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Investment Analysis
ESG - Environmental/Social/Governance
SRI - Socially Responsible Investing

for the
Gainesville Operating Fund
General Employees Pension Plan
Retiree Health Insurance Fund

ESG & SRI Investing

- ESG Investment involves investing in companies that support various Environmental, Social & Governance concepts through their business models and operating polices
- SRI Investment involves restricting investments in companies that are viewed negatively: Alcohol, Tobacco, Gambling, Fossil Fuels, Firearms/High Capacity Gun Magazine Manufacturers
- Various ESG/SRI Polices have been evaluated numerous times over the past 25 years by Pensions & Investments Staff
- Staff's conclusions have always been that ESG/SRI investment policies were not recommended
  - ESG/SRI Investment Policies can negatively impact Investment Risks & Returns and increase the City's required Pension Contributions
  - ESG/SRI policies are subjective and create restrictive precedents
  - ESG/SRI mandates have no effect on targeted Companies
  - ESG/SRI may be considered a breach of Fiduciary Duty

ESG Considerations

- What is the Objective?
  - Support Specific Company Behavior or Policies?
  - Encourage Specific Products or Technologies?
  - Reward Companies that act responsibly?
- There are hundreds of ESG Factors that can be evaluated
- ESG Factor selection and prioritization is subjective
- Company Adherence to ESG Factors changes frequently, and can be difficult to assess and track
- Purchasing a Company's products is a more effective support method
- Investing in a Company's Stock doesn't provide it with any revenue or financial support unless it's an Initial Public Offering
  - 99+% of Stock Trades occur in secondary markets between buyers and sellers unrelated to stock issuing companies
- ESG Focused Investing Impact on Investment Portfolios
  - Basing investment decisions on factors other than generating the highest expected returns has the potential to significantly reduce the Plan's investment returns

SRI Considerations

- What is the Objective?
  - End Production of Fossil Fuels/Alcohol/Tobacco/Weapons?
  - Change Company Behavior?
  - Force Companies Out of Business?
- Divestment doesn't affect Targeted Companies
  - Selling a company's stock has no impact on its revenues. Companies receive no income from their stock traded in the secondary market
  - Boycotting a Company or Banning its Products is more effective because it directly impacts company revenues
  - It's possible to use Shareholder Voting to influence Company Boards and Policies
- Department of Labor Recommendations Don't Support SRI Divestment for Non-Financial Reasons
- Divestment Impact on Pension Plan Investment Portfolio
  - Restricts valuable investment options
  - Decreases Investment Portfolio Diversification
  - Can Reduce Plan Investment Returns and Increase Risk
  - May force the Plan out of high performing Commingled Investment Funds

ERISA Standards

- Title I of the Employee Retirement Income Security Act of 1974 (ERISA) establishes minimum standards that govern the operation of private-sector employee benefit plans, including fiduciary responsibility rules. Section 404 of ERISA, in part, requires that plan fiduciaries act prudently and diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. Sections 403(c) and 404(a) also require fiduciaries to act solely in the interest of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan.
- Courts have interpreted the exclusive purpose rule of ERISA section 404(a)(1)(A) to require fiduciaries to act with "complete and undivided loyalty to the beneficiaries," observing that their decisions must "be made with an eye single to the interests of the participants and beneficiaries." The Supreme Court as recently as 2014 unanimously held in the context of ERISA retirement plans that such interests must be understood to refer to "*financial*" rather than "nonpecuniary" benefits, and Federal appellate courts have described ERISA's fiduciary duties as "the highest known to the law." The Department's longstanding and consistent position, reiterated in multiple forms of sub-regulatory guidance, is that when making decisions on investments and investment courses of action, plan fiduciaries must be focused solely on the plan's financial returns, and the interests of plan participants and beneficiaries in their benefits must be paramount.

Trustee Fiduciary Responsibility

- Trustees have a Fiduciary Duty to act solely in the best interests of the Trust Members
- Adoption of ESG/SRI Policies may be considered a breach of Trustee Fiduciary Duty
- Plan Members, Unions and Taxpayers may take legal action against Trustees for implementing ESG/SRI Policies

City of Gainesville Operating Funds

- Operating Fund Assets

  $10,000,000 in Truist Bank Accounts

  $190,000,000 in the Florida SBA Fund & Investment Grade Fixed Income Securities
- Investments are managed in accordance with 2021 City Operating Funds Investment Policy Statement
- Direct Investments in Fossil Fuel Companies and Private Prison Companies is Restricted
- Currently No Direct Investments in Alcohol, Tobacco or Firearms Companies, Russian or Belarusian Companies

