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THE PENSION REVIEW COMMITTEE

REPORT TO THE

GENERAL EMPLOYEES' PENSION PLAN

BOARD OF TRUSTEES IN RESPONSE TO THE

REFERRAL ON SOCIALLY RESPONSIBLE INVESTING

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Executive Summary

Pursuant to the November 27, 2000 referral from the Board of Trustees the Pension Review Committee (PRC) took up the issue of Socially Responsible Investing (SRI) at their meeting of April 18, 2001. The results of the research done on other municipalities, as well as a survey of General Plan retirees and active member's opinions on socially responsible investing, were reviewed and discussed. Included in their deliberations was the Committee's assessment of the SRI investment process as described by Octavio Cabrera, Regional Vice President of Retirement Sales for Citizens Funds in his February 28, 2001, presentation to the PRC. After considering all these factors, the PRC unanimously reaffirmed their recommendation to the Board of Trustees of November 27, 2000 that the Board should not implement socially responsible investing screens in the management of the General Employees' Pension Plan portfolio. Additionally, the Plan's external investment consultant recommends against enacting SRI guidelines. The attached letter from the consultant, Dan Holmes of Summit Strategies Group, details the reasoning behind his recommendation. (Attachment 1)

For the most part, the plan has been managed by choosing defined asset mix and diversification strategies, and hiring professional managers to fulfill specific roles in that strategy. If the managers perform as expected, they are retained. If they perform poorly, they are dismissed. We compensate these managers well with the single goal of maximizing Plan returns generated within acceptable diversification and risk parameters.

That being said, there are two issues that emerged from our research on this subject. First, although none of the peer cities we were directed to survey include SRI screens within their defined benefit pension plans, there are a number of organizations that are making available to their employees socially responsible investment products through defined contribution or deferred compensation plans.

Second, though plan members (actives and retirees) voted 2 to 1 not to implement SRI screens in the Plan portfolio, this result does indicate some desire for a socially responsible investing alternative among a certain segment of members. Though it is the position of the PRC and the Plan's investment consultant that the Plan portfolio is not the appropriate vehicle for SRI products, it is the PRC's recommendation that the City Commission instruct staff to work with its defined contribution and deferred compensation providers to include the availability of SRI instruments to employees through these plans.

Five Elements of Commission Referral

At its meeting of November 27, 2000 the Board of Trustees directed that the following tasks be accomplished:

1) Distribute a copy of the e-mail on socially responsible investing presented by Trustee Hanrahan to the Board of Trustees on November 27 to the Pension Review Committee for their information and consideration;
2) Provide a history of the City of Gainesville's investment policy regarding South Africa and any other screening that has been applied over time;
3) Provide information on peer cities such as Ann Arbor, Madison, Austin, Minneapolis, Portland and Seattle regarding whether their investment policies contain socially responsible screens;
4) Report on any statutory restrictions prohibiting the introduction of socially responsible investment screens; and
5) Survey City employees and retirees to determine their position on the inclusion of socially responsible screens in the General Employees' Pension Plan investment policy

The matter was referred to the Pension Review Committee, with a report due back no later than May 27, 2001.

1) **DISTRIBUTION OF E-MAIL ON SOCIALLY RESPONSIBLE INVESTING**
   The e-mail presented by Commissioner Hanrahan to the Board of Trustees at their November 27 2000 meeting was distributed to the Pension Review Committee at their meeting of November 29, 2000.

2) **CITY HISTORY OF SOCIALLY RESPONSIBLE INVESTING**
   As far as can be determined, the City's only effort at incorporating socially responsible screens in its pension fund investment policies is related to the divestiture of South African assets. Following is a brief chronology of the events associated with the implementation of that policy.

9/30/85 Resolution No. R-85-96 This was the initial resolution related to the South African divestiture passed by the Board of Trustees of the Employees' Pension Plan. The resolution called for investment managers to identify and utilize comparable investment opportunities other than investments in corporations, their subsidiaries or parent companies which conducted business in or with the Republic of South Africa, or with corporations organized under the laws of South Africa. The managers were instructed to utilize these investment opportunities consistent with the goals of preserving capital and maximizing return with prudent regard for risk.

The resolution directed that the divestment should be completed not later than three years from the effective date of the resolution. Finally, there was a provision which called for the resolution to be renewed annually.

9/30/85 Resolution No. R-85-97 This was the companion resolution to R-85-96, passed by the Board of Trustees of the Consolidated Police Officers' and Firefighters' Retirement Plan. Its provisions were identical to R-85-96.

