

Oregon Investment Council

Statement
of
Fund Governance
for the
Oregon Public Employees Retirement Fund

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Glossary of Selected Terms

Terms highlighted in *italics* are explained in the glossary.

1.0 Purpose

- 1.1 This statement summarizes the governance structure established by the *Oregon Investment Council* (the “Council”) to ensure the prudent, effective and efficient management of the assets of the *Oregon Public Employees Retirement Fund (OPERF)*.
- 1.2 The Council approved this governance structure after careful consideration of alternative approaches to governing a very large and growing pension fund within an increasingly complex financial and investment environment.
- 1.3 The Statement has been prepared with five audiences in mind: 1) incumbent, new and prospective Council members; 2) Treasury staff; 3) OPERF active and retired members; 4) Oregon State Legislature and Governor; and 5) agents engaged by the Council to manage and administer OPERF assets.
- 1.4 The Statement summarizes more detailed policies and procedures documents prepared and maintained by Treasury staff, and numerous other documents that govern the day-to-day management of OPERF assets.
- 1.5 The Council regularly assesses the continued suitability of the OPERF governance structure, initiates change as necessary, and updates this Statement accordingly.

2.0 Guiding Principles

- 2.1 Three principles guided the Council’s development of the OPERF governance structure:
 - (a) To fulfill its role as *governing fiduciary*, the Council retains responsibility for investment decisions. In accordance with ORS 293.721, the general duty of the Council “is to make the moneys as productive as possible,” subject to the standard of judgment and care in ORS 293.726. In addition, the “. . . assets of [OPERF] may not be diverted or otherwise put to any use that is not for the exclusive benefit of members and their beneficiaries” (ORS 238.660(2)).
 - (b) To ensure OPERF assets are prudently, profitably, and efficiently managed on a day-to-day basis, the Council has chosen to delegate the management and implementation of specified Council investment policies to qualified *managing and operating fiduciaries*. Such delegation is consistent with ORS 293.726(4)(b), which states the Council must “act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents.” Council delegates have the training, expertise, experience, tools and time to cost-effectively implement Council policies.
 - (c) To ensure effective oversight of delegates, the Council requires timely performance reports that reveal if delegates have complied with their mandates and guidelines, and indicate how assets under their care have performed relative to established *investment objectives*.

3.0 Investment Decisions Retained by the Council

- 3.1 The Council approves the following investment policies:
- (a) Total fund investment objective;
 - (b) Target asset allocation policy;
 - (c) Asset mix policy re-balancing ranges;
 - (d) Asset class structural tilts;
 - (e) Active management exposure within each asset class;
 - (f) Manager structure within each asset class; and,
 - (g) Retaining, terminating and replacing investment managers within each asset class.
- 3.2 Before approving or amending policy decisions, the Council seeks advice, guidance and recommendations from Treasury staff, Council-retained investment consultants, investment managers and other experts or sources as considered prudent by the Council.
- 3.3 Private equity investment commitments in first-time funds exceeding \$100 million, or exceeding 200% increases in follow-on partnerships, must be brought to the Council for approval.
- 3.4 Real estate investment commitments in first-time funds exceeding \$100 million, or exceeding 200% increases in follow-on partnerships or core managers, must be brought to the Council for approval.
- 3.5 Opportunity Portfolio or Alternative Investment commitments in first-time funds exceeding \$50 million, or exceeding 200% increases in follow-on investments, must be brought to the Council for approval.

4.0 Investment Decisions Delegated to Treasury Staff

- 4.1 The Council has delegated to qualified Treasury staff the following investment management and implementation decisions:
- (a) Re-balancing of total fund, asset class and manager exposures to ensure OPERF assets are within the total fund, asset class strategy and manager structure guidelines approved by the Council. Re-balancing activity is included as an information item in the Treasury staff's monthly report to the Council.
 - (b) Recommending retaining, terminating and replacing investment managers within each asset class. Before recommending a manager change, Treasury staff will satisfy the Council that the manager change is supported by a satisfactory level of analysis and due diligence. This will include: documenting the reasons for the manager change, a list of the managers considered, the expected improvement in performance attributable to the change, how the manager complements the existing portfolio, verification that the change complies with the asset class strategy and manager structure approved by the Council, and access to all supporting working papers and reports. One or more Council members may elect to work with Treasury staff when manager issues are being examined.

- (c) The Equity Investment Officers may negotiate and execute trades in public equities and public equity futures contracts under the general guidance of the Chief Investment Officer for specific strategies defined in OIC Policy.
 - (d) Preparing, negotiating and executing investment manager mandates, guidelines and fee agreements.
 - (e) Overseeing individual investment managers to ensure their portfolios comply with their respective portfolio mandates and guidelines.
 - (f) Providing oversight of the master custodian to ensure that the Fund's rights to pursue securities class action litigation are appropriately protected.
- 4.2 In making these decisions, Treasury staff seeks the advice, guidance and recommendations from Council-retained investment consultants, investment managers and other experts and sources as considered prudent by Treasury Staff.

