

OREGON STATE TREASURER TOBIAS READ

Stewardship

CORPORATE GOVERNANCE & ESG • 2018

Photo: Wind Power in Sherman County, Gary Halvorson, Oregon State Archives



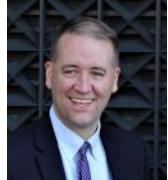
OREGON
STATE
TREASURY





OREGON STATE TREASURER TOBIAS READ

As a responsible investor, we seek sustainable long-term returns to help ensure Oregon keeps its promises



Sustainable investment returns are critical to the long-term health of the global financial and real asset portfolio we manage at the Oregon Treasury. And in this case sustainable means helping ensure Oregon keeps its promises to public servants and other trust fund beneficiaries.

We are investing for the future, and that requires considering an array of risks that can impact the value of holdings, over the long run. Among those factors that go beyond the balance sheet and income statement are Environmental, Social and Governance (ESG) risks. An infinite investment horizon means we have to think about what matters decades into the future.

As a responsible investor, we are leading efforts to account for these risks and to press corporations to make decisions that improve long-term value. Our portfolio will benefit from predictable market structures and companies that prioritize shareholders, and their long-term investments.

To achieve these goals, we use our status as a shareholder and our corporate governance program. Our priorities include advancing shareholder rights, improving board diversity, and recognizing and acting on material risks and opportunities connected to the environment and climate change. We are also working to better quantify “social” risks connected to workforce safety, cybersecurity, and customer treatment.

In 2018, I hosted the Oregon Sustainable Investing Summit to highlight ways institutional investors and the public can make investing decisions that improve long-term returns and advance sustainability. Also in 2018, Treasury hired its first-ever investment officer focused on investment risks and opportunities associated with ESG factors.

Sustainable investment success supports retirement security for Oregon pension fund beneficiaries, and advances the interests of taxpayers in the form of efficient and smart government. In addition, every person who invests in the markets benefits from our corporate governance program’s efforts to empower shareholders and improve transparency. Thank you for your interest in Treasury’s stewardship efforts.

ENHANCING VALUE

Corporate Governance is the process and rules under which a company is managed on the behalf of an array of internal and external stakeholders. Good governance balances interests among management, shareholders, directors, employees, customers, suppliers, financiers, government and the community. As a shareholder, Treasury engages for governance measures that improve long-term corporate value.

Environmental, Social and Governance (ESG) criteria are measures of key elements of a company's performance. Environmental criteria consider how a company performs as a steward of the natural environment. Social criteria examine how a company manages relationships with its employees, suppliers, customers and the communities in which it operates. Governance deals with a company's leadership, executive compensation, audits, internal controls, and shareholder rights.

Oregon trust funds must be invested for the sole and exclusive long-term benefit of beneficiaries, and trust fund capital cannot legally be invested or divested to advance social, political or economic development goals. Consistent with this fiduciary obligation, Treasury engages via its corporate governance program to improve the economic sustainability, ESG profile and long-term profitability of companies in which it invests. Non-shareholders have no voting rights and no influence over the direction of public companies.

LEARN MORE



JENNIFER J. PEET, J.D.
Corporate Governance Director
Jennifer.Peet@ost.state.or.us



ANNA TOTDAHL
Investment Officer, ESG and Sustainability
Anna.Totdahl@ost.state.or.us



KARL CHENG
Senior Investment Officer,
Portfolio Risk and Research
Karl.Cheng@ost.state.or.us



KIM OLSON
Policy Director
Kim.Olson@ost.state.or.us



JAMES SINKS
Director of Communications and Stakeholder Relations
503-881-4747
James.Sinks@ost.state.or.us



SUSTAINABLE INVESTING SUMMIT

Oregon Treasury summit convened national leaders to highlight strategies for institutional investors and the public

Climate change is real -- and it is creating both risks and opportunities for investors large and small.

