728 P.2d 30 (Or. App. 1986), *pet. den.* 734 P.2d 354 (Or. 1987); *Sgaglione v. Levitt*, 337 N.E.2d 592 (N.Y. 1975); *Board of Trustees of Employees’ Retirement System of City of Baltimore v. Mayor & City Council of Baltimore*, 562 A.2d 720 (Md. App. 1989). To our knowledge after exhaustive research, no contrary court decisions have been issued in the 33 years since *Skamania* was decided, or in the wake of any of the other ESG decisions.

Meanwhile the U.S. Department of Labor has repeatedly reaffirmed the ESG “tie-breaker” framework, in which collateral benefits of an ESG proposal may only be considered if the ESG and non-ESG investment options are economically equivalent. The most recent of these reaffirmations came in 2015, in U.S. Dept. of Labor Interpretive Bulletin 2015-1.

In addition, as noted above, law firms other than MMPL have conducted independent analyses of the fiduciary responsibilities applicable to ESG proposals to plans like SCERS, and concluded that the ESG standard is consistent with SCERS’s existing policy.

There are thus no court decisions or other authorities to suggest any likelihood of changes to the law of ESG investment consideration.

2. Continuing Need to Rely on Experts and Well-Accepted Economic Principles

Particularly in the wake of financial services scandals and the economic crisis of 2008-2009, some advocates of broader ESG investment have argued that ordinary methods of valuation of stocks and other securities are missing the mark and should be supplemented – simply for the benefit of the retirement fund and the beneficiaries, to protect them from overvaluations. In particular, advocates of divestment from fossil-fuel companies have suggested that the financial markets are overvaluing them, and that alternative analyses of the alleged weaknesses of these companies require consideration of fossil fuel divestment.

However, in the last few years the U.S. Supreme Court has reaffirmed that it is generally “implausible” for a fiduciary to believe that a retirement plan committee can predict the value of a publicly-traded company better than the financial markets have. *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2471 (2014). The Supreme Court has endorsed rulings in other court cases that: “[a] trustee is not imprudent to assume that a major stock market . . . provides the best estimate of the value of the stocks traded on it” and “[f]iduciaries are not expected to predict the future of the company stock’s performance.” *Id.* (internal quotation marks and citations omitted).

Thus, we continue to believe that the legal hazards would be great if a fiduciary were to consider taking an ESG action based (in whole or in part) on a rejection of ordinary economic principles as explained by investment professionals. As stated above, U.S. Supreme Court expressly considers a fiduciary’s acceptance well-established economic principles like the “efficient markets” view of publicly-traded companies to be prudent. More generally, the decisions by the U.S. Supreme Court (and other federal courts throughout the country) on these issues demonstrate the legal safety of basing investment decisions on analysis by established professionals with unquestionable expertise, and following established and accepted modes of analysis as well as the great hazard of failing to do so.

3. Rejection of General-Community-Benefit ESG Standard

It has sometimes been suggested that an ESG investment decision may be justified by not merely considering the economic value of the investment, but also considering the overall benefit to the community (particularly including non-economic advantages provided to beneficiaries of the plan). This reasoning has not been accepted by any courts or decision makers in the U.S., nor to our knowledge in any other countries. It also appears to be inconsistent with *Skamania* and the court decisions and agency rules discussed above.

While it might appear that some reputable treatises and reports have endorsed this type of expansive approach to ESG investments, no significant authorities have actually done so. For example, the 1988 edition of the legal treatise *Scott on Trusts* indicated that it might be permissible to consider the general benefit to the community as an element of fiduciary review of a corporate investment (even where that benefit does not translate into economic value of the company), stating that “the investor, through a trustee of funds for others, is entitled to consider the welfare of the community, and refrain from allowing the use of funds in a manner detrimental to society.” Austin W. Scott, *The Law of Trusts* (“*Scott on Trusts*”), § 227.14 (4th ed. 1988). But the subsequent edition of that treatise clarified that in accordance with the Uniform Prudent Investor Act and the *Third Restatement of Trusts*:

[T]he trustee should seek to secure for the beneficiaries the maximum overall return that is consistent with the level of risk that is appropriate under the circumstances. . . . No form of so-called “social investing” is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries – for example, by accepting below-market returns – in favor of the

interests of the persons supposedly benefitted by pursuing the particular social cause.

Scott on Trusts, § 19.1.13 (5th ed. 2007) (quoting Uniform Prudent Investor Act; internal quotation marks omitted).

