



2021



ESG Stewardship Report

Fiscal Year 2021

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TABLE OF CONTENTS

Letter from the Executive Director & CIO.....1

Introduction.....2

Stewardship

 Proxy Voting6

 Engagement.....12

ESG Incorporation

 ESG Integration.....18

 Screening22

Conclusion24

LETTER FROM THE EXECUTIVE DIRECTOR AND CIO

January 2022

I am pleased to present the Minnesota State Board of Investment's (SBI) inaugural Stewardship Report.

This Stewardship Report provides information on how the SBI fulfills its fiduciary duty by managing Environmental, Social and Governance (ESG) risks across its investment portfolios through Stewardship and ESG Incorporation.

The primary mission of the SBI is to maintain the long-term viability of various retirement and other state funds for the State of Minnesota, which are governed by the prudent person rule and other standards codified in Minnesota Statutes, [Chapter 11A](#) and [Chapter 356A](#). It is the responsibility of the Executive Director and CIO of the SBI to address ESG issues that support the primary mission of the agency.

In 2017, the SBI adopted its Investment Belief that ***“utilizing engagement initiatives to address environmental, social, and governance (ESG) issues can lead to positive portfolio and governance outcomes.”*** Since adopting this Belief, the SBI has been on a journey to expand its Stewardship capabilities. In February 2020, the SBI adopted a resolution on ESG that further directed the Executive Director to engage the SBI in a variety of Stewardship activities, including producing a Stewardship Report. At that time, few could have foreseen the events that would transpire throughout the remainder of 2020.

These past two years have been a turbulent time for all of us. Families across Minnesota and the whole world together have faced the challenges of the global COVID-19 pandemic, the murder of George Floyd, drought, widespread wildfires, and much more. At the same time, the prices of securities, properties, and companies across the markets that the SBI invests in experienced significant volatility. These events highlight how much the SBI depends on a healthy global financial system to achieve its goals.

For large, diversified, and long-term investors such as the SBI, broad market returns are the primary driver of the returns experienced by the investor. Market returns depend on the long-term health of the economy, which in turn depends on the productivity of social and environmental systems. Diversification and divestment are not necessarily the most prudent ways to address systemic risk. Instead, along with many other institutional investors, the SBI attempts to address some of these systemic risks with Stewardship activities that promote the long-term sustainability and health of financial markets.

In addition, as a signatory of the Principles of Responsible Investment (PRI), the SBI has committed to incorporating ESG into its investment analysis and decision-making process. In order for the SBI to fulfill this commitment, the SBI evaluates how its managers use ESG information alongside other financial information to determine the enterprise risk at the individual investment level. With both Stewardship and ESG Incorporation, the SBI expects to stay the course through short-term market volatility and fulfill its primary mission to the State of Minnesota.

On behalf of the Board Members, the Investment Advisory Council and the SBI Staff, we would like to thank all SBI stakeholders for your interest in these important topics and continued commitment to the SBI's long-term success.

Sincerely,



Mansco Perry III,
Executive Director and Chief Investment Officer

INTRODUCTION

INTRODUCTION

Throughout this report, the terms “Stewardship” and “ESG Incorporation” are used according to the definitions developed by industry experts in conjunction with the United Nations Principles of Responsible Investing (PRI).

- **STEWARDSHIP:** The use of influence by institutional investors to maximize overall long-term value, including the value of common economic, social and environmental assets, on which returns and clients’ and beneficiaries’ interests depend.
- **ESG INCORPORATION:** The review and use of ESG information in the investment decision-making process.

STEWARDSHIP

The SBI organizes its Stewardship activities into two main categories: *Proxy Voting* and *Engagement*. These activities are guided by the SBI Investment Beliefs (“Beliefs”). The primary purpose of the Beliefs is to guide the SBI toward sound investing principles related to investing pension funds. In this respect, the Beliefs help provide context for SBI’s actions, reflect SBI’s investment values, and acknowledge SBI’s role in supporting the State’s broader retirement systems. Below is one of the Beliefs that relates to ESG:

“Utilizing engagement initiatives to address environmental, social, and governance-related issues can lead to positive portfolio and governance outcomes.”

In conjunction with this belief, the SBI votes proxies and participates in engagement initiatives in ways that address both systemic risks to the portfolio (i.e. climate change) and enterprise risks to individual investments (i.e. lack of diversity).

PROXY VOTING

The SBI’s proxy voting activities are overseen by the SBI’s Proxy Committee which is responsible for voting the SBI’s proxy rights with respect to shares owned in publicly traded U.S. companies. By exercising its proxy rights, the SBI influences how companies address ESG issues.

In FY 2021, the SBI voted proxies for 2,429 company meetings. From a shareholder stewardship perspective, 2021 was very successful in terms of passing shareholder proposals. Thirty-one ESG related shareholder proposals received majority votes, surpassing the 2020 record of 18. Some highlights of items receiving majority shareholder support include:

Chevron – A proposal requesting the Company substantially reduce the greenhouse gas emissions of their energy products in the medium- and long-term future.