6/16/87 Resolution No. CR-87-01 Pursuant to Florida Statutes, on October 1, 1986 a separate Consolidated Board of Trustees was formed. On June 16, 1987, the Consolidated Board passed this resolution related to divestiture of South African stocks. While similar to R-85-97, there were several significant differences:

- The provisions of the resolution stated that nothing in the resolution prohibited the purchase of any investment, whether it was currently held as a part of the manager's portfolio or not, as long as the investment met the criteria specified in the investment guidelines for the plan.
- This made it clear that the investment manager could make any purchase as long as it met the established investment criteria. Therefore, if the manager found a South African stock that was an attractive investment, felt that the company's overall exposure in South Africa was minimal to the point that there was no relative risk, and could not find an equal or superior non-South African investment, the manager was free to make the purchase.
- The reference in R-85-97 to the fact that divestment should occur within three years of the effective date was removed.
- The annual renewal requirement was removed. Therefore, the resolution became an ongoing policy.

10/12/87 Resolution No. R-87-72 This resolution, passed by the Board of Trustees of the Employees' Pension Plan, amended Resolution No. R-85-96. The only material change incorporated in this amendment was the provision that the scheduled date for completion of divestiture was moved to September 30, 1990.

12/1/87 The Consolidated Board of Trustees moved to rescind Resolution CR-87-01 and "operate without any resolution other than prudent investment rules".

10/24/88 Resolution No. R-88-40 This resolution from the Board of Trustees of the Employees' Pension Plan represents the required annual renewal of R-87-72. No provisions of the existing resolution were changed.

9/27/93 At a City Commission special session held to discuss City advisory boards upcoming workplans, the Pension Review Committee discussed the South African Investment Policy. The Pension Review Committee was asked to return to the Board of Trustees of the Employees' Pension Plan with a recommendation regarding South African investment at the second City Commission meeting in October.

10/18/93 Resolution No. R-93-63 In response to the 9/27/93 request, the Pension Review Committee returned on 10/18/93 with a recommendation that the Board of Trustees of the Employees' Pension Plan repeal Resolution No. R-88-40. The Board of Trustees then passed Resolution No.R-93-63, thereby repealing R-88-40. The Board cited the following three factors in repealing this ordinance:

- On September 24, 1993 Nelson Mandela called for a lifting of economic sanctions against South Africa in an address to the United Nations

- Also on September 24, 1993 the federal government, after having lifted most trade and investment restrictions against South Africa in July of 1991, lifted the remaining restrictions
- The Mayor received a letter from the Ambassador of South Africa requesting that investment relations be normalized

Upon passage of R-93-63, investment managers were to be informed that they were no longer constrained from purchasing the securities of subsidiaries or parent companies which conduct business in or with South Africa, or with corporations organized under the laws of South Africa.

3) PEER CITY SURVEY

Staff contacted a number of different cities and inquired as to whether their investment policies incorporated socially responsible investing clauses. Following are the results of this search:

Peer Cities

Ann Arbor, Michigan

Contact Person: Willie Powell – Executive Director
(734) 994-4590

The City of Ann Arbor's defined benefit pension plan covers 1,000 active employees with assets of $412 million dollars.

The defined benefit pension plan does not include any SRI investments.

The City of Ann Arbor has a VEBA Trust. The VEBA Trust, funded solely by employer contributions, is used by employees to pay for qualified medical expenses. Currently, 60% of the Trust's $13.5 million dollars is invested in the Active Socially Responsible Equity Common Trust Fund managed by State Street Global Advisors.

Madison, Wisconsin

Contact Person: Vicki Hearing – Public Information Officer
(608) 261-2415

The State of Wisconsin Investment Board currently manages about $65 billion dollars for the Wisconsin Retirement System (WRS). The WRS has 463,000 participants that include the majority of public employees for the state, local government and schools. WRS does not currently make investments based on social concerns.

The following is an e-mail received from Keith Johnson, Chief Legal Counsel for The State of Wisconsin Investment Board.

"The State of Wisconsin Investment Board (SWIB) does not restrict managers on the basis of different peoples' ideas of what are socially responsible investments.

However, we do encourage mangers to take the economic and financial impact of irresponsible activities into consideration when evaluating a company as a potential investment. We believe this focuses the analysis in a way that complies with our fiduciary responsibility.

In addition, we have used ratings by Freedom House as a screen for unacceptable levels of risk to investors in foreign nations. Countries that are rated "Not Free" by Freedom House are excluded from the potential investment universe.

We will also write letters to management of companies where we are invested asking them to take socially responsible actions, like comply with the Cigarette Advertising Code prohibitions on marketing to minors. We also support shareholder resolutions on that issue. We sometimes support, on a case by case basis, resolutions put forth by other shareholders seeking greater disclosure on environmental or human rights issues."

