

MEMORANDUM

January 31, 2017

TO: Government Operations and Fiscal Policy Committee
Transportation, Infrastructure, Energy and Environment Committee

FROM: Robert H. Drummer, Senior Legislative Attorney 

SUBJECT: **Worksession:** Bill 44-16, Retirement – Fossil Fuel Investments – Restrictions

Bill 44-16, Retirement – Fossil Fuel Investments - Restrictions, sponsored by Lead Sponsors Council Vice President Berliner and Councilmember Navarro and Co-Sponsor Councilmember Elrich, was introduced on October 25, 2016. A public hearing was held on December 6.

Bill 44-16 would restrict the Board of Investment Trustees and the Consolidated Retiree Health Benefits Trust Board of Trustees from investing in certain businesses holding the largest amount of fossil fuel reserves under certain circumstances. The Bill would also require both Boards to research and adopt a socially responsible investing policy.

Background

The Board of Investment Trustees (BIT) manages prudent investment programs for the trust fund established to pay retirement benefits guaranteed under the Employees' Retirement Plans. The Consolidated Retiree Health Benefits Trust Board of Trustees (CRHBT) Board is responsible for investing the funds designated to pay for all or a portion of benefits provided under the County retiree benefit plans or a County-funded agency retiree benefit plan, such as retiree health insurance.

Bill 44-16 would be the third time the County enacted a law requiring the BIT to sell certain types of investments to further important government objectives. In 1986, the Council, in Bill 23-86, restricted certain investments in companies doing business in the Republic of South Africa or Namibia due to the apartheid laws mandating racial segregation in those nations. This restriction on certain investments was repealed when those nations repealed their apartheid laws. The Maryland Court of Appeals upheld a similar restriction on investments in companies doing business in the Republic of South Africa and Namibia in *Board of Trustees v. Mayor & City Council of Baltimore City*, 317 Md. 72 (1989).

In 2008, the Council, in Bill 3-08, restricted certain investments in companies doing business in Sudan in order to influence the Government of Sudan to end the atrocities in Darfur. State and local laws requiring the divestment of holdings in companies doing business in Sudan or other nations had been challenged in court on the basis of Federal preemption. The Supreme Court struck down a Massachusetts statute that required the state to boycott certain companies doing business with or in Burma in *Crosby v. National Foreign Trade Council*, 530 US 363 (2000). The Supreme Court held that the Massachusetts

law was preempted by federal statutes imposing sanctions on Burma and therefore violated the Supremacy Clause of the U.S. Constitution. Similarly, the U.S. District Court in Illinois issued an injunction against the Illinois Sudan Act in *National Foreign Trade Council v. Giannoulis*, 523 F.Supp.2d 731 (N.D. Ill. 2007). The Illinois statute in question prohibited the state from depositing funds in any financial institution unless it could certify that it did not loan money to the government of Sudan or certain companies doing business in Sudan and also prohibited state and local pension funds from investing in certain companies doing business in Sudan. The Court held that this statute violated the Supremacy Clause and the Foreign Commerce Clause of the U.S. Constitution.

In response to these decisions, Congress enacted the Sudan Accountability and Divestment Act of 2007. The President signed this Act into law on December 31, 2007. The Act expressly authorizes state and local governments to divest in companies doing business in Sudan and grants investment managers who implement these laws immunity from suit under certain circumstances. The Act establishes guidelines for the state or local government to follow in taking these divestment actions. The Act also requires a state or local government to submit written notice describing a Sudan divestment law to the Attorney General of the United States within 30 days after the enactment of the law. Bill 3-08 was consistent with the guidelines for divestment laws authorized by the Sudan Accountability and Divestment Act of 2007.

Unlike the laws restricting investments in companies doing business in the Republic of South Africa or Sudan, the investment restrictions in Bill 44-16 are unrelated to any actions by a foreign government formally opposed by the United States Government. It would be the first time the Council restricted an investment in a company due to the type of business a company was engaged in.

Both the BIT and the CRHBT Board hire professional investment managers to buy and sell securities. Bill 44-16 would limit the restriction to actively managed separate accounts and would exclude investments in an index fund, private equity fund, real estate fund, mutual fund, or other commingled or passively managed fund. The Bill would define a fossil fuel company as:

... a company listed in the 200 publicly traded coal, oil, and gas companies that hold reported fossil fuels reserves with the largest potential carbon emissions, as ranked in the Fossil Free Indexes US (FFIUS) published by Fossil Free Indexes LLC or a successor index, as updated annually.

The Bill would also require the Boards to divest in these companies gradually over the next 5 years and would permit the Boards to delay the sale of any individual security if necessary due to its fiduciary duty.

The Lead Sponsors, Council Vice President Berliner and Councilmember Navarro explained their reasons for introducing Bill 44-16 in ©8-9.

The County Attorney's Office (OCA) prepared a comprehensive bill review memorandum finding that Bill 44-16, as introduced, may be held unlawful for several reasons. OCA found that the Bill contains an unlawful delegation of legislative authority to a private third party by requiring the Boards to rely on a list of fossil fuel companies published by Fossil Free Indexes LLC. OCA also found that prohibiting a company to lobby government officials in order to avoid these investment restrictions would violate the company's First Amendment rights. Finally, OCA found that the provision permitting the Board to delay divestment in a company was inconsistent with the statutory fiduciary duty imposed on the Boards in other

provisions of the Code. For a complete discussion of these issues, see the OCA opinion at ©10-17. OCA suggested that these legal issues could be resolved by amending the Bill. Finally, the Board of Investment Trustees and the Board of Trustees for the Consolidated Retiree Health Benefits Trust adopted a resolution opposing Bill 44-16. See ©18.

Public Hearing

The Council held a spirited public hearing on December 6 with 34 speakers. The Bill was supported by environmental groups, including Jeffrey Weisner of 350 Montgomery County (©19), Mike Tidwell of the Chesapeake Climate Action Network (©20-21), and Michael Freedman of the Sierra Club (©22-23). Each of these speakers highlighted the dangers associated with climate change due to the use of fossil fuels and argued that divestment from companies with the largest fossil fuel reserves would be effective in changing their corporate behavior. Seventeen individuals also supported the Bill, including County retirees Rick Sullivan (©24) and Susan Jacobson (©25).

Members of the Boards that would be directed to divest from fossil fuel companies and representatives of the employee groups who are the beneficiaries of the retirement trust funds opposed the Bill. Yvette Cuffie, testifying for Gino Renne, President of UFCW Local 1994, MCGEO, and Chair of the Board of Trustees (©26-37) opposed the Bill arguing that the Bill would require the Board members to violate the standard of care they must follow in managing the investments. Ms. Cuffie also argued that several provisions of the Bill were unworkable for the Board. Jeffrey Buddle, President of the Montgomery County Career Firefighters, IAFF Local 1664, (©38-39), Walt Bader, representing the Fraternal Order of Police, Montgomery County Lodge 35, (©40-41), Rob Klein, President of the Montgomery County Retired Employees Association, (©42-43), Robert Disinger, representing the Montgomery County Police Alumni Association, Inc., (©44-45), David Locke, Public Member of the BIT and CRHBT, (©46-47), and Bob Doody, member of the CRHBT, (©48), opposed the Bill for similar reasons. We also received written testimony from Bill Talbot, a member of the CRHBT, (©49), opposing the Bill for similar reasons.

The opponents generally agreed that the use of fossil fuels has helped to create climate change, but disagreed with the argument that divestment from fossil fuel companies was a reasonable method to halt climate change. The supporters of the Bill generally acknowledged the fiduciary duty of the Board members, but argued that divestment from fossil fuel companies would not violate this fiduciary duty. Although most of the speakers supported the Bill, all of the speakers who are charged with managing the investments and almost all of the beneficiaries of the trust funds opposed the Bill.

Issues

1. What is the fiduciary duty owed by the Boards and the Managers?

Section 33-61C establishes the fiduciary duty for the BIT and its managers:

Sec. 33-61C. Standard of care.

A fiduciary must discharge the fiduciary's duties regarding the retirement systems:

- (a) only in the best interest of the participants and their beneficiaries;*
- (b) only to provide benefits to the participants and their beneficiaries, and defray reasonable expenses of administering the retirement systems;*

- (c) *with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes;*
- (d) *by diversifying the investments of the retirement systems to minimize the risk of large losses, unless it is clearly not prudent to diversify under the circumstances;*
- (e) *according to a good faith interpretation of the law governing the retirement systems;*
- (f) *according to a good faith interpretation of the documents and instruments governing the retirement systems, if they comply with this Article.*

Section 33-163(a) establishes a similar fiduciary duty for the members of the CRHBT:

Sec. 33-163. Board duties and responsibilities.

- (a) *Duty of Care. The Board must discharge its duties with respect to the Trust Fund:*
 - (1) *only in the interest of the participants in retiree benefit plans and eligible dependents;*
 - (2) *only to provide benefits to participants in retiree benefits plans and to defray reasonable expenses of administering and operating the Trust Fund;*
 - (3) *with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person 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;*
 - (4) *by diversifying the investments of the Trust Fund to minimize the risk of large losses, unless it is clearly not prudent to diversity under the circumstances; and*
 - (5) *in accordance with the laws, policies, and instruments governing the Trust.*

This standard of care is derived from the common law for fiduciaries. One of the key components of this duty is that the fiduciary must make decisions only in the interest of the beneficiaries, which in this case are the employees and retirees who are eligible for these retirement benefits. The second key component is that the interest of the beneficiaries is to maximize the ability of the funds to provide these benefits by seeking the best investment returns with the lowest risk and lowest expenses.

As pointed out in the County Attorney’s supplemental memorandum of December 19, 2016 (see ©50-52), Md. Code Ann., Local Gov’t §17-102 requires a trustee of a local government retirement plan to adhere to the same fiduciary duty. Therefore, the Council does not have the authority to modify this statutory fiduciary duty.

Bill 44-16, as introduced, would require the Boards to divest from certain investments in fossil fuel companies based upon the amount of fossil fuel reserves under their control. While this may be a prudent investment decision in certain circumstances, Bill 44-16 would mandate this divestment without regard for the standard risk-return analysis that the investment managers are hired to make. Although many speakers at the public hearing argued that an investment in a fossil fuel company in 2017 is a bad investment due to the inevitable movement away from fossil fuels as an energy source, this is a broad analysis that must be performed on a case by case basis by the investment manager rather than the Council in legislation.¹ The County Attorney has concluded that Bill 44-16, as introduced, is inconsistent with the statutorily prescribed fiduciary duty. See pages 6-8 of the County Attorney’s November 15 memorandum at ©15-17. Council staff agrees with this legal analysis, but believes that the amended Bill that we expect

¹ This argument may have lost some steam for the near future when the President appointed the President of Exxon-Mobil as Secretary of State.

to be introduced by Council President Berliner at the Committee worksession avoids this legal issue. See Draft Bill 11 at ©85-92.²

2. Does the Bill, as introduced, unlawfully delegate legislative authority to private persons?

Bill 44-16, as introduced, required the Boards to rely upon a list of the 200 companies with the most fossil fuel reserves published by a private company, Fossil Free Indexes LLC. See lines 22-26 of Bill 44-16 at ©2. The County Attorney explained why this would be an unlawful delegation of legislative authority to a private person on pages 2-4 of a November 15 memorandum at ©11-13. Council staff agrees with this analysis. Draft Bill 11 would avoid this legal issue by permitting the Boards to refer to this list or perform their own analysis with or without a consultant. See lines 47-54 of Draft Bill 11 at ©87-88.

3. Does the restriction on lobbying violate the First Amendment rights of a fossil fuel company?

Bill 44-16, as introduced, would permit a fossil fuel company to avoid divestment if it agrees to stop exploring for hydrocarbons, sell 80% of its fossil fuel reserves, and stop lobbying government officials for favorable tax treatment. The County Attorney explained why conditioning this exemption on agreeing to stop lobbying government officials would violate the First Amendment rights of a fossil fuel company on pages 4-5 of a November 15 memorandum at ©13-14. Council staff agrees with this legal opinion. Draft Bill 11 would avoid this legal issue by deleting the exemption. See lines 116-124 of Draft Bill 11 at ©90.

4. What is socially responsible investing?

Draft Bill 11 would define socially responsible investing as:

Socially responsible investing means considering environmental, social, and corporate governance factors as part of the evaluation of the economic and financial value of an investment in a company.

Environmental issues refers to how a company treats the environment, such as promoting the use of fossil fuels or renewable energy. Social issues refers to how a company treats its employees and its customers. Corporate governance issues refers to a company's internal management, such as executive pay. Socially responsible investing is based upon a belief that a company that acts responsibly on these issues is more likely to provide better long-term results. Socially responsible investing is selecting investments based on collateral or social benefits the investment may confer in addition to an expectation of future investment returns. The U.S. Department of Labor issued an interpretive bulletin on October 26, 2015 explaining the legal limits on "economically targeted investments"³ by a fiduciary under an ERISA plan. See 29 CFR Part 2509 at ©53-55. Although the ERISA fiduciary standard does not apply to a government sponsored retirement plan, such as the County retirement plans, the fiduciary standard established by State and County law are virtually the same as the ERISA standard.

The Department of Labor explained that a fiduciary can make an economically targeted investment if the fiduciary believes the investment has equal risk and reward as any alternative investment made under a pure financial analysis or to the extent that there is a direct relationship between a company's socially

² We will discuss the amendments made in Draft Bill 11 later in this memo.

³ Economically targeted investments is another term used for socially responsible investing.

responsible policies and its intrinsic economic and financial value. However, the Department of Labor has stated that a fiduciary may not use plan assets to promote public policy objectives at the expense of the financial interests of the plan's beneficiaries.

5. What are the Boards' current policies on socially responsible investing?

The Boards currently have an Environmental, Social, and Governance or ESG policy. This policy is explained in the Board's response to questions from Council President Berliner. See Linda Herman's memorandum of January 25 at ©56-77. The Board's current ESG policy follows the fiduciary duty established in law and the Department of Labor guidance described above.

6. What are President Berliner's proposed amendments?

In response to the legal issues raised by the County Attorney and mirrored by the Boards, Lead Sponsor, President Berliner, worked with Council staff and the County Attorney to draft amendments that would avoid the legal issues. Draft Bill 11 is a proposed amended Bill that both the County Attorney and Council staff agree is legally sufficient. See Draft Bill 11 at ©85-92 and a clean copy of Draft Bill 11 without the brackets and underlining at ©93-98. Draft Bill 11 would make the following changes:

- (a) Add findings to the beginning of the Bill about fossil fuel companies. See lines 4-28 at ©86-87.
- (b) Change the term "real estate fund" to "private real asset fund" to correlate to the type of investments made by the Boards. See line 34 at ©87.
- (c) Change the definition of fossil fuel company to permit the Boards to make their own analysis of who is a fossil fuel company or by using a consultant. See lines 47-54 at ©87-88.
- (d) Add a definition of socially responsible investing. See lines 55-57 at ©88.
- (e) Clarify that the Boards must direct their investment managers to review investments recognizing that the Boards hire investment managers to make individual investments in actively managed separate accounts. See line 63 at ©88.
- (f) Delete the mandatory divestment of fossil fuel investments over 5 years in recognition of the legal restraints of their fiduciary duty. See lines 66-82 at ©88-89.
- (g) Subject to their fiduciary duty, require the Boards to direct their investment managers to divest from fossil fuel investments in actively managed separate accounts when the manager determines it would have a *de minimis* impact on their portfolio. This standard is based upon the opinion of the Maryland Court of Appeals upholding the Baltimore City law requiring divestment of certain investments in companies doing business in South Africa. See *Board of Trustees v. City of Baltimore*, 317 Md. 72 (1989). See lines 83-89 at ©89.
- (h) require the Boards to work toward divestment in fossil fuel company investments held in actively managed separate accounts by applying the Department of Labor's interpretive bulletin. See lines 90-99 at ©89.
- (i) Adding a provision that clarifies that the law does not require actions that are inconsistent with the statutory fiduciary duty. See lines 100-109 at ©89-90.
- (j) Deletes the exemption for a fossil fuel company that agrees to certain conditions. See lines 116-124 at ©90.

- (k) Requires the Boards to consider an investment manager's policies on socially responsible investing, including the manager's policy on investing in fossil fuel companies, when selecting an investment manager. See lines 125-128 at ©90.
- (l) Deletes the requirement for the Board to correspond with a fossil fuel company before divesting from the company as unworkable. See lines 129-136 at ©90-91.
- (m) Requires the Boards to report annually to the Council and Executive, in the aggregate, on each purchase and sale of a fossil fuel company. The report would also require the Boards to explain the reason for each decision to invest in a fossil fuel company or to retain a fossil fuel company investment. See lines 137-149 at ©91.

7. Does the proposed amended bill violate the fiduciary duty of the Boards and the investment managers?

Both the County Attorney and Council staff agree that Draft Bill 11 avoids the legal issues raised in the County Attorney's original opinion and is, therefore, legal. Draft Bill 11 is careful to avoid the unlawful delegation of legislative authority to a private person, the First Amendment issues with requiring a company from lobbying the government as a condition of a government benefit, and is consistent with the statutory fiduciary standards established in State and County law. There is no legal impediment to enacting Draft Bill 11.

8. What is the fiscal and economic impact of Bill 44-16?

Unfortunately, we have not yet received a Fiscal and Economic Impact Statement from the Executive Branch at the time this packet went to print. OMB requested an extension of time to submit the FEIS up to February 13.

9. Should the Council enact the proposed amended bill?

Draft Bill 11 is legal, but it raises significant policy issues. The threat of climate change and the role of fossil fuels in affecting our climate is supported by much scientific evidence. For the purpose of this discussion, we must assume this as a fact. The effect of divestment of investments in fossil fuel companies in actively managed separate accounts managed by the BIT and the CRHBT on climate change is much more speculative. We believe this analysis must also look to the purpose of the trust funds in question. They are both trust funds established for the exclusive purpose of paying retiree benefits for public employees.⁴ Although the money in the funds comes from County taxpayers, it is money that has already been paid to the public employee beneficiaries in the form of compensation. Thus, the fiduciary duty to use the money only for the interests of the beneficiaries is consistent with the purpose of the funds. The interest of the beneficiaries is to increase the value of the fund through prudent investment based upon a careful risk-reward analysis of each investment and the entire portfolio. Unlike these trust funds, the Council must decide during its budget deliberations each year how best to use the taxpayer money in the General Fund for the benefit of all County residents.

Although Draft Bill 11 is careful to avoid a violation of this fiduciary duty, it would divert resources of each Board from the sole task the Boards are asked to perform. Draft Bill 11, by itself, is

⁴ Although the bulk of the beneficiaries in the fund managed by the BIT are County employees and retirees, employees and retirees of outside agencies are also beneficiaries. The Montgomery County Public School employees and Montgomery College employees who are beneficiaries of the fund managed by CRHBT greatly outnumber the beneficiaries who are County employees.

unlikely to significantly diminish the value of the trust funds. However, it would lay the groundwork for future movements toward using plan assets to promote public policy objectives at the expense of the financial interests of the plan’s beneficiaries.⁵ As pointed out by the Boards, there are many good arguments for divesting from investments in many other types of companies for strong public policy objectives. See the Board’s January 30 memorandum at ©81-84. The advocates for the Bill argue that climate change is unique because it is an existential threat to the planet. While that may be a reasonable belief today, it may be joined by other “unique” issues in the minds of future legislators. There are many ways the County can do its part to reduce the use of fossil fuels directly. We do not believe this is an appropriate way to do it. **Council staff recommendation:** do not enact the Bill.

This packet contains:	<u>Circle #</u>
Bill 44-16	1
Legislative Request Report	7
Berliner and Navarro Memorandum	8
County Attorney Bill Review Memorandum	10
BIT and CRHBT Resolution	18
Selected Public Hearing Testimony	
Jeffrey Weisner	19
Mike Tidwell	20
Michael Freedman	22
Rick Sullivan	24
Susan Jacobson	25
Yvette Cuffie	26
Jeffrey Buddle	38
Walt Bader	40
Rob Klein	42
Robert Disinger	44
David Locke	46
Bob Doody	48
Bill Talbot	49
County Attorney Supplemental Memorandum	50
Department of Labor Interpretive Bulletin	53
Linda Herman’s Memorandum of January 25	56
MCREA proposed Resolution	78
Boards Memorandum of January 30, 2017	81
Draft Bill 11	85
Draft Bill 11 – clean copy	93

⁵ Neither fund currently contains enough money to pay all estimated future benefits.

Bill No. 44-16
Concerning: Retirement – Fossil Fuel
Investments - Restrictions
Revised: October 21, 2016 Draft No. 5
Introduced: October 25, 2016
Enacted: April 25, 2018
Executive: _____
Effective: _____
Sunset Date: _____
Ch. _____, Laws of Mont. Co. _____

COUNTY COUNCIL FOR MONTGOMERY COUNTY, MARYLAND

Lead Sponsors: Council Vice President Berliner and Councilmember Navarro
Co-sponsor: Councilmember Elrich

AN ACT to:

- (1) prohibit the Board of Investment Trustees and the Consolidated Retiree Health Benefits Trust Board of Trustees from investing in certain businesses holding certain amounts of fossil fuel reserves under certain circumstances;
- (2) require the Boards to research and adopt a socially responsible investing policy; and
- (3) generally amend the law governing the investment of funds held in trust for the employees' retirement system and the consolidated retiree health benefits trust.

By adding

Montgomery County Code
Chapter 33, Personnel and Human Resources
Section 33-60C

By amending

Montgomery County Code
Chapter 33, Personnel and Human Resources
Sections 33-61A and 33-165

Boldface	<i>Heading or defined term.</i>
<u>Underlining</u>	<i>Added to existing law by original bill.</i>
[Single boldface brackets]	<i>Deleted from existing law by original bill.</i>
<u>Double underlining</u>	<i>Added by amendment.</i>
[[Double boldface brackets]]	<i>Deleted from existing law or the bill by amendment.</i>
* * *	<i>Existing law unaffected by bill.</i>

The County Council for Montgomery County, Maryland approves the following Act:

1 **Sec. 1. Section 33-60C is added and Sections 33-61A and 33-165 are**
2 **amended as follows:**

3 **33-60C. Fossil Fuel Investments – Restrictions**

4 (a) Definitions. In this Section, the following words have the meanings
5 indicated:

6 Actively managed separate account means assets held in a separate
7 account by an investment manager hired by the Boards. Actively
8 managed separate account does not include an index fund, private equity
9 fund, real estate fund, mutual fund, or other commingled or passively
10 managed fund.

11 Boards means the Board of Investment Trustees established by Section
12 33-59 and the Consolidated Retiree Health Benefits Trust Board of
13 Trustees established by Section 33-160.

14 Company means any sole proprietorship, organization, association,
15 corporation, partnership, joint venture, limited partnership, limited
16 liability partnership, limited liability company, or other entity or business
17 association, including any wholly-owned subsidiary, majority-owned
18 subsidiary, and parent company of any of them, or business association,
19 that exists for profit-making purposes.

20 Divest means selling, redeeming, transferring, exchanging, or otherwise
21 disposing of, and refraining from further buying of, certain investments.

22 Fossil Fuel Company means a company listed in the 200 publicly traded
23 coal, oil, and gas companies that hold reported fossil fuels reserves with
24 the largest potential carbon emissions, as ranked in the Fossil Free
25 Indexes US (FFIUS) published by Fossil Free Indexes LLC or a successor
26 index, as updated annually.

27 Trust funds means the assets held for the Employees' Retirement System
 28 and the assets held for the Consolidated Retiree Health Benefits Trust.

29 (b) Review of investments. Each Board must review the investment holdings
 30 in each actively managed separate account of the trust funds and identify
 31 each investment in any fossil fuel company. Each Board must review its
 32 investment holdings in these accounts periodically and update the list of
 33 fossil fuel companies at least every 6 months.

34 (c) Divestment. Except as provided in subsection (d), each Board:

35 (1) within 1 year after the date this law takes effect, must divest at least
 36 20% of its investments in fossil fuel companies held in an actively
 37 managed separate account as of the date this Act takes effect:

38 (2) within 2 years, must divest at least 40% of its investments in fossil
 39 fuel companies held in an actively managed separate account as of
 40 the date this Act takes effect;

41 (3) within 3 years, must divest at least 60% of its investments in fossil
 42 fuel companies held in an actively managed separate account as of
 43 the date this Act takes effect;

44 (4) within 4 years, must divest at least 80% of its investments in fossil
 45 fuel companies held in an actively managed separate account as of
 46 the date this Act takes effect; and

47 (5) within 5 years, must divest 100% of its investments in fossil fuel
 48 companies held in an actively managed separate account; and

49 (6) must not make any new investment in an actively managed
 50 separate account in any fossil fuel company.

51 (d) Divestment delay. Nothing in this Section must require a Board to take
 52 action as described in this Section unless the Board determines in good
 53 faith that the action described in this Section is consistent with the

54 fiduciary responsibilities of the Board described in Section 33-61C or
 55 Section 33-163. If the Board determines that a delay in divesting from a
 56 fossil fuel company is necessary due to its fiduciary duty, the Board must
 57 report this delay within 30 days to the Executive and the Council along
 58 with an estimated timeline for the resumption of divestment.

59 (e) Research on socially responsible investing. Each Board must:

60 (1) review academic and professional literature on socially
 61 responsible investing;

62 (2) investigate the benefits and disadvantages of socially responsible
 63 investing of public trust funds; and

64 (3) adopt a Socially Responsible policy for investments.

65 (f) Exemption. The divestment or investment prohibition under this Section
 66 must not apply to a company that can demonstrate that it:

67 (1) has stopped exploring for new hydrocarbons;

68 (2) agrees contractually to not develop or sell 80% of its current
 69 proven fossil fuel reserves; and

70 (3) has stopped lobbying or attempting to influence government
 71 officials to preserve its special treatment, including subsidies, tax
 72 breaks, or competitive advantage with respect to clean, renewable
 73 energy.

74 (g) Notice. Each Board:

75 (1) before divesting from a fossil fuel company under this Section,
 76 must provide written notice and an opportunity to comment in
 77 writing to each company subject to the action;

78 (2) must not divest until 90 days after written notice is provided to the
 79 company; and

(3) must not divest if the company shows that it is exempt from divestment under subsection (f).

