Oregon Investment Council

Spring Workshop

May 28, 2014
1:00 PM

Hotel deLuxe
729 S.W. 15th Avenue
Portland, OR 97205

Dick Solomon
Chair

John Skjervem
Chief Investment Officer

Ted Wheeler
State Treasurer

OREGON INVESTMENT COUNCIL

Spring Workshop Agenda

May 28, 2014
1:00 PM

Hotel deLux
729 S.W. 15th Avenue
Portland, OR 97205

Time	**A. Information Items**	**Presenter**	**Tab**
1:00-1:05	**1. Introduction**	**John Skjervem** *Chief Investment Officer* Oregon State Treasury	**1**
1:05-1:45	**2. Principles of Responsible Investing**	**Sonal Mahida** *U.S. Network Manager* United Nations	**2**
1:45-2:25	**3. Public Markets Panel**	**Jean Rogers, PhD** *CEO and Founder* Sustainability Accounting Standards Board **Chad Spitler** *Global Chief Operating Officer, Corporate Governance and Responsible Investment* BlackRock	**3**
2:25-2:45	**4. Private Market Applications**	**Kenneth B. Mehlman** *Global Head of Public Affairs* Kohlberg Kravis Roberts	**4**
2:45-2:55	**-------------------- BREAK --------------------**		
2:55-3:15	**5. Power Generation Dynamics**	**John King** *Executive Vice President* LS Power	**5**

3:15-3:35	**6.**	**Constituents and Consultants**	**Michael Ring** *Assistant Director, Capital Stewardship Program* SEIU **Janet Becker-Wold, CFA** *Senior Vice President* Callan Associates Inc. **Allan Emkin** *Managing Director* Pension Consulting Alliance, Inc.	**6**
3:35-4:00	**7.**	**A Peer Fund's Approach**	**Janine Guillot** *Former Chief Operating Investment Officer* CalPERS	
	8.	**Speaker Biographies**		**7**
	9.	**Appendix: Policy and Legal Framework**		**8**

TAB 1 – INTRODUCTION

OIC Spring Workshop

Introduction

May 28, 2014

John D. Skjervem
CHIEF INVESTMENT OFFICER
OREGON STATE TREASURY

work·shop

1. A small establishment where manufacturing or handicrafts are carried on

2. A usually brief intensive educational program for a relatively small group of people that focuses especially on techniques and skills in a particular field

Source: Merriam-Webster (m-w.com)

Objectives

1. Understand recent developments in ESG (Environmental, Social & Governance) practices

2. Gain insight into the application of ESG practices among select, existing OPERF investment managers

3. Use these learnings to inform subsequent Investment Beliefs discussions

Source: Merriam-Webster (m-w.com)

TAB 2 – PRINCIPLES OF RESPONSIBLE INVESTING

Principles for Responsible Investment

Sonal Mahida, US Network Manager

Principles for Responsible Investment

LOOKING AT THE WHOLE PICTURE

- Supply chain risks
- Reputational and Brand Impact
- Operational or product delays and lost productivity
- Potential for impaired assets
- Human Capital: Recruiting necessary talent
- Winning bids/License to operate
- Regulatory and legislative risks
- Operating costs

DRIVERS OF RISKS ACROSS LONGER INVESTMENT HORIZON

- Global 500 companies identify exposure to substantive business risks driven by water related impacts (current to 5 years)[1]
- Oil and Gas companies identify environmental, health and safety incident combined with regulatory compliance as the top risk in 2013 for that year and looking forward to 2015[2]
- Conflict with local communities can lead to delays costing $20 million a week and in aggregate up to double digit % of annual operating profits over 2 years[3]
- Bank of America's $4B purchase of Countrywide Financial cost the company an additional $40B in "real-estate losses, legal expenses and settlements with state and federal agencies" [4]

1 CDP Global Water Report 2013
2 Business Pulse: Oil and Gas Report, Ernst & Young 2013
3 **The costs of conflict with local communities in the extractive industry. Rachel Davis** *(Corporate Social Responsibility Initiative, Harvard Kennedy School, Harvard University)* and **Daniel M. Franks** *(Centre for Social Responsibility in Mining, The University of Queensland, Australia)*
4 BofA's Blunder: $40 Billion-Plus, Wall Street Journal July 1, 2012

MORE EXAMPLES…

BusinessDay
BDlive

“Call for Lonmin’s mining licence to be suspended.”

The New York Times

“US poised to announce $13 billion JPMorgan settlement.”

Bloomberg

“Retail News Bangladesh Labor Protests on Wages Shut 100 Garment Factories.”

REUTERS

“BP shares drop as oil spill worsens”

FT FINANCIAL TIMES

“China accuses GlaxoSmithKline of bribing officials over prices… Sales face growing pressure.”

THE WALL STREET JOURNAL.

“UBS to pay $1.5 billion to settle Libor charges.”

THIS IS ABOUT BEING A BETTER INVESTOR

PERFORMANCE

not philanthropy

"The high-sustainability companies dramatically outperformed the low-sustainability ones in terms of both stock market and accounting measures"

Harvard Business School

RISK MANAGEMENT

not breach of fiduciary duty

"As we note above, the links between ESG factors and financial performance are increasingly being recognised. On that basis, integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions."

Freshfields Bruckhaus Deringer

RETURNS

not sacrifice

"There are positive, strongly statistically significant positive abnormal returns associated with going long good corporate governance firms and shorting those with poor governance."

Yale School of Management

DIVERSE APPROACHES

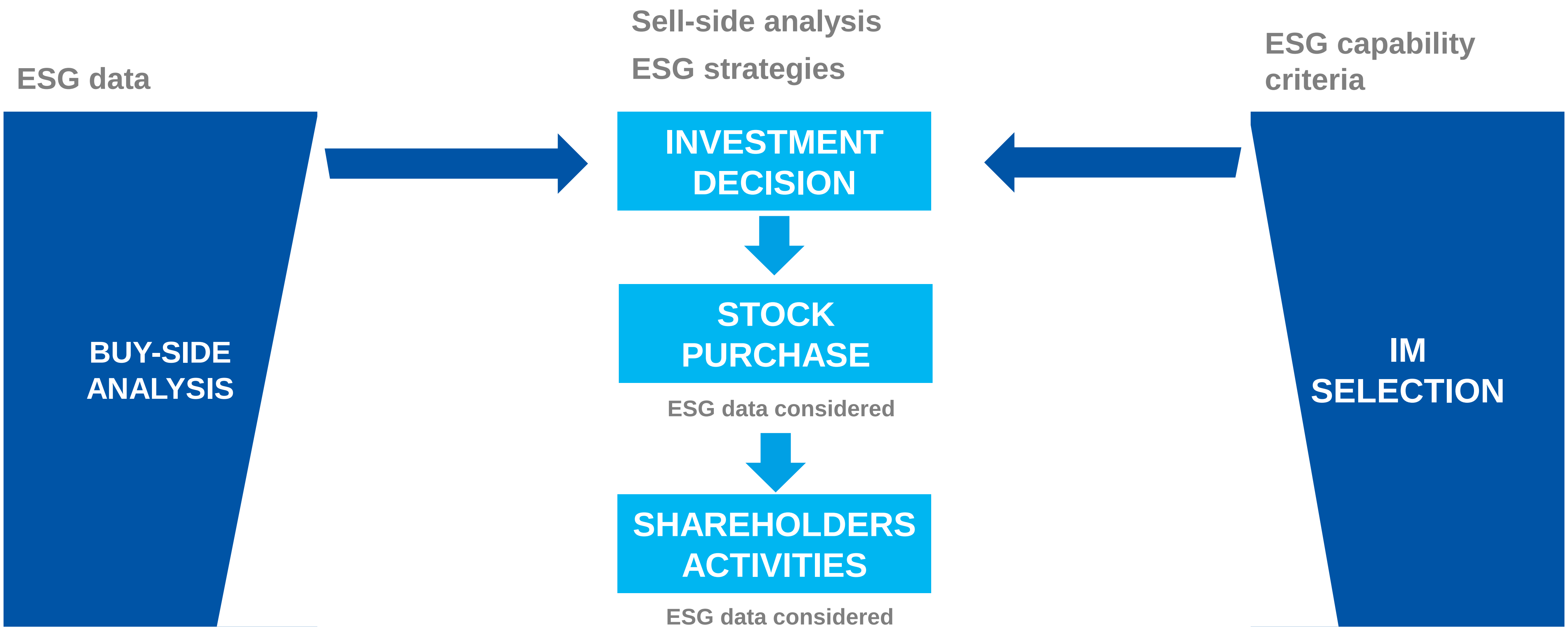
not just excluding "unethical" investments

"We believe that ESG analysis should be built into the investment processes of every serious investor and into the corporate strategy of every company that cares about shareholder value."

Deutsche Bank

SPECTRUM OF STRATEGIES: DECISION POINTS

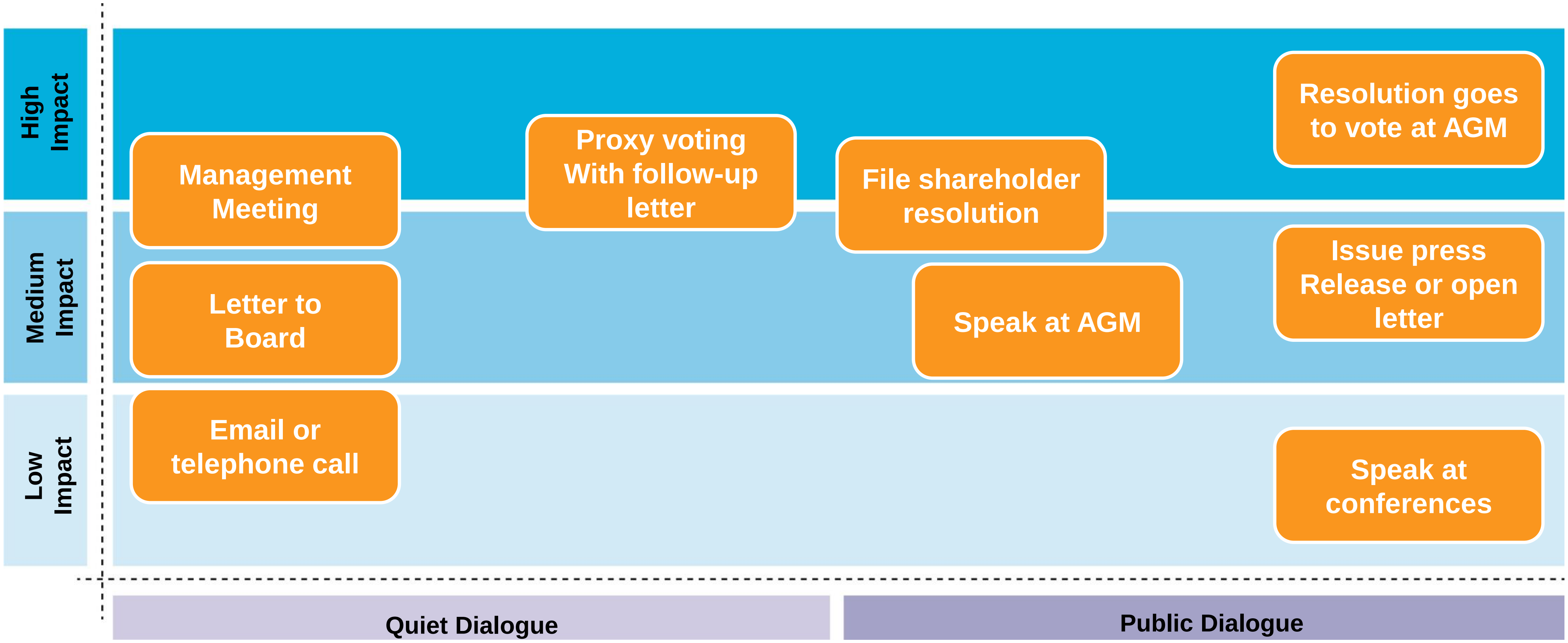
ASSET OWNER INVESTMENT PROCESS



SPECTRUM OF STRATEGIES: VALUATION AND DECISION MAKING

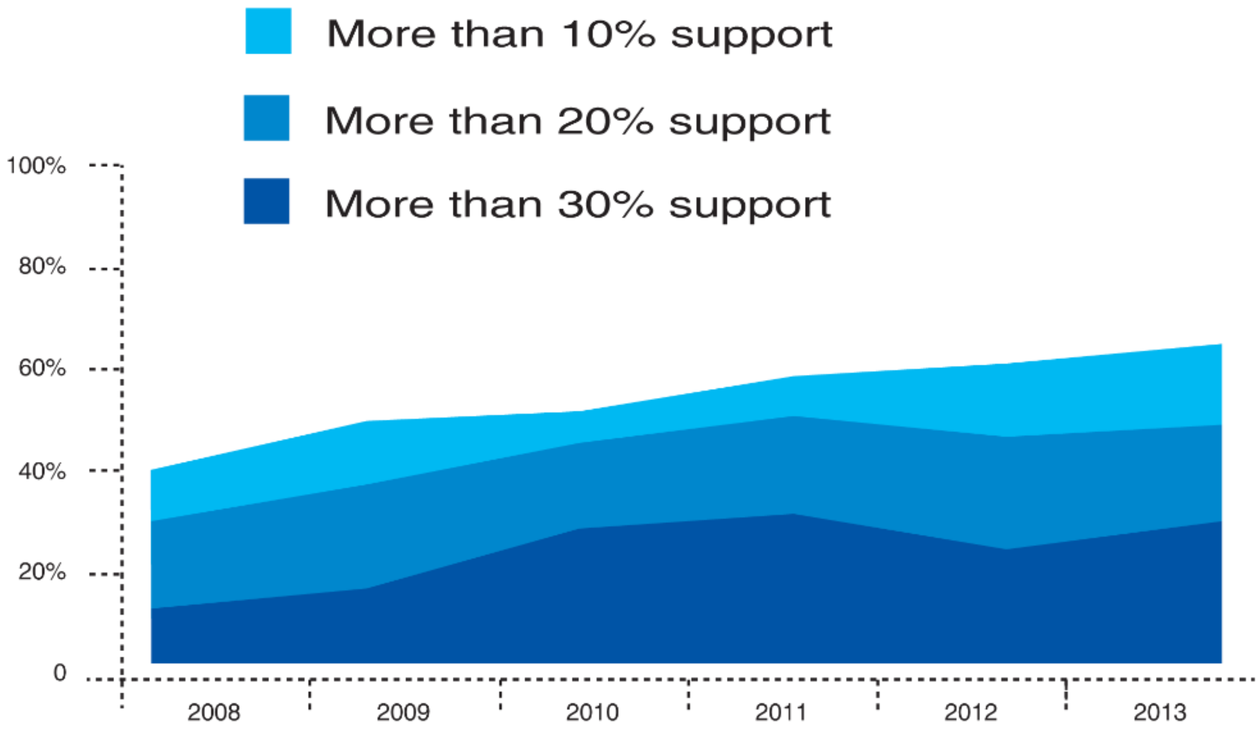
Valuation and investment decision making: Understanding how analysts are integrating ESG considerations into valuation

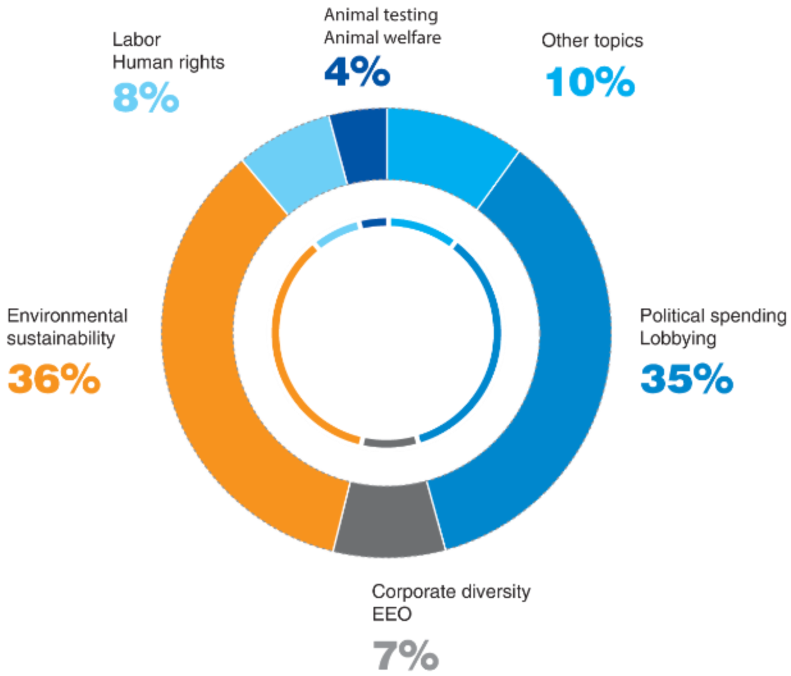
SPECTRUM OF ENGAGEMENT STRATEGIES



...AND INVESTORS ARE PAYING EVER INCREASING ATTENTION

Voting support for environmental and social shareholder proposals by threshold





AT A GLANCE

Launched in April 2006 at the NYSE, the Principles for Responsible Investment has:

2

UN PARTNERS:

UNEP FINANCE INITIATIVE
UN GLOBAL COMPACT

1200

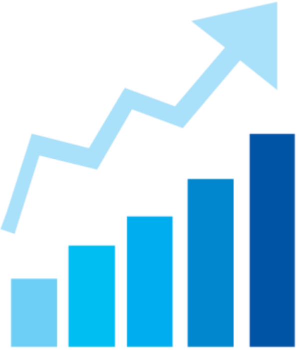
SIGNATORIES:

ASSET OWNERS, INVESTMENT MANAGERS AND SERVICE PROVIDERS

34

US$ TRILLION:

ASSETS UNDER MANAGEMENT



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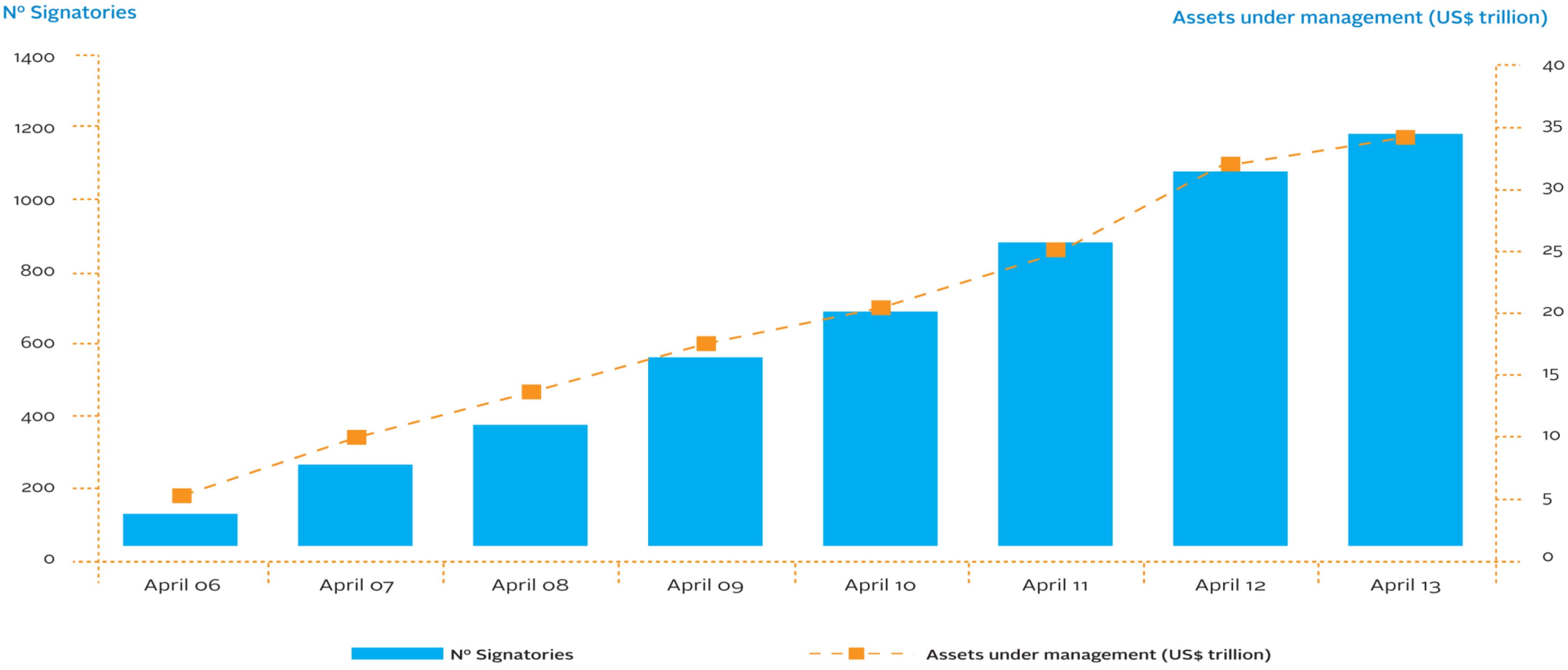
PRINCIPLES:

RECOGNISING THE MATERIALITY OF ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE ISSUES

GATHERING MOMENTUM

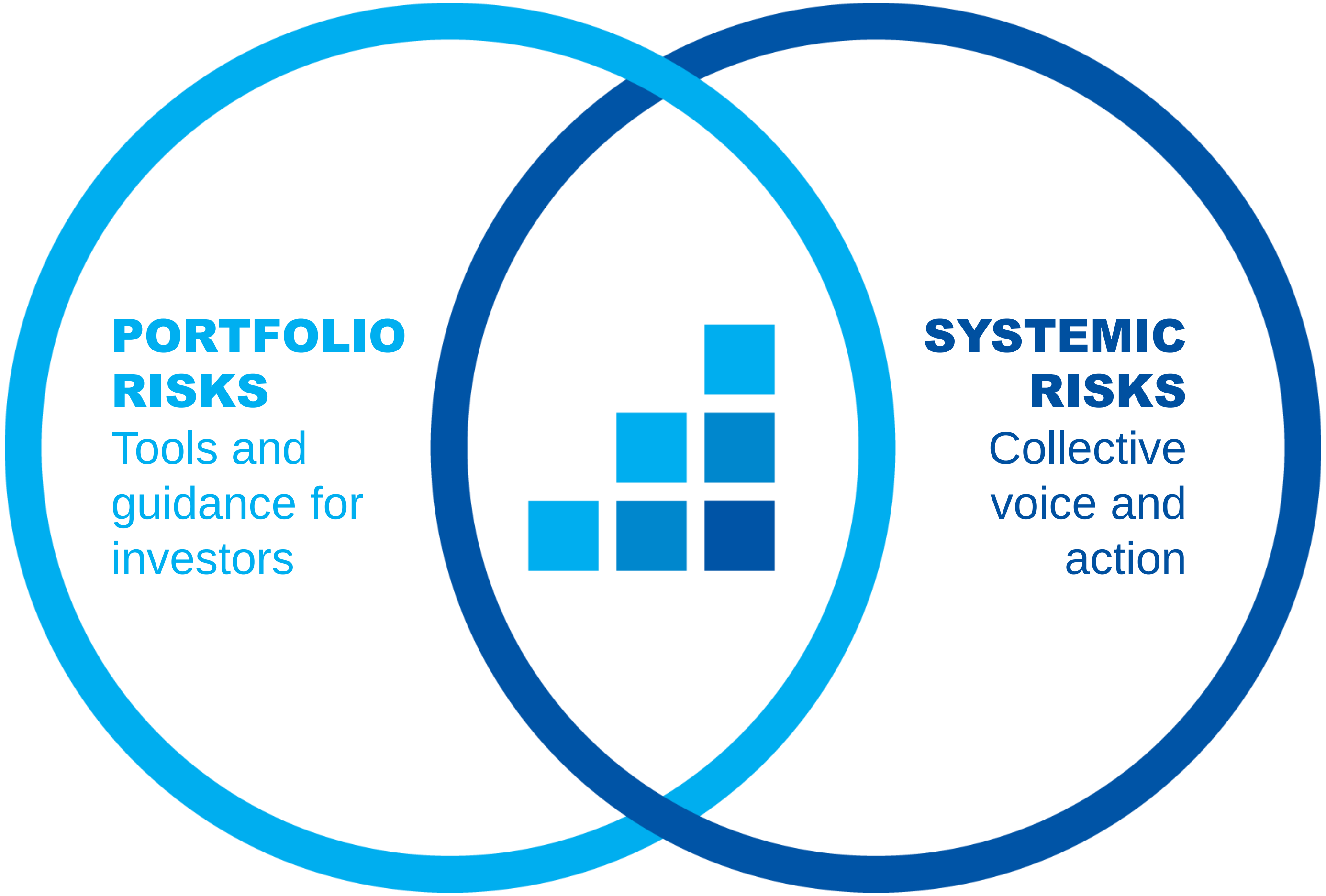


A UNIQUE OFFER

WORLD’S LEADING INVESTOR NETWORK
for implementation support, collaboration and discussion on ESG issues

REPORTING AND TRANSPARENCY
on ESG processes and performance through the annual Reporting and Assessment process

INDEPENDENT LINK
between institutional investors globally and the United Nations



THE SIX PRINCIPLES

1 We will **incorporate ESG issues** into investment analysis and decision-making processes.

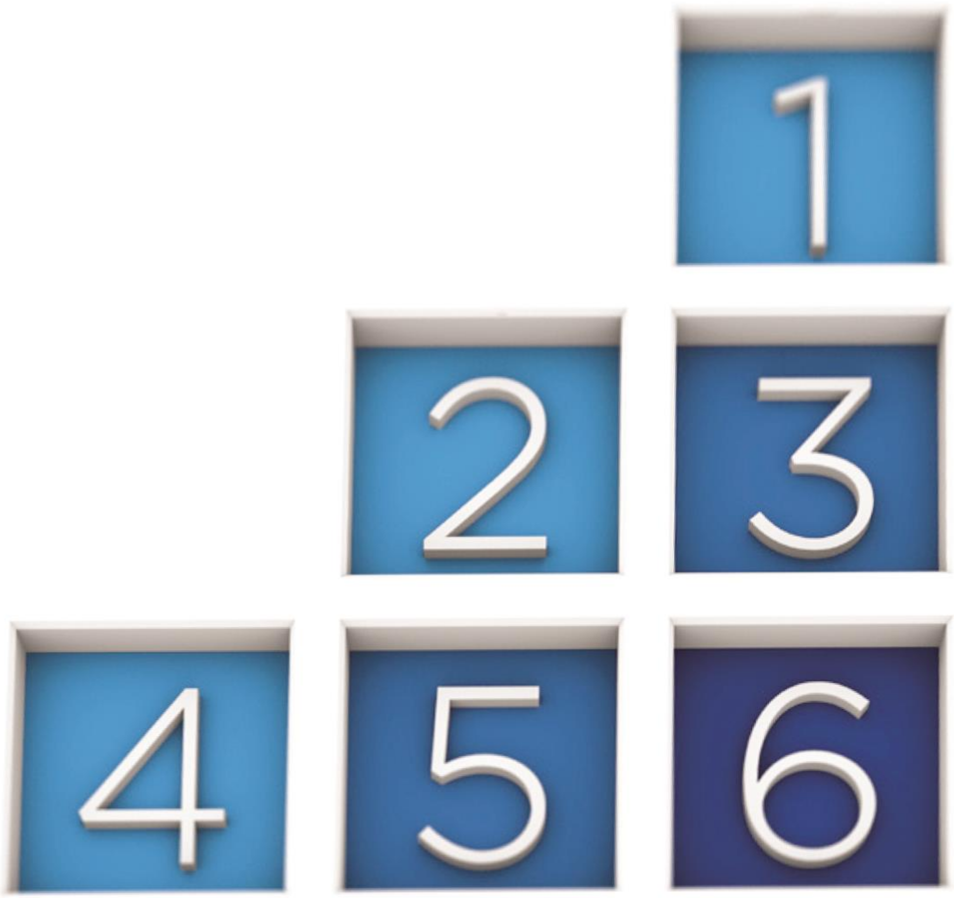
2 We will **be active owners** and incorporate ESG issues into our ownership policies and practices.