Phillips 66 – A proposal requesting the Company set and publish emissions reduction targets

covering the greenhouse gas emissions of the Company’s operations and energy products.

IBM – A proposal requesting an annual report assessing the Company’s diversity, equity and inclusion efforts.

DuPont – A proposal requesting the Company to disclose on its website its Consolidated EEO-1 Report, which is a comprehensive breakdown of its workforce by race, ethnicity and gender that the Company is required to submit annually to the U.S. Equal Employment Opportunity Commission.

ExxonMobil – Three shareholder nominated directors were elected to serve on the Company board to address poor performance and the need for the company to evolve in response to climate change.

Additional information on the SBI’s Proxy Committee, legislative requirements (as it pertains to Northern Ireland), and fiscal year 2021 in review can be found in the Proxy Voting Section of this report beginning on page 6.

INTRODUCTION

ENGAGEMENT

The SBI's engagement activities are all associated with institutional investor coalitions. The SBI has partnered with several organizations to engage with companies and regulatory authorities on ESG issues. These organizations include:

- Ceres Investor Network
- Climate Action 100+
- Council of Institutional Investors (CII)
- Institutional Limited Partners Association (ILPA)
- Midwest Investors Diversity Initiative (MIDI)
- RFK Compass Initiative
- Thirty Percent Coalition
- United Nations Principles of Responsible Investment (PRI)

These organizations provide research, engagement opportunities, and other resources to help the SBI effectively address ESG issues. Common issues addressed by the coalitions include, but are not limited to, climate; gender, racial, and ethnic diversity; shareholder rights; corporate governance; and workers' rights.

Company Engagements

Engagement opportunities with companies take the form of direct communication, letter writing, and filing of shareholder resolutions. In recent years, the SBI has:

- Engaged with Xcel Energy on climate issues through the Climate Action 100+.
- Helped start a new engagement with Hess Corporation through Ceres.
- Joined MIDI and directly engaged on board diversity with ANI Pharmaceuticals, Inc., Groupon Inc. and Navistar.

Regulatory Engagements

In addition to engaging with companies, the SBI engages with regulatory authorities on ESG issues impacting institutional investors.

• [Securities Exchange Commission \(SEC\)](#) •

In 2020, the SBI submitted a comment to the SEC opposing new rules regulating SBI's proxy service providers. If enforced, these rules will impair the SBI's access to timely and independent proxy research that greatly aids SBI's exercise of its proxy rights.

In 2021, the SBI co-signed several letters encouraging the SEC to establish public company disclosure standards on climate change risks.

• [U.S. Department of Labor](#) •

The SBI submitted a comment to the U.S. Department of Labor in opposition to amended rules regarding ESG considerations in ERISA regulated investment portfolios. If left unchanged, these rules will narrow consideration of ESG factors in ERISA regulated investment portfolios.

• [Russell 3000 Companies](#) •

The SBI cosigned a letter that was sent to companies included in the Russell 3000 index urging the companies to disclose the racial/ethnic and gender composition of their boards of directors in each company's 2021 proxy disclosure statement.

Additional information on each of the coalitions and the engagement activities that they SBI has participated in can be found in the Engagement Section beginning on page 12.



INTRODUCTION

ESG INCORPORATION

ESG Incorporation is the review and use of ESG information in the investment decision-making process. The SBI currently uses two forms of ESG Incorporation: *ESG integration* and *Screening*.

ESG INTEGRATION

ESG Integration is systematically including ESG issues in investment decisions to manage risks and improve returns. Since the SBI hires external managers to invest the pension plan assets and other funds for the State of Minnesota, it expects its managers to integrate ESG into their investment process. With discussion during meetings and with written questionnaires, SBI staff gathers information to evaluate its managers on their ESG integration practices.

ESG Integration has become widely accepted as best practice for prudent investment decision-making, and the SBI has explicitly recognized its importance. In February 2020, the SBI adopted a [Resolution on ESG Initiatives](#) directing the SBI Executive Director to continue developing the SBI's approach to addressing ESG investment risk throughout its investment portfolios. The resolution stated that SBI believes that corporations and partnerships that do not take ESG risk into consideration may jeopardize their financial viability and decrease their value, and that the SBI encourages managers to enhance their ESG risk analysis.



SCREENING

Screening is using ESG information to remove certain securities from the authorized list of investments. For the SBI, some screens are intended to meet national security objectives, like those regarding Iran. In other cases, the long-term financial risks of certain business activities are so large that the SBI has determined exposure to those risks are inappropriate for the portfolio. A recent example of this is the [SBI Resolution Concerning Reduction of Investments Associated with Thermal Coal Production](#).

In May 2020, the Board adopted a resolution stating that investments in publicly traded companies that derive more than 25% of their revenue from thermal coal were no longer authorized investments in the SBI's Combined Funds investment portfolio. The SBI Executive Director expanded this mandate to the SBI's non-retirement portfolios and Stable Value Fund. Investment managers removed such companies from the SBI's portfolio by the end of calendar year 2020. In addition, the SBI Executive Director began the process of removing investments in fossil fuel companies from the Invested Treasurer's Cash Account (ITC). The ITC will be prohibited from holding such investments in the future.