Those were key messages on Sept. 6 at the Oregon Sustainable Investing Summit, at which State Treasurer Tobias Read brought together an array of state and national financial leaders to discuss how investors can drive positive investment performance and environmental progress.

"For Oregonians and our investment portfolios' beneficiaries, sustainable investing is the future -- and the future can't wait," said Treasurer Read, who convened the summit and also announced that Treasury had already achieved a goal set in 2015 to double renewable energy holdings by 2020.

Keynote presenters included Gina McCarthy, former administrator at the U.S. Environmental Protection Agency and now Operating Advisor at Pegasus Capital Advisors; John Streur, President and Chief Executive Officer of Calvert Research and Management; Rukaiyah Adams, Chair of the Oregon Investment Council and Chief Investment Officer at Meyer Memorial Trust; and John Goldstein, Managing Director at Goldman Sachs Asset Management.

The increase in Oregon's renewable-related exposure is largely reflective of an evolving energy and environmental landscape, although specific investments in solar power

and other projects were highlighted at the summit. Another summit presentation focused on a national food service business in which Oregon's investment partner realized operating efficiencies and a commensurate increase in profitability, following the application of environmental and logistical improvements.

The Sept. 6 sustainability event outlined how Treasury is evaluating climate risks -- such as the recent hiring of the state's first investment officer devoted to analyzing Environmental, Social and Governance (ESG) risk factors -- and also how institutional investors are engaging as responsible shareholders to advance climate-related goals.

In addition, the summit gave individual investors a toolbox of ideas -- such as investing locally in sustainable bonds and clean tech startups -- to invest their own money in ways that match their values.

Other presenters and panelists came from an array of leading investment firms and service organizations including BlackRock, Sustainable Accounting Standards Board (SASB), KKR & Co., Dimensional Fund Advisors, State Street Global Advisors, Service Employees International Union, Pacific Pension & Investment Institute, VirtueLab, Sustainable Northwest, Council of Institutional Investors, Equilibrium Capital, Brookfield, and Stonepeak Infrastructure Partners.



Oregon led shareholder resolution at prescription opioid distributor, launched ESG research, and helped boost climate-related disclosures

State Treasurer Tobias Read called for more responsible compensation practices and accountability at pharmaceutical giant McKesson Corp., a prescription opioid distributor, via a shareholder resolution.



McKesson filed jointly by Oregon, the AFL-CIO Equity Index Fund, As You Sow, and the Zaitlyn Nienberg Family trust of California.

The proposal shined a spotlight on the company's compensation calculation formula, which historically has enabled executives to more easily hit performance targets and trigger incentive compensation bonuses.

The shareholder resolution was considered at the annual meeting in July, but did not garner a majority. That is not unusual for a first attempt. It may be resubmitted in 2019.

ESG Research: Treasury's Investment Division expanded its Portfolio Risk and Research team with the addition of Anna Totdahl, Treasury's first

investment officer focused on ESG factor research. The efforts will fall into several focus areas: factor, asset class and sector risks; peer and association engagement activities; and interactions with asset managers and data providers to develop assessment protocols and metrics.

Shareholder action: Oregon Treasury is part of a coalition – whose members jointly manage more than \$4.8 trillion – that released a set of Principles for a Responsible Civilian Firearms Industry. The five principles provide a framework to align shareholder interests with companies that make, distribute and sell products within the firearms industry. Goals include improving business practices surrounding gun safety and reducing related investment risks.

The signatories stress that they believe in the rule of law and respect the 2nd Amendment of the U.S. Constitution. At the same time, "as asset owners and asset managers, we have a duty to our beneficiaries who depend on us for fi-

nancial security; such obligations compel us to assume responsibility for reducing risks that we and our beneficiaries face if and when we hold a financial interest in both private and public firearms related enterprises."

