Summary
Divest Oregon Response to
Oregon Treasury Analysis of SB 681 - The Pause Act

March 2025

- One of the "Major Actions" of Oregon Treasury's Net Zero Plan is focused on OPERF's private investments, committing OST to "Exclude new investments in private market funds that have a stated intention to invest primarily in fossil fuels"[1].

- This is important because the Treasury's analysis of its holdings found that 51% of its baseline emissions were in private investments, with the highest percentage coming from Real Assets (30%)[2]. **In effect, there is no way for OST to reach its net zero goals without addressing private investments.**

- Treasury cannot ignore fossil fuels in private investments because, as detailed below, private investments have become an increasingly large part of OST investment strategy, now making up almost 60% percent of the OPERF portfolio. This is far beyond other State pension fund private market allocations and according to the PERS director is currently the main source of a shortfall increasing employer contributions and undermining school budgets.

- **As is quite clearly documented in OST's Analysis of the Pause Act, Treasury staff is extremely resistant to ANY fossil fuel limitation on their private investments,** despite the fact that it will be critical to achieving the goals of the Net Zero Plan, and despite the need to rebalance the overall OPERF portfolio away from private investments.

- We have been in an ongoing dialog with the Treasury on this issue and have only heard arguments for inaction.

- Doing nothing is not an option if the Treasury's goal of managing climate risk and lowering the Fund's emissions is to be achieved, as now stated in HB2200.

The Pause Act was introduced to support the goals of the Net Zero Plan by adding specificity to how the exclusion of private investments with fossil fuels would be implemented.

What exactly does Treasury staff *plan to do* with regards to their Net Zero Plan mandate to limit private investments in fossil fuels, now that they have outlined all of their concerns?

[1] Pathway to Net Zero (Oregon Treasury, 2024), p21
[2] Pathway to Net Zero (Oregon Treasury, 2024), p33