Additional information on ESG Integration and Screening can be found in the ESG Incorporation Section beginning on page 18 of this report.



STEWARDSHIP

PROXY VOTING

PROXY COMMITTEE

Established

In 1982, the SBI established the Proxy Committee to carry out the SBI's proxy voting responsibilities. As a stockholder, the SBI is entitled to participate in corporate annual meetings through direct attendance or by casting its votes by proxy. Through proxy voting, the SBI votes its shares in a particular way on resolutions under consideration at annual meetings. Many of these proxy votes are on proposals concerning material ESG issues related to subjects such as board of directors, audits, executive compensation, climate change, diversity, opioids and other ESG related risks. In effect, as a shareholder the SBI can participate in shaping corporate policies and practices.

Committee Membership

The [SBI Proxy Committee](#) is composed of a representative selected by each member of the SBI and chaired by the designee of the Governor. The Committee meets on an as-needed basis to review and vote on proxy ballot items not covered by existing precedent and establish new precedents. Traditionally, the Board has re-authorized the proxy committee every two years.

The current Proxy Committee membership is:

Karl Procaccini, Governor's designee

Ramona Advani, State Auditor's designee

Bibi Black, Secretary of State's designee

Luz Frias, Attorney General's designee

Proxy Voting – Guidelines and Precedents

The Committee has formulated guidelines by which it votes on a wide range of corporate governance, social responsibility and environmental issues. Each year the Proxy Committee reviews existing guidelines and determines which issues it will review on a case-by-case basis. In accordance with the [Proxy Voting Guidelines](#) (approved by the Board) and precedents established by the Committee, SBI staff votes the proxies of all U.S. companies for which the SBI is entitled a vote. The Proxy Voting Guidelines are shared with the SBI's external investment managers to guide their voting decisions for non-U.S. companies. When a proposal at a U.S. company is not covered by the Proxy Voting Guidelines, it is added as a voting item to the agenda of the next Proxy Committee meeting.

Proxy Advisory Services

The SBI currently uses the proxy advisory services firm Glass Lewis to compile large amounts of disparate data and make researching ballot items more efficient. SBI staff and the SBI Proxy Committee use research material provided by Glass Lewis to gain a better understanding of many proposals but do not necessarily rely on the voting recommendations provided by Glass Lewis. Proxy advisory services are integral to the SBI's ability to conduct due diligence on companies and proxy ballot items.

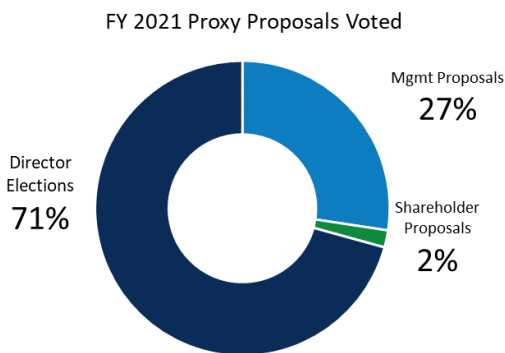
PROXY VOTING - LEGISLATIVE REQUIREMENTS

The SBI monitors investments in Northern Ireland according to [Minnesota Statutes, § 11A.241](#). This statute was established in 1988 and requires the SBI to, whenever feasible, sponsor, cosponsor or support shareholder resolutions designed to encourage companies in which the Board has invested to pursue a policy of affirmative action in Northern Ireland. Out of the 148 companies held by the SBI doing business in Northern Ireland, 92 have not adopted the McBride principles as their formal employment practices. The SBI continues to maintain a voting precedent in accordance with this statute. No shareholder resolutions applicable to this statute were submitted this year.

PROXY VOTING 2021 REVIEW

FY 2021 Proxy Voting

2021 was a historic year for SBI proxy voting and for shareholder advocacy across the investment industry. Over the course of fiscal year 2021, the SBI voted ballots for 2,429 different company meetings on over 20,000 items. The majority of these votes were for director elections but there were also 6,105 management proposals and 416 proposals submitted by shareholders.



The number of ESG related shareholder proposals receiving majority votes increased from 18 in 2020 to 31 in 2021. These numbers reflect the increasing investor awareness of the importance of ESG issues. Of the nearly 100 ESG resolutions receiving majority support in the last decade, half have been in the last two years. These numbers do not include the many proposals withdrawn by shareholders after successful engagements with companies.

The SBI, along with many other U.S. public pensions and institutional investors, plays an important role in encouraging improved environmental, social and governance practices that are material to the long-term sustainability of the world’s largest corporations.

DIRECTOR ELECTIONS HIGHLIGHT

New Directors Elected to ExxonMobil Board of Directors

The 2021 Board of Directors election at ExxonMobil was one of the most significant ESG-related shareholder events in recent years. Three of four directors nominated by an ExxonMobil shareholder, Engine No. 1, won seats on ExxonMobil’s 12 person board. Engine No. 1 offered the candidates (known as dissident directors) in opposition to candidates offered by Exxon’s management.