(h) Report. The Board must report annually to the Council and Executive on the operation of and compliance with this Section. The report must:

(1) identify each investment in a fossil fuel company held in an actively managed separate account of the trust funds;

(2) list each divestment action taken under this Section

(3) describe each decision to delay investment under Subsection (d);
and

(4) calculate the administrative cost of compliance.

33-61A. Indemnification of trustees

(a) *Authorized.* The County must indemnify every member of the Board who is or may become a party to any action, suit, or proceeding, including administrative and investigative proceedings, because of service as a member of the Board, including any action taken to comply with [Section] Sections 33-60A and 33-60C, subject to the conditions stated in this Section.

* * *

33-165. Indemnification of Board Members.

(a) *General.* The County must indemnify each member of the Board who is or may become a party to any legal action, including any administrative or investigative proceeding, because of service as a Board member, including any action taken to comply with Sections 33-60A and 33-60C, subject to the conditions in this Section.

* * *

Sec. 2. Initial review. Each Board must complete its initial review of the investment holdings in all actively managed separate accounts of the trust funds and

107 identify all investments in fossil fuel companies within 90 days after the date this Act
108 takes effect.

109 *Approved:*

110

Roger Berliner, President, County Council Date

111 *Approved:*

112

Isiah Leggett, County Executive Date

113 *This is a correct copy of Council action.*

114

Linda M. Lauer, Clerk of the Council Date

LEGISLATIVE REQUEST REPORT

Bill 44-16

Retirement – Fossil Fuel Investments - Restrictions

DESCRIPTION: Bill 44-16 would restrict the Board of Investment Trustees and the Consolidated Retiree Health Benefits Trust Board of Trustees from investing in certain businesses holding the largest amount of fossil fuel reserves under certain circumstances. The Bill would also require both Boards to research and adopt a socially responsible policy for investing.

PROBLEM: Investing in fossil fuel companies is inconsistent with the County's established policies to be environmentally responsible.

GOALS AND OBJECTIVES: Encourage fossil fuel companies to move into more environmentally responsible renewable energy sources.

COORDINATION: Board of Investment Trustees, Office of Human Resources, County Attorney.

FISCAL IMPACT: To be requested.

ECONOMIC IMPACT: To be requested.

EVALUATION: To be requested.

EXPERIENCE ELSEWHERE: To be researched.

SOURCE OF INFORMATION: Robert H. Drummer, Senior Legislative Attorney

APPLICATION WITHIN MUNICIPALITIES: Not applicable.

PENALTIES: None.

MEMORANDUM

October 11, 2016

TO: Council President Nancy Floreen
Council Colleagues

FROM: Council Vice President Roger Berliner
GO Chair Nancy Navarro

SUBJECT: Fossil Fuel Divestment and Socially Responsible Investing

Colleagues, we are writing to ask for your support for legislation we plan on introducing that more closely aligns our values with our role as a major financial investor of nearly \$4 billion -- *without sacrificing the returns on those investments*. We would do this in two distinct ways: (1) directing the county's Board of Investment Trustees (BIT) to divest from the 200 publicly traded fossil fuel companies that hold reported reserves with the largest potential carbon emissions; and (2) directing the BIT to study adopting a Socially Responsible Investing screen for its portfolio.

We are proposing this measure fully aware of the Board's fundamental fiduciary responsibilities. Our legislation would address this explicitly by allowing the BIT to waive the divestment requirement if the Board were to certify to the Council that in its judgment alternative investments in non-fossil fuels are not available that would meet or exceed the returns of the \$65 million in fossil fuel stocks currently in its portfolio. Given the strength of portfolios without fossil fuels, and the relatively poor performance of fossil fuel stocks, we are confident that the Board will be able to harmonize our county's values with its fiduciary duties.

We are also very mindful of the "slippery slope" argument – i.e., that there are a host of serious moral and ethical issues that have been put forward over the years as a justification for divestment, and we have said no. We believe climate change is different: it represents an existential threat to the entire planet. It is, in our view, in a class by itself, and its correlation with the companies principally responsible for creating climate change is direct. We know it is caused by the burning of carbon-heavy oil, coal, and natural gas. It is why our Council has passed literally dozens of measures to support clean energy and energy efficiency. We should not be investing in the very companies that undermine our commitment to sustainability.

Specifically, this legislation would prohibit the BIT from purchasing any new stocks or bonds in the fossil fuel industry and phase in over a 5 year time line divestment of the \$65 million worth of holdings in the coal, oil and gas companies in the Carbon Underground 200, a list of fossil fuel companies ranked by their potential carbon emissions. As noted, the 5 year phase-in would be subject to an off-ramp if the Board can certify divesting these funds would reduce the return of the portfolio.

More broadly, this legislation would also address longer term issues related to how we invest our money by requiring the BIT to study the impact on its portfolio of adopting a Socially Responsible Investing (SRI) approach, expanding on its current policies in this area. This approach considers environmental, social and corporate governance issues in determining whether to make an investment while seeking to maintain strong returns for investors. It is widely used today by investors: more than \$6.57 trillion in the United States is already invested using socially responsible practices.

SRI is based on the belief that we should use our investments to bring about positive change by aligning our investments with companies that achieve good returns by being a good corporate citizen. Given the ever increasing role corporations have in our world today, exercising that prerogative is important. The latest example of this can be seen in the Wells Fargo scandal in which more than 2 million bank accounts or credit cards were opened without customers' knowledge or permission. An SRI "screen" could result in shifting investments from companies like Wells Fargo to more socially responsible companies, and that would be a good thing.

We thank you in advance for your consideration of this legislation and we look forward to working with you as it moves forward.

Roger Berliner



Council Vice President

Nancy Navarro



Chair, GO Committee



OFFICE OF THE COUNTY ATTORNEY

Isiah Leggett
County Executive

Marc P. Hansen
County Attorney

MEMORANDUM

TO: Linda Herman, Executive Director
Montgomery County Employee Retirement Plans

VIA: Marc P. Hansen *Marc Hansen*
County Attorney

FROM: Edward B. Lattner, Chief *EBL*
Division of Government Operations

Amy Moskowitz *AM/EBL*
Associate County Attorney

DATE: November 15, 2016

RE: **Bill 44-16, Retirement - Fossil Fuel Investments - Restrictions**

Bill 44-16 prohibits the Board of Investment Trustees and the Consolidated Retiree Health Benefits Trust Board of Trustees (collectively referred to as “the Boards”) from investing in fossil fuel companies—businesses holding the largest amount of fossil fuel reserves. We conclude the Bill, as presently drafted, (1) unlawfully delegates legislative authority to a private third party to determine whether an entity is a fossil fuel company, (2) violates the unconstitutional conditions doctrine by permitting the Boards to invest in a fossil fuel company if it gives up certain First Amendment rights, and (3) is inconsistent with the Boards’ present statutorily-imposed fiduciary duties. But all of these infirmities can be remedied by amendment. We also have some suggested technical amendments.

I. BACKGROUND

The Bill would prohibit the Boards from investing in businesses holding the largest amount of fossil fuel reserves.¹ A fossil fuel company is defined as “a company listed in the 200 publicly traded coal, oil, and gas companies that hold reported fossil fuels reserves with the largest potential carbon emissions, as ranked in the Fossil Free Indexes US (FFIUS) published by Fossil Free

¹ Each Board hires professional investment managers to buy and sell securities. Bill 44-16 would limit the prohibition to actively managed separate accounts and would exclude investments in an index fund, private equity fund, real estate fund, mutual fund, or other commingled or passively managed fund.

Indexes LLC or a successor index, as updated annually.”² The Bill would also require the Boards to divest in these companies gradually over the next 5 years and would permit the Boards to delay the sale of any individual security if necessary due to its fiduciary duty.

A fossil fuel company can avoid the investment prohibition/divestment if it can demonstrate that it (1) has stopped exploring for new hydrocarbons; (2) agrees contractually to not develop or sell 80% of its current proven fossil fuel reserves; and (3) has stopped lobbying or attempting to influence government officials to preserve its special treatment, including subsidies, tax breaks, or competitive advantage with respect to clean, renewable energy.

The Bill would also require the Boards to research and adopt a socially responsible policy for investing.

II. ANALYSIS

A. Delegation Of Legislative Authority

The Bill’s reliance upon a private third party to determine when a company is a “fossil fuel company” represents an impermissible delegation of legislative authority. Subject to certain exceptions, a legislature may not delegate its lawmaking function to others. *See Pressman v. Barnes*, 209 Md. 544 (1956).

The Maryland courts have allowed legislative bodies to delegate rule making authority to executive branch officials. *Pressman*, 209 Md. 544, 552 (the Director of Traffic, who was appointed by the Mayor, could prescribe speed limits for Baltimore streets); *see also, Andy’s Ice Cream v. City of Salisbury*, 125 Md. App. 125, *cert. denied*, 353 Md. 473 (1999). But delegations of rulemaking authority to executive officials must be limited. Insofar as a delegation “requires the exercise of a certain amount of discretion which may be regarded as part of the police power . . . , such discretion [must be] guided and restrained by standards sufficient to protect the citizens against arbitrary or unreasonable exercise thereof.” *Pressman*, 209 Md. at 552; *see also West Montgomery Citizens Association v. Maryland-National Capital Park and Planning Commission*, 309 Md. 183 (1987).

Although the concept of delegating government authority to executive branch officials is well established, the premise of delegating government power to private persons does not rest on a similarly firm constitutional foundation. The Maryland Court of Appeals has discussed the concept of whether government power may be “lodged in and permitted to private persons” *Board of Trustees of the Employees’ Retirement System v. Mayor and City Council of Baltimore*

² According to its website, Fossil Free Indexes LLC is a company that delivers research, consulting and investment solutions to investors concerned about climate and environmental risk. It publishes the “Carbon Underground 200” on its website, a list of the 100 largest public oil and gas and the 100 largest public coal companies globally, as measured by the potential CO2 emissions of their reported fossil fuel reserves. It is updated quarterly and serves as the basis for a negative screen on the S&P 500 to create the FFIUS Index, a fossil free index.

City, 317 Md. 72, 94 (1989). In *Board of Trustees*, the Court addressed a challenge to a Baltimore City ordinance instructing the City's retirement system to divest its investment holdings in companies doing business in South Africa. Among various challenges to this ordinance, the plaintiffs challenged as an unconstitutional delegation of government power to private persons a provision in the ordinance that companies doing business in South Africa "shall be identified by reference to the most recent annual report of the Africa Fund entitled 'Unified List of United States Companies with Investments or Loans in South Africa and Namibia'" *Id.* at 81.

The Court began its analysis of the delegation issue by noting that "the legislature acts in the exercise of a power conferred upon it by the people." *Id.* at 93. The Court observed that "this principle follows from the nature of representative democracy" and that the "City Council members generally have no authority to substitute the judgment of others for their own judgment." *Id.* at 94. The Court acknowledged that "our cases have long sanctioned delegations of legislative power to administrative officials where sufficient safeguards are legislatively provided for the guidance of the agency in the administration of the statute." *Id.* With respect to the delegation of authority to private persons or entities, however, such delegation is "strictly scrutinized because, unlike governmental officials or agencies, private persons will often be wholly unaccountable to the general public." *Id.*

In this context, the Court cited with approval a New York case, *Fink v. Cole*, 302 N.Y. 216, 224, (1951), where the New York Court of Appeals struck down a statute that vested the Jockey Club with authority to license owners, trainers, and jockeys at horse races in the state. *Id.* n. 23. The Maryland Court of Appeals went on to note that legislation may sometimes incorporate fixed standards created by private entities,³ but with respect to delegating future revision of regulatory standards to a private entity, the courts have only approved such delegation "in limited circumstances such as where the standards are issued by a well-recognized, independent authority . . . [that] provide guidance on technical and complex matters within the entity's area of expertise." *Id.* at 96. This type of delegation usually involves accreditation programs established by professional organizations, such as the accreditation of law schools by the American Bar Association.

As currently drafted, Bill 44-16 is an unconstitutional delegation of the Council's legislative power because it prohibits the Boards from investing, and requires them to divest, from any company identified in the Fossil Free Indexes US (FFIUS) published by Fossil Free Indexes LLC or a successor index, as updated annually. This delegation of discretion is similar to the authority invalidly transferred to the Jockey Club to license horse trainers and jockeys, and is far removed from the delegation of authority to a "well-recognized, independent authority" that "provides guidance on technical and complex matters within the entity's area of expertise." It is in short, permitting a private party to determine what investments are in the public interest—a practice condemned by the Court of Appeals in *Board of Trustees of the Employees' Retirement*

³ An example of incorporation of a fixed standard created by a private entity can be found in § 22-14, which requires the Fire Chief to recommend that the Executive adopt by regulation parts of the National Fire Code as published by the National Fire Protection Association.

System v. Mayor and City Council of Baltimore City, 317 Md. at 94.

But, this infirmity can be remedied. In *Board of Trustees*, the court saved the city ordinance by interpreting it to require the Trustees to refer to a list prepared by a private organization of companies doing business in South Africa, rather than blindly follow that list. Thus, the list amounted to a mere reference, which the Trustees could accept or reject. *Id.* at 97-98. Bill 44-16 could be amended to similarly provide that the Boards may use the Fossil Free Indexes US as a reference rather than a mandated list of prohibited companies.

Fossil Fuel Company means a publicly traded coal, oil, and gas company holding fossil fuel reserves with one of the 200 largest potential carbon emissions. The Boards may refer to the Fossil Free Indexes US (FFIUS) published by Fossil Free Indexes LLC or a successor index, as updated annually, to determine if a company is a fossil fuel company. In addition, the Boards may hire a consultant to assist in identifying Fossil Fuel Companies.

By making the Fossil Free Indexes a mere reference, this amendment should eliminate any issue surrounding an unlawful delegation of legislative authority.

B. First Amendment Issues.

Bill 44-16 violates the “unconstitutional conditions” doctrine when it allows a fossil fuel company to avoid the divestment/investment prohibition by giving up its right to petition the government. The “unconstitutional conditions” doctrine provides that the government may not deny a benefit to a person on a basis that infringes his constitutionally protected freedom of speech. *Perry v. Sindermann*, 408 U.S. 593, 597 (1972). The doctrine recognizes that constitutional violations may arise from the deterrent, or chilling, effect of governmental efforts that fall short of a direct prohibition against the exercise of First Amendment rights. *Laird v. Tatum*, 408 U.S. 1, 11 (1972).

For at least a quarter-century, this Court has made clear that even though a person has no right to a valuable governmental benefit and even though the government may deny him the benefit for any number of reasons, there are some reasons upon which the government may not rely. It may not deny a benefit to a person on a basis that infringes his constitutionally protected interests—especially, his interest in freedom of speech. For if the government could deny a benefit to a person because of his constitutionally protected speech or associations, his exercise of those freedoms would in effect be penalized and inhibited. This would allow the government to produce a result which it could not command directly. Such interference with constitutional rights is impermissible.

Perry, 408 U.S. at 597 (internal citations and quotations omitted). Thus, “[a] predicate for any unconstitutional conditions claim is that the government could not have constitutionally ordered

Linda Herman
November 15, 2016
Bill 44-16, Retirement - Fossil Fuel Investments - Restrictions
Page 5

the person asserting the claim to do what it attempted to pressure that person into doing.” *Koontz v. St. Johns River Water Mgmt. Dist.*, 133 S.Ct. 2586, 2598 (2013).

As noted above, the Bill provides a fossil fuel company with a means of avoiding the divestment/investment prohibition. The divestment or investment prohibition does not apply to a company that can demonstrate that it (1) has stopped exploring for new hydrocarbons; (2) agrees contractually to not develop or sell 80% of its current proven fossil fuel reserves; and (3) has stopped lobbying or attempting to influence government officials to preserve its special treatment, including subsidies, tax breaks, or competitive advantage with respect to clean, renewable energy. It is this latter requirement, codified as § 33-60C(f)(3), that infringes on the First Amendment’s guarantee of freedom of speech, including the freedom to petition the government.

The First Amendment protects the right to lobby legislators and administrators. *See, e.g., Cal. Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508, 510 (1972). Certainly, the County could not enact a viewpoint-based prohibition against petitioning the government to preserve certain tax breaks. When the government targets not subject matter, but particular views taken by speakers on a subject, the violation of the First Amendment is all the more blatant. *Rosenberger v. Rector & Visitors of Univ. of Va.*, 515 U.S. 819, 829 (1995).

The government does have greater leeway to regulate private conduct when those restrictions are attached to the use public funds.⁴ For example, in *Regan v. Taxation With Representation*, 461 U.S. 540 (1983) (TWR), the Court held that an IRS provision that only granted tax exemptions to non-profit corporations that did not lobby (501(c)(3) organizations) did not violate TWR’s First Amendment rights because “Congress chose not to subsidize lobbying as extensively as it chose to subsidize other activities that non-profit organizations undertake to promote the public welfare.” *Id.* at 544. Moreover, TWR was not subject to a blanket prohibition on lobbying. The Court noted that it could create a separate 501(c)(4) organization to conduct its lobbying activities, so long as the 501(c)(3) organization did not subsidize the 501(c)(4) organization; otherwise, public funds might be spent on an activity Congress chose not to subsidize. *Id.* at 544. Likewise, in *Rust v. Sullivan*, 500 U.S. 173 (1991), the Court upheld certain conditions on federal funds for family planning services that required that service providers not use those funds to advocate for abortion or provide abortion counseling; the service providers were not subject to a blanket prohibition on providing abortion-related services.

But Bill 44-16 does not present a situation where the government is limiting the use of public funds spent to subsidize a particular program. In fact, it is not a subsidy program at all. Rather, it is the provision of a benefit (participation in the Boards’ investments) conditioned upon the limitation of certain First Amendment rights (lobbying or attempting to influence government officials to adopt policies favoring a specific viewpoint). This is impermissible.

⁴ “Determining the constitutionality of government subsidization of expression is one of the most frustrating tasks . . . of the First Amendment.” Martin H. Redish & Daryl Kessler, *Government Subsidies and Free Expression*, 80 Minn. L. Rev. 543, 544 (1996).

The remedy, however, is rather straightforward. The unconstitutional provision in § 33-60C(f)(3) must be deleted.

C. Fiduciary Issues.

1. Standard of Care.

The Maryland Court of Appeals has recognized that while a trustee is not blindly obligated to maximize the return on investment, a social investment policy that has a greater than *de minimis* impact upon return on investment may violate a trustee's duty of prudence and loyalty. We understand that Bill 44-16 may have a greater than *de minimis* impact upon return on investment and is therefore inconsistent with the duty of prudence and loyalty currently impressed upon the Boards in the County Code. Assuming more than a greater than *de minimis* impact, the Council must either amend that statutory duty to allow for investment decisions driven, in part, by the presence of fossil fuels or the Council can preserve the investment policy underlying Bill 44-16 by incorporating the Department of Labor's guidance for the use of economic, social, and governance factors when making investments for retirement plans.

County Code Sections 33-61C and 33-163 set forth the standard of care under which the Boards operate the trust funds. Among other requirements these provisions require that the Boards make investments "with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes" and "only in the best interest of the participants and their beneficiaries." Although the Employee Retirement Income Security Act (ERISA) does not apply to governments, the standard of care in County Code Sections 33-61C and 33-163 are virtually identical to the standard applicable to ERISA fiduciaries, set forth in ERISA Section 404.

In *Board of Trustees of the Employees' Retirement System of the City of Baltimore v. Mayor and City Council of Baltimore City*, 317 Md. 72 (1989), the Court of Appeals held that legislation requiring divestment of investments in South Africa did not interfere with these fiduciary duties because of certain factors, the most significant factor being that the cost of the social investing was *de minimis*. The initial cost of divestment was \$750,000, or 1/16th of 1% of the fund's value. The on-going cost was \$1.2 million per year, or 1/10th of 1% of the fund's total value. Thus, only if the impact to the ERS and CRHBT would be *de minimis*, will the Boards satisfy their fiduciary standards under the County Code. But we understand that divestment under Bill 44-16 is likely to cause more than a *de minimis* impact to the trusts.

By requiring divestment from "fossil fuel companies, Bill 44-16 compels the Boards to deviate from the currently applicable prudent investor standard and duty of loyalty standard. Therefore, the legislation should modify the standard of care and expressly state that the Council intends that the Board is authorized to ignore the prudent investor standard and duty of loyalty standard in order to comply with the divestment requirement of the legislation.

Alternatively, rather than amend the fiduciary duty applicable to the Boards, the Council can preserve the investment policy underlying Bill 44-16 by incorporating Department of Labor's (DOL) recent guidance for the use of economic, social, and governance factors when making investments for retirement plans. Over the years, DOL, the agency which regulates ERISA, has published guidance with regard to investments which allow fiduciaries take into account non-economic factors and still satisfy their fiduciary duties. Most recently the DOL issued Interpretive Bulletin 2015-01 in which the DOL states that fiduciaries can take into account economic, social and governance (ESG) issues when making investment decisions, as the DOL recognized that these factors can influence investment performance. ESG factors should not be the sole consideration in making the investment, but may be considered in addition to other factors influencing risk and return. The DOL also stated that the fiduciaries' focus is the plan's financial returns so that fiduciaries cannot use plan assets to promote social, environmental, or other public policy causes at the expense of the plan's participants. In other words, fiduciaries may not accept lower returns in order to obtain collateral benefits.

Because County law uses the same standard of care as ERISA, it may be presumed that the County should adhere to the DOL's guidance for the use of ESG factors when making investment decisions. Although the DOL guidance is not binding, a court may recognize that the DOL guidance regarding ESG issues was issued subsequent to *Board of Trustees of the Employees' Retirement System of the City of Baltimore* and take the DOL guidance into consideration. Bill 44-16 does not satisfy the DOL's interpretation because social and policy factors are the sole reason for divestment. To incorporate the DOL standard, the Bill would have to be amended to provide that fossil fuel is not be the sole consideration in making the investment, but may be considered in addition to other factors influencing risk and return. The Boards have adopted an ESG policy which incorporates various ESG factors in evaluating investments and managers since they believe that these factors may have the potential to influence risk and return characteristics.

2. Discretion.

The legislation (lines 51-58) provides that the Boards must divest unless the Boards "determine that a delay in divesting from a fossil fuel company is necessary due to its fiduciary duty." But the Boards' present fiduciary duty is incompatible with the initial decision to divest from fossil fuel companies. Why would the Boards determine that their fiduciary duty requires a delay in divestment if their fiduciary duty would counsel against divestment in the first place? If the Council wants to impose an investment restriction, the Council should explicitly do so and alter the Boards' fiduciary duties.

In addition, as required under the County Code, investment managers, not the Boards, make individual investments. Because the Boards do not make decisions to invest in individual companies, such as fossil fuel companies, the Boards do not have the knowledge to "determine a delay in divesting from a fossil fuel company" is necessary due to its fiduciary duty." Investment managers making investments on behalf of the trusts are subject to the fiduciary duties set forth in

Linda Herman
November 15, 2016
Bill 44-16, Retirement - Fossil Fuel Investments - Restrictions
Page 8

County Code Section 33-60C and 33-163. The Boards provide the investment managers with guidelines and/or policies. While the Boards could amend the contracts to direct managers to divest from fossil fuel companies, presumably the Board could not give the investment managers discretion on delaying divestment and requiring the managers to justify the delay. Presumably, if they would agree, the investment managers would request indemnification and an altered fiduciary duty standard. Therefore, the Council should delete the "divestment delay" provision found in Lines 51-58 of the legislation.

C. Technical Issues.

Additional County Code Section: The legislation adds Section 33-60C (although Line 3 has 33-60A) to the County Code which is in Chapter 33, Article III and contains the Employees' Retirement System whose investments are overseen by the Board of Investment Trustees. However, the Section includes the Consolidated Retiree Health Benefits Trust, which provisions are in Chapter 33, Article XI. To avoid confusion, another Code Section should be added to the Consolidated Retiree Health Benefits Trust and its governing provisions which are in Chapter 33, Article XI.

Definition of Actively Managed Account, Lines 6-10: Private real assets, private debt funds, and hedge funds should be added to the definition of actively managed separate accounts.

Divestment, Lines 34-50: This provision requires divestment of 20% each year. This provision should specifically provide how divestment should occur. For example, should 20% from each actively managed separate account be divested, or is it the portfolio as a whole? Also, due to market fluctuations the percentage will vary, when should the 20% be measured, at the beginning of each calendar year? The Council should direct how divestment is accomplished.

Divestment, Lines 49-50: Are reinvestments of dividends considered a new investment? The Council should clarify if dividends are excluded.

Research on socially responsible investing, Lines 59-64. As noted above, the Boards adopted an ESG policy which incorporates various ESG factors in evaluating investments and managers since they believe that these factors may have the potential to influence risk and return characteristics.

cc: Timothy Firestine, CAO
Bonnie Kirkland, Assistant CAO
Robert H. Drummer, Senior Legislative Attorney
Steve Farber, Council Administrator

ebl
16-008963
Bill 44-16 OCA analysis



MONTGOMERY COUNTY EMPLOYEES' RETIREMENT SYSTEM
CONSOLIDATED RETIREE HEALTH BENEFITS TRUST

On November 18, 2016 the Board of Investment Trustees for the County's Retirement Plans and the Board of Trustees for the Consolidated Retiree Health Benefits Trust each unanimously approved the following resolution on Bill 44-16:

Resolved, that the Board opposes Bill 44-16, Retirement – Fossil Fuel Investments – Restrictions, which mandates divestment from certain fossil fuel companies. The Board considers the bill legally flawed, as outlined in the November 15, 2016 memo from the Office of the County Attorney; operationally unworkable; and inconsistent with the fiduciary duties outlined in the County Code. The Standard of Care requires the Board to act “only in the best interest of the participants and their beneficiaries.” The Board requests the Executive Director to prepare a memo informing the County Council of its views. The memo should also indicate that the Board currently considers Environmental, Social and Governance (ESG) factors in its investment process and monitoring efforts, as set forth in Board policies, and that the bill's requirement that the Board do so is therefore unnecessary.

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Testimony of Jeffrey Weisner - Public Hearing, Bill 44-16 - Dec. 6, 2016 On Behalf of 350 Montgomery County (350MoCo)

My name is Jeffrey Weisner. I am a Bethesda resident and the Steering Committee President of 350 Montgomery County or 350MoCo, on whose behalf I am testifying today.

350MoCo is a local group affiliated with the global 350.org climate movement. 350 groups seek through activism and education to create action on the greatest crisis of our time - the crisis of global climate change.