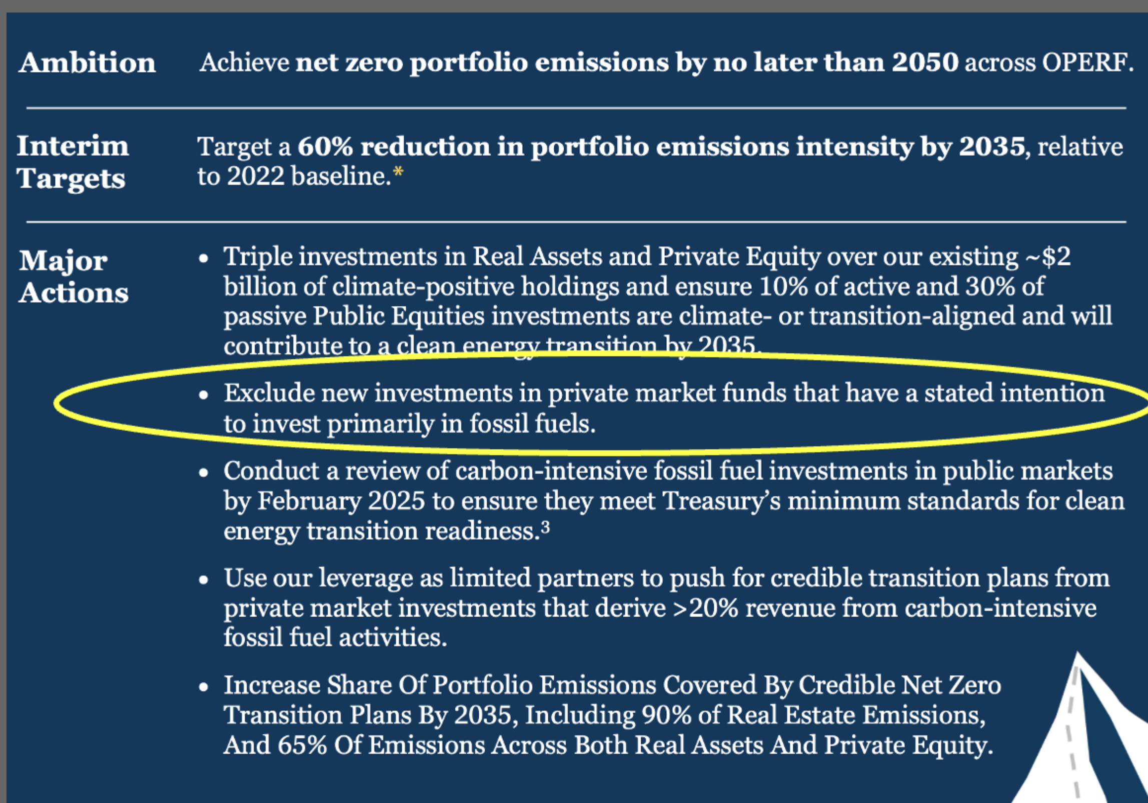
Divest Oregon Response

Oregon State Treasury (OST) Analysis of the Pause Act (SB 681): Unintended consequences and implementation challenges pose risks to OST's fiduciary responsibilities

– OST Analysis document in italics –

"The Pause Act (SB 681) would prohibit the State Treasurer from renewing or making new investments in private market funds over the next five years if the managers of the fund have stated an intention to invest in fossil fuels. The Oregon State Treasury (OST) has significant concerns about certain provisions in SB 681. Treasury shares the sponsors' intent to maintain Oregon's progress toward the Net Zero goal."

Divest Oregon Response: The Pause Act is based on Treasurer Read's Net Zero Plan. One of the "Major Actions" of that plan is to "Exclude new investments in private market funds that have a stated intention to invest primarily in fossil fuels" (p.21)[3]. The Pause Act's 5-year moratorium allows the Treasury to figure out how best to implement that key element.



"However, the Pause Act could reduce OPERF investment returns and increase unfunded liabilities, would create unintended consequences that would undermine OST's Net Zero goal, and poses significant implementation challenges."

[3] Pathway to Net Zero (Oregon Treasury, 2024), p21

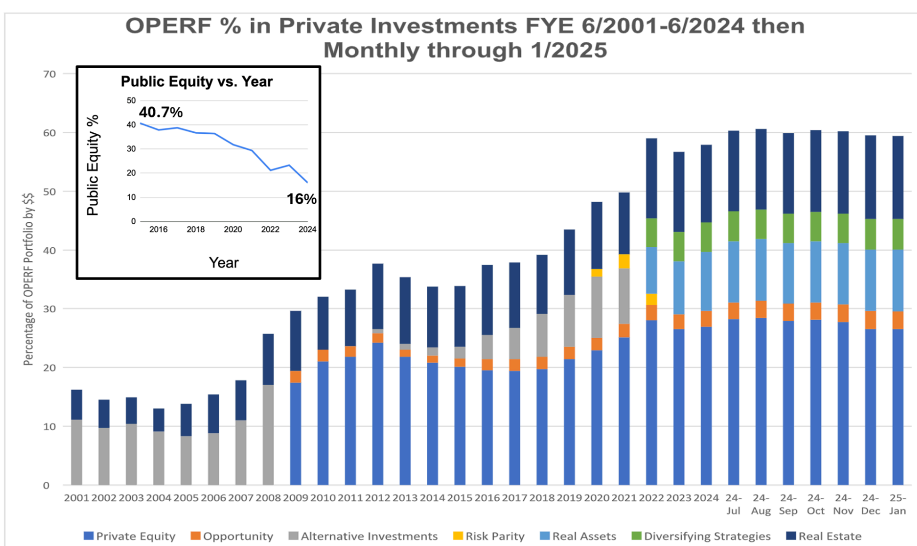
"• ***Fiscal impact: Reduced rates of return would increase unfunded liabilities in OPERF and expose public agencies to higher contribution rates.*** *Treasury must ensure it has the flexibility to maintain its fiduciary responsibilities to retirees, whose retirement funds Treasury does not own, but manages in trust."*