3 We will **seek appropriate disclosure** on ESG issues by the entities in which we invest.

4 We will **promote acceptance and implementation** of the Principles within the investment industry.

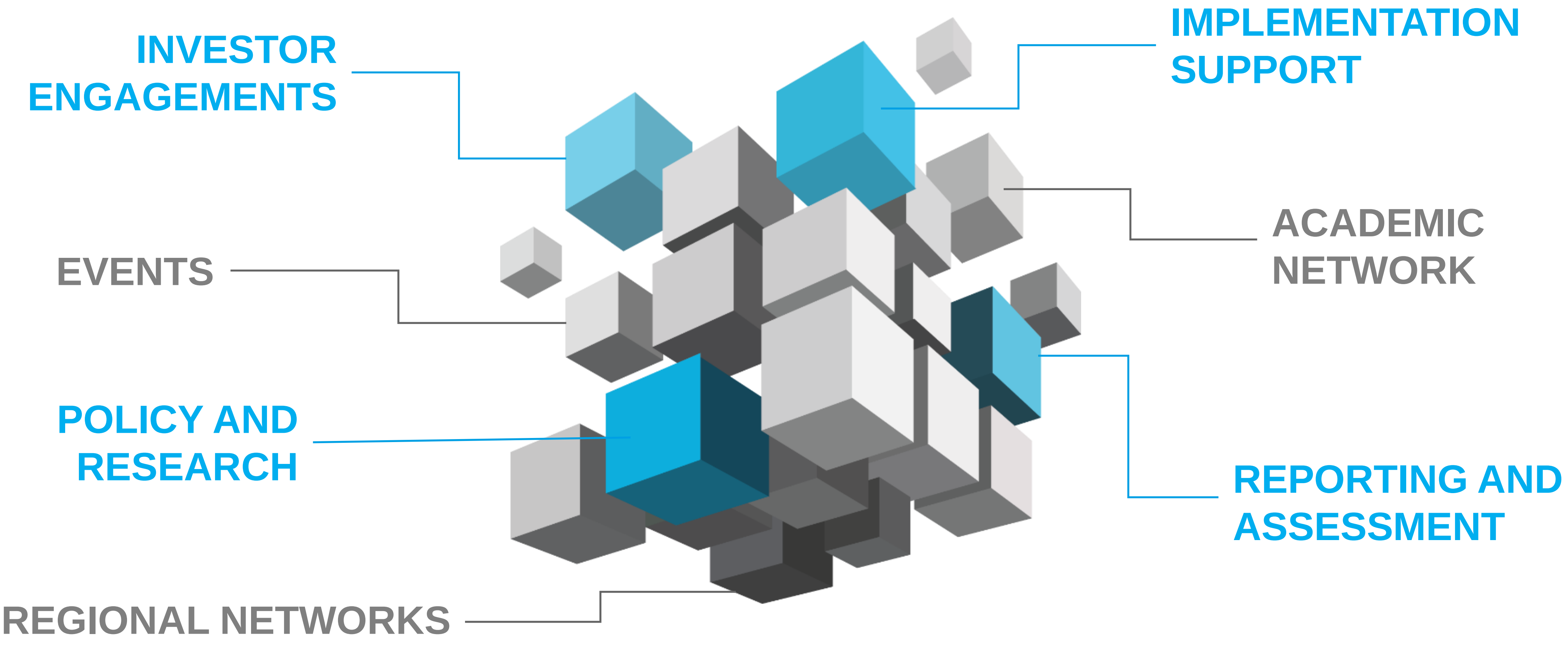
5 We will **work together** to enhance our effectiveness in implementing the Principles.

6 We will each **report** on our activities and progress towards implementing the Principles.



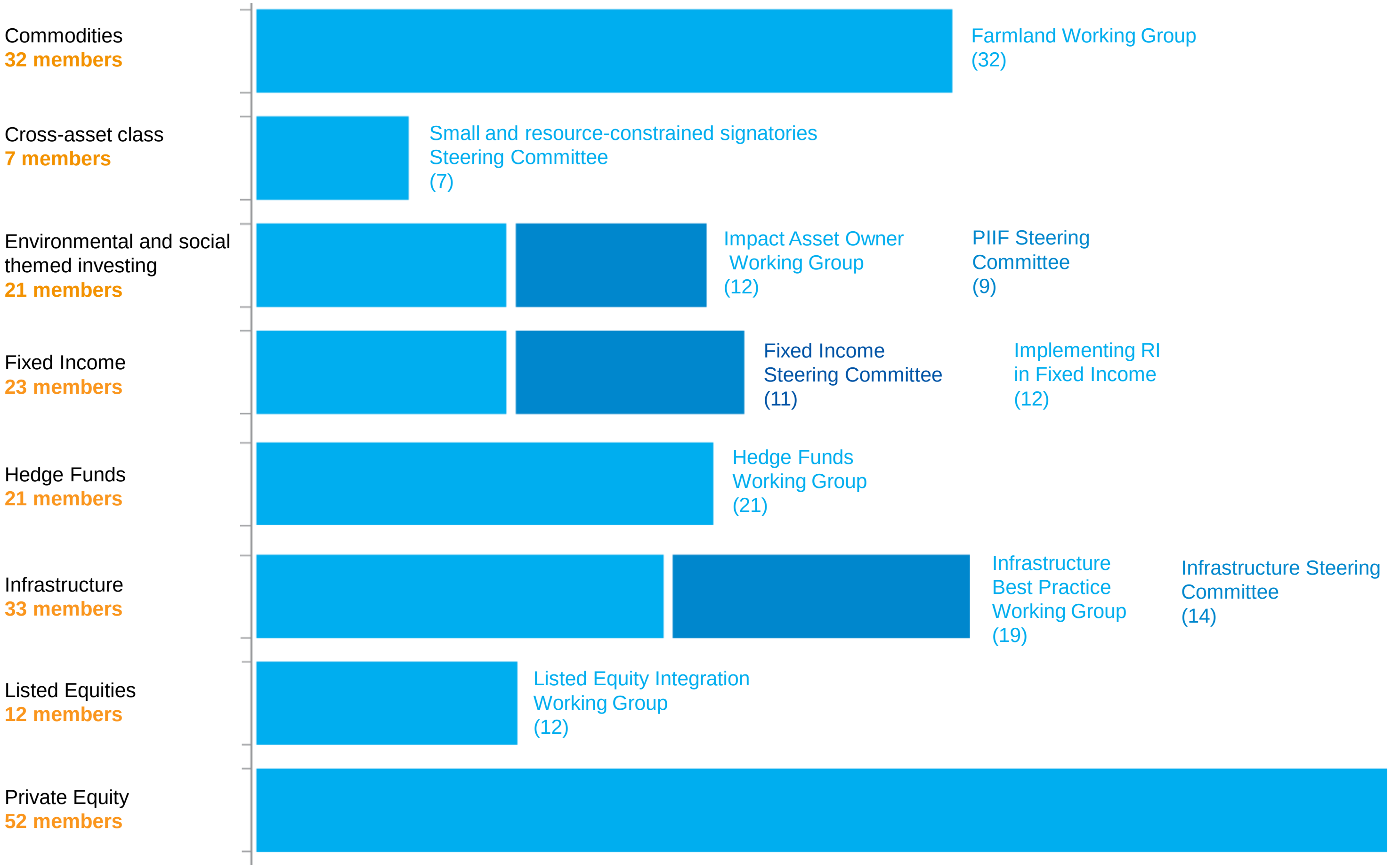
FIXING THE INVESTMENT CHAIN

HOW THE PRI INITIATIVE SUPPORTS SIGNATORIES



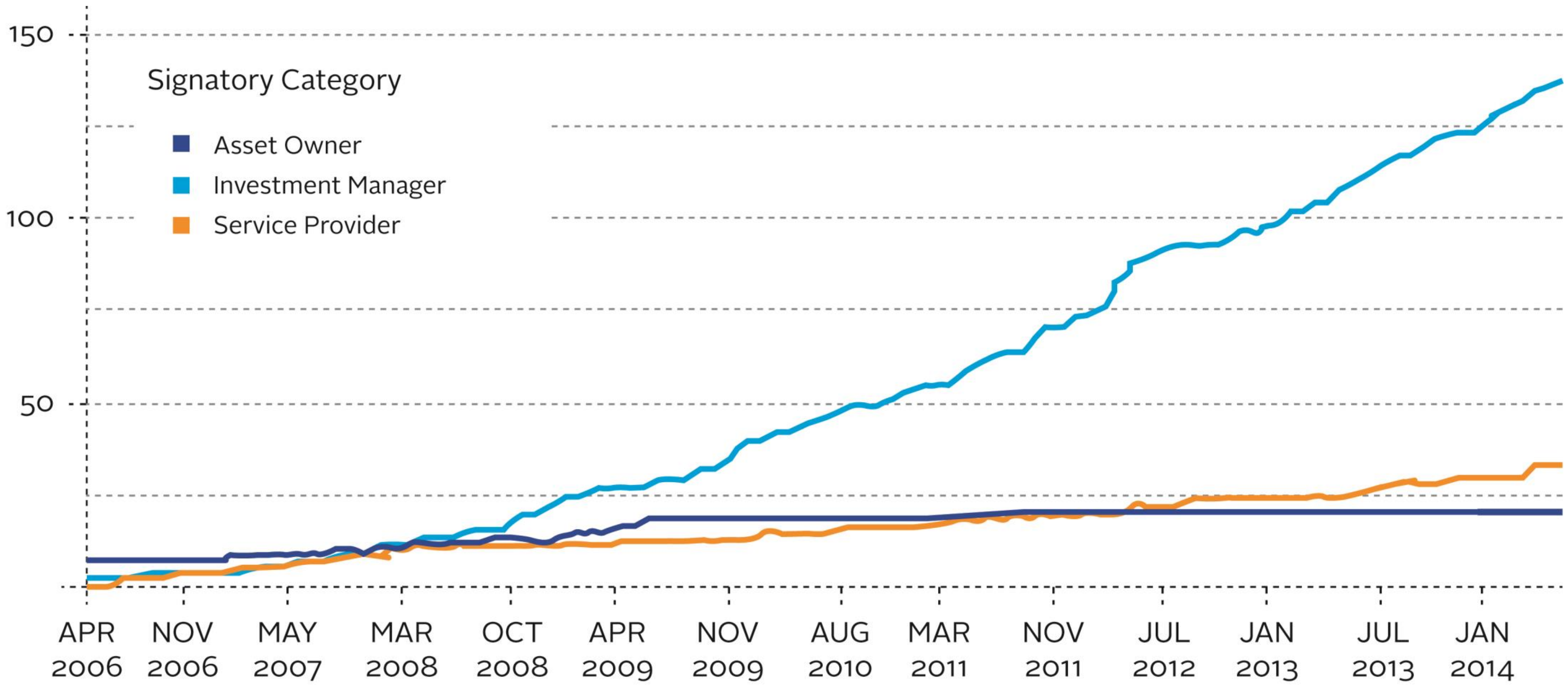
IMPLEMENTATION SUPPORT

Helping signatories put the six principles into practice



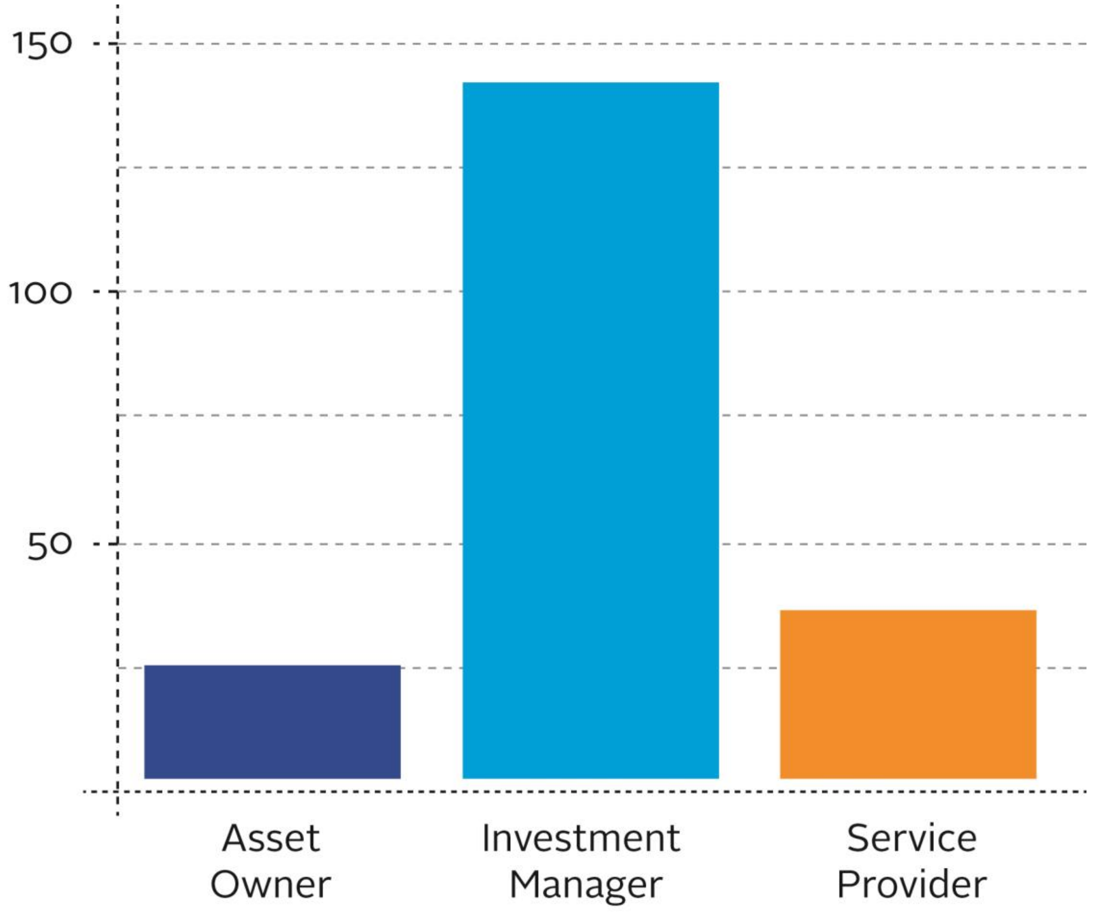
PRI Principles for Responsible Investment

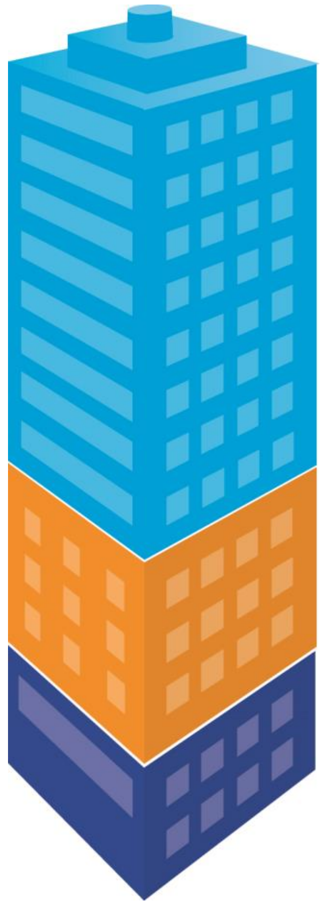
US signatory growth 2006-14



US signatory breakdown by type

Total no. of signatories in the US = 192





PRI Principles for Responsible Investment

US Asset Owner Signatories:

- AFL-CIO Reserve Fund
- CalPERS
- CalSTRS
- Connecticut Retirement Plans and Trust Funds (CRPTF)
- Harvard University Endowment
- Illinois State Board of Investments
- International Finance Corporation (IFC)
- Los Angeles County Employees Retirement Association (LACERA)
- Maryland State Retirement and Pension System
- Middletown Works Hourly and Salaried Union Retirees Health Care Fund
- Multi-Employer Property Trust
- Nathan Cummings Foundation
- New York City Employees Retirement System
- New York State Local Retirement System
- SEIU Pension Plans Master Trust
- State Universities Retirement System of Illinois
- UAW Retiree Medical Benefits Trust
- UFCW International Union Pension Plan for Employees
- United Church Funds
- United Nations Joint Staff Pension Fund
- Universal Health Care Foundation of Connecticut
- Wespath Investment Management (General Board of Pension and Health Benefits of the United Methodist Church)

Principles for Responsible Investment

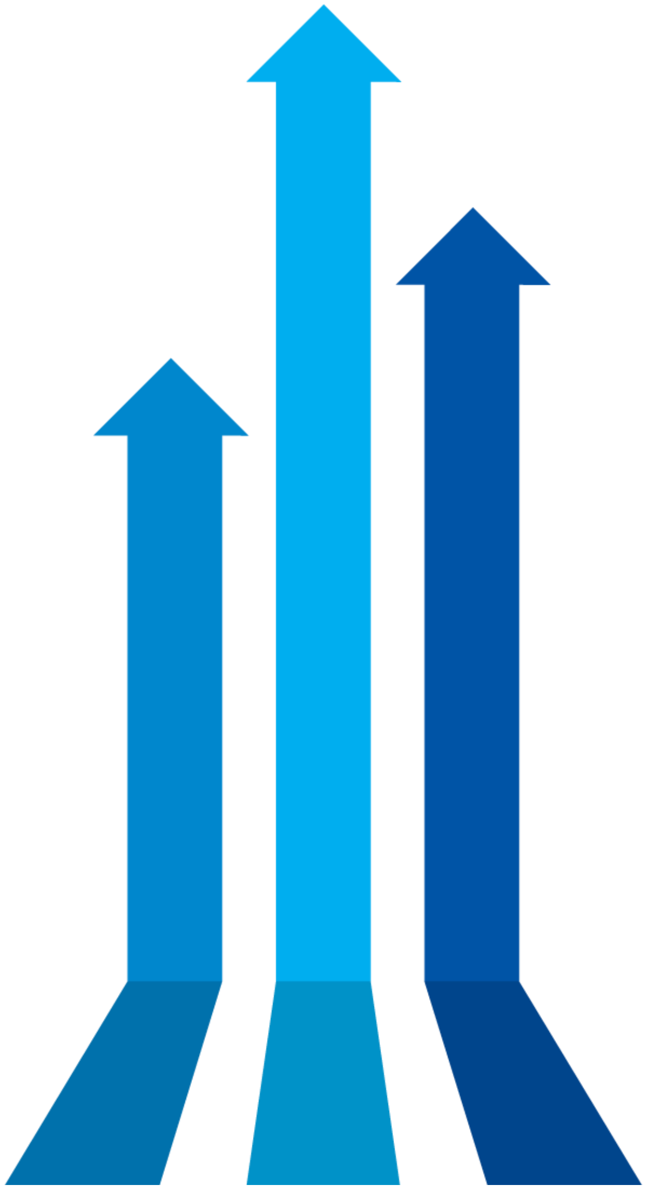
US Investment Manager Signatories:

- AllianceBernstein LP
- Amalgamated Bank
- BlackRock
- Breckinridge Capital Advisors
- Goldman Sachs Asset Management
- Franklin Templeton Investments
- JPMorgan Asset Management
- Kohlberg Kravis Roberts & Co Partners LLP
- Legg Mason Investment Counsel
- Morgan Stanley Investment Management
- Neuberger Berman Group LLC
- Northern Trust Asset Management
- PIMCO
- State Street Global Advisors (SSgA)
- T Rowe Price
- TIAA – CREF
- Wellington Management Company LLP

US NETWORK: Approach

Goal: Support Implementation & Market Growth

- Education around tools, guidance and current research
- Developing specific tools and guidance for the US market
- Collaboration
- Outreach and education for the wider market
- Representing the US perspective internally and providing insights to the other teams



Upcoming PRI Events

JUN 5	**GP Implementation Guidance Launch** New York, NY
JUN 26	**Research, Innovation and Stewardship Event** New York, NY
JUL 1	**PRI Council Panel** New York, NY
SEP 22-26	**PRI in Person** Montréal, Canada
SEP 22-26	**Fixed Income Integration Guidance Launch** Montréal, Canada

MOVING FROM AWARENESS TO IMPACT

TAB 3 – PUBLIC MARKETS PANEL

Sustainability Accounting Standards Board

Industry-Based Standards to Guide Disclosure and Action on Material Sustainability Issues

Oregon Investment Council
May 2014

Dr. Jean Rogers
Chief Executive Office & Founder, SASB

SASB's Mission

SASB's mission is to develop and disseminate sustainability accounting standards that help publicly-listed corporations disclose material factors in compliance with SEC requirements. Through these standards, along with associated education and outreach, SASB is working to increase the usefulness of information available to investors, and improve corporate performance on the environmental, social, and governance issues most likely to impact value.

SASB is accredited to establish sustainability accounting standards by the American National Standards Institute (ANSI). SASB is not affiliated with FASB, GASB, IASB or any other accounting standards boards.

ANSI
American National Standards Institute

SASB Board of Directors

Michael R. Bloomberg*
Philanthropist, Founder of Bloomberg LP, and the 108th Mayor of New York City

Bob Eccles, PhD
Professor of Management Practice – Harvard Business School

Jack Ehnes
CEO – CalSTRS

Steven O. Gunders, CPA, MBA
Partner – Deloitte & Touche LLP (Retired)

Dan Hanson, CFA
Partner and Director of U.S. Equities – Jarislowsky Fraser USA

Erika Karp
CEO – Cornerstone Capital Inc.

Peter Knight
President – Generation Investment Management

Shawn Lytle
Head of Americas – UBS Global Asset Management

Suz Mac Cormac
Partner – Morrison & Foerster LLP

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Aulana Peters
Partner – Gibson, Dunn & Crutcher LLP (Retired)

Jean Rogers, PhD PE
Chief Executive Officer & Founder – SASB
(Ex-officio)

Mary Schapiro**
Former Chairman—SEC

Elisse Walter
Former Chairman – SEC

Edward D. White
Managing Partner – Fahr LLC

** Chair   **Vice Chair*

Achievements to Date

150	Advisory Council Members	**>2500**	Media mentions since public launch
16	Standards Council Members	**19/80+**	Industry standards issued to the public
16	Board Members	**>2800**	Standards downloads (in 65 countries outside the US)
27	Staff Members	**>1600**	Industry Working Group Members to date
8	Foundation Supporters	**$17T**	AUM Representation in Working Groups
1	Conceptual Framework	**$8T**	Market Capitalization in Working Groups

Comparing Fundamentals, Competing on Performance

SASB accounting metrics enable peer-to-peer comparisons and foster competition

SASB Metrics

TBLAnalysts

Sustainability Fundamentals: Airlines

TRA Go Lookup Symbol | Company Compare Go

This view compares the company you have selected to all other companies in the same industry. Click on the column heading to sort the report on any of the variables shown.

Impacts | Opportunities

Profiling Indicators

		Annual Passenger air miles	Annual Revenue ton miles	Fleet Size	Revenue	Profit	Employees
		M Miles	RTM	# Planes	$ M	$ M	#
Industry Average		148,009	15,989	801	18,034	121	25,000
▶ TRA	TruAir	141,287	16,860	892	22,935	21	16,000
PLA	Plateau Airlines	127,158	15,174	803	20,642	32	25,000
ABL	Air Blanc	57,928	6,913	366	9,403	207	38,000
GS	GreenSky	98,907	17,197	624	18,348	514	55,000
CJT	CayJet	165,306	19,726	1,044	14,726	590	98,397
BAIR	BelAir	213,927	25,528	1,351	34,727	347	10,000
OJT	OffsetJet	142,321	17,432	752	21,658	280	63,000
OPF	One Planet Flying	56,789	9,643	341	9,304	702	35,670
SUSJ	SusJet	97,823	18,547	234	54,980	650	32,000
NLN	New Line	156,342	19,098	789	38,098	890	12,000

Performance Indicators

	On-Time Flights	Pass-enger Load Factor	Pilot Flight Hours Logged	Avgerage Age of Fleet	Unscheduled Maintenance	DOT Complaints	Accidents / Incidents	Noise exceed-ances	Worker strikes	Fuel efficiency	CO2e emissions	Pass miles offset
	%	%	Hours	Years	%	#/100,000 Emplanements	#/100,000 Departures	# /1,000 Flights	Days / Yr	Gal/RTM	MT/1000 RTM	%
Industry Average	89	86	17,500	8.6	48%	1.25	0.15	6	20	0.8	4.51	2%
TRA	68	81.5%	16,800	12.9	52%	1.16	0.10	55	2	0.19	4.78	0%
PLA	71	72%	15,120	11.6	58%	1.04	0.20	29	18	0.38	5.6	0%
ABL	87	84%	12,617	5.3	74%	0.48	0.25	23	12	0.27	2.83	2%
GS	82	88%	14,280	4.2	78%	0.74	0.12	4	0	0.16	2.67	0%
CJT	67	56%	12,675	15.1	61%	0.56	0.06	16	16	0.22	3.08	0%
BAIR	88	80%	18,450	12.9	52%	2.20	0.02	8	0	0.19	2.67	0%
OJT	90	72%	15,600	11.6	45%	3.10	0.01	3	0	0.18	1.6	0%
OPF	92	84%	23,345	5.3	28%	0.25	0.03	2	0	0.17	1.83	12%
SUSJ	98	88%	21,098	4.2	32%	0.30	0.21	11	0	0.16	1.67	88%
NLN	99	56%	24,780	2.1	12%	0.21	0.01	1	0	0.12	1.08	98%

Internet 100%

Peer Comparison

Complete Data Set

Benchmarking

Normalizing Factors

Consistent Units

SUSTAINABILITY ACCOUNTING STANDARDS BOARD SASB

SASB Standards Support MD&A

Reconciliation of measures prepared in accordance with Generally Accepted Accounting Principles (GAAP) versus non-GAAP measures

Projected ratio of total debt to total capitalization (as of December 31, 2005)

($ in millions)	*GAAP measure* at 12/31/05		*Adjusted* at 12/31/05	
Securities due within one year				
Short-term debt	$825		$825	
Long-term debt				
Equity-linked debt securities	330		330	
Junior Subordinated Debentures	1,441			
Other long-term debt	14,829		14,829	
Long-term debt - total	16,600		15,159	
Total debt	17,425	56.0%	15,984	50.8%
Preferred stock	257		257	
Junior Subordinated Debentures			1,441	
Common shareholders' equity	13,442		13,442	
Equity-linked debt securities			330	
Total equity	13,699	44.0%	15,470	49.2%
Total capitalization	$31,124		$31,454	

US GAAP

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

(Mark One)
☑ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2008
or
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From to
Commission File Number 001-31240

Newmont Mining Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	84-1611629 (I.R.S. Employer Identification No.)
6363 South Fiddler's Green Circle Greenwood Village, Colorado (Address of Principal Executive Offices)	80111 (Zip Code)

Registrant's telephone number, including [illegible]
(303) 863-7414

10-K

[illegible]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

As of June 30, 2008, the aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant was $23,670,310,860 based on the closing sale price as reported on the New York Stock Exchange. There were 478,507,759 shares of common stock outstanding (and 10,687,382 exchangeable shares exchangeable into Newmont Mining Corporation common stock on a one-for-one basis) on February 11, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Registrant's definitive Proxy Statement submitted to the Registrant's stockholders in connection with our 2009 Annual Stockholders Meeting to be held on April 29, 2009, are incorporated by reference into Part III of this report.

Integrated Filings

Airlines	Performance Indicators	Management Disclosures
Impacts	Scope 1 metric tons CO2e emissions per 1000 revenue ton miles (RTM)	Labor relations and practices
	Total scope 1 and 2 metric tons CO2e, in millions	Policies and practices with respect to customer rights and customer privacy
	Metric tons of Nox emissions per 1000 revenue ton miles	Systems for environmental management
	Fuel efficiency: Gallons per RTM	
	% of operating entities registered under IATA Operational Safety Audit	
	Average number of flight hours logged per pilot	
	Accidents per 100,000 departures	
	% of flights arriving on time	
	Customer complaints to DOT per 100,000 enplanements	
	Total noise exceedances per 1000 operations	
	Average age of fleet	
	% of maintenance that is unscheduled	
	Passenger load factor	
	Number of notices of environmental violations or non-compliances	
	Total number of days with worker strikes in US	
Innovation	% of ground support equipment that is electric or certified as a low-emissions vehicle	Research and development on alternative fuels
	% passenger miles offset through customer programs	Programs for customers with emergency travel needs
	% of waste diverted from landfill	Carbon management strategy
		Carbon offset programs for passengers
		Sustainable purchasing policies
		Commitment to sustainable operating practices

SASB Material Disclosure Topics and Accounting Metrics

Developing Standards for 80+ Industries in 10 Sectors

To date, we have issued standards for 19 industries

Time Frame	Sector	# of Industries
Q4, 2012	Health Care Services	6
Q1, 2013	Financials	7
Q2, 2013	Technology & Communication	6
Q3, 2013	Non-Renewable Resources	8
Q4, 2013	Transportation	8
Q1, 2014	Services	10
Q2, 2014	Resource Transformation	5
Q3 + Q4, 2014	Consumption	15
Q1, 2015	Renewable Resources & Alt. Energy	8
Q2, 2015	Infrastructure	10

Example of Industries

Oil & Gas – Exploration & Production
Oil & Gas – Midstream
Oil & Gas – Refining & Marketing
Oil & Gas – Services
Coal Operations
Iron & Steel Producers
Metals & Mining
Construction Materials

Standards Development Pipeline

Consumption I

Resource Transformation

Services

Transportation

Non-Renewable Resources

Industry research

Evidence collection

Document review

Brief preparation

Working Groups

Multi-stakeholder participation

Delta Series + research dialogue

Standards development

Metric development

Technical protocols

Standards Council review

Public comment

90 day public comment period

Standards Council review

Issued and Available for Use

Health Care

Financials

Technology & Communications

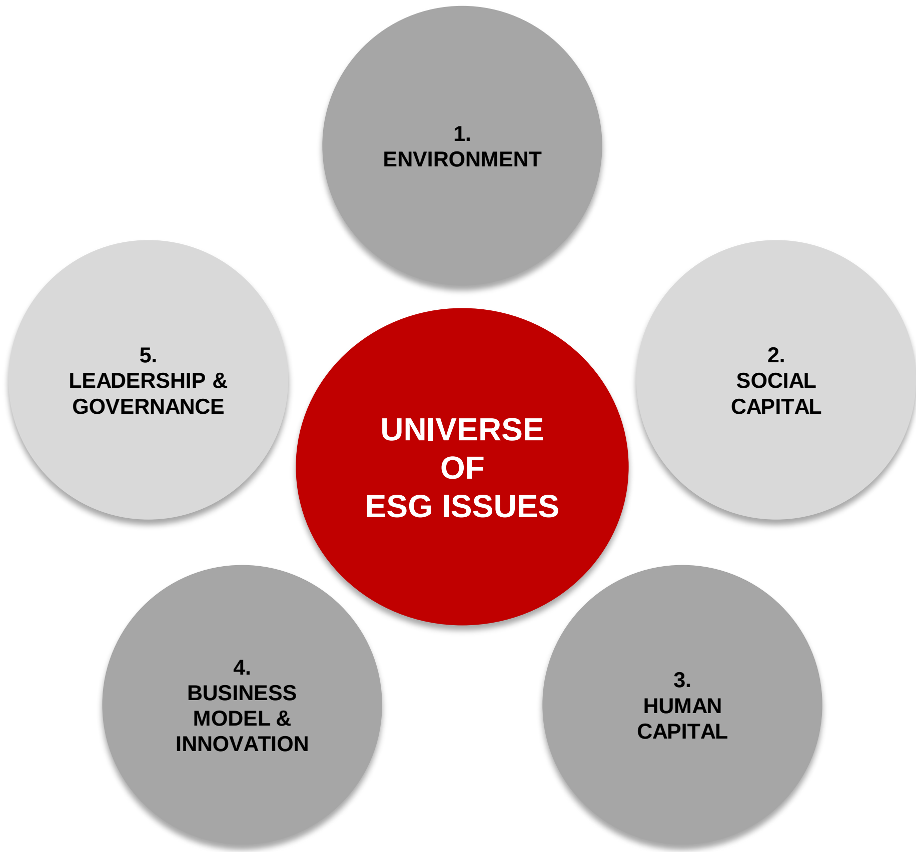
Universe of Sustainability Issues

An evidence-based industry-specific approach helps SASB identify the most material.

