

Amendment record 4-5-2017

WEDNESDAY, 2:00 PM, APRIL 5, 2017

THOSE PRESENT WERE: Mayor Wheeler, Presiding; Commissioners Eudaly, Fish, Fritz and Saltzman, 5.

- 340** **TIME CERTAIN: 2:00 PM** – Adopt City of Portland Investment Policy (Previous Agenda 312; Resolution introduced by Mayor Wheeler) 2 hours requested
- 1. Motion to amend Section III (F) add Nestle to the Do Not Buy list as recommended by the Socially Responsible Investment Committee in their September 20, 2016 report:** Moved by Eudaly.
 - 2. Motion to amend Section III (F) by adding Caterpillar to the Do Not Buy list as recommended by the Socially Responsible Investment Committee in their September 20, 2016 report:** Moved by Eudaly.
 - 3. Motion to amend Section III (F) by adding Bank of New York Mellon to the Do Not Buy list as recommended by the Socially Responsible Investment Committee in their September 20, 2016 report:** Moved by Eudaly.
 - 4. Motion to amend Section III (F) by reinstating the language “From time to time City Council may approve the addition of specific company names to its Do-Not-Buy list, at which point investment officers are not permitted to purchase securities of the companies that have been added; any existing positions of these companies need not be sold. From time to time City Council may approve the removal of specific company names from its Do-Not-Buy list, at which point investment officers are permitted to purchase securities issued by these companies”:** Moved by Eudaly.
- After being seconded by Commissioner Fritz, the 4 motions made by Commissioner Eudaly were not voted on, as they were subsumed by the subsequent motion made by Commissioner Saltzman.
- Motion to eliminate Sections III (F, G) investment in corporate securities:**
 Moved by Saltzman and seconded by Fritz.
 (Y-3 Fish, Saltzman, Eudaly. N-2 Fritz, Wheeler.)

(Y-5)

37278
 AS AMENDED

Amendment 1

2nd Fritz

I would like to amend Section III, Item F by adding Nestle to the Do Not Buy list as recommended by the Socially Responsible Investment Committee in their September 20, 2016 report.

Amendment 2

2nd Fritz

I would like to amend Section III, Item F by adding Caterpillar to the Do Not Buy list as recommended by the Socially Responsible Investment Committee in their September 20, 2016 report.

Amendment 3

2nd Fritz

I would like to amend Section III, Item F by adding Bank of New York Mellon to the Do Not Buy list as recommended by the Socially Responsible Investment Committee in their September 20, 2016 report.

Amendment 4

2nd Fritz

I would like to amend Section III, Item F by reinstating the language: "From time to time City Council may approve the addition of specific company names to its Do-Not-Buy list, at which point investment officers are not permitted to purchase securities of the companies that have been added; any existing positions of these companies need not be sold. From time to time City Council may approve the removal of specific company names from its Do Not Buy list, at which point investment officers are permitted to purchase securities issued by these companies."

Amendment 5 - Consider Cmsr. Saltzman's amendment first & then may make another amendment.
Saltzman 1:

Eliminate investmt in corporate
~~bonds~~ securities..



CITY OF PORTLAND
OFFICE OF MANAGEMENT AND FINANCE

Ted Wheeler, Mayor
Tom Rinehart, Chief Administrative Officer
Kenneth L. Rust, Chief Financial Officer

Bureau of Revenue and Financial Services
Jennifer Cooperman, Treasurer
Treasury Division
1120 SW Fifth Ave., Room 1250
Portland, Oregon 97204-1912
(503) 823-4220
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Date: February 23, 2017

37278

To: Tom Rinehart, Chief Administrative Officer
Ken Rust, Chief Financial Officer

From: Jennifer Cooperman, City Treasurer

Re: Establishing a Minimum ESG-Rating for Treasury's Direct Investments in Corporate Securities

On December 21, 2016, Council unanimously approved Resolution #37262 which directed the City Treasurer to (1) suspend direct investments of City cash assets in corporate debt securities until Council has approved the City's Investment Policy in 2017, (2) amend the City's Investment Policy by adding a restriction on additional direct investments in corporate securities to those meeting a to-be-determined minimum environmental-social-governance (ESG) rating at the time of purchase as determined by a third-party ESG investment research provider, and (3) return to Council for approval of the City's Investment Policy by April 1, 2017.