Climate risk: Starting with a 2009 letter to the SEC on the definition of "material" with respect to environmental risk factors, followed by a series of increasingly popular proxy votes in favor of better disclosure of environmental risks, energy companies now take sustainability more seriously. This change is evidenced in a series of risk reports in 2018 from companies such as Shell Oil, BP and Occidental Petroleum.

National leadership: Corporate Governance Director Jennifer J. Peet, J.D., was elected to the board of the Council of Institutional Investors. John Hershey, Director of Alternative Investments, was elected to the board of the Institutional Limited Partner Association.

CORPORATE GOVERNANCE & ESG STRATEGIES



Treasury interacts with company executives, directors and financial industry regulators in pursuit of shareholder-oriented governance practices and improvements in financial reporting. In 2018, Treasury sponsored a shareholder resolution to improve compensation calculus at McKesson Corp.



As a fiduciary, Treasury must have a factual basis to engage in support of sustainability and long-term performance improvements. New ESG-focused capacity at Treasury is fortifying the research process by analyzing material risks across portfolio holdings and sectors.



The Treasurer takes an active role in encouraging lawmakers to protect consumers and monitor the financial sector. The quality of regulation and corporate governance can affect the long-term value of investments, and transparent market structures ensure accurate and timely valuations.



As a global investor with thousands of international shareholder positions, Oregon trust funds are entitled to proxy votes, which have economic value. Shareholders have a voice in management decisions, whereas non-shareholders do not.



Public awareness can be a motivator for better stewardship. In 2018, Treasury launched a new social media outreach effort to highlight corporate governance. Now you can follow noteworthy engagements on Twitter at #OregonProxy.



To seek sustainable returns, we collaborate with other investors and public companies, such as a new Oregon roundtable launched in 2018. We also work with peer funds through participation in organizations like the National Association of State Treasurers and the Institutional Limited Partner Association.



As a last resort, Oregon files lawsuits to demand accountability. Between 2013 and 2018, securities litigation efforts by the Treasurer and Attorney General returned more than \$22 million to the pension fund.

COALITIONS AND PARTNERS



EXAMPLES OF ENGAGEMENT AND SHAREHOLDER ACTION



Equifax Inc. (EFX)
Stock Exchange: NYSE
OPERF shares: 36,998
Value: \$3.4 million

ACCOUNTABILITY/COMPENSATION: A massive data breach at Equifax exposed the personal and financial information of millions of consumers. Treasury considers cybersecurity a social risk factor, and failing to address it can lead to major costs that undermine long term value. Oregon trust funds voted against the executive compensation package and opposed three board directors on the technology committee for failing to adequately shield data and for poor crisis management, which put people, the company and shareholders at unnecessary risk.



Navient Corp. (NAVI)
Stock Exchange: NASDAQ
OPERF shares: 510,814
Value: \$4.5 million

TRANSPARENCY: Oregon trust funds joined the quest for answers from student loan servicer Navient in the wake of allegations about an array of abusive tactics. A shareholder proposal at the company's annual meeting called for a report to help shareholders better understand how the company is managing and mitigating risks associated with the massive student debt crisis. Manipulative loan tactics prevent students from pursuing their goals and Treasurer Read is working to protect investments in this company, and also this vulnerable population.



30 Percent Coalition
Network of investors and asset managers with combined \$3.2 trillion

BOARD DIVERSITY: The Oregon Treasurer is supporting an ongoing direct engagement to interface with companies where women make up less than 30% of boards of directors.

The Coalition's collaborative institutional investors' initiatives had, through the end of 2018, persuaded more than 180 companies to appoint a first woman to their boards. Oregon Treasury Corporate Governance Director Jennifer Peet completed a term on the organization's board in 2018.



Exxon Mobil Corp. (XOM)
Stock Exchange: NYSE
OPERF shares: 1,189,223
Value: \$81.1 million

CLIMATE RISK AND DISCLOSURE: A majority of shareholders including OPERF and mutual fund giant Blackrock voted at the 2017 annual meeting in support of enhanced disclosure about impacts of technology and global climate change policies. In response to shareholders, the company produced its first Sustainability Report in 2018 and noted that "Climate change is a global issue that requires the collaboration of governments, companies, consumers and other stakeholders."