1
- Climate change risks
- Environmental accidents and remediation
- Water use and management
- Energy management
- Fuel management and transportation
- GHG emissions and air pollution
- Waste management and effluents
- Biodiversity impacts

2
- Communications and engagement
- Community development
- Impact from facilities
- Customer satisfaction
- Customer health and safety
- Disclosure and labeling
- Marketing and ethical advertising
- Access to services
- Customer privacy
- New markets

3
- Diversity and equal opportunity
- Training and development
- Recruitment and retention
- Compensation and benefits
- Labor relations and union practices
- Employee health, safety and wellness
- Child and forced labor



4
- Long term viability of core business
- Accounting for externalities
- Research, development and innovation
- Product societal value
- Product life cycle use impact
- Packaging
- Product pricing
- Product quality and safety

5
- Regulatory and legal challenges
- Policies, standards, codes of conduct
- Business ethics and competitive behavior
- Shareholder engagement
- Board structure and independence
- Executive compensation
- Lobbying and political contributions
- Raw material demand
- Supply chain standards and selection
- Supply chain engagement & transparency

Materiality Assessment

SASB follows the legal definition of materiality through an evidence-based approach

Materiality: "A substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of the information made available"

TSC Industries v. Northway, Inc., Supreme Court, 1976

Universe of sustainability issues

TESTS

Evidence of investor interest

Issue frequency in 5 data-driven tests:

- Financial risks (10K and 20Fs)
- Legal drivers (legal news)
- Industry norms (CSR Reports)
- Stakeholder test (DEF14A + Media)
- Innovation test (innovation news)

Evidence of financial impact

Issue impact financial value drivers:

- Revenue and Cost
- Assets and Liabilities
- Cost of Capital

Forward-looking impact

Potential for systemic risk:

- Probability
- Magnitude

Factors that would be of interest to the reasonable investor

Material Factors for the Health Care Sector

	Biotechnology and Pharmaceuticals	Medical Equipment and Supplies	Health Care Delivery	Health Care Distribution	Managed Care
Environment	▪ Energy, water and waste efficiency	▪ Energy, water and waste efficiency	▪ Energy, water and waste efficiency ▪ Climate change impacts on human health	▪ Fuel efficiency	▪ Climate change impacts on human health
Social Capital	▪ Safety of clinical trial participants ▪ Access to Medicines ▪ Counterfeit drugs ▪ Ethical marketing	▪ Product safety ▪ Affordability and fair pricing ▪ Ethical marketing	▪ Quality of care and patient satisfaction ▪ Access for low-income patients ▪ Patient privacy and electronic health records	▪ Product safety ▪ Counterfeit drugs	▪ Access to coverage ▪ Customer privacy and technology standards
Human Capital	▪ Employee recruitment, development and retention ▪ Employee health and safety		▪ Employee recruitment, development and retention		
B. Model & Innovation	▪ Affordability and fair pricing ▪ Drug safety and side-effects	▪ Product design and lifecycle management		▪ Product lifecycle management	▪ Improved outcomes
Leadership & Governance	▪ Corruption and bribery ▪ Manufacturing and supply chain quality management	▪ Corruption and bribery ▪ Manufacturing and supply chain quality management	▪ Fraud and unnecessary procedures ▪ Pricing and billing transparency	▪ Corruption and bribery	▪ Plan performance ▪ Pricing and billing transparency

Material Factors for the Financials Sector

	Commercial Banking	Investment Banking	Asset Management	Consumer Finance	Mortgage Finance	Exchanges	Insurance
Environment					▪ Environmental risk to mortgaged properties		▪ Environmental risk exposure
Social Capital	▪ Financial inclusion and capacity building ▪ Customer privacy and data security		▪ Transparent information and fair advice for customers	▪ Financial inclusion ▪ Transparent information and fair advice for customers ▪ Responsible lending and debt prevention ▪ Customer privacy and data security	▪ Transparent information and fair advice for customers ▪ Responsible lending and debt prevention	▪ Promoting transparent and efficient capital markets	▪ Plan performance
Human Capital		▪ Employee inclusion ▪ Employee incentives and risk-taking	▪ Employee inclusion ▪ Employee incentives and risk-taking				
Leadership & Governance	▪ Management of the legal and regulatory environment ▪ Systemic risk management	▪ Management of the legal and regulatory environment ▪ Systemic risk management	▪ Management of the legal and regulatory environment ▪ Systemic risk management		▪ Management of the legal and regulatory environment	▪ Managing business continuity and technology risks ▪ Managing conflicts of interest	▪ Systemic risk management
B. Model & Innovation	▪ Integration of environmental, social and governance risk factors in credit risk analysis	▪ Integration of environmental, social and governance risk factors in services and lending	▪ Integration of environmental, social and governance risk factors in investment management and advisory				▪ Integration of environmental, social and governance risk factors in investment management ▪ Policies designed to incentivize responsible behavior
Emerging	▪ Regulatory Capture and Political Influence	▪ Regulatory Capture and Political Influence	▪ Regulatory Capture and Political Influence	▪ Regulatory Capture and Political Influence	▪ Regulatory Capture and Political Influence ▪ Energy efficient mortgages	▪ Promoting integration of environmental, social and governance performance in capital markets	▪ Regulatory Capture and Political Influence

Material Factors for the Technology & Communications Sector

	Hardware	EMS & ODM	Semiconductors	Software & IT Services	Internet Media & Services	Telecom
Environment		▪ Water & waste management in manufacturing	▪ GHG emissions ▪ Energy management in manufacturing ▪ Water & waste management in manufacturing	▪ Environmental footprint of hardware infrastructure	▪ Environmental footprint of hardware infrastructure	▪ Environmental footprint of operations
Social Capital	▪ Product security			▪ Data privacy & freedom of expression ▪ Data security	▪ Data privacy, advertising standards, and freedom of expression ▪ Data security	▪ Data privacy ▪ Data security
Human Capital	▪ Employee inclusion	▪ Fair labor practices	▪ Recruiting & managing a global, skilled workforce ▪ Employee health & safety	▪ Recruiting & managing a global, diverse skilled workforce	▪ Employee recruitment, inclusion, and performance	
B. Model & Innovation	▪ Product lifecycle management	▪ Product lifecycle management	▪ Product lifecycle management			▪ Product end-of-life management
Leadership & Governance	▪ Supply chain management & materials sourcing	▪ Supply chain management & materials sourcing	▪ Supply chain management & materials sourcing ▪ Intellectual property protection & competitive behavior	▪ Managing systemic risks from technology disruptions ▪ Intellectual property protection & competitive behavior	▪ Intellectual property protection & competitive behavior	▪ Managing systemic risks from technology disruptions ▪ Competitive behavior
Emerging Issues			▪ Delivering Sustainability Solutions	▪ Delivering Sustainability Solutions		▪ Delivering Sustainability Solutions ▪ Mobile phone radiation

SASB Accounting Standards

Disclosure topics, metrics, and protocols

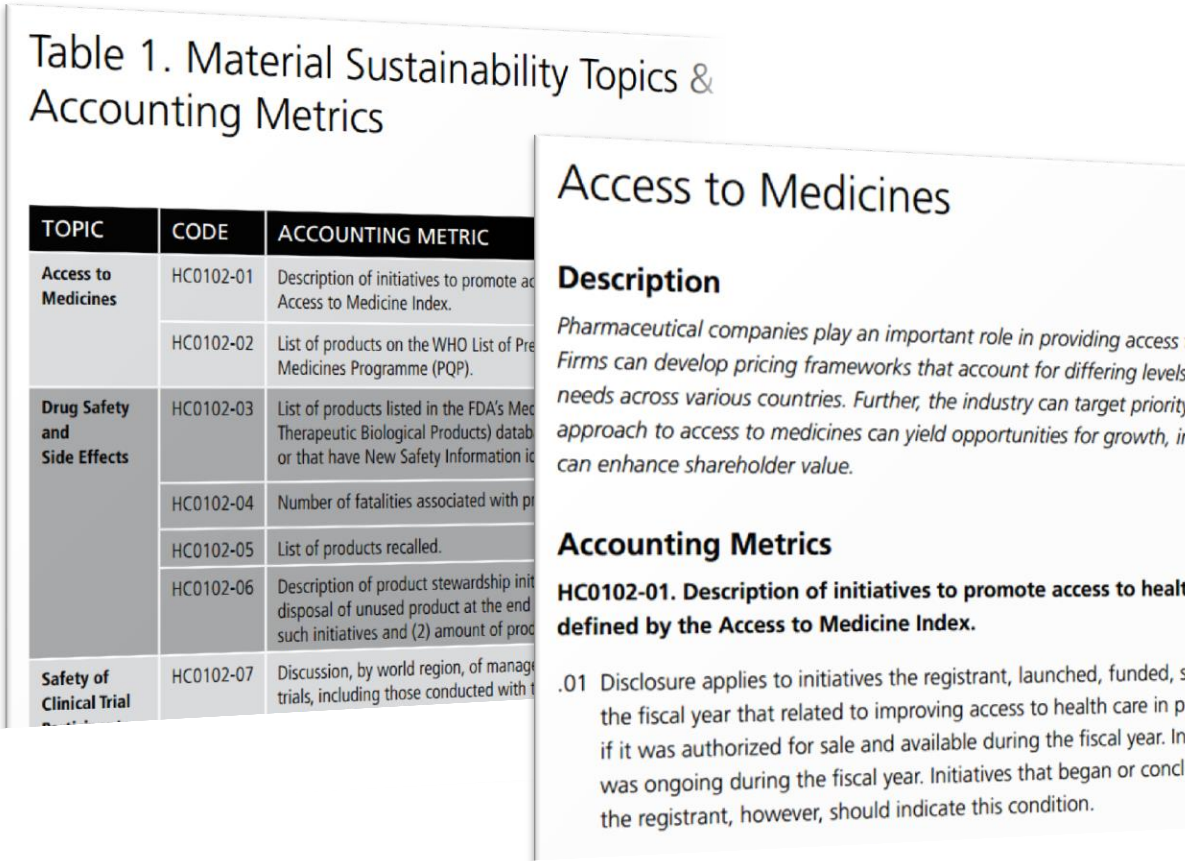


Table 1. Material Sustainability Topics & Accounting Metrics

TOPIC	CODE	ACCOUNTING METRIC
Access to Medicines	HC0102-01	Description of initiatives to promote ac Access to Medicine Index.
	HC0102-02	List of products on the WHO List of Pre Medicines Programme (PQP).
Drug Safety and Side Effects	HC0102-03	List of products listed in the FDA's Med Therapeutic Biological Products) datab or that have New Safety Information id
	HC0102-04	Number of fatalities associated with pr
	HC0102-05	List of products recalled.
	HC0102-06	Description of product stewardship init disposal of unused product at the end such initiatives and (2) amount of prod
Safety of Clinical Trial	HC0102-07	Discussion, by world region, of manage trials, including those conducted with t

Access to Medicines

Description

Pharmaceutical companies play an important role in providing access Firms can develop pricing frameworks that account for differing levels needs across various countries. Further, the industry can target priority approach to access to medicines can yield opportunities for growth, in can enhance shareholder value.

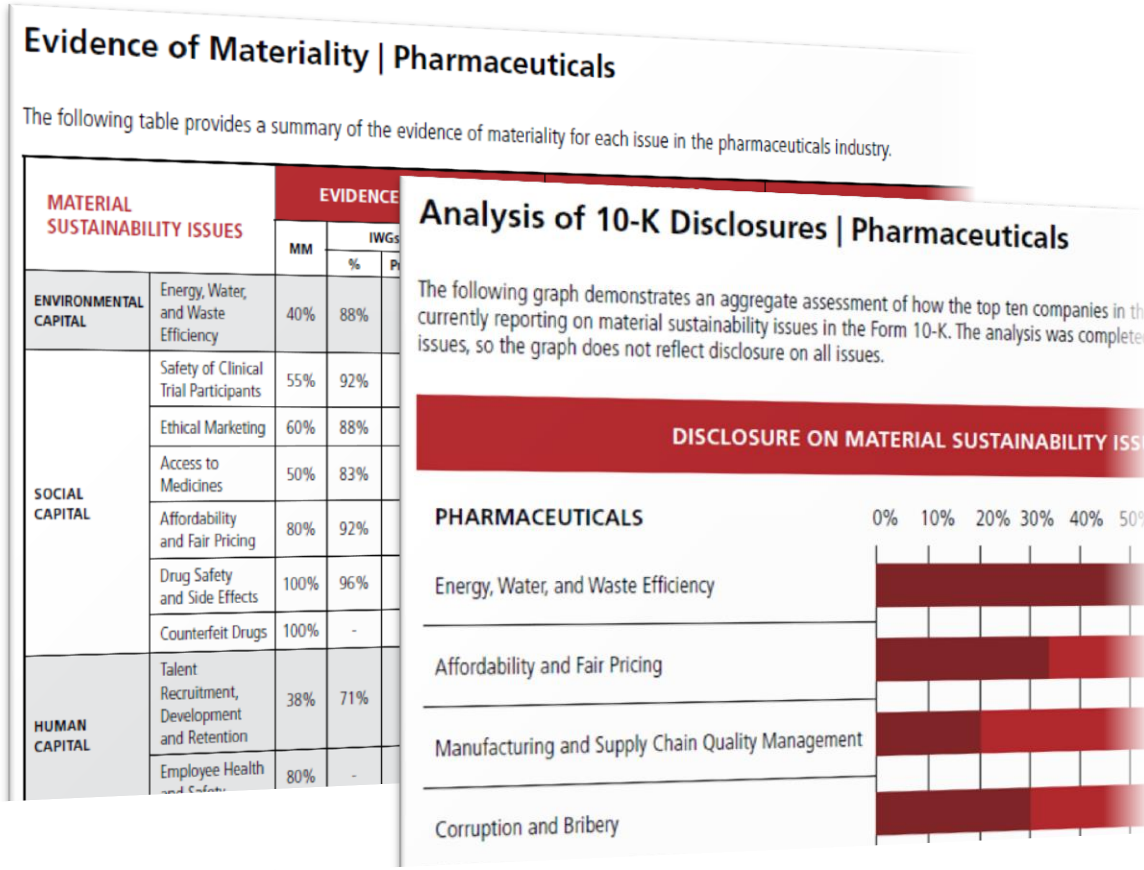
Accounting Metrics

HC0102-01. Description of initiatives to promote access to healt defined by the Access to Medicine Index.

.01 Disclosure applies to initiatives the registrant, launched, funded, s the fiscal year that related to improving access to health care in p if it was authorized for sale and available during the fiscal year. In was ongoing during the fiscal year. Initiatives that began or concl the registrant, however, should indicate this condition.

SASB Industry Brief

Basis for inclusion, evidence, and the current state of disclosure



Evidence of Materiality | Pharmaceuticals

The following table provides a summary of the evidence of materiality for each issue in the pharmaceuticals industry.

MATERIAL SUSTAINABILITY ISSUES		EVIDENCE MM	IWGs %
ENVIRONMENTAL CAPITAL	Energy, Water, and Waste Efficiency	40%	88%
SOCIAL CAPITAL	Safety of Clinical Trial Participants	55%	92%
	Ethical Marketing	60%	88%
	Access to Medicines	50%	83%
	Affordability and Fair Pricing	80%	92%
	Drug Safety and Side Effects	100%	96%
	Counterfeit Drugs	100%	-
HUMAN CAPITAL	Talent Recruitment, Development and Retention	38%	71%
	Employee Health	80%	-

Analysis of 10-K Disclosures | Pharmaceuticals

The following graph demonstrates an aggregate assessment of how the top ten companies in the currently reporting on material sustainability issues in the Form 10-K. The analysis was completed issues, so the graph does not reflect disclosure on all issues.

DISCLOSURE ON MATERIAL SUSTAINABILITY ISSU

PHARMACEUTICALS	0% 10% 20% 30% 40% 50%
Energy, Water, and Waste Efficiency	
Affordability and Fair Pricing	
Manufacturing and Supply Chain Quality Management	
Corruption and Bribery	

Accounting for a Sustainable Future

BLACKROCK®

Environmental, Social & Governance (ESG) Integration within Oregon Investment Council's Public Equity Portfolios

May 2014

ESG Integration

Agenda

Overview

Our team

Investment process

Analysis

Engagement

Proxy voting

Case studies

Appendix

Principles for Responsible Investment (PRI)

Organizational affiliations

Overview

“Responsible Investment” (RI), “Socially Responsible Investing” (SRI) or **“Sustainability”** may mean different things to different people. However, they all imply a **long-term investment horizon, active ownership,** and a **nexus between extra financial factors and investment performance.**

In general, these concepts can be classified in two ways:

1) **ESG Integration –** The inclusion of environmental, social and governance considerations within a traditional investment mandate where these factors **may** be financially material
   - Principles for Responsible Investment (PRI) - framework for integration, BlackRock signed in 2008
   - 20 person Corporate Governance & Responsible Investment (CGRI) team that manages ESG integration

2) **Responsible Investment Products –** Mandates that **explicitly** consider social, ethical or environmental criteria as part of the portfolio construction or investment strategy
   - May be categorized into **a) screens b) themes or c) indices**, and they are not necessarily mutually exclusive
   - Approximately 6% of BLK’s assets, or $249 billion USD as of 12/31/13 may be considered RI products

In discussing RI, it is important to reflect on whether you are discussing integration or product

Robust CGRI capability

BlackRock's CGRI team delivers meaningful value to our clients through a range of services:

Standard

- Governance evaluation of the companies in which we invest, including the assessment of environmental and social considerations
  - ✓ Quarterly thematic analysis on topics like board diversity, human rights in the supply chain, sustainable palm oil, hydraulic fracturing, etc.
- Provision of these evaluations internally, primarily to fundamental portfolio managers
- Engagement and relationship management with our portfolio companies for mutual understanding regarding performance issues and risk mitigation
- Proxy voting and reporting under BlackRock's internal policy
- Market updates on the evolving governance landscape

Custom/ Premium

- Client consultation on policy development
- Responsible investment product development
- Customized ESG portfolio evaluations

CGRI integrated into the investment process

STEP 1

Responsible Investment mandate	Traditional mandate

STEP 2

Responsible Investment mandate: Investment evaluation to buy/sell **explicitly** includes ESG factors:

- Screens
- BlackRock proprietary ESG rating
- Themes (e.g., renewable energy)
- Index (e.g. FTSE4Good, etc.)

Traditional mandate: Investment evaluation to buy/sell **may** include ESG factors:

- Fundamental – company analysis
- Scientific Active – quantitative modeling
- Index – not applicable

STEP 3

Aggregation of investment held by BlackRock globally across RI and traditional mandates

STEP 4

Analysis of ESG risks and opportunities at our aggregated investments

STEP 5

Relationship management, engagement and proxy voting at our investments consistent with our analysis

STEP 6

Feedback mechanism into Step 2 based on the mandate and product type

Analysing ESG at our portfolio companies

We rate ESG performance & risk exposure using key performance indicators

Overall Performance

Economic

- Client Loyalty
- Brand Value
- Earnings
- Restatements
- Profit Warnings
- Insider Dealings

Environmental

- Controversies
- Resource Reduction
- Emission Reduction
- Product Innovation

Social Performance

- Employment Quality
- Health & Safety
- Training
- Diversity
- Human Rights
- Community
- Product Responsibility

Corporate Governance

- Board Composition
- Board Structure
- Board Functions
- Shareholders Rights

- **Identify ESG best-in-class and laggards based on BLK proprietary methodology or custom client approach**
- **Monitor controversies**
- **Conduct further due diligence on the laggards with additional research from vendors, investment banks, and industry entities or NGO’s etc.**

To determine whether to proactively engage …

Engagement with portfolio companies

BlackRock believes engagement is a means to protect and enhance the value of our clients' assets

Our approach to engagement has long been one of having a private dialogue with companies, setting out our views and discussing ways that any concerns could be addressed

Triggers for engagement

- Corporate governance concerns (e.g., board/management weakness; remuneration; accounting issues; weak shareholder rights; disclosure; social, ethical or environmental impacts; etc.)
- Historic underperformance of share price
- Complicated or controversial items on general meeting agenda

Forms of engagement

- Discussion with executive management
- Discussion with non-executive directors
- Face-to-face meetings with management or board members
- Engagement with other shareholders (where appropriate)
- Communication with company's advisors
- Proxy voting

Typical topics addressed

- Corporate governance
  - Shareholder rights / governance structures
  - Board effectiveness, composition, refreshment
  - Social, ethical, environmental risks
- Strategy
  - Growth drivers
  - Portfolio of business
  - Key risks
- Financial performance / sustainability
- Operations

Proxy voting process as an engagement mechanism

Voting is the broadest based level of engagement we have with companies; it provides a routine opportunity for investors to provide feedback to the board and encourages board and management teams to consider and address investor concerns

1 RESEARCH AND ISSUE SPOTTING

- Process begins with review of research from leading proxy advisory firms, company materials, broker research, and other publicly available news flow as necessary
- Internally developed guidelines are applied in determining how to vote
- Straightforward meetings proceed to vote execution
- Remainder are flagged for additional research

2 REVIEW AND ENGAGEMENT

- In depth research and review of particularly complicated or controversial matters
- Leverage expertise of portfolio managers as necessary
- If warranted, schedule an engagement with the issuer's executives or board members to discuss key questions or concerns

3 VOTE EXECUTION

- Votes are executed through an electronic platform
- Vote positions reconciled against holdings to ensure clean operating environment
- For exceptional conflict issues, votes are cast as instructed by independent fiduciary
- Oversight committees receive monthly vote reports and generally meet quarterly to review voting

Case study: A range of ESG issues at a mining company

Profile of Company: Principal activities are in mining, smelting and refining in India, Zambia, Australia, Netherlands and Mauritius. The executive chairman maintains a 60% stake in the company.

1 - ISSUES

Governance structure – perceived lack of independent non-executive directors

Poor track record on environmental, health and safety issues

Relations with local communities – allegations of forced evictions

2 - OBJECTIVES

Board refreshment –independent directors

Independent verification – UN site visit in partnership with NGOs and full access to local community

Internal controls – separate board committee to oversee community consultations and environmental/social risks

3 - STEPS TAKEN

Established contact with company and began direct dialogue with executives and board members

Engaged with relevant local NGOs

Site visit

4 - OUTCOME

Several meetings with Chief Sustainability Office and CEO

Meetings included an on-going evaluation of progress on environmental and social policies

Progress benchmarked vs. international standards and best practices

Case study: Proxy contest settled at an oil and gas producer

Profile of Company: Independent oil and natural gas exploration and production operating in the Mississippi Basin and Gulf of Mexico.

1 - ISSUES

Large shareholder sought to remove the board, including the Chairman and CEO, and replace the entire board with dissident nominees

Key concerns of underperformance, shifting strategic focus, poor capital discipline, excessive executive compensation, and questionable related party transactions

2 - OBJECTIVE

Explore the concerns and evaluate the activists proposed strategy

Compare director candidates relative to incumbent directors

Consider the number of board seats the dissident nominees would need to effect change, to the extent we determined that change is warranted

3 - STEPS TAKEN

Conducted analysis

Met with both the dissident and the management teams to understand their perspectives and strategies

Voted to remove the four longest tenured directors, other than the CEO, and in support of four dissidents, based on their experience and expected abilities to contribute to a strengthened and constructive board going forward

4 - OUTCOME

Company settled with the dissident, two days prior to the expiration of the consent solicitation

Board expanded to include four dissident nominees (all of whom BlackRock supported), governance review commenced, CEO succession plan announced

Stock performance appears to be approximately in-line with peers since initial dissident engagement made public

Appendix

Appendix - BlackRock and the PRI

The Principles for Responsible Investment (PRI) consist of six aspirational statements to provide a framework within which non-financial, ESG issues can be taken into account in the investment process

Principle	BlackRock's work in support of the Principles
1. We will incorporate ESG issues into investment analysis and decision-making processes	• Consider ESG metrics and analysis in risk assessment as part of fundamental investment analysis • Support development of ESG-related tools, metrics and analyses and periodically review the relevance of these to active investment strategies • Offer index-based funds with ESG screens including tobacco, alcohol, defence, gambling and genocide free • Provide tailored ESG screens based on clients' specific needs • More than US$200 billion invested in ESG products globally as of June 2012 • Promote academic and other research into ESG and governance matters through partnerships with academic institutions (e.g., Stanford University) • Advocate ESG and governance training for investment professionals
2. We will be active owners and incorporate ESG issues into our ownership policies and practices	• BlackRock's Global Corporate Governance and Engagement Principles and suite of region-specific voting guidelines are consistent with the Principles and are disclosed to clients and posted on our website • Engage with companies where there exists a potential for material economic ramifications for investors that may not be fully addressed by the board • Vote in the best long-term economic interests of fund investors • Participate in the development of policy, regulation and standard setting in markets around the globe • Contribute to collaborative engagement initiatives (where allowed by law)

Appendix - BlackRock and the PRI continued

Principle	BlackRock's work in support of the Principles
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest	• Encourage reporting on ESG and governance issues as appropriate and relevant to the economic viability of the business and the long term economic health of the company • Encourage companies to explain actions within the context of best long-term economic interests of fund investors (emphasis on sustainable value creation) • Request information from companies regarding adoption of / adherence to relevant market best practices or international initiatives • Consider supporting shareholder initiatives and resolutions that do not seek to micromanage a company's business or that promote the long-term economic interest of fund investors
4. We will promote acceptance and implementation of the Principles within the investment industry	• Support regulatory or policy developments that enable implementation of the Principles (e.g., initiatives to guarantee shareholders a meaningful vote in corporate elections and policies to ensure shareholders can collaborate) • Raise awareness of PRI through public speaking and round table discussion • Engage clients on PRI and ESG issues where relevant including education on ESG in the marketplace • Actively engage the PRI Secretariat to raise awareness of implementation issues
5. We will work together to enhance our effectiveness in implementing the Principles	• Support and participate in networks and similar initiatives to enhance our effectiveness and understanding (e.g. Institutional Investor Group on Climate Change, Council of Institutional Investors, ICGN, Eumedion, FTSE Policy Group, Aspen Institute Corporate Values Strategy Group, etc.) • Consider opportunities to collectively address relevant emerging issues at a market-wide or policy level • Consider supporting collaborative initiatives
6. We will each report on our activities and progress towards implementing the Principles	• Disclose how ESG issues are integrated within investment practices • Disclose active ownership activities (voting, engagement, and/or policy dialogue) to clients • Participate in the PRI annual survey • Disclose proxy voting record to clients and the markets as appropriate

Appendix 2 – Corporate governance & SRI organizations with which BlackRock is involved

Region	Organizations
Americas	• Aspen Institute Corporate Values Strategy Group • **Associação de Investidores no Mercado de Capitais** • **Broadridge Domestic Steering Committee** • **Broadridge Global Steering Committee** • **Canadian Coalition for Good Governance** • Conference Board, Global Corporate Governance Research Center • Council of Institutional Investors • **Institutional Network on Climate Risk** • International Standards Organization • RiskMetrics Group, Proxy Voting Operations Committee • Stanford Institutional Investor Forum

Europe, Middle East and Africa	• Association of British Insurers
	    • Executive Investment Advisory Panel
	    • Investment Committee
	• Corporate Reporting User Forum
	• Corporate Governance Forum
	    • Japan Focus Group
	• **Eumedion**
	• European Fund & Asset Managers Association
	• Financial Reporting Council
	• FTSE Policy Group
	• Institutional Investor Group on Climate Change
	• Institutional Shareholders' Committee
	• **National Association of Pension Funds (NAPF)**
	    • Shareholder Affairs Committee
	• **UK Social Investment Forum**
	• UK Takeover Panel Code Committee