This memo recommends a minimum MSCI ESG-rating for inclusion in the City's Investment Policy so the City Treasurer can resume direct investments in corporate debt securities.

Background

ESG Research

Socially responsible investing (SRI) is intended to reflect investor values by taking ESG considerations – emerging and overlooked factors that can impact the risk and return profile of investment portfolios – into account. To select an appropriate research vendor, the Treasury Division of the Bureau of Revenue and Financial Services ("Division") evaluated independent providers of ESG research against the City's seven social- and values-concerns (Principles) as expressed in the Socially Responsible Investments Committee Charge.

MSCI Contract

In May 2015, the Division executed a contract with MSCI ESG Research Inc. (MSCI) for online access to the *MSCI World* database. The current annual subscription fee of \$37,500 is included in the Division's budget. The contract obligates the City to not disclose MSCI's detailed ESG methodology or individual company ESG-ratings. City staff with access to MSCI's proprietary ESG research and members of the Socially Responsible Investments Committee (SRIC) have executed confidentiality agreements.

To help ensure equal access to programs, services and activities, the Office of Management & Finance will reasonably modify policies/procedures and provide auxiliary aids/services to persons with disabilities upon request.

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MSCI's ESG Methodology

MSCI's ESG methodology identifies three Pillars – environment, social, governance – under which there are ten Themes (e.g., climate change, human capital, corporate behavior). Each Theme has several ESG Key Issues (risks) that are selected annually for each industry and weighted based on MSCI's materiality mapping framework. Companies are rated on their exposure to and management of each Key Issue. To arrive at a final ESG-rating between AAA (best) and CCC (worst), the weighted averages of the Key Issue scores are combined and company scores are normalized by their industries. MSCI's ESG ratings are intended to be relative to the standards and performance of a company's industry peers. ESG-ratings are updated when there are significant changes to underlying scores. Companies receive an in-depth review at least annually.

City's Investment Policy Regarding Direct Investment in Corporate Securities

The City's investments are limited to those authorized under state law. Oregon Revised Statutes (ORS) 294 allows up to 35% of the City's investment portfolio to be directly invested in corporate bonds rated Aa/AA (Moody's/S&P) or higher (A/A rated if issued by Oregon companies) and A-1/P-1 rated commercial paper, with a 5% limit per issuer. The City's Investment Policy is written in accordance with ORS, reviewed by the State of Oregon's Short Term Fund Board and the City's Investment Advisory Committee, and adopted annually by City Council. The City's Investment Policy includes a maximum 3-year maturity limit to manage interest rate risk and credit risk.

Corporate Issuers Eligible for the City's Direct Investment

Given the minimum credit ratings and 3-year maturity limit in the City's Investment Policy, there are only a limited number of issuers of corporate bonds eligible for the City's direct investment. The Division identifies Eligible Issuers by searching on Bloomberg (a financial information system widely used by investors throughout the United States) for all outstanding U.S. corporate bonds that meet minimum credit ratings and will mature in 3-years or less. Currently, there are only thirty-five (35) Eligible Issuers*.

Corporations are eligible if they (1) issue new bonds with 3-years or less to maturity that meet minimum credit rating requirements, (2) credit ratings on outstanding bonds with 3-years or less to maturity are upgraded to meet minimum requirements, or (3) previously-issued long-term bonds that meet minimum credit rating requirements reach 3-years or less to maturity. Conversely, corporations are removed as their outstanding bonds mature or are downgraded below minimum credit rating requirements.

There is no assurance there will be eligible corporate securities available for purchase when the City is ready to invest its available cash for two primary reasons: (1) not all Eligible Issuers (those that would meet minimum credit rating requirements) actively issue new securities within the City's 3-year maturity limit, and (2) not all outstanding eligible securities actively trade in the secondary market. Additionally, not all eligible securities offered for sale are priced at good value relative to other available investment options.

Financial Analysis of Restrictions on Investments in Corporate Securities

The Division measures the financial impact of policies that limit the City's direct investment in corporate securities as the investment earnings potentially lost by having to invest City cash, instead, in lower yielding U.S. Treasury (UST) securities with a comparable 3-year maximum maturity. The Division uses UST securities for this analysis since UST securities are the standard market benchmark against which to measure prices and value of other interest-rate sensitive fixed income securities. Investing alternatively in UST securities would be a worst case, however, since U.S. Agency securities do historically yield more than UST securities**. Currently, U.S. Agency securities are yielding 9 basis points more than UST securities.