The campaign in favor of these new directors focused on the poor performance of Exxon in recent years and the need for the company’s business strategy to evolve in response to climate change and society’s transition toward a lower-carbon economy. Many large shareholders believe that the dissident directors have experience that will improve ExxonMobil’s chances of succeeding with this effort.

SBI’s Role in the ExxonMobil Campaign

- ❖ Large U.S. public pensions like the SBI, played a key role in electing these new directors beyond directly voting in favor of the dissident directors.
- ❖ The effort to elect shareholder nominated directors came after many years of engagement with Exxon by CalSTRS and groups like the Climate Action 100+, of which the SBI is a member.
- ❖ In 2020, the SBI and some other groups voted against the entire board as part of this engagement.
- ❖ In 2021, the 3.5 million shares held by the SBI amounted to about 5% of the difference between the 3rd dissident director winning a seat and the closest management nominated candidate who did not win a seat.

PROXY VOTING 2021 REVIEW

MANAGEMENT AND SHAREHOLDER PROPOSALS

GOVERNANCE

It is typical for both shareholders and management to submit proposals addressing governance issues. In general, the SBI supports proposals that preserve or enhance shareholder rights to effect change. Such proposals include requiring independent board chairs, requiring shareholder approval of poison pill plans, repealing classified boards, and adopting majority voting.

Conversely, the SBI generally opposes proposals that would restrict shareholder ability to effect change. Such proposals include instituting super-majority requirements to ratify certain actions or events, creating classified boards, prohibiting or limiting shareholder action by written consent, and granting certain stockholders superior voting rights over other stockholders.

Executive Compensation alignment with shareholders is another key area of focus for SBI proxy voting activities. In general, the SBI supports efforts to have executive compensation linked to a company's long-term performance and to encourage full disclosure of compensation packages for principal executives. Accordingly, the SBI evaluates compensation packages on a case-by-case basis, including compensation agreements that are contingent upon corporate change in control.

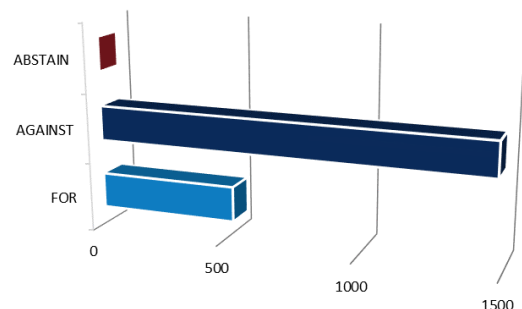
Corporate Governance Proposals: The SBI voted for the vast majority of shareholder proposals related to corporate governance practices such as proxy access, independent chair, declassification of boards, written consent, reports on political spending and majority voting.

Sixteen proposals related to governance issues that increase shareholder rights and information received majority shareholder support.



Executive Compensation: In 2021, the SBI voted against approximately 70% of advisory votes on executive compensation due to lack of sufficient alignment or transparency with shareholders.

Advisory Votes on Executive Compensation



ENVIRONMENTAL

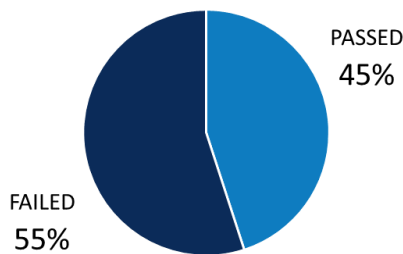
Environmental proposals are most often submitted by shareholders. In general, the SBI supports proposals that require a corporation to report or disclose to shareholders company efforts to address environmental issues, seek to improve a company's environmental practices to protect the world's natural resources, or address climate change. Proposals that request the adoption of various environmental policies are evaluated on a case-by-case basis.

PROXY VOTING 2021 REVIEW

MANAGEMENT AND SHAREHOLDER PROPOSALS

Climate Change Risk: Compared to just two climate change risk related proposals receiving majority support in 2020, nine such proposals received majority votes in 2021. The SBI voted in favor of all nine. These proposals were at General Electric, Norfolk Southern, United Airlines, ExxonMobil, Delta Air Lines, Chevron, Conoco-Phillips, and two at Phillips 66.

Success Rate of Climate Change Risk Related Proposals supported by SBI



Eleven climate change risk related proposals that the SBI supported did not receive majority support. Two of these proposals were at ExxonMobil, the others were Chevron, Caterpillar, Sempra Energy, UPS, Union Pacific Corporation, Berkshire Hathaway, General Motors, Wal-Mart, and Xcel Energy.

Climate Change and Other Environmental Proposals: The SBI also supported 11 other environmental and climate related proposals at DuPont, Alphabet, Amazon, T. Rowe, DTE Energy, Monster Beverages, Proctor & Gamble, Moody's, S&P Global, and two at Booking Holdings.

In total during 2021, the SBI voted for 31 proposals related to environmental and climate change issues.