Asia-Pacific	• Asian Corporate Governance Association • Australian Institute of Company Directors • China Water Risk • Conference for the Promotion of Corporate Governance • Financial Services Council • **Investor Group on Climate Change** • Japan Finance Association • **Japan Society** • MPT Forum • Responsible Investment Association Australasia
Global	• Carbon Disclosure Project • **International Corporate Governance Network (ICGN)** • International Standards Organization Securities Evaluation Group • **United Nations Principles for Responsible Investment**

Note: **Bold** represents organization in which BlackRock plays a leadership role

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BLK-0843-0613

TAB 4 – PRIVATE MARKET APPLICATIONS

Prepared at the Request of the Oregon Investment Council:

Responsible Investment at KKR

May 28, 2014

Ken Mehlman

KKR Kohlberg Kravis Roberts

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For Investment Professionals Only

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KKR's Commitment and Approach to Responsible Investment

We believe it is not only possible for companies today to do well and do good, but it is an essential part of their success

- At KKR, we approach environmental, social, and governance (ESG) issues as critical to our investment process. We offer our companies specialized resources, access to best in class partners, and a series of customizable programs
- KKR is a signatory to the U.N. Principles for Responsible Investment and the Private Equity Council Guidelines on Responsible Investment
- We have ongoing relationships with leading organizations on issues that are critical to our business and to our portfolio companies. The organizations we work with include:

EDF Environmental Defense Fund – Finding the ways that work
BSR
American Heart Association | American Stroke Association
Transparency International – the global coalition against corruption
PRI
Ceres – Mobilizing Business Leadership for a Sustainable World
Investor Network on Climate Risk – a project of Ceres

Sample ESG Issues

ENVIRONMENTAL

- Land Use
- Carbon & Greenhouse
- Gas Emissions
- Biodiversity
- Natural Resource Scarcity
- Priority Chemicals
- Water Scarcity

SOCIAL

- Employee Relations & Labor Engagement
- Health and Safety
- Consumer Protection
- Data Privacy
- Human Rights

GOVERNANCE

- Regulation
- Anti-fraud & Anti-corruption
- Ethics & Integrity Stakeholder Expectations
- Transparency
- Board Composition &
- Independence

The Advantages of the Private Equity Model

Longer Time Horizon

- Measure progress over years, not quarters
- Invest 5-7 years on average

Alignment of Interests

- Work with key stakeholder groups (fund investors, company management, KKR employees)
- Focus on mutually agreed upon objectives

Active Management

- Engage fully in the operations and strategy of portfolio companies
- Provide resources and advice to help accomplish shared goals

Integrating ESG Management into the Private Equity Process

Material ESG Risks and Opportunities Assessed and Addressed

PRE-INVESTMENT

Identifying potential risks and opportunities

MANAGEMENT

Setting expectations and partnering with portfolio companies

Resources Available

- IC deck guidance
- Global Public Affairs and Legal & Compliance teams
- Sector-specific guidance documents
- Outside experts, including NGOs, legal, and consultants

Resources Available

- PMC annual report guidance
- Global Public Affairs, Legal & Compliance, KKR Capstone
- Outside experts, including NGOs, legal, and consultants

Core ESG Programs in our Private Equity Portfolio

	Program	Our Involvement	Shared Value Benefits	
Global	Green Portfolio Program	Since 2008, 25 portfolio companies enrolled: • Spanning North America, Europe and Asia • Across a variety of industries	Environmental benefits (at 19 PCs): • 1.8 million metric tons of greenhouse gas emissions • 4.7 million tons of waste • 19.5 million cubic meters of water use	Business benefits (at 19 PCs): • $917 million estimated cumulative costs avoided and additional revenue
Global	Responsible Sourcing Initiative	• 26 portfolio companies assessed for sourcing policies and protocols • 50% of KKR PE portfolio has received training	Social benefits: • Improved oversight and management of human rights issues in supply chains	Business benefits: • Reduced reputation risk • Enhanced supply chain relationships • Reduce possible supply chain disruptions
Global	Integrity and Engagement	In 2011, formed formal partnership with Transparency International to support our entire global PE portfolio	Social benefits: • Reduced corruption • Better understanding of all local stakeholders impacted by investments	Business benefits: • Protect our investments from a reputational & business perspective • Focus on compliance with FCPA, UK anti-bribery code
U.S. Only	KKR Wellness Works	9 portfolio companies participating in Wellness Works 4 portfolio companies and KKR participating in the research study	Social benefits: • More than 190k employees • Increased employee engagement levels	Business benefits: • Improved productivity • Fewer sick days • Control health care costs overtime
U.S. Only	Vets @ Work	19 portfolio companies participating in the program and tracking veterans hired	Social benefits: • High-quality jobs for nearly 22,000 US military veterans	Business benefits: • Highly skilled work force

Responsible Sourcing Case Study: CAPSUGEL®

In early 2012, Capsugel was assessed by BSR as part of KKR's Responsible Sourcing Initiative (RSI).

The assessment focuses on:

1. *Leadership and Vision*
2. *Designing and Measuring Performance*
3. *Establishing Expectations*
4. *Engaging with Suppliers*

Capsugel identified gaps and opportunities in its sourcing practices and made improvements in all four areas.

Key Initiatives

- Integrating responsible sourcing efforts cross-functionally in Procurement, Production, Quality, EH&S, and Supply Chain
- Appointing a global, cross-functional team to oversea these efforts
- Developing a Supplier Code of Conduct
- Embedding Responsible Sourcing requirements in Global Procurement Corporate Policies

When reassessed, Capsugel's new score was at the "leadership" level.

Note: Capsugel is the only North American portfolio company that engaged in a corrective action plan in 2013 as part of RSI. The specific portfolio company referenced is not representative of investments made by KKR Funds, and it should not be assumed that any investment in the company identified was or will be profitable.

Green Portfolio Case Study: Pets at Home

Pets at Home joined the Green Portfolio Program in 2008 to focus on energy efficiency, fuel efficiency and waste reduction.

Estimated cumulative results (2008-2012)

- $7.7M in avoided fuel costs
- 12,800 metric tons of GHG emissions avoided
- 23,800 metric tons of waste recycled

Key Initiatives

Fleet:

- Increased load efficiency of vehicles by maximizing space
- Invested in four extra-long trailers that can carry nearly 10% more pallets of stock, generating a saving in kilometers travelled; and therefore, a reduction in fuel use and CO_2

Facilities (Energy):

- Installed automatic meter reading at stores and established store baselines
- Replaced equipment, such as doors, with automatic options where relevant

Facilities (Waste):

- Implemented a 75% landfill diversion strategy with waste haulers
- Sent all waste from stores and the support office to a treatment facility
- Created an employee engagement program on recycling

Note: The following companies are all of KKR's portfolio companies enrolled in the Green Portfolio Program as of December 31, 2013: Accellent Inc., ATU, Bharti Infratel Limited, Biomet, Inc., Bis Industries Limited, Capsugel, Dalmia Cement, Del Monte Corporation, Dollar General, First Data Corporation, HCA Holdings, Inc., KION Group, MMI Holdings Limited, Oriental Brewery, Pets at Home, Sealy, SunGard Data Systems, Inc., Tarkett S.A., TDC, US Foods, Van Gansewinkel Groep, Versatel, Visant Corporation, Wild Flavors. They are not representative of all investments made by KKR Funds, and it should not be assumed that any investment in the companies identified was or will be profitable. Please see Important Information at the beginning of this presentation for additional disclosure regarding the Green Portfolio Program.

Investing in Solutions Around the World

The above highlights companies that KKR believes most represent its focus on ESG-related issues globally and is for illustrative purposes only. They are not representative of investments made by KKR Funds, and it should not be assumed that any investment in the companies identified was or will be profitable.

Our Global ESG, Regulatory and Stakeholder Engagement Team

Global Macro and Political Expertise

Henry McVey

Head of Global Macro and Asset Allocation

Ken Mehlman

Global Head of Public Affairs

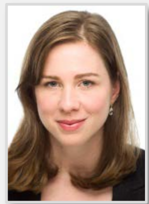
David Petraeus

Chairman of KKR Global Institute

Global ESG and Corporate Sustainability Expertise

Elizabeth Seeger

Global ESG



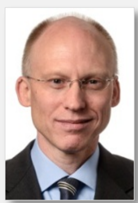
Ali Hartman

Global ESG

Regional Regulatory and Legislative Expertise

Travers Garvin

Americas Government & Regulatory Affairs



Ludo Bammens

EMEA Government & Regulatory Affairs

Steve Okun

Asia Government & Regulatory Affairs

Operational Expertise

Todd Cooper*

Procurement & Strategic Sourcing Subject Matter Expert

+

KKR Capstone

60 executives globally

+

KKR Legal & Compliance

Diligence & ongoing management globally

Global Approach
ESG principles, policies, processes, programs, reporting to investors and stakeholders

↓

Regional Implementation
Diligence of local investments, working with local portfolio companies, application of local laws, and exchange of expertise with local investors

↓

Cross-functional and integrated Diligence and Portfolio Management

* Managing Director in KKR Capstone

KKR

Sharing Best Practices Across the KKR Portfolio

We work to leverage key learnings from our portfolio companies in a variety of ways:

Annual Webinars

- Led by our non-profit partners and subject matter experts
- More than 12 webinars to date
- Topics range from diversity to raw material sourcing to good governance

ESG Roundtables

- Bring together the entire private equity investment chain
- Share and discuss best practices with respect to real-life ESG case studies, challenges, and opportunities

Creation of Tools and Resources

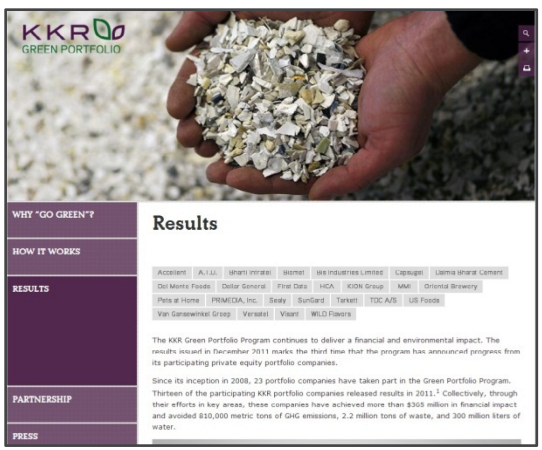
- Green Portfolio Program Handbook
- Supply Chain Sustainability Resource Guide
- Veteran’s Hiring Guide
- Workplace Wellness Playbook

ESG Reporting and Additional Resources

We believe communicating with stakeholders on ESG-related efforts is a critical component to creating shared value.

KKR is committed to transparency and communicating progress in a variety of ways:

- Annual ESG Report
- Dedicated ESG Websites
- Fact Sheets, Videos, Brochures
- Targeted Communications



For information more, visit: www.kkresg.com

TAB 5 – POWER GENERATION DYNAMICS

LS Power Group

The Economic Dynamics of Power Generation

Notice of Confidentiality & Disclosure

BY ACCEPTING THIS PRIVATE AND CONFIDENTIAL PRESENTATION AND ALL RELATED INFORMATION FURNISHED TO YOU ("CONFIDENTIAL INFORMATION"), YOU AGREE TO HOLD IT IN STRICT CONFIDENCE AND YOU AGREE NOT TO DISCLOSE THE CONFIDENTIAL INFORMATION TO ANY PERSON. YOU HEREBY ACKNOWLEDGE THAT THE CONFIDENTIAL INFORMATION MAY CONTAIN MATERIAL NON-PUBIC INFORMATION RELATING TO PUBLICLY TRADED SECURITIES. YOU FURTHER HEREBY ACKNOWLEDGE THAT YOU ARE AWARE THAT THE UNITED STATES SECURITIES LAWS (INCLUDING THE SECURITIES ACT OF 1933, THE SECURITIES EXCHANGE ACT OF 1934 AND THE RULES AND REGULATIONS PROMULGATED THEREUNDER AND THE PROHIBITIONS AND LIMITATIONS IMPOSED UPON A RECIPIENT OF MATERIAL NON-PUBLIC INFORMATION BY SUCH ACTS, RULES AND REGULATIONS) PROHIBIT ANY PERSON WHO HAS RECEIVED ANY MATERIAL, NONPUBLIC INFORMATION (SUCH AS THE CONFIDENTIAL INFORMATION) FROM PURCHASING OR SELLING SECURITIES OF THE ISSUER DESCRIBED HEREIN OR FROM COMMUNICATING SUCH INFORMATION TO ANY OTHER PERSON UNDER CIRCUMSTANCES IN WHICH IT IS REASONABLY FORESEEABLE THAT SUCH PERSON IS LIKELY TO PURCHASE OR SELL SUCH SECURITIES. THE TERM "PERSON" AS USED IN THIS AGREEMENT SHALL BE BROADLY INTERPRETED TO INCLUDE THE MEDIA AND ANY CORPORATION, PARTNERSHIP, GROUP, INDIVIDUAL OR OTHER ENTITY.

IN CONSIDERING ANY PERFORMANCE DATA CONTAINED HEREIN, YOU SHOULD BEAR IN MIND THAT PAST OR TARGETED PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS, AND THERE CAN BE NO ASSURANCE THAT THE FUND WILL ACHIEVE COMPARABLE RESULTS OR THAT TARGET RETURNS WILL BE MET. YOU SHOULD ALSO BEAR IN MIND THAT PAST OR TARGETED PORTFOLIO CHARACTERISTICS ARE NOT INDICATIVE OF FUTURE PORTFOLIO CHARACTERISTICS AND THERE CAN BE NO ASSURANCE THAT A FUND WILL HAVE COMPARABLE PORTFOLIO CHARACTERISTICS OR THAT TARGET PORTFOLIO CHARACTERISTICS WILL BE ACHIEVED. IN ADDITION, THERE CAN BE NO ASSURANCE THAT UNREALIZED INVESTMENTS WILL BE REALIZED AT THE VALUATIONS SHOWN AS ACTUAL REALIZED RETURNS WILL DEPEND ON, AMONG OTHER FACTORS, FUTURE OPERATING RESULTS, THE VALUE OF THE ASSETS AND MARKET CONDITIONS AT THE TIME OF DISPOSITION, ANY RELATED TRANSACTION COSTS, AND THE TIMING AND MANNER OF SALE, ALL OF WHICH MAY DIFFER FROM THE ASSUMPTIONS ON WHICH THE VALUATIONS CONTAINED HEREIN ARE BASED. THE IRRS PRESENTED ON A "GROSS" BASIS DO NOT REFLECT ANY MANAGEMENT FEES, CARRIED INTEREST, TAXES AND ALLOCABLE EXPENSES BORNE BY INVESTORS, WHICH IN THE AGGREGATE MAY BE SUBSTANTIAL. NOTHING CONTAINED HEREIN SHOULD BE DEEMED TO BE A PREDICTION OR PROJECTION OF FUTURE PERFORMANCE OF THE FUND.

LS Power Group Overview

LS Power is a fully-integrated investment, development and management services organization, focused on the North American power generation and energy infrastructure industries

- Founded in 1990, LS Power has built a significant franchise, with 180 employees across offices in New York, New Jersey, Missouri and California
- LS Power's affiliates include (i) a greenfield generation and transmission development business, (ii) a private equity business and (iii) a hedge fund manager
- A large team of in-house functional experts provide due diligence and management services to the projects the Firm acquires or develops

LS Power Group

LS Power Equity Advisors

- $6.36 billion in equity capital committed to the North American power and energy infrastructure industries through three private equity funds
- Acquired over 20,000 MW of power generation assets

LS Power Management & Development Expertise

- In-house functional experts support seasoned management teams for each asset, advising on all commercial, operational, financial, legal and regulatory issues
- Financed $27 billion of power and energy infrastructure
- Completed over 9,000 MW of power generation development
- Completed over 470 miles of high voltage (345 kV+) transmission development

Luminus Management

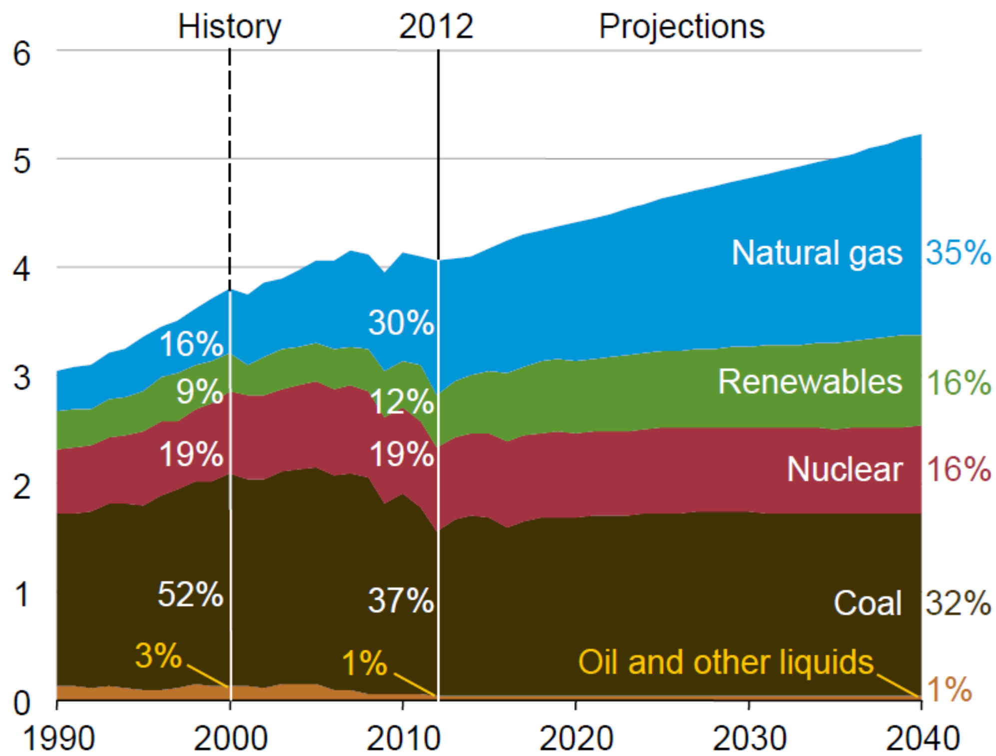
- $1.3 billion AUM long-short hedge fund utilizing fundamentally driven approach
- Invests through long and short positions across the capital structure of companies in the power, energy, utilities and related industries and sectors

Substantial market knowledge, extensive industry network and significant in-house expertise resident across the LS Power platform

Projected Electricity Generation by Fuel

- **Coal fired generation has traditionally been the largest component of electricity generation**
- **By 2035, natural gas generation is projected to surpass coal generation**
- **Increased generation from renewable energy, excluding hydropower, is expected to account for 28% of the overall growth in electricity generation from 2012 to 2040**

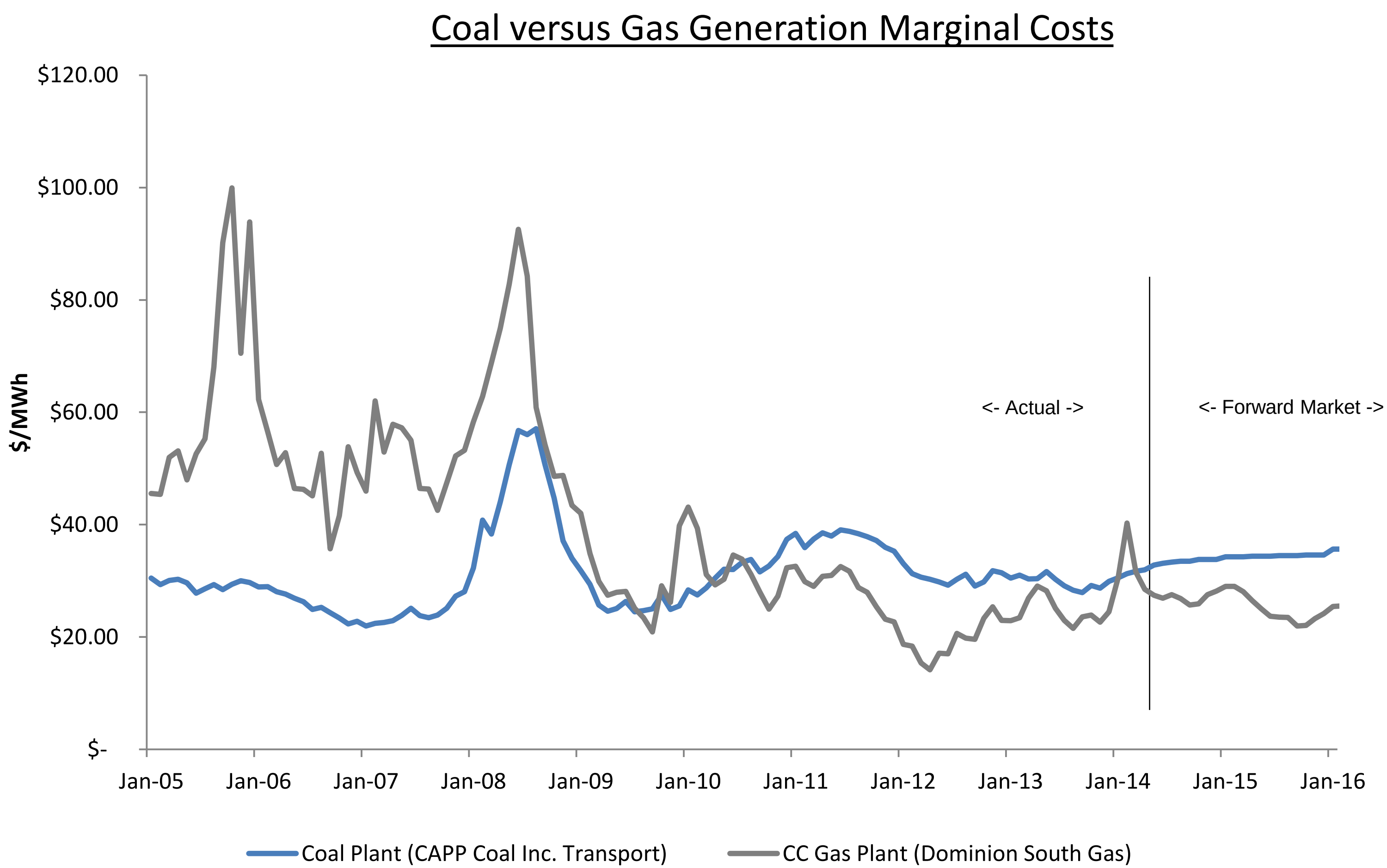
Electricity Generation by Fuel Type, 1990-2040 (trillion kWh)



Source: U.S. Energy Information Administration | Annual Energy Outlook 2014 Early Release Overview

Supply Dynamics

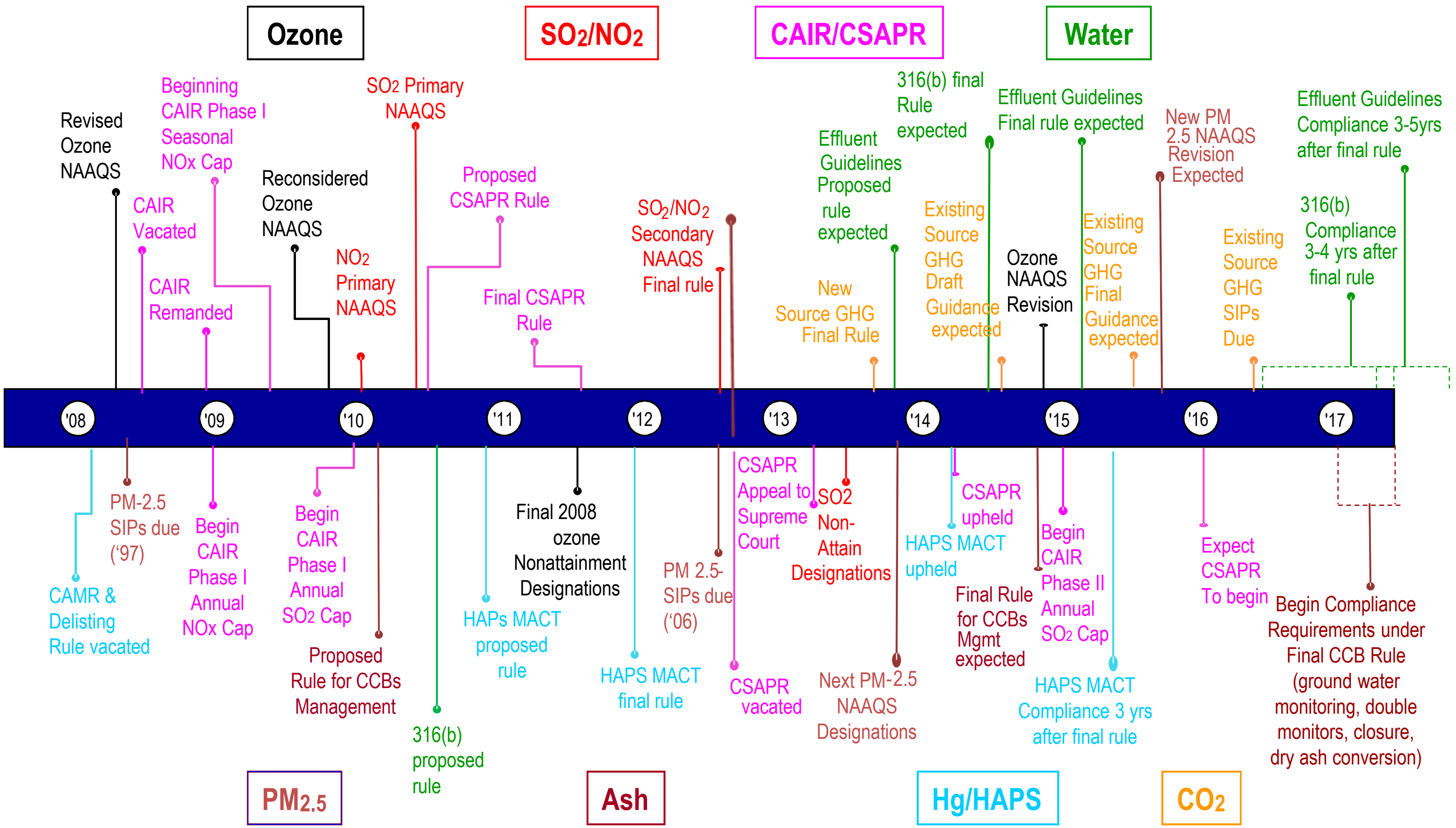
Given relative fuel cost differences, coal generation marginal costs have risen relative to natural gas generation, compressing profit margins for many merchant coal plants. Fixed costs are also higher for coal plants



Source: ICAP, LSP, ICE, Bloomberg, May 9, 2014

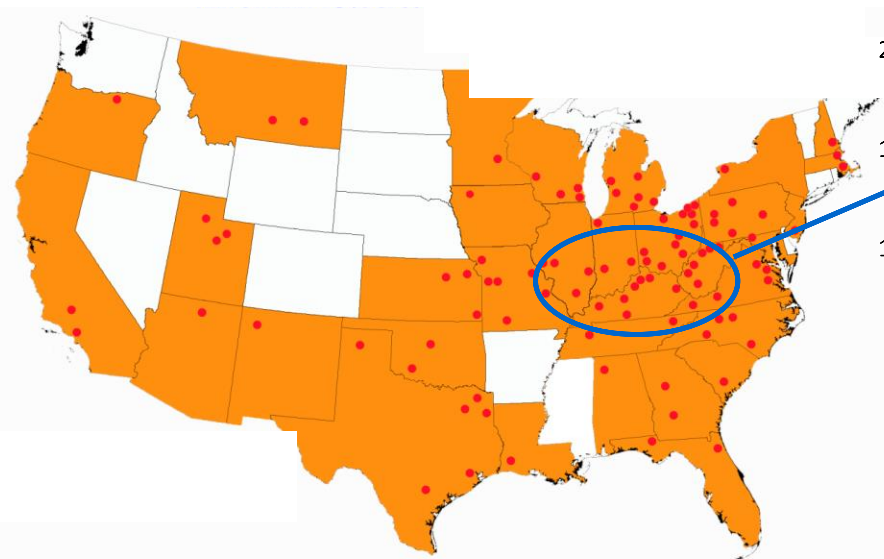
Additional Pressure from Environmental Regulations

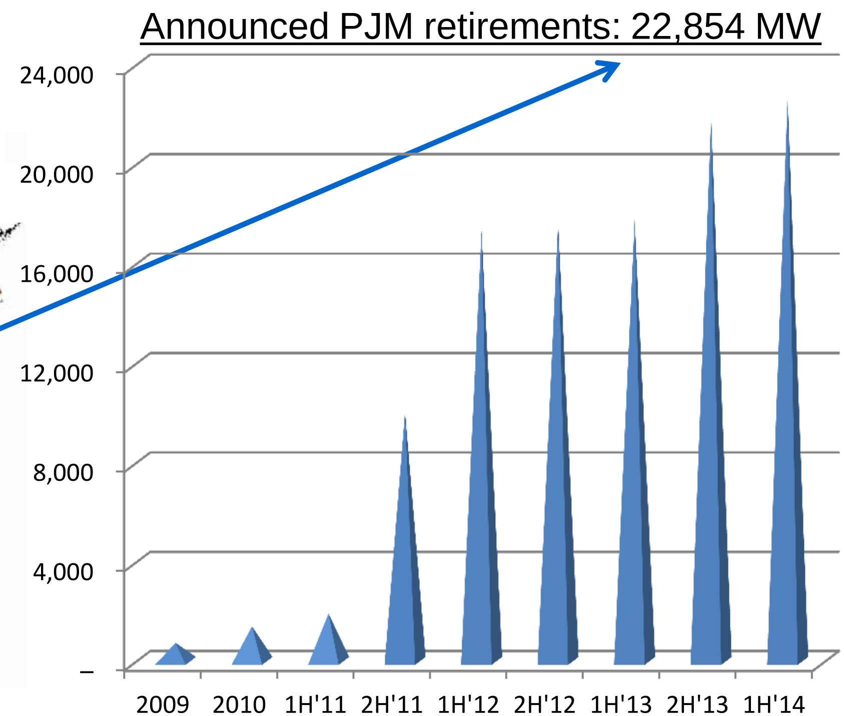
Environmental regulations will require capital expenditures, applying additional stress to older, primarily coal-fired, facilities



Intermediate-term Effect: Coal Plant Retirements

- **Over 33,200 MW of coal plant retirements have been announced across U.S.**
- **Drivers of retirement include margin pressure and expected capital expenditure to meet environmental regulations**





PJM Coal

- 22,854 MW in announced retirements (represents 29% of the region's coal and 13% of overall capacity)
- The cost to retrofit much of the existing coal capacity in PJM approximates or exceeds the cost to build a new gas-fired, combined-cycle asset in the same area

Nuclear Plant Retirements Emerge

- ***"More than one-third of US nuclear power plants are "on the razor's edge" of economic viability and could be forced into retirement by an unexpected "precipitating factor" such as … competition from lower-cost energy sources, falling demand, safety retrofit expenses, costly repairs, and rising operating costs" – Platt's (7/17/2013)***

- ***"Even plants with no pressing repair problems are feeling the pinch, especially in places where wholesale prices are set in competitive markets" – NY Times (10/23/2012)***

Nuclear Plants Retired / Announced (4,865 MW)

Plant Name	Capacity (MW)	State	Market
Crystal River	890	FL	N/A
Kewaunee	560	WI	MISO
Oyster Creek	637	NJ	PJM
SONGs	2,150	CA	CAISO
Vt Yankee	628	VT	ISO-NE

Nuclear Plants at Risk (9,696 MW)

Plant Name	Capacity (MW)	State	Market
Pilgrim	685	MA	ISO-NE
Clinton	1,078	IL	MISO
Duane Arnold	622	IA	MISO
RE Ginna	582	NY	NYISO
Beaver Valley	1,844	PA	PJM
Dresden	1,734	IL	PJM
Perry	1,268	OH	PJM
Three Mile Island	976	PA	PJM
Davis-Besse	908	OH	PJM

Source: Citi report (9/18/2013)

Levelized Total Costs by Fuel in PJM

When compared to annualized fixed costs, net revenue is an indicator of generation investment profitability, and thus is a measure of overall market performance and incentive to invest in new generation

PJM New Entrant 20-year Levelized Total Costs ($ per installed MW/yr)

Generation Type	2013	Net Revenue[1] > Levelized Fixed Costs[2]?
Combustion Turbine	$ 109,731	**mixed**
Combined Cycle	$ 150,654	**mixed**
Coal Plant	$ 491,240	**no**
Nuclear Plant	$ 801,100	**no**
Wind Installation (with 1603 grant)	$ 196,148	**yes***
Solar Installation (with 1603 grant)	$ 263,824	**yes***

*** Net Revenue including tax credits and renewable energy credits**

[1] Net Revenue equals total revenue received by generators (includes revenue from the PJM Energy Market, the PJM Capacity and Ancillary Service Markets, black start/reactive service provisions, production tax credits, and renewable energy credits), less the variable costs of energy production.