Divest Oregon Response: OPERF is already experiencing "reduced investment returns" and an increase in "unfunded liabilities." This is because it is overallocated in precisely the private investments the Pause Act addresses. These investments are now ~$11 Billion dollars over targets set by the Oregon Investment Council and make up almost 60% of all OPERF investment. Public market investments (e.g. stocks) have been reduced from 40% of the portfolio to around 16%, leaving OPERF on the sidelines of the stock market rally of the last few years. Because of this, OPERF is significantly underperforming and causing Oregon employers to increase their contributions, significantly straining already stressed school budgets.

According to Kevin Olineck, Director of the PERS system, as reported in the Capital Chronicle[4], this is because:

> **"The Oregon Investment Council is very highly invested in private equities, and they did less than what the public equity markets did," Olineck explained.**

Some kind of "Pause" is definitely needed to get the portfolio back in balance. As it rebalances down its excess $11+ Billion in private investments, **why would OST choose investments with the additional risks involved with fossil fuels?**

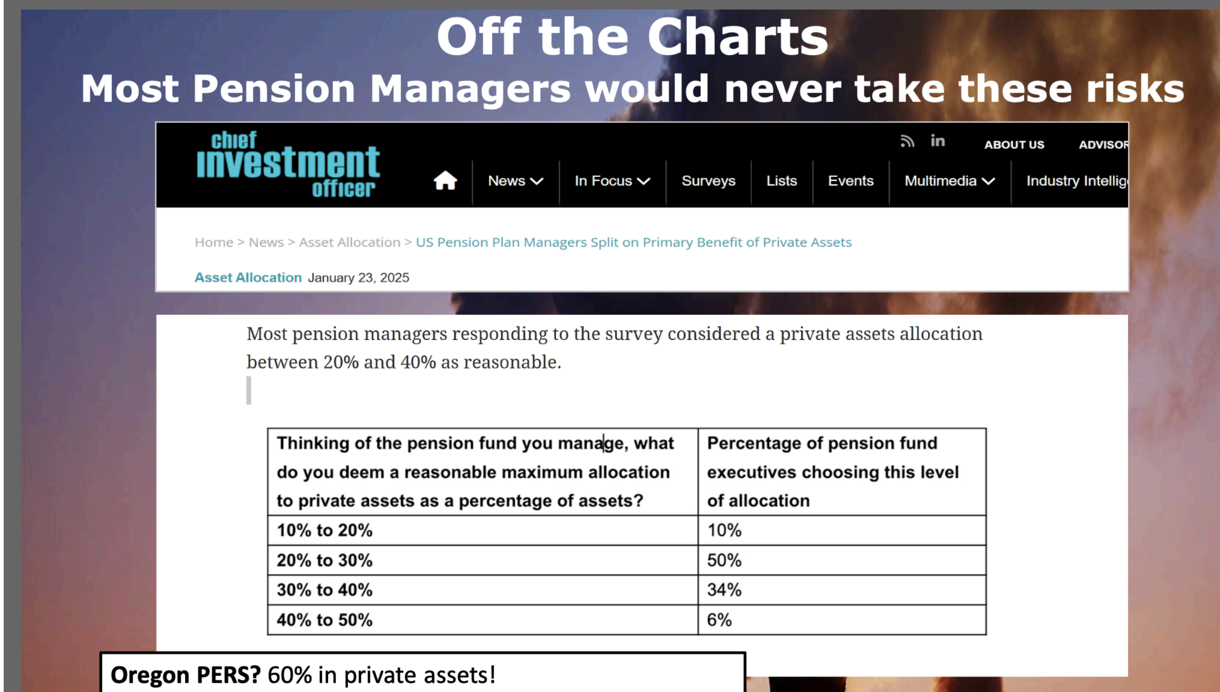


Sources: Fiscal Year End PERS Annual Comprehensive Financial Reports 2001-2023; 2024; Oregon State Treasury monthly OPERF returns and asset allocation

[4] Oregon School districts, employees face $670 million increase in payments to public pension system (Oregon Capitol Chronicle, 11/15/2024)

"For all investments, diversification is necessary to reduce risks and maximize returns."