5.0 Investment Decisions Delegated to Investment Professionals

- 5.1 The Council has delegated to qualified investment managers the buying and selling of individual securities and/or other investments authorized under the portfolio management guidelines approved by the Council.
- 5.2 The Council has delegated to a qualified independent third-party the voting of shareholder proxies that accompany the securities and/or investments held by the portfolio with oversight by Treasury staff and in accordance with Council voting guidelines.

6.0 Effective Council Oversight

- 6.1 The Council approves the criteria for monitoring and evaluating the impact of different investment decisions on total fund, asset class, and manager level performance. Performance is monitored and evaluated with respect to investment risks taken, and investment returns earned.
- 6.2 Investment *risks* are monitored and evaluated quarterly by comparing total fund, asset class and manager holdings to the risk characteristics of suitable *benchmarks*. Additionally, the tracking error of the public asset classes and the total fund is monitored and reported to the Council, quarterly.
- 6.3 Investment *returns* are monitored monthly, and evaluated quarterly by comparing total fund, asset class and manager level returns against suitable benchmarks. Quarterly attribution reports identify the impact that Council, Treasury staff, and investment manager decisions have had on total fund, asset class and manager level returns over different time horizons.
- 6.4 Before approving or amending the criteria for monitoring and evaluating investment decisions, the Council seeks advice, guidance and recommendations from Treasury staff, Council-retained investment consultants, investment managers and other experts and sources as considered prudent by the Council.

Glossary

Benchmark: A standard by which investment performance can be measured and evaluated. For example, the performance of US equity managers is often measured and evaluated relative to the benchmark performance of the Russell 3000 Index.

Governing, managing and operating fiduciaries. Terminology increasingly used in the pension field to distinguish between the governance, management and operations functions in a pension fund. The governance function is mission choice, funding and investment policy decisions, organizational design decisions, the monitoring of organizational effectiveness, and communication of results to stakeholders. This is the domain of governing fiduciaries. Management acts as advisors to the governing fiduciaries, devises strategies for achieving the fund mission and implementing the policies in a cost-effective manner, and organizes and monitors fund operations. This is the domain of managing fiduciaries. Finally, fund operations in the form of portfolio management, risk monitoring, and information system management and reporting are delegated to operating fiduciaries either inside or outside the pension fund organization. See Ambachtsheer, K. P. and D. Don Ezra, *Pension Fund Excellence*, Wiley, 1998, “Mapping the Road to Excellence”, chapter 3.

Investment Objectives: The investment objectives of OPERF are summarized in the Statement of Investment Objectives and Policy Framework for the Oregon Public Employees Retirement Fund.

Oregon Investment Council (OIC): Oregon Revised Statute (ORS) 293.706 establishes the OIC, which consists of five voting members, four of whom are subject to Senate confirmation (the Treasurer serves by position, and is not subject to confirmation). The members appointed by the Governor must be qualified by training and experience in the field of investment or finance. In addition, the Director of the Public Employees Retirement System is an ex-officio member of the OIC. ORS 293.721 and 293.726 establish the investment objectives and standard of judgment and care for the OIC: 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, subject to the prudent investor standard.

Oregon Public Employees Retirement Fund (OPERF): Holds the assets of beneficiaries of the Oregon Public Employees Retirement System (PERS). PERS is a statewide-defined benefit retirement plan for units of state government, political subdivisions, community colleges, and school districts. PERS is administered under ORS chapters 237, 238, 238A, and applicable provisions of the Internal Revenue Code by the Public Employees Retirement Board (PERB). Participation by state government units, school districts, and community colleges is mandatory. Participation by most political subdivisions is optional but irrevocable if elected. All system assets accumulated for the payment of benefits may legally be used to pay benefits to any of the plan members or beneficiaries of the system. PERS is responsible for administering the management of the plan’s liability and participant benefits.

Return: The gain or loss in value of an investment over a given period of time, expressed as a percentage of the original amount invested. For example, an initial investment of \$100 that grows to \$105 over one year has earned a 5% return.

Risk: A statistical measure of the possibility of losing or not gaining value. May also be expressed as the probability of not achieving an expected outcome.

Tracking Error: When using an indexing or any other benchmarking strategy the amount by which the performance of the portfolio differed from that of the benchmark. In reality, no indexing strategy can perfectly match the performance of the index or benchmark, and the tracking error quantifies the degree to which the strategy differed from the index or benchmark. Usually defined as the standard deviation of returns relative to a pre-specified benchmark.

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