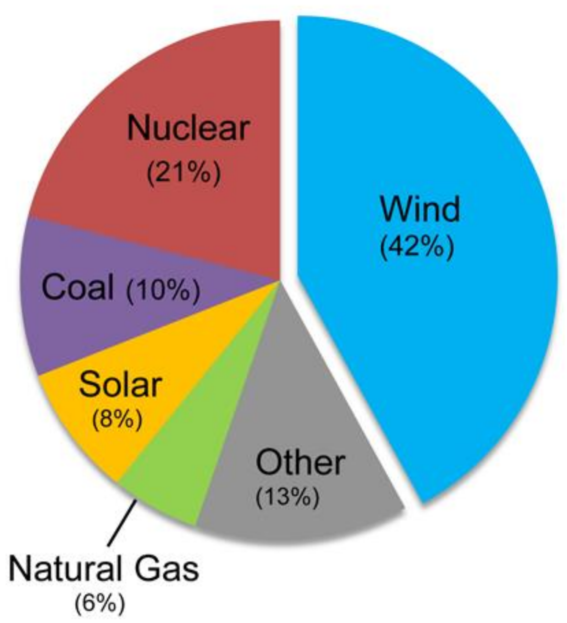
[2] Levelized Fixed Costs represent the costs associated with building and operating a generating plant over the lifetime of a project, including fixed operation and maintenance expenses, a return on investment, depreciation, and taxes. Wind and Solar energy properties are eligible for a 30% payment of the total eligible capital costs of the project under Section 1603 of the American Recovery and Reinvestment Tax Act of 2009.

Source: Monitoring Analytics, LLC, 2013 State of the Market Report for PJM, March 13, 2014

Renewable Energy is a Subsidy Driven Market

- **The economic viability of renewable energy generation relies heavily upon federal investments and tax subsidies**
- **State-level Renewable Portfolio Standards have increased demand for renewable energy generation. RPS mandates are currently in place in 29 states**
- **Despite the state incentives and federal subsidies, renewable energy (excluding hydropower) produced less than 6% of the entire US electricity generation in 2012**

<u>2010 Renewable Energy Subsidies</u>



Source: US Energy Information Administration, FY 2010 Data and U.S. Energy Information Administration

Conclusion

- Coal generation has historically been the largest component of electricity generation
- Several factors are hastening coal and nuclear retirements, and are leading to change within the fuel mix of the power generation market, including:
  - natural gas pricing dynamics, driven by advantages in extraction technologies and techniques
  - the implementation of environmental regulations and associated compliance costs
- The change in fuel mix will be gradual, and will not happen overnight
- Renewable energy will play an increasing role, subject to:
  - federal incentives and policy-driven demand growth
  - reliability (dispatchable generation) requirements
- Key drivers affecting the rate of change include:
  - policy at the state and federal level
  - the relative cost of fuel

TAB 6 – CONSTITUENTS AND CONSULTANTS

CalPERS: Investment Belief 4

Long-term value creation requires effective management of three forms of capital: financial, physical and human

….. Strong governance, along with effective management of environmental and human capital factors, increases the likelihood that companies will perform over the long-term and manage risk effectively

CalSTRS: Investment Policy for Mitigating ESG Risks

….As a significant investor with a very long-term investment horizon and expected life, the success of CalSTRS is linked to global economic growth and prosperity. Actions and activities that detract from the likelihood and potential of global growth are not in the long-term interests of the Fund.

World Economic Forum

…..The World Economic Forum's *Global Risks 2014* report finds income disparity the most likely risk to cause an impact on a global scale in the next decade

Oregon Investment Council

Environmental, Social and Governance (ESG) Discussion

May 28, 2014

Janet Becker-Wold, CFA
Senor Vice President
Fund Sponsor Consulting

Environmental, Social and Governance Investing (ESG)

- **ESG themes – clean energy, environmental protection; sustainable infrastructure and development; health and well being; social equity**
- **Criticisms**
  - Does not support fundamental analysis, restricts the investable universe, Efficient Market Theory would assert that all relevant information is in the price
- **Proponents**
  - Markets do not efficiently price ESG factors because they address long-term risks not absorbed by the economy therefore alpha generation is possible as markets recognize undervalued influences
- **Academic research is inconclusive**
  - Low quality of ESG data reported by companies
  - Lack of consistent standards of comparison
  - Short measurement history
- **Approaches to integrating ESG vary**
  - Full ESG integration
  - Issue-based screening
  - Responsible Investing or ESG-branded products
  - Governance or active ownership (shareholder activism) – most prevalent

Callan's Approach to ESG

- **Callan works with clients to understand their investment objectives and establish a sound fiduciary process for making decisions**
- **Biggest issue: defining ESG**
- **Public DB – Labor Focus: Emerging Market Permissible Country Screen**
  - Fashioned after CalPERS approach which ended in 2007
  - Restricts EM equity benchmark at country level based on Trustee determined non-financial factors
- **Specialist mandates vs. traditional allocation = level of ESG emphasis**
  - ESG as a component of a traditional approach (corporate governance is most common)
  - Specialist ESG mandates are rare in the US (largest public plans = environmental sustainability focus)
- **Ex- Tobacco, Sudan, Iran**
- **Recently: Divest fossil fuels?**

U.S. Investor Views of ESG

Summary of Callan Survey Results

- **Adoption Rates – 22% responded yes, 78% no**
  - By fund type – Foundations had the highest rate of ESG adoption followed by endowments, public and corporate pension funds
  - By asset size – Funds with greater than $2 billion tend to embrace ESG more than their smaller counterparts
- **Top 5 reasons for incorporating ESG (in descending order of popularity)**
  - Investment Policy dictates consideration of ESG
  - Other goals beside maximizing risk-adjusted returns – ESG helps obtain these other goals
  - Fiduciary responsibility
  - Expect to achieve higher risk adjusted returns over the long run (public funds and endowments only)
  - Expect to improve risk profile
- **Top 5 reasons for not incorporating ESG (in descending order of popularity)**
  - Unclear what the value proposition is (53%)
  - Will not consider non-financial factors in investment decision making (47%)
  - Unsure of how ESG factors fit in strategic asset allocation (31%)
  - Do not have the time and/or staff resources to explore (21%)
  - Benchmarking is too difficult (14%)

Survey respondent profile: 129 funds and trusts representing $830 billion in assets (23% corporate, 32% public, 19% endowment, 17% foundation and 9% other).

PENSION
CONSULTING
ALLIANCE

Academic and Market Research on Divestment

Sarah Bernstein
May, 2014

Table of Contents

Acknowledgements

PCA extends our thanks to those authors who have contributed over the years to the body of research on the financial impacts of divestment on investors. We also thank the following individuals and organizations for their contributions in our effort to be as comprehensive as possible on the research available on this aspect of divestment.

Alka Banerjee, Managing Director, Equity Indices Product Mgt, S&P, Dow Jones Indices
Bevis Longstreth, former Commissioner, U.S. Securities and Exchange Commission
Bob Massie, President, New Economics Institute
Brett Fleischman, Senior Analyst, 350.org
Clem Dinsmore, Financial Advisor, Oppenheimer & Co., Inc.
Dan Kern, President & Chief Investment Officer, Advisor Partners
David Harris, Director of Responsible Investment FTSE
John Noel, DC Divest
Ken Locklin, Managing Director, IMPAX
Patrick Geddes, Chief Investment Officer and Partner, Aperio Group
Peter Ellsworth, Senior Manager, Investor Relations, C.E.R.E.S.
Tom Kuh, Business Director, ESG Indices, and Michael Anderberhan, V.P. MSCI

Executive Summary

Beginning in the late 1970's when the South Africa divestment campaign began, through to today's fossil fuel divestment campaign, numerous estimates and studies have sought to quantify the financial impact of various divestment campaigns on the pension plans engaged in the divestments. Since the South Africa divestment campaign, institutional investors' presence and influence as shareholders of companies has grown and become significantly more organized. The trend among institutional investors is to engage rather than divest. The trend has been strengthened as engagement strategies on a variety of matters have been successful.

This report focuses solely on a review of the analytic literature on the financial impacts of divestment. This review does not address the important tradeoffs of large institutional shareholder engagement compared to divestment, or the advantages/disadvantages of concurrent divest in some, engage in others strategies.

On the whole, theoretical models suggest that narrowing the universe of investable securities should have a negative impact on the portfolio in the near term, due to the direct costs of divestment including commission costs, market impact costs, and due to the opportunity cost of the portfolio being constrained and stocks being excluded from the universe of investment opportunities. Over the longer term, a portfolio that is restricted for non-financial reasons would therefore be expected to reduce the risk-adjusted return of the portfolio as compared to a non-restricted portfolio. The empirical literature shows mixed results, in large part due to:

1. The **breadth of the market** which is targeted for divestment (for example, targeting four stocks in a Sudan divestment campaign had close to zero impact on the overall portfolio, as compared to targeting 37% of the NYSE market capitalization for a South Africa-free portfolio),

2. The **time period studied** (for example, fossil fuel free portfolios clearly outperform (underperform) benchmark portfolios during periods when pricing dynamics in oil and gas hurt (enhance) these company's profitability. Tobacco stocks meaningfully under-performed the market in the two decades of social concern (1947-1965) prior to 1965 government restrictions being imposed. Post-1965, sin stocks, including tobacco, outperformed.

3. The **market characteristic differences between the 'replacement' portfolio and the benchmark**: For example, South Africa-free campaigns included empirical studies that found increased returns in the divested and redeployed portfolio compared to the benchmark, due to the smaller-cap bias of the replacement portfolio, with only a modest increase in risk, and fossil fuel free empirical estimates are similarly affected by the choices made for replacement stocks. Low carbon investable benchmarks that keep tracking error narrow and reduce carbon reserve exposure by 30% or more are now offered.

Researchers also analyze the transaction costs involved in selling targeted stocks and replacing them with non-targeted stocks. Transaction costs are always incurred and estimates have ranged from less than 0.2% of the total portfolio to 3%, depending on assumptions including the percentage of the total portfolio that is being replaced.

Distinct from the financial impact on investors, is a question of whether divestment campaigns provide the non-financial benefit of furthering the social cause they were designed to support. Studies suggest that the measurable financial impact on the companies targeted for divestment has been largely minimal. There is some weak evidence that there was a financial improvement in the stock price of companies who subsequently exited the country in question, and some evidence that the tobacco-free portfolios of many large institutions have made financing more expensive for tobacco companies. The most comprehensive review to date (Oxford, 2013) finds that divestment campaigns' successes have not been through the direct impact on the company's financials, but through a larger 'stigmatization' impact which resulted in successful lobbying of governments for restrictive legislation, which in turn had meaningful effects on the business practices of targeted companies/industries. These studies do not compare engagement strategies with divestment strategies.

South Africa

In the 1980s, many states directed their retirement systems to purge themselves of the stocks of companies operating in South Africa. The early research into portfolios flagged for social/ethical reasons related to portfolios constrained by South Africa exclusions.

Rudd (1979) looked at the avoidance of 177 United States S&P companies operating in South Africa (42% of the S&P market value). The remaining list of stocks was then optimized to form a portfolio that matched the S&P 500 as closely as possible. Rudd found that the effect on portfolio risk of excluding the companies operating in South Africa was not particularly meaningful. He derived a formula which related the increase in 'units of volatility' (square of the annual standard deviation or tracking error) to expected loss. The general result was 0.0075% for every unit of volatility. He found that while there is some increase in risk, it should not be prohibitively significant unless a very large number of stocks are excluded. Rudd calculated that a loss of 0.03% a year might be expected based on an increased annual tracking error of 2-3%.

Loeb (1983) presents evidence that trading costs are significantly higher for midcap stocks than for large cap stocks for large block trades. Therefore, operating under conditions which restrict a significant number of large capitalization stocks, managers cannot maximize portfolio returns and must settle for some 'optimized' return within the given constraints.

Wagner, Emkin and Dixon (1984) examined the effects of divesting from 152 companies in the S&P 500 with South African links. They replaced each targeted company with the largest company available in the same industry and estimated the transaction costs of replacement with an equally weighted portfolio of substitute stocks to be 6.0% of the amount divested, or

2.28% of the overall portfolio value. The returns for these companies were examined over the five-year period ending in the first quarter of 1984. The rates of return were 7% higher for the non-South African linked companies than for the South African linked companies, a possible smaller company effect. They then looked at the increase in risk using the portfolio's beta and R-squared and found that the non-South Africa linked universe was very well diversified with an R-squared of 0.968 but that it was riskier than the market, having a beta of 1.08. Wagner et al conclude that "In general, the restrictions will increase investment risk, reduce investment and diversification opportunities, and increase the costs of research, trading and administration. And the larger the fund, the greater the impact will be."

Love (1985) estimated the one-time divestiture cost at 1.3% or $13 million per $1 billion portfolio. Ennis and Parkhill (1986) estimated a cost of $15 million per $1 billion for an unqualified divestment. Ongoing costs to monitor firms' actions toward South Africa are not captured in these studies, and would be in addition to those mentioned.

Grossman and Sharpe (1986) analyze the results of a 'buy and hold' divestment strategy from the 1984 IRRC list of firms. Because most of the firms with operations in South Africa were quite large, the impact of excluding all stocks from the investable universe reduced the market capitalization of the S&P 500 investable universe to less than 55% of the market capitalization of the S&P 500, and reduced the New York Stock Exchange market capitalization to approximately 63%. Because of the larger cap nature of companies with direct investments in South Africa, the South Africa-free universe shows a 'small cap' bias.

Grossman and Sharpe conclude their analysis of the financial implications of divestment from South Africa stocks stating that: "compared with a portfolio representing the overall stock universe, a representative highly diversified South Africa-free strategy can provide a slightly higher expected return with the same risk but considerably less liquidity (both results due to its concentration in small stocks). The relative importance of these two differences will, of course, depend on the circumstances of the fund in question, as will the assessment of the potential non-financial benefits of divestment which have not been treated here."

CalPERS' divestment from companies doing business in South Africa began in January 1987 and was lifted in 1994. CalPERS estimates that there were $529 million in financial losses to the fund attributable to this divestment action, including commission costs, market impact and opportunity costs for the entire divestment period. In May, 2007, Wilshire estimated that if those $529 million in foregone funds would have earned the overall rate of return of the fund during all subsequent periods, the total impact of CalPERS' South Africa divestment as of December 31, 2006 would have been $1.86 billion. This cost includes all applicable and appropriate costs (actual transaction costs, market impact and opportunity costs) since the original divestment in 1987.

Another example of a state retirement system South Africa divestment program is that of the New Jersey Division of Investment. New Jersey began divesting from companies doing business in South Africa as mandated by New Jersey State law in August 1985, and completed its divestment program in August 1988, having sold or otherwise disposed of $4.2 billion in targeted securities. The November 1988 report to the New Jersey State Legislature concludes that the program cost the fund, after initial transaction costs estimated at $44 million, opportunity costs considerably in excess of the original $25 million annual cost estimate. The report states that although market access has been improved in recent months by the withdrawal from South Africa of several large international companies, including IBM, Exxon, Kodak and Merck, the aggregate equity market access of the South Africa free universe available to the Division was $1.07 billion vs. $1.56 billion for the previously available universe. They conclude, "However, the effects to date are modest when viewed in the context of the size of the pension fund portfolios ($19.9 billion at market value on August 31, 1988)." The report is qualified with the statement: "the period covered is only three years, and the respective returns and markets for targeted and non-targeted securities will change over time".

Transaction Costs of Divestment

One-time transaction costs of divesting from some stocks and replacing those stocks have also been researched. Wagner, Emkin and Dixon estimated the transaction costs of replacement of 152 stocks in the S&P 500 and replacement with an equally weighted portfolio of substitute stocks to be 6.0% of the amount divested, or 2.28% of the overall portfolio value.

Grossman and Sharpe estimated that selling 37.1% of the value of the initial NYSE portfolio and reinvesting the proceeds on a value-weighted basis in the remaining South Africa-free stocks would generate transaction costs of 2.57% of the amount divested, or 0.95% of the overall portfolio value.

The November 1988 report to the New Jersey State Legislature concludes that the initial transaction costs of having sold or otherwise disposed of $4.2 billion in targeted securities was estimated at $44 million. This amounts to transaction costs 0.22% of that $19.9 billion total portfolio.

Impact of Divestment on Targeted Companies

Teoh, Welch and Waazan (1999) examine the effect of the shareholder boycott of South Africa's apartheid regime. They find that for all the visibility associated with the boycott, there was little discernible effect either on the valuations of banks and corporations with South African operations or on the South African financial markets, because corporate involvement in South Africa was relatively small. They do find some weak evidence that institutional shareholdings in corporations with South African investments increased when those corporations divested from South Africa.

Summary

In sum, the literature on the largest country-specific divestment campaign ever conducted generally appears to have incurred costs to the funds that would not have been born if the plans had not divested from companies doing business in South Africa.

Apartheid was brought to an end. The contribution of the broad divestment campaign to public pressure on the South African apartheid government is not measurable. Proponents argue that such strong measures contributed greatly to the eventual demise of apartheid, including encouraging large multinational companies to cease business operations with South Africa under the Apartheid regime. At the time, many plans concluded that although their South Africa divestment program imposed a financial cost to their pension plan, that cost was de minimis in relation to the total assets of the fund. Opponents contend that divestment took away large shareholders' ability to influence the companies with operations in South Africa without having any meaningful impact on those companies financial situation.

Tobacco, 'Sin Stocks', and Munitions

A range of academic studies have been conducted on 'sin stocks,' which typically include companies involved in producing tobacco, alcohol and gaming products. In contrast to the South Africa campaign, which included many state legislative mandates to divest, campaigns to divest from tobacco holdings have often gone forward in the absence of legislative mandates.

A 1999 review by EIRIS on ethical investing summarizes prior studies on tobacco. Kahn et al looked at the outperformance of tobacco stocks compared to the S&P 500. Over the 10-year period 1987-1996 the S&P Ex-tobacco index underperformed by 0.21% in terms of total return and the tracking error (standard deviation of the relative return) was 0.46. Kahn et al looked at reducing this risk by replacing tobacco with some of the highly correlated industries, and found that it was possible to reduce tracking error to 0.42 from 0.46. Their general conclusions were that: tobacco divestiture doesn't stand up as an investment decision and that it doesn't reduce risk in the typical pension fund context.

A 1997 study by Guerard showed that the use of a) environmental, b) alcohol, tobacco & gambling, c) military and d) nuclear screens produces portfolios with higher excess returns than those from unscreened portfolios and tobacco-free portfolios for the period 1987-1996. Guerard found that the only social screen that consistently cost the investor returns is the military screen for the period 1992-1997. Guerard concluded that there were no statistically significant differences between the average returns of a socially screened and an unscreened universe during the period 1987-1996.

A recent comprehensive review and study on tobacco and other "sin" stocks was conducted by Hong and Kacperczyk (2008). Hong et al hypothesize that there is a societal norm against funding operations that promote vice and that some investors, particularly institutions subject to norms, pay a financial cost in abstaining from these stocks. Consistent with this hypothesis, Hong and Kacperczyk find that sin stocks are less held by normally-constrained institutions, such as pension plans as compared to mutual or hedge funds that are natural arbitragers, and that sin stocks receive less coverage from analysts than stocks of otherwise comparable characteristics. Sin stocks also have higher expected returns than otherwise comparable stocks, consistent with them being neglected by normally-constrained investors and facing greater litigation risk heightened by social norms.

Hong et al found that sin stock comparables had, on average, about 28% of their shares held by institutions, in contrast to about 23% by sin stocks, or 8% lower institutional shareholdings. They hypothesize that sin stock prices should be depressed relative to their fundamental values because of limited risk sharing and hence sin stocks should have higher expected returns than comparables. Second, because of neglect or limited risk sharing, the increased litigation risk associated with the products of sin companies, which is further heightened by social norms, should further increase the expected returns of sin stocks.

Using time-series regressions during the period of 1965-2006, they find that a portfolio that is long sin stocks and short their comparables has a return of 26 basis points per month. Second, using cross-sectional regressions controlling for firm characteristics (data from 1965-2006) they find that sin stocks outperform their comparables by 29 basis points a month- a statistically and economically significant and sizeable magnitude – even after accounting for well-known determinants of expected returns in cross-sectional regressions such as market size, past return, and market-to-book ratio.

They further validate their findings by looking at the fluctuation over time of tobacco stocks and the variation in the social norms governing tobacco over time. The key prediction is that tobacco stocks should under-perform over the period of the late 1940's (when anecdotal evidence suggested the change in norms with previous reports about health in the late 1940s) until the mid-1960's, when essentially even the government recognized that tobacco posed a health risk and imposed many restrictions. The study finds that tobacco under-performed the market by a significant 3% a year, or something on the order of 40% over the period 1947-1965. Post-1965, sin stocks, including tobacco outperformed. Hong et al conclude that "some investors, particularly institutions subject to public scrutiny and social norms, pay a financial price for not holding these stocks."

In 2000, the CalPERS Board voted to implement tobacco free benchmarks and indices and divest from passively-managed tobacco stocks and bonds. This decision was based on a portfolio risk-return analysis, including a review of the litigation, regulatory, and reputational risks that could affect the long term sustainability of the tobacco industry. In December 2000, CalPERS became the fifth state employee retirement system to divest from tobacco stocks. The divestment program was complete by February 2002. A total market value of $0.74 billion of tobacco securities were sold by CalPERS and external passive managers.

CalSTRS initiated an ex-tobacco modified benchmark in June 2000 that remains in place today. Under the CalSTRS program, active investment managers are not prohibited from buying equity or debt of tobacco companies. However, since these securities are not in their performance benchmark, ownership of these companies may be a significant bet away from their "home base" benchmark. The CalSTRS semi-annual review of the Benchmark modification policy states that the "practical result of the Policy is that our external managers avoid these securities." The CalSTRS total tobacco-free opportunity cost is now estimated at approximately $1 billion.

Florida SBA divested from tobacco in June 1997, at which time the state of Florida had lawsuits filed against the tobacco companies. The Florida Retirement Plan lifted its tobacco investment ban three years later when a new Administration and a new set of Trustees determined that the litigation risk hanging over tobacco was largely over. The plan estimated its direct investment loss from deleting 16 stocks, including the transaction costs at $482 million.

Statman and Glushkov's (2009) thorough survey of the social responsible investment ("SRI") analytic articles emphasizes that SRI screens tend to be a mix of positive screens that include companies that score high on the particular SRI issue of concern, and negative screens that exclude companies based on socially responsible criteria, such as tobacco, alcohol, gambling, firearms, and military or nuclear operations. Their findings for analysis of 1992-2007 returns found that SRI tilts gave SRI investors an advantage over conventional investors. It also found that shunning stocks resulted in a disadvantage for such investors relative to conventional investors. They conclude that Socially Responsible Investors can thus do both well and good by adopting the 'best-in-class' method in constructing their portfolios: tilting toward stocks of companies with high scores on social responsibility characteristics, but refraining from shunning stocks of any companies. This article's findings on shunning stocks is thus consistent with findings that some amount of lower risk-adjusted return should be expected from divestment of tobacco, 'sin stocks' and munitions as compared to a conventional portfolio.

Summary

The general conclusion from the literature and experience with the widest industry-related divestment campaign among public pension plans suggests that the tobacco free campaign has burdened plans that have divested with an opportunity cost that has, over time, become meaningful in some cases. The literature on the impact on the tobacco companies suggests that the broad institutional and individual tobacco free campaign may have increased the financial costs to tobacco companies somewhat. In general, it is strongly debated whether divestment has generated the social benefit that it was intended to generate. The fund performance results have been on the whole negative to differing degrees, both for divestment plans, and for plans that introduced benchmark modification plans without explicitly dictating that their investment managers divest.

Sudan

The Sudan divestment campaign began in 2003 and is the largest country-specific divestment campaign since South Africa, more than two decades earlier. The campaign differed markedly from predecessor divestment campaigns in the accommodation to the fiduciary constraints on divestment of pension plans. As a result, the Sudan divestment model deployed was less typically expansive and intrusive for investors than the South Africa divestment efforts.

The targeted Sudan divestment model entails less than thirty problematic companies, none of which are in the S&P 500 (or any other U.S. predominant index). At that time, United States law prohibited most U.S. multinational companies from engaging in trade and foreign investment with Sudan. Exceptions are made for some firms in the agriculture and health care sectors, which received a license from the U.S. Department of the Treasury to do business in Sudan. However, U.S. law did not prohibit companies, institutions, or individuals from investing in foreign multinationals that operate in or sell to Sudan. The Sudan divestment efforts focused solely on foreign multinational companies. In contrast, South Africa divestment targeted a wide range of large multinational companies, including roughly one third of the companies in the S&P 500 (with the S&P 500 representing a major portion of investor stock portfolios at the time).

The targeted approach to Sudan divestment was not universal. Adopting a broad inclusive target list was a major problem at the Teachers Retirement System of Illinois (TRSI), a $30 billion pension system. In Illinois, state law passed a Sudan divestment law that utilizes a very broad definition for companies doing business with Sudan. As a result, it was expected that TRSI would have to divest $3.3 billion to restructure its overall portfolio. In addition, the Illinois law requirements may have precluded TRSI from investing in numerous private equity vehicles. For example, the Texas Pacific Group, a leading private equity investor and a firm TRSI has done business with, indicated that it would no longer accept TRSI capital. At the other end of the spectrum, Stanford University approved a narrow divestment focus list of only four companies.