Divest Oregon Response: With almost 60% of its funds in private investments, OPERF is putting more and more eggs in one basket and seems to be abandoning "diversification" for a singular private investment strategy. Compared to other pension funds[5], or what other pension managers find "reasonable," OPERF is off the charts:



Most pension managers responding to the survey considered a private assets allocation between 20% and 40% as reasonable.

Thinking of the pension fund you manage, what do you deem a reasonable maximum allocation to private assets as a percentage of assets?	Percentage of pension fund executives choosing this level of allocation
10% to 20%	10%
20% to 30%	50%
30% to 40%	34%
40% to 50%	6%

[5] US Pension Plan Managers Split on Primary Benefit of Private Assets (Chief Investment Officer, 1/23/2025)

"A blanket moratorium on private market investments in fossil fuels would significantly narrow OST's investment opportunities across multiple asset classes. For example, a moratorium would effectively eliminate infrastructure as an investable asset class, which would hinder the overall performance of the fund and require altering OST's capital allocation plan, risk profile, and actuarial assumptions."

Divest Oregon Response: Is the Treasury really saying it cannot implement one of the Major Actions of the Net Zero Plan? How does that square with HB 2200 which commits the Treasury to implement that plan? 51% of the emissions come from the private investment funds as reported by the Treasury.[6]

BASELINE EMISSIONS DATA*

Private Investment Emissions 51% (Real Assets, Private Equity, Real Estate)

Asset Class	Share of OPERF Emissions (%)	Emissions Intensity	Absolute Emissions (tCO_2)
Public Equity Total	47%	93	1,819,638
Active	36%	119	
Passive	11%	56	
Real Assets	30%	128	1,141,429
Private Equity	16%	27	598,157
Real Estate	5%	15	183,062
Fixed Income	3%	72	134,646
OPERF	100%	60	3,876,933

Infrastructure investments include vastly more than fossil fuels: electricity transmission and distribution facilities, district heating, water distribution and wastewater collection and processing assets, toll roads, bridges and tunnels, airports, seaports, liquid bulk and other storage facilities, parking facilities and rail cars and lines.

Avoiding fossil fuel investments would hardly "eliminate infrastructure as an investable asset class." See details below on page 11.

[6] Pathway to Net Zero (Oregon Treasury, 2024), p33

"OPERF investment returns comprise approximately 70 cents of every dollar disbursed as retirement benefits (the remaining 30 cents are paid by public employers and employees). Any reduced return rates on OPERF investments would increase contribution rates for public agencies, which would likely mean fewer teachers in classrooms and other cuts in public services."

Divest Oregon Response: The Net Zero Plan is built around the acknowledgement that climate risk is a financial risk – and that OPERF must do everything it can to mitigate the financial impact of climate change on returns. As Treasurer Read wrote in the 2024 annual report on the Net Zero Plan[7]:

> "Treasury stewards around $100 billion in the OPERF; we must think and act for the long run on behalf of hundreds of thousands of beneficiaries, putting their financial interests first. With the effects of climate change here today, the decisions we make now will have deep meaning and importance decades down the line."

"• ***Unintended consequences:*** *Pause Act's proposed investment restrictions could hamper climate-positive investments."*

Divest Oregon Response: Climate positive investments are intended to move the world away from fossil fuels. It is hard to see how avoiding fossil fuel investments would significantly limit climate positive investing.

OPERF cites no data to support their statement.