Austin, Texas

Contact Person: Catherine Harrington – Pension Director
(512) 458-2551

The City of Austin General Employees' Plan holds $1.2 billion dollars in assets. They have no Socially Responsible Investing (SRI) allocations.

Minneapolis, Minnesota

Contact Person: Judith Johnson – Executive Director
(612) 335-5939

The Minneapolis Employees Retirement Plan has approximately $1.7 billion dollars in investments. There are no allocations to SRI.

Portland, Oregon

Contact Person: Don Smith – Director of Investments
(503) 378-4111

The City of Portland employees are covered by the Oregon State Public Employees Retirement system with $38 billion dollars in assets. Investments are made on the basis of prudence. There are no SRI allocations.

Seattle, Washington

Contact Person: Mel Robertson – Assistant Executive Director
(206) 386-1292

There are no SRI allocations for their $1.5 billion dollar defined benefit pension plan.

In addition to contacting these peer cities as directed by the Board of Trustees, we expanded our review to other organizations and cities as detailed below.

East Lansing, Michigan

Contact Person: Ronald Beaton – Director of Administrative Services
(800) 767-6377

East Lansing employees participate in the Municipal Employees' Retirement System of Michigan (MERS). MERS is a state-wide, public employee pension plan established in 1945 to provide a retirement system for municipalities that choose to participate.

MERS has approximately $3.9 billion dollars in plan assets and includes over 500 participating municipalities and courts with a membership of more than 37, 000 active members. Their defined benefit plan has no SRI investments.

Boulder, Colorado

Contact Person: Meredith Williams – President
(800) 759-7372

Boulder's General Employees are covered by the Public Employees' Retirement Association of Colorado (PERA). PERA is a $30.2 billion dollar plan with no SRI allocations.

Columbia, Missouri

Contact Person: Keith Hughes – Assistant Executive Secretary
(800) 447-4334

The Missouri Local Government Employees Retirement System provides a defined benefit plan for Columbia, Missouri. The fund is approximately $2.5 billion dollars and has no SRI allocations.

Our research disclosed that the following organizations have recently moved to divest certain portions of their holdings:

FRS Florida Retirement System

The three- (3) member board of the FRS voted 2 to 1 in favor of divesting of tobacco stocks in May, 1997. Approximately $800 million dollars, or 1.2 % of tobacco stocks in this portfolio were liquidated over the next several months.

CALSTERS California State Teachers Retirement System
CALSTERS voted in June 2000 to sell approximately $275 million dollars, or .25% in tobacco holdings.

CALPERS California Public Employees' Retirement System

CALPERS voted 7 to 5 in October, 2000 to sell approximately $525 million dollars, or .3% in tobacco holdings.

CALPERS is conducting an emerging market manager search and is working with their consultant, Wilshire Associates, to develop investment screens based on Prohibition of Abusive Labor Practices and the International Labor Organization (ILO) Eight Fundamental Principles and Rights at Work.

Finally, the following companies have recently offered an SRI choice to their employees.

Ford has recently added the Domini Social Equity Fund to its 401(k)-fund lineup. The Domini Social Equity Fund is the oldest and largest socially and environmentally screened index fund in the world, with $1.4 billion dollars in assets.

The State of California's $4.7 billion dollar savings plus deferred compensation plan and the $2.8 billion dollar Commonwealth of Massachusetts' deferred compensation plan have both added the Domini Social Equity Fund for a social investing option for their participants.

New York City's $4.2 billion dollar deferred compensation plan added one of the Citizens Funds socially responsible mutual funds as an investment option for their participants.

The State of Iowa's $250 million dollar deferred compensation plan added one of the Citizens Funds socially responsible mutual funds as an investment option for their participants as of January 1, 2001.

The City of San Francisco's $650 million dollar 457 Plan began offering several of the Citizens Funds socially responsible mutual funds as an investment option for their participants as of January 1, 2001.

4) STATUTORY PROHIBITIONS TO SOCIALLY RESPONSIBLE INVESTING

To our knowledge, these are no statutory prohibitions in the State of Florida that preclude utilizing socially responsible investment screens. However, investment policies as set forth in Florida Statute 112.661, Section 4 indicate in part that the board in performing its investment duties shall comply with the fiduciary standards set forth in the Employee Retirement Income Security Act of 1974 at 29 U.S.C. 1104. This states that 'a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries.'

