Testimony of Rick Pope in support of HB 2601
February 15, 2023
House Committee on Emergency Management, General Government and Veterans

My name is Rick Pope. I am a volunteer with Divest Oregon, a coalition of 99 statewide organizations including unions with 66,000 PERS members.

I am a retired member of the Oregon State Bar who spent most of my career in business disputes. I maintained a Martindale-Hubbell peer review rating of "pre-eminent," meaning I was ranked by my peers at the highest level of professional excellence for legal expertise and ethical standards. I am also a PERS contingent beneficiary through my wife of 48 years, who is a retired second grade teacher.

Over the past 15 months I have spent scores of hours reviewing meeting materials presented by Treasury staff and consultants to the Oregon Investment Council (OIC), OPERF investment records of the Oregon State Treasury, and financial statements of PERS. I have made 20 carefully targeted public records requests to the Treasury and reviewed those records. They include all investment policies of the OIC, which are published nowhere. I am currently in a mediation with Treasury before the Oregon Public Records Advocate. The mediation concerns Treasury's lack of full disclosure of a climate risk report it commissioned and received in 2021. I have attended three recent OIC meetings in person, and reviewed portions of audio records of those and other meetings. I personally attended the Treasury briefing before this committee had last week.

This written testimony gives specifics and evidence for the abbreviated oral testimony I plant to give on February 16, 2023. I am contemporaneously filing supporting Exhibits 1-28 as a separate covered document.

1. **While claiming divestment is imprudent, Treasury suppressed from an ongoing public records request its own expert's "deep dive" study that says the exact opposite. The suppressed report says in any scenario but energy business as usual, fossil fuel divestment from public equities alone would generate $500 million to $1.4 billion more for OPERF over 5 to 20 years. It ranked fossil fuels at the top of overall investment risks for OPERF.**

The report by Treasury's retained international consultant, Ortec Finance, addressed the key issue: "What if . . . OPERF divested from its liquid-market fossil fuel investments? What is the interplay between risk and return from that?"[1]

The suppression began from the time Treasury received the report in February 2022, as it its subject was within my pending public records request. It continued until after Treasurer Read wrote to the entire Legislature on January 18, 2023, claiming that

[1] Exhibit 1 p. 2.

divestment would "almost certainly" lead to lower returns for OPERF.

Here is how that happened:

Treasury suppresses the Ortec divestment risk report during an ongoing public records request

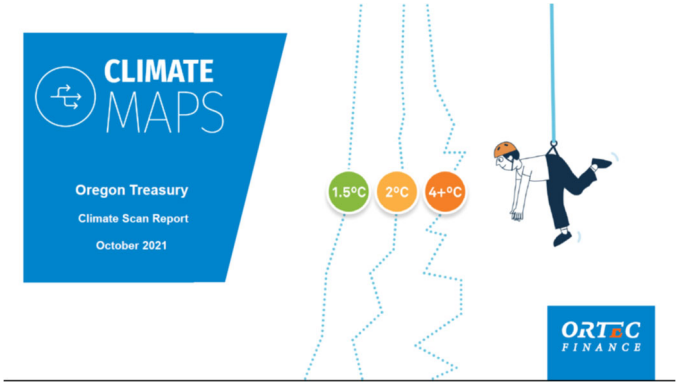
Materials presented to the Oregon Investment Council on 9/8/21 described a consultant engagement with Manifest Climate of Toronto and Ortec Finance of Rotterdam to better understand "climate risk at the total portfolio level." Treasury said that job was outside its expertise, and "requires outside help offering complex tools & econometric analyses that account for uncertainty and interconnectivity of factors being modeled."[2]

I made a public records request in December 2021 for Treasury's request for proposals and responses to them, and for the consulting contract.

Displaying their confidence in the specific consultants, Treasury asked for a proposal only from Ortec and Manifest. The contract was signed in May 2021 by Chief Investment Officer Rex Kim. The scope of work is attached.[3]

On January 12, 2022, I made a public records request for "Any documents . . . that relate to assessments of or responses to climate-related financial risk to assets held in investment funds as defined by ORS 293.701."

Treasury produced nothing in response until July 20, 2022, when it said it was focusing on **"the deliverable," (singular not plural)**, from the contractor, and that a heavily redacted **"final report"** was available from Treasury's public records center (emphases added).[4] That report, titled "Climate MAPS, Oregon Treasury Climate Scan Report, October 2021," addressed "climate risk exposure" to the "OPERF investment portfolio" through a "view from 10,000 feet."[5]



In August 2022, I began an ongoing mediation over these redactions and other requested documents through Oregon's Public Records Advocate. As a result, Treasury on December 23, 2022, released a less-redacted version of the allegedly final "Climate MAPS" report.[6]

[2] Exhibit 2 p. 3, 4.
[3] Exhibit 3.
[4] Exhibit 4.
[5] Exhibit 5 p. 3.
[6] Exhibit 6.

