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Agenda Date: 8/11/2020
Item No.: 2.8.

BOARD AGENDA MEMORANDUM

SUBJECT:
Approve the Revised Fiscal Year 2020-2021 Santa Clara Valley Water District Investment Policy and Approve an Update Executive Limitations Policy EL 4.7, Financial Management. (Continued from July 28, 2020)

RECOMMENDATION:

A. Approve the Revised Fiscal Year 2020-2021 Santa Clara Valley Water District Investment Policy;
B. Approve an update to Executive Limitation Policy EL-4.7, Financial Management; and
C. Provide additional direction to staff as necessary.

SUMMARY:
Executive Summary
Staff recommends that the FY 2020-21 Investment Policy be amended as follows:

3.5.1 California Bank Investments

Keeping investments to local banks, within the Bay Area, to keep money at home and jobs local; invest only in banks with below $10 billion in assets; and keep a minimum of 4% of liquid cash in banks with up to $10 billion in assets and 1% in banks with up to $2 billion in assets for a limit of 5 years (short term) at the discretion of the treasurer; such investments may be in the form of collateralized deposits, FDIC/NCUA insured CDs, CDARS, or any other legally allowable deposits.

7.13.3 Prohibited Banks

No investments will be made in any banks who do not have an Environmental, Social and Governance (ESG) ranking at or better than the “Average/Medium” category by at least one of the professional ESG research companies such as Sustainalytics, or other equivalent rankings published by other ESG research firms. Small and local banks/credit unions located within the nine Bay Area counties with total assets at or below $10 billion are exempt from this provision.

To ensure consistency in implementing the ESG policy related to banking and financial management, staff also recommends that Executive Limitation 4.7 Financial Management be updated to include the following new section:

E.L. 4.7.7
Valley Water shall not do business with banks who do not have an ESG ranking at or better than the "Average/Medium" category by at least one of the professional ESG research companies such as Sustainalytics, or other equivalent rankings published by other ESG research firms. Small and local banks/credit unions located within the nine Bay Area counties with total assets at or below $10 billion are exempt from this provision.

Board approval of the above amendments to the FY 2020-21 Investment Policy and Executive Limitation will establish a clear, objective, legally valid and transparent policy to guide Valley Water's investment and business activities in the banking sector.

Background
On May 12, 2020, the Santa Clara Valley Water District Board (Board) adopted the Fiscal Year 2020-21 Investment Policy in compliance with California Government Code (Government Code) Sections 53607 and 53608. As part of the approval, the Board provided feedback regarding three key issues summarized below and directed staff to return with additional information and recommendations to address the Board's concerns.

May 12, 2020 Board Feedback:
1. Do not invest in banks and financial institutions that support human rights violation, such as recent cases involving Bank of America and Wells Fargo Bank that are funding companies that have extractive human rights violations; follow the Global Sullivan Principles to avoid investing in companies that support environmental and human capital violations
2. Add a provision to invest up to 1% of the portfolio in smaller banks and credit unions that have equal to or less than $2 billion in total assets, and 4% of the portfolio in small banks with a maximum of $10 billion in total assets.
3. Add the Certificate of Deposit Account Registry Service (CDARS) program to increase local bank investments

Furthermore, on June 23, 2020, the Board provided additional feedback as follows: (1) update the Investment Policy to state that Valley Water shall invest a minimum of 1% of the portfolio in smaller banks/credit unions that have up to $2 billion in total assets, and a minimum of 4% of the portfolio in banks/credit unions with up to $10 billion in total assets. The total investments in banks/credit union shall not exceed the maximum limit pursuant to the California Government Code (currently 30%, as amended); and (2) the Board directed staff to conduct additional research on developing a method to evaluate the Environmental, Social, and Governance (ESG) policies for the Investment portfolio, including investments in the banking sector.

Staff researched each of the above issues raised by the Board and summarized the findings and recommendations in the corresponding sections below. The recommended changes to the Investment Policy are incorporated in Attachment 1 and delineated with red font text to highlight the changes for Board consideration. The Powerpoint presentation provided in Attachment 2 highlights the recommended changes as well as a high-level summary of the ESG evaluation criteria that is examined by professional research firms to establish an objective and transparent ESG policy to incorporate into Valley Water's Investment Policy.

Analysis

1. Investment Prohibition Against Banks that Violate Human Rights and Environment

Directors Santos and Kremen both referenced the Sullivan Principles in the May 12, 2020 and June 23, 2020 board meetings. The Sullivan Principles are the names of two corporate codes of conduct developed by the African-American preacher Rev. Leon Sullivan, promoting corporate social responsibility. The original Sullivan principles were developed in 1977 to apply economic pressure on South Africa in protest of its system of apartheid. The new global Sullivan principles were jointly unveiled in 1999 by Rev. Sullivan and United Nations (UN) Secretary General Kofi Annan. The new and expanded corporate code of conduct, as opposed to the originals' specific focus on South African apartheid, were designed to increase the active participation of corporations in the advancement of human rights and social justice at the international level. In 2011, the UN updated its guidance on these matters with the "UN Guiding Principles on Business and Human Rights"[1] which are guidelines for States and companies to prevent, address and remedy human rights abuses committed in business operations.