350MoCo has been advocating on the issue of fossil fuel divestment for some time, and other members and I have had the pleasure of meeting with many of you to discuss it. We have also heard from the over two thousand County residents who have signed our divestment petitions and cards, and the many local environmental, labor, and community groups who support divestment.

Over 600 institutions have already chosen divestment. They span a global array of foundations, local governments, religious organizations, colleges and universities, and nonprofits. Examples include the Episcopal Church, The Canadian Medical Association, The Field Museum in Chicago, the Rockefeller Brothers Fund, The University of Maryland, and the District of Columbia public pension system. Organizations and institutions collectively worth over \$3.4 trillion dollars are now on the divestment path. While divesting entities are not all at the same level of divestment, all have made a moral choice to stop investing in the companies whose core business model endangers our future.

What lessons might we draw from the growth of fossil fuel divestment?

First, divestment is **serious**. Fossil fuel divestment has exploded since the movement began in 2012. Divestment is no longer a fringe movement but is part of the mainstream of investment options.

Second, divestment is **possible**. All the institutions I mentioned have financial obligations, and their boards must exercise fiduciary responsibility over the management of their assets. Yet they have all found paths to divestment that maintain financial stability for their institutions. We see no reason that our County cannot do the same.

Third, divestment **matters**. Some say divestment is merely symbolic and therefore unimportant, but symbols are important expressions of our values. Recent controversies over the Confederate flag and other symbols of racism show the power of symbols to shape debate. Our County has enacted many strong climate policies, from clean energy for County operations to the Green Bank to the Office of Energy and Sustainability. We should be proud of our leadership in these areas. But when we then continue to invest our public pensions - funded in part by residents' tax dollars - in companies whose actions are completely incompatible with our goals on climate, we weaken our stance and open the door for others to discount our leadership.

350MoCo includes climate scientists and financial professionals among its members. But you do not need to be a climate scientist to understand that climate change is a crisis for us all, and you don't need to be a financial professional to know that it is wrong to profit from fossil fuel companies whose actions have contributed - and continue to contribute - to the climate crisis. 350MoCo's members urge the Council to divest from fossil fuels.

Time for Montgomery County to divest from fossil fuels

Testimony in favor of Bill 44-16

December 6th, 2016

By Mike Tidwell

I've lived in Montgomery County for 28 years – and I love this place. I love the libraries, the parks, the diverse population. My son attended our county's excellent public schools from K through 12.

But here's what I *don't* love: In an era of rapid global warming, part of my county tax dollars go directly to buying stock in mega-polluting companies like ExxonMobil, Arch Coal, and British Petroleum.

Hats off to Councilmembers Roger Berliner, Nancy Navarro, and Marc Elrich for introducing Bill 44-16. It would require the County pension fund to sell off all direct holdings in fossil fuel companies. That's about \$65 million out of a portfolio of over \$4 billion, so it would have almost no impact on the overall health of the fund. In fact, with average prices for dirty energy falling in recent years, this divestment will almost certainly *help* the pension fund.

Unfortunately, some critics object to this bill. They say it's perfectly okay to use tax dollars to invest in companies who profit from global warming. They say, "What's next? Divest from Coca-Cola since sodas contribute to diabetes?" It's a silly question, of course. Global warming is an existential threat to our society, and ExxonMobil is not a soda company. The fossil fuel industry is knowingly pushing the world toward climate catastrophe for its own short-term profits.

Critics also claim that the small brokerage fees for selling dirty-energy stocks would be a burden to the county. Really? Imagine telling your kids, "We wanted to help stave off climate calamity, but the routine transaction costs of selling and reinvesting in greener companies was just too much to bear – so we kept investing in climate calamity."

I'm proud that Montgomery County already leads the nation in many programs to fight climate change. We invest heavily in energy efficiency measures and wind power for county buildings.

But some critics claim that adopting the best and strongest fossil fuel divestment policy in America is just going too far. Nothing could be further from the truth. Here's an example. In 2004, under the leadership of Councilmember George Leventhal, our county made what was then the biggest wind power purchase in US history east of the Mississippi River. It was rightly touted by councilmember Leventhal as a challenge to and an example for the entire nation. And it worked! Today, our county buildings are powered 100% by wind power, saving taxpayers lots of money in the process, and wind power is now ubiquitous across the US. Indeed, it's the fastest-growing energy resource in the world today. And we helped start that revolution right here in 2004. Period. We led. It's what we do.

And now it's time to do the same with our pension investment dollars. If apartheid still existed in South Africa, would we invest there? No. Would we knowingly invest in companies today that profit from child labor or human trafficking? Of course not. And now the act of investing directly in mountain-top removal for coal has grown similarly controversial. The act of profiting from fracking for oil and planet-warming gas has reached a special level of moral offense. It's time to stop. Period.

Bill 44-16 would end these direct investments. Again, I love this county -- and I will love it even more when Montgomery's investment patterns finally begin to align better with the deep environmental values of its voters.

Mike Tidwell is director of the Chesapeake Climate Action Network

Mtidwell@chesapeakeclimate.org

240-460-5838

7125 Willow Ave

Takoma Park, MD 20912

Testimony of Montgomery County Sierra Club on Bill 44-16 before the
Montgomery County Council
December 6, 2016

Good evening. My name is Michal Freedman and I am here on behalf of the 5,000 Sierra Club members in Montgomery County. We welcome this opportunity to testify in support of Bill 44-16.

The dangers of global warming have been known for decades. But the threat is no longer something abstract, on the distant horizon. We witness at home and across the globe the devastation in lived time: the raging hurricanes, the record-breaking heatwaves, the rising sea levels, new public health threats appearing as rising temperatures move disease hosts from one region to the next. We know that increasingly harsh degradation of the planet is already baked in from the burning of fossil fuels over past decades.

Despite all this, climate change denial is now dominating the national discourse. What will it take to make a difference to the current trajectory of catastrophe?

Mostly progress has been slow. Even here in Montgomery County where people are unusually ecologically sensitive and where the Council has enacted several far-reaching laws to facilitate our transition to a clean energy economy, change is not swift. The 2016 Office of Sustainability Annual Report stated, for example, that residential energy use had grown by 26% in the last four years. Non-residential use increased by 13% in the same period.

How do we spur much faster change from institutions and industry that wish to move slowly, if at all? One answer lies in highlighting the urgency of our goal through moral action. We cannot continue to invest in fossil fuel companies that undermine the goal that Montgomery County policies seek to address. We need to underscore the urgency of becoming

a clean energy economy by divesting from fossil fuel companies and refusing to bet our investment dollars on the continued destruction of the planet. Committing to reduce our investments in the largest greenhouse gas emitters is a moral call to action on behalf of the lives of our children and grandchildren. It is a call to action to our institutions and companies that we must act in ways commensurate with the dangers. We urge enactment of this legislation.

**Rick Sullivan Testimony
Bill 44-16**

My name is Rick Sullivan. I am 68 years old and I live in Kensington, Maryland. In 2011 I retired from Montgomery County Government after 21 years of service in the Department of Health and Human Services. During my employment with the County I was a shop steward with UFCW Local 1994 MCGEO. Since retiring I have become active with 350MontgomeryCounty and I serve on the board of the Montgomery County Retired Employees Association. I am also the father of a 27-year-old daughter who enjoyed the benefits of a Montgomery County Public Schools education.

I have been studying climate change for over a dozen years. I am convinced that climate change is very real and is caused by human activity. In my opinion climate change is the greatest threat that humanity currently faces and is arguably the greatest threat that we have ever faced. I am convinced that we must make radical changes in the way we collectively live our lives in order to avoid climate catastrophe. The most obvious and urgent change that needs to be made is the termination of our use of fossil fuels at the earliest possible date. I am personally committed to doing everything I can do to make this happen. It has been said that those of us living on this earth at the current time are the first people to experience the effects of human-caused climate change and that we are the last people who have an opportunity to prevent full-blown climate catastrophe. I take this responsibility very personally and very seriously. My daughter, the children she may have, and unborn generations to come are depending on us to take action to protect our precious and irreplaceable human habitat.

As a pensioner with the Montgomery County Employees' Retirement System and as a county taxpayer I object to my income and my tax dollars being connected to fossil fuel investments. These investments are scientifically unsound, financially reckless and morally reprehensible. Finally, I would like to thank Council Members Berliner, Navarro and Elrich for showing the leadership and courage to sponsor bill 44-16. I hope that the rest of the Council joins you in passing this vital legislation. Thank you.

Testimony of Susan B. Jacobson 12/6/16

For Bill 44-16

Hi, I'm Sue Jacobson and I live in Rockville. I'm a Montgomery County retiree. I started working in Montgomery County as a Children's Librarian in the Montgomery County Public Libraries in 1977 and now receive my pension from the county. I care very deeply about how our County responds to climate change I want my pension to be invested ethically. I was thrilled to learn about the introduction of the fossil fuel divestment bill. Thank you council members Berliner, Navarro, and Elrich.

The Trump election means that local action to help mitigate climate change is more important than ever. Trump plans to undo as many environmental regulations as possible allowing fossil fuel companies to unleash more pollutants than they have for many years. His comments and appointments so far show that oil and gas company executives - not scientists, are going to be his primary advisers on climate. How can we have good climate policy when the companies that helped create the problem are telling him what he should do? The world is looking for signs that the US will continue to show leadership on this issue and we (Montgomery County) can and should do the right thing with divestment from the fossil fuel industry. We will not be the only place to do this but we should take a lead on this issue.

Much of the funding for our pensions comes from our taxes and some from money deducted from our pay checks. I know that I don't want my tax dollars and/or my pension, invested in the oil, coal and natural gas industries - I don't support what those companies are doing to the climate and I don't want the County to support them with its investments. I don't support them with my personal investments. I think the divestment bill is a great idea and I hope you will all come together and pass it as soon as possible - we don't have any time to waste as we are already seeing dangerous signs of climate change all over the world - increases in storms and flooding in some places and extreme drought in others as well as enhanced warming in the Arctic at a level that has not been seen before! These companies also endanger the quality of our air and water which are the two things human beings can not live without.



2

**MONTGOMERY COUNTY EMPLOYEES' RETIREMENT SYSTEM
CONSOLIDATED RETIREE HEALTH BENEFITS TRUST**

**Testimony from Gino Renne, President, UFCW Local 1994, on Bill 44-16
Montgomery County Council, December 6, 2016**

Good evening, I'm Yvette Cuffie, Secretary/Treasurer of UFCW Local 1994, MCGEO, AFL-CIO, and an employee of Montgomery County as well as a participant in the Employees' Retirement System. I'm here to read the testimony of Gino Renne, President of UFCW Local 1994, MCGEO, AFL-CIO who strongly opposes Bill 44-16.

I am the Chair of the Board of Investment Trustees of the Employees' Retirement System (ERS), the pension fund for County government employees with assets of \$3.8 billion. I'm also a member of the Board of Trustees for the Consolidated Retiree Health Benefits Trust (CRHBT) for employees of County government, Montgomery County Public Schools, and Montgomery College with assets of \$700 million. The Chair of that Board is Lynda von Barga, who is a College retiree. She and I have written a memo to the Council to be included in the record for this hearing.

Our two Boards voted unanimously to oppose Bill 44-16, which mandates divestment from certain fossil fuel companies. I have a simple message: We are doing a great job for our employees, our retirees, and our taxpayers. The 10-year return for our pension fund is in the top one percent of the Wilshire Large Public Funds Universe. We respectfully request that you do not intrude in our fiduciary process by mandating legislation.

I say this as one who is deeply concerned about climate change. In fact, our Union's Executive Board voted to support divestment. But for our pension fund, I wear the hat of a fiduciary. That is a dead serious responsibility, and it runs smack up against Bill 44-16.

The County Attorney's Office wrote on November 15 that to require the Board to divest from fossil fuel companies, the Council would have to change the Standard of Care in the County Code. The Code says that our Duty of Loyalty as fiduciaries is to act "only in the best interest of the participants and their beneficiaries." We are not permitted to use plan assets to promote the social, environmental, or other goals we may favor. Any weakening of this Standard of Care would be a serious mistake because it could lead to decisions driven by politics, not prudent investment principles. I will tell you flat out that that is a non-starter.

There are other problems with Bill 44-16.

First, the bill is unworkable. The bill requires us to jump through too many hoops and split too many hairs in deciding whether to divest from a company.

26

Second, the bill requires us to develop a policy on socially responsible investing. But we have long had such a policy.

Third, this Council is a national leader in moving toward clean energy and energy efficiency. That's real action, and you can do more. Divestment is symbolism. Symbols are important, but we are past that.

Fourth, Bill 44-16 requires divestment from fossil fuel companies but not from what those companies produce. The County still uses fossil fuels to heat and cool our buildings, pave our roads, and fuel our vehicles, like the Ride-On buses, snow plows, and heavy equipment that my members drive. The County is moving fast toward renewables, but we are not there yet.

In sum, we share the deep concern about climate change that the supporters of Bill 44-16 have expressed. But at a time when real action is needed, this bill only provides symbolism, and it undermines the Duty of Loyalty that we as fiduciaries have by law. Please oppose this bill.



**MONTGOMERY COUNTY EMPLOYEES' RETIREMENT SYSTEM
CONSOLIDATED RETIREE HEALTH BENEFITS TRUST**

MEMORANDUM
December 5, 2016

TO: Montgomery County Council

FROM: Gino Renne, Chair, Board of Investment Trustees, ERS
Lynda von Bargen, Chair, Board of Trustees, CRHBT

SUBJECT: Boards' Resolution on Bill 44-16, Retirement – Fossil Fuel Investments – Restrictions

On November 18, 2016 the following resolution was unanimously approved by two separate Boards: the Board of Investment Trustees of the Employees' Retirement System (*ERS*, the defined benefit pension plan for County government employees with assets of \$3.8 billion) and the Board of Trustees of the Consolidated Retiree Health Benefits Trust (*CRHBT*, the trust for retiree health benefits for employees of County government, Montgomery County Public Schools, and Montgomery College with assets of \$700 million):

Resolved, that the Board opposes Bill 44-16, Retirement – Fossil Fuel Investments – Restrictions, which mandates divestment from certain fossil fuel companies. The Board considers the bill legally flawed, as outlined in the November 15, 2016 memo from the Office of the County Attorney; operationally unworkable; and inconsistent with the fiduciary duties outlined in the County Code. The Standard of Care requires the Board to act “only in the best interest of the participants and their beneficiaries.” The Board requests the Executive Director to prepare a memo informing the County Council of its views. The memo should also indicate that the Board currently considers Environmental, Social and Governance (*ESG*) factors in its investment process and monitoring efforts, as set forth in Board policies, and that the bill's requirement that the Board do so is therefore unnecessary.

The purpose of this memo is to set forth the views expressed by the Boards in their deliberations on the bill on October 28 and November 18, 2016.

1. Bill 44-16 is legally flawed.

The November 15, 2016 memo from the Office of the County Attorney (*OCA*) lists three infirmities in the bill. (The bill is Attachment A. The OCA memo is Attachment B.) The bill “(1) unlawfully delegates legislative authority to a private third party to determine whether an entity is a fossil fuel company, (2) violates the unconstitutional conditions doctrine by permitting the Boards to invest in a fossil fuel company if it gives up certain First Amendment rights, and (3) is inconsistent with the Boards' present statutorily-imposed fiduciary duties.” The OCA memo adds that “all of these infirmities can be remedied by amendment.” The possible remedies for points (1) and (2) are straightforward. As discussed below, the Boards believe that there is no adequate remedy for the fiduciary issue in point (3).

2. Bill 44-16 is operationally unworkable.

The bill lists a series of conditions that must be met before a security is divested, including extensive communication with potentially affected companies and, if necessary, with the Council. (The list is Attachment C.) These conditions include possible exemptions, notice requirements, and reconsideration of potential divestment decisions. The conditions presumably are intended to assure “fairness” in the divestment process. But meeting these conditions would require the Boards to commit major time and staff resources that should be focused instead on investment issues, and to make continuous value judgments at the margin that are remote from their expertise and their core responsibility. For example, how would the Boards respond to the fact that some fossil fuel companies, seeing the future, are investing heavily in renewables?

The Boards and their staff are required by law to serve an investment fiduciary function. They are not equipped to make the kind of judgments required by the bill. They need to focus instead on their fundamental obligation to the employees and retirees of County government, MCPS, and Montgomery College.

3. Bill 44-16 is inconsistent with the fiduciary duties outlined in the County Code.

The OCA memo in Attachment B provides critical advice on the Boards’ fiduciary duties. (The entire memo warrants careful review.) The memo refers to the standard of care specified in Section 33-61C of the Code for the ERS, including the requirement that a fiduciary may act “only in the best interest of the participants and their beneficiaries,” and the duty of care specified in Section 33-163 of the Code for the CRHBT, including the requirement that the Board must act “only in the interest of the participants in retiree benefit plans and eligible dependents.” These Code sections are Attachment D.

The OCA memo states: “By requiring divestment from fossil fuel companies, Bill 44-16 compels the Boards to deviate from the currently applicable prudent investor standard and duty of loyalty standard. *Therefore, the legislation should modify the standard of care and expressly state that the Council intends that the Board is authorized to ignore the prudent investor standard and duty of loyalty standard in order to comply with the divestment requirement in the legislation.*” (Emphasis added.)

The OCA memo suggests that alternatively, the bill could be amended to incorporate recent guidance from the Department of Labor, which regulates private sector plans that fall under the Employee Retirement Income Security Act (ERISA). The OCA memo says that in Interpretive Bulletin 2015-01, “DOL states that fiduciaries can take into account economic, social and governance (ESG) factors when making investment decisions.” The OCA memo continues: “*DOL also stated that the fiduciaries’ focus is the plan’s financial returns so that fiduciaries cannot use plan assets to promote social, environmental, or other public policy causes at the expense of the plan’s participants. In other words, fiduciaries may not accept lower returns in order to obtain collateral benefits.*” (Emphasis added.) While some observers assert that divestment from fossil fuel companies would actually produce higher rather than lower returns, that assertion going forward is impossible to verify. Further discussion of this issue appears below.

The OCA memo also addresses the bill’s provision that the Boards must divest unless the Boards “determine that a delay in divesting from a fossil fuel company is necessary due to its fiduciary duty.”

The OCA memo adds: *“If the Council wants to impose an investment restriction, the Council should explicitly do so and alter the Boards’ fiduciary duties.”* (Emphasis added.)

The OCA memo also points out that “as required under the County Code, investment managers, not the Boards, make individual investments. [All investment managers are fiduciaries to the trust funds.] Because the Boards do not make decisions to invest in individual companies, such as fossil fuel companies, the Boards do not have the knowledge to ‘determine that a delay in divesting from a fossil fuel company is necessary due to its fiduciary duty.’” The OCA memo adds that if the Boards want investment managers to make this decision, *“the investment managers would request indemnification and an altered fiduciary duty standard.”* (Emphasis added.)

The Boards believe that any action by the Council to weaken the standard of care that the Boards are required by law to exercise as fiduciaries would be a serious mistake. It would set the precedent that future decisions could be driven by political considerations, not prudent investment principles. The Boards strongly urge the Council to uphold the current standard of care.

It should be noted that for private sector retirement plans that fall under ERISA, the Department of Labor advises that **the act of appointing fiduciaries to a plan – as the Council and the Executive do for the Boards – is itself a fiduciary act.**

4. The requirement in Bill 44-16 regarding socially responsible investing is unnecessary.

The bill requires each Board to “review academic and professional literature on socially responsible investing; investigate the benefits and disadvantages of socially responsible investing of public trust funds; and adopt a Socially Responsible policy for investments.”

The Boards have examined these issues carefully for many years and have incorporated them in their investment and governance policies. The Boards consider Environmental, Social and Governance (ESG) factors, as they are termed, in their evaluation of both investments and investment managers. This requirement in the bill is therefore unnecessary.

5. Bill 44-16 raises additional issues for the Boards.

In their deliberations on Bill 44-16 on October 28 and November 18, 2016, the Boards discussed a number of additional issues:

a. Real climate action v. symbolism

Montgomery County is a national leader in taking real action on climate change, achieving real results. The Council has enacted wide-ranging measures to support clean energy and energy efficiency, with consistent progress on the shift to renewables and sustainability. This is what a county government can and should do. This is where we should focus and where our performance should be assessed. The County can now build on its record by examining more closely how its land use policies, capital improvements program, and personnel and transportation policies interact with climate change.

By contrast, divestment from fossil fuel companies is a symbolic action. Symbolism is important, but climate action has moved far beyond symbolism. The huge challenge of climate change persists, but

the movement has realized great success, as reflected in the Paris Agreement (April 2016) and scores of related developments. What is needed now is sustained follow-up action by the world community to implement the Paris goals, starting with an honest focus on our individual carbon footprints from the way we live our lives. We are past feel-good symbolic gestures that merely confirm what we already know.

b. Divestment from fossil fuel companies but not from what they produce

Bill 44-16 requires divestment from fossil fuel companies, but it does not require divestment from products made by those companies for multiple County functions, such as heating and cooling buildings, paving roads, and fueling police cars, fire engines, ambulances, buses, snow plows, and heavy vehicles. Plastics, medical equipment, and other products derived from fossil fuels are in constant use by the County. The County is shifting away from fossil fuels wherever possible but, like billions of people worldwide, continues to rely on them.

c. Resolutions v. laws: a reality check

The passion and commitment of climate action advocates are laudable. The movement has persuaded a number of progressive jurisdictions to adopt resolutions supporting their divestment template. San Francisco provides a good reality check. In April 2013 a Board of Supervisors resolution unanimously urged the Retirement Board to follow the divestment template. The Retirement Board has tried to be responsive, but because of its fiduciary responsibility under law, it has taken little concrete action. Its \$16 billion pension fund still has fossil fuel holdings of nearly \$600 million in separately managed accounts and additional holdings in other investment vehicles. Bill 44-16, by contrast, does not just urge divestment, it requires it. (As shown in point 2 above, however, the divestment requirement in the bill is operationally unworkable.) Jurisdictions elsewhere have used resolutions, not bills.

d. Duty of loyalty to tens of thousands of employees, retirees, beneficiaries, and dependents

As discussed in point 3 above, the standard of care in the Code for the ERS directs the Board to act “only in the best interest of participants and their beneficiaries,” while the duty of care for the CRHBT directs the Board to act “only in the interest of the participants in retiree benefit plans and eligible dependents.” County government, MCPS, and Montgomery College retirees currently total more than 20,000, not including their beneficiaries and dependents. Active employees, who will become retirees, currently total more than 30,000, not including their beneficiaries and dependents. The Boards’ duty of loyalty as fiduciaries is to all of them.

e. Possible risks from divestment

As stated in point 3 above, while some observers assert that divestment from fossil fuel companies would actually produce higher rather than lower returns, that assertion going forward is impossible to verify. The possible risks associated with accepting that assertion at face value include a decreased opportunity set, difficulty in accessing superior managers, higher fees, and a larger employer (taxpayer) contribution. These possible risks and outcomes are outlined in Attachment E. They warrant careful review. They are not guaranteed, but neither are assurances that divestment would have a positive impact on returns.

f. *Potential impact on taxpayers*

For the ERS and the CRHBT combined, County taxpayers are contributing nearly \$200 million in Fiscal Year 2017. If divestment actions and weakening the fiduciary standard result in lower returns, the taxpayer burden will increase.

g. *Views of three major universities*

The views of three major universities – Stanford, Harvard, and Yale – on the advisability of divesting fossil fuel companies from their endowments offer one perspective. Excerpts of their views are in Attachment F. The concerns they raise about divestment warrant careful consideration.

h. *The “slippery slope” issue*

Some advocates of climate action say that divestment from fossil fuel companies is justified because climate change is a unique danger. Advocates of other causes may see unique danger in the conduct of other companies – for example, companies (including highly regarded companies) that permit gross inequality in their pay practices and follow other regressive social and economic policies, assist totalitarian governments, engage in tax inversions, gouge or cheat consumers, propagate obesity and diabetes, tolerate human suffering in their supply chain, or helped to cause the Great Recession.

The Boards and the staff are serving our employees, our retirees, and our taxpayers well. The 10-year return for the ERS, our pension fund, is in the top one percent of the Wilshire Large Public Funds Universe for funds with assets greater than \$1 billion. Let us continue to do our job.

Risk Exposure – Due to Divestment - Equities

The table below is an analysis of domestic and international indexes versus their ex-Fossil Fuel counterparts. It reflects the impact of fossil fuel divestment in terms of tracking error (a measure of active risk over a benchmark return) and Value At Risk (VAR), an analysis that shows the potential loss in value over various time periods. The results indicate the following:

- The fossil fuel divestment would result in an increase in tracking error in each of the domestic and international portfolios (58bps and 52bps, respectively). This increase is not expected to be compensated by higher returns due to limiting the investible universe.
- The VAR analysis indicates that the divestment could generate substantial losses over various time periods. For instance, there would be a 40% probability that the value of equity assets would decline more than \$7.3 million (shown in red) over a ten year period (based on our portfolio values as of June 30, 2016).

Equities

Asset Class:	US Equity	Non-US Equity	Total
Market Benchmark	Russell 3000	MSCI ACWI ex-US	
Total Market Cap (\$ billion)	22,633.0	20,514.0	
Ex-Fossil Fuel Benchmark	Russell 3000 ex-Carbon 200	MSCI ACWI ex-US ex-Carbon 200	
Total Market Cap (\$ billion)	21,594.0	19,344.0	
Market Cap Excluded (\$ billion)	(1,039.0)	(1,170.0)	
Market Cap Excluded (%)	4.6%	5.7%	
Total Montgomery County Assets (\$ mm)	839.40	814.89	1,654.30
Expected Tracking Error due to Divestment	0.58%	0.52%	
1-Year Value at Risk (\$ mm) vs. Market Benchmark			
40% probability	(1.2)	(1.1)	(2.3)
25% probability	(3.3)	(2.9)	(6.2)
10% probability	(6.2)	(5.4)	(11.6)
5-Year Value at Risk (\$ mm) vs. Market Benchmark			
40% probability	(2.8)	(2.4)	(5.2)
25% probability	(7.4)	(6.4)	(13.8)
10% probability	(13.8)	(12.1)	(25.9)
10-Year Value at Risk (\$ mm) vs. Market Benchmark			
25% probability	(10.5)	(0.9)	(11.4)
10% probability	(19.5)	(17.0)	(36.5)

Risk Exposure – Due to Divestment – Fixed Income

- ❑ The fossil fuel divestment would also result in an increase in tracking error for the fixed income segments, with High Yield being impacted the most (the divestment would result in a 1.13% tracking error).
- ❑ The VAR analysis indicates that the divestment could also generate substantial losses over various time periods. For instance, there would be a 40% probability that the value of fixed income assets would decline more than \$6.5 million (shown in red) over a ten year period (based on our portfolio values as of June 30, 2016). This increase is not expected to be compensated by higher returns due to limiting the investable universe.
- ❑ The total (equities and fixed income) VAR analysis would indicate that there would be a 40% probability that the divestment would result in a more than \$13.8 million decline over the same time period.