SOCIAL

Shareholders submit the majority of proposals related to social issues. In general, the SBI supports proposals that require a company to report or disclose to shareholders company efforts concerning diversity, sexual harassment, and human rights.

During 2021, the SBI Proxy Committee established a precedent to vote for shareholder proposals requesting that a company conduct a Racial Equity Audit to analyze a company's impact of its products, services and practices on non-white stakeholders and communities of color. Racial injustice resulting from company activities could result in significant reputational risks and harm to shareholder interests, especially for consumer-facing companies. Controversies related to racial injustice at a company can result in customer and employee attrition, negative press, significant fines and regulatory inquiries.

Diversity: In 2021, the SBI voted for 14 Diversity or Gender/Racial Equality related proposals. Five of these proposals received more than 50% of the vote. These were for IBM, DuPont, American Express, and two at Union Pacific.

Racial Justice: The SBI voted for a total of 14 proposals related to Racial Justice in 2021.

Following the murder of George Floyd and other high profile events in 2020, customers, employees, and investors all increased their focus on racism and racial equity. To get a better understanding of these risks that companies might be facing, shareholders submitted proposals requesting Racial Equity Audits at eight different companies. These proposals received more than 25% but less than 50% of votes at Amazon, JP Morgan, Abbott Labs, Citigroup, State Street, Johnson & Johnson, and Goldman Sachs.

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STEWARDSHIP

ENGAGEMENT

In order to amplify its engagement efforts, the SBI maintained membership in several investor organizations (coalitions) such as:

- ❖ Ceres Investor Network
- ❖ Climate Action 100+
- ❖ Council of Institutional Investors (CII)
- ❖ Institutional Limited Partners Association (ILPA)
- ❖ Midwest Investors Diversity Initiative (MIDI)
- ❖ RFK Compass Initiative
- ❖ Thirty Percent Coalition
- ❖ United Nations Principles of Responsible Investment (PRI)



Below is a summary of the engagement activities the SBI supports as a member of each of these coalitions.

ENGAGEMENT ACTIVITY WITH COALITIONS

Ceres Investor Network



The SBI became a member of Ceres in 2016.

Ceres is a coalition of various institutional investors that provides resources and advocacy in addressing environmental investment risk. The SBI leverages Ceres organized engagements, educational opportunities, and research.

Along with other institutional investors, the SBI began an engagement with Hess Corporation at the end of 2020.

- The engagement with Hess Corporation focuses on disclosure of its targets to reduce flaring intensity and methane emissions intensity within its broader greenhouse gas emissions reduction goals.
- For the 2021 proxy season, the SBI co-filed a shareholder resolution at the Hess Corporation, which was then withdrawn when Hess Corporation added continued Bakken flaring reduction as one of the performance metrics in the company's annual incentive plan.

Joining in an effort organized by members of Ceres and PRI, the SBI continues to engage with companies about the impact of deforestation in South America. In 2019, the SBI signed on to an

investor letter urging large global agricultural companies to require beef producers in their supply chains to eliminate illegal farming operations in the Amazon region. In 2020, the SBI signed on to a similar effort reaching out to soy producers in the region.

Climate Action 100+

A proud participant of:



The SBI joined Climate Action 100+ in 2019.

Climate Action 100+ is investor-led and seeks to engage with companies to further the Paris Agreement, with support from Ceres and PRI. Climate Action 100+ seeks commitments from companies to implement practices to address risks related to climate change.

As a member of the Climate Action 100+, the SBI supports engagements with many companies on Climate Change risk related topics and is actively participating in an engagement with Xcel Energy.

- The engagement with Xcel Energy focuses on disclosure of its plans to transition to carbon free electricity generation by 2050 and plans to ensure a just transition to carbon free electricity production.

STEWARDSHIP

ENGAGEMENT

Council of Institutional Investors (CII)



The SBI has been a member of CII since it was founded in 1985.

CII promotes policies that enhance long-term value for U.S. institutional asset owners and their beneficiaries. CII believes the involvement of defined benefit plans, particularly state and local government and union pension systems, in corporate governance issues has benefited investors at large in the U.S. capital markets and contributed to the vitality of the U.S. economy and U.S. corporations.

Pension fund advocacy has resulted in regulatory and legislative reforms to strengthen rights for shareowners, improved corporate governance standards for U.S. companies and boards, increased accountability of corporate directors and executives, and enhanced transparency of governance activities and financial accounting.

In March 2021, the SBI's Executive Director and CIO, Mansco Perry III, was elected Treasurer of the Board of Directors for the CII. As a highly respected leader among institutional investors, Mr. Perry is contributing to this important governance work by volunteering to serve on the CII Board of Directors as Treasurer.



Treasurer: Mansco Perry
Executive Director and CIO
Minnesota State Board of Investment
Member of CII board since 2020

Institutional Limited Partners Association (ILPA)



ILPA engages, empowers and connects limited partners (LPs) to

maximize their performance on an individual, institutional and collective basis. Like many other institutional investors, the SBI invests in private markets as a LP. LPs serve as trusted financial stewards who direct critical capital into private equity investments on behalf of their beneficiaries. ILPA members believe that good stewardship is critical to the success of their portfolios. ILPA's stewardship work focuses on ESG issues as well as diversity, equity and inclusion (DEI).