[7] Annual Progress Report: Oregon Public Employees Retirement Fund's Net Zero Plan (Oregon Treasury, 12/2024)

*"o **Energy transition investments:** The energy transition from fossil fuels to renewables is an investment megatrend. However, adequate renewable energy production cannot be bootstrapped from existing renewable energy production (i.e., there is insufficient renewable energy production to power the energy transition). Prudent investment in other energy sources, will be required to complete the transition. The abrupt shift away from fossil fuel investments may ignore the transitional needs of affected industries and workers, potentially leading to job losses, economic instability and investment losses to OPERF."*

Divest Oregon Response: There are many studies of this issue. Treasury staff cites none. However, studies generally show that the shift away from fossil fuels will have a positive economic jobs impact:

One typical study[8] "finds that jobs in low-carbon industries would outweigh losses in most of the country's fossil-fuel rich regions, as oil, coal and gas operations close down. **Total employment in the nationwide US energy sector could double or even triple by 2050** to meet the demand for wind turbines, solar panels and transmission lines, according to the modelling published in Energy Policy[9]."

*"o **Clean subsidiary acquisitions:** Occasionally, a private fund will buy an entire company to gain access to a particular subsidiary, patent, or market. This line of investment would be arbitrarily cut off as the fund would not be able to acquire the entire company without violating the restrictions in SB 681."*

Divest Oregon Response: Since this is an "occasional" issue and there are many options for investment, this is not compelling.

*"• **Implementation challenges:** Pause Act ties OST's hands with restrictions that would undermine OPERF's near- and long-term performance: The proposed 5-year pause is arbitrary, and its effects could extend well beyond this timeframe. The OIC would need to completely restructure asset allocations and potentially rebuild private equity investments from scratch. This could require purchasing private equity stakes on the secondary market at disadvantageous prices to fill portfolio gaps, further reducing returns. In addition, SB 681 imposes other implementation challenges, such as:*

*o **Private equity investments are not a menu:** Investments in private funds are long-term contractual agreements for commingled funds. Treasury*

[8] Jobs created by net-zero transition will 'offset' fossil-fuel job losses in Republican US states (Carbon Brief, 05/30/2023)
[9] Labor pathways to achieve net-zero emissions in the United States by mid-century (Energy Policy, 06/2023)

does not have the ability to selectively choose investments in a commingled private equity fund after agreeing to join as a Limited Partner.

• ***Increased costs:*** *The Pause Act's restrictions would raise costs and hamper the ability for Treasury to negotiate advantageous deals on behalf of OPERF. Investment managers may recognize the limited options due to the limitations imposed by SB 681 for deploying capital and demand higher prices."*

Divest Oregon Response: Treasurer Read, after 8 years in office, was aware of the complexities of investing. He decided as a Major Action in the Net Zero Plan: "Exclude new investments in private market funds that have a stated intention to invest primarily in fossil fuels".

Why would the three New York City public pension funds be able to do this, committing to "exclude upstream fossil fuel investments (i.e. exploration and extraction) in their private markets investments in 2023"?[10]

Why are OST leaders so resistant to implementing this part of the Net Zero Plan when their peers can find ways to move forward?

[10] NYC Comptroller Lander Proposes Excluding Future Private Markets Investments in Midstream and Downstream Fossil Fuel Infrastructure by the New York City Retirement Systems (NYC Comptroller Press Release, 10/22/2024)

"OST private investments have historically outperformed public markets, these superior returns aren't simply due to investing in private equity as an asset class. The key has been partnering with top-tier private equity managers who have proven track records and deep expertise. Senate Bill 681 could significantly restrict our ability to work with many qualified managers. This limitation may force a shift toward public markets, which in OST's experience typically deliver 3% lower returns."

Divest Oregon Response: We do not question that private investments have had their heyday in the past. But they are not currently performing well, and few can predict the economic future: Soft landing? Increase in inflation? Recession? By OPERF's own data, the last decade performance of private equity is not reassuring, showing significant underperformance vs their benchmark.