Gainesville General Employees' Pension Plan & Board of Trustees

- The General Employees' Pension Plan is a Trust
- Legal Title to Plan Assets is held by the Trust. The Beneficial Owners are the Members of the Plan – Not the City
- The City Commission is the Board of Trustees for the Plan
- Trustees have a Fiduciary Duty to act solely in the best interest of Plan Members
- The City as Plan Sponsor and the Trustees have Statutory Duty of Plan Administration
  - Must Keep the Plan Actuarially Sound
  - Must Insure that Benefits are Payable When Due
  - Must use Prudent Investor/Expert Standard for Investment Decisions
  - Must enforce State Legislation applicable to Local Law Pension Plans
- Annual Employer Contributions vary based on Investment Returns & Plan Experience
- Employee Contributions are Fixed at 5.00%

General Employees' Pension Plan Investments 9/30/2021

- General Employees Pension Plan's $694 Million Investment Portfolio is managed using Modern Portfolio Theory
- Institutional Consultants AndCo provide Investment Advisory Services, Investment Manager Due Diligence, and Performance Reporting
- Portfolio is diversified by Asset Class & Style and invested by Nine Highly Rated External Investment Management Firms
  - 62% Domestic Equities/Stocks
  - 30% International Equities/Stocks
  - 4% Fixed Income Securities/Bonds
  - 4% Real Estate Investments
- Investment Managers already evaluate ESG factors they consider relevant in their investment analysis and decision processes

General Employees' Pension Plan Investment Income vs. Contributions & Debt

- General Employees' Pension Plan Investment Portfolio Totals Approximately $719 Million in Diversified Investments as of 12/31/2021
- Pension Plan Investment Returns Have Ranked in the Top 1% of BNY Mellon National Peer Group of Over 300 Public Pension Plans Since 1994
- Annual Pension Plan Investment Returns are the largest revenue source for the City's Pension Plans by far
- Annual Investment Returns are typically 3 - 4 times the amount of the Annual City Pension Contributions & Pension Bond Debt Payments:
  - FY21 Pension Investment Return: 25.21% = $144 Million on $571,327,000 Assets
  - FY21 City Pension Contributions: $5,461,714
  - FY21 General Employees Pension 2003 & 2020 Bond Debt Payments: $11,058,000
  - 35 Year Annualized Pension Returns: 9.32%
- Any reduction in Annualized Pension Investment Returns forces an equivalent increase in Annual City Pension Contributions
  - Lowering Annualized Investment Return .10% from 9.3% to 9.2% would cost $694,000/Year and require an Equivalent Increase in Annual City Contributions
  - Lowering Annualized Investment Return 1.0% from 9.3% to 8.3% would cost $6,940,000/Year and require an Equivalent Increase in Annual City Contributions

Gainesville Retiree Health Insurance Trust Fund

- Legal Title to Trust Fund Assets is held by the Trust
- The City Commission is the Board of Trustees
- Beneficial Owners are the Members of the Trust – Not the City
- Trustees have a Fiduciary Duty to act solely for the benefit of Trust Members and in the best interest of Trust Members
- Trustees Must use Prudent Investor/Expert Standard for Investment of Plan Assets
- Trustees Must enforce Federal and State Regulations applicable to OPEB Plans

Retiree Health Insurance Trust Fund Investments 9/30/2021

- The Trust's $71.2 Million Investment Portfolio is managed using Modern Portfolio Theory
- Morgan Stanley Provides Investment Advisory Services, Investment Manager Due Diligence, Investment Custody & Reporting
- Portfolio is Diversified by Asset Classes & Styles and Managed by Eight External Investment Management Firms
  - 63% U.S. Equities/Stocks
  - 22% International Equities/Stocks
  - 4% Fixed Income Securities/Bonds
  - 11% Real Estate Investments
- Investment Managers already evaluate ESG factors they consider relevant in their investment analysis and decision processes

Retiree Health Insurance Trust Fund Investment Income vs. Contributions

- Trust Fund Annualized Investment Returns have been 7.76% since its 2004 Inception through 9/30/2021
- In June 2020, despite strong objections from Staff, the former City Manager mandated that $33,000,000 in assets be transferred from the Fund's Legacy U.S. Equity Investment Managers to new High ESG Factor Ranked U.S. Equity Investment Managers
- From July 1, 2020 through December 31, 2021, the Fund's new High ESG Factor Investment Managers underperformed the Fund's Legacy Investment Managers by a combined 6.20% which cost the Fund $2.05 million over an 18 month period
- Similar 6.20% U.S. Equity Manager underperformance in the General Employees Pension Plan would cost $28 million using 12/31/2021 Plan Asset Values

Conclusion

- ESG & SRI investment mandates have negligible impacts on targeted companies
- ESG & SRI factor prioritization, evaluation and monitoring processes are difficult to implement and maintain
- Professional Investment Managers already evaluate substantial ESG & SRI factors in their investment analysis
- ESG & SRI mandates can significantly reduce investment returns
- There may be Fiduciary Liability issues with ESG & SRI investment mandates