Alignment of economic interests, fair governance and appropriate disclosures from managers to LPs are especially important in private markets. ILPA articulates and amplifies the voice of its members in policy and regulatory discussions on these and other issues globally. Through its industry work and advocacy ILPA also seeks to encourage convergence on its ESG related metrics and works to promote regulatory standardization.

In 2021, the SBI used due diligence questionnaires, based on ILPA recommendations, to gather ESG information on potential private markets investments. ILPA has also developed a questionnaire with a focus on diversity and inclusion. These standard due diligence questionnaires have helped the SBI integrate ESG into its investment process. In addition to using these ILPA developed tools, the SBI also supports ILPA's engagement efforts. Including in 2019, when the SBI signed a letter that was sent from ILPA members to the SEC on the importance of fiduciary duty in private equity.



Midwest Investors Diversity Initiative (MIDI)



The SBI joined MIDI in 2019.

As part of the SBI's effort to promote greater diversity and inclusion on corporate boards and within the investment industry, the SBI is an active member of the MIDI. The coalition engages with companies in the Midwest to promote diverse gender, racial, and ethnic participation on corporate boards.

Since the SBI joined the 16-member MIDI, the SBI has contributed to efforts in order to increase board diversity at Midwest-based companies. Since its formation in 2016, 75 companies have been engaged by members of the MIDI, 90 women and persons of color have received board appointments, and 34 companies have adopted a diverse candidate search policy.

MIDI identifies companies with little or no documented racial, ethnic, and/or gender diversity on their boards of directors and asks the company to adopt a rule to include in the pool of board candidates at least one woman and one person with a racial/ethnically diverse background.

Through its involvement in MIDI, the SBI has led or co-led engagements on board diversity with several target companies in the Midwest region. These engagements included ANI Pharmaceuticals, Navistar, and Groupon, and involved submitting a formal shareholder proposal, having conversations with representatives from these companies asking them to voluntarily adopt this rule. In each case the SBI withdrew the shareholder proposal based on these discussions.



RFK Compass Initiative



As a core program within Robert F. Kennedy Human Rights' Business & Human Rights portfolio, the RFK Compass Investor Program clarifies the

human rights issues that investors and asset managers should consider during their investment process as they seek superior risk-adjusted returns. The initiative provides important connections and tools to support actions on the "S" in ESG by focusing on racial and economic inequity. The focus is on catalyzing action that yields both profits and positive impact for people and planet.

The SBI Executive Director has been a long term supporter of the RFK Compass Initiative and is a regular participant in events hosted by the organization.

Thirty Percent Coalition



The SBI joined the Thirty Percent Coalition in 2019.

As part of the SBI's effort to promote greater diversity and inclusion on corporate boards and within the investment industry, the SBI is an active member of the Thirty Percent Coalition. The Thirty Percent Coalition is a global network of investors seeking to increase gender and racial diversity on U.S. corporate boards.

Joining with many members of MIDI and the Thirty Percent Coalition, the SBI cosigned a letter that was sent to companies listed in the Russell 3000 index urging the companies to disclose the racial/ethnic and gender composition of their board of directors in each company's 2021 proxy disclosure statement.

The letter, which was authored jointly by the Illinois and Connecticut State Treasurers' Offices, was signed by investment entities comprising of over three trillion dollars of assets under management. The letter notes that research consistently indicates that diversity on corporate boards enhances long-term value for investors and

that investors continue to develop proxy voting policies that take diversity into account when voting for or against corporate boards. Furthermore, increased voluntary disclosure will provide investors with reliable data to assist investors in making proxy voting decisions and provide additional avenues for direct engagement with companies.

United Nations Principles of Responsible Investment (PRI)



The SBI became a signatory to the PRI in 2019.

PRI works to achieve a global sustainable financial system that benefits the environment and society as a whole.

In 2021 the SBI reported on the SBI's progress towards evaluating and confronting sustainability related investment risk using the PRI framework. As part of this process, the SBI reported on activities related to ESG risk activities, including various ESG related policies and procedures. PRI reviews the data provided and evaluates the SBI's progress toward meeting PRI's minimum requirements for sustainability, including, for example, having public policies on addressing ESG related risk and voting proxy shares in a manner that takes into account potential ESG related risks. Representatives from PRI then work with the SBI to improve best practices and address any shortfalls in the SBI's ESG practices and procedures.

Much of the PRI responsible investment framework is focused on ESG Incorporation in the investment process and the Stewardship activities of asset owners.

PRI defines ESG Incorporation as having three parts: *Integration*, *Screening* and *Thematic*.

- **Integration** is systematically including ESG issues in investment decisions to manage risks and improve returns.
- **Screening** is prohibiting investments based on certain ESG information.
- **Thematic** is seeking investments that combine attractive risk return profiles with social outcomes.