Fixed Income

Asset Class:	Long Duration	High Yield	Total
Market Benchmark	Barclays Long Gov't / Credit	Merrill Lynch High Yield Master II	
Total Market Cap (\$ billion)	2,977.8	1,275.0	
Ex-Fossil Fuel Benchmark	Barclays Long G/C Index ex- Energy	Merrill Lynch High Yield Master II Index ex-Energy	
Total Market Cap (\$ billion)	2,715.8	1,088.9	
Market Cap Excluded (\$ billion)	(262.0)	(186.2)	
Market Cap Excluded (%)	8.8%	14.6%	
Total Montgomery County Assets (\$ mm)	630.16	433.25	1,063.40
Expected Tracking Error due to Divestment	0.51%	1.13%	
1-Year Value at Risk (\$ mm) vs. Market Benchmark			
40% probability	(0.8)	(1.2)	(2.0)
25% probability	(2.2)	(3.3)	(5.5)
10% probability	(4.1)	(6.2)	(10.3)
5-Year Value at Risk (\$ mm) vs. Market Benchmark			
40% probability	(1.8)	(2.8)	(4.6)
25% probability	(4.9)	(7.5)	(12.4)
10% probability	(9.1)	(13.8)	(22.9)
10-Year Value at Risk (\$ mm) vs. Market Benchmark			
25% probability	(6.9)	(10.6)	(17.5)
10% probability	(12.9)	(19.4)	(32.3)

Possible Impact– Higher Fees

- Certain investment managers may not agree to excluding fossil fuel companies from their investment universe due to the administrative burden and trading costs of investing our account differently than other clients. If the Boards wish to remain invested with the manager, they would have to move from a separate account to a commingled vehicle, typically resulting in higher fees.
- The tables below highlight the fee differences between separate accounts and commingled funds for the managers with exposure to fossil fuels. Moving to a commingled fund with the investment managers listed below results in an increase in fees of approximately \$3 million.

ERS

Manager	Market Value	Current Separate Account Fee	Commingled Fund Option Fee	Fee Increase
Equity Manager A	\$113,391,064	0.46%	1.13%	\$759,720
Equity Manager B	191,130,389	0.40%	0.50%	191,130
Equity Manager C	193,134,255	0.55%	0.65%	193,134
Fixed Income Manager D	179,264,758	0.47%	0.71%	430,235
Fixed Income Manager E	176,122,832	0.50%	0.50%	0
Fixed Income Manager F	250,950,821	0.24%	0.37%	326,236
Fixed Income Manager G	230,482,797	0.18%	0.40%	507,062
Total Fee Increase				\$2,407,518
Total Fee Increase				0.07%

CRHBT

Manager	Market Value	Current Separate Account Fee	Commingled Fund Option Fee	Fee Increase
Equity Manager A	\$26,576,909	0.46%	1.13%	\$178,065
Equity Manager B	41,305,300	0.40%	0.50%	41,305
Fixed Income Manager D	46,478,127	0.47%	0.71%	111,548
Fixed Income Manager F	49,400,147	0.24%	0.37%	64,220
Fixed Income Manager G	45,054,749	0.18%	0.40%	99,120
Total Fee Increase				\$494,259
Total Fee Increase				0.07%

Possible Impact – Accessing Managers

- ❑ The Boards consistently invest with top quartile investment managers who can achieve the strongest returns at a reasonable level of risk. Managers with exposure to fossil fuels may decline to exclude these companies from their universes due to the administrative burden and trading costs of investing our account differently. Many top quartile managers are closed to new clients and are less likely to accept new accounts with restrictions that they believe limit their investment capabilities.
- ❑ If the boards were to look for a replacement manager, the chart below shows the return differential of the current managers in our portfolio that invest in fossil fuels relative to the median manager's return.

ERS			10-Yr Returns			
Manager	Date Hired	Market Value	Manager	Percentile Ranking	Peer Group Median	Return Difference
Equity Manager A	2014	\$113,391,064	7.05%	38%	6.77%	\$317,495
Equity Manager B	2005	191,130,389	4.30%	31%	3.30%	1,911,304
Equity Manager C	2002	193,134,255	5.64%	11%	3.30%	4,519,342
Fixed Income Manager D	2005	179,264,758	9.52%	1%	7.12%	4,302,354
Fixed Income Manager E	2005	176,122,832	8.37%	10%	8.21%	281,797
Fixed Income Manager F	2009	250,950,821	9.07%	16%	6.66%	6,047,915
Fixed Income Manager G	2008	230,482,797	9.42%	8%	6.66%	6,361,325
Total Difference						\$23,741,531
Total Difference						0.66%

CRHBT			10-Yr Returns			
Manager	Date Hired	Market Value	Manager	Percentile Ranking	Peer Group Median	Return Difference
Equity Manager A	2014	\$26,576,909	7.05%	38%	6.77%	\$74,415
Equity Manager B	2013	41,305,300	4.30%	31%	3.30%	413,053
Fixed Income Manager D	2016	46,478,127	9.52%	1%	7.12%	1,115,475
Fixed Income Manager F	2016	49,400,147	9.07%	16%	6.66%	1,190,544
Fixed Income Manager G	2016	45,054,749	9.42%	8%	6.66%	1,243,511
Total Difference						\$4,036,998
Total Difference						0.60%

- ❑ Additionally, the Boards may elect not to pursue certain managers if their universe is limited (e.g. a concentrated manager).
- ❑ The resulting difference over a one year period would be over \$27 million.

Stanford/Harvard/Yale

- Shown below are comments made by three of the largest endowments in the United States explaining their opposition to fossil fuel divestment:

Stanford University

As trustees, we are convinced that the global community must develop effective alternatives to fossil fuels at sufficient scale, so that fossil fuels will not continue to be extracted and used at the present rate. Stanford is deeply engaged in finding alternatives through its research. However, despite the progress being made, at the present moment oil and gas remain integral components of the global economy, essential to the daily lives of billions of people in both developed and emerging economies. Moreover, some oil and gas companies are themselves working to advance alternative energy sources and develop other solutions to climate change. The complexity of this picture does not allow us to conclude that conditions for divestment outlined in the Statement on Investment Responsibility have been met.

Note: Stanford supports divestment from thermal coal companies but not oil and gas companies.

Harvard University (President Drew Faust)

I also find a troubling inconsistency in the notion that, as an investor, we should boycott a whole class of companies at the same time that, as individuals and as a community, we are extensively relying on those companies' products and services for so much of what we do every day. Given our pervasive dependence on these companies for the energy to heat and light our buildings, to fuel our transportation, and to run our computers and appliances, it is hard for me to reconcile that reliance with a refusal to countenance any relationship with these companies through our investments.

Yale University

Yale Corporation Committee on Investment Responsibility agrees that climate change is a grave threat to human welfare. "We believe, however, that the actions Fossil Free Yale proposes Yale take as an institutional investor – divestment or shareholder engagement as a precondition to divestment – are neither the right means of addressing this serious threat nor would they be effective. Yale will have its greatest impact in meeting the climate challenge through its core mission: research, scholarship and education conducted by its faculty and students."



LOCAL 1664

Montgomery County Career Fire Fighters Association

4

December 6, 2016

The Honorable Roger Berliner, President
Montgomery County Council
Stella B. Werner Council Office Building
100 Maryland Avenue
Rockville, Maryland 20850

Re: Bill 44-16 – Retirement – Fossil Fuel Investment – Restrictions

Dear Council President Berliner,

The Montgomery County Career Fire Fighters Association, IAFF Local 1664 (hereinafter, "MCCFFA") which represents 1500 active and retired members, strongly opposes Bill 44-16. All of MCCFFA's members are, at the same time, members of the Montgomery County Employee Retirement System – Group G Defined Benefit Plan. Bill 44-16, if enacted, would seriously compromise the financial health and long term security of the defined benefit pension plan which is one of the strongest public sector pension plans in terms of current funding ratios when compared to its peer group plans across the Country.

In assessing the merits of the proposed legislation, the County Council needs to look no further than an opinion issued by the Office of the County Attorney on November 15, 2016. In his memorandum opinion, the County Attorney sets out several serious legal concerns with this bill. In summary the County Attorney concluded:

"We conclude the Bill, as presently drafted, (1) unlawfully delegates legislative authority to a private third party to determine whether an entity is a fossil fuel company, (2) violates the unconstitutional conditions doctrine by permitting the Boards to invest in a fossil fuel company if it gives up certain First Amendment rights, and (3) is inconsistent with the Boards' present statutorily imposed fiduciary duties."

While this opinion raises certain fundamental concerns about the legality of the proposed legislation, there are still other concerns that must be recognized. On November 18, 2016, the Board of Investment Trustees of the Employee Retirement System **and** the Board of Trustees of the Consolidated Retiree Health Benefit Trusts **unanimously** passed a resolution opposing Bill 44-16. In that resolution, the two Boards noted that that in their view the bill was legally flawed, operationally unworkable, and inconsistent with the fiduciary duties outlined in the County Code.

What is unique about these two Boards is the composition of their members. Combined, these two Boards have 19 different trustees comprised of the following individuals, groups or interests: Montgomery College (President), Montgomery County Public Schools (Superintendent), Montgomery College Retirees, MCPS Retirees, MCG Retirees, Montgomery College Bargaining Unit, MCPS Bargaining Unit, Police Bargaining Unit, OPT/SLT Bargaining Unit, Fire/Rescue Bargaining Unit, MCG Non-Represented Employees, Montgomery County Council, County Council Administrator, Director of

The Honorable Roger Berliner

December 6, 2016

Page 2

Management & Budget, Director of Finance, Director of Human Resources and the Public-At-Large. All of these trustees are appointed by the County Executive and confirmed by the County Council. There is no other Board in Montgomery County, Maryland that represents nearly every entity and function of County Government. The *unanimous* opposition of these two Boards to Bill 44-16 is extraordinarily *unprecedented!*

It is extremely important for the County Council to recognize and understand the "Standard of Care" that each trustee must adhere to when appointed to serve on either of these Boards of Trustees. The Montgomery County Code is quite clear on a trustee's principal obligation. Section 33-61C and Section 33-163, in very clear and unambiguous language, require that each trustee act "*with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes*" and "*only in the best interest of the participants and their beneficiaries*". This legally binding standard is substantially similar and nearly identical to the standard of care contained in the Employee Retirement Security Income Act which is considered to be the "gold standard" of the retirement investment industry.

Additionally, the Maryland Court of Appeals has recognized that a social investment policy that has greater than a *de minimis* impact upon a pension fund's investment return may violate a trustee's duty of prudence and loyalty. It is quite simply a bad idea and of grave concern if the Montgomery County Council were to pass legislation that would in all likelihood cause trustees to breach their legal duties and responsibilities to the pension plan and trust fund. It would make matters even worse if Council action were to lower, in any manner or form, the standard of care or the duty of loyalty and prudence that is required of a trustee.

In summary, MCCFFA strongly opposes Bill 44-16 and respectfully requests that the Montgomery County Council reject this legislation on the grounds that it is legally flawed, operationally unworkable, inconsistent with the required standard of care and impermissibly interferes with fiduciary duties and responsibilities required under applicable law.

Thank you for your consideration of our view point regarding Bill 44-16.

Respectfully,



Jeffrey Buddle, President

IAFF Local 1664

cc: Montgomery County Council Members
Montgomery County ERS – Board of Investment Trustees
Consolidated Retirement Health Benefit Trust – Board of Trustees
File

**FRATERNAL ORDER OF POLICE
MONTGOMERY COUNTY LODGE 35**

Before the Montgomery County Council

December 6, 2016

RE: Bill 44-16 – Fossil Fuel Investments – Restrictions

POSITION: **AGAINST**

Statement of Walter E. Bader, Past President Fraternal Order of Police, Montgomery County Lodge 35 concerning Council Bill 44-16 – Fossil Fuel Investments – Restrictions

Good evening, I am Walter E. Bader, Past President of FOP Lodge 35, testifying on behalf of FOP Lodge 35 and its Active and Retired Members. I am also a former Trustee to the Montgomery County Board of Investment Trustees [BIT] (1995-2001 and 2005-2011) and a 40 year member of the Employees Retirement Plan.

Trustees of the BIT and the Consolidated Retiree Health Benefits Trust Board of Trustees [CRHBT] have a fiduciary duty to act only in the best interest of participants and beneficiaries and eligible dependents. See Mont. Co. Code Sections 33-61C and 33-163.

Bill 44-16, though creatively drafted, attempts to impair this duty by requiring the divestment of certain investments. Further, it would require Trustees and staff to engage in research and actions unnecessary to the proper performance of their duties. Trustees and staff must be free to make prudent investments and to pay full time and attention to functions that are solely in the best interests of participants, beneficiaries and eligible dependents.

That provisions of this bill require specific indemnification of Board Trustees charged with complying with its mandates raises a red flag.

Currently, the Boards maintain investment and other policies and engage in practices fully consistent with Trustees' fiduciary duties that may result in divestment of fossil fuel or non-fossil fuel investments if deemed prudent and advisable due to performance or other appropriate concerns. Similarly, the Boards may consider Socially Responsible Investing [SRI] so long as investments are deemed prudent and do not take on greater risk or reduce an expected rate of return, consistent with the Trustees' fiduciary duty. Indeed, it is our understanding that the Boards' policies do provide for Environmental, Social and Governance considerations.

Employee retirement and health benefit funds are not endowments. An endowment may operate under different rules that could allow social investing or divestment. In contrast, our important funds were not created to become tools to promote political or social causes.

There is the old Arabian proverb about the camel being permitted first to get his nose in the tent followed thereafter by his entire body, ultimately leaving his host out in the cold. If passed, this bill will surely encourage others with social objectives to exert political pressure for future legislation not consistent with fidelity to participants. For example, there exist organized opposition to windmills, hydroelectricity, nuclear power, solar panels, sugary beverages, anti-union corporations, and hotels and restaurants that do not pay a living wage,

While pension and health benefit funds are real and critical to the health and welfare of employees and retirees, this bill is merely symbolic. But, there is a certain contradiction where the County is a consumer of the very fossil fuels being condemned by supporters of this legislation. Use of fossil fuels by the county is a necessity. Assuming that only 50% of the electricity used by Montgomery County is generated with fossil fuels, the County and Agencies use about \$60,000,000 worth of fossil fuels for utilities alone. This does not include gasoline, diesel and natural gas used to fuel Ride-On busses, school busses, snow plows, emergency vehicles, construction equipment, mowers, and other vehicles and machinery. It does not include the asphalt used to pave and repair roads, materials used to roof schools, or the many products, including plastics, made from petroleum that are purchased and used by the County.

We ask that you vote against this legislation and support the Trustees who are charged with the duty to act only in the best interest of participants and beneficiaries and eligible dependents.

Thank you.



P.O. Box 73 • Rockville, Maryland • 20848-0073

December 6, 2016

RE: Bill 44-16, Retirement- Fossil Fuel Investments - Restriction

Dear Montgomery County Councilmembers;

On November 21, the Montgomery County Retired Employees Association (MCREA) voted to oppose Bill 44-16, Retirement- Fossil Fuel Investments- Restriction. MCREA, began in 1977 and represents more than 6,000 retired County employees who have paid their money into these funds in the expectation that there is a County legal and moral obligation to retirees. Our mission is to provide information to and advocate for individuals currently receiving retirement benefits and/or retiree group insurance.

The MCREA Board acknowledges the seriousness of global warming. We praise the County Council's leadership in actions to reduce the consumption of fossil fuels, such as Green Building standards. We encourage your continued support for county-wide measures.

After listening to and discussing both sides of the divestment issue, MCREA believes Bill 44-16 seriously threatens and impacts the funding for both the retirement plan trust fund and the retiree health care trust fund. We also believe that divestment offers symbolic rather than genuine impact on climate change given the complexity of fossil fuel investments. Our members are already concerned about both the funding and politicizing of trust funds. Thus, MCREA strongly opposes Bill 44-16 and believes it is not amenable to technical corrections.

This Bill will not have the desired effect and will have real and potentially negative impacts to pension structure and funding.

Except for Initial Public Offerings, corporation stock sales do not affect corporation funding. Divestment will result in the transfer of ownership away from those who care about fossil fuels, thus diminishing shareholders voices advocating for progressive environmental, social and governance factors.

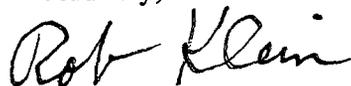
The Employees' Retirement System's investment returns are among the highest in the country, due to the Board's asset allocation decisions and the quality of outside fund managers hired. Bill 44-16 threatens to decrease the quality of investment managers, increase fees, and restrict the investable universe. As cited in the Board of Investment Trust memorandum, Wilshire Consultants estimates the potential cost impact to be (between -0.1 percent and -1.0 percent for a per annum) a loss of \$2.7 million to \$26.8 million annually. Even taking their lowest estimate, that would result in an estimated \$27 million loss over a ten-year period. Whatever the loss, it will need to be made up plus any additional funding short falls.

Under County Code (Section 33-61C and 33-163), the pension and health care funds carry fiduciary responsibilities to act only in the best interest of fund participants and their beneficiaries. Investment standards mean maximizing investment returns in relationship to appropriate risk. Any increased expenses and decrease in returns on investments, means a real impact on the funds. We must stay aware that the Health Benefits Trust is currently just 21% funded. These factors affect County budgetary choices and could result in higher contributions from employees and retirees.

MCREA believes fossil fuel issues should be restricted to policies on environmental, social and governance factors and not violate fiduciary responsibilities and impact investor standards. In addition, we note that the organizations with the greatest investments in alternative fuels are often fossil fuel providers.

MCREA thanks the Council for considering the concerns of our 6,000 plus members. MCREA looks forward to being part of Council committee meetings and discussions.

Cordially,

A handwritten signature in black ink that reads "Rob Klein". The signature is written in a cursive, slightly slanted style.

Rob Klein, President

Council Bill 44-16

December 6, 2016

Testimony of Robert C. Disinger, President, Montgomery County Police Alumni Assn. Inc.

“Good evening. I would like to thank you for allowing me the opportunity to speak before you tonight about Council Bill 44-16. My name is Robert C. Disinger. I am the President of the Montgomery County Police Alumni Association, Inc. Our association consists of nearly 800 former and retired members of the Montgomery County Police Department. Most of our retired members served the citizens of Montgomery County as sworn police officers or civilian employees. The majority retired after many dedicated years of service. Others were retired on disability retirements that were awarded after they were injured in the line of duty protecting the citizens of the county. However, all of us are dependent upon the Employee Retirement Plans for payment of our retirements and the Consolidated Retiree Health Benefits Trust for continued support of our health benefit plans.

My understanding of the Employee’s Retirement System is that the Board of Investment Trustees and the Board of Trustees for the Consolidated Retiree Health Plans were established to specifically prevent anyone within the county government from changing or tampering with the funds held by them. The Board of Investment Trustees for both plans have a fiduciary responsibility as established by the Montgomery County Code to act only in the best interest of the participants and their beneficiaries. Our greatest fear is that if this council using this bill can make changes in our plans for “social or environmental issues” then what comes next?

On November 18, 2016, the Board of Investment Trustees for the Employees Retirement System and the Board of Trustees for the Consolidated Retiree Health Benefits Trust each unanimously approved a resolution that opposes Bill 44-16 as legally flawed, as outlined by the Office of the County Attorney; operationally unworkable and inconsistent with the fiduciary duties specified in the County Code. These duties require the Board to act “only in the best interests of participants and their beneficiaries.”

Page 2 of 2

Testimony of Robert C. Disinger, President, MCPAA, Inc.
December 6, 2016

The Montgomery County Police Alumni Association, Inc. would like to go on record that we DO NOT support Council Bill 44-16 and we strongly urge the County Council that it not be passed into law. Our retired members worked hard to earn their pensions from a system that is very successful and works. Please do not tamper with it. Thank you.”



17

MONTGOMERY COUNTY EMPLOYEES' RETIREMENT SYSTEM

CONSOLIDATED RETIREE HEALTH BENEFITS TRUST

Testimony from David Locke, Senior Managing Director, National Railroad Retirement Investment Trust and Trustee
Montgomery County Council, December 6, 2016

Good evening, I am David Locke. The Council has twice appointed me as a public member of two important investment boards. One oversees the County government's Employee Retirement Plans. The other oversees the Consolidated Retiree Health Benefits Trust for employees of County government, Montgomery County Public Schools, and Montgomery College. The combined assets exceed \$4.5 billion.

I'm here to speak in opposition to Bill 44-16. The memo you have received from the Chairs of the two Boards, Gino Renne and Lynda von Bargen, clearly state the factors that led the Boards to vote unanimously to oppose the bill. Other speakers this evening have addressed legal and fiduciary concerns. My comments are focused on investment-related issues. They are based on my long experience as an investment professional and fiduciary for retirement boards.

First, eliminating certain securities from consideration, as Bill 44-16 mandates, would increase the likelihood that our portfolios' return on investment will decline. "Breadth of Opportunities" is a fundamental law of investing. It states that the Potential Excess Return is directly related to the number of investment opportunities. In other words, reducing the number of available investment opportunities will reduce the maximum potential excess return. Moreover, practitioners of the Capital Asset Pricing Model developed by William Sharpe, winner of the 1990 Nobel Prize in Economic Sciences, know that eliminating investment opportunities increases the potential risk of a portfolio. It mathematically cannot reduce it.

Second, in making investment decisions, Environmental, Social and Governance (ESG) factors should not be arbitrarily imposed by eliminating certain kinds of investments altogether, as the bill would do. Instead, ESG factors should be proactively incorporated as a consideration in the investment process. This is precisely what the Boards do. This is the correct approach.

Third, it is useful to assess the bill in the context of the Chartered Financial Analyst (CFA) designation. The CFA designation is a highly regarded certification program for investment professionals and a requirement at many investment management firms. Some elements of Bill 44-16 are in direct conflict with the Code of Ethics and Standards of Professional Conduct required of all charter holders and candidates. A number of my colleagues on the Boards and on our staff hold the CFA designation, and I myself am a level II candidate. We are acutely sensitive to the conflict between the fiduciary duties that are inherent in the CFA designation, on the one hand, and the requirements of the bill, on the other.

These investment-related issues provide further reasons to reject Bill 44-16. The Boards would appreciate your consideration of our unanimous opposition to the bill. Thank you.



6

BOARD OF TRUSTEES

CONSOLIDATED RETIREE HEALTH BENEFITS TRUST

Testimony of Bob Doody on Bill 44-16

Montgomery County Council, December 6, 2016

President Berliner and Council members, my name is Bob Doody. I am a member of the Board of Trustees for the Consolidated Retiree Health Benefits Trust (CRHBT). I am here to oppose Bill 44-16. I believe strongly in the need for climate action, but I also believe that this bill is badly misdirected.

As you know, our Trust is designed to provide health benefits for retirees of County government, Montgomery County Public Schools, and Montgomery College, and their dependents. If you add up the current and retired employees of the three agencies, plus their dependents, the total is well over 100,000 people. The Trust is still in the early stage of accumulating assets for retiree health benefits. We are making great progress. We need to continue that progress.

The Chair of our Board of Trustees, Lynda von Bargen, and the Chair of the Board of Trustees for the County's pension fund, Gino Renne, have sent you a detailed memo explaining why both Boards voted unanimously to oppose Bill 44-16. Let me briefly summarize some of the reasons.

First, as the County Attorney's Office said on November 15, the bill is legally flawed.

Second, the bill is unworkable. The steps it requires us to go through as we evaluate whether to divest from a fossil fuel company will excessively burden staff and carry no weight to incentivize target companies to cooperate.

Third, the bill is inconsistent with our fiduciary duties as outlined in the County Code. This is a fatal flaw. The bill should be rejected for this reason alone.

Fourth, the requirement in the bill regarding socially responsible investing is unnecessary, as the Boards are already committed in their policies to this goal.

Fifth, while it's nice to hear the claim that our investment return would not suffer, and even could improve, if we divest from fossil fuel companies, the fact is that no one really knows, and the opposite could easily happen. Warren Buffet is a brilliant investor and progressive thinker. His Berkshire Hathaway portfolio includes some major positions in fossil fuel companies. Many of these companies are moving to renewables because they see the future.

Sixth, the bill is symbolic – it would have no practical effect – at a time when real action is required to meet the goals of the Paris climate accord. The County needs to remain a national leader on real steps to address climate change. Feel-good gestures that confirm what we already know about greenhouse gas emissions really don't achieve anything.

For these and other reasons, I and our entire Board urge you to oppose Bill 44-16. Thank you.



BOARD OF TRUSTEES

CONSOLIDATED RETIREE HEALTH BENEFITS TRUST

Statement by Bill Talbot before the Montgomery County Council on Bill 44-16, December 6, 2016

Good evening, President Berliner members of the Council, I am Bill Talbot. I am a professor of accounting at Montgomery College, and I am a Trustee of the Consolidated Retiree Health Benefits Trust (CRHBT). My fellow trustees and I respect the commitment of the advocates who support Bill 44-16 on fossil fuel divestment. However, we feel strongly that interfering with the investment duties we have as fiduciaries would be a serious mistake and would have no meaningful impact on climate change.

The purpose of this Trust is to enable County government, MCPS, and Montgomery College to maintain health benefits for current and future retirees and their dependents. These promises have been made and must be kept. Right now they are funded on an annual pay-as-you-go basis. In the future, resources from the Trust will also be needed. With \$700 million in assets, our Trust has a funded ratio of 21 percent – much better than most similar trusts but well below the 90 percent funded ratio of the County pension fund. We're making good progress, but we have a long way to go. We can't afford to make mistakes.