Likewise, reports by influential international bodies are sometimes characterized as promoting a more permissive view of ESG investments, when they actually have not done so. For example, the 2005 legal analysis by the Freshfields Bruckhaus Deringer law firm for the United Nations Environmental Programmes' Finance Initiative (commonly known as the "Freshfields Report") broadly states that "a decision-maker may integrate ESG considerations into an investment decision to give effect to the views of the beneficiaries in relation to matters beyond financial return," but in the same section that Report ultimately states as follows:

[In] cases where a decision-maker has exhausted the analysis of financial criteria, including value-related ESG considerations [i.e. those related to the economic value of the investment] . . . and is still left with a number of alternatives, of equal attractiveness from the point of view of the overall investment strategy the decision-maker would be entitled to select on alternative on the basis of its non-value-related ESG characteristics, without thereby being in breach of his or her fiduciary duties or civil law obligations.

UNEP Finance Initiative, *A Legal Framework for the Integration of Environmental, Social and Governance Issues Into Institutional Investment*, p. 12 (October 2005) (emphasis added) (emphasis added).

Thus the "Freshfields Report," like many other reports promoting ESG investment, may be referenced in ways that suggest that the field of legally-permissible ESG investments should be (or even has already been) expanded, when in fact the legal analysis in that report is in line with the ordinary rule that only where there are a "number of alternatives, of equal attractiveness" from an economic perspective can a fiduciary choose an ESG option on the basis of non-economic factors.

4. Impossibility of Obtaining Universal Beneficiary Consent to ESG Investments

Under Washington law and a wide variety of national legal authorities, including the *Restatement of Trusts*, it is widely accepted that there is no breach of fiduciary duty if a well-informed beneficiary consents to an investment – even if that investment underperforms economically.

On the basis of this, some have suggested that it may be permissible to make an ESG investment decision on the basis of a broad but not universal "consensus" of the beneficiaries of the trust – particularly in light of language of the Freshfields Report that fiduciary can make an investment decision by "point[ing] to a consensus amongst the beneficiaries in support of" the decision. *See Freshfields Report*, p. 12. But that types of statement in the Freshfields Report (and elsewhere) cannot be read to provide a legal basis for an ESG decision based on the consent of only *some* of

the beneficiaries affected by it. Under the well-established law, “the power of one beneficiary to ratify [an investment decision] cannot be used to impair the rights of the other beneficiaries.” See, e.g., John H. Langbein and Richard A. Posner, *Social Investing and the Law of Trusts*, 79 Mich. L. Rev. 72, 105 (1980).

In a pension plan with thousands of active members and retirees, it would be impossible to obtain universal consent to any proposed ESG decision, and the notion of a general “consensus” to a proposed ESG action would be of essentially no use in preventing claims of fiduciary breach. This would be true even if a mechanism could somehow be developed and implemented to “poll” members of SCERS and obtain express statements of support for an ESG action from a wide group (or even a large majority) of members of the system. In the end, even having done such laborious work to demonstrate “support” for an ESG action, there would still be a great risk that claims of fiduciary breach could be brought (at a minimum) by each and every person who had not given such “consent” or otherwise expressed support.



TITLE: Consideration of Environmental, Social, and Governance Policy and Procedure

EFFECTIVE DATE: June 9, 2016

BOARD ADOPTION: June 9, 2016

POLICY

The Board of Administration (Board) adopts this policy regarding consideration of environmental, social and governance (ESG) issues for Seattle City Employees' Retirement System (SCERS) investments.

The Board's fiduciary obligations to the members of SCERS are paramount. Investment actions that promote an ESG goal such as rewarding workplace diversity, promoting local industry, or protecting the environment may be considered if the proposed action does not adversely affect investment risk and/or return for SCERS and if the resulting expected return on investment and related risk for the proposed action are economically equivalent to other available investments in the same category. While the Board may give serious consideration to environmental, social and governance issues, the Board must follow its fiduciary obligations and Investment Policy and an investment cannot be selected, rejected, or divested from based solely on those considerations. In addition, where an ESG consideration has a direct relationship to the economic value of an investment, that factor is a proper component of the Board's fiduciary analysis of the economic merit of the investment decision.

To further its ESG objectives, the Board will seek to select Investment Managers from a broad universe that, to the extent available, includes qualified Investment Managers that further ESG goals (for example, firms promoting workplace diversity, sustainability, and governance objectives). The Board will give preference to an Investment Manager that advances its ESG goals if the selection results in an expected return on investment and related risk that it is at least economically equivalent to other available Investment Managers in the same category. SCERS staff will report on efforts to include such Investment Managers in the search process.