Following are excerpts from certain plan or statute language:

Florida

Florida Law, Section 121.153, directs the State Board of Administration (SBA) to invest its assets in companies that are making advances in eliminating ethnic and religious discrimination in Northern Ireland. Section 121.153 also directs correspondence with financial institutions in which the SBA maintains accounts in order to gauge their exposure, if any, to operations and/or subsidiaries in Northern Ireland. During fiscal year 2000, written confirmation was received from all financial institutions indicating that there are no operations or activities of any kind in Northern Ireland by firms in which the SBA maintains accounts.

The Free Cuba Act of 1993 (F.S. 215.472) was passed by the Florida Legislature in accordance with federal law against Fidel Castro and the policies of his government. Section 1 of the Act prohibits state agencies from investing in a financial institution or company domiciled in the U.S. that does business of any kind with Cuba or any company doing business in or with Cuba in violation of federal law. Section 2 of the act prohibits any state agency from investing in any financial institution or company domiciled outside of the United States if the President of the United States has applied sanctions against the foreign country in which the institution or company is domiciled.

As long as the President of the United States has not issued sanctions against a country of which the SBA holds an equity position in a company domiciled in that sanctioned country, the SBA is not prohibited from purchasing or holding such equity.

In order to comply with this legislation, the Cuban Affairs Section at the U.S. State Department is contacted semi-annually (January and July of each year) to confirm that no sanctions have been implemented. Since the Act's inception, the President has never issued sanctions against any country.

State of Minnesota

> "Prudent person standard. A fiduciary identified in section 356A.02 shall act in good faith and shall exercise that degree of judgment and care, under the circumstances then prevailing, that persons of prudence, discretion, and intelligence would exercise in the management of their own affairs, not for speculation, considering the probable safety of the plan capital as well as the probable investment return to be derived from the assets."

Seattle City Employees' Retirement System

> "Investment in securities of companies which promote a socially desired goal such as rewarding nondiscrimination and promoting local industry, will be given priority if the investment meets the goals of the Retirement System and if the resulting return on investment and related risk are comparable to other available investments."

Massachusetts

Massachusetts' statutes found at Massachusetts General Laws c.32, §23 (2) (g) (ii) and (iii). They restrict investments in military type companies (or banks that hold funds for such companies) in South Africa and Northern Ireland, and to companies or investors holding more than 15% assets or business in tobacco. The restriction on South Africa was later modified to permit investment in accordance with the "Statement of Guiding Principles."

Kansas - Attorney General Opinion No. 87-62

"The 'Prudent Person' rule establishes a high fiduciary standard of care in managing trust assets. Hence, traditional notions of prudent investment would not enable trustees to make a decision to divest based solely on moral beliefs without violating their fiduciary responsibilities."

In March 1997, a succeeding Attorney General referred back to the 1987 opinion and stated, in part: "The Board's standard for investment is stricter now than it was in 1987, and the Statute now specifically prohibits investing solely or primarily for social purposes. These statutory changes affirm the conclusion reached in Attorney General opinion No. 87-62."

5) CITY EMPLOYEE AND RETIREE SURVEY

As directed by the Board of Trustees, staff solicited Plan member's opinions on socially responsible investing. The attached survey was used to poll General Employees' Pension Plan retirees and active employees (Attachment 2). The results of the poll were as follows:

	Total surveyed	Total responses	% responded	Yes- Approves of investing a portion of plan dollars in socially responsible funds	No – does not approve of investing a portion of plan dollars in socially responsible funds
Active	1,284	472	36.8	156 (33.1%)	316 (66.9%)
Retirees	527	269	51.1	95 (35.3%)	174 (64.7%)
Total	1,811	741	40.9	251 (33.9%)	490 (66.1%)

ATTACHMENT 1

Summit *Strategies Group*

7700 Bonhomme Avenue
Suite 300
St. Louis, MO 63105
www.summitstrategies.com
314.727.7211 phone
314.727.6068 fax

April 23, 2001

Board of Trustees
c/o City of Gainesville General Employees' Pension Plan
Treasury Division
200 East University Avenue
Gainesville, FL 32601

RE: Socially Responsible Investing by the City of Gainesville General Employees' Pension Plan

Dear Board Members:

I am writing to the Investment Committee, in my capacity as the Plan's new investment consultant, regarding the issue of socially responsible investment (SRI) guidelines. I recommend that no SRI guidelines be enacted for any part of the Plan's investments. I also respectfully request that a copy of this letter be distributed to the City's Board of Commissioners, as the Plan's fiduciary body, and the Investment Committee as well.