For example, we can't accept at face value the assertion of some advocates that divestment from fossil fuel companies would actually produce higher returns. That assertion is impossible to verify and may be dead wrong, especially as more of these companies move into renewables. As our Board Chair, Lynda von Bargen, and the Board Chair of the County's pension fund, Gino Renne, have written to you, there are serious possible risks to following the mandate of Bill 44-16. The set of potentially good investment opportunities available to our Board would be reduced. Some of the highly sought after investment managers we select may tell us to take our business elsewhere. If we have to move to commingled vehicles, the result could be higher fees. The overall result could be a larger required contribution from taxpayers. Our Board does not want to take these risks. Our Board needs to fulfill its fiduciary duties.

My fellow trustees and I respect the commitment of the advocates who support Bill 44-16 on fossil fuel divestment. However, we feel strongly that interfering with the investment duties we have as fiduciaries would be a serious mistake and would have no meaningful impact on climate change. I would seriously have to consider my tenure on the Board if this bill passes. Thank you for considering our views.



OFFICE OF THE COUNTY ATTORNEY

Isiah Leggett
County Executive

Marc P. Hansen
County Attorney

MEMORANDUM

TO: Linda Herman, Executive Director
Montgomery County Employee Retirement Plans

VIA: Marc P. Hansen *Marc Hansen*
County Attorney

FROM: Edward B. Lattner, Chief *EBL*
Division of Government Operations

Amy Moskowitz *AM/EBL*
Associate County Attorney

DATE: December 19, 2016

RE: **Bill 44-16, Retirement - Fossil Fuel Investments - Restrictions
Supplement**

We are writing to supplement our earlier advice regarding Bill 44-16, Retirement – Fossil Fuel Investments - Restrictions. In our November 15, 2016, memorandum, we advised (among other matters) that Bill 44-16 is inconsistent with the Boards' present statutorily-imposed fiduciary duties, but that inconsistency could be corrected in one of two ways: the Council could either (1) amend the Board's statutory fiduciary duty to allow for investment decisions driven by the presence of fossil fuels; or (2) the Council could incorporate the Department of Labor's guidance for the use of economic, social, and governance factors by the Boards when making investment decisions.

While we continue to believe that Bill 44-16 (as currently drafted) is inconsistent with the Boards' present statutorily-imposed fiduciary duties, we do not believe that the Council can remedy that infirmity by altering that statutory duty because that duty is mandated by State law. Specifically, Md. Code Ann., Local Gov't § 17-102 provides that the trustees or other officers in charge of a pension or retirement system or fund, or other postemployment benefits fund, of a political subdivision of the State must comply with the same minimum fiduciary standards applicable to their state counterparts. That State standard is:

A fiduciary shall discharge the fiduciary's duties with respect to the several systems

solely in the interest of the participants and as follows:

(1) for the exclusive purposes of providing benefits to the participants and for reasonable expenses of administering the several systems;

(2) **with the care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person 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;**

(3) by diversifying the investments of the several systems so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so;

(4) in accordance with the laws governing the several systems; and

(5) in accordance with the documents and instruments governing the several systems to the extent that the documents and instruments are consistent with this subtitle.

Md. Code Ann., State Pers. & Pens. § 21-203 (emphasis added). This same standard is reflected in current County law.

A fiduciary must discharge the fiduciary's duties regarding the retirement systems:

(a) only in the best interest of the participants and their beneficiaries;

(b) only to provide benefits to the participants and their beneficiaries, and defray reasonable expenses of administering the retirement systems;

(c) **with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes;**

(d) by diversifying the investments of the retirement systems to minimize the risk of large losses, unless it is clearly not prudent to diversify under the circumstances;

(e) according to a good faith interpretation of the law governing the retirement systems;

(f) according to a good faith interpretation of the documents and instruments governing the retirement systems, if they comply with this Article.

Montgomery County Code § 33-61C (emphasis added).

Therefore, the Council cannot alter the standard of care to authorize the Board to ignore the prudent investor standard and duty of loyalty standard in order to comply with the divestment requirement of Bill 44-16.

As noted, we continue to believe that Bill 44-16, as currently drafted, is inconsistent with the requirement imposed by State law that the Boards make investment decisions "with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a similar

Linda Herman
December 19, 2016
Bill 44-16, Retirement - Fossil Fuel Investments - Restrictions
Page 3

capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes.” It has been suggested that Section 33-60C(d) (lines 51-58) of Bill 44-16 provides the Boards with the latitude to decline to divest the funds that they manage of investments in fossil fuel companies if doing so would not be prudent. But Subsection (d), when read as a whole, does not provide the Boards with that option. Subsection (d), at most, provides the Boards with the ability to delay divestment of investments in fossil fuel companies, but it does not relieve the Boards of the obligation ultimately to divest the funds of investments in fossil fuel companies.

The Council could amend Bill 44-16 to incorporate the Department of Labor’s guidance for the use of economic, social, and governance (ESG) factors by the Boards when making investments decisions. This amendment could require the Boards to take into account economic, social, and governance issues when making investment decisions. As the Department of Labor recognized these ESG factors can influence investment performance. The Council cannot, however, mandate that these ESG factors be the sole consideration in making investment decisions, but ESG factors may be considered in addition to other factors influencing risk and return when making investment decisions.

cc: Timothy Firestine, Chief Administrative Officer
Bonnie Kirkland, Assistant Chief Administrative Officer
Robert H. Drummer, Senior Legislative Attorney
Steve Farber, Council Administrator

ebl

16-008963
Bill 44-16 OCA analysis

that on November 1, 2015, the Automated Commercial Environment (ACE) will be a CBP-authorized Electronic Data Interchange (EDI) System. That document erroneously included language in Amendatory Instruction 38 that was not consistent with the text of the existing CFR. This document corrects the text in Amendatory Instruction 38.

DATES: Effective November 1, 2015. The effective date for the interim final rule, published October 13, 2015 (80 FR 61278), remains November 1, 2015. Written comments must be submitted on or before November 12, 2015.

FOR FURTHER INFORMATION CONTACT: Robert Altneu, Chief, Trade and Commercial Regulations Branch, Regulations and Rulings, Office of International Trade, at robert.f.altneu@cbp.dhs.gov.

SUPPLEMENTARY INFORMATION: On October 13, 2015, U.S. Customs and Border Protection (CBP) published in the *Federal Register* (80 FR 61278) an Interim Final Rule (CBP Dec. 15–14) document, entitled Automated Commercial Environment (ACE) Filings for Electronic Entry/Entry Summary (Cargo Release and Related Entry). As published, the Interim Final regulation contains an error in the text of Amendatory Instruction 38 in the “Amendments to the CBP Regulations” section of FR Doc. 2015–25729.

Correction

On page 61289, in the second column, under “§ 141.57 [Amended]” revise Amendatory Instruction 38 to read as follows:

- 38. Amend § 141.57, in paragraph (d)(2) by removing the words “through the Customs ACS (Automated Commercial System)” and adding in their place the words “to the CBP Automated Commercial Environment (ACE) or any other CBP-authorized electronic data interchange system”.

Dated: October 20, 2015.

Harold M. Singer,

Director, Regulations and Disclosure Law Division, Regulations and Rulings, Office of International Trade, U.S. Customs and Border Protection.

Heidi Cohen,

Senior Counsel for Regulatory Affairs, Department of the Treasury.

[FR Doc. 2015–27103 Filed 10–23–15; 8:45 am]

BILLING CODE 9111–14–P

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2509

RIN 1210–AB73

Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments

AGENCY: Employee Benefits Security Administration, Labor.

ACTION: Interpretive bulletin.

SUMMARY: This document sets forth supplemental views of the Department of Labor (Department) concerning the legal standard imposed by sections 403 and 404 of Part 4 of Title I of the Employee Retirement Income Security Act of 1974 (ERISA) with respect to a plan fiduciary’s decision to invest plan assets in “economically targeted investments” (ETIs). ETIs are generally defined as investments that are selected for the economic benefits they create in addition to the investment return to the employee benefit plan investor. In this document, the Department withdraws Interpretive Bulletin 08–01 and replaces it with Interpretive Bulletin 2015–01 that reinstates the language of Interpretive Bulletin 94–01.

DATES: This interpretive bulletin is effective on October 26, 2015.

FOR FURTHER INFORMATION CONTACT: Office of Regulations and Interpretations, Employee Benefits Security Administration, (202) 693–8500. This is not a toll-free number.

SUPPLEMENTARY INFORMATION:

Background

The Department has been asked periodically over the last 30 years to consider the application of ERISA’s fiduciary rules to pension plan investments selected because of the collateral economic or social benefits they may further in addition to their investment returns. Various terms have been used to describe this and related investment behaviors, such as socially responsible investing, sustainable and responsible investing, environmental, social and governance (ESG) investing, impact investing, and economically targeted investing (ETI). The terms do not have a uniform meaning and the terminology is evolving. As used in this interpretive bulletin, however, an economically targeted investment broadly refers to any investment that is selected, in part, for its collateral benefits, apart from the investment

return to the employee benefit plan investor. The Labor Department previously addressed issues relating to ETIs in Interpretive Bulletin 94–1 (IB 94–1)¹ and Interpretive Bulletin 2008–1 (IB 2008–1).² The Department’s stated objective in issuing IB 94–1 was to correct a popular misperception at the time that investments in ETIs are incompatible with ERISA’s fiduciary obligations. The preamble to the Interpretive Bulletin explained that the requirements of sections 403 and 404 of ERISA do not prevent plan fiduciaries from investing plan assets in ETIs if the ETI has an expected rate of return that is commensurate to rates of return of alternative investments with similar risk characteristics that are available to the plan, and if the ETI is otherwise an appropriate investment for the plan in terms of such factors as diversification and the investment policy of the plan. Some commenters have referred to this standard as the “all things being equal” test.

The Department has also consistently stated, including in Interpretive Bulletin 94–1, that the focus of plan fiduciaries on the plan’s financial returns and risk to beneficiaries must be paramount. Under ERISA, the plan trustee or other investing fiduciary may not use plan assets to promote social, environmental, or other public policy causes at the expense of the financial interests of the plan’s participants and beneficiaries. Fiduciaries may not accept lower expected returns or take on

¹ 59 FR 32606 (June 23, 1994). Prior to issuing IB 94–1, the Department had issued a number of letters concerning a fiduciary’s ability to consider the collateral effects of an investment and granted a variety of prohibited transaction exemptions to both individual plans and pooled investment vehicles involving investments, which produce collateral benefits. See, Advisory Opinions 80–33A, 85–36A and 88–16A; Information Letters to Mr. George Cox, dated January 16, 1981; to Mr. Theodore Groom, dated January 16, 1981; to The Trustees of the Twin City Carpenters and Joiners Pension Plan, dated May 19, 1981; to Mr. William Chadwick, dated July 21, 1982; to Mr. Daniel O’Sullivan, dated August 2, 1982; to Mr. Ralph Katz, dated March 15, 1982; to Mr. William Ecklund, dated December 18, 1985, and January 16, 1986; to Mr. Reed Larson, dated July 14, 1986; to Mr. James Ray, dated July 8, 1988; to the Honorable Jack Kemp, dated November 23, 1990; and to Mr. Stuart Cohen, dated May 14, 1993; PTE 76–1, part B, concerning construction loans by multiemployer plans; PTE 84–25, issued to the Pacific Coast Roofers Pension Plan; PTE 85–58, issued to the Northwestern Ohio Building Trades and Employer Construction Industry Investment Plan; PTE 87–20, issued to the Racine Construction Industry Pension Fund; PTE 87–70, issued to the Dayton Area Building and Construction Industry Investment Plan, PTE 88–96, issued to the Real Estate for American Labor A Balcors Group Trust; PTE 89–37, issued to the Union Bank; PTE 93–16, issued to the Toledo Roofers Local No. 134 Pension Plan and Trust, et al.

² 73 FR 61734 (October 17, 2008).

greater risks in order to secure collateral benefits.

Specifically, the Department stated in Interpretive Bulletin 94-1:³

Sections 403 and 404 of the Employee Retirement Income Security Act of 1974 (ERISA), in part, require that a fiduciary of a plan act prudently, and to diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In addition, these sections require that a fiduciary act solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries. The Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.

The Department continued in Interpretive Bulletin 2008-1:⁴

ERISA's plain text thus establishes a clear rule that in the course of discharging their duties, fiduciaries may never subordinate the economic interests of the plan [participants and beneficiaries] to unrelated objectives [].

In the preamble to IB 94-1, the Department elaborated:⁵

While the Department has stated that a plan fiduciary may consider collateral benefits in choosing between investments that have comparable risks and rates of return, it has consistently held that fiduciaries who are willing to accept expected reduced returns or greater risks to secure collateral benefits are in violation of ERISA. It follows that, because every investment necessarily causes a plan to forgo other investment opportunities, an investment will not be prudent if it would provide a plan with a lower expected rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return.

Thus, it has been the Department's consistent view that sections 403 and 404 of ERISA do not permit fiduciaries to sacrifice the economic interests of plan participants in receiving their promised benefits in order to promote collateral goals.

At the same time, however, the Department has consistently recognized that fiduciaries may consider such collateral goals as tie-breakers when choosing between investment alternatives that are otherwise equal with respect to return and risk over the appropriate time horizon. ERISA does not direct an investment choice in circumstances where investment

alternatives are equivalent, and the economic interests of the plan's participants and beneficiaries are protected if the selected investment is in fact, economically equivalent to competing investments.

On October 17, 2008, the Department replaced Interpretive Bulletin 94-1, with Interpretive Bulletin 2008-01, codified at 29 CFR 2509.08-01. IB 2008-01 purported not to alter the basic legal principles set forth in IB 94-1. Its stated purpose was to clarify that fiduciary consideration of collateral, non-economic factors in selecting plan investments should be rare and, when considered, should be documented in a manner that demonstrates compliance with ERISA's rigorous fiduciary standards.

The Department believes that in the seven years since its publication, IB 2008-01 has unduly discouraged fiduciaries from considering ETIs and ESG factors. In particular, the Department is concerned that the 2008 guidance may be dissuading fiduciaries from (1) pursuing investment strategies that consider environmental, social, and governance factors, even where they are used solely to evaluate the economic benefits of investments and identify economically superior investments, and (2) investing in ETIs even where economically equivalent. Some fiduciaries believe the 2008 guidance sets a higher but unclear standard of compliance for fiduciaries when they are considering ESG factors or ETI investments.

An important purpose of this Interpretive Bulletin is to clarify that plan fiduciaries should appropriately consider factors that potentially influence risk and return. Environmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment. In these instances, such issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices. Similarly, if a fiduciary prudently determines that an investment is appropriate based solely on economic considerations, including those that may derive from environmental, social and governance factors, the fiduciary may make the investment without regard to any collateral benefits the investment may also promote. Fiduciaries need not treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take into consideration environmental, social, or other such factors. When a fiduciary

prudently concludes that such an investment is justified based solely on the economic merits of the investment, there is no need to evaluate collateral goals as tie-breakers.

In addition, this Interpretive Bulletin also clarifies that plan fiduciaries may invest in ETIs based, in part, on their collateral benefits so long as the investment is economically equivalent, with respect to return and risk to beneficiaries in the appropriate time horizon, to investments without such collateral benefits. In an effort to correct the misperceptions that have followed publication of IB 2008-01 the Department is withdrawing IB 2008-01, replacing it with this guidance that reinstates the language of IB 94-1.

Consistent with fiduciaries' obligations to choose economically superior investments, the Department does not believe ERISA prohibits a fiduciary from addressing ETIs or incorporating ESG factors in investment policy statements or integrating ESG-related tools, metrics and analyses to evaluate an investment's risk or return or choose among otherwise equivalent investments. Nor do sections 403 and 404 prevent fiduciaries from considering whether and how potential investment managers consider ETIs or use ESG criteria in their investment practices. As in selecting investments, in selecting investment managers, the plan fiduciaries must reasonably conclude that the investment manager's practices in selecting investments are consistent with the principles articulated in this guidance.

In addition, the Department does not construe consideration of ETIs or ESG criteria as presumptively requiring additional documentation or evaluation beyond that required by fiduciary standards applicable to plan investments generally. As a general matter, the Department believes that fiduciaries responsible for investing plan assets should maintain records sufficient to demonstrate compliance with ERISA's fiduciary provisions. As with any other investments, the appropriate level of documentation would depend on the facts and circumstances.

The Department also has concluded that the same standards set forth in sections 403 and 404 of ERISA governing a fiduciary's investment decisions, discussed above, apply to a fiduciary's selection of a "socially-responsible" mutual fund as a plan investment or, in the case of an ERISA section 404(c) plan or other individual account plan, a designated investment alternative under the plan. Specifically, in Advisory Opinion 98-04A, the

³ 59 FR 32606, 07.

⁴ 73 FR 61734, 35.

⁵ 59 FR 32606, 07 (footnote omitted).

Department has expressed the view that the fiduciary standards of sections 403 and 404 do not preclude consideration of collateral benefits, such as those offered by a “socially-responsible” fund, in a fiduciary’s decision to designate an investment alternative in an individual account plan. Whether a particular fund or investment alternative satisfies the requirements set forth in sections 403 and 404 of ERISA is an inherently factual question that the appropriate plan fiduciaries must decide based on all the facts and circumstances of the individual situation.

The following Interpretive Bulletin deals solely with the applicability of the prudence and exclusive purpose requirements of ERISA as applied to fiduciary decisions to invest plan assets in ETIs, and in particular the collateral benefits they may provide apart from a plan’s performance and the interests of participants and beneficiaries in their retirement income. The bulletin does not supersede the regulatory standard contained at 29 CFR 2550.404a-1, nor does it address any issues which may arise in connection with the prohibited transaction provisions or the statutory exemptions from those provisions.

List of Subjects in 29 CFR Part 2509

Employee benefit plans, Pensions.

For the reasons set forth in the preamble, the Department is amending subchapter A, part 2509 of title 29 of the Code of Federal Regulations as follows:

SUBCHAPTER A—GENERAL

PART 2509—INTERPRETIVE BULLETINS RELATING TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

- 1. The authority citation for part 2509 continues to read as follows:

Authority: 29 U.S.C. 1135. Secretary of Labor’s Order 1–2003, 68 FR 5374 (Feb. 3, 2003). Sections 2509.75–10 and 2509.75–2 issued under 29 U.S.C. 1052, 1053, 1054. Sec. 2509.75–5 also issued under 29 U.S.C. 1002. Sec. 2509.95–1 also issued under sec. 625, Public Law 109–280, 120 Stat. 780.

§ 2509.08–1 [Removed]

- 2. Part 2509 is amended by removing § 2509.08–1.
- 3. Part 2509 is further amended by adding § 2509.2015–01 to read as follows:

§ 2509.2015–01 Interpretive bulletin relating to the fiduciary standard under ERISA in considering economically targeted investments.

This Interpretive Bulletin sets forth the Department of Labor’s interpretation of sections 403 and 404 of the Employee

Retirement Income Security Act of 1974 (ERISA), as applied to employee benefit plan investments in “economically targeted investments” (ETIs), that is, investments selected for the economic benefits they create apart from their investment return to the employee benefit plan. Sections 403 and 404, in part, require that a fiduciary of a plan act prudently, and to diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In addition, these sections require that a fiduciary act solely in the interest of the plan’s participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries. The Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.

With regard to investing plan assets, the Department has issued a regulation, at 29 CFR 2550.404a–1, interpreting the prudence requirements of ERISA as they apply to the investment duties of fiduciaries of employee benefit plans. The regulation provides that the prudence requirements of section 404(a)(1)(B) are satisfied if (1) the fiduciary making an investment or engaging in an investment course of action has given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary’s investment duties, the fiduciary knows or should know are relevant, and (2) the fiduciary acts accordingly. This includes giving appropriate consideration to the role that the investment or investment course of action plays (in terms of such factors as diversification, liquidity, and risk/return characteristics) with respect to that portion of the plan’s investment portfolio within the scope of the fiduciary’s responsibility.

Other facts and circumstances relevant to an investment or investment course of action would, in the view of the Department, include consideration of the expected return on alternative investments with similar risks available to the plan. It follows that, because every investment necessarily causes a plan to forgo other investment opportunities, an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees

of risk or is riskier than alternative available investments with commensurate rates of return.

The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally. Therefore, if the above requirements are met, the selection of an ETI, or the engaging in an investment course of action intended to result in the selection of ETIs, will not violate section 404(a)(1)(A) and (B) and the exclusive purpose requirements of section 403.

Phyllis C. Borzi,

Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor.

[FR Doc. 2015–27146 Filed 10–22–15; 11:15 am]

BILLING CODE 4510–29–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 117

[USCG–2015–0964]

Drawbridge Operation Regulations; Tchefuncta River, Madisonville, LA

AGENCY: Coast Guard, DHS.

ACTION: Notice of deviation from regulations.

SUMMARY: The Coast Guard has issued a temporary deviation from the operating schedule that governs the SR 22 Bridge over the Tchefuncta River, mile 2.5, at Madisonville, St. Tammany Parish, Louisiana. This deviation is necessary to complete scheduled maintenance of the bridge. This deviation allows the bridge to remain closed to navigation for approximately six weeks while allowing for two scheduled openings on scheduled work days except for a five-day period and a 36-hour period, both in December, when there will be complete closures. The bridge will operate normally on non-scheduled work days and on weekends.

DATES: This deviation is effective from 7 a.m. on November 2, 2015 until 7 p.m. on December 15, 2015.

ADDRESSES: The docket for this deviation, [USCG–2015–0964] is available at <http://www.regulations.gov>.

FOR FURTHER INFORMATION CONTACT: If you have questions on this temporary deviation, call or email Jim Wetherington, D8 Bridge Administration Branch, Coast Guard; telephone 504–671–2128, email james.r.wetherington@uscg.mil.



BOARD OF INVESTMENT TRUSTEES

BOARD OF TRUSTEES

MEMORANDUM

January 25, 2017

To: Roger Berliner, Council President and Chair - Transportation, Infrastructure,
Energy & Environment Committee

Nancy Navarro, Chair - Government Operations and Fiscal Policy Committee

From: Linda A. Herman, Executive Director *LAH*

Subject: Bill 44-16, Retirement – Fossil Fuel Investments

Thank you for your request for additional information related to the Boards' memorandum to the Council dated December 5, 2016. Responses to your questions are shown below in *italics*.

What is the Boards' ESG policy?

Please see the attached excerpts (Attachment A) from the Boards' governance documents – Governance Manual and Statement of Investment Policy & Objectives – which refer to Environmental, Social and Governance (ESG) matters.

Has the consideration of ESG factors resulted in any decisions regarding active or direct investments, investment manager selection or the ongoing management of private market investments that would not have occurred otherwise? Is so, what were the financial impacts of those ESG-driven decisions?

As outlined in the attached policies, ESG factors have long been considered in the hiring of investment managers, as well as the investment managers' selection of investments in the underlying securities. We actively screen new investment manager candidates in the universe for appropriate ESG policies before including them in searches and conducting full due diligence. Our due diligence evaluation of investment managers includes a rigorous review of their procedures and policies in this area. If, as part of our due diligence of their policies, we were to believe that the manager does not incorporate the spirit of the Boards' policies, we would request that the manager update its policies or provide us with a written response as to why changes cannot be made. The Board would not hire an investment manager that does not incorporate appropriate ESG factors into their investment process, as these considerations are among a multitude of factors that the Board and the pension industry believe drive positive long-term company performance. Board Staff, and the Boards' financial advisors/consultants, discuss ESG matters with the managers hired by the Trust Funds on an ongoing basis, including changes in the industries they invest in that might have a direct impact on their portfolio.

The Board believes that a company's ability to create long-term shareholder value is positively correlated with highly sustainable businesses that have incorporated responsible ESG practices. The results of the Boards' policies can be seen in the investment performance of the Trust Funds, as adhering to good practices, as defined in the Board's policies, has had a direct impact on the investment returns generated by the investment managers we have hired (see Attachment B).

Who are the Boards' aforementioned investment managers (companies) with exposure to investments in fossil fuel companies?

See Attachment C.

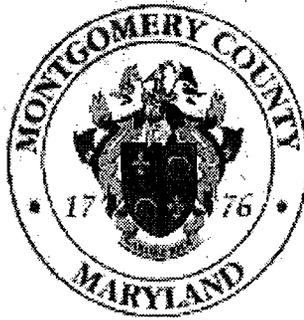
What fossil fuel companies are those investment managers invested in and how much have those managers invested in those companies or funds?

See Attachment C.

What have their returns been?

See Attachment D.

Please let me know if we can provide further information or assistance.



Montgomery County Employee Retirement Plans

Governance Manual

I) PURPOSE

This Governance Manual summarizes the governance structure established by the Board of Investment Trustees (the "Board") to ensure prudent, effective and efficient management of the assets of the Montgomery County Employee Retirement Plans ("ERP"). It is a guide to assist the Board in fulfilling its fiduciary responsibilities and to facilitate the organized, efficient, and cohesive functioning of the management of the ERP. This manual also outlines the roles and responsibilities of the various entities overseeing the administration of the Plans and establishes and documents practices and procedures with the intent of having a positive impact on performance and risk oversight. The stronger the governance of the Plans, the better risks (such as operational risk, investment risk) will be managed and controlled. In addition, the Board is committed to encouraging service providers to adopt policies and practices that are designed to control risk and enhance long-term financial performance. We believe that high standards of corporate responsibility generally make good business sense and can have a positive material impact on investment risk and return. The Board believes it can provide consistent, long-term performance at appropriate levels of risk by taking into account various material financial and non-financial factors as defined throughout this Governance Manual.

The Board may choose to consider Environmental Social and Governance (ESG) factors, provided they are consistent with the Boards' obligations to the participants and beneficiaries of the ERS and with the standard of care established by the Montgomery County Code. In cases where the investment characteristics, including return, risk, liquidity, and compliance with the Boards' Governance Policy and Statement of Investment Policy & Objectives, are appropriate, the Board may consider ESG factors that have a substantial, direct and measurable benefit to the economic interests of the Trust, provided these factors are consistent with the Boards' fiduciary duty.

V) SERVICE PROVIDER PROCUREMENT

A) Background

5) Environmental Social and Governance (ESG) Policy

It is the policy of the Board of Investment Trustees for the County's Retirement Plans that the Executive Director and Investment Staff incorporate ESG considerations into all investments considered or made by the ERS and examine opportunities for ESG integration in existing investments. This policy also applies to investment consultants and investment managers hired by the ERS to provide guidance on investment due diligence matters. The Board annually reviews engagement outcomes and updates this policy as appropriate.