The Sudan Divestment Task Force 2008 Peer Performance Review found that "evidence from states that have already adopted highly-targeted Sudan divestment programs or policies suggests that only minimal percentages of an investment portfolio will be affected." None of the U.S. public pension plans that adopted the targeted model held over 0.3% of their assets in problematic companies. Most held less than 0.1%. The report also found that "Recent data supports the hypothesis that targeted Sudan divestment may be a sound financial decision. The May 2008 report finds that on average the 'Highest Offenders' in Sudan underperformed their peer group average by 45.97% over one year, 22.2% over three years, and 7.22% over five years. Forecasted return on equity for 'Highest Offenders' was on average 6.06% less than the peer group mean."

The median returns for "Highest Offenders" in Sudan underperformed their peer group median by 1.09% over 1 year, 16.07% over three years, and 3.3% over five years. The underperformance of the "Highest Offenders" in Sudan corresponds with the rise of the Sudan divestment movement, which gained significant momentum at the start of 2007.

Parwada (2013) analyzes four targeted Sudan Divestment stocks for the period 2001-2012 to investigate the campaign intensity impact on the four stocks. He finds some evidence of a positive relationship between the campaign and shifts in the ownership breadth of the stocks. "However, selling by institutional shareholders is far from universal. Overall there is an increase (decrease) in shareholdings of U.S. (non-U.S.) investors, rather than an overall decline in ownership. Measures of campaign intensity are negatively related to short term expected returns."

Summary

Because of the relatively narrow targeting of the Sudan divestment campaign, the financial impact on most plans was de minimis, in contrast to South Africa. The Sudan divestment campaign also contrasts with the most significant industry divestment campaign – tobacco. Like South Africa, the tobacco campaign targeted a wider segment of the large cap market, which, during various time periods, included relatively highly profitable stocks, thus resulting in a long-term loss to larger pension funds.

Fossil Fuels

The fossil fuel divestment campaign emerged as concern that the rising levels of carbon dioxide in the earth's atmosphere are threatening to humanity due to climate change. Led by students, the focus of climate change campaigns shifted dramatically in 2013, to calls for divestment from fossil fuel companies from the world's major pension funds and endowments from lobbying policymakers for carbon emission regulations. The imperative and goal: cease fossil fuel extraction.

The fossil fuel divestment campaign mirrors previous campaigns in most respects. It is distinct in:

- **Global Implications**: Climate change concerns are global rather than of a single country (South Africa, Sudan) or industry (tobacco, gaming, munitions). The latest Intergovernmental Panel on Climate Change Report (September 2013) estimates that there is a 95% - 100% probability that human activities are responsible for the emissions of heat-trapping greenhouse gases (GHG) that raise global temperatures.

- **Carbon Bubble Argument that target fossil fuel stocks are overvalued**: Fossil free divestment arguments often include expectations that because of the physical necessity of the world to move beyond fossil fuels, the fossil fuel company valuations are in fact higher than warranted today because 'stranded assets' are not yet being taken into account into valuations. Thus, for example, Toronto350 (2013) argues that "by selling its holdings before the majority of investors accept that most remaining fossil fuel reserves are unburnable, the University of Toronto can protect itself from the risk that fossil fuel stock values will fall substantially as the world realizes that their reserves are too dangerous to burn."

- **Divest fossil fuel campaigns are commonly linked to Invest in sustainable companies themes**: Fossil fuel divestment campaigns are often paired with arguments to invest in sustainable energy, rather than just divest from a given set of stocks and replace them with as similar as possible stocks from a market capitalization perspective.

The organization 350.org which spearheaded the initial calls for divestment asks institutional investors to:

  - Stop investing in the Carbon Tracker 200
  - Divest over five years from direct ownership and any comingled funds that include fossil fuel public equities and corporate bonds within five years.

The fossil fuel divestment campaigns reignited studies on the financial impacts of divestment. None of the analytic literature to date that we are aware of has produced any estimates of this type of five-year approach to fossil free divestment. We are aware of only a few estimates of transaction costs in this campaign, to date.

Estimates of divestment risk for fossil fuels range widely, and empirical studies encompass financial impacts of divesting from limited lists of the 'Filthy Fifteen', to more encompassing lists, most notably the Carbon Tracker top 200 coal, oil and gas companies that have the greatest estimated carbon reserves, to partial divestment lists that still hold companies among the top 200 that have the best Environmental track records, and a range of other variations.

Kritzman (2013), builds on Adler and Kritzman (2008) to argue that "an investor who chooses 250 securities from a representative sampling of world stocks and who is correct 52 percent of the time, if that investor were to exclude 20 percent of available securities, he would sacrifice about $270 million over 20 years, assuming an initial portfolio value of $1 billion and an average market return of 8 percent, the long-term expected return for many asset owners these days. That estimate arises solely from the fact that restricted investment universes offer fewer opportunities to skillful investors. And it does not include the substantial transaction costs that one would incur by divesting part of a portfolio." Ruud (2013) questions the fact that Adler and Kritzman fail to report risk-adjusted returns, and the lack of real world data inputs to their mathematical models.

In contrast to the materially negative impact estimated by Kritzman and Adler, the Aperio Group (2013) found that divesting from the 13 listed members of the "Filthy Fifteen" top 15 coal mining and utility companies, increases absolute portfolio risk by only 0.0006 percent and that divesting from the entire fossil fuel sector resulted in a 0.0034 percent return penalty, or less than one half a basis point. In historical back testing for January 1988 – December 2012, they find a slightly higher return +0.08% higher, with 0.78% tracking error, for a portfolio with no stocks from Oil, Gas & Consumable Fuels, as compared to the Russell 3000 benchmark. They conclude that "the investment math does affect a portfolio's risk and return, but also shows that the impact may be far less significant than presumed."

Aperio Group (2014) reviews the carbon free tracking portfolio from a global perspective, and developing carbon-free equity tracking portfolios that exclude Oil, Gas and consumable Fuels and track their respective indices as tightly as possible which generally shifts investments into energy consumers -utility stocks and materials. Back tests were performed, re-weighting the portfolio's quarterly. For the trailing 10-year results, differences for the U.S. portfolio were positive for the carbon-free portfolios until late 2006, and have been mostly negative since, however the differences are small throughout the study period. The return differences were positive throughout the 10-year history for the Australian, Canadian and Global portfolios. For the Australian, U.S. and Global markets, the return differences were less than 0.50%. Canada, which has relatively high carbon exposure, with an average fraction of the market excluded of 20.6% (as compared to the U.S. of 7% and Global of 8%), the return differences were close to 1.0% at their highest. Aperio group also shows that implementing positive screens such as renewable energy or other sustainable industries on top of fossil fuel divestment further increases tracking error.

Advisor Partners (2013) conducts empirical studies of three different carbon free alternatives:

Full Divestment:	S&P500 excluding 72 U.S. oil, gas, and coal companies and many chemical companies, utilities and miners.
Partial Divestment:	S&P500 minus fossil fuel companies that receive the worst ratings.
No Divestment:	S&P500.

Their simulated historical performance over the 22 years from 1990 -2012 found that the full divestment portfolio had a significant performance advantage in the early years (includes 2002-2004 oil price bubble), and underperformance during several years in the second decade of analysis. The differences in the standard deviations of the three portfolios were modest: No divestment 21.74%, Partial Divestment 22.04%, Full Divestment 21.96%. The predicted tracking error for the partial divestment portfolio was 1.06%, and 1.57% for the full divestment portfolio. Advisor Partners concludes that the incremental increase in risk is relatively low.

On the following page, MSCI (December 2013) summarizes their back test results of four different approaches to fossil fuel divestment and low carbon economy investment.

MSCI Summary of Four Approaches to fossil fuel divesting and low carbon investing

Approach #1 **Fossil Fuel Divestment**	*Approach #2* **Low Carbon**	*Approach #3* **Carbon Tilt**	*Approach #4* **Thematic Opportunity**
Exclude from MSCI ACWI any company with identifiable fossil fuel reserves in the following GICS industries: Integrated Oil, Oil & Gas Exploration, and Coal & Consumable Fuels.	Exclude the biggest carbon reserve owners up to 50% of the reserves in the MSCI ACWI; additionally, exclude the largest carbon emitters, up to 25 percent of the carbon emissions in the index. This is similar to the methodology for a custom index recently designed by MSCI.	Apply no exclusions to MSCI ACWI. Tilt the portfolio, with higher weights given to companies in each industry with stronger performance on their carbon strategy relative to peers, and lower weights given to companies in each industry with weaker performance on their carbon strategy relative to peers.	Focus on the upside using a thematic approach. Unlike the other approaches, this approach does not involve applying exclusions or tilts to MSCI ACWI. We use MSCI's Global Environmental Index to demonstrate this approach.

For the period January 1, 2007 through December 31, 2013, MSCI finds that:

> The current snapshot of *all four approaches shows lower carbon intensity relative to MSCI ACWI*. The Divestment approach and the Low Carbon approach have very similar overall carbon intensity, at 77% and 71% of the ACWI carbon intensity. Over the test period, all three ACWI-based approaches (Approaches #1, 2, and 3) performed roughly in line with the MSCI ACWI, with annualized returns ranging from 4.22% to 4.40%, compared to 4.30% for MSCI ACWI. Tracking error ranged from .47 to 1.23. Of the three ACWI-based approaches, the *Low Carbon approach showed the lowest carbon intensity and the highest active returns*.
>
> MSCI's Global Environmental Index, which includes approximately 155 companies that derive at least 50% of their revenues from clean technology, performed roughly

comparable to the MSCI ACWI IMI. Annualized gross returns since inception (November 2008) through December 2013 averaged 17.33%, versus 16.83% for the MSCI ACWI IMI. However, given greater risk, taking this approach would have returned lower risk-adjusted returns since inception, compared to the MSCI ACWI IMI.

MSCI (December 2013), conducted a ten-year back-test of a list of carbon-reserve owning companies provided by CalSTRS which mirrors the Carbon Tracker list. The 10-year time series shows similar overall results as the five-year. However, the MSCI ACWI IMI slightly outperformed the MSCI ACWI IMI ex-CalSTRS fossil fuel portfolio during the ten years June 2003 – May 2013 by an annualized 16 basis points. For shorter periods, the 'ex-carbon portfolio' slightly outperformed. The tracking error over the 10-year period was 0.99% (99 basis points).

Impax Asset Management (2013) conducted an empirical study that excluded fossil energy stocks from the MSCI World Index for the seven years May 2007-April 2013 and found a small positive impact on returns (0.5% annually) and a modest increase in tracking error of 1.6% per year, similar to MSCI research. They then modeled the performance of the MSCI World Index, replacing the fossil energy sector with FTSE's Environmental Opportunities (EO) energy universe, which at this time comprises 243 energy efficiency and renewable stocks and finds that, over the same seven years, there would have been no impact on performance, while the substitution of the fossil fuel stocks for the environmental opportunities stocks adds tracking error of 1.6% per year.

To date, the research on the financial impact of fossil fuel divestment impact has concentrated on the sector biases introduced when taking out fossil fuel stocks. The literature focuses on the critical energy sector market characteristics (which move closely with oil prices) as a central aspect of performance differences between fossil free portfolios and benchmarks.

The studies range in their approaches to substitution from substituting other 'cleaner' energy stocks such as utilities, to direct focus on sustainable companies. Similar to the South Africa literature, these efforts may introduce a capitalization size and/or growth bias that can further impact performance differences, even when overall tracking error remains minimal. For example, small capitalization stocks have outperformed large capitalization stocks in recent years. Such biases are important to understand if investors are considering potential divestment approaches.

Fossil Free and Low-Carbon Economy (LCE) Benchmarks

As environmental/green SRI funds have burgeoned, and discussions of fossil free strategies have become more prominent, benchmarks that seek to provide ongoing comparisons for investors are proliferating.

S&P Dow Jones Indices (S&PDJI) offers "Low Carbon Beta" indices that are designed to track the broad market and simultaneously reward more carbon efficient companies at the expense of less carbon efficient ones. Historically, their S&P500 results show reductions of annual carbon footprint (GHG emissions/Annual Revenue) of one third to half of that of the S&P500, with performance correlation of 99.9% for the years 2004-2013. S&PDJI has under development Fossil Fuel free indices that exclude all heavily fossil-free dependent activities.

MSCI today offers two climate related indices, and has developed a custom Low Carbon Economy index. The MSCI Global Climate Index consists of 100 leading companies in mitigating the causes of the impact of climate change, selected from the Developed market equity universe and including small, mid and large cap companies that lead in one of three themes: Renewable energy, future fuels, and clean technology and efficiency.

The MSCI Global Environment Index is derived of securities of approximately 155 companies that derive at least 50% of their revenues from environmentally beneficial products and services based on key environmental themes: Alternative Energy, Sustainable Water, Green Building, Pollution Prevention or Clean Technology.

MSCI designed a Custom Emerging Markets Low Carbon Index, designed for Swedish pension fund AP4 that is licensed for the Northern Trust Emerging Markets Custom Low Carbon Dioxide Equity Index Fund. The MSCI Low Carbon index excludes the companies representing the top 25% of carbon emissions and the companies representing the top 50% of carbon reserves, and optimizes the resulting portfolio to reduce carbon exposure subject to keeping tracking error constrained to 0.90% and one way semi-annual turnover to a maximum of 10%, and sector weights within +/-5% of the parent index, similar to the back-tested results above for a low carbon option.

FTSE anticipates having a fossil free exclusionary index available in 1H2014 and is developing a new macro industrial model that tracks the change in corporate revenues as businesses transition towards the provision of green (Low Carbon Economy) focused goods, products & services. FTSE anticipates having FTSE LCE™ available in 2014 as an investable index of corporations that generate at least 1% of their revenues from LCE activities. The FTSE LCE index will include approximately 2,000 of the 7,400 companies in the FTSE Global Equity Index Series that account for 98% of global market cap.

Both fossil free indices, and 'active' stock selection divestment, efforts will likely introduce portfolio characteristic biases, such as sector, small cap, value/growth tilts, country biases, even in portfolios that seek to keep tracking error to a minimum (around 1%). Most of the fossil free efforts set some limits on particular biases [refer to appendix for articles by index providers]. In our opinion, it is critical to keep in mind how such biases may affect an investment portfolio.

<u>Transaction Costs of Divestment</u>

The preponderance of the fossil free literature concentrates on the long-term risk and return impacts of divestment. The one-time costs of selling stocks in an existing portfolio to divest and buying replacement stocks have been noted by specific entities considering divestment.

The Vermont Office of the State Treasurer's (April 2013) report 0.25% as a total cost of converting all Vermont pension fund accounts to fossil-free holdings, based on NEPC (2013) estimates on their behalf. PCA (2014), on behalf of The Seattle City Employees' Retirement System (SCERS) estimated that a reasonable preliminary estimate of transition costs associated with moving out of energy into other segments would amount to approximately 50 basis points (0.5%) on both the buy and sell sides of the adjustment process. This is to divest from exposure amounting to more than 5% of the SCERS total portfolio.

Divestment Campaign success in achieving their social goals

Recent work has also taken up the question of the impact divestment campaigns have in achieving their goals. The University of Oxford (2013), produced the most comprehensive review to date on the success of divestment campaigns in achieving the goals they seek. This study indicates that divestment campaigns have little impact on the stock prices of the firms targeted for investment, and, because the firms in question make their profits from selling their products, any negative dip in the stock price typically has little negative financial impact on the firm. They state that divestment campaigns can and have had a larger 'stigmatization' impact as they have been successful in lobbying governments for restrictive legislation. The Oxford study anticipates much the same for the fossil fuel divestment impact.

Connelly, Schultz and Shallow's (2014) study from the Nelson A. Rockefeller Center Dartmouth College review also concludes that divestment is determined to be most efficacious in its ability to stigmatize the fossil fuel industry by generating considerable media attention.

It is far from clear at this stage in the fossil fuel divestment campaign whether it will result in legislation that materially achieves the current goals of the fossil free movement. These studies represent research from universities involved in the fossil free movement. The studies do not incorporate the evolution of energy related policies today, for example in Europe and Australia to incrementally move away from pro-green energy and back to more traditional (coal and petroleum) forms of energy as these governments reconsider the overall economic, environmental and social impacts of such policies (see for example Goldman Sachs (2013). Nor, do they evaluate, for example, the powerful dynamic growth impact that 'fracking' is having on the U.S. economy both domestically and internationally, and how that impacts the economics of different sources of energy.

To date, we are not aware of any U.S. pension funds that have decided to divest fossil fuel stocks. The divestment pressure appears to be stimulating funds to review and more closely analyze climate risk and opportunity considerations in their portfolio. For example, a bill introduced for MainePERS to divest from fossil fuels was defeated (January 9, 2014). MainePERS is examining how best to incorporate ESG and climate risk & opportunity considerations into their fund going forward. In March 2014, the Vermont Senate Government Operations Committee voted down a bill to divest the Vermont State Pension fund from the top 200 fossil fuel companies, which make up 1% of the fund. The Vermont Treasurer announced the creation of a fossil fuel free mutual fund that is expected to be available May 1, 2014 as an option in which state employees may invest additional retirement funds.

Summary and Conclusions

This survey of academic and financial firm analyses of how divestment impacts investment portfolios finds that:

The impact of divestment campaigns on risk-adjusted returns has been mixed. They depend significantly on the breadth of stocks and market capitalization of the stocks that are targeted for divestment. In addition, portfolio characteristic biases such as sector, small cap/large cap, growth/value, and country may have positive or negative effects on risk-adjusted performance depending on the time period studied.

A key conclusion is that the narrower the restricted list of companies, the lower the financial impact on the pension plan. The most historically prominent divestment campaigns of South Africa, Tobacco, and more recently Fossil Fuel, differ significantly from the Sudan campaign which in general offered a more nuanced approach, including a ranked list of highest offenders that offers pension funds an alternative to divesting from a significant number of large multinational companies, for which comparable replacements are difficult to find. The Sudan campaign, and many state laws, including California's, emphasize constructive engagement as the most powerful tool investors can use to effect change at portfolio companies, and include divestment as a last resort.

The South Africa campaign typically targeted 150 plus companies, which were generally all large capitalization stocks. Tobacco divestment programs have varied but typically target a broad segment of the tobacco industry. Differentiation has included, for example, specifying consumer tobacco companies as in CalPERS' program, but generally tobacco free programs are not currently aimed at ranking tobacco companies into a 'highest offenders' list similar to the Sudan approach. The most commonly reviewed fossil fuel divestment lists are either narrow 15 worst, or the top 200 carbon stocks.

Portfolio characteristics matter. The South Africa-free campaigns targeted very large cap stocks, due to the fact that only large companies had direct operations in South Africa. The result was a full South Africa-free divestment strategy meant considering divesting nearly 40% of the holdings in the New York Stock Exchange index, and 45% of the large cap S&P 500 index. This literature is mixed on the impact of divestment strategies, some finding negative risk-adjusted returns, while another finds marginally increased risk, but with improved returns due to the small-cap stock bias of moving out of so many large cap stocks.

Today's fossil fuel divestment campaigns range from divesting from the 'filthy fifteen', to the Carbon Tracker list of top 200 carbon intensive companies. The top 200 carbon intensive companies account for a much smaller percent of the typical institution's investment universe today.

Timing is everything? The research reveals the importance of the time period under review when analyzing empirical results. This is most evident in the fossil fuel divestment literature as fossil free portfolios significantly outperform compared to non-fossil free portfolios when oil and gas stocks are under pressure, and the reverse when such stocks are rising. Not surprisingly, the fossil fuel literature too finds a range of financial impacts. A number of empirical studies find a slightly positive impact on returns from a fossil free portfolio as compared to a benchmark with minimal increase in risk; some academic research come to the opposite conclusion.

The fossil fuel literature is further enriched by the discussion of a current 'carbon bubble'. As with any market bubble, being early to exit can have a meaningfully negative impact in the near term on a portfolio. Thus if indeed this bubble 'bursts' within a few years, that would have very different results for those divested of these stocks now, than if the underlying 'stranded assets' retain their value for decade/s.

Transaction costs will be incurred, from trivial to meaningful. The studies that address the issue of transaction costs vary in their analysis of how material these costs are, from trivial, to more meaningful, in part due to whether the comparison is with another actively managed portfolio which typically can incur transaction costs of approximately 5%, or a passively managed portfolio with significantly lower transaction costs.

Divestment campaign's success is not in financially hurting the companies they target. The studies that address the success of divestment campaigns in achieving their goals, indicate that their primary success has been gaining widespread attention and influencing government policy to adopt legislation that in turn materially effects the social goal/s of the campaign.

Engagement versus divestment is generally not addressed in this literature. The research does not compare the success of divestment campaigns to the trend toward significant active shareholder engagement**.** Institutional shareholder organizations were in their infancy during the South Africa campaign. Similarly, the successes that have been achieved by coordinated shareholder engagement were non-existent during the South Africa divestment campaign.

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TAB 7 – SPEAKER BIOGRAPHIES

Sonal Mahida, US Network Manager

During her career Sonal has worked on responsible investing from institutional investor, non-profit, and corporate perspectives. Her experience includes shareholder engagement, developing proxy voting guidelines, proxy voting analysis, ESG integration, and directing a global corporate transparency initiative in the US.

Currently she is responsible for engaging with and supporting US investors in the practice and implementation of Environmental, Social and Governance (ESG) integration and risk management as part of her role leading the PRI's US Network. Prior to joining PRI, Sonal focused on corporate sustainability reporting as part of the Environmental, Health and Safety team at Hess. In addition, she was Vice President of the Carbon Disclosure Project (CDP), where she managed the organization's US operations. Before joining CDP in 2008, Sonal was a Senior Governance Analyst at TIAA-CREF, where she led ESG dialogues and engagements with portfolio companies, and undertook internal proxy voting analysis. Throughout her career, Sonal has been a frequent speaker at leading events from investor roundtables to major business conferences.

Sonal holds an M.B.A. in Finance from Boston University's School of Management and a B.A. from Barnard College, Columbia University.

JEAN ROGERS, PHD, PE
CEO & Founder
SASB

Dr. Jean Rogers is the CEO and founder of SASB. Since 2010 SASB developed from an idea formulated in collaboration with the Harvard University Initiative for Responsible Investment at the Kennedy School of Government into a globally-respected, ANSI-accredited, independent standards-setting organization with more than 1,350 corporate and investor participants—representing $15T in assets under management and $6.5T in market capitalization—in the standards process to date.

Jean draws upon her 20 years' experience in sustainability and management consulting across a wide range of industries including utilities, extractives, financials, and real estate. She has worked with international clients to integrate sustainability into strategy and operations, minimizing risk and maximizing returns across the triple bottom line. Jean's leadership experience includes 10 years as a Principal at Arup, a global engineering consultancy focused on sustainable development. Jean was also a management consultant at Deloitte, working in the environmental and manufacturing practices to help leading companies improve business and product performance through sustainability.

Jean is a former Loeb Fellow at Harvard University and holds a PhD in Environmental Engineering from the Illinois Institute of Technology, and an ME in Environmental Engineering and a BE in Civil Engineering from Manhattan College.

Presenter biography

Chad Spitler, Managing Director, is the Global Chief Operating Officer for BlackRock's Corporate Governance & Responsible Investment team within the Portfolio Management Group. He is responsible for the daily operations of the team worldwide and strategic planning. Mr. Spitler is the Proxy Facilitator for the Securities Evaluation Group of the International Standards Organization (ISO), and is a member of the International Corporate Governance Network's (ICGN) Shareholders Responsibility Committee, and the Broadridge Global and Domestic Steering Committees.

Mr. Spitler's service with the firm dates back to 2000, including his years with Barclays Global Investors (BGI), which merged with BlackRock in 2009. At BGI, Mr. Spitler last managed the Americas proxy voting team, responsible for analyzing and voting proxies, and engaging with the corporations of which BGI was a shareholder. Throughout his tenure he managed the corporate actions, trade operations, cash analysis and central control departments. Prior to BGI, Mr. Spitler was a Senior Market Research Analyst with the Franklin Templeton Group.

Mr. Spitler earned an MA degree in Anthropology from the University of Colorado in 1996, and a BS degree in Resource Management from the University of Michigan in 1992. He is a Series 7, 6 and 63 FINRA Registered Securities Representative.

Ken Mehlman (New York) joined KKR in 2008 and is Global Head of Public Affairs. Prior to joining KKR, Mr. Mehlman was a partner at Akin Gump Strauss Hauer & Feld with a bi-partisan practice in legislative and regulatory counseling. He previously served in high-level positions on Capitol Hill and at the White House, including serving as Chairman of the Republican National Committee and Campaign Manager of President Bush's successful re-election campaign. Mr. Mehlman graduated with a B.A. from Franklin & Marshall College and holds a J.D. from Harvard Law School. Mr. Mehlman is a trustee of the United States Holocaust Memorial Museum and Franklin & Marshall College, a member of the Council on Foreign Relations and the American Enterprise Institute's National Council, serves on the Robin Hood Veterans Advisory Board and is a member of the boards of directors at the American Foundation for Equal Rights and the IDEAL School of Manhattan, and a member on the Senior Advisory Committee of the Harvard University Institute of Politics.

John King, Executive Vice President, LS Power

Mr. King joined LS Power in 2005 and has twenty years of experience in the power industry. Mr. King has responsibility for LS Power’s Western business activities and renewable business efforts, including solar power development for which LS Power has 300 MW of solar generation in operation or construction. Additionally, Mr. King has executive management responsibility for LS Power’s portfolio of operating power plants. Prior to joining LS Power, Mr. King was a Senior Vice President of Calpine Corporation (“Calpine”). From 1994 to 2005, Mr. King held various positions with Calpine, including Head of International Business, and was in charge of business development in the Western United States. Mr. King holds a B.S.C. from Santa Clara University and an MBA from California State University, Hayward.

Michael Ring

Assistant Director, SEIU Capital Stewardship Program

Michael has worked with the Service Employees International Union (SEIU) Capital Stewardship Program since 2002 supporting the efforts of SEIU members and allies in California and Oregon to ensure that their retirement trust monies are invested in their long term interests. He also actively organizes with members and allies in efforts to expand retirement security for all working people. SEIU represents over 2 million workers in the areas of health care, property services and public services.

Janet Becker-Wold, CFA, is a Senior Vice President and the Manager of Callan's Denver Fund Sponsor Consulting office and a shareholder of the firm. Janet joined the investment management business in 1991. Her experience at Callan includes all facets of investment consulting including investment policy analysis, asset and liability studies as well as manager search and structure. She has a particular expertise in international investing and currency management. Her clients include corporate, public and non-U.S. based funds. Janet is a member of Callan's Management, Manager Search and Defined Contribution committees.

Janet joined the firm in 1994 from Century Link (formerly U.S. WEST) pension fund where she worked in the international equity, fixed income and real estate areas. While at Callan, she has authored white papers on a variety of investing issues and is a speaker at industry forums.

Janet received an MBA in Finance from the University of Colorado and a BS in Biology from the University of Texas. She earned the right to use the Chartered Financial Analyst designation.

PCA | PENSION CONSULTING ALLIANCE
CELEBRATING 25 YEARS

Allan Emkin, Founder, Managing Director, Pension Consulting Alliance, Inc.
Los Angeles, CA

Allan Emkin founded Pension Consulting Alliance, Inc. in 1988, with offices in Los Angeles, New York City, and Portland, Oregon.

Long a member of the consulting community, Mr. Emkin has thirty-two years of general consulting experience emphasizing public plan administration and investment policy, as well as international, global, and real estate investments.

Mr. Emkin was a Vice President at Wilshire Associates before forming PCA in 1988. Prior to his work in the consulting field, Mr. Emkin worked in the California Governor's office in the Pension Investment Unit. Before joining the Brown administration, he was a registered lobbyist for ten years specializing in affordable housing and other matters affecting low-income families.

Mr. Emkin is a frequent speaker at various conferences and educational seminars and has long standing relationships with Liberty Hill Foundation in Santa Monica, California as well as The Labor and Worklife Program at Harvard University.

Janine Guillot has over 25 years of experience in operating, risk management and finance roles in financial services. From 2010 to 2013, she served as chief operating investment officer for the California Public Employees' Retirement System (CalPERS), one of the world's largest pension funds. She was responsible for CalPERS investment office business and operational management, CalPERS affiliate funds and CalPERS defined contribution plans.

Ms. Guillot also oversaw the CalPERS corporate governance program, including integration of sustainability and governance factors into investment decision-making and CalPERS engagement on financial market reform. She led development of CalPERS Investment Beliefs, a set of guiding principles for strategic management of the investment portfolio.

Ms. Guillot joined CalPERS from Barclays Global Investors (BGI), a global asset manager with approximately $1.5 trillion under management. She served as chief operating officer for BGI's $450 billion Global Fixed Income business and as chief operating officer for BGI's European business, based in London. In both roles, she was responsible for leading cross-functional teams to reduce operating risk, improve scalability and increase profitability of the businesses.

Prior to joining BGI, Ms. Guillot was at Bank of America for 12 years. She held a variety of positions at Bank of America, including chief planning and administrative officer for the consumer business, chief financial officer for the middle-market banking/commercial real estate businesses, and director of brand development. She started her career in public accounting at Ernst & Young.

Ms Guillot holds a bachelor's degree in Business Administration with a concentration in accounting from Southern Methodist University in Dallas, TX. She previously served as Co-Chair of the Accounting and Auditing Practices Committee of the International Corporate Governance Network, and she is a member of the FDIC Advisory Committee on Systemic Resolution. She is a member of the Board of Directors of Equilibrium Capital, Community Initiatives and the Marin Agricultural Land Trust.