On January 17, 2023, I wrote to Treasury that "as part of this request, please provide me a copy of any document establishing climate risk investment policies to be followed by Treasury investment staff."

Treasurer Read tells every legislator that divestment will "almost certainly" cause lower returns for OPERF

On January 18, 2023, Treasurer Read wrote to all members of the Oregon Legislature, contending that fossil-fuel investment restrictions in HB 2601 "**will almost certainly lead to a reduction in investment returns. . . .**" (emphasis added)."[7]

Treasury finally discloses the suppressed expert report that finds divestment producing higher returns for OPERF

On January 25, 2023, a week after Treasurer Read's letter, that Treasury disclosed to me Ortec's additional report dated a year earlier. It is titled "Climate Risk Scenario Modelling, Public equity sector deep dive."[8]

It posed and answered the question: "What if OPERF divested from its liquid-market fossil fuel investments?"[9] It stated its purpose: "to cut through the immense detail and deliver the key insights."[10]

That is what Treasury suppressed for almost all of the past year.

For this analysis, Treasury provided Ortec with data on OPERF's public equity investments. Ortec applied its detailed model to OPERF's data across 18 investment sectors, 28 geographic investment regions, and 504 time series per climate scenario.[11]

Ortec next described how it determined that OPERF's fossil-fuel exposures constituted 4.4% of its public equity holdings.[12] (Treasury separately valued OPERF's public equity portfolio at $25.7 billion in December 2021, two months before Ortec submitted its "deep dive" report.)[13]

Ortec then presented its key findings –the "Impact of replacing fossil-fuel with a 'climate aligned benchmark,'" by looking at three scenarios it also used in its October 2021 "view from 10,000 feet" report:

- What Ortec labels a "Paris Orderly" pathway, which assumes a soft landing from

[7] Exhibit 7 p. 1.
[8] Exhibit 1.
[9] Exhibit 1 p. 2.
[10] Exhibit 1 p. 5.
[11] Exhibit 1 p. 3.
[12] Exhibit 1. P. 5.
[13] Exhibit 8.

energy transition. This model tests OPERF exposure to the risks and opportunities from systemic drivers of an orderly energy transition and locked-in physical risk.

- What Ortec labels a "Paris Disorderly" pathway assumes a bumpy landing from energy transition. This model shows the resilience of OPERF's portfolio to sudden transition shocks triggering a market dislocation centered on high emitting stocks;
- What Ortec labels a "Failed Transition" pathway where business as usual continues with no new policy measures. This model assumes severe and increasing physical impacts to OPERF investments, and average warming by the year 2100 increasing 3.8° C (6.8°F).[14]

Ortec measured the impacts assuming a rising "baseline" of historic market performance without regard to climate change.[15] Thus, negative performance compared to the baseline still produces absolute increases over time – just not as much for some OPERF climate-impacted investments as for others.

Ortec's answer to "What if OPERF divested from its liquid-market fossil fuel investments? What is the interplay between risk and return from that?"

In a key table, Ortec calculated what would happen if OPERF switched its public-equity portfolio out of fossil fuels and into a climate-aligned benchmark:[16]

- **In the Paris Orderly (PO) "soft landing" scenario,** switching OPERF's public equity portfolio out of its 4.4% fossil fuel holdings and into climate alignment would, relative to baseline:
  - Over 5 years
    - Improve its performance by 11.1% annually
    - Increase its value by .71% per year ($913 million total, using Treasury's 12/21 valuation of OPERF's public equity portfolio)
  - Over 10 years
    - Improve its performance by 8.2% annually
    - Increase its value by .47% per year ($1.2 billion)
  - Over 20 years
    - Improve its performance by 4.9% annually;
    - Increase its value by .27% per year ($1.4 billion).

- **In the Paris Disorderly (PD) "bumpy landing" scenario,** switching OPERF's public equity portfolio out of its 4.4% fossil fuel holdings and into climate alignment would, relative to baseline:

[14] Exhibit 5 p. 6; Exhibit 1 p. 6.
[15] Exhibit 5 p. 7; Exhibit 1 p. 6.
[16] Exhibit 1 p. 6. The black boxes are added to direct attention to the two tables described in the text of my testimony. The decreasing performance differential over time results from an assumption in the model that fossil fuel companies over time will themselves transition to renewables.

- Over 5 years
  - Improve its performance by 14.5% annually
  - Increase its value by .41% per year ($527 million)
- Over 10 years
  - Improve its performance by 10% annually
  - Increase its value by .33% per year over 10 years ($850 million)
- Over 20 years
  - Improve its performance by 5.8% annually
  - Increase its value by.20% per year ($1 billion)

Ortec's model assumed that eventually, fossil fuels companies would become "part of the solution." It also noted that some clients investigated what to expect if fossil fuel companies failed to transition their businesses.[17] Treasury chose not to investigate this.