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Recommendation

MSCI is an independent research firm with an ESG methodology that is defensible and ensures that issuers are vetted consistently. It will be administratively easy for the Division to ensure corporate investments have a minimum MSCI ESG rating at the time of purchase, in addition to meeting all other Investment Policy requirements.

The Division recommends that a minimum MSCI ESG-rating of BBB be added to the City's Investment Policy. Requiring a minimum ESG rating of BBB will permit investments in 24 Eligible Issuers, which should allow the Division to remain fully invested at the 35% maximum limit for corporate securities.

Attached are recommended changes to the City's Investment Policy to incorporate a minimum MSCI ESG rating of BBB and to incorporate a ban on fossil fuel investments.

*Over the last year, eight previously-eligible issuers experienced credit rating downgrades, two previously-eligible issuers had outstanding eligible bonds mature, and one previously-eligible issuer has chosen to issue only private commercial paper.

**The Division's analysis of historical interest rate spreads [1997-2016] using the BAML CVA2 Index, indicates that 3-year Aa3-rated corporate bonds have offered an average additional yield of 91 basis points more than comparable U.S. Treasuries.

The Division's analysis of historical interest rate spreads [1997-2016] using the BAML G1P0 Index, indicates that US Agency securities have offered an average additional yield of 29 basis points more than comparable U.S. Treasuries.

Adding a Minimum MSCI ESG Rating to the City's Investment Policy

General considerations

- Investing in corporate securities adds incremental yield and diversification to the City's investment portfolio and should be facilitated.
- The City's Investment Policy should allow the Division sufficient opportunity to reach the 35% corporate securities limit, given the 5% limit per issuer.
- Mathematically, these limits imply the City needs seven (7) Eligible Issuers; however, since there is no assurance there will be sufficient eligible securities available for purchase when the City is ready to invest available cash, the list of Eligible Issuers should be at least three (3) times the minimum required, i.e. at least twenty-one (21) issuers.

TABLE 1—Eligible Issuers Ranked by MSCI Ratings

MSCI ESG rating	AVERAGE 3-year yield spread to UST (basis points)	RANGE 3-year yield spread to UST (basis points)	# of Eligible Issuers	Cumulative # of Eligible Issuers
AAA	+34	+25 – 42	3	3
AA	+48	+30 – 65	7	10
A	+47	+35 – 95	8	18
BBB	+46	+25 – 75	6	24
BB	+62	+45 – 100	5	29
B	+60	+34 – 102	5	34
CCC	+75	+75	1	35

Minimum ESG rating of AAA, AA, or A

- As Table 1 indicates, there are insufficient Eligible Issuers at these three ESG rating levels combined to ensure the Division could invest up to the 35% portfolio limit for corporate securities.
- Based on current average credit spreads from Table 1, for each percentage point below the 35% limit that the City would be forced to underinvest in 3-year corporate securities by not having enough Eligible Issuers, the potential financial impact is \$51,000 - \$70,500, assuming an average \$1.5 billion portfolio.
- Based on historical average corporate spreads**, the potential financial impact of each percentage point for this same underinvestment is \$136,500.

Minimum ESG rating of BBB

- An ESG rating of BBB currently offers a sufficient number of Eligible Issuers in which to invest with average yield spreads that are comparable to ESG ratings of AA and A.

Banning Fossil Fuel Investments

We expect City Council will want to continue the ban on fossil fuel investments. Since adding a minimum ESG rating threshold will not necessarily eliminate investments in fossil fuel companies because MSCI's analysis is agnostic as to industry (i.e., a company's ESG rating is relative to the standards and performance of a company's industry peers), this ban will need to be addressed separately in the Investment Policy. Reinstating this ban will eliminate two Eligible Issuers from the current universe of thirty-five (35).

Recommended changes to current Investment Policy [new language is underlined]:

F. Corporate Indebtedness (Commercial Paper and Corporate Bonds) Issued by United States Corporations in Compliance With the Provisions of ORS 294.035

Combined Corporate Indebtedness:

- Maximum Percent of Portfolio: 35%
- Maximum Percent of Portfolio Per Issuer (includes securities issued by Parent Company and all subsidiaries): 5%

MSCI ESG rating of the Parent Company issuer must be at least BBB at the time of purchase.