The Executive Director ensures that this policy is part of the investment due diligence process. A comprehensive report describing the implementation and outcomes of this policy, including recommendations for updates or revisions to this policy, is provided to the Trustees as part of the year-end reporting process.

B) Procurement of Service Providers – Procedures

2) Stage 2 – Research Process

a) Criteria

Based on need, Staff will create a specific list of criteria for determining eligible vendors ("service providers") for the ERP. The Board incorporates various factors when analyzing a service provider including whether the service provider

acts in a responsible manner with regard to the environment, their employees and other constituents. The Board also evaluates the service provider's corporate governance policies and practices and the impact these declarations may have on the financial sustainability of the firm. The initial criteria will pertain to minimum requirements related to expertise in the service area being procured. The Board may add additional criteria to be used in a particular search.

d) Evaluation of Candidates

Staff, in conjunction with the consultant (if applicable); will evaluate prospective candidates based on criteria related to organizational structure, investment process, historical performance, governance practices and policies, regulatory requirements and other related factors. We believe that focusing on the criteria identified above results in targeting prospective candidates whose operating framework is designed to maximize investment returns without exposure to undue risk.

3) Stage 3 – Review and Verification Process

a) Due diligence evaluations

Staff will complete a due diligence process to confirm findings identified in Stage 2. Those candidates deemed to be eligible will be interviewed by Staff, and the Board's consultant (if applicable), by phone or in person in the Board's office.

Staff includes the consideration of a manager's ESG policies when selecting external active managers. The ERS and their external investment managers take material ESG factors into account throughout the investment decision making process when considering and evaluating an investment in publicly traded securities. When making direct investments in non-listed assets, the ERS considers ESG factors in a manner consistent with their approach to actively investing in publicly traded securities. Prior to making an investment in any private market fund, staff incorporates ESG considerations as part of their normal due diligence process. This includes, where possible, management interviews, site visits, and general internet background information searches as part of a formal process.

Qualitative

- Organizational structure
- Competitive advantage
- Experience and depth of personnel, including turnover
- Firm-specific operational philosophy
- In the case of limited partnership arrangements such as private equity, real estate or hedge funds, fund-specific aspects including but not limited to liquidity and tax issues.
- Firm-specific regulatory/legal/litigation issues
- Human capital management policies
- Compliance with governmental regulations
- References from Board consultant(s)
- References from other sources
- Alignment of interest with stakeholders

b) Selection of prospective service provider(s)

Staff will usually conduct an onsite due diligence review of the prospective service provider(s) which will include an interview, and prepare a report, along

with a due diligence evaluation form, with input from the Board consultant resulting in either selection, in the case of prospective ERS investment managers, or a recommendation to the Board, in the case of all other prospective service providers. The selection of the prospective service provider will be based on both quantitative and qualitative evaluations as well as interviews and results of reference checks. Staff uses checklists and questionnaires to ensure consistency of implementation across both investments and investment team members. Any issues that arise during the due diligence process are brought to the attention of the investment team. The Executive Director is responsible for determining the materiality of such issues and is able to engage outside advisers as needed for the resolution of any issues.

C) Monitoring of Service Providers

1) Review process

Staff regularly conducts contract compliance reviews, including reviews of service provider performance, conformance to guidelines, organizational structure and any other performance requirements as specified in the service provider's contract. Service provider related matters other than performance and contract compliance matters will be reported to the Compliance and Audit Committee when deemed significant by Staff, i.e. if the matter(s) have a possible effect on the service provider's ability to perform as expected. Staff will apprise the Board of performance issues as necessary. The Compliance and Audit Committee will assess compliance issues and make recommendations to the Board as necessary.

Staff will be accessible to, and engage with, relevant stakeholders and provide timely and transparent information accessible by stakeholders on the matters addressed in this policy. Generally, Staff conducts reviews of all aspects of the service provider's contract on an annual basis and encourages governance structures that provide appropriate levels of oversight in the areas of audit, risk management, and potential conflicts of interest. The review may include a due diligence review in the service provider's office or the Board's office when necessary. Matters to be reviewed include but are not limited to the quantitative and qualitative factors which served as the basis for selection as a service provider. In addition, as part of the ongoing monitoring process, each service provider is required to provide the Board with a quarterly report affirming their compliance with contract terms as well as Board policies. These reports serve to notify the Board of changes in the service provider's organizational, operational and regulatory risk profiles.

Staff encourages and supports the adoption and implementation of sound ESG practices by companies in which the ERS invests and by investment managers hired. The ERS remains engaged with the managers of its private market investments during the life of the investment and monitors performance on ESG related issues. This monitoring may include attending annual meetings and advisory committee meetings and addresses performance at the organization, portfolio, and project/investment levels.

Annually the Compliance and Audit Committee will review and report compliance by Board service providers with contract disclosure requirements.

VI) DUE DILIGENCE AND CONTINUING EDUCATION

The Board has developed the following guidelines to ensure propriety in actions taken by Board and staff, keeping in mind community values.

A) Objective

The objective of Board and staff is to ensure:

- Business matters pertaining to the Board's investment program are properly attended to
- Board representation at selected meetings or conferences involving matters of investment-related importance to the Employee Retirement Plans (ERP), the Board, or the Board program (e.g. annual consultant conferences and annual meetings of membership organizations)
- The Board's fiduciary responsibility related to the "prudent person rule" as set forth under state and local law is met by providing adequate educational and networking opportunities to all Board members and staff
- Compliance with the Board's Annual Fiduciary Affirmation requiring Board members take any necessary training or education opportunities and to keep current on pension and investment developments.
- Maintain awareness of new and existing key ESG considerations and their impact on investment valuations, and update the due diligence process used to identify material ESG issues accordingly.
- Examine each existing or potential investment's material ESG risk exposure and use this knowledge when evaluating potential investments and during the duration of investment ownership.



Montgomery County Employee Retirement Plans

Statement of Investment Policy & Objectives

VI) RETIREMENT SAVINGS PLAN AND DEFERRED COMPENSATION PLAN

A) Investment Options

Recognizing that Plan participants have different investment styles and degrees of involvement in managing their retirement savings, the Board developed the following investment tiers to categorize the investment options offered in the Plan:

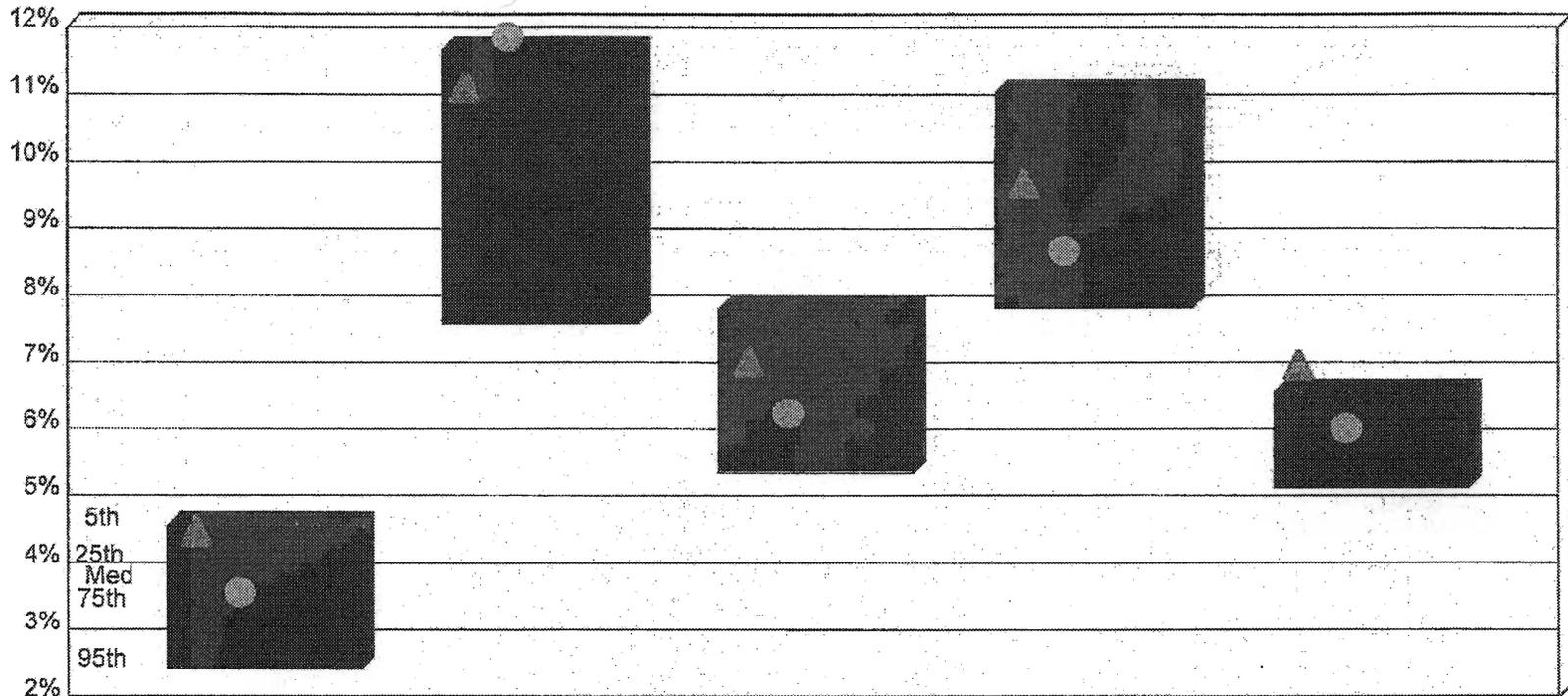
Tier	Investment Style	Investments Offered
Tier 1	One decision funds	Lifecycle funds
Tier 2	Passive exposure	Index funds across major asset classes
Tier 3	Active management	Funds within all major asset classes
Tier 4	Active management - no evaluation by Board of investment options	Self Directed Brokerage Account

The Board offers a variety of options within each tier. Recognizing that some participants may want to invest in funds not currently offered by the Board, such as socially responsible funds, and to have more independence, or greater control in managing their Plan account, the Board permits participants to select any mutual fund, exchange traded product (e.g. ETFs), equity, or fixed income product, unless otherwise prohibited, through the Self-Directed Brokerage Account (SDBA). The Board will not monitor or evaluate the investment options available within the SDBA.

Performance Comparison

Total Fund vs. Wilshire Large Public Funds Universe*

Periods Ended September 30, 2016



▲ MCERS Total Fund
● MCERS Policy

	1 Quarter	1 Year	3 Years	5 Years	10 Years
MCERS Total Fund	4.45 (12)	11.23 (5)	7.08 (26)	9.78 (50)	7.01 (1)
MCERS Policy	3.46 (68)	11.76 (2)	6.27 (67)	8.60 (85)	5.98 (40)
5th %tile	4.54	11.66	7.78	11.03	6.54
25th %tile	3.97	10.64	7.08	10.36	6.15
Median	3.68	9.84	6.61	9.83	5.91
75th %tile	3.35	8.87	6.11	9.19	5.56
95th %tile	2.44	7.59	5.35	7.83	5.11
Number of Funds	61	59	59	59	51

The Board compares the performance of the portfolio to that of a universe of peer funds; the universe is constructed by Wilshire Associates Incorporated, a national consulting firm. The value in parenthesis represents the rank of the total portfolio's performance relative to the peer group for each time period. A lower rank indicates a greater return within the universe relative to the other funds. For example, a one-year rank of (40) indicates that the portfolio achieved a greater return than 60% of the funds represented in the universe over the one-year period.

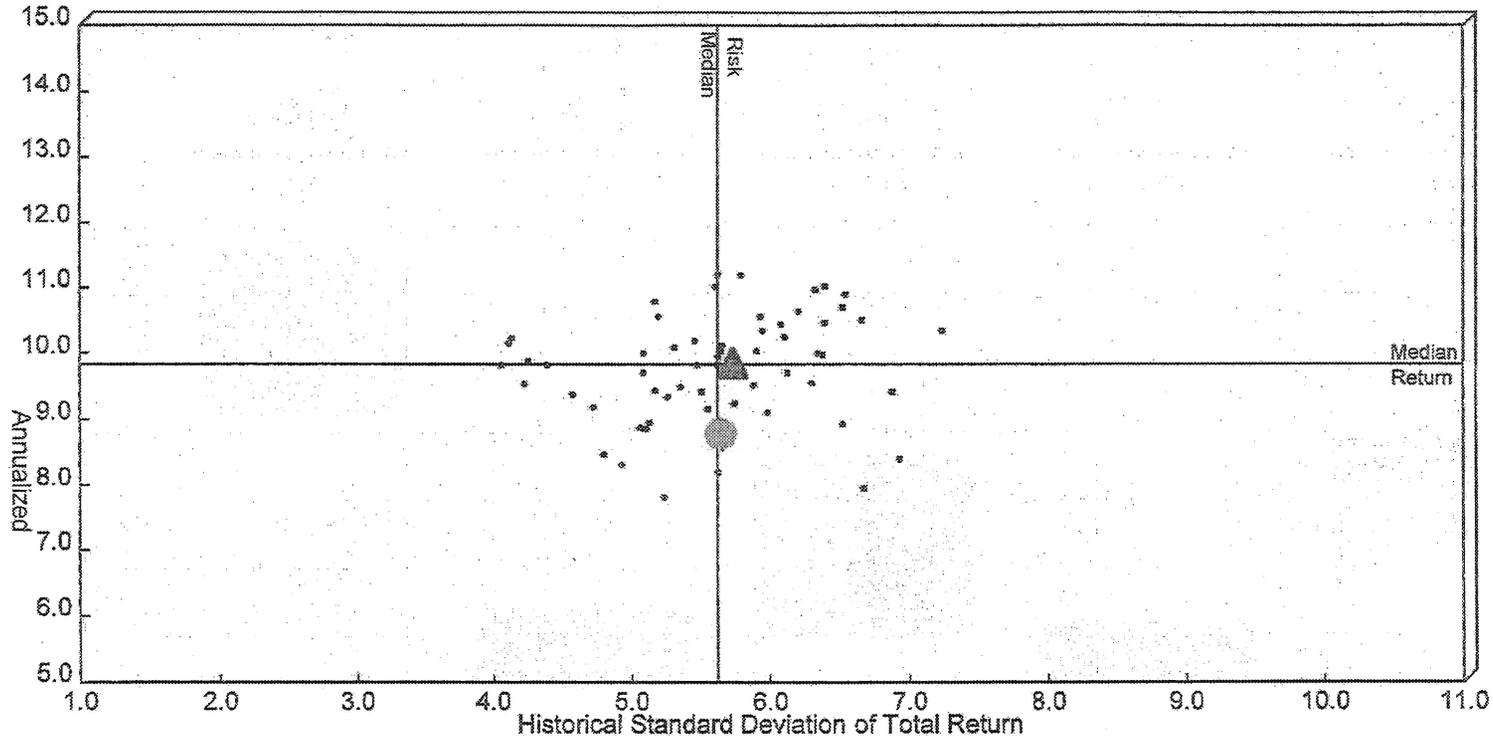
*Wilshire TUCS Total Return Master Trust / Public Funds / Assets Greater than \$1 Billion / Gross of Fees / 5th-25th-50th-75th Breakpoints Shown

Attachment B 65

Risk / Return Analysis

Total Fund vs. Wilshire Large Public Funds Universe*

Five Years Ending September 30, 2016



Description	Legend	Gross Fee Ret		Standard Deviation	
		Value	Rank	Value	Rank
MCERS Total Fund	▲	9.78	50	5.77	41
MCERS Policy	●	8.60	85	5.68	45
Median		9.83		5.62	

The Board compares the performance of the portfolio to that of a universe of peer funds; the universe is constructed by Wilshire Associates Incorporated, a national consulting firm. The Rank represents the total portfolio's performance relative to the peer group for each time period. A lower rank indicates a greater return within the universe relative to the other funds. For example, a one-year rank of 40 indicates that the portfolio achieved a greater return than 60% of the funds represented in the universe over the one-year period.

99



MONTGOMERY COUNTY EMPLOYEE RETIREMENT PLANS

The data below displays the exposure to Carbon Underground 200 companies the ERS portfolio as of June 30, 2016. Eight managers have exposure to companies listed on the Carbon Underground 200, representing about 2% of the ERS portfolio.

Public Market Fixed Income Investment Managers

Manager	Market Value	Fossil Exposure (\$)	Fossil Exposure (%)
Nomura	\$179,264,758	\$8,283,939	4.62%
Loomis	\$176,122,832	\$15,485,388	8.79%
Jennison	\$250,950,821	\$14,932,521	5.95%
Schroders	\$230,482,797	\$5,402,997	2.34%
Total Fixed Income	\$836,821,208	\$44,104,845	5.27%

Public Market Equity Investment Managers

Manager	Market Value	Fossil Exposure (\$)	Fossil Exposure (%)
BHMS	\$113,391,064	\$7,463,415	6.58%
Rhumblin	\$75,383,587	\$3,990,715	5.29%
Gryphon	\$191,130,389	\$7,052,035	3.69%
Marathon	\$193,134,255	\$8,904,574	4.61%
Total Equity	\$573,039,295	\$27,410,739	4.78%

Total ERS Portfolio

	Market Value	Fossil Exposure (\$)	Fossil Exposure (%)
TOTAL ERS	\$3,615,821,648	\$71,515,584	1.98%



MONTGOMERY COUNTY CONSOLIDATED RETIREE HEALTH BENEFITS TRUST

The data below displays the exposure to Carbon Underground 200 companies the CRHBT portfolio as of June 30, 2016. Five managers have exposure to companies listed on the Carbon Underground 200, representing about 1.6% of the CRHBT portfolio.

Public Market Fixed Income Investment Managers

Manager	Market Value	Fossil Exposure (\$)	Fossil Exposure (%)
Nomura	\$46,478,127	\$3,907,310	8.41%
Jennison	\$49,400,147	\$2,996,970	6.07%
Schroders	\$45,054,749	\$798,994	1.77%
Total Fixed Income	\$140,933,023	\$7,703,273	5.47%

Public Market Equity Investment Managers

Manager	Market Value	Fossil Exposure (\$)	Fossil Exposure (%)
BHMS	\$26,576,909	\$1,684,497	6.34%
Gryphon	\$41,305,300	\$1,520,297	3.68%
Total Equity	\$67,882,210	\$3,204,794	4.72%

Total ERS Portfolio

	Market Value	Fossil Exposure (\$)	Fossil Exposure (%)
TOTAL CRHBT	\$675,839,413	\$10,908,067	1.61%

MCERS (Separately Managed Account) Exposure to Top 200 Fossil Fuel Companies

Manager	Security	Tot Mkt Value	Oil&Gas	Coal
FIXED INCOME				
Jennison	APACHE CORP 4.25% DUE 01-15-2044	532,423	532,423	
Jennison	APACHE CORP 4.75% DUE 04-15-2043	205,613	205,613	
Jennison	APACHE CORP 5.1% DUE 09-01-2040	458,245	458,245	
Jennison	BHP BILLITON FIN 5% DUE 09-30-2043	842,430		842,430
Jennison	CONOCOPHILLIPS 5.9% DUE 05-15-2038	840,160	840,160	
Jennison	CONOCOPHILLIPS GTD NT 6.5 DUE	1,335,461	1,335,461	
Jennison	DEVON ENERGY CORP 5% DUE 06-15-2045	517,744	517,744	
Jennison	DEVON ENERGY CORP 5.6 DUE 07-15-2041	299,517	299,517	
Jennison	ENCANA CORP 6.5% DUE 02-01-2038	615,840	615,840	
Jennison	ENI S P A 5.7% DUE 10-01-2040	371,529	371,529	
Jennison	HESS CORP 5.6% DUE 02-15-2041	468,886	468,886	
Jennison	MARATHON OIL CORP 6.6% DUE 10-01-2037	828,955	828,955	
Jennison	NOBLE ENERGY INC 4.15% DUE 12-15-2021	215,552	215,552	
Jennison	NOBLE ENERGY INC 5.05% DUE 11-15-2044	438,058	438,058	
Jennison	RIO TINTO FIN USA 4.125 DUE 08-21-2042	231,990		231,990
Jennison	Royal Dutch SHELL INTERNATIONAL FIN 4.375% DUE 05-11-2045	1,069,349	1,069,349	
Jennison	Royal Dutch SHELL INTERNATIONAL FIN 4.55 DUE 08-12-2043 REG	995,438	995,438	
Jennison	Royal Dutch SHELL INTL FIN B V 6.375% DUE 12-15-2038	611,304	611,304	
Jennison	Royal Dutch SHELL INTL FIN B V GTD NT 5.5 DUE 03-25-2040	86,699	86,699	
Jennison	STATOIL ASA 2.45 DUE 01-17-2023 REG	323,972	323,972	
Jennison	STATOIL ASA 3.25% DUE 11-10-2024	322,095	322,095	
Jennison	STATOIL ASA 3.95 DUE 05-15-2043	563,312	563,312	
Jennison	STATOIL ASA 4.8 DUE 11-08-2043	244,748	244,748	
Jennison	SUNCOR ENERGY INC 6.85% DUE 06-01-2039	1,900,928	1,900,928	
Jennison	TOTAL CAP INTL 3.7% DUE 01-15-2024	612,275	612,275	
Jennison Total		\$14,932,521		

Attachment C

69

Manager	Security	Tot Mkt Value	Oil&Gas	Coal
Loomis Sayles	ANGLO AMERN CAP PLC 144A 4.875% DUE 05-14-2025 BEO	460,750		460,750
Loomis Sayles	ANGLO AMERN CAP PLC GTD SR NT 144A 4.125% DUE 09-27-2022 BEO	185,500		185,500
Loomis Sayles	ANTERO RESOURCES COR 5.125% 12-01-2022	888,000	888,000	
Loomis Sayles	ANTERO RES FIN 5.375% DUE 11-01-2021	97,750	97,750	
Loomis Sayles	ARCELORMITTAL SA STEP CPN 7.5% DUE 03-01-2041	1,728,788		1,728,788
Loomis Sayles	CALIFORNIA RES CORP 5.5% DUE 09-15-2021	376,225	376,225	
Loomis Sayles	CHESAPEAKE ENERGY CORP 4.875 DUE 04-15-2022	1,549,400	1,549,400	
Loomis Sayles	CHES ENERGY CORP 5.375% DUE 06-15-2021	22,575	22,575	
Loomis Sayles	CHES ENERGY CORP 5.75% DUE 03-15-2023	89,600	89,600	
Loomis Sayles	CHES ENERGY CORP 6.125% DUE 02-15-2021	138,375	138,375	
Loomis Sayles	CHES ENERGY SR NT 6.625 DUE 08-15-2020	24,588	24,588	
Loomis Sayles	CONCHO RES INC 5 DUE 04-01-2023 REG	270,675	270,675	
Loomis Sayles	CONCHO RES INC 5.5% DUE 10-01-2022	150,750	150,750	
Loomis Sayles	CONSOL ENERGY INC 5.875% DUE 04-15-2022	658,738	658,738	
Loomis Sayles	FREEPORT-MCMORAN 4.55% DUE 11-14-2024	616,875	616,875	
Loomis Sayles	FREEPORT-MCMORAN 5.45% DUE 03-15-2043	329,025	329,025	
Loomis Sayles	FREEPORT-MCMORAN INC 5.4% DUE 11-14-2034/11-14-2014 REG	51,675	51,675	
Loomis Sayles	LUNDIN MNG CORP SR SECD NT 7.5% DUE 11-01-2020	433,500	433,500	
Loomis Sayles	MEG ENERGY CORP SR NT 144A 7% DUE 03-31-2024/10-01-2013 BEO	281,050	281,050	
Loomis Sayles	MEG ENERGY CORP SR NT 6.375 DUE 01-30-2023	436,600	436,600	
Loomis Sayles	MEG ENERGY CORP SR NT 6.5% DUE 03-15-2021/03-15-2016 BEO	100,750	100,750	
Loomis Sayles	NEWFIELD EXPL CO 5.625% DUE 07-01-2024	235,000	235,000	
Loomis Sayles	NOBLE ENERGY INC 5.625% DUE 05-01-2021	493,761	493,761	
Loomis Sayles	NOBLE HLDG INTL 5.25% DUE 03-15-2042	247,950	247,950	
Loomis Sayles	PETROBRAS GLOBAL 4.875% DUE 03-17-2020	778,125	778,125	
Loomis Sayles	PETROBRAS GLOBAL 6.25% DUE 03-17-2024	465,938	465,938	
Loomis Sayles	PETROBRAS GLOBAL 8.375% DUE 05-23-2021	294,120	294,120	
Loomis Sayles	PETROBRAS INTL FIN 5.375% DUE 01-27-2021	645,745	645,745	
Loomis Sayles	QEP RES INC 5.375 DUE 10-01-2022 REG	470,913	470,913	
Loomis Sayles	QEP RES INC 6.875% DUE 03-01-2021	5,050	5,050	
Loomis Sayles	QEP RESOURCES INC 5.25 DUE 05-01-2023	427,800	427,800	
Loomis Sayles	SM ENERGY CO 5 DUE 01-15-2024	260,775	260,775	
Loomis Sayles	SM ENERGY CO 5.625% DUE 06-01-2025	133,300	133,300	
Loomis Sayles	SM ENERGY CO 6.125% DUE 11-15-2022 REG	238,875	238,875	
Loomis Sayles	SM ENERGY CO 6.5 DUE 01-01-2023	23,250	23,250	
Loomis Sayles	SM ENERGY CO 6.5 DUE 11-15-2021	9,375	9,375	
Loomis Sayles	SOUTHWESTN ENERGY STEP CPN 6.7% DUE 01-23-2025	359,063	359,063	
Loomis Sayles	WHITING PETE CORP 5% DUE 03-15-2019	78,200	78,200	
Loomis Sayles	WHITING PETE CORP 5.75% DUE 03-15-2021	342,950	342,950	
Loomis Sayles	WHITING PETE CORP SR NT CONV 1.25% DUE 04-01-2020 REG	1,084,013	1,084,013	
Loomis Sayles Total		\$15,485,388		