The prudence of such an investigation finds support in recent releases of internal fossil fuel company documents by the U.S. House Committee on Oversight and Reform, https://oversight.house.gov/sites/democrats.oversight.house.gov/files/2022-12-09.COR_Supplemental_Memo-Fossil_Fuel_Industry_Disinformation.pdf, pp. 2-3.

It is also supported by findings that oil company scientists began internally, accurately and continuously predicting global warming from CO2 beginning in the 1970s, while their corporate public relations officials continuously claimed the science was inconclusive or erroneous. *Assessing ExxonMobil's global warming projections,* Science 13 Jan 2023, https://www.science.org/doi/10.1126/science.abk0063.

- **In the Failed Transition (FT) "hidebound" scenario,** or energy business as usual with no new policy measures, switching OPERF's public equity portfolio out of its 4.4% fossil fuel holdings would, relative to baseline:
  - Over 5 years
    - Decrease its performance by .1% annually
    - Remain flat in relative value
  - Over 10 years
    - Decrease its performance by .3% annually
    - Decrease its value by .01% per year over 10 years (-$257 million)
  - Over 20 years
    - Decrease its performance by 1.1% annually
    - Decrease its value by .05% per year over 20 years (-$2.57 billion.

Notably, as shown below, under all scenarios Ortec found OPERF's fossil fuel investments top-rated risks.[18]

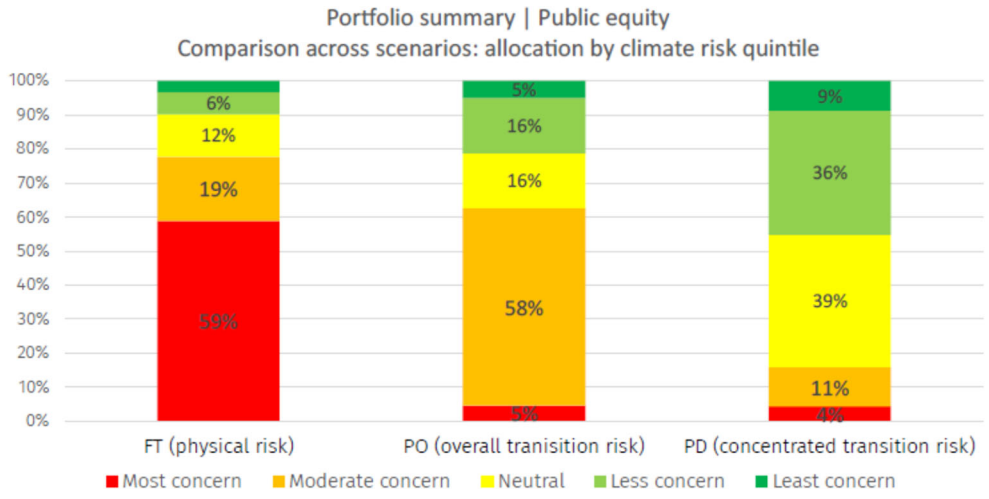
[17] Exhibit 1 p 6 at bottom in blue box, "Engagement and implementation note."
[18] Exhibit 1 p. 13.

High level insights - Sector Risk MAPS

Averaging the sector quintiles across all regions, combining results from the two transition scenarios to inform systemic transition exposure and using the failed transition to inform physical risk.

	Sector quintile score (low = worse) across all regions			
Sector/activity	Transition quintile	Physical risk quintile	Combined	RiskRank
Consumer discretionary	2.4	1.2	1.8	1
Oil and gas	1.4	3.0	2.2	2
Coal and manufactured fuels	1.1	3.4	2.2	3
Fossil based utilities	1.0	4.0	2.5	4

Also notably, as shown below, Ortec found the Failed Transition scenario produced far more risk generally to OPERF's portfolio than any other scenario. There, as seen on the left, almost 60% of the portfolio is in a risk "red zone."[19]



Importantly, in a separate private equity section, Ortec warned that "the illiquidity of this asset class suggest that climate risk should be considered as part of deal due diligence, since exiting positions can take significant time."[20]

2. **Treasury's climate consultant warned 17 months ago of substantial risk to OPERF from climate change. The Treasurer says he cares deeply. But Treasury's investment bureaucracy ignored climate risks and opportunities in OPERF's latest strategic asset allocation. And Treasury has no documented climate-specific policy for how to address climate risks in OPERF's portfolio.**

Ortec's October 2021 "Climate MAPS" report warned that "Over the next 20 years, all three climate scenarios see lower growth expectations compared to a baseline. This poses

[19] Exhibit 1 p. 15.
[20] Exhibit 1 p. 21.

a material risk to both scheme balance sheets and future contribution/funding needs." Ortec further warned that "Transition risk impacts may occur soon than most expect."[21]

A year later, Treasurer Read issued a press release in November 2022 saying, "Addressing the risk of climate change to our investments is critical to our missions to provide a secure retirement to Oregon's teachers, firefighters, nurses, and other hardworking public servants."[22]

But despite Ortec's warnings and the Treasurer's public statement, Treasury is failing to address climate risks and opportunities for OPERF in systematic ways. Whatever is being done today is ad hoc, not systematic.