PRI defines Stewardship as having two parts: Engagement and Voting.

- **Engagement** is interactions between investors and managers/companies in order to improve practices on an ESG issue.
- **Voting** is primarily proxy voting.

Also in 2021, the SBI co-signed a letter drafted by PRI to the SEC supporting standardized, mandatory disclosure of ESG data and encouraging the SEC to build a mandatory corporate reporting regime for ESG information so that investors and their fiduciaries can have access to consistent and comparable data to inform their investment decisions.



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ESG INCORPORATION

ESG INTEGRATION

As stated in the 2020 SBI Resolution on ESG Initiatives, SBI staff includes ESG and diversity, equity and inclusion (DEI) information as part of its due diligence and monitoring practices for its external investment managers. As a primarily externally managed plan, the SBI relies heavily on its managers to implement its investment plan. Outlined below are some of the steps the SBI takes in its due diligence process with external investment managers.

Public Markets Program Managers

In public markets, the team sends each external manager a Request for Information (RFI) form to complete and return to the SBI on an annual basis. Included in the RFI are several questions related to ESG and DEI.

RFI ESG/DEI Questions

1. What ESG activities has your firm identified to address as a priority in the upcoming year? Provide details about your objectives, the methodology and how progress will be measured.
2. What other ESG-related organizations is your firm a member of?
3. How are ESG risks captured in the analysis of a company's or security's financial value (including debt)?
 - Does your firm assign each company or security an ESG score?
4. Is your firm a signatory to the UN Principles for Responsible Investment? If so, when did you become a signatory?
5. What ESG data, research, resources, tools and practices does your firm use to integrate ESG factors into your investment process, valuations and decisions? Please address each of the factors (environmental, social and governance) in your response.
 - What ESG reporting does your firm provide current and prospective clients?
6. Does your firm have any official diversity programs in place specifically to recruit, develop, or retain a diverse or inclusive workforce?
 - If so, please provide a short summary of its objectives and provisions.
 - What are the measures taken to ensure effective implementation?
 - How is senior leadership accountable for your diversity and inclusion efforts?
 - If not, why doesn't your firm have one?

Private Markets Program Managers

In 2021, the private markets team included ESG or DEI information in each investment recommendation memo presented to the Board and frequently responded to questions from the Investment Advisory Council regarding the ESG and DEI activities of investment managers in its private markets program.

In recent years, it has become increasingly common for managers to integrate ESG into their investment processes. It is important for managers to both evaluate ESG risks and opportunities prior to making an investment; and add value by improving ESG practices once a company is purchased.

With respect to DEI, many managers are working to identify opportunities where they can make improvements with respect to recruitment, hiring, retention, promotion, and to create a workplace environment that sets people up to succeed from a variety of different backgrounds. While in some cases, the SBI's private markets managers have increased diversity at the junior levels of their organization, there is often less change in diversity at the senior levels given the lower turnover associated with these positions.

In conjunction with the SBI Resolution on ESG Initiatives, the SBI encourages managers to enhance their ESG risk analysis and increase their efforts related to DEI.

*Participant Directed Investment Program**MN 529 College Savings Plan**Addition of New ESG Investment Option*

In June 2021, the SBI added a new fund option to the Minnesota 529 College Savings Plan that includes ESG considerations. Participants are now able to select the TIAA-CREF Social Choice Equity Fund along with all the pre-existing options.

An ESG option was recommended by the Program Manager as part of the annual asset allocation review conducted with the SBI and the Office of Higher Education, who share responsibility for the Plan. After due diligence was completed by SBI staff, the TIAA-CREF Social Choice Equity Fund was selected as a viable addition to the investment menu.

TIAA-CREF Social Choice Equity Fund

The Social Choice Equity Fund was established in July of 1999 and seeks favorable long-term total return that reflects the investment performance of the overall U.S. stock market while considering certain ESG criteria. The fund's evaluation process favors companies with leadership in ESG performance relative to their peers. The investment process starts with an investable universe of companies that meet defined ESG performance criteria. The process incorporates a company's exposure to ESG-related issues and involvement in certain controversial business activities. Approximately half of the companies evaluated make it into the ESG Eligible Universe.



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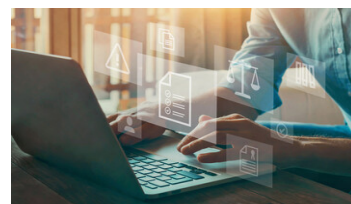


ESG INCORPORATION

SCREENING

The SBI maintains compliance with various screening obligations as dictated by legislation or Board resolution. The SBI currently does screening on four items:

- Sudan
- Iran
- Tobacco
- Thermal Coal



The screenings for Sudan and Iran are required by state legislation designed to meet human rights and national security objectives. The screenings for Tobacco and Thermal Coal are governed by Board resolutions designed to manage whole portfolio risks to health impacts and stranded assets.