9/30/2024	1 Yr.	3 Yr.	5 Yr.	10 Yr.
OPERF Private Equity	7.2%	2.9%	13.2%	12.1%
Russell 3000 + 3%	39.2%	13.7%	19.5%	16.1%
OPERF Value-Add:	*-32.0%*	*-10.8%*	*-6.3%*	*-4.1%*

OREGON STATE TREASURY

PE Annual Review & 2025 Plan

According to the OPERF 12/2024 financial report[11], over the last two years public equities (stocks) have returned 17-18% per year while private equity has returned 4-5%. The reason to have a balanced portfolio is to optimize overall returns as the market shifts. "Putting all your eggs in one basket," based on some past trend, does not seem financially prudent.

> *"o* ***Definitions lack specificity:*** *Several of SB 681's definitions lack specificity or breadth for full implementation. For example, the 10% limit of Assets Under Management (AUM) could be measured at investment or at Net Asset Value (NAV). If measured at NAV, a company could unforeseeably grow to cross a threshold. Alternatively, if an investment could be sold to a fossil fuel company for stock consideration to facilitate the private fund exit, this restriction could prevent a profitable deal from being consummated as the receipt of stock could cross SB 681's thresholds."*

[11] Oregon Public Employee Retirement System Financial Report (Oregon Treasury, 12/2024)

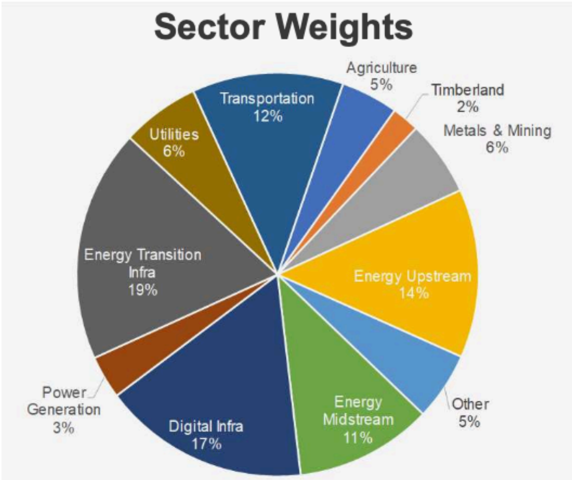
"o ***"Intent" is uncertain:*** *SB 681's restrictions on investing in funds that "intend" to invest in fossil fuels is difficult to apply. Funds maintain flexibility by keeping all market areas open and listing all industries as potential investments, regardless of their intent to invest. Judging a manager's "intent," is difficult to determine and limits OST's opportunities to partner with managers who can maximize value for OPERF and find competitive returns in low-carbon investments."*

Divest Oregon Response: The word "intent" was used in SB 681 because it is the exact language the Treasurer chose to put in the Net Zero Plan. If OST would like to suggest alternative legislative language, Divest Oregon is open to considering it. Funds do not generally list "all industries as potential investments." We expect that OST exercises due diligence on its investments that would allow it to discern where a fossil fuel investment is likely and where it would need to opt out (see pp. 11-12).

Bottom Line: Since limiting new fossil fuel private investments is a critical part of the Net Zero Plan the question remains: what is the OST staff's proposal to do this?

It would be much more helpful to know what Treasury staff **plans to do** versus what it feels it **cannot do** with regards to their mandate to limit private investments in fossil fuels.

We remain open to dialog on how best to achieve the goals we know the Treasurer wants to achieve.



Digging Deeper: Details on key issues raised by OST

OPERF has plenty of private investment choices without fossil fuels

Treasury staff maintains that a fossil fuel restriction would effectively eliminate infrastructure as an investable asset class. Infrastructure is actually a sub-asset class of Real Assets within OPERF.