The Board also wishes to stay abreast of developments related to ESG issues and to follow best practices to the extent that they are consistent with its fiduciary obligations. To this end, the Board directs that: (1) SCERS participate in membership organizations and partner with other institutional investors to share information and pursue ESG issues of mutual concern; (2) SCERS staff provide quarterly updates on its activities and industry developments related to ESG issues; and, (3) the SCERS Investment Consultant provide an annual overview of ESG issues and industry responses to the Board or Investment Committee to guide future ESG policy and practices.

PROCEDURE FOR CONSIDERATION OF ESG INVESTMENT PROPOSALS

SCERS sometimes receives proposals for consideration of ESG investment actions from outside sources other than its investment staff or professional advisors – for example, proposals to make particular investments, to refrain from doing so, or to take other actions related to the handling of SCERS's assets or the rights associated with those assets. Any and all such proposals are to be considered in the manner outlined in this policy and procedure.

- A. To receive consideration, a proposed ESG investment action must meet the following requirements:
1. It must be specific and presented in writing to the Executive Director of SCERS;
 2. It must include objective, reasoned analysis indicating how the proposal meets the fiduciary obligations of SCERS, and how it does not adversely affect SCERS's expected risk adjusted return as compared to other available investments in the same category;



3. It must be reasonably feasible for SCERS to accommodate within SCERS's portfolio of investments or in a reasonable modification of them; and
4. It must not, in the discretion of the Board, be considered duplicative of a recently considered proposal or similar proposal.

The Board will address whether proposals meet these requirements only at its March, June, September, and December regular meetings, except where it finds a postponement appropriate.

- B. If an ESG investment proposal meets all of the requirements of Section A as determined by the Board, it shall be forwarded to SCERS's Investment Consultant for review and written analysis of whether the proposal meets the requirements of this Policy and SCERS's Investment Policy. The written analysis shall provide:
 1. Identification of the potentially available ESG investment options, if any, that meet the requirements of SCERS's investment policies;
 2. A survey of comparable investment funds' approaches to this type of proposal, or similar proposals;
 3. An assessment of the projected impact of the proposal on SCERS's expected risk adjusted return as compared to other available investments in the same category; and
 4. Whether the Investment Consultant recommends that the proposal be adopted by the Board.
- C. If the Investment Consultant reports that the ESG proposal meets the requirements of SCERS's investment policies, the Board shall consider taking action on the proposal, after receiving such additional information as the Board may deem necessary or appropriate from the Investment Consultant, Investment Advisory Committee, SCERS staff, and any other investment professionals.

POLICY REVIEW


The Board shall review this policy at least once every three (3) years to ensure that it remains relevant and appropriate.

Privileged & Confidential

Attorney-Client Communication

MEMORANDUM

TO: Mr. Phillip Tencick

FROM: Lorne O. Dauenhauer 

DATE: April 16, 2018

CLIENT 041347.000001

MATTER NO.:

SUBJECT: Payment of OPEB Expenses from SERS Assets

You have asked me to provide you with advice regarding whether certain other post-employment benefits (OPEB) expenses being assessed against the City of Spokane department that handles administration of the Spokane Employees' Retirement System (the "Department") are properly payable from the assets of the Spokane Employees' Retirement System ("SERS").

Executive Summary

As further discussed below, our recommendation is that the Board not permit Fund assets to be used for the payment of OPEB expenses being assessed by the City against the Department unless and until the City provides information to the Board to enable the Board to determine that the amount being assessed against the Department bears a reasonable relationship to the City's actual costs for the Department's employees. Moreover, inasmuch as none of the OPEB expense being allocated by the City to the Department is attributable to post-retirement medical benefits being received by current or former Department employees, we do not believe any portion of the allocated expense is properly payable using SERS assets.

Background and Analysis

SERS is a tax-qualified retirement plan under Section 401(a) of the Internal Revenue Code of 1986, as amended (the "Code"), and is sponsored by the City of Spokane (the "City"). As with all qualified retirement plans, SERS is required to have a written plan document that governs how SERS is administered. The SERS plan document is codified in Title 03, Chapter 5 of the Spokane Municipal Code (the "SMC"). Pursuant to SMC 3.05.070, SERS is funded by the Employees'

Retirement Fund (the “Fund”). Under that section, the Fund “shall be a trust fund held for the exclusive benefit of the members of the retirement system and their beneficiaries [under which, none of the Fund assets] shall be used for, or diverted to, purposes other than for the exclusive benefit of the members or their beneficiaries **and the payment of fees and expenses of maintaining and administering the retirement system.**” (emphasis supplied).