In theory, I understand the desire to have SRI guidelines. Our firm works with a number of religious organizations and their funds which employ SRI guidelines. Theirs is an admirable goal – to make a positive impact in a demonstrable way on U.S. society through the practices and policies utilized by U.S. corporations. However these religious institutions are dealing with their own money, not public money.

I recommend that SRI guidelines not be enacted for the following reasons:

1. Violation of fiduciary duty. I believe implementation of SRI guidelines would directly violate the fiduciary duty often called the duty of "loyalty" which states that Board members must discharge their duties with respect to the Plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses of Plan administration.

2. Violation of the Association of Investment Management and Research Code of Ethics and Standards of Conduct. The AIMR Code and Standards state that the applicable fiduciary duty for each client must be identified and followed. Summit Strategies Group has adopted the AIMR Code and Standards; therefore I must follow them in my dealing with clients. I have identified the applicable fiduciary duties; they are those as stated in ERISA and codified by Florida statute. I may be hard pressed to develop and implement SRI guidelines, absent state statute or legal opinion from the Plan's qualified legal counsel stating that such SRI guidelines do not violate the Board's fiduciary duty.

3. Violation of fiduciary duty may subject the Board, and its members on a personal basis, to legal liability from disgruntled participants.

4. SRI guidelines narrow the universe of acceptable investments for the managers. Narrowing the universe of potential investments is likely to reduce investment returns over the long run. This will increase costs to the City as employer (in the form of increased contributions) and the beneficiaries (in the form of decreased benefits). In addition severe short term out performance of restricted investments under SRI guidelines, such as tobacco stocks in 2000, increases the likelihood of legal liability.

5. No bright lines. The definitions of what is acceptable and not acceptable under SRI guidelines are very subjective and very personal. One person may believe a certain type of stock is objectionable, but another may not. Not even all of Summit's Catholic clients can agree on uniform SRI guidelines. So who is going to make the decision for the Gainesville Plan and based upon what criteria?

6. Slippery –slope. Once SRI guidelines are adopted, then the next consideration will be economically targeted investments, etc. with each successive step becoming increasingly political. Don't take my word for it; ask the investment staffs for the majority of state retirement systems around the country.

7. The enactment of SRI guidelines by the Gainesville Plan will have absolutely no effect on the underlying companies whose stock is prohibited. If the purpose is to help the managers select the "right" stock, let the manager make the decision.

Most legal commentators have come down on the side of the argument that socially responsible investments by public plans violate fiduciary duty. Some however, take a middle of the road position that SRI issues may be considered if they are "collateral benefits." In other words, if everything is equal for a particular investment, especially on a risk-adjusted return basis, then SRI issues may be considered as a collateral benefit but clearly not as a primary determinant or benefit.

I think you will find that the majority of public pension plans that engage in any sort of SRI activity or have such guidelines are:

1. Doing so pursuant to state statute or city ordinance, giving Board members fiduciary cover;
2. Do so after further obtaining a legal opinion from qualified ERISA counsel or Plan counsel which states there is no violation of fiduciary duty; and
3. Limited to adoption of the McBride Principles relating to investments in South Africa and Northern Ireland.

Please call me if you wish to discuss further or if you have any questions.

Sincerely,

Daniel J. Holmes
Managing Director, Consulting

Attachment 2

Socially Responsible Investing Pension Survey

The City Commission acting as the General Employees' Pension Plan Board of Trustees has asked for your opinion regarding the potential investment of a portion of the General Employees' Pension Plan investment portfolio in a "socially responsible" stock mutual fund.

Socially responsible investing seeks to avoid investing in companies that have business practices or interests in areas that might be viewed as undesirable to some individuals. The companies excluded or screened from consideration by the mutual fund may have business interests in or derive profits from a wide variety of activities. These areas may include but are not limited to the following:

1) Tobacco sales
2) Alcohol sales
3) Birth control and abortion products
4) Genetic research
5) Defense, military, gun and ammunition companies
6) Companies with a history of polluting or poor environmental records
7) Companies that operate in countries where human rights violations occur
8) Companies that promote or endorse violence
9) Producers of adult magazines, videos, or adult internet content

It is important to remember that a socially responsible fund, if selected, may perform better or worse than our current pension plan managers or others that may be selected in the future.

Please check one of the following boxes and please return by Friday, March 23, 2001 to:

Mr. Timothy Christiansen
Pension Management Analyst
City of Gainesville
P.O. Box 490 – Station 8
Gainesville, FL 32602

☐ Yes – I approve of investing a portion of the General Employees' Pension Plan dollars in a "socially responsible" mutual fund.

☐ No – I do not approve of investing a portion of the General Employees' Pension Plan dollars in a "socially responsible" mutual fund.