Costco Wholesale Corp. (COST)
Stock Exchange: NASDAQ
OPERF shares: 373,981
Value: \$76.2 million

HUMAN CAPITAL: To get a better understanding of workforce-related opportunities and challenges that can face retailers – and how to analyze and measure them – Treasury engaged with Costco Wholesale, a company that is widely considered a sector leader and a highly regarded employer. These sorts of collaborative fact-finding efforts will assist Oregon in better reviewing other companies, and can lead to more sustainable returns for fund beneficiaries.



Tesla Inc. (TSLA)
Stock Exchange: NASDAQ
OPERF shares: -45,153
Value: \$15.0 million

BOARD ACCOUNTABILITY: Treasury held a short position in Tesla as of Dec. 31, 2018. Treasury joined with a coalition of investors who combined hold \$773.8 billion in assets and formally requested new representation on the company's board of directors, due to lack of responsiveness to a spate of fundamental governance concerns as well as improper social media disclosures by the CEO. The request included separating the roles of chief executive and board chair, improving diversity, and adding board members with manufacturing and regulatory expertise.

CORPORATE GOVERNANCE PRIORITIES 2019

Oregon will continue advancing efforts to improve material ESG risk-related data



*John D.
Skjervem,
Chief
Investment
Officer*

To promote and improve the integration of ESG factors in the investment decision making process, Chief Investment Officer John D. Skjervem is helping lead a key effort to incorporate these factors in financial reporting standards.

The work is directed by the Sustainability Accounting Standards Board (SASB), based on the premise that ESG factors, when material, are integral to corporate financial performance and investors' regular evaluation.



Mr. Skjervem serves as vice chair of the SASB Investor Advisory Group, which comprises leading asset owners and asset managers who recognize the need for consistent, comparable and reliable disclosure of material and decision-useful ESG information.

With the development of these standards, SASB members including Oregon Treasury hope to foster more holistic corporate governance practices, which ultimately will lead to more sustainable business models.

TREASURER READ: ELEVATE ATTENTION TO 'S' FACTORS

Companies succeed when they respect their employees and customers. Treasurer Read is asking companies and the U.S. Securities and Exchange Commission to support stronger and more uniform reporting on social risk factors, which could then foster better decisions. Without progress, public attention about these factors could result in unproductive political pressure on institutional investors, he said.

GLASS LEWIS REHired AS PROXY AGENT

Treasury employs a specialized firm to help research public companies and manage votes, but Congress could intrude

As part of the Oregon Investment Council's investment and management beliefs, the Council highlights the value of casting votes as a shareholder in public companies.

To facilitate this effort, Treasury in 2018 rehired San Francisco proxy advisory firm Glass Lewis & Co, to help accumulate data about thousands of corporations and corporate board of director nominees. The information informs Treasury's decisions, and helps ensure

votes are cast for the Oregon Public Employees Retirement Fund in alignment with a matrix of shareholder priorities.

Proxy advisory firms like Glass Lewis offer important services to major institutional investors including the Oregon Treasury. However, these firms could be undercut by efforts in Congress, at the urging of some interests, who say the firms give certain shareholders too much influence.



Glass Lewis has opened a proxy program research office in Kansas City.

SECURITIES LITIGATION

National settlement recouped \$430,399 for Oregon pension fund

Oregon was part of a national settlement involving a number of financial industry giants for wrongly manipulating a key interest rate on international short-term loans.

The wrongdoing came at the expense of consumers worldwide, as well as large institutional investors such as the Oregon Public Employees Retirement Fund.

The participating global banks pleaded guilty and paid major fines -- and a coalition of state attorneys general subsequently entered negotiations to recoup losses, on behalf of State Treasurers and state-managed investments.