Treasury acknowledged in a May 2022 survey by its investment consultant Meketa, done for the Minnesota State Board of Investments, that it **did not** address climate change risks and opportunities in OPERF's strategic asset allocation. Seven of its peers do address them.[23]

Treasury in November 2022 presented the conclusion of its year-long OPERF asset-liability study to the OIC, with the ultimate goal being "to select a new long-term policy allocation for OPERF." Its investment consultants Meketa and Aon presented **124 slides. None mentioned climate change**.[24] Meka ran 10,000 20-year simulations for each potential OPERF portfolio.[25] As it considered 7 portfolio options,[26] Meketa ran **70,000 simulations.**

I attended the November meeting of the OIC in person. **Not one of the reported simulations was described as addressing impacts of climate change**. Instead of integrating climate change risks and opportunities, Meketa's scenario testing concerned only what Ortec would surely describe as "traditional baseline investing" with no regard for the impact of climate change.[27]

Finally, as of February 14, 2023, Treasury confirmed it has **no climate-specific policy document for how to address climate risk in OPERF's portfolio**.[28]

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[21] Exhibit 6 p. 3.
[22] https://www.oregon.gov/newsroom/Pages/NewsDetail.aspx?newsid=87431
[23] Exhibit 9.
[24] Exhibit 10 and p. 5.
[25] Exhibit 10 pp. 10-11.
[26] Exhibit 10 p. 7.
[27] Exhibit 10 pp. 35-39.
[28] Exhibit 11 p. 2.

3. **Treasury claims that OPERF is a No.1 performer in 2022, but national figures for more typical years show OPERF to be below average among top tier plans. Why this difference? The claimed performance bump results the Treasurer's lack of candor about a temporary artificial bubble in private investments. All the Treasury team witnesses last week know the bubble will be deflated in coming quarters.**

The Treasurer claims OPERF performed No. 1 among peers in 2022, and argues "don't mess with outstanding success." His claims, however, say much more about his lack of candor on the issue of divestment than they do about OPERF's actual performance.

We all want OPERF performing well. Typically, however, OPERF has performed respectably but somewhat below average within the top 15 public pension funds—according to figures reported to the nationally respected and nonpartisan Public Pension Plans Database. They are presented below:

Rank by Size	Pension Fund Name	Largest 15 Pension Funds by Net Assets (6/30/2021)*	Overall 5-year investment return (highest to lowest)	Overall 10-year investment return	Private Equity Percentage of Portfolio Actual	Private Equity Percentage of Portfolio Target
7	Georgia Teachers	$102,146,688.00	12.3%	9.8%	0.1%	0.0%
10	Ohio Teachers	$89,379,040.00	12.2%	10.0%	0.0%	0.0%
4	Florida RS	$202,082,176.00	12.0%	9.3%	8.7%	10.8%
6	New York State Teachers	$148,148,464.00	11.9%	10.1%	10.9%	9.0%
2	California Teachers	$310,293,440.00	11.8%	9.7%	12.0%	10.0%
11	New York City ERS	$85,906,208.00	11.8%	9.3%	7.6%	8.0%
13	New York City Teachers	$78,347,296.00	11.6%	9.3%	11.4%	6.2%
9	University of California	$91,826,000.00	11.6%	8.9%	8.0%	10.0%
3	NY State & Local ERS	$220,580,576.00	11.2%	9.2%	11.4%	10.0%
5	Texas Teachers	$201,807,008.00	11.2%	9.0%	16.6%	13.2%
14	LA County ERS	$73,012,024.00	10.8%	8.6%	12.9%	10.0%
8	Virginia RS	$98,880,864.00	10.7%	8.8%	15.6%	14.0%
12	**Oregon PERS**	**$84,331,320.00**	**10.5%**	**8.8%**	**26.4%**	**17.5%**
1	California PERF	$477,322,752.00	10.3%	8.5%	8.2%	8.0%
15	Pennsylvania School Employees	$71,967,352.00	10.1%	8.0%	15.8%	10.9%
		Average of ALL funds	**11.2%**	**8.9%**	**10.2%**	**9.1%**
		Average of top 15 funds	**11.3%**	**9.2%**	**11.0%**	**9.2%**

** The Public Plans Database is developed and maintained through a collaboration of the Center for Retirement Research at Boston College, the Mission Square Research Institute, the National Association of State Retirement Administrators, and the Government Finance Officers Association.*

What accounts for the difference between the Treasurer's recent claims and more typical reported facts?