Real Assets underperformed its 1-year benchmark, overperformed its 3-year benchmark, and was flat for 5 and 10 years, according to staff's March 2024 presentation to the OIC.

Real Assets is 10.3% of OPERF and by OIC policy should be 7.5% instead, so there should be some natural reduction over the next several years. OIC investment guidelines expect the natural resources sub-asset class to be up to 50% of Real Assets. This means infrastructure is somewhere around $4 billion of a properly weighted Real Assets class – less than 4% of OPERF's total value.

But infrastructure is far more than locked-in, high-emitting fossil fuel power plants, LNG terminals and pipelines whose emissions will damage the value of all OPERF investments for decades.

Treasury's Real Asset report to the OIC in March 2024 showed a variety of likely non-fossil fuel investments in this secretive asset class (see pie chart). The American Investment Council, composed of leading private equity firms, in December 2024 identified infrastructure as consisting of construction and engineering, building products, communications and networking, logistics and supply chain technology, IT services, fossil and renewable energy materials and resources, and oil and gas.[12]

The AIC's figures show that in 2023, private equity non-fossil fuel infrastructure investments totaled about $85 billion, while fossil fuels totaled about $43 billion. In 2024 allocations were about $52 billion non fossil fuel and about $12 billion in fossil fuels. Averaging these proportions and applying them to $4 billion in OPERF's estimated infrastructure numbers indicates approximate expected fossil investments of about $1 billion in this sub-assets class. Treasury's own chart may

[12] 2024 AIC Infrastructure Report

indicate another billion or so, which the Pause Act would subject to natural attrition as the investments ended.

That is both only 1-2% of OPERF, and large enough to do decades-long damage to the climate on which all OPERF returns depend. OPERF needs to help the climate now to avoid having much less for all.

OPERF can negotiate side letters to opt out of private equity fossil fuel investments

Private equity funds invest in a number of different companies. Each private equity fund has an investment strategy it discloses to potential investors as part of investor due diligence.

Through side letters negotiated in advance, private equity fund managers often provide opt-out rights to investors who negotiate clear investment restrictions.[13] The side letters allow investor opt-outs on a case by case basis and do not materially hinder a private equity fund's disclosed strategy.[14]

During portfolio construction, the private fund manager identifies attractive investments that fall within its predetermined investment strategy.[15] If an investment also falls within an investor's restriction, the investor opts out and avoids a capital contribution for that particular investment.[16]

Treasury staff will be rebuilding private equity investments anyway due to substantial overallocation

Staff complains of the work involved in allocating OPERF in light of a private equity fossil fuel restriction. Any complexity is part of the normal burden of overall portfolio management that heavy reliance on private investments creates.

Moreover, staff will be rebuilding a private equity program anyway, because it has for years violated OIC's limits on the amount of private equity investments in OPERF. Most recently about 28% of OPERF was in private equity – 8 full points above the OIC target of 20%, making it a 40% overshoot. After years of underperformance, Treasury policy monitors are having to pull in staff's private equity reins.

Shifting private equity into public equity will happen anyway, and if anything will save costs

---

[13] Mayer Brown, Developing Side Letter Issues p. 4
[14] Options for ESG provisions in private equity fund terms | Technical guide | PRI.
[15] An Introduction to Private Equity Basics (Morgan Stanley)
[16] Mayer Brown, Developing Side Letter Issues p. 4

Treasury staff's concern that "good" fund managers will spurn them and shift OPERF into public equity if they have a fossil fuel restriction is unproven speculation. Fund managers are used to side letters with opt-out investment restrictions. A temporary restriction, or pause, will allow the Treasury to see if those concerns are well founded or not.

Private equity over the past 10 years has performed worse than the stock market, so a key part of staff's concern is unfounded.

And there is no better time to try out a pause. If private-equity manager response does shift OPERF into public markets, that will be occurring anyway as the Treasury corrects its serious overallocation to illiquid private equity and serious underallocation to easily transferable public equity.