TAB 8 – APPENDIX: POLICY AND LEGAL FRAMEWORK

FUNCTION: **General Policies and Procedures**
ACTIVITY: **Consideration of Investments**

POLICY: **This is an advisory letter of the Council setting forth guidelines and procedures that govern all investment activities of the Council.**

PROCEDURES:

I. Background

A. Objective of this Advisory Letter

The purpose of this Oregon Investment policy Advisory Letter is to set forth the guidelines within which the Council considers all investments.

This Advisory Letter does not represent a new or separate policy, but merely describes the guidelines and procedures that govern *all* investment activities of the Oregon Investment Council and the Office of the State Treasurer (OST).

The statutory standards of prudence and productivity are the *only* standards that apply to the investment of public trust funds, including the OPERS fund.

B. Authority of the Investment Council

The Oregon Investment Council can only consider investments that meet the investment productivity objective of ORS 293.721 and the prudence standard of ORS 293.726. Each proposed investment is separately evaluated based on its unique structure and potential in accordance with the Council and OST's standard investment criteria.

II. Policies

The Council's statutory duties, as defined in Oregon Revised Statues (ORS) 293.721, to formulate and review investment policies consistent with the productivity objective set forth in ORS 293.721 and the prudence standards set forth in ORS 293.726, shall take precedence over any other consideration. The Council's implementation of these objectives and standards can be stated as follows:

1. Consideration of investments is limited to those which, when judged solely on the basis of economic value, enhance portfolio returns on a risk-adjusted basis.

2. Any benefit an investment may confer, other than meeting the statutory standards of prudence and productivity, is not and shall not be considered the responsibility or within the control of OST, the Council or its agents.

3. For allocation purposes, proposed investments are included within similar investment categories, and the combined assets subject to the Council's asset allocation guidelines, ranges and targets.

4. Proposed investments shall be consistent with OIC's desired level of diversification and asset allocation goals, including the mix of asset types, the exposure to different economic and industry sectors, and the mix of investment quality.

5. Investments shall at all times conform to all the laws, requirements, policies and procedures governing the Council, OST and OPERF.

6. Because investments are part of an actively managed portfolio, full due diligence is exercised. This due diligence, conducted by OST staff, designated private managers and/or advisors, addresses, at a minimum (1) legal sufficiency, (2) investment sufficiency, and (3) identification of any potential conflicts of interest. Only those proposals that comply with the proposal format prescribed by the Council shall be considered. The costs associated with all legal and financial review for each investment proposal shall be addressed pursuant to policy consistent with similar investment types. Where no such policies exist, these costs shall be borne entirely by the proposer. Furthermore, the proposer shall provide all the information that the Council, OST staff, or designated private managers or advisors deem necessary to a proper evaluation. If the information is not provided within the specified time frame (which time frame shall be reasonable), the Council OST staff or designated private managers or advisors may discontinue consideration of the proposal. All investments that are approved by the Council shall be subject to a continuing obligation to disclose requested information.

7. Investments shall be valued at market prices and will be subject to performance measure at least annually.

8. The Council considers investment structures such as partnerships and joint ventures, or similar arrangements, when such structures ensure an initial investment and ongoing participation by the sponsoring entity. The Council will only consider structures that ensure such financial participation and risk sharing by other partners/participants. OST staff or designated private managers or advisors shall consider and recommend to the Council means to limit risks of investment losses or liabilities that relate to investments, such as federal government credit insurance, personal guarantees, corporate guarantees, cross-corporate collateralization, and other such mechanisms, thereby limiting the exposure of the OPERF to such losses or liabilities. Furthermore, only those investments that have stated exit strategies that define the means of realization of return shall be considered.

9. Due to OST administrative resource constraints, only those investments that impose reasonable administrative burdens directly upon Council and the State Treasurer shall be acceptable.

10. All persons or firms managing, evaluating, or monitoring investments on behalf of the Council shall act in a fiduciary capacity when giving advice or information to the Council.

11. The Oregon Investment Council recognizes that excellent investment opportunities may exist in Oregon and actively considers investments within the state. Third-party investment managers or partners determine whether or not investments are made in Oregon-based companies. However, it is recognized that the OIC selects managers and general partners.

12. The Council recognizes that Oregon is an underserved market within the venture capital arena and, that such circumstances may result in good investment opportunities from time to time. Further, the Council recognizes that prudent investments may satisfy the exclusive benefit rule for pension plan participants as well as provide the collateral benefit of encouraging economic development within the state. Whenever diversification and quality standards permit, the Council will endeavor to hire local partners or by will encourage top tier national firms to open an Oregon office.

13. The same, consistent methodical evaluation is required of investment opportunities within Oregon as in all other investments. Consequently, the risk, return and liquidity characteristics of investments within Oregon must be determined to assure that these investments are consistent with the legal standards and investment policies that govern all Council Actions.

SAMPLE FORMS, DOCUMENTS, OR REPORTS (Attached):
None

FUNCTION: **General Policies and Procedures**
ACTIVITY: **Divestiture Initiatives**

The Oregon Investment Council recognizes its obligation to adhere to applicable law and that political, social and legal circumstances in various nations and regions of the world may impact the productivity and prudence of investments that are connected with those various nations and regions.

POLICY:

(1) ORS 293.721 states, in part: "Moneys in the investment funds shall be invested and reinvested to achieve the investment objective of the investment funds, which is to make the moneys as productive as possible." Under ORS 293.726 (1) and (2), the OIC and its investment officer (the "Treasurer" or "OST") also are required to invest with prudence, reasonable care, skill and caution. Under subsection (4), the OIC and OST must adhere to the fundamental fiduciary duties of loyalty and impartiality.

(2) In recognition of the above statutory standards, and consistent with its "fundamental fiduciary duties of loyalty and impartiality" the OIC has adopted OIC Policy 4.01.07(I)(A), wherein it reaffirms that the applicable standards of prudence and productivity are the *only* standards that may govern its investment decisions concerning "investment funds," including OPERF.

(3) Pursuant to OIC Policy 4.01.07(I)(B), each proposed investment must be separately evaluated on its unique structure and potential in accordance with the obligation of the OIC and OST to exercise diligent judgment of appropriate investment criteria in consideration of their fundamental fiduciary duties.

(4) OIC Policy 4.01.07(II) states, in part:

"The Council's statutory duties, as defined in Oregon Revised Statues (ORS) 293.721, to formulate and review investment policies consistent with the productivity objective set forth in ORS 293.721 and the prudence standards set forth in ORS 293.726, shall take precedence over any other consideration. The Council's implementation of these objectives and standards can be stated as follows:

1. Consideration of investments is limited to those which, when judged solely on the basis of economic value, enhance portfolio returns on a risk-adjusted basis.
2. Any benefit an investment may confer, other than meeting the statutory standards of prudence and productivity, is not and shall not be considered the responsibility or within the control of OST, the Council or its agents."

(5) While political, social and legal circumstances material to prudent and productive investment should receive appropriate consideration in the making and maintaining of

investments, such factors may not be given undue weight, i.e., weight disproportionate to their impact upon economic prudence and productivity, when implementing the OIC's and the OST's investment responsibilities of acting with prudence to make the moneys under their care as productive as possible – including adherence to their fundamental fiduciary duties of loyalty and impartiality.

(6) The OIC and OST are subject to, and will comply with, applicable federal and state law.

PROCEDURES:

(1) The federal government of the United States of America (the "United States") has preeminent governmental power for those subject to its jurisdiction with respect to the conduct of foreign policy and interstate commerce. When the United States sanctions or restricts investment by subject entities in other nations, as when it regulates interstate commerce, the OIC requires all of its investment managers to comply with those regulations, as applicable. The OIC also expects companies in which it invests, that are subject to such regulations, to comply with those regulations.

(2) The OIC requires its investment managers to consider all material risks and benefits when making an investment. Material risks or benefits may include those factors that arise from the political, social, or legal circumstances affecting regions or governments with or within which companies considered for investment conduct business.

(3) The State Treasurer's staff will maintain a dialogue with the OIC's proxy voting agent(s) and investment managers to ascertain how ballot issues and investment decisions related to international investments and compliance with government regulations are addressed.

(4) When not inconsistent with the policies described above, the OIC prefers that its managers avoid holdings in companies doing business with or in countries where such conduct is prohibited if performed by companies subject to the jurisdiction of the United States.

FUNCTION: Real Estate Investments
ACTIVITY: Responsible Contractor Policy

I. PURPOSE

This Responsible Contractor Policy (the "Policy") for the Public Employees Retirement Fund ("OPERF" or "the Fund") is designed to guide the selection of appropriate contractors and subcontractors ("Responsible Contractors") who provide building operations and construction services (collectively, "Services") to real estate properties wholly owned by the Fund. **Selection of Responsible Contractors should be consistent with fiduciary responsibilities to Fund beneficiaries, particularly the obligations of maximizing investment returns while exercising appropriate prudence.** This Policy seeks to ensure that Responsible Contractors will be selected based upon their ability to provide productive Services of appropriate quality, thereby maximizing with prudence the value of OPERF Properties.

As used in this Policy, a Responsible Contractor is a contractor or subcontractor that provides goods or services to the OIC in a manner that is consistent with the fiduciary duties owed by the OIC to the Fund and in compliance with applicable law. A Responsible Contractor is distinguished by qualities such as capacity, experience, reputation, honesty, integrity, responsiveness, dependability, and its appropriate treatment of and relations with its employees, including payment of fair wages and fair benefits. What constitutes "fair wages" and "fair benefits" depends upon the circumstances in each case, and may include a consideration of wages and benefits paid on comparable real estate projects, local market factors, the nature of the project (e.g., residential or commercial, public or private), comparable job or trade classifications, and the scope and complexity of services provided. This Policy does not require that "prevailing wages" be paid in order to satisfy the requirement that a Responsible Contractor treat its employees appropriately.

This Policy recognizes the statutory right of employees to representation and expects its managers, and contractors and subcontractors retained by its managers, to comply with federal and state laws that protect those rights in the event of a legitimate attempt by a labor organization to organize workers employed by contractors or subcontractors retained by the manager.

This Policy encourages a broad outreach and, where appropriate, competitive bidding in the selection of Responsible Contractors. OPERF advisors, managers and their agents should contact local trades as well as others to suggest contractors, which in their view qualify as Responsible Contractors. The advisors, managers and their agents are responsible for gathering and analyzing information relevant to identifying and hiring Responsible Contractors.

II. REQUIREMENTS OF THE RESPONSIBLE CONTRACTING POLICY

A. Duty of Loyalty: **Notwithstanding any other considerations, assets shall be managed for the exclusive benefit of the beneficiaries of the Fund.** Fiduciary duties owed to Fund beneficiaries shall take precedence over any other responsibility under this Policy.

B. Prudence: The OIC, staff, advisors, managers and their agents are charged with the fiduciary duty of exercising the care, skill, prudence and diligence appropriate to the task.

C. Competitive Return: To comply with duties of loyalty and prudence, all investments and services must be made and managed in a manner that maximizes a prudently risk-adjusted return.

D. Competitive Bidding: Responsible Contractors should be selected through a competitive bidding and selection process in order to encourage competition and to actively seek bids from best-qualified providers. Competitive bidding should include reasonable notification and invitation to bid - distributed to a broad spectrum of potential bidders. In the review of bids, advisors, managers and their contractors, as applicable, should consider appropriate factors consistent with this Policy. Competitive bidding is not required if advisors, managers or their contractors reasonably determine it would be infeasible or otherwise inconsistent with their fiduciary obligations.

E. Compliance with Laws: Each advisor, property manager, contractor and subcontractor shall observe all local, state, and national laws (including by way of illustration those pertaining to insurance, withholding taxes, minimum wage, labor relations, health, and occupational safety).

III. MINIMUM CONTRACT SIZE

Minimum Contract Size: The Policy shall apply to all operating service contracts of a minimum size of $25,000, individually or annually as applicable and all construction contracts in excess of $250,000. Minimum contract size refers to the total project value of the work being contracted for and not to any desegregation by trade or task. For example, a $25,000 contract to paint two buildings in a single office complex would not be treated as two $12,500 contracts, each less than the minimum contract size. Desegregation designed to evade the requirements of the Policy is not permitted.

IV. MONITORING AND ADMINISTRATION

A. Applicable Investments:

This Policy shall apply to real estate advisors managing real estate investments solely for the benefit of the Fund. The Policy shall not apply to investments such as hybrid debt, joint ventures, opportunity funds and other real estate investments where OPERF does not have 100% ownership and/or full control of the investment.

B. Responsibilities: Persons and entities subject to this Policy shall act in accordance with its terms, including as follows:

1. The Investment Division of the Office of the State Treasurer will communicate this Policy to all relevant advisors and exercise appropriate due diligence as to its implementation by such advisors.

2. Advisors subject to this Policy will:

    a. Communicate this Policy to all property managers.
    b. Exercise appropriate due diligence as to its implementation by managers.

3. Property managers subject to this Policy will:

    a. Communicate this Policy in bid documents to contractors seeking to secure construction or building service contracts.
    b. Maintain a list of potential Responsible Contractors interested in providing services to the property (Names, addresses and telephone numbers).
    c. When appropriate, use a competitive bidding process consistent with this Policy in the selection of Responsible Contractors.
    d. Maintain documentation of successful bidders.
    e. Provide property level summary report annually to advisor.

4. Contractors subject to this Policy will communicate this Policy to subcontractors.

SAMPLE FORMS, DOCUMENTS, OR REPORTS (Attached):
None

JOHN R. KROGER
Attorney General

MARY H. WILLIAMS
Deputy Attorney General

DEPARTMENT OF JUSTICE
GENERAL COUNSEL DIVISION

August 5, 2010

Ted Wheeler, State Treasurer
Office of the State Treasurer
159 State Capitol
900 Court St., NE
Salem, OR 97301-4043

Re: Opinion Request OP-2010-3

This opinion addresses the factors that the Oregon Investment Council (OIC) and the Oregon State Treasurer (Treasurer) may consider when establishing and implementing investment policies for the Oregon Public Employees Retirement Fund (OPERF). The principal focus of the opinion is the extent to which the OIC and the Treasurer may constitutionally accommodate so-called "social factor" instructions from the Legislative Assembly.

FIRST QUESTION PRESENTED

May the OIC or Treasurer consider statutory investment factors other than those directed by their fiduciary obligations, particularly as set forth in ORS 293.721 and 293.726, when establishing and implementing investment policy for OPERF?

SHORT ANSWER

Yes, provided the OIC and the Treasurer do not subordinate the interests of Public Employees Retirement System (PERS) members and their beneficiaries in their retirement income to unrelated objectives, such as social investing. The OIC and the Treasurer may consider statutory social factors in making an investment decision, but the OIC and Treasurer may select or reject an investment based on such factors only if the investment is equal to or superior to alternative investments when judged solely on the basis of its potential economic value.

SECOND QUESTION PRESENTED

May the Legislative Assembly require the OIC or Treasurer to deviate from their fiduciary duties when establishing and implementing investment policy for OPERF?

SHORT ANSWER

Yes, but only with significant consequences.

ORS 238.660(2) establishes a statutory contractual obligation to use OPERF for the exclusive benefit of PERS members and their beneficiaries. If the legislature changes that obligation as to prior employer or employee contributions and the earnings thereon, then this action would impair an obligation of contract in violation of Article I, section 21, of the Oregon Constitution.

The legislature may unequivocally direct the OIC or Treasurer to ignore the exclusive benefit obligation in ORS 238.660(2) in making OPERF investment decisions, but that action would breach the statutory PERS contract and provide a basis for a breach of contract action by PERS members and their beneficiaries. The action also would imperil the tax-exempt status of OPERF.

As to future employer and employee contributions to OPERF and earnings on those contributions, the Legislative Assembly may alter the exclusive benefit obligation in ORS 238.660(2) or require the OIC and the Treasurer to act inconsistently with their duty to manage OPERF for the exclusive benefit of PERS members. But this action would also imperil the tax-exempt status of OPERF.

DISCUSSION

I. Statutory Framework for OPERF Investments

OPERF is a trust fund. ORS 238.660(1). It is for the "uses and purposes set forth" in [ORS chapters 238] and 238A and ORS 237.950 to 237.980 and for "no other use or purpose * * *." *Id.* Neither the state nor any other contributing public employer has any "proprietary interest" in OPERF or in the contributions made by them to OPERF. ORS 238.660(3).

The Legislative Assembly expressly intends PERS to be "qualified and maintained under sections 401(a), 414(d) and 414(k) of the Internal Revenue Code as a tax-qualified defined benefit government plan." ORS 238.600(1).

OPERF "may not be diverted or otherwise put to any use that is not for the exclusive benefit of members and their beneficiaries" until all liabilities to PERS and their beneficiaries are satisfied. ORS 238.660(2). This restriction satisfies one of the requirements for a tax qualified plan under Internal Revenue Code (IRC) section 401(a)(2): It must be "impossible" under "the trust instrument," at any time "for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of [an employer's] employees or their beneficiaries * * *." 26 USC § 401(a).

The Public Employees Retirement Board (PERB) is the trustee of OPERF. ORS 238.660(1). But PERB neither establishes OPERF investment policy nor invests OPERF. Instead, the OIC is responsible for formulating OPERF's investment polices. ORS 293.731 (policies for "investment funds"); ORS 293.701(2)(a) (defining OPERF as "investment funds"). In developing these investment policies, the OIC is subject to its obligations under ORS 293.721 to "make moneys as productive as possible" and to the duties imposed by ORS 293.726(1)-(4) to act as a prudent investor, invest in accordance with the laws governing OPERF, employ an overall investment strategy, diversify investments, conform to the fundamental fiduciary duties of loyalty and impartiality, make prudent delegations, and incur only reasonable and appropriate expenses.

The Treasurer is the investment officer for the OIC. ORS 293.716(1). For the sake of brevity, this opinion refers simply to the Treasurer below when discussing investment duties related to OPERF, but those duties also apply equally to the OIC and to those performing investment duties for the OIC pursuant to a contract in accord with ORS 293.736(2).

In addition to the directions provided to the Treasurer in ORS 293.721 and ORS 293.726(1)-(4) mentioned above, the Legislative Assembly has enacted several additional investing instructions applicable to OPERF investments, which include:

- "[N]ot more than 50 percent of the moneys contributed to the [OPERF] may be invested in common stock * * *." ORS 293.726(6).[1/]

- "[N]otwithstanding any other general or specific law, moneys in the [Variable Annuity Account] shall be invested primarily in equities, including common stock, securities convertible into common stock, real property and other recognized forms of equities, whether or not subject to indebtedness." ORS 238.260(6).

- In making venture capital investment decisions, "look first at Oregon opportunities for diversification unless, under the circumstances, it is not prudent to do so." ORS 293.733(1).

- "[A]ct reasonably and in a manner consistent with ORS 293.721 and 293.726 to try to ensure that subject investment funds are not invested in any company the council knows is doing business in Sudan * * *," but divest and reinvest without "monetary loss to the fund[]." ORS 293.814(1), (2).

The latter two instructions involve in part what are commonly referred to as "social factors," i.e., factors considered to achieve a social as well as an investment objective.

II. Oregon Legislative Power and Impairment of Statutory Contracts

The lawmaking authority of the Oregon legislature is plenary, subject only to limitations in the state constitution or from federal law. *See*, *e.g.*, *Kellas v. Dept. of Corrections*, 341 Or 471, 478, 145 P3d 139 (2006) (so stating). One such limitation is the Contracts Clause of the

Oregon Constitution, Article I, section 21, which provides in pertinent part that "[n]o * * * law impairing the obligation of contracts shall ever be passed * * *." This provision applies to contracts made by the state as well as to contracts between private parties. *Eckles v. State of Oregon*, 306 Or 380, 390, 760 P2d 846 (1988) ("This court * * * has interpreted Oregon's provision to apply to contracts of the state and its subdivisions"), *appeal dismissed* 490 US 1032, 109 S Ct 1928, 104 L Ed2d 400 (1989).

There are two principal steps to analyzing an impairment of contract claim under Article I, section 21:

(1) Does "a contract exist[] to which the person asserting an impairment is a party?" and,
(2) Has "a law of this state * * * impaired an obligation of that contract"?

Hughes v. State, 314 Or 14, 17, 838 P2d 1018 (1992). In the case of an alleged impairment of a statutory contract, the first step may be broken into three subcomponent inquiries:

(1) [I]s there a state contract?;
(2) [I]f so, what are its terms?; and
(3) [W]hat obligations do the terms provide?

Strunk v. Public Employees Retirement Bd., 338 Or 145, 170, 108 P3d 1058, 1075 (2005) *Hughes,* 314 Or at 17-29.

In the case of PERS, the Oregon Supreme Court already has answered the first subcomponent inquiry in the affirmative: PERS is a statutory contract. *See Hughes,* 314 Or at 20, 25 (holding that "the legislature intended and understood that PERS generally constituted an offer, by the state to its employees, for a unilateral contract"). But in order to complete an Article I, section 21, impairment of contract analysis in the context of OPERF's investments, it remains necessary to determine the relevant terms of the PERS contract, the obligations imposed by those terms, and whether any current statutes or prospective statutes contemplated by your questions would impair or breach those obligations.

III. PERS' Exclusive Benefit Provision

As explained below, we conclude that the exclusive benefit provision in ORS 238.660(2) is an essential term of the PERS contract and that it limits the legislature's ability to require consideration of social factors in OPERF investment decisions. This provision is the functional equivalent of a trustee's common law fiduciary duty of loyalty. *See* ORS 293.726(4)(a) ("the [OIC and Treasurer] must * * * [c]onform to the fundamental fiduciary dut[y] of loyalty * * *."); *see also* RESTATEMENT (THIRD) OF THE LAW OF TRUSTS (2007), § 90(c) ("General Standard of Prudent Investment": "the trustee must * * * conform to the fundamental fiduciary dut[y] of loyalty"). While the exclusive benefit provision does not preclude consideration of social factors, it relegates such factors to a tie-breaker status. Investments supported by a consideration of social factors are permitted only insofar as they are equal to or superior to alternative investments, when judged solely on the basis of their economic value.

A. History of ORS 238.660(2) and 238.600(1)

The OPERF "exclusive benefit" provision in ORS 238.660(2) was enacted in 1999. Or Laws 1999, ch 317, § 8(2). But the OPERF "trust fund" language now found in ORS 238.660(1) originally was enacted in 1953. Or Laws 1953, ch 200, § 10 (1). The 1953 legislation declared OPERF to be "a trust fund" to be used for purposes set out in Oregon Laws 1953 chapters 180 and 200 and "for no other use or purpose, except that this provision shall not be deemed to amend or impair the force or effect of any law of this state specifically authorizing the loan of moneys from [OPERF] for the construction of state office buildings." *Id.* That provision also declared PERB to be the "trustee of said fund" "[f]or all purposes." *Id.*

Before 1999, we had interpreted the trust fund language in ORS 238.660(1)[2/] to satisfy "the requirement stated in Treas. Reg. § 1.401-2(a)(1)" that OPERF be used for the exclusive benefit of employee members and their beneficiaries. 46 Op Atty Gen 180, 203 (1989).[3/] Subsection (2) of ORS 238.660 thus makes explicit what had been implicit from subsection (1)'s declaration that OPERF was a trust that could be used only for PERS purposes and that the state may use assets of the fund only to benefit PERS members and their beneficiaries, not to further its own ends.

In 2005, the legislature expressly declared its intent that PERS comply with the tax-exemption requirements for qualified government plans and trusts under relevant sections of the IRC.[4/] Or Laws 2005, ch 808, §§ 1, 9; ORS 238.600(1) ("It is the intent of the Legislative Assembly that the system be qualified and maintained under sections 401(a), 414(d) and 414(k) of the Internal Revenue Code as a tax-qualified defined benefit governmental plan").

B. ORS 238.660(2) as Term of Statutory PERS Contract

ORS 238.660(2) expressly requires OPERF assets to be used exclusively for the benefit of PERS members and their beneficiaries: OPERF "may not be diverted or otherwise put to any use that is not for the exclusive benefit of members and their beneficiaries" until "all liabilities to members and their beneficiaries are satisfied." ORS 238.660(2). That requirement is not conditioned on the legislature's ability to authorize or mandate specific investments. The language is unambiguously promissory and, on its face, binds subsequent legislatures as it endures until all PERS liabilities are satisfied.

Moreover, complying with the exclusive benefit requirement is essential to avoiding taxation of both of employer and employee contributions to OPERF and the interest earned on them. The following consequences potentially could flow from the loss of tax-qualified status: (1) employer contributions could become currently taxable to employees as income; (2) the earnings on the fund could become taxable, probably as capital gains; (3) the state might be required to pay income tax withholding, FICA, and FUTA taxes on that income; and (4) the tax liabilities might be assessed retroactively to the date on which it was determined that OPERF no longer qualified for tax exemption. Letter dated August 16, 1994, to Hon. Jim Hill, State Treasurer, from Robert W. Muir, Assistant Attorney General, at 1-2.

If the legislature were to retreat from the exclusive benefit requirement, that change would take away the tax exemption that employees have always received, which would have a direct financial impact on them. For that reason, the fact that the provision was enacted to ensure the tax exempt status of the fund also weighs in favor of finding that the provision creates a contractual obligation.

Accordingly, we conclude that the exclusive benefit provision in ORS 238.660(2) establishes a contractual obligation because of: (1) the unambiguously promissory language; (2) the long duration of the requirement; (3) its appearance in the PERS statutes (in determining whether a provision is a term of the PERS contract, the Oregon Supreme Court consistently has given weight to whether the provision was enacted as part of the PERS statutes, *Hughes,* 314 Or at 22); (4) the context of OPERF's trust status and the state's declaration that it has no proprietary interest in the fund;[5/] and (5) the longstanding interpretation of ORS 238.660(1) to implicitly contain this requirement to make the fund tax-exempt qualified under federal law.

C. Obligations Imposed by "Exclusive Benefit" Provision

1. Method for Interpreting ORS 238.660(2)

In order to discern the specific obligations imposed by the exclusive benefit provision, we must construe that statute and related statutes. In interpreting statutes, we first examine the text in context. *PGE v. Bureau of Labor and Industries,* 317 Or 606, 610-611, 859 P2d 1143 (1993). In doing so, we apply statutory and judicial rules for reading text and context, such as giving terms of common usage their plain meanings. *Id.* Statutory context includes other provisions of the same statute, related statutes, the Oregon Supreme Court's interpretations of those statutes, and the existing common law. *Id.*; *Fresk v. Kraemer,* 337 Or 513, 520-21, 99 P3d 282 (2004). Courts also examine legislative history when it is useful to the analysis. *State v. Gaines,* 346 Or 160, 171-172, 206 P3d 1042 (2009).

Because the Oregon exclusive benefit requirement was patterned on and intended to ensure compliance with the federal statute, interpretations of the federal statute existing at the time that the state statute was enacted are relevant context for interpreting ORS 238.660(2). *See Stevens v. Czerniak*, 336 Or 392, 401, 84 P3d 140 (2004) (Federal Rules of Civil Procedure may serve as context for construing Oregon counterparts); *State of Oregon DCS v. Anderson*, 189 Or App 162, 171-172, 74 P3d 1149 (2003), *rev den* 336 Or 92, 79 P3d 313 (2003) (federal child support legislation is context for state law); *Harris v. Pameco Corp*., 170 Or App 164, 176, 12 P3d 524 (2000) (federal civil rights law is "instructive" in interpreting state law).

2. Text

We begin by examining in greater detail the statutory phrase that assets of the fund "may not be diverted or otherwise put to any use that is not for the exclusive benefit of members and their beneficiaries." First, "may not" is an expression of "absolute prohibition." ORS 174.100(4). The pertinent plain meaning of "divert" is "to turn from one course, direction, objective or use to another." WEBSTER'S THIRD INTERNATIONAL (UNABRIDGED) DICTIONARY (2002) at 663. "Use" means "the act or practice of using something * * * the privilege or benefit of using something." *Id.* at 2523. "Exclusive" means "excluding or having power to exclude * * * limiting or limited to possession, control, or use * * * SINGLE, SOLE * * * UNDIVIDED, WHOLE." *Id.* at 793. The purpose of the OPERF trust is to provide benefits to members and their beneficiaries and to pay the associated administrative costs. Putting it all together, the provision prohibits using fund assets for any purpose other than funding the liabilities to PERS members and their beneficiaries. Hence, the provision would appear to prohibit investing OPERF to achieve objectives other than funding those PERS liabilities.

3. Internal Revenue Service Interpretations

We next consider the statute's context to determine whether it suggests that the plain meaning was the one intended or suggests a different interpretation. The impetus for the exclusive benefit provision was compliance with federal requirements to receive tax advantages for the trust. The IRC of 1986 (and its predecessors) provides substantial tax benefits to qualified government pension plans. As a precondition for obtaining those tax advantages, Congress required the plans to conform to certain limitations and safeguards analogous to those provided under the common law of trusts. As noted above, to qualify for the exemption the trust instrument must make it:

> [I]mpossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries.