Manager	Security	Tot Mkt Value	Oil&Gas	Coal
Nomura	ANGLO AMERN CAP PLC 144A 4.875% DUE 05-14-2025 BEO	380,000		380,000
Nomura	ANGLO AMERN CAP PLC GTD SR NT 144A4.125% DUE 09-27-2022 BEO	185,500		185,500
Nomura	ANGLO AMERN CAP PLC SR NT 144A 4.125% DUE 04-15-2021 BEO	189,000		189,000
Nomura	ANTERO RES CORP 5.625% DUE 06-01-2023	194,000	194,000	
Nomura	ANTERO RESOURCES COR 5.125% 12-01-2022	48,000	48,000	
Nomura	ANTERO RES FIN 5.375% DUE 11-01-2021	73,313	73,313	
Nomura	ANTERO RES FIN 6% DUE 12-01-2020	303,252	303,252	
Nomura	ARCELORMITTAL 6.25 DUE 02-25-2022	342,063		342,063
Nomura	ARCELORMITTAL SA DUE 08-05-2020	105,000		105,000
Nomura	ARCELORMITTAL SA STEP CPN 8% DUE 10-15-2039	291,000		291,000
Nomura	CALIFORNIA RES CORP 8.0% DUE 12-15-2022	355,000	355,000	
Nomura	CHES ENERGY CORP 5.375% DUE 06-15-2021	258,000	258,000	
Nomura	CHES ENERGY CORP 5.75% DUE 03-15-2023	80,000	80,000	
Nomura	CHES ENERGY CORP 6.5% DUE 08-15-2017	304,688	304,688	
Nomura	CHES ENERGY CORP 6.875% DUE 11-15-2020	52,125	52,125	
Nomura	CHES ENERGY CORP SR SECD 2ND LIEN NT 144A 8 DUE 12-15-2022/12-23-2015 BEO	339,000	339,000	
Nomura	CHES ENERGY SR NT 6.625 DUE 08-15-2020	105,375	105,375	
Nomura	CLOUD PEAK ENERGY 6.375% DUE 03-15-2024	57,750		57,750
Nomura	CONCHO RES INC 7% DUE 01-15-2021	179,813	179,813	
Nomura	DENBURY RES INC SR SECD 2ND LIEN NT 144A 9% DUE 05-15-2021/05-10-2016 BEO	280,000	280,000	
Nomura	EP ENERGY LLC / 6.375% DUE 06-15-2023	192,600	192,600	
Nomura	FREEMPORT-MCMORAN 2.375% DUE 03-15-2018	245,000	245,000	
Nomura	FREEMPORT-MCMORAN 4.55% DUE 11-14-2024	21,875	21,875	
Nomura	FREEMPORT-MCMORAN 5.45% DUE 03-15-2043	260,813	260,813	
Nomura	LINN ENERGY LLC / 6.25 DUE 11-01-2019	134,000	134,000	
Nomura	LINN ENERGY LLC / LINN ENERGY FIN CORP SR NT 6.5 05-15-2019	39,656	39,656	
Nomura	LINN ENERGY LLC / LINN ENERGY FIN CORP SR NT 8.625 DUE 04-15-2020	77,063	77,063	
Nomura	MEG ENERGY CORP SR NT 6.375 DUE 01-30-2023	129,500	129,500	
Nomura	MEG ENERGY CORP SR NT 6.5% DUE 03-15-2021/03-15-2016 BEO	38,750	38,750	
Nomura	MURPHY OIL CORP 4% DUE 06-01-2022	22,176	22,176	
Nomura	MURPHY OIL CORP STEP CPN 4.7% DUE 12-01-2022	343,077	343,077	
Nomura	NEWFIELD EXPL CO 5.375% DUE 01-01-2026	170,188	170,188	
Nomura	NEWFIELD EXPL CO 5.625% DUE 07-01-2024	25,000	25,000	

Manager	Security	Tot Mkt Value	Oil&Gas	Coal
Nomura	NEWFIELD EXPL CO 5.75% DUE 01-30-2022	480,938	480,938	
Nomura	NOBLE HLDG INTL GTD SR NT 4.9 DUE 08-01-2020	21,063	21,063	
Nomura	RANGE RES CORP 4.875% DUE 05-15-2025	71,438	71,438	
Nomura	RANGE RES CORP 5 DUE 08-15-2022 REG	212,063	212,063	
Nomura	RANGE RES CORP 5% DUE 03-15-2023	140,625	140,625	
Nomura	SANDRIDGE ENERGY 7.5 DUE 03-15-2021 IN DEFAULT	38,813	38,813	
Nomura	SM ENERGY CO 5 DUE 01-15-2024	192,375	192,375	
Nomura	SM ENERGY CO 6.125% DUE 11-15-2022 REG	137,813	137,813	
Nomura	SM ENERGY CO 6.5 DUE 01-01-2023	116,250	116,250	
Nomura	SM ENERGY CO 6.5 DUE 11-15-2021	46,875	46,875	
Nomura	SOUTHWESTN ENERGY 4.1% DUE 03-15-2022	89,250	89,250	
Nomura	SOUTHWESTN ENERGY SR NT 7.5 DUE 02-01-2018	398,438	398,438	
Nomura	TECK RES LTD 3% DUE 03-01-2019	57,340		57,340
Nomura	TECK RESOURCES LTD 4.75% DUE 01-15-2022	42,245		42,245
Nomura	TECK RESOURCES LTD 6% DUE 08-15-2040	35,000		35,000
Nomura	WHITING PETE CORP 5.75% DUE 03-15-2021	45,125	45,125	
Nomura	WPX ENERGY INC 6% DUE 01-15-2022	186,000	186,000	
Nomura	WPX ENERGY INC 7.5% DUE 08-01-2020	149,718	149,718	
Nomura Total		\$8,283,939		
STW	CONOCOPHILLIPS CO 4.3% DUE 11-15-2044	2,098,348	2,098,348	
STW	DEVON ENERGY CORP 5% DUE 06-15-2045	1,039,219	1,039,219	
STW	MARATHON PETE CORP 5% DUE 09-15-2054	1,132,522	1,132,522	
STW	NOBLE ENERGY INC 5.05% DUE 11-15-2044	1,132,908	1,132,908	
STW Total		\$5,402,997		
TOTAL FIXED INCOME		\$44,104,845	\$38,970,491	\$5,134,355

Manager	Security	Tot Mkt Value	Oil&Gas	Coal
EQUITY				
BHMS	BP	1,931,744	1,931,744	
BHMS	CHEVRON CORP COM	1,950,991	1,950,991	
BHMS	CONOCOPHILLIPS COM	1,691,680	1,691,680	
BHMS	OCCIDENTAL PETROLEUM CORP	1,889,000	1,889,000	
BHMS Total		\$7,463,415		
Gryphon	TOTAL EUR2.5	7,052,035	7,052,035	
Gryphon Total		\$7,052,035		
Marathon	ARCELORMITTAL NPV	315,689		315,689
Marathon	BASF - ORD SHS COMSTK	1,332,643	1,332,643	
Marathon	BHP BILLITON LTD NPV	181,778		181,778
Marathon	BHP BILLITON PLC USD0.50	436,063		436,063
Marathon	BP ORD USD0.25	1,869,796	1,869,796	
Marathon	CENTRICA ORD GBP0.061728395	80,999	80,999	
Marathon	CNOOC LTD HKD0.02	162,230	162,230	
Marathon	GLENCORE PLC ORD USD0.01	489,137		489,137
Marathon	GREAT EASTERN HLDG NPV	262,620	262,620	
Marathon	LG CORP KRW5000	132,615		132,615
Marathon	MINITUBISHI CORP NPV	615,230		615,230
Marathon	RIO TINTO ORD GBP0.10	520,375		520,375
Marathon	ROYAL DUTCH SHELL 'A'SHS EURO.07	798,370	798,370	
Marathon	ROYAL DUTCH SHELL 'B'ORD EURO.07	741,935	741,935	
Marathon	SANTOS LIMITED NPV	93,943	93,943	
Marathon	STATOIL ASA	533,800	533,800	
Marathon	TOTAL EUR2.5	337,351	337,351	
Marathon Total		\$8,904,574		

Manager	Security	Tot Mkt Value	Oil&Gas	Coal
Rhumblin	AGL RES INC COM CASH MERGER 07-01-2016	29,027		29,027
Rhumblin	ANADARKO PETRO CORP COM	100,909	100,909	
Rhumblin	ANTERO RES CORP COM	15,588	15,588	
Rhumblin	APACHE CORP COM	76,825	76,825	
Rhumblin	CABOT OIL & GAS CORP COM	42,728	42,728	
Rhumblin	CHESAPEAKE ENERGY CORP COM	9,502	9,502	
Rhumblin	CHEVRON CORP COM	726,262	726,262	
Rhumblin	CIMAREX ENERGY CO COM	41,046	41,046	
Rhumblin	CONCHO RES INC COM STK	57,250	57,250	
Rhumblin	CONOCOPHILLIPS COM	199,252	199,252	
Rhumblin	CONSOL ENERGY INC COM	13,355	13,355	
Rhumblin	CONTINENTAL RES INC COM	15,392	15,392	
Rhumblin	DEVON ENERGY CORP NEW COM	69,238	69,238	
Rhumblin	ENERGEN CORP COM	17,838	17,838	
Rhumblin	EOG RESOURCES INC COM	170,093	170,093	
Rhumblin	EQT CORP COM	51,026	51,026	
Rhumblin	EXXON MOBIL CORP COM	1,434,784	1,434,784	
Rhumblin	FIRSTENERGY CORP COM	53,412		53,412
Rhumblin	FREEPORT-MCMORAN INC	50,843	50,843	
Rhumblin	GULFPORT ENERGY CORP COM NEW COM NEW	14,067	14,067	
Rhumblin	HESS CORP COM STK	61,302	61,302	
Rhumblin	MARATHON OIL CORP COM	46,081	46,081	
Rhumblin	MARATHON PETE CORP COM	73,946	73,946	
Rhumblin	MURPHY OIL CORP COM	18,415	18,415	
Rhumblin	MURPHY USA INC COM	9,418	9,418	
Rhumblin	NEWFIELD EXPLORATION	32,251	32,251	
Rhumblin	NOBLE CORP PLC COMMON STOCK	7,004	7,004	
Rhumblin	NOBLE ENERGY INC COM	55,096	55,096	
Rhumblin	OCCIDENTAL PETROLEUM CORP	211,795	211,795	
Rhumblin	PG& E CORP COM	116,334		116,334
Rhumblin	PIONEER NAT RES CO COM STK	90,575	90,575	
Rhumblin	QEP RES INC COM STK	13,928	13,928	
Rhumblin	RANGE RES CORP COM	25,884	25,884	
Rhumblin	SM ENERGY CO COM	6,480	6,480	
Rhumblin	SOUTHWESTERN ENERGY CO COM	17,486	17,486	
Rhumblin	WHITING PETE CORP COM STK	6,852	6,852	
Rhumblin	WPX ENERGY INC COM SHS	9,431	9,431	
Rhumblin Total		\$3,990,715		
TOTAL EQUITY		\$27,410,739	\$24,521,080	\$2,889,660
TOTAL		\$71,515,584	\$63,491,570	\$8,024,014

74

CRHBT (Separately Managed Account) Exposure to Top 200 Fossil Fuel Companies

Mgr	Security	Tot Mkt Value	Oil&Gas	Coal
FIXED INCOME				
Jennison	APACHE CORP 4.75% DUE 04-15-2043	231,315	231,315	
Jennison	BHP BILLITON FIN 5% DUE 09-30-2043	156,866		156,866
Jennison	CONOCOPHILLIPS GTD NT 6.5 DUE 02-15-2039REG	483,863	483,863	
Jennison	DEVON ENERGY CORP 5% DUE 06-15-2045	153,924	153,924	
Jennison	ENCANA CORP 5.15 DUE 11-15-2041	125,600	125,600	
Jennison	HESS CORP 5.6% DUE 02-15-2041	95,794	95,794	
Jennison	MARATHON OIL CORP 6.6% DUE 10-01-2037	161,747	161,747	
Jennison	NOBLE ENERGY INC 4.15% DUE 12-15-2021	120,920	120,920	
Jennison	RIO TINTO FIN USA 4.125 DUE 08-21-2042	44,424		44,424
Jennison	Royal Dutch SHELL INTERNATIONAL FIN 4.375% DUE 05-11-2045	542,817	542,817	
Jennison	Royal Dutch SHELL INTL FIN B V 6.375% DUE 12-15-2038	135,845	135,845	
Jennison	STATOIL ASA 3.95 DUE 05-15-2043	121,446	121,446	
Jennison	STATOIL ASA 3.25% DUE 11-10-2024	149,872	149,872	
Jennison	STATOIL ASA 3.95 DUE 05-15-2043	352,270	352,270	
Jennison	SUNCOR ENERGY INC 6.85% DUE 06-01-2039	120,268	120,268	
Jennison Total		\$2,996,970		
Nomura	ANTERO RES FIN 5.375% DUE 11-01-2021	97,750	97,750	
Nomura	ANTERO RES FIN 6% DUE 12-01-2020	277,981	277,981	
Nomura	ARCELORMITTAL SA LUXEMBOURG 6.125% DUE 06-01-2025	99,500		99,500
Nomura	ARCELORMITTAL SA STEP CPN 8% DUE 10-15-2039	97,000		97,000
Nomura	CALIFORNIA RES CORP 8.0% DUE 12-15-2022	159,750	159,750	
Nomura	CHES ENERGY CORP 6.5% DUE 08-15-2017	117,188	117,188	
Nomura	CHES ENERGY CORP 6.875% DUE 11-15-2020	17,375	17,375	
Nomura	CHES ENERGY CORP SR SECD 2ND LIEN NT 144A 8 DUE 12-15-2022/12-23-2015 BEO	190,688	190,688	
Nomura	CHES ENERGY SR NT 6.625 DUE 08-15-2020	17,563	17,563	
Nomura	DENBURY RES INC SR SECD 2ND LIEN NT 144A 9% DUE 05-15-2021/05-10-2016 BEO	125,000	125,000	
Nomura	FREEPORT-MCMORAN 5.45% DUE 03-15-2043	40,125	40,125	
Nomura	MEG ENERGY CORP SR NT 6.5% DUE 03-15-2021/03-15-2016 BEO	58,125	58,125	
Nomura	MURPHY OIL CORP STEP CPN 4.7% DUE 12-01-2022	365,949	365,949	
Nomura	NEWFIELD EXPL CO 5.375% DUE 01-01-2026	425,955	425,955	
Nomura	NOBLE HLDG INTL GTD SR NT 4.9 DUE 08-01-2020	21,063	21,063	
Nomura	RANGE RES CORP 5 DUE 08-15-2022 REG	23,563	23,563	
Nomura	RANGE RES CORP 5% DUE 03-15-2023	117,188	117,188	
Nomura	SM ENERGY CO 6.125% DUE 11-15-2022 REG	275,625	275,625	
Nomura	SOUTHWESTN ENERGY 4.1% DUE 03-15-2022	89,250	89,250	
Nomura	SOUTHWESTN ENERGY SR NT 7.5 DUE 02-01-2018	584,375	584,375	

Mgr	Security	Tot Mkt Value	Oil&Gas	Coal
Nomura	TECK RES LTD 3% DUE 03-01-2019	19,740		19,740
Nomura	TECK RESOURCES LIMITED SR NT 144A 8% DUE 06-01-2021/06-07-2016 BEO	25,750		25,750
Nomura	WHITING PETE CORP 5% DUE 03-15-2019	92,000	92,000	
Nomura	WPX ENERGY INC 6% DUE 01-15-2022	69,750	69,750	
Nomura	WPX ENERGY INC 7.5% DUE 08-01-2020	499,060	499,060	
Nomura Total		\$3,907,310		
STW	CONOCOPHILLIPS CO 4.3% DUE 11-15-2044	456,604	456,604	
STW	NOBLE ENERGY INC 5.05% DUE 11-15-2044	342,390	342,390	
STW Total		\$798,994		
TOTAL FIXED INCOME		\$7,703,273	\$7,259,993	\$443,280
EQUITY				
BHMS	BP P L C SPONSORED	437,945	437,945	
BHMS	CHEVRON CORP COM	438,609	438,609	
BHMS	CONOCOPHILLIPS COM	383,070	383,070	
BHMS	OCCIDENTAL PETROLEUM CORP	424,874	424,874	
BHMS Total		\$1,684,497		
Gryphon	TOTAL EUR2.5	1,520,297	1,520,297	
Gryphon Total		\$1,520,297		
TOTAL EQUITY		\$3,204,794	\$3,204,794	
TOTAL		\$10,908,067	\$10,464,787	\$443,280



MONTGOMERY COUNTY EMPLOYEE RETIREMENT PLANS

The data below displays the gross of fee returns of MCERS' public market fixed income and equity managers over 1, 3, 5, and 10-year time periods relative to their respective benchmarks and peers as of June 30, 2016.

Composite returns highlighted in **blue** are used where a MCERS' separate account track record is not available. All Peer Universe Ranking Percentiles are based off of the product's composite returns.

Public Market Fixed Income Investment Managers

Manager	1-Year	3-Year	5-Year	10-Year
Nomura	2.47%	5.79%	8.42%	9.43%
<i>Merrill Lynch High Yield II Constrained</i>	1.74%	4.20%	5.70%	7.51%
<i>Peer Universe Ranking (Percentile)</i>	17th	8th	4th	2nd
Loomis Sayles	-0.07%	4.76%	5.82%	8.46%
<i>Merrill Lynch High Yield II Constrained</i>	1.74%	4.20%	5.70%	7.51%
<i>Peer Universe Ranking (Percentile)</i>	86th	41st	35th	11th
Jennison Associates	16.57%	9.73%	9.71%	9.62%
<i>Barclays U.S. Gov't/Credit Long</i>	15.72%	9.33%	9.18%	8.42%
<i>Peer Universe Ranking (Percentile)</i>	11th	15th	20th	15th
Schroders	15.20%	10.94%	10.05%	9.93%
<i>Barclays U.S. Gov't/Credit Long</i>	15.72%	9.33%	9.18%	8.42%
<i>Peer Universe Ranking (Percentile)</i>	29th	4th	9th	10th

Public Market Equity Investment Managers

Manager	1-Year	3-Year	5-Year	10-Year
Marathon	-8.12%	4.71%	4.95%	5.46%
<i>MSCI EAFE</i>	-10.16%	2.06%	1.68%	1.58%
<i>Peer Universe Ranking (Percentile)</i>	44th	31st	23rd	8th
Gryphon International	-10.70%	2.44%	1.50%	4.03%
<i>MSCI EAFE</i>	-10.16%	2.06%	1.68%	1.58%
<i>Peer Universe Ranking (Percentile)</i>	76th	72th	85th	31th
Barrow, Hanley, Mewhinney, & Strauss (BHMS)	-3.41%	8.71%	10.47%	7.20%
<i>Russell 1000 Value</i>	2.86%	9.87%	11.35%	6.13%
<i>Peer Universe Ranking (Percentile)</i>	95th	76th	68th	53rd

Background

1. The Employees' Retirement System (the System) was established in 1965 as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. Eight other agencies and political subdivisions have elected to do so.
2. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees and employees who elect to participate in the Guaranteed Retirement Income Plan ("GRIP").
3. As of September 30, 2016, the System includes approximately 5,550 ERS and GRIP active members and 6,470 retirees and beneficiaries. Annual benefits are approximately \$230 million.
4. Section 33-59 of the Montgomery County Code established the Board of Investment Trustees and vested in the Board the exclusive power and duty to manage the System's assets. The County's Chief Administrative Officer is responsible for overseeing the day-to-day administration of the plan.
5. Section 33-61C specifies the Standard of Care for the Board of Investment Trustees. Members must discharge their fiduciary responsibilities only in the best interest of the participants and their beneficiaries.
6. As of June 30, 2016 System assets total almost \$4 Billion and Net Investment Income totaled \$57.7 million for FY16. The System is 91.7 percent funded with an unfunded liability of \$343 million. For the 10-year period ending on June 30, 2016 the System ranked in the top two percent among 55 public funds with assets greater than \$1 billion.
7. The Board currently retains more than 60 investment managers across a broad range of asset classes. As of September 30, 2016 the asset allocation was: Domestic Equities 19.3%, International Equities 15.3%, Global Equities 3.1%, Fixed Income 24.0%, Inflation Linked Bonds 11.0%, Public Real Assets 9.2%, Private Equity 6.9%, Private Real Assets 5.4%, Private Debt 0.6%, Opportunistic 3.8%, and Cash 1.4%.
8. In the fiscal year ending on June 30, 2016 county taxpayers contributed \$134.8 million to the System.
9. Montgomery County established the Consolidated Retiree Health Benefits Trust in 2008 as a Section 115 Trust to provide retiree health and life insurance benefits to County government retirees and their beneficiaries and retirees of other agencies or political subdivisions who elect to participate.
10. The Trust Fund must be held for the exclusive benefit of participants in retiree benefit plans and eligible dependents, and used only to provide benefits and defray reasonable expenses of administering retiree benefit plans.
11. Section 33-160(a) established the 19-member Consolidated Retiree Health Trust Board of Trustees to manage the Trust.
12. Section 33-162 provides that all powers and duties required to manage the Trust Fund are vested in the Board of Trustees.

13. Section 33-163 specifies that the Board of Trustees must discharge its duties only in the interest of the participants in retiree benefit plans and their beneficiaries.
14. The actuarial accrued liability for retiree health benefits for County Government, Montgomery County Public Schools and Montgomery College is multiple billions of dollars.
15. The Board of Trustees appoints investment managers to invest Trust Fund assets consistent with applicable guidelines.
16. The total market value of trust assets at June 30, 2016 was \$675.8 million. The asset allocation was: Domestic Equities 23.3%, International Equities 18.1%, Global Equities 4.2%, Fixed Income 25.5%, Treasury Inflation Index Bonds 10.0%, Public Real Assets 11.0%, Hedge Funds 2.2%, Private Real Assets 1.7%, Private Equity 3.1%, Private Debt 0.1%, and 0.8% Cash.
17. Each Board has adopted Environmental Social and Governance (ESG) Guidelines within their governance documents. The Executive Director and Investment Staff incorporate ESG considerations into all investments considered or made and examine opportunities for ESG integration in existing investments. The ESG Guidelines also apply to investment consultants and financial advisors who provide guidance on investment due diligence matters. The Boards annually review engagement outcomes and update the Guidelines as appropriate.
18. The scientific community supports the view that human activities are a primary contributor to climate change and global warming.
19. A major contributor to climate change is the burning of fossil fuels.
20. Market based strategies have made substantial progress in fostering the development of alternative energy sources, but the use of fossil fuels continues to contribute to climate change.
21. In its efforts to address the threats posed by climate change the County Council has adopted numerous policies and actions to support clean energy and energy efficiency.
22. Limiting the burning of oil, coal, and natural gas remains a priority for the county's land use, transportation, environmental, and other countywide policies.
23. The academic and professional community has undertaken limited research to identify the effects of social investing of public pension funds. One study, a November 2016 report by the Center for Retirement Research at Boston College, advises that public pension funds should not engage in social investing. In addition to producing lower investment returns, the report advises that social investing is not effective, as other investors step in to buy divested stocks to exploit lower prices for higher returns.
24. A divestment strategy has the potential to transfer ownership from those concerned about global warming thereby diminishing the voices of those advocating for policies to reduce global warming.
25. Estimates vary as to the annual cost if the Boards were to pursue a strategy to divest its investments in fossil fuel companies. One scenario estimates that annual county taxpayer contributions could increase \$30 million due to reduced investment income and increased fees.

Action

The County Council for Montgomery County, Maryland recommends

- The Employees' Retirement System Board of Investment Trustees and the Consolidated Retiree Health Benefits Trust Board of Trustees incorporate in their Environmental Social and Governance (ESG) Guidelines a review of any company in the 200 publicly traded coal, oil, and gas companies that hold fossil fuel reserves with the largest potential carbon emissions. This review must be fully consistent with the fiduciary responsibilities of Board members, staff, and professional investment managers.
- The Boards report annually to the County Executive and County Council on any actions taken to limit investments in these fossil fuel companies.



**MONTGOMERY COUNTY EMPLOYEES' RETIREMENT SYSTEM
CONSOLIDATED RETIREE HEALTH BENEFITS TRUST**

MEMORANDUM
January 30, 2017

TO: Montgomery County Council

FROM: Gino Renne, Chair, Board of Investment Trustees, ERS *Gino*
Lynda von Bargen, Chair, Board of Trustees, CRHBT *Lynda*

SUBJECT: Further Comments on Bill 44-16, Retirement – Fossil Fuel Investments – Restrictions

In our memo to you of December 5, 2016, we detailed the serious concerns about the subject bill expressed by our two Boards: the Board of Investment Trustees of the Employees' Retirement System (*ERS*, the defined benefit pension plan for County government employees with assets of \$3.8 billion) and the Board of Trustees of the Consolidated Retiree Health Benefits Trust (*CRHBT*, the trust for retiree health benefits for employees of County Government, Montgomery County Public Schools, and Montgomery College with assets of \$700 million). The Boards' unanimous position was that the bill as introduced was legally flawed, as pointed out by the County Attorney; operationally unworkable; and inconsistent with our fiduciary duty as outlined in the County Code. The Standard of Care requires the Board to act "only in the best interest of the participants and their beneficiaries."

On January 27, Council President Roger Berliner met with the Boards to discuss an amended version of the bill (Draft 10). We appreciated Mr. Berliner's exchange of views with Board members. Mr. Berliner said that the County Attorney has found Draft 10 to be "legally sufficient" and that Draft 10 addresses the operational complexity of the bill as introduced. While the Boards consider these changes constructive, we remain strongly opposed to the bill for the following reasons:

1. Draft 10 of the bill requires the Boards to impose arbitrary, confusing, and intrusive directives on our investment managers.

Subsection (d) of Draft 10 (lines 73-89) states:

Fossil fuel company investments. Subject to subsection (e), each Board must:

- (1) direct each investment manager to divest any investment in a fossil fuel company held in an actively managed separate account whenever the manager determines that the divestment would have a *de minimis* impact on the overall return for the part of the trust fund under the control of the investment manager; and

- (2) work toward reducing its investments in fossil fuel companies by directing each investment manager to evaluate before investing or retaining a fossil fuel company in an actively managed account:
- a. the company's impact on climate change as part of the standard risk analysis for any investment;
 - b. the direct relationship of a company's fossil fuel operations to its economic and financial value; and
 - c. if there is an alternative investment that is not an investment in a fossil fuel company that is expected to produce similar returns with similar.

