CORPORATE GOVERNANCE UPDATE

Office of General Treasurer Seth Magaziner

September 2018 SIC Update

BACKGROUND ON CORPORATE GOVERNANCE

The SIC has a fiduciary duty to act in the long-term financial interests of ERSRI participants and their beneficiaries

- As a pension fund, ERSRI is a long-term investor. The pension fund has an indefinite life and the SIC owes an equal duty to young members of the pension as older members.
- Company management teams are often incentivized to focus on short-term performance, which can cause them to act in conflict with the interests of long-term investors like ERSRI.
- Boards of directors are elected by shareholders to provide oversight to company management and ensure that the actions of management are aligned with shareholder interests.
- Investors in the United States and some international countries also have the opportunity to propose non-binding proxy referenda to communicate the will of investors to the board and management.

PROXY VOTING

Each year, publicly-traded companies ask shareholders to vote on items that are pending on their annual proxy ballots.

- Shareholders have the right to vote on appointments to board of directors, non-binding ‘say on pay’ executive compensation proposals, and non-binding proxy proposals on issues that are of material concern to the financial prospects of the company.
- The SIC approved a proxy voting policy in 2016, which instructs staff and ERSRI’s proxy advisory service how to vote on a range of different issues.

PROXY VOTING POLICY

Among the most notable considerations of the ERSRI proxy voting policy are:

- Support of proxy access (*maintaining shareholder ability to place proxy proposals on the ballot*)
- Opposing proposals to limit Board accountability to shareholders (special share classes, inappropriate dilution of shares, etc).
- Board composition (*emphasizing expertise, independence, absence of conflicts, and diversity*)
- Alignment between long-term performance and executive compensation
- Supporting measures to identify and mitigate environmental and social risks that could threaten a company's long-term sustainability.

PROXY VOTING

Shareholder Proposals Filed / Co-Filed by ERSRI in 2018

- Wells Fargo (Business Standards Report – Consumer Fraud)
- Equifax (Cybersecurity Risk Disclosure – Data Breach)
- Navient Corp. (Risks Related to Student Debt Crisis)
- McKesson (Lobbying Expenditure Disclosure – Opioid Crisis)
- Cardinal Health (Legal fees, fines, as Executive Compensation factor – Opioid Crisis)
- Devon Energy (Lobbying Expenditure Disclosure)
- ConocoPhilips (Lobbying Expenditure Disclosure)
- Chevron (Lobbying Expenditure Disclosure)
- Apple (Tying Diversity Goals to Compensation)

ENGAGEMENT HIGHLIGHTS- WELLS FARGO

Wells Fargo to report on root causes of illegal behavior following investor pressure

BY JAMES COMTOIS · MARCH 6, 2018 2:44 PM

Wells Fargo & Co. agreed to publish a report on the root causes of unethical and illegal behavior at the bank and its impact on customers and investors after a group of institutional investors jointly filed a shareholder proposal demanding a comprehensive review of its business standards.

- Concerned Wells Fargo investors requested information on the culture at Wells Fargo which allowed systemic fraud to occur over years
- Investors filed a proposal requesting greater transparency in 2016. In 2017, in response to the strong 2016 vote, Wells Fargo began actively engaging with investors on the issues raised in the proposal
- Treasurer Magaziner and other investors met with CEO Tim Sloan and several Board members to express concerns.
- In March 2018, Wells Fargo announced that they would publish a "Business Standards Review" that addressed investor concerns – and remain engaged with investors on issues of transparency and disclosure.

ENGAGEMENT HIGHLIGHTS- NAVIENT

As investors, we are concerned that Navient, the largest student loan servicer, is not adequately managing the risks associated with the growing student loan debt crisis.

- In 2017 & 2018 ERSRI filed a shareholder proposal requesting the company report on the measures taken to manage the risks of debt crisis, with 8 million Americans already in default on more than $178 billion of student loans.
- Navient is facing legal action from multiple states and the CFPB alleging that the company has failed to provide adequate servicing to borrowers.
- Continued mismanagement of the crisis will put Navient's business, including the retention of federal contracts, at risk - jeopardizing long-term shareholder value.
- At the company's 2018 Annual Meeting, more than 40 percent of shares were voted in favor of our proposal– one of the highest votes for any shareholder proposal this year.
- ERSRI continues to lead investor engagement with Navient to encourage meaningful communication and transparency.

PROXY VOTING – BOARD DIVERSITY

There is growing evidence that companies with greater levels of diversity at senior levels have stronger financial performance and lower risk over time*.

- Rhode Island's policy allows us to vote against all director nominees on boards with less than 30% diversity, inclusive of ethnicity and gender, on their board of directors.
- Over the past 2 years, ERSRI has voted against management-proposed board candidates at about 200 companies each year.
- Our office followed up with each of the companies at which we voted against management-proposed directors, explaining our vote and asking the company to consider strengthening the diversity of their boards.
- We have engaged in productive discussions with approximately 20-30 companies each year.

* "Why Diversity Matters" McKinsey, Feb 2015.
* "Women on Boards: Global Trends in Gender Diversity on Corporate Boards" MSCI, Nov 2015.
* "Is Gender Diversity Profitable?" Peterson Institute for International Economic, Feb 2016.

PROXY VOTING – EXECUTIVE COMPENSATION

Executive compensation must be closely tied to long-term performance and structured in a manner that keeps corporate executives accountable to shareholders.

The current SIC Proxy Voting Policy on Executive Compensation states ERSRI will:

- *Vote against a proposal if executive performance and compensation aren't correlated, or if a significant portion of the compensation plan is non-performance-based equity awards*

- *Vote against a proposal if the company engages in problematic pay practices; if the Board fails to act as good stewards of investors' money; or if the Board is un-responsive to investor inquiries regarding executive compensation policies.*

In general, the voting policy on executive compensation is broadly worded and could benefit from additional specificity.

PROPOSED POLICY CHANGE:
PROXY VOTING EXECUTIVE COMPENSATION

There is an opportunity to strengthen ERSRI's voting policy on executive compensation to strengthen accountability of managers to shareholders

- Staff recommends updating the policy to allow "no votes" if:
  - CEO pay exceeds the 4x average named executive officer (NEO) pay
    - Too large a disparity can negatively impact culture and succession planning
  - Performance-based pay is less than 50 percent of total CEO compensation
    - Compensation should be strongly aligned with performance
  - The magnitude of CEO pay exceeds the 75th percentile of the company's peer group, while company performance is below its industry peer median
    - Compensation should not exceed industry norms, particularly if performance is lacking
  - Equity-based incentive plans, if the potential dilution represented by the proposal exceeds 4 percent of shares outstanding
    - Executive compensation should not unduly dilute shareholder value