There are several professional ESG research firms that provide ESG rankings for various business sectors. BankTrack covers the 50 large international banks and evaluates the ESG rankings against the UN Guiding Principles (BankTrack's Human Rights Benchmarking Report[2]). BankTrack published the third edition of the report on May 6, 2020 which evaluated 50 of the latest private sector commercial banks globally against a set of 14 criteria based on the UN Guiding Principles. The criteria examine four aspects of banks' implementation of the Guiding Principles: their policy commitment, human rights due diligence process, reporting on human rights and their approach to access to remedy. Professional ESG research firms such as Sustainalytics and MSCI, among others, provide broader and more in-depth ESG rankings for over 10,000 public and private companies across all business sectors, including both U.S. and international banks. Given that each professional research firm utilizes its own proprietary ESG ranking methodology, staff recommends that the Board consider the following update to the Investment Policy to establish a transparent policy in determining which banks to prohibit in the Valley Water investment portfolio.

7.13.3 Prohibited Banks

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The estimated annual ESG research subscription fee is between $15,000 to $35,000, depending on the level of research and analysis Valley Water subscribes. This cost estimate is based on the fee quote from Sustainalytics[3], which provides ESG ratings for over 10,000 public and private companies, including most banks in the United States. A sample Sustainalytics report for Deutsche bank is provided in Attachment 3, which provides an example of a bank that would be prohibited from the Valley Water investment portfolio due to the ESG rating that is worse than the medium risk level.

2. Invest in small/local banks and credit unions located in the Bay Area

In Fiscal Year 2017-18 the Board directed staff to add section 3.5 California Certificates of Deposit to the Investment Policy to invest 5% of the portfolio in local banks with total assets up to $10 billion. To meet the Board's direction, staff downloaded the list of banks and credit unions located in the nine Bay Area Counties that meet the criteria from the Federal Deposit Insurance Corporation (FDIC) and National Credit Union Administration (NCUA). A list of 90 banks and credit unions was prepared by staff, and attention was focused on banks and credit unions located in the Counties of Santa Clara, Alameda, San Mateo and San Francisco. To-date the District investment portfolio has over $27 million or approximately 5% of the portfolio in these small local banks, of which $5.9 million or approximately 1% is invested in the following small banks and credit unions with under $2 billion in total assets: Alliance Credit Union (total assets $552 million), Bank of San Francisco (total assets $397 million), Community Bank of the Bay (total assets $494 million), and Meriwest Credit Union (total assets $1.8 billion).

Given the Board's direction to specify investments in small local banks, staff recommends amending the Investment Policy as follows (change highlighted in red):

3.5 California Bank Investments

To the extent permitted by California Government Code, while meeting Valley Water's investment objectives for safety, liquidity and yield, Valley Water encourages investing in Certificates of Deposit issued by California based banks, up to the Federal Deposit Insurance Corporation limit at the time of such investment which is currently set at $250,000, and up to 30% of the portfolio, as amended

3.5.1 Keeping investments to local banks, within the Bay Area, to keep money at home and jobs local; invest only in banks with below $10 billion in assets; and keep a minimum of 4% of liquid cash in banks with up to $10 billion in assets and 1% in banks with up to $2 billion in assets for a limit of 5 years (short term) at the discretion of the treasurer; such investments may be in the form of collateralized deposits, FDIC/NCUA insured CDs, CDARS, or any other legally allowable deposits.

3. Add CDARs to increase investments in local banks

In 2018 as part of staff's ongoing efforts to meet the Board's direction to invest in local banks, staff researched extensively on whether the Certificate of Deposit Account Registry Service (CDARS) (www.cdars.com <http://www.cdars.com>) would be an appropriate tool for Valley Water to utilize to increase our investments in CDs. Staff held several conference calls with the Promontory Interfinancial Network (Promontory) that developed the CDARs platform to learn about this platform and assess whether it would meet Valley Water's business needs. CDARs acts as an intermediary to aggregate CD offerings from the thousands of banks that are members of the CDAR network. To allow additional flexibility in utilizing the CDARs program, staff proposes to amend the Investment Policy, section 3.5.1, to allow the use of CDARS program (see above). This is consistent with the California Government Code (Government Code) Sections 53607 and 53608.

Footnotes:

1. <https://www.business-humanrights.org/en/un-guiding-principles>
2. <https://www.banktrack.org/campaign/banks_and_human_rights>
3. <https://www.sustainalytics.com/>

FINANCIAL IMPACT:
The cost for subscribing to professional ESG research is estimated between $15,000 to $35,000 per fiscal year, to be funded by FY 2019-20 budget savings in the Finance division (project no. 60221003); no budget adjustment is necessary for FY 2020-21.

CEQA:
The recommended action does not constitute a project under CEQA because it does not have the potential for resulting in direct or reasonably foreseeable indirect physical change in the environment.

ATTACHMENTS:
Attachment 1: Revised Investment Policy
Attachment 2: PowerPoint
Attachment 3: Sample ESG Evaluation Report for Deutsche Bank

UNCLASSIFIED MANAGER:
Darin Taylor, 408-630-3068