The Treasury team witnesses who appeared before you last week—Treasurer Read, his chief investment officer Rex Kim, and PERS director Kevin Olineck—know why and didn't tell you. They all sat in December and January meetings of the OIC, where Treasury's investment consultant and staff told them **OPERF's outperformance is artificial and temporary**. It is occurring because private equity "returns" are well above market – not because they actually are, but because OPERF's private equity firms have not yet marked down their illiquid valuation estimates to reflect reality in a severe market decline. But, the Treasury team was told, the markdowns are coming.

A little background is necessary. OPERF's private investments are now 60% of the pension fund. According to OIC Investment Policy 701 Appendix A, the vast majority of them "do not have readily determinable market prices established by arm's-length transactions; moreover, there exists no broadly accepted methodology for determining fair value, and valuations of such securities may contain subjective elements." For this reason, "The General Partner (GP) of each limited partnership will determine valuations for the investments within its limited partnerships." [29]

It is easy to understand that private equity firms, who advertise themselves as wizards who produce outsized returns, are reluctant to voluntarily devalue their own holdings. That is exactly what is going on with OPERF now. Everyone on the OIC, including Treasurer Read, knows it.

At the OIC's November 2, 2022, meeting, Treasury Director of Private Markets Michael Langdon told the council "**We're reflecting an excess mark-up in our portfolio of about 7 [undecipherable] dollars.** With the passage of time either that turns into cash remunerizations or we find out it's never actually real and we get write downs."[30]

At the OIC's December 7, 2022, meeting, Treasury's consultant Meketa reported that "By far the most meaningful contributor to absolute performance for the Quarter and the year to date period was the Real Assets Portfolio, producing a 15.6% positive return in 2022 thus far."[31]

"Real Assets" are a form of OPERF private investment in infrastructure and natural resources,. They consist of "commingled funds organized as limited partnerships and limited liability companies" that last for 10-14 years. Like private equity, they are valued as provided by the general partner.[32]

Meketa further told the OIC that "On a relative basis, private equity returns, which were well ahead of their Russell 3000 +300 benchmark, helped produce benchmark-relative outperformance." Meketa concluded, **"Note that the lag in valuations here contributes positively, and a future pullback of these returns is expected."**[33]

The reports of a temporary private investment bubble continued at OIC's January 25, 2023, meeting. Treasury's own director of private markets told the OIC that "there is currently an **extreme disconnect between public and private equity markets from a valuation and, consequently, return perspective**." That, he said, is because of "recent public market volatility and the vagaries of private market valuations." **The disconnect,**

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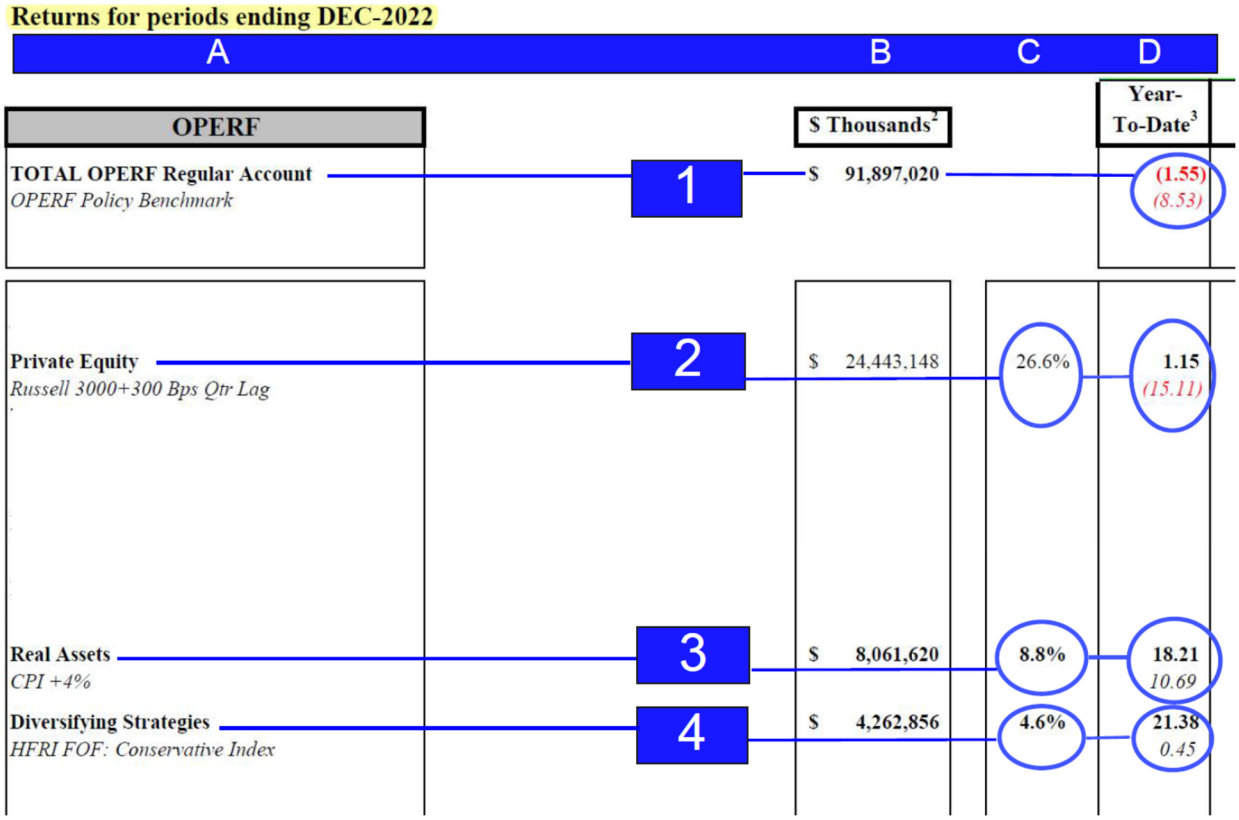
[29] Exhibit 12 p. 1.
[30] https://www.oregon.gov/treasury/invested-for-oregon/Documents/Invested-for-OR-47OIC-Agenda-and-Minutes/Audio/2022/OIC-20221102.mp3 at 58:29.
[31] Exhibit 13 p. 1.
[32] Exhibit 14 pp. 1-2, 2022 Oregon PERS Annual Comprehensive Financial Report, notes to financial statements.
[33] Exhibit 13 p. 1.