These required directives to our investment managers raise serious questions. What is the meaning of *de minimis*? Don't investment managers by definition hold the securities they believe will provide the best risk-adjusted return, rather than those that will not? How are investment managers supposed to evaluate the vague requirements outlined in (2) a, b, and c above? Is it the role of the Council to intrude in this way on the investment process of the Boards and our managers?

2. Draft 10 then specifies an exception for fiduciary duty that can effectively negate these requirements.

Subsection (e) of Draft 10 (lines 90-99) states:

Fiduciary duty. Nothing in this Section must require a Board or an investment manager to take action if the Board or the investment manager determines in good faith that the action described in this Section is inconsistent with their fiduciary responsibilities.

In the Boards' view, it is inconsistent with our fiduciary responsibilities to direct our investment managers to take the steps required in Subsection (d). Initial feedback from our investment managers is similarly that the requirements in Subsection (d) are inconsistent with their fiduciary responsibilities. What then is the purpose of Subsection (d)?

3. Draft 10 includes highly prescriptive and cumbersome reporting requirements.

Subsection (h) of Draft 10 (lines 127-139) states:

Reports. Each Board must report annually to the Council and Executive on the operation of and compliance with this Section during the preceding 12 months. The report must:

- (1) identify, in the aggregate, each investment in a fossil fuel company held in an actively managed separate account of the trust funds;
- (2) list, in the aggregate, each purchase or sale of a fossil fuel company security in an actively managed separate account made under this Section;
- (3) explain the reason for each decision to purchase or not sell an investment in a fossil fuel company in an actively managed separate account; and
- (4) calculate the administrative cost of compliance.

These requirements, like those in Subsection (d), are a diversion from the Boards' core mission and our fiduciary duty to participants and their beneficiaries and dependents.

4. The requirement in Draft 10 regarding socially responsible investing is unnecessary.

Subsection (f) of Draft 10 (lines 100-105) states:

Research on socially responsible investing. Each Board must:

- (1) review academic and professional literature on socially responsible investing;
- (2) investigate the benefits and disadvantages of socially responsible investing of public trust funds; and
- (3) adopt a Socially Responsible policy for investments.

The Boards have examined these issues carefully for many years and have specifically incorporated them into their investment and governance policies. The Boards carefully consider Environmental, Social and Governance (*ESG*) factors, as they are termed, in their evaluation of investment managers based on due diligence by staff. The ESG policy is manifested in the screens our managers use to eliminate securities from consideration.

5. The divestment required by Draft 10 raises major possible risks for the retirement funds and additional potential costs for taxpayers.

While some advocates assert that divestment from fossil fuel companies would produce the same or even higher returns, that assertion going forward is impossible to verify. The possible risks associated with accepting that assertion at face value include a decreased opportunity set of investment options, difficulty in accessing superior managers, higher fees, and a larger employer (i.e., taxpayer) contribution. These outcomes are not guaranteed, but neither are assurances that divestment would have a neutral or positive impact on returns.

For the ERS and the CRHBT combined, County taxpayers are contributing nearly \$200 million in Fiscal Year 2017. If divestment actions result in lower returns, the taxpayer burden will increase.

6. The “slippery slope” issue is real and cannot be ignored.

Some advocates say that divestment from fossil fuel companies is justified because climate change is a unique danger – an existential threat. Advocates of multiple other causes see other companies as an existential threat – for example, companies that permit gross inequality in their pay practices, follow other regressive social and economic policies, assist offensive governments, engage in tax inversions, gouge or cheat consumers, propagate obesity and diabetes, tolerate human suffering in their supply chain, helped cause the Great Recession, or incur large fines for violation of federal law. Draft 10 provides a template for all advocates to demand divestment bills to address their strongly felt concerns.

7. Climate change requires real action, not feel-good symbolism.

Montgomery County is a national leader in taking real action on climate change, achieving real results. The Council has enacted wide-ranging measures to support clean energy and energy efficiency, with consistent progress on the shift to renewables and sustainability. This is what a county government can and should do. We should focus on tangible results where our performance can be assessed. Additionally, the funding required should be transparent to our taxpayers. The County should now build on its record by examining more closely how its land use policies, capital improvements program, and personnel and transportation policies interact with climate change.

By contrast, divestment from fossil fuel companies is feel-good symbolism that would achieve no actual reduction in carbon emissions. The huge challenge of climate change persists, but in recent years the movement has realized increasing success, as reflected in the Paris Accord (2015) and scores of related developments. Market forces alone are moving strongly in the direction of clean energy. What is needed now is sustained follow-up action by the world community to implement the Paris goals, starting with an honest focus on our individual carbon footprints from the way we live our lives. We are long past the need for feel-good symbolism that would achieve nothing concrete and could have a negative impact on our retirement funds.

In terms of what it would affect, the divestment required by Bill 44-16 is highly selective and inconsistent. It applies to only some fossil fuel companies (lines 37-44), and only to those in an “actively managed separate account.” It does not apply to those in an “index fund, private equity fund, private real asset fund, mutual fund, or other commingled or passively managed fund” (lines 23-25). It does not apply to the hundreds of companies that service or profit from fossil fuel companies. Nor, of course, does it apply to fossil fuel company securities held by the mutual funds that millions of us own.

8. The bill mandates divestment from fossil fuel companies but not from what they produce.

Bill 44-16 requires divestment from fossil fuel companies, but it does not require divestment from products made by those companies for multiple County functions, such as heating and cooling buildings, paving roads, and fueling police cars, fire engines, ambulances, buses, snow plows, and heavy vehicles. Plastics, medical equipment, and hundreds of other products derived from fossil fuels are in constant use by the County. The County is shifting away from fossil fuels wherever possible but, like County residents and billions of people worldwide, it continues to rely on them.

For these reasons, we remain strongly opposed to Bill 44-16 (Draft 10). While we believe that no bill is needed, one alternative is to consider a resolution that addresses the issue but does not have the force of law.

One example is a draft resolution proposed by the Montgomery County Retired Employees' Association, which represents the County's 6,000 retirees. In a January 23 email to the Council, MCREA president Rob Klein wrote: “We continue to strongly oppose Bill 44-16, which politicizes the pension and health insurance funds and adds restrictive language to the County Code that will have lasting and negative impacts on these funds.” He suggested instead a resolution that calls on the Boards to incorporate a review of fossil fuel companies in their ESG guidelines, consistent with the fiduciary responsibilities of Board members and investment managers, and to report annually to the Council and Executive on any actions taken to limit investments in these companies.

The stakes here are very high. The ERS Board has worked long and hard to bring our pension fund to a 91 percent funded level. The dangerous condition of many pension funds elsewhere confirms the vital importance of our efforts. The CRHBT, which is designed to provide health benefits for retirees of County Government, MCPS, and Montgomery College and their dependents, is still in the early stage of accumulating assets and currently has a funded level of just 21 percent. We are making good progress. We need to stay on course.

The Boards and the staff are serving our employees, our retirees, and our taxpayers well. The 10-year return for the ERS is in the top one percent of the Wilshire Large Public Funds Universe with assets greater than \$1 billion. Our efforts are focused and successful, and we ask that we be allowed to continue our work unhampered by Bill 44-16 or any similar restriction, however worthy the cause. Thank you for your serious consideration of our concerns.

Bill No. 44-16
 Concerning: Retirement -- Fossil Fuel Investments - Restrictions
 Revised: January 30, 2017 Draft No. 11
 Introduced: October 25, 2016
 Expires: April 25, 2018
 Enacted: _____
 Executive: _____
 Effective: _____
 Sunset Date: None
 Ch. _____, Laws of Mont. Co. _____

**COUNTY COUNCIL
 FOR MONTGOMERY COUNTY, MARYLAND**

Lead Sponsors: Council Vice President Berliner and Councilmember Navarro
 Co-sponsor: Councilmember Elrich

AN ACT to:

- (1) ~~[[prohibit]]~~ require the Board of Investment Trustees and the Consolidated Retiree Health Benefits Trust Board of Trustees ~~[[from investing in]]~~ to direct their investment managers to evaluate each investment in certain ~~[[businesses]]~~ companies holding certain amounts of fossil fuel reserves and consider whether to retain those investments under certain circumstances;
- (2) require the Boards to research and adopt a socially responsible ~~[[investing]]~~ investment policy; and
- (3) generally amend the law governing the investment of funds held in trust for the ~~[[employees' retirement system]]~~ Employees' Retirement System and the ~~[[consolidated retiree health benefits trust]]~~ Consolidated Retiree Health Benefits Trust.

By adding

Montgomery County Code
 Chapter 33, Personnel and Human Resources
 Section 33-60C

By amending

Montgomery County Code
 Chapter 33, Personnel and Human Resources
 Sections 33-61A and 33-165

Boldface	<i>Heading or defined term.</i>
<u>Underlining</u>	<i>Added to existing law by original bill.</i>
[[Single boldface brackets]]	<i>Deleted from existing law by original bill.</i>
<u>Double underlining</u>	<i>Added by amendment.</i>
[[Double boldface brackets]]	<i>Deleted from existing law or the bill by amendment.</i>
* * *	<i>Existing law unaffected by bill.</i>

The County Council for Montgomery County, Maryland approves the following Act:

1 **Sec. 1. Section 33-60C is added and Sections 33-61A and 33-165 are**
2 **amended as follows:**

3 **33-60C. Fossil Fuel Investments – Restrictions**

4 **(a) Findings.**

5 **(1) The release of greenhouse gases, such as carbon dioxide and**
6 **methane, into the atmosphere through human activity is a major**
7 **cause of climate change.**

8 **(2) Carbon dioxide is emitted into the atmosphere from the burning**
9 **of fossil fuels, including oil, natural gas, and coal.**

10 **(3) Methane is emitted into the atmosphere by the production and**
11 **transportation of oil, natural gas, and coal;**

12 **(4) The United States Environment Protection Agency has reported**
13 **that climate change has resulted in rising temperatures, shifting**
14 **snow and rainfall patterns, and more extreme climate events in**
15 **recent years and poses profound risks to human health.**

16 **(5) Montgomery County is a national leader among local**
17 **governments in addressing climate change by supporting clean**
18 **energy, energy efficiency, and sustainability.**

19 **(6) The global community has, through signing of the Paris**
20 **Agreement and in other ways, indicated that it intends to avoid**
21 **the greatest impacts of climate change by reducing and**
22 **eventually eliminating almost all greenhouse gas emissions,**
23 **including carbon dioxide.**

24 **(7) Global policy to reduce fossil fuel consumption, technological**
25 **advancement, increasing physical impacts, changing consumer**
26 **beliefs, possible unfunded liabilities in the form of litigation**

27 costs, and other factors embed fossil fuel assets with inherent
 28 financial riskiness that prudent investors should evaluate.

29 (b) Definitions. In this Section, the following words have the meanings
 30 indicated:

31 Actively managed separate account means assets held in a separate
 32 account by an investment manager hired by the Boards. Actively
 33 managed separate account does not include an index fund, private equity
 34 fund, private real [[estate]] asset fund, mutual fund, or other commingled
 35 or passively managed fund.

36 Boards means the Board of Investment Trustees established by Section
 37 33-59 and the Consolidated Retiree Health Benefits Trust Board of
 38 Trustees established by Section 33-160.

39 Company means any sole proprietorship, organization, association,
 40 corporation, partnership, joint venture, limited partnership, limited
 41 liability partnership, limited liability company, or other entity or business
 42 association, including any wholly-owned subsidiary, majority-owned
 43 subsidiary, and parent company of any of them, or business association,
 44 that exists for profit-making purposes.

45 Divest means selling, redeeming, transferring, exchanging, or otherwise
 46 disposing of, and refraining from further buying of, certain investments.

47 Fossil Fuel Company means a [[company listed in the 200]] publicly
 48 traded coal, oil, and gas [[companies that hold reported]] company
 49 holding fossil fuels reserves with one of the 200 largest potential carbon
 50 emissions. [[, as ranked]] The Boards may refer to the rankings in the
 51 Fossil Free Indexes US (FFIUS) published by Fossil Free Indexes LLC
 52 or a successor index, as updated annually, to determine if a company is a

53 fossil fuel company. The Boards may also hire a professional consultant
 54 to assist in identifying fossil fuel companies.

55 *Socially responsible investing* means considering environmental, social,
 56 and corporate governance factors as part of the evaluation of the
 57 economic and financial value of an investment in a company.

58 *Trust funds* means the assets held for the Employees' Retirement System
 59 and the assets held for the Consolidated Retiree Health Benefits Trust.

60 [(b)] (c) *Review of investments.* Each Board must direct each investment
 61 manager to review the investment holdings in each actively managed
 62 separate account of the trust funds and identify each investment in any
 63 fossil fuel company. Each Board must direct each investment manager
 64 to review its investment holdings in these accounts periodically and
 65 update the list of fossil fuel companies at least every 6 months.

66 [(c) *Divestment.* Except as provided in subsection (d), each Board:

67 (1) within 1 year after the date this law takes effect, must divest at least
 68 20% of its investments in fossil fuel companies held in an actively
 69 managed separate account as of the date this Act takes effect:

70 (2) within 2 years, must divest at least 40% of its investments in fossil
 71 fuel companies held in an actively managed separate account as of
 72 the date this Act takes effect;

73 (3) within 3 years, must divest at least 60% of its investments in fossil
 74 fuel companies held in an actively managed separate account as of
 75 the date this Act takes effect;

76 (4) within 4 years, must divest at least 80% of its investments in fossil
 77 fuel companies held in an actively managed separate account as of
 78 the date this Act takes effect; and

79 (5) within 5 years, must divest 100% of its investments in fossil fuel
 80 companies held in an actively managed separate account; and

81 (6) must not make any new investment in an actively managed
 82 separate account in any fossil fuel company.]]

83 (d) Fossil fuel company investments. Subject to subsection (e), each Board
 84 must:

85 (1) direct each investment manager to divest any investment in a fossil
 86 fuel company held in an actively managed separate account
 87 whenever the manager determines that the divestment would have
 88 a de minimis impact on the overall return for the part of the trust
 89 fund under the control of the investment manager; and

90 (2) work toward reducing its investments in fossil fuel companies by
 91 directing each investment manager to evaluate before investing in
 92 or retaining a fossil fuel company in an actively managed account:

93 (A) the company's impact on climate change as part of the
 94 standard risk analysis for any investment;

95 (B) the direct relationship of a company's fossil fuel operations
 96 to its economic and financial value; and

97 (C) if there is an alternative investment that is not an investment
 98 in a fossil fuel company that is expected to produce similar
 99 returns with similar risk.

100 ~~[(d)]~~ (e) ~~[[Divestment delay]]~~ Fiduciary duty. Nothing in this Section must
 101 require a Board or an investment manager to take action [[as described in
 102 this Section unless]] if the Board or the investment manager determines
 103 in good faith that the action described in this Section is [[consistent]]
 104 inconsistent with [[the]] their fiduciary responsibilities. [[of the Board
 105 described in Section 33-61C or Section 33-163. If the Board determines

106 that a delay in divesting from a fossil fuel company is necessary due to
 107 its fiduciary duty, the Board must report this delay within 30 days to the
 108 Executive and the Council along with an estimated timeline for the
 109 resumption of divestment.]]

110 [[e]] (f) *Research on socially responsible investing.* Each Board must:

111 (1) review academic and professional literature on socially
 112 responsible investing;

113 (2) investigate the benefits and disadvantages of socially responsible
 114 investing of public trust funds; and

115 (3) adopt a Socially Responsible policy for investments.

116 [[f) *Exemption.* The divestment or investment prohibition under this Section
 117 must not apply to a company that can demonstrate that it:

118 (1) has stopped exploring for new hydrocarbons;

119 (2) agrees contractually to not develop or sell 80% of its current
 120 proven fossil fuel reserves; and

121 (3) has stopped lobbying or attempting to influence government
 122 officials to preserve its special treatment, including subsidies, tax
 123 breaks, or competitive advantage with respect to clean, renewable
 124 energy.]]

125 (g) *Investment managers.* Each Board must consider an investment
 126 manager's policies on socially responsible investing, including its
 127 policies on investing in fossil fuel companies, when selecting investment
 128 managers for actively managed accounts.

129 [[g) *Notice.* Each Board:

130 (1) before divesting from a fossil fuel company under this Section,
 131 must provide written notice and an opportunity to comment in
 132 writing to each company subject to the ac tion;

133 (2) must not divest until 90 days after written notice is provided to the
134 company; and

135 (3) must not divest if the company shows that it is exempt from
136 divestment under subsection (f).]]

137 (h) *Report.* [[The]] Each Board must report annually to the Council and
138 Executive on the operation of and compliance with this Section during
139 the preceding 12 months. The report must:

140 (1) identify, in the aggregate, each investment in a fossil fuel company
141 held in an actively managed separate account of the trust funds;

142 (2) list, in the aggregate, each [[divestment action taken]] purchase or
143 sale of a fossil fuel company security in an actively managed
144 separate account made under this Section;

145 (3) [[describe each decision to delay investment under Subsection
146 (d);]] explain the reason for each decision to purchase or not sell
147 an investment in a fossil fuel company in an actively managed
148 separate account; and

149 (4) calculate the administrative cost of compliance.

150 **33-61A. Indemnification of trustees**

151 (a) *Authorized.* The County must indemnify every member of the Board who
152 is or may become a party to any action, suit, or proceeding, including
153 administrative and investigative proceedings, because of service as a
154 member of the Board, including any action taken to comply with
155 [Section] Sections 33-60A and 33-60C, subject to the conditions stated in
156 this Section.

157 * * *

158 **33-165. Indemnification of Board Members.**

159 (a) *General.* The County must indemnify each member of the Board who is
160 or may become a party to any legal action, including any administrative
161 or investigative proceeding, because of service as a Board member,
162 including any action taken to comply with Sections 33-60A and 33-60C,
163 subject to the conditions in this Section.

164 * * *

165 **Sec. 2. Initial review.** Each Board must complete its initial review of the
166 investment holdings in all actively managed separate accounts of the trust funds and
167 identify all investments in fossil fuel companies within 90 days after the date this Act
168 takes effect.

169 *Approved:*

170

Roger Berliner, President, County Council Date

171 *Approved:*

172

Isiah Leggett, County Executive Date

173 *This is a correct copy of Council action.*

174

Linda M. Lauer, Clerk of the Council Date

Bill No. 44-16
 Concerning: Retirement – Fossil Fuel Investments - Restrictions
 Revised: January 30, 2017 Draft No. 11
 Introduced: October 25, 2016
 Expires: April 25, 2018
 Enacted: _____
 Executive: _____
 Effective: _____
 Sunset Date: None
 Ch. _____, Laws of Mont. Co. _____

COUNTY COUNCIL FOR MONTGOMERY COUNTY, MARYLAND

Lead Sponsors: Council Vice President Berliner and Councilmember Navarro
 Co-sponsor: Councilmember Elrich

AN ACT to:

- (1) require the Board of Investment Trustees and the Consolidated Retiree Health Benefits Trust Board of Trustees to direct their investment managers to evaluate each investment in certain companies holding certain amounts of fossil fuel reserves and consider whether to retain those investments under certain circumstances;
- (2) require the Boards to research and adopt a socially responsible investment policy; and
- (3) generally amend the law governing the investment of funds held in trust for the Employees' Retirement System and the Consolidated Retiree Health Benefits Trust.

By adding

Montgomery County Code
 Chapter 33, Personnel and Human Resources
 Section 33-60C

By amending

Montgomery County Code
 Chapter 33, Personnel and Human Resources
 Sections 33-61A and 33-165

Boldface	<i>Heading or defined term.</i>
<u>Underlining</u>	<i>Added to existing law by original bill.</i>
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[[Double boldface brackets]]	<i>Deleted from existing law or the bill by amendment.</i>
* * *	<i>Existing law unaffected by bill.</i>

The County Council for Montgomery County, Maryland approves the following Act:

1 **Sec. 1. Section 33-60C is added and Sections 33-61A and 33-165 are**
2 **amended as follows:**

3 **33-60C. Fossil Fuel Investments – Restrictions**

4 (a) *Findings.*

- 5 (1) The release of greenhouse gases, such as carbon dioxide and
6 methane, into the atmosphere through human activity is a major
7 cause of climate change.
- 8 (2) Carbon dioxide is emitted into the atmosphere from the burning
9 of fossil fuels, including oil, natural gas, and coal.
- 10 (3) Methane is emitted into the atmosphere by the production and
11 transportation of oil, natural gas, and coal;
- 12 (4) The United States Environment Protection Agency has reported
13 that climate change has resulted in rising temperatures, shifting
14 snow and rainfall patterns, and more extreme climate events in
15 recent years and poses profound risks to human health.
- 16 (5) Montgomery County is a national leader among local
17 governments in addressing climate change by supporting clean
18 energy, energy efficiency, and sustainability.
- 19 (6) The global community has, through signing of the Paris
20 Agreement and in other ways, indicated that it intends to avoid
21 the greatest impacts of climate change by reducing and
22 eventually eliminating almost all greenhouse gas emissions,
23 including carbon dioxide.
- 24 (7) Global policy to reduce fossil fuel consumption, technological
25 advancement, increasing physical impacts, changing consumer
26 beliefs, possible unfunded liabilities in the form of litigation

27 costs, and other factors embed fossil fuel assets with inherent
28 financial riskiness that prudent investors should evaluate.

29 (b) *Definitions.* In this Section, the following words have the meanings
30 indicated:

31 *Actively managed separate account* means assets held in a separate
32 account by an investment manager hired by the Boards. *Actively*
33 *managed separate account* does not include an index fund, private equity
34 fund, private real asset fund, mutual fund, or other commingled or
35 passively managed fund.

36 *Boards* means the Board of Investment Trustees established by Section
37 33-59 and the Consolidated Retiree Health Benefits Trust Board of
38 Trustees established by Section 33-160.

39 *Company* means any sole proprietorship, organization, association,
40 corporation, partnership, joint venture, limited partnership, limited
41 liability partnership, limited liability company, or other entity or business
42 association, including any wholly-owned subsidiary, majority-owned
43 subsidiary, and parent company of any of them, or business association,
44 that exists for profit-making purposes.

45 *Divest* means selling, redeeming, transferring, exchanging, or otherwise
46 disposing of, and refraining from further buying of, certain investments.

47 *Fossil Fuel Company* means a publicly traded coal, oil, and gas company
48 holding fossil fuels reserves with one of the 200 largest potential carbon
49 emissions. The Boards may refer to the rankings in the Fossil Free
50 Indexes US (FFIUS) published by Fossil Free Indexes LLC or a successor
51 index, as updated annually, to determine if a company is a fossil fuel
52 company. The Boards may also hire a professional consultant to assist in
53 identifying fossil fuel companies.

54 *Socially responsible investing* means considering environmental, social,
 55 and corporate governance factors as part of the evaluation of the
 56 economic and financial value of an investment in a company.

57 *Trust funds* means the assets held for the Employees' Retirement System
 58 and the assets held for the Consolidated Retiree Health Benefits Trust.

59 (c) *Review of investments.* Each Board must direct each investment manager
 60 to review the investment holdings in each actively managed separate
 61 account of the trust funds and identify each investment in any fossil fuel
 62 company. Each Board must direct each investment manager to review its
 63 investment holdings in these accounts periodically and update the list of
 64 fossil fuel companies at least every 6 months.

65 (d) *Fossil fuel company investments.* Subject to subsection (e), each Board
 66 must:

67 (1) direct each investment manager to divest any investment in a fossil
 68 fuel company held in an actively managed separate account
 69 whenever the manager determines that the divestment would have
 70 a *de minimis* impact on the overall return for the part of the trust
 71 fund under the control of the investment manager; and

72 (2) work toward reducing its investments in fossil fuel companies by
 73 directing each investment manager to evaluate before investing in
 74 or retaining a fossil fuel company in an actively managed account:

75 (A) the company's impact on climate change as part of the
 76 standard risk analysis for any investment;

77 (B) the direct relationship of a company's fossil fuel operations
 78 to its economic and financial value; and

- 79 (C) if there is an alternative investment that is not an investment
80 in a fossil fuel company that is expected to produce similar
81 returns with similar risk.
- 82 (e) *Fiduciary duty.* Nothing in this Section must require a Board or an
83 investment manager to take action if the Board or the investment manager
84 determines in good faith that the action described in this Section is
85 inconsistent with their fiduciary responsibilities.
- 86 (f) *Research on socially responsible investing.* Each Board must:
87 (1) review academic and professional literature on socially
88 responsible investing;
89 (2) investigate the benefits and disadvantages of socially responsible
90 investing of public trust funds; and
91 (3) adopt a Socially Responsible policy for investments.
- 92 (g) *Investment managers.* Each Board must consider an investment
93 manager's policies on socially responsible investing, including its
94 policies on investing in fossil fuel companies, when selecting investment
95 managers for actively managed accounts.
- 96 (h) *Report.* Each Board must report annually to the Council and Executive
97 on the operation of and compliance with this Section during the preceding
98 12 months. The report must:
99 (1) identify, in the aggregate, each investment in a fossil fuel company
100 held in an actively managed separate account of the trust funds;
101 (2) list, in the aggregate, each purchase or sale of a fossil fuel company
102 security in an actively managed separate account made under this
103 Section;

- 104 (3) explain the reason for each decision to purchase or not sell an
- 105 investment in a fossil fuel company in an actively managed
- 106 separate account; and
- 107 (4) calculate the administrative cost of compliance.

33-61A. Indemnification of trustees

(a) *Authorized.* The County must indemnify every member of the Board who is or may become a party to any action, suit, or proceeding, including administrative and investigative proceedings, because of service as a member of the Board, including any action taken to comply with Sections 33-60A and 33-60C, subject to the conditions stated in this Section.

* * *

33-165. Indemnification of Board Members.

(a) *General.* The County must indemnify each member of the Board who is or may become a party to any legal action, including any administrative or investigative proceeding, because of service as a Board member, including any action taken to comply with Sections 33-60A and 33-60C, subject to the conditions in this Section.

* * *

Sec. 2. Initial review. Each Board must complete its initial review of the investment holdings in all actively managed separate accounts of the trust funds and identify all investments in fossil fuel companies within 90 days after the date this Act takes effect.

Approved:

Roger Berliner, President, County Council

Date