In a settlement announced in October with Germany-based Deutsche Bank AB, the Oregon pension fund recouped \$430,399.

Deutsche Bank is one of several global banks that admitted to manipulating the London Interbank Offered Rate, or LIBOR, until the practice was shut down amid the Global Financial Crisis. Settlement talks are ongoing with several of them.

Barclays reached an earlier LIBOR-manipulation settlement with Oregon, worth \$305.578.

2018 PROXY VOTING REPORT

TOTAL SHARES – OPERF

9,500	74	2.2 B
public companies	countries	shares

ANNUAL MEETINGS PARTICIPATED

7,638	8,981	9,453
2016	2017	2018

TOTAL BALLOTS CAST

12,432	15,227	16,963
2016	2017	2018

RESOLUTIONS CONSIDERED—2018

MANAGEMENT

88,014
Supported 82.3%

SHAREHOLDER

777
Supported 41.4%

OREGON-SUPPORTED RESOLUTIONS, BY TYPE

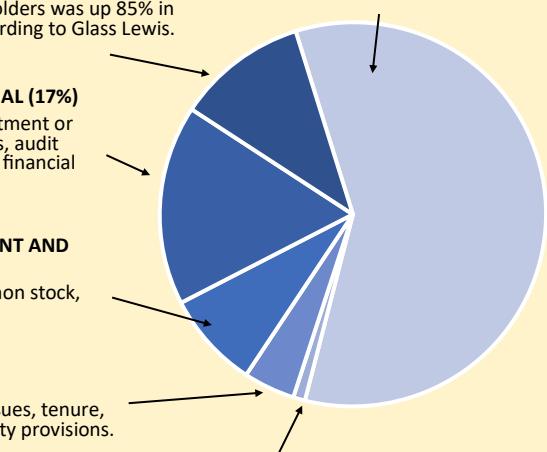
BASED ON 72,733 TOTAL "YES" VOTES

COMPENSATION (11%)

Executive and board salaries, Say-on-Pay, stock options, bonuses, golden parachutes. The number of rejected "Say on Pay" votes by shareholders was up 85% in 2018 from 2017, according to Glass Lewis.

BOARD-RELATED (59%)

Includes board size, diversity, committees, elections, indemnification of directors.



AUDITS AND FINANCIAL (17%)

Audit-related, appointment or ratification of auditors, audit fees, special auditors, financial statements.

CAPITAL MANAGEMENT AND MERGERS (8%)

Issues involving common stock, dual-class shares.

GOVERNANCE (4%)

Board qualification issues, tenure, training, super-majority provisions.

SOCIAL, ENVIRONMENT AND OTHER (1%)

Includes environment, animal welfare, product responsibility, worker conditions, drug pricing, political spending.

FIDUCIARY DUTY TO BENEFICIARIES

Treasury manages Oregon's trust fund portfolio in alignment with the legal and fiduciary obligations of the Oregon Investment Council (OIC). The Council is a six-member fiduciary board that sets policy for all state investment funds.

The Council also establishes overarching investment beliefs that guide both long-term strategy and daily implementation efforts. Those beliefs provide a foundation for staff's various investment activities and Treasury's corporate governance program.

In accordance with OIC policies, Treasury's investment mandate for Oregon trust funds is to maximize long-term returns on a risk-adjusted basis for beneficiaries such as schoolchildren, injured workers, and public employees and retirees. Treasury also moni-

tors and manages various operating, investment and compliance risks.

Treasury takes seriously the opportunity and obligation to act as a responsible investor and engage all marketplace participants in support of improved governance and better management accountability. Investor-friendly regulations such as better reporting transparency will benefit every Oregonian who relies on or is exposed to financial markets.

The Council has directed Treasury to engage in pursuit of sustainable, long-term performance, via proxy voting and other means, and considers divestment an abdication of its fiduciary obligations with potentially harmful impacts on long-term investment returns.