which he described as "temporary," left private equity unrealistically "down only 2% last twelve months through 9/30/22." The disconnect, he said, "is most acute in the venture capital asset class, which is down only 7% for year end 9/30/22 despite a massive correction in the valuation of unprofitable technology companies in the public market."[34]

Major reasons for outperformance appear in the chart below, taken from Treasury's year-end return statement for OPERF. The chart focuses on total OPERF return for 2022 (line 1), and returns from three major private asset classes (lines 2-4)with ostensible values that are far above what benchmarks would ordinarily expect. Column A shows the asset class name; column B the total valuation, column C the allocation percentage within OPERF, and column D the stated value compared with expected benchmarks.



[34] Exhibit 15 pp. 1, 2.

4. **Treasury staff doesn't want to be constrained by statute. But staff needs to understand who sets policy. For a salient example, OPERF's large amounts of high-risk private equity investments for years have been far above the policy target established by the Oregon Investment Council. Staff's response boils down to "so what?"**

ORS 293.736 says the Treasury "shall" invest OPERF "subject to the policies formulated by the Oregon Investment Council." Treasury's investment bureaucracy is balking not just at fossil fuel divestment, but also at at OIC policies limiting OPERF's exposure to high-risk investments. Targeted direction from the Legislature would be beneficial.

OPERF's private equity investments are a salient example of a Treasury staff culture of autonomy. The OIC has a set policy that high-risk private equity investments should be targeted at a percentage of the pension fund.[35] Since 2010, Treasury staff has exceeded—even blown past—that policy target.[36] At the end of 2022, the OIC private equity target was 20% while the actual pension fund allocation to private equity was 26.6%.[37]

At the OIC's November 2, 2022, meeting, chair Cara Samples opposed a staff recommendation to increase OPERF's private-equity target allocation from 20% to 22.5%. Staff sought the increase because private equity as of August 2022 was already 28% of OPERF.[38]

Chair Samples said, "The policy targets that we set are things that we always want to be working toward, and so to the extent that we offer solutions to increase allocation targets to solve the problem of being over-allocated, I don't think we need to do that. So I'll stop there."[39] Treasury's consultant Colin Bebee of Meketa responded, "I think it's just the nature of private equity, it's been difficult for us to bring that back down to target. . . . If you want it more liquid … you may never actually get there."[40]

Treasury Director of Private Markets Michael Langdon at the same meeting told Chair Samples: "I could tell you candidly whether it 20 or 22 it makes no difference to us. We're still going to be executing the same plan. . . . And that number, by the way, in our world is really about a dollar figure, it's not about a percentage."[41]

At the OIC's January 25, 2022, meeting, Treasury Chief Investment Officer Rex Kim told