Accordingly, the Fund’s assets can be used to pay the “fees and expenses of maintaining and administering” SERS.

Although SERS is a qualified plan, because SERS’ sponsor is the City, SERS is considered a “governmental plan” and, as such, is exempt from ERISA.

Still, even for governmental plans, it is common to look to ERISA as a guide to establish reasonable practices for the manner in which the governmental plan is operated.

ERISA plans are subject to an “exclusive benefit” rule that is actually very similar to that found in SMC 03.05.070. Specifically, ERISA 403(c)(1) provides that, except otherwise provided, “the assets of a [retirement] plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and **defraying reasonable expenses of administering the plan.**” (emphasis supplied). With respect to the “defrayment” of reasonable expenses, ERISA 408(b)(2) provides that administrative fees can be paid to a “party in interest” (which would include, among other things, the plan’s sponsor) “for services necessary for the operation of the plan if no more than reasonable compensation is paid.”

We understand that the Department’s responsibilities are mostly limited to the administration of the SERS plan. We further understand that the salaries and benefits of the Department’s employees are paid from the Fund.

Under the ERISA construct, because the Department’s employees are for the most part dedicated to providing service to SERS, the payment of the Department’s employees’ salaries and benefits would be permitted, so long as those salaries and benefits were “reasonable.”

We further understand that certain City employees are currently eligible for post-retirement medical benefits. An employee does not become eligible for those post-retirement medical benefits, however, unless and until the employee retires with sufficient service to make him/her vested in those benefits. We further understand that these post-retirement medical benefits are offered under a post-retirement medical benefit plan (the “PRMBP”), which is administered by the City. Retirees covered by the PRMBP pay premiums equal to the medical premiums being paid by the City’s active employees. However, the actual cost of PRMBP coverage is higher than the PRMBP premiums being paid by the retirees. Since the cost of PRMBP coverage is greater than the premiums being paid by retirees for PRMBP coverage, this is not a cost-neutral benefit for the City. As a result, the City is expensing as OPEB the excess of actual PRMBP costs over actual PRMBP premiums as a “charge” under GASB 75.

We further understand that the City is assessing the OPEB charge against all City departments – including the Department – and that the allocation itself against any particular department is

determined based on the number of active employees in a given department enrolled in the City's insurance plan (for active employees) divided by the total number of active employees in all City departments enrolled in that same insurance plan.

You have asked whether the OPEB assessment against the Bureau is an expense that can be paid by the Fund consistent with SMC 3.05.070.

As discussed above, SMC 3.05.070 permits the Fund to pay "the fees and expenses of maintaining and administering the retirement system." In the instant case, however, unlike the salaries and benefits paid to Department employees (which, as noted above, are properly payable from the Fund, both under SMC 3.05.070 and its ERISA analogs), it is not clear at all whether and how the Department's OPEB assessment – a pro-rata allocation based on City-wide active employees - bears a reasonable relationship to the actual costs of "maintaining and administering the retirement system."

As we currently understand the facts, no former Department employee is currently enrolled in PRMBP benefits. Consequently, no portion of the OPEB amount being allocated to the Department is attributable to PRMBP benefits being paid to Department employees. Consequently, no portion of the OPEB amount being allocated to the Department is attributable to PRMBP benefits being paid to Department employees.

Unless the OPEB amount being allocated against the Department is reasonably related to the actual costs of maintaining and administering SERS, payment of that allocated amount from the Fund could violate SMC 3.05.070.

Moreover, if SERS was subject to ERISA, it is safe to say that the Department's OPEB assessment, if paid with SERS assets, would violate ERISA's exclusive benefit rule since no portion of the assessment relates to services rendered by Department employees (and therefore no portion of that assessment would be "necessary" for SERS operations).

In light of the foregoing, my recommendation is for the Board to not authorize payment by the Fund of any OPEB amounts being allocated against the Department without the City first providing the Board with information sufficient to demonstrate to the Board's satisfaction that the allocated amounts are reasonably related to the actual cost of providing those benefits to the Department's employees (i.e., City employees who were providing services to SERS). Under the current facts, with none of the OPEB amount being directly, or even indirectly, related to the costs of providing benefits to current or retired Department employees, it is difficult to see how any of the Department's OPEB allocation (under the City's current allocation method) could be paid by SERS without violating SMC 03.05.070.

Should you have any questions or concerns about the foregoing, please let me know.