Direct investments are not to be made in debt securities issued by companies on the Carbon Underground 200 TM list (as updated).

~~From time to time City Council may approve the addition of specific company names to its Do Not Buy list, at which point investment officers are not permitted to purchase securities of the companies that have been added; any existing positions of these companies need not be sold. From time to time City Council may approve the removal of specific company names from its Do Not Buy list, at which point investment officers are permitted to purchase securities issued by these companies.~~

F.1. Commercial Paper (CP)

- Minimum Ratings: Short-Term (ST) ratings of A-1, P-1, F-1 (or better) by any Nationally Recognized Statistical Rating Organizations (NRSROs) of the Securities and Exchange Commission (SEC) at the time of purchase. In the event of a split rating, the lowest rating will be utilized to evaluate investment portfolio compliance.
- Maximum Maturity 270 Days

F.2. Corporate Bonds

- Minimum Ratings: Short-Term (ST) or Long-Term (LT) bond ratings of AA- or Aa3 (or better), equivalent to the security's maturity, by at least two Nationally Recognized Statistical Rating Organizations (NRSROs) of the Securities and Exchange Commission (SEC) at the time of purchase.
- When the corporate indebtedness is issued by an Oregon entity, the rating must be A- or A3 (or better), equivalent to the security's maturity at the time of purchase, by at least two NRSROs.
- Includes US dollar-denominated discount notes and bonds of Supranational organizations.
- Maximum Maturity 3 Years

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IMPACT STATEMENT

Legislation title: Adopt City of Portland Investment Policy (Resolution)

Contact name: Jennifer Cooperman, City Treasurer

Contact phone: 503-823-6851

Presenter name: Jennifer Cooperman

Purpose of proposed legislation and background information:

Oregon law pertaining to the investment of public funds (ORS 294.135) requires the City to adopt an Investment Policy annually since the City makes investments that exceed 18 months in maturity. This annual adoption requirement is included in Section II of the Investment Policy itself, which is attached as Exhibit A.

The Investment Policy outlines the framework and criteria for managing the City's investment program.

On December 21, 2016, Council approved Resolution #37262 which directed the City Treasurer to (1) suspend direct investments of City cash assets in corporate debt securities until Council has approved the City's Investment Policy in 2017, (2) amend the City's Investment Policy by adding a restriction on additional direct investments in corporate securities to those meeting a to-be-determined minimum environmental-social-governance (ESG) rating at the time of purchase as determined by a third-party ESG investment research provider, and (3) return to Council for approval of the City's Investment Policy by April 1, 2017.

The changes to the City's current Investment Policy are:

- Section I – changes the estimated average balance of investments to reflect actual experience;
- Section III – Corporate Indebtedness: clarifies which securities are included in the 5% per issuer limit; adds a required minimum ESG rating; adds exclusions for certain direct investments that were approved by prior Council actions; and, deletes references to the City's Do-Not-Buy-List.

Financial and budgetary impacts:

The Investment Policy continues to reflect prudent strategies the City has utilized in the past, which are designed to (1) protect the City's financial assets, (2) provide liquidity to meet the City's cash needs, and (3) enable the City to generate a market rate of return from its investment activities.

Reductions to the investible universe of corporate securities may reduce investment earnings on the portfolio as explained in the attached memo.

Community impacts and community involvement:

There may be an indirect community impact if there are reduced investment earnings, which equate to reduced money for bureaus and their services to the community.

Both the Temporary Socially Responsible Investments Committee (2014) and the more recent Socially Responsible Investments Committee (2016) provided recommendations related to the City's corporate securities investments. Both committees were composed of community members and both had time during their meetings dedicated to public input. Much was learned from both committees, and their work was considered and impacted the City Treasurer's recommendations in this resolution.

- Recommendations from the temporary Socially Responsible Investing Committee (2014) can be found here: <https://www.portlandoregon.gov/OMF/article/496831>
- Recommendations from the most recent Socially Responsible Investing Committee (2016) can be found here: <https://www.portlandoregon.gov/omf/71697>

Budgetary Impact Worksheet**Does this action change appropriations?**☐ **YES:** Please complete the information below.☒ **NO:** Skip this section

Fund	Fund Center	Commitment Item	Functional Area	Funded Program	Grant	Sponsored Program	Amount