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[35] Exhibit 16.
[36] Exhibit 17.
[37] Exhibit 18.
[38] Exhibit 19.
[39] https://www.oregon.gov/treasury/invested-for-oregon/Documents/Invested-for-OR-47OIC-Agenda-and-Minutes/Audio/2022/OIC-20221102.mp3 at 43:10.
[40] https://www.oregon.gov/treasury/invested-for-oregon/Documents/Invested-for-OR-47OIC-Agenda-and-Minutes/Audio/2022/OIC-20221102.mp3 at 43:40, 48:19.
[41] https://www.oregon.gov/treasury/invested-for-oregon/Documents/Invested-for-OR-47OIC-Agenda-and-Minutes/Audio/2023/OIC-20230125-Audio-only.mp3 at 57:

Chair Samples the OIC's private-equity target was "some 20% artificial number."[42]

The private-equity problem illustrates how investment managers at Treasury are ready, willing and able to resist policy oversight by the OIC. It will take extra work for Treasury to screen OPERF's new investments and replace OPERF's current fossil fuel investments. Treasury's investment managers have made it plain they prefer not to be bothered. But it is necessary work for the benefit and protection of OPERF. The Legislature would be fulfilling its role by directing a recalcitrant staff to undertake that work for the good of OPERF.

5. **The Treasurer says a complicated decarbonization review of OPERF is the way to go. But Treasury is already 2 ½ years overdue on a regular comprehensive audit of its investment policies, practices and specific investments that is mandated by statute.**

The Treasurer says it is best for Treasury and OIC to develop a complex plan of top to bottom review of every OPERF investment, and how it can be decarbonized by the year 2050. But Treasury has significant limitations on its capacity to conduct the most basic reviews the law already requires. Given these systemic problems, it is a counterproductive pipe dream to expect it to successfully implement a massive new, complex review. The simpler approach of HB 2601 is feasible and preferable.

ORS 293.776, enacted in 1967, already requires periodic top to bottom reviews of OPERF investments and its investment program. It requires the OIC to provide for an examination and audit of OPERF's investment program at least once every four years, and a report of results. The examination and audit "shall include an evaluation of current investment funds investment policies and practices and of specific investments" of OPERF "in relation to the objective set forth in ORS 293.721 [productivity], the standard set forth in ORS 293.726 [prudence] and other criteria as may be appropriate." It further requires "recommendations relating to" OPERF's "investment policies and practices and to specific investments" of OPERF "as are considered necessary or desirable."

The last such examination and audit, reflected in a report obtained by public records request, was in September 2016 and was labeled "DRAFT."[43] This means Treasury and the OIC are 2 ½ years late in meeting their quadrennial investment-audit statutory requirements. As there is no indication Treasury has its late review under way, it appears probable the required examination, audit and report will be substantially later than it already is.

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[42] https://www.oregon.gov/treasury/invested-for-oregon/Documents/Invested-for-OR-47OIC-Agenda-and-Minutes/Audio/2022/OIC-20221102.mp3 at 1:26:40.
[43] Exhibit 20.

Among issues noted in the 2016 audit report:

- The risk management system Treasury staff used for each investment at the operational level "is beyond the scope of this review." (Ex 20 p. 14).

- As OPERF's size and complexity has grown, staffing levels have not kept pace. That limits the level and type of internal management mandates, and limits timely implementation of audit recommendations. **Constrained staffing levels limit staff's ability to adequately monitor OPERF's myriad investments.** (Ex 20 p. 16).

- An analysis of collateral benefits that an equally returning investment may offer is permissible. Clear policies on the topic and documentation of individual investments will assist in supporting the prudence of any decision made by the Council of a legal challenge should arise. (Ex 20 p. 17).

- Investments in private equity, real estate, alternatives and opportunities portfolio often comprise illiquid assets and are approved by the OIC based on subjective estimates of risk and return projections. (Ex. 20 p. 18).

- Treasury's internal audit services unit is an important means of self-assessment for the OIC. (Ex 20 p. 20).

- In the area of assessing alternative (private market) investments, roles and responsibilities are not clearly defined between staff and consultants. (Ex 20 p. 25).

- In assessing alternative investments, Treasury should focus less on performance and more on overall fund strategy and reinvestment risks. (Ex 20 p. 26).

- There is poor documentation supporting decisions to invest in alternatives. (Ex 20 p. 27).

- Staff is not examining private equity firms' back-office operations, and needs to in order to prevent risks and potential losses. Staff should also conduct more background checks of private equity managers. (Ex 20 p. 28).

- Treasury's 2012 audit issued nine high-risk recommendations. Of those nine, two were resolved and progress was made on two others. (Ex 20 p. 31).

- A 2012 recommendation to adopt a prohibited transactions policy and to fully comply with federal securities requirements was not done. (Ex 20 p. 32).

- A 2012 high-risk recommendation to created a dedicated Enterprise Risk Management Function was not acted upon. (Ex 20 p. 32).