Sudan



Minnesota Statutes, § 11A.243 concerns the SBI’s investment in companies with operations in Sudan. The law requires the SBI to make its best efforts to identify all “scrutinized companies” in which the SBI has direct or indirect stock holdings or could possibly have holdings of in the future. The statute also requires that the SBI communicate with those companies, and divest stocks over a specified period of time if the companies continue their restricted business activities in Sudan.

To ensure compliance with the statute, the SBI retains the firm Vigeo EIRIS CRN to provide a list of scrutinized companies. SBI Staff sends this list of restricted Sudan companies to the SBI’s equity investment managers quarterly; and has required divestment of those listed companies. SBI Staff reports to the Board each quarter on its actions to implement the law.

Iran



Minnesota Statutes, § 11A.244, requires the SBI to take a series of steps to identify companies that engage in sanctioned business operations in Iran, communicate with those companies, and divest stocks and bonds over a specified period of time if the companies continue these business activities in Iran.

The SBI retains the firm Institutional Shareholder Services, Inc. (ISS) to provide a list of scrutinized companies to implement the law. SBI Staff sends this list of restricted Iran companies to the SBI’s equity and fixed income investment managers quarterly; and has required divestment of holdings to maintain compliance with the law. SBI Staff reports to the Board each quarter on its actions to implement the law.

Tobacco



At its September 1998 meeting, the Board adopted a resolution that required each active and semi-passive equity manager to liquidate by September 2001 shares of any company which obtained more than 15% of its revenues from the manufacture of consumer tobacco products upon adoption. SBI Staff notified each active and semi-passive equity manager of the policy.

Since 2001, the SBI has continued to regularly update the list of restricted tobacco companies and communicate this restricted stock listing to its active and semi-passive equity managers accordingly. SBI Staff have monitored compliance with this resolution for over 20 years.

Thermal Coal



In May of 2020, the Board adopted a resolution stating that any publicly traded company that derives more than 25% of its revenue from thermal coal production (exploration or mining) is no longer an authorized investment for the SBI’s Combined Funds. The SBI’s Executive Director expanded this mandate to the SBI’s Non-Retirement Funds and Stable Value Fund; and this past year also began the process of removing fossil fuel companies from the ITC State Cash Account.

Unauthorized thermal coal holdings were removed from the portfolio by December 31, 2020.

The SBI retains Vigeo EIRIS CRN to provide a list of unauthorized thermal coal holdings. SBI Staff updates and communicates the unauthorized thermal coal holdings list annually to all active and passively managed equity and fixed income portfolio managers.

CONCLUSION

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At the direction of the Board Resolution passed in 2020, SBI staff will continue to develop and refine its approach to addressing ESG investment risk throughout the investment portfolios. Because all of the Combined Funds' assets are externally managed, SBI staff will continue to evaluate whether investment managers appropriately consider ESG risk and encourage managers to enhance their ESG risk analysis. In addition, two special initiatives were introduced in the FY22 SBI Management Plan, a Climate Risk Assessment and a Task Force to address diversity, equity and inclusion.

2022 Initiatives

Climate Risk Assessment



In 2019, the SBI engaged Meketa Investment Group to gather information and review the potential impact of climate change on the SBI's investment portfolio. The SBI's Climate Risk Investment Study, concluded that the SBI should continue its efforts to address and manage climate and other material ESG risks and opportunities. Since then, the SBI has implemented several recommendations from that report such as engaging with companies and participating in coalitions addressing climate change risk.

The 2022 Climate Risk Assessment will review the impact of climate risk and address how best to mitigate its impact on the SBI Investment Assets. While divestment does not necessarily represent the best approach to responsible investing, it should be acknowledged that the SBI will need to transition aspects of the portfolio to meet certain terms of the Paris Agreement. Climate change presents a critical risk to the SBI's investment program and the task of determining the SBI's obligations and corresponding strategy is a complicated one requiring considerable thoughtfulness and rationality.

Diversity, Equity and Inclusion Task Force



In response to the Board directive included in the ESG Resolution dated February 26, 2020, the Executive Director formed the Diversity, Equity and Inclusion (DEI) Task Force to advise and assist in the development of recommendations related to DEI.

The DEI Task Force will review a variety of approaches to the topic, such as:

- engaging with corporations and investment management organizations to promote DEI;
- instituting programs geared towards greater inclusion of diverse asset management teams;
- implementing staffing strategies to increase the diversity profile of the SBI staff; and
- directing fund commitments towards return-seeking funds that will invest in businesses owned and operated by minorities or women, or promote economic prosperity among undercapitalized racial and ethnic groups or communities.

The SBI Executive Director will work with the Task Force to present a potential recommendation to the Board in Fiscal Year 2022.

Stewardship and ESG Incorporation are two key activities that will help the SBI fulfill its mission of maintaining the long-term viability of various retirement and other state funds for the State of Minnesota. As institutional investors continue to evolve in their approaches to ESG issues, the SBI remains committed to actively evaluating the risks and rewards of stewardship in achieving long-term financial sustainability for its funds and incorporating ESG into its investment process.

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