26 USC § 401(a)(2) (also referred to as IRC § 401(a)(2)). That provision was intended to ensure that exempt pension plans were in fact operated for the exclusive benefit of employee members. *See, e.g.*, JERRY S. ROSENBLOOM, THE HANDBOOK OF EMPLOYEE BENEFITS, DESIGN, FUNDING, AND ADMINISTRATION 1051-52 (6th ed 2005). Many commentators equate the "exclusive purpose" rule with the common law fiduciary duty of loyalty, which requires a fiduciary to administer a trust solely in the best interests of the beneficiaries. *Id.*

The pertinent Treasury Regulation, 26 CFR § 1.401-2(1)(3), provides that:

> As used in section 401(a)(2), the phrase "purposes other than for the exclusive benefit of his employees or their beneficiaries" includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees or their beneficiaries covered by the trust.

But, according to the Internal Revenue Service (IRS), the "exclusive benefit" requirement does not preclude investment in the employer (which obviously does not "exclusively benefit" the employee member but benefits the employer as well and would likely conflict with the duty of loyalty in some cases) as long as the following safeguards are met:

> (1) the cost must not exceed fair market value at the time of purchase;
>
> (2) a fair return commensurate with the prevailing rate must be provided;
>
> (3) sufficient liquidity must be maintained to permit distributions in accordance with the terms of the plan; and
>
> (4) the safeguards and diversity that a prudent investor would adhere to must be present.

Rev Rul 69-494, 1969-2 CB 88. While that ruling directly concerned investments in the employer, Rev Proc 72-6, 1972-1 CB 710 subsequently confirmed that it applied to any pension fund investments.

In other words, the IRS has not interpreted the federal requirement literally to require that investments "exclusively benefit" pension members to the exclusion of all others. That requirement would be impractical as all investments benefit the entity invested in as well as the investor. Instead, the federal requirement has been interpreted to permit an investment that would achieve benefits for the employer or other benefits, provided that "adequate safeguards that a prudent investor would adhere to" are present. Thus, the federal interpretation would appear to permit consideration of social factors if a socially-motivated investment option is at least as prudent, taking into account the balance between risk and likely investment return, as other available investments.

D. United States Department of Labor's Interpretations

Our view of the IRS interpretation of the exclusive benefit rule is consistent with the United States Department of Labor's (USDOL) more detailed interpretations of the exclusive benefit rule found in the federal Employee Retirement Income Security Act of 1974, as amended ("ERISA"). 29 USC §§ 1002-1461. ERISA is a comprehensive system of regulation of private pension and welfare plans. ERISA imposes uniform fiduciary duties upon all private pension plan trustees. ERISA, in relevant part, also includes an exclusive purpose or benefit rule:

> [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;

29 USC § 1104(a)(1).

Although ERISA, and specifically the fiduciary provisions of ERISA, do not directly apply to state government retirement plans,[6/] the ERISA fiduciary duties provisions are based on existing common law trust principles. HR REP NO. 93-533, 93d Cong, 1st Sess, at 11-12 (1974). Because of this etiology, the ERISA fiduciary duties, and the USDOL's interpretations of them, help inform interpretations of IRC section 401(a) and are instructive in interpreting similar obligations imposed by state statutes like ORS 236.660(2) and the common law. *See, e.g.*, RESTATEMENT (THIRD) OF THE LAW OF TRUSTS § 78 cmt. f (citing USDOL Interpretive Bulletin, 29 CFR § 2509.94-1 (updated by Interpretive Bulletin, 29 CFR § 2509.08-01 discussed below)).

USDOL issues advisory opinions about ERISA pursuant to ERISA Procedure 76-1 (41 Fed Reg 36281 (Aug. 27, 1976)). In a 1998 advisory opinion discussing "social investing," USDOL, Employee Benefits Security Administration (formerly Pension and Welfare Benefits Administration) states:

> The 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 evaluation of a particular investment opportunity. However, the existence of such collateral benefits may be decisive only if the fiduciary determines that the investment offering the collateral benefits is expected to provide an investment return commensurate to alternative investments having similar risks.
>
> * * * * *
>
> Your letter requests guidance concerning the application of the above standards to a plan fiduciary's selection of a "socially-responsible" mutual fund as a plan investment or as a designated investment alternative for an ERISA section 404(c) plan.
>
> With regard to your request, it is the view of the Department 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, a designated investment alternative under the plan. Accordingly, if the above requirements are met, the selection of a "socially-responsible" mutual fund as either a plan investment or a designated investment alternative for an ERISA section 404(c) plan would not, in itself, be inconsistent with the fiduciary standards set forth in sections 403(c) and 404(a)(1) of ERISA.

ERISA Sec. 404(c), 98 Op. USDOL Off. Regulations and Interpretations, 04A (1998), *available at* http://www.dol.gov/ebsa/programs/ori/advisory98/98-04a.htm.

And in a 2008 Interpretive Bulletin, "Supplemental guidance relating to fiduciary responsibility in considering economically targeted investments" (ETIs), the USDOL advises that ERISA fiduciaries may make such investments if they conclude that an ETI is "truly equal" to alternative investments, *i.e.*, commensurate rates of return and degrees of risk. 29 CFR § 2509.08-01 (2008), *updating* 29 CFR § 2509.94-1 (1994). ETIs are "investments selected for the economic benefits they create apart from their investment return to the employee benefit plan." *Id.* at 1. The USDOL guidance explains:

> ERISA's plain text does not permit fiduciaries to make investment decisions on the basis of any factor other than the economic interest of the plan. Situations may arise, however, in which two or more investment alternatives are of equal economic value to a plan. The Department has recognized in past guidance that under these limited circumstances, fiduciaries can choose between the investment alternatives on the basis of a factor other than the economic interest of the plan. The Department has interpreted the statute to permit this selection because (1) ERISA requires fiduciaries to invest plan assets and to make choices between investment alternatives, (2) ERISA does not itself specifically provide a basis for making the investment choice in this circumstance, and (3) the economic interests of the plan are fully protected by the fact that the available investment alternatives are, from the plan's perspective, economically indistinguishable.

Id. The Interpretive Bulletin provides several examples, including one involving investment in "green companies":

> A plan sponsor adopts an investment policy that favors plan investment in companies meeting certain environmental criteria (so-called "green" companies). In carrying out the policy, the plan's fiduciaries may not simply consider investments only in green companies. They must consider all investments that meet the plan's prudent financial criteria. The fiduciaries may apply the investment policy to eliminate a company from consideration only if they appropriately determine that other available investments provide equal or better returns at the same or lower risks, and would play the same role in the plan's portfolio.

Id. In sum, even the USDOL's highly rigorous approach to the exclusive benefit rule does not rule out all considerations of social factors.

E. Treasurer's Fiduciary Duty of Loyalty

As noted above, many legal commentators view the exclusive benefit rule as being identical to a trustee's fiduciary duty of loyalty. ORS 293.726 expressly requires the Treasurer to "[c]onform to the fundamental fiduciary dut[y] of loyalty" in making OPERF investment decisions, along with other standards:

> (1) The investment funds shall be invested and the investments of those funds managed as a prudent investor would do, under the circumstances then prevailing and *in light of the* purposes, terms, distribution requirements and *laws governing each investment fund*.

> * * * * *
>
> (3) In making and implementing investment decisions, the Oregon Investment Council and the investment officer have a duty to diversify the investments of the investment funds unless, under the circumstances, it is not prudent to do so.
>
> (4) In addition to the duties stated in subsection (3) of this section, *the council and the investment officer must*:
>
> (a) *Conform to the fundamental fiduciary duties of loyalty* and impartiality;
>
> * * * * *.

ORS 293.726(1), (3), (4)(a) (emphasis added). The investment standards now found in ORS 293.726(1)-(4) reflect changes to the statute made by the legislature in 1993 to align with modern fiduciary obligations of prudence recognized generally in the common law dealing with trusts. Or Laws 1993, ch 75, § 1; Minutes, House General Government Committee (HB 2164), March 29, 1993, Exhibit F (letter dated October 26, 1992 from Robert W. Muir, Assistant Attorney General, to Dan Smith, Investment Manager, Oregon State Treasury); Minutes, House General Government Committee (HB 2164), March 29, 1993, Exhibit G (written testimony of the Oregon State Treasury). Indeed, ORS 293.726(1)-(4) closely tracks section 227 of the 1992 version of the RESTATEMENT (THIRD) OF THE LAW OF TRUSTS ("General Standards of Prudent Investment"), now numbered as section 90 (2007).[7/]

The "Duty of Loyalty" section in the RESTATEMENT (THIRD) OF THE LAW OF TRUSTS, section 78, states in pertinent part:

> (1) Except as otherwise provided in the terms of the trust, a trustee has a duty to administer the trust solely in the interest of the beneficiaries, or solely in furtherance of its charitable purpose.

Comment f to section 78 states in part:

> In administering a trust the trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust.

The Reporter's Note to comment f observes that the "comment to Uniform Prudent Investor Act [UPIA] § 5 ('Loyalty') is analogous and relevant here." The UPIA comment in turn relies heavily on the USDOL Interpretive Bulletin, 29 CFR § 2509.94–1, which was updated and replaced by Interpretive Bulletin, 29 CFR 2509.08-01 discussed above. The 1994 USDOL Interpretive Bulletin not only reminded "fiduciary investors that they are prohibited from "subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives," but also permitted them to select an economically targeted investment (ETI) or to engage in "an investment course of action intended to result in the selection of ETIs" if they adhered to the other prudence requirements of ERISA. 29 CFR 2509.94–1. This suggests that, as with ERISA, the consideration of collateral benefits, like social factors, is not inconsistent with the common law fiduciary duty of loyalty so long as the fiduciary determines that the investment offering the collateral benefits is expected to provide an investment return commensurate to alternative investments having similar risks.

Moreover, the Treasurer's statutory and common law fiduciary duties of prudent investment are subject, respectively, to "laws governing each investment fund," ORS 293.726(1), and "the rule of § 91, dealing primarily with contrary investment provisions of a trust or statute," RESTATEMENT (THIRD) OF THE LAW OF TRUSTS, section 90(d).

F. Prior Attorney General Opinions

Three prior Attorney General opinions discuss the issue of social factors and Treasurer-invested trust funds. While the first opinion (1978) appears to exclude the Treasurer from considering any social factors, the latter two opinions (1989 and 1993) permit consideration of social factors so long as any investment or divestiture in the end also accords with the applicable statutory standards for investments, such as ORS 293.726 and 291.721.

In the first opinion, Attorney General James A. Redden addressed several questions from the Chancellor of the State Department of Higher Education concerning investment roles and standards arising from mounting political concerns over the South African government's apartheid policies of that era. 38 Op Atty Gen 2017 (1978). After stating that the OIC had statutory responsibility for establishing investment policy for the investment funds under discussion, including Higher Education Board investment funds, the Attorney General observed that OIC policy should comply with the productivity objective in ORS 293.721 and the "prudent man" rule expressed in ORS 293.726. *Id*. at 2018, 2022. He further opined that it would not be appropriate or relevant (apparently in keeping with then ORS 237.271(1) and his understanding of the common law duty of loyalty) for the OIC to consider "any factors other than the probable safety of, and the probable income from, the investments * * *." *Id.* at 2018.[8/] This opinion did not consider the impact of statutory investment instructions on this conclusion.

In 1989, Attorney General Dave Frohnmayer addressed South African investments involving higher education funds in the context of the Anti-Apartheid Act of 1987 (Or Laws 1987, ch 193). 46 Op Atty Gen 143 (1989). The Anti-Apartheid Act mandated the "orderly, prudent" divestiture of subject investment funds, including OPERF, "in stocks and bonds in United States business entities directly investing in South Africa and in Namibia." ORS 293.855(2) (1987). Attorney General Frohnmayer acknowledged a legislative finding in the Anti-Apartheid Act of the risks inherent in South African investment as well as the directive for prudent divestiture without abrogation of fiduciary responsibilities. 46 Op Atty Gen at 154. He stated that "the prudent investor rule does not absolutely prohibit divestiture." *Id.* Accordingly, he said that the OIC could "carry out divestiture * * * to the extent that such divestiture can be accomplished while complying with" the applicable statutory standards for investment. *Id.*[9/]

In 1993, Attorney General Theodore R. Kulongoski discussed these two prior Attorney General opinions in the course of analyzing the respective duties of the Treasurer, OIC, and PERB as to OPERF. 46 Op Atty Gen 506 (1993). On the question of social factors generally, he observed:

> Thus, ORS 293.726 would prohibit both the treasurer and OIC from making an investment for social policy reasons if that investment would not maximize the income of [O]PERF and comply with the constraints of ORS 293.726.

Id. at 511.

IV. Current Social Factor or Economic Target Legislation

A. Sudan Divestments

In 2005, the legislature enacted the Oregon Human Rights and Anti-Genocide Act of 2005. ORS 293.811 to 293.817. The legislature makes numerous findings about the human rights abuses in Sudan, concluding that "[t]he investment of subject investment funds in business firms and financial institutions with ties to the repressive regime in Sudan is inconsistent with the moral and political values of the people of Oregon." ORS 293.813(2)(m).

ORS 293.814(1) requires the OIC and Treasurer to "act reasonably and in a manner consistent with ORS 293.721 and 293.726 to try to ensure that subject investment funds are not invested in any company that the council knows is doing business in Sudan for as long as the Sudanese government's campaign of human rights violations, atrocities or genocide continues in Sudan." OPERF is one of the "subject investment funds." ORS 293.812(4)(a).

Subsection (2) of ORS 293.814 requires divestment and reinvestment to be accomplished "without monetary loss to the funds through reasonable, prudent and productive investments in companies and institutions generating returns that are comparable to the returns generated by companies subject to divestment."

Notably, ORS 293.814(1) merely directs the Treasurer to "try to ensure" that funds are not invested in companies doing business in Sudan. The applicable definition of "try" is "to make an attempt to achieve something or carry out some action. WEBSTER'S at 2457. In other words, the Treasurer must *attempt* to avoid those investments, but is not absolutely barred from them.

But the provision *requires* the Treasurer to (the Treasurer "shall") act "in a manner consistent with ORS 293.721 and 293.726." ORS 293.814(2) also requires divestment and reinvestment to be accomplished "without monetary loss to the funds through reasonable, prudent and productive investments in companies and institutions generating returns that are comparable to the returns generated by the companies subject to divestment."

In brief, under ORS 293.814, the Treasurer must avoid those investments or divest and reinvest if he can do so in accordance with ORS 293.721 or 293.726 and without monetary loss to the funds. But if he concludes that he can meet those requirements and that investments with comparable returns exist, then this statute directs him to divest. Given these conditions, ORS 293.814 does not impair or breach the "exclusive benefits" term of the PERS statutory contract. By its very terms, the statute does not permit the Treasurer to subordinate the interests of PERS members and their beneficiaries to an objective unrelated to their benefit.

B. Oregon Venture Capital

A second social investment statute imposes a duty on the Treasurer "[i]n making and implementing investment decisions related to venture capital * * * *to look first at Oregon opportunities for diversification, unless, under the circumstances, it is not prudent to do so*." ORS 293.733 (emphasis added). This law was enacted in 2003. Or Laws 2003, ch 606, §§ 3, 5.

In that law, the legislature finds that the availability of Oregon venture capital "is critical to the continued growth and development of the economy of Oregon," and that the investment in Oregon businesses can "produce substantial positive returns for long-term investors." ORS 293.796(1)(a), (c). Paragraph (1)(d) of that provision finds that "[p]ension funds managed by the [OIC] constitute a major financial resource of the State of Oregon, and that such funds may be prudently invested in start-up and emerging growth businesses in this state under policies established by the [OIC]."[10/]

Those findings express the legislature's belief that prudent and productive investment opportunities in Oregon venture capital exist. The legislature then directs the Treasurer in ORS 293.733 to consider those investments "first" "unless, under the circumstances, it is not prudent to do so." Thus, by the express terms of this statute, the Treasurer does not have to consider Oregon investments "first" for diversification if he does not believe it is prudent under the circumstances.

While ORS 293.733 is less explicit than the Sudan divestment law on its interaction with ORS 293.721 and 293.726, it is similar to the Sudan divestment law in its application for several reasons. First, there is the specific condition of prudence ("unless * * * it is not prudent"). ORS 293.733(1); ORS 293.814(2). As ORS 293.733 was placed in the ORS 293.701 to 293.820 series of the Treasurer's investment statutes by a legislative directive (Or Laws 2003, ch 606, § 2), the word "prudent" in this statute likely was intended to relate to a "prudent" investor in ORS 293.726(1) and (2). *See State v. Carr*, 319 Or 408, 411-12, 877 P2d 1192 (1994) ("Context includes other related statutes"). Second, the legislature did not provide that ORS 293.733 was an exception to ORS 293.726. If the legislature had so intended, it would have been easy to state, "notwithstanding ORS 292.726" at the beginning of ORS 293.733. In interpreting a statute, we are not to "insert what has been omitted." ORS 174.010. Finally, in interpreting the statute as being subject to ORS 293.726 and, specifically, the "fundamental fiduciary duty of loyalty" described in ORS 293.726(4)(a), the ORS 293.733 "duty to look first to Oregon opportunities" avoids any conflict with the exclusive benefit obligation owed to PERS members and their beneficiaries under ORS 238.660(2).

Accordingly, under ORS 293.733, the Treasurer must consider Oregon venture capital investments “first” only if it is prudent and in accordance with ORS 293.721 and 293.726. If he concludes that Oregon venture capital investments meet those requirements and are equal or superior to alternative investments, then ORS 293.733 directs him to consider those investments “first.” Again, given such conditions, ORS 293.733 does not impair or breach the exclusive benefit term of the PERS statutory contract. Properly construed, the statute does not permit the Treasurer to subordinate the interests of PERS members and their beneficiaries to an objective unrelated to their benefit.

V. Compulsory Disregard of Exclusive Benefits Obligation

You also ask whether the legislature could require the Treasurer to make investments that do not comply with the exclusive benefits rule and the Treasurer’s related fiduciary standards. Legislatures generally are free to amend or repeal enactments of earlier legislatures unless doing so impairs a contractual obligation in violation of constitutional guarantees. *See Eckles*, 306 Or at 390-91.

As stated above, we conclude that ORS 238.660(2) establishes a statutory contractual obligation not to use OPERF for anything but the exclusive benefit of PERS members and their beneficiaries. Accordingly, as to prior employer and employee contributions to OPERF and the earnings on those contributions, if the Legislative Assembly altered the exclusive benefits obligation, then that action would impair an obligation of the PERS contract and violate Article I, section 21, of the Oregon Constitution. If the legislature did not alter the exclusive benefits obligation in ORS 238.660(2), but instead unequivocally required the Treasurer to act inconsistently with that obligation as to prior contributions and earnings thereon, then PERS members and their beneficiaries could bring a cause of action for breach of the PERS contract. *See Strunk*, 338 Or at 170 (“legislation that mandated a breach on the state’s part of such a contractual obligation – but did not change or eliminate the obligation itself – did not *contravene* Article I, section 21, although, in accordance with that constitutional provision, such legislation ordinarily would require payment of damages resulting from the breach”) (discussing *Eckles*, 306 Or at 399-402). This action also would imperil the federal tax-exempt status of OPERF under IRC § 401(a).

But the legislature likely could change the exclusive benefit obligation found in ORS 238.660(2) prospectively without impairing a contract in violation of Article I, section 21. *See, e.g.*, Hughes, 314 Or at 31 (“a law impairing an obligation of a contract * * * is a nullity as it relates to PERS retirement benefits accrued or accruing for work performed before the effective date of that [law]”). In this context, such a change could apply only to employer and employee contributions and earnings thereon made or earned *after* the statute’s effective date. In effect, those contributions and earnings would have to be segregated from earlier funds. Such an action also would imperil the tax-exempt status of at least this portion of OPERF.

Sincerely,

David E. Leith
Associate Attorney General and
Chief General Counsel
General Counsel Division

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[1/] We have advised that "cash dividends and increases in value of stock, whether or not realized by subsequent sales and repurchases would be ignored in computing the numerator and denominator of the ratio" because they are not "contributions." Letter of Advice to Robert B. Moore, Deputy State Treasurer, January 31, 1985 at 2 (1985 WL 199940, 2).

[2/] In 1989, the provision stating that OPERF "is declared to be a trust fund" was codified in ORS 237.271(1) (1989). Or Laws 1989, ch 966, § 9.

[3/] In 46 Op Atty Gen 180, 184 (1989), Attorney General David Frohnmayer concluded that a diversion of employer and employee contributions to fund a health insurance supplement for retirees and an intra-fund transfer of gain-loss reserves violated PERS members' contractual and trust rights.

[4/] The legislature has similarly declared its "intent" that "the individual account program [of PERS] be established and maintained as a tax-qualified defined contribution governmental plan" pursuant to section 414(k) of the IRC. ORS 238A.021(1).

[5/] *See also Sprague v. Straub***,** 252 Or 507, 522 n 9, 451 P2d 49 (1969) (holding that "public employers cease to have a proprietary interest in the fund after they have made their contributions to it. The fund then becomes, in effect, a trust fund with the beneficial interest vesting in participating employees.")

[6/] *See* ERISA, 29 USC § 1003(b) (2001).

[7/] RESTATEMENT (THIRD) OF THE LAW OF TRUSTS, § 90 (2007) states:

> The trustee has a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.
>
> (a) This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.
>
> (b) In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.
>
> (c) In addition, the trustee must:

> (1) conform to fundamental fiduciary duties of loyalty (§ 78) and impartiality (§ 79);
>
> (2) act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents (§ 80); and
>
> (3) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship (§ 88).

> (d) The trustee's duties under this Section are subject to the rule of § 91, dealing primarily with contrary investment provisions of a trust or statute.

[8/] Speaking about certain Higher Education funds subject to express requirements of donors, the Attorney General qualified that advice adding that "[t]he State of Oregon as trustee, acting through the [OIC], is bound to follow the directions of the settlor, just as is any other trustee. ORS 128.065; ORS 351.130."

[9/] The Anti-Apartheid Act of 1987 was repealed in 1999. Or Laws 1999, chapter 295, § 1.

[10/] Also, the OIC "shall have at least $100 million in venture capital investments in Oregon *unless, under the circumstances, it is not prudent to do so***.**" ORS 293.733(2) (emphasis added). The OIC must submit an "annual report to the Speaker of the House of Representatives and the President of the Senate detailing the investments and commitments made by the [OIC] in accordance with ORS 293.733." ORS 293.734.

Exhibit Book
Oregon Investment Council - Workshop
5/28/2014

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CalPERS | Investment Office

CalPERS Investment Beliefs

Adopted September 16, 2013

In September 2013, the CalPERS Board of Administration adopted a set of ten Investment Beliefs intended to provide a basis for strategic management of the investment portfolio, inform organizational priorities, and ensure alignment between the Board and CalPERS staff.

The Investment Beliefs are not a checklist to be applied to every decision. They are a guide for making decisions that often require balancing multiple, inter-related decision factors. They provide context for CalPERS actions, reflect CalPERS values, and acknowledge CalPERS responsibility to sustain its ability to pay benefits for generations.

Investment Belief 1

Liabilities must influence the asset structure

Sub-beliefs:

- Ensuring the ability to pay promised benefits by maintaining an adequate funding status is the primary measure of success for CalPERS
- CalPERS has a large and growing cash requirement and inflation-sensitive liabilities; assets that generate cash and hedge inflation should be an important part of the CalPERS investment strategy
- CalPERS cares about both the income and appreciation components of total return
- Concentrations of illiquid assets must be managed to ensure sufficient availability of cash to meet obligations to beneficiaries

Investment Belief 2

A long time investment horizon is a responsibility and an advantage

Long time horizon requires that CalPERS:

- Consider the impact of its actions on future generations of members and taxpayers
- Encourage investee companies and external managers to consider the long-term impact of their actions
- Favor investment strategies that create long-term, sustainable value and recognize the critical importance of a strong and durable economy in the attainment of funding objectives
- Advocate for public policies that promote fair, orderly and effectively regulated capital markets

Long time horizon enables CalPERS to:

- Invest in illiquid assets, provided an appropriate premium is earned for illiquidity risk
- Invest in opportunistic strategies, providing liquidity when the market is short of it
- Take advantage of factors that materialize slowly such as demographic trends
- Tolerate some volatility in asset values and returns, as long as sufficient liquidity is available

Investment Belief 3

CalPERS investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries

Sub-beliefs:

- As a public agency, CalPERS has many stakeholders who express opinions on investment strategy or ask CalPERS to engage on an issue. CalPERS preferred means of responding to issues raised by stakeholders is engagement
- CalPERS primary stakeholders are members/beneficiaries, employers, and California taxpayers as these stakeholders bear the economic consequences of CalPERS investment decisions
- In considering whether to engage on issues raised by stakeholders, CalPERS will use the following prioritization framework:
  - » Principles and Policy – to what extent is the issue supported by CalPERS Investment Beliefs, Principles of Accountable Corporate Governance or other Investment Policy?
  - » Materiality – does the issue have the potential for an impact on portfolio risk or return?
  - » Definition and Likelihood of Success – is success likely, in that CalPERS action will influence an outcome which can be measured? Can we partner with others to achieve success or would someone else be more suited to carry the issue?
  - » Capacity – does CalPERS have the expertise, resources and standing to influence an outcome?

Investment Belief 4

Long-term value creation requires effective management of three forms of capital: financial, physical and human

Sub-beliefs:

- Governance is the primary tool to align interests between CalPERS and managers of its capital, including investee companies and external managers

- Strong governance, along with effective management of environmental and human capital factors, increases the likelihood that companies will perform over the long-term and manage risk effectively

- CalPERS may engage investee companies and external managers on their governance and sustainability issues, including:
  - » Governance practices, including but not limited to alignment of interests
  - » Risk management practices
  - » Human capital practices, including but not limited to fair labor practices, health and safety, responsible contracting and diversity
  - » Environmental practices, including but not limited to climate change and natural resource availability

Investment Belief 5

CalPERS must articulate its investment goals and performance measures and ensure clear accountability for their execution

Sub-beliefs:

- A key success measure for the CalPERS investment program is delivery of the long-term target return for the fund

- The long time horizon of the fund poses challenges in aligning interests of the fund with staff and external managers

- Staff can be measured on returns relative to an appropriate benchmark, but staff performance plans should include additional objectives or key performance indicators to align staff with the fund's long-term goals

- Each asset class should have explicit alignment of interest principles for its external managers

Investment Belief 6

Strategic asset allocation is the dominant determinant of portfolio risk and return

Sub-beliefs:

- CalPERS strategic asset allocation process transforms the fund's required rate of return to the market exposures that staff will manage
- CalPERS will aim to diversify its overall portfolio across distinct risk factors / return drivers
- CalPERS will seek to add value with disciplined, dynamic asset allocation processes, such as mean reversion. The processes must reflect CalPERS characteristics, such as time horizon and size of assets
- CalPERS will consider investment strategies if they have the potential to have a material impact on portfolio risk and return

Investment Belief 7

CalPERS will take risk only where we have a strong belief we will be rewarded for it

Sub-beliefs:

- An expectation of a return premium is required to take risk; CalPERS aims to maximize return for the risk taken
- Markets are not perfectly efficient, but inefficiencies are difficult to exploit after costs
- CalPERS will use index tracking strategies where we lack conviction or demonstrable evidence that we can add value through active management
- CalPERS should measure its investment performance relative to a reference portfolio of public, passively managed assets to ensure that active risk is being compensated at the Total Fund level over the long-term

Investment Belief 8

Costs matter and need to be effectively managed

Sub-beliefs:

- CalPERS will balance risk, return and cost when choosing and evaluating investment managers and investment strategies
- Transparency of the total costs to manage the CalPERS portfolio is required of CalPERS business partners and itself
- Performance fee arrangements and incentive compensation plans should align the interests of the fund, staff and external managers
- CalPERS will seek to capture a larger share of economic returns by using our size to maximize our negotiating leverage. We will also seek to reduce cost, risk and complexity related to manager selection and oversight
- When deciding how to implement an investment strategy, CalPERS will implement in the most cost effective manner

Investment Belief 9

Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error

Sub-beliefs:

- CalPERS shall develop a broad set of investment and actuarial risk measures and clear processes for managing risk
- The path of returns matters, because highly volatile returns can have unexpected impacts on contribution rates and funding status
- As a long-term investor, CalPERS must consider risk factors, for example climate change and natural resource availability, that emerge slowly over long time periods, but could have a material impact on company or portfolio returns

Investment Belief 10

Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives

Sub-beliefs:

- Diversity of talent (including a broad range of education, experience, perspectives and skills) at all levels (Board, staff, external managers, corporate boards) is important
- CalPERS must consider the government agency constraints under which it operates (e.g., compensation, civil service rules, contracting, transparency) when choosing its strategic asset allocation and investment strategies
- CalPERS will be best positioned for success if it:
  - » Has strong governance
  - » Operates with effective, clear processes
  - » Focuses resources on highest value activities
  - » Aligns interests through well designed compensation structures
  - » Employs professionals who have intellectual rigor, deep domain knowledge, a broad range of experience and a commitment to implement CalPERS Investment Beliefs

CalPERS is the largest public pension fund in the U.S., with more than $265 billion in assets. We administer health and retirement benefits on behalf of 3,064 public school, local agency and State employers. Our members number more than 1.6 million in our retirement system and more than 1.3 million in our health plans. For more information about the Investment Beliefs and the CalPERS Asset Liability Management Process, visit: www.calpers.ca.gov/alm.

CalPERS

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