Just as the 2016 audit reported how many 2012 recommendations were acted upon or not, a timely 2020 audit would have told us how many 2016 recommendations were acted

upon. It would also have disclosed what new issues were then facing Treasury and OIC.

Given these shortcomings, a simple approach to divestiture, followed by a longer time for development of a climate resilience plan for OPERF, is preferable to a cumbersome, complex investment-by-investment decarbonization review that Treasury is, as a practical matter, completely unable to manage and implement.

6. Treasury has not had a fully functional audit program since December 2018 or earlier.

Official Treasury policy states that its Internal Audit Services is there to bring "a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."[44] On paper, Treasury implements its audit function through an audit committee that oversees its internal audit service. On paper, both groups report to Treasury's Chief Audit Executive.[45]

Treasury's response to a 2/7/23 public records request, for Treasury's last four audit committee meeting records, says it has had no functioning audit committee since December 2018.[46]

The meeting records Treasury produced show that the committee struggled in 2018—and for an unknown time earlier than that—with Treasury's failure to fill the critical position of Chief Audit Executive. The committee ultimately addressed the risk by simply accepting it and removing it from plan consideration – even though it rated this lack as the second highest overall risk facing Treasury.[47] Treasury failed to fill this post until an unstated time in 2022—which may explain why it is years late on the statutorily required investment program audit.[48]

There is another timely piece of unfinished business from Treasury's lack of a fully functioning audit program: A high-risk audit of analytics and valuation policies for private equity investments.[49]

[44] Exhibit 21.
[45] Exhibits 22, 23.
[46] Exhibit 24.
[47] Exhibit 25.
[48] Exhibit 26.
[49] Exhibit 27.

7. **The Treasurer claims fossil fuel divestment would violate his fiduciary duty. He omitted to tell you he has been investing the $367 million state Public University Fund under fossil-free restrictions since 2019.**

We have seen the Treasurer repeatedly telling the Legislature and this committee that fossil fuel divestment would violate his fiduciary duty.

What he has failed to tell you is that, since May 2019, Treasury has been investing the $367 million Public University Fund, which is a state investment fund subject to the same investment statutes as OPERF, with a fossil-free restriction.[50]

8. **Three Oregon Attorney General opinions, four statutes, one OIC formal divestment policy, and ERISA regulations for private pensions all permit consideration of social issues in pension investing so long as there is equal or greater economic value. And fossil fuel divestment is a money maker for OPERF.**

The Treasurer told the Legislature that enacting HB 2601 would "disregard existing state law about investing for the sole benefit of OPERF beneficiaries."[51] But, as the 2016 Treasury audit report corroborates, HB 2601 follows to the letter decades of existing law. That law says when a preferred policy choice generates equal or greater potential economic value, OPERF investments **are** for the sole benefit of PERS beneficiaries.

HB 2601 follows three opinions over 20 years from the Oregon Attorney General on OPERF investing that takes into account social or political issues.[52] The most recent, in 2010, says:

> 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.
>
> . . . [T]he 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.[53]

[50] Exhibit 28 p. 1, 4, 8.
[51] Exhibit 7 p. 1.
[52] 2010 Oregon Atty Gen Op 3 (8/5/2010); 46 Oregon Atty Gen Op 143 (1989); 46 Oregon Atty Gen Op 506 (1993).
[53] 2010 Oregon Atty Gen Op 3 at pp. 1, 12.

HB 2601 follows four other Oregon statutes[54] and the OIC's own formal divestment policy.[55] It follows statutory and trust requirements to invest prudently with risks and returns suitable to a pension fund,[56] to preserve the corpus of the trust,[57] and to protect the pension fund's long-term stability.[58] It is consistent with the latest ERISA regulation on when and how private pension funds may take collateral benefits into account in investing.[59]

The Treasury's own retained experts concluded that fossil fuel divestment would benefit OPERF under every scenario but one with no energy transition. OPERF's past fossil fuel investments stayed flat over the past nine years. These problematic and risk-laden investments have no place in a pension fund intended to remain in existence well beyond 2050.

Screening and replacing fossil fuel investments with investments of equal or greater economic value will take some work from Treasury's investment bureaucracy. But the work is prudent, feasible, and necessary for the long-term protection and benefit of OPERF.

[54] Oregon Anti-Apartheid Act of 1987, ORS 293.830 et seq (repealed); Venture capital investments, ORS 293.733; Investing in Sudan, ORS 293.911; Investing in Iran, ORS 293.837.
[55] OIC INV 205.
[56] ORS 293.726(1)-(2).
[57] ORS 238.601.
[58] *White v. PERB*, 351 Or 426, 437, 268 P3d 600, 608 (2011).
[59] 29 CFR § 2550404a-1, 87 Fed. Reg. No. 230, pp. 73884-86 (December 1, 2022).