



WASHINGTON STATE INVESTMENT BOARD



ENVIRONMENTAL, SOCIAL, AND GOVERNANCE REPORT

ASSET STEWARDSHIP & SUSTAINABILITY FOR THE LONG TERM

PUBLISHED APRIL 2020

THE LINK BETWEEN SUSTAINABILITY AND LONG-TERM INVESTMENT SUCCESS



For long-term investors like the Washington State Investment Board (WSIB), the links connecting asset stewardship, sustainability, and successful investment outcomes are familiar concepts. We are seeing increased data, resources, and technology-enabled information to improve investors' ability to incorporate factors related to sustainability into all aspects of the investment process.

Given the devastating human and financial toll of the COVID-19 pandemic in 2020, we know that markets and companies, now more than ever, will be evaluated based on leadership capabilities, vital human capital issues, impact on communities, and the long-term sustainability of business models. This epic health challenge has become an all-too-realistic stress test for both humankind and our capital markets.

This report outlines the WSIB's most recent initiatives and outcomes related to environmental, social, and governance (ESG) issues. The WSIB is thoughtfully advancing its ESG work in order to continue its successful investing in context of today's evident ESG risks and opportunities.

Our investment approach is working. The WSIB's investment program ranks as a top-decile performer among comparable public pension plans in the country for virtually all time periods. Since its inception, the Commingled Trust Fund has earned 8.8 percent annually as of year-end 2019. We believe we have the necessary liquidity and investment discipline to respond to unpredictable economic declines as seen in 2008-2009 and now in 2020. Our beneficiaries recognize and appreciate this resilience and focus, especially in times of unsettling market volatility.

To sustain this success, we will evaluate factors such as climate risks, social issues, and shifting governance practices at corporations. As we have seen, external issues

are often material to investments, and increasingly investors are seeking the data and measurements to better assess these factors.

Here are a few of our ESG-related highlights from 2019:

- ⊙ During 2019 and prior to the 2020 collapse of the broad energy sector, the WSIB's investment exposure to fossil fuels dropped to 4.8 percent of total assets from 6.5 percent of total assets – a reduction of 24.6 percent exposure in a single year.
- ⊙ By 2019 nearly all of the WSIB's investments in coal were strategically sold due to forward-looking views of the energy sector. Residual exposure to coal as of year-end 2019 was a mere 0.03 percent of total investments.
- ⊙ Our in-house fixed income investment team has been a net-seller of oil and gas holdings. Their trading resulted in an overall net sell-off of \$745 million of oil and gas securities in 2019.
- ⊙ In renewable energy, the WSIB has invested \$736 million in companies that earn all revenue from renewable sources of electricity. We also have invested in utilities and other enterprises where a significant portion of business is derived from renewables.
- ⊙ Our real estate program is investing in relatively affordable and stable middle-income housing, along with commercial/residential properties that are close to public transportation hubs.
- ⊙ Our tangible assets program has invested in solar/wind power generation, along with agriculture that emphasizes smart water management.
- ⊙ We created a new full-time position of Sustainability Officer, an experienced professional who will be integral to our Investment Committee and our investment process.

I hope this summary provides you with a clear sense of the WSIB's direction and commitment when it comes to the intersection between investments and ESG issues. Be assured that our emphasis will continue to be on investment strategy and financial results, while we will leave the demands of fiscal policymaking to our duly elected officials. At the same time, our Board and staff will continue to treat long-term sustainability as a centerpiece in our investment program.

Sincerely,
Theresa Whitmarsh, Executive Director

ESG PROGRAM FRAMEWORK

The WSIB's ESG Program now consists of two vital programs, a long-standing asset stewardship effort and a newly established ESG integration and measurement initiative. These programs each include internal and external responsibilities based on the need to address ESG issues. In sum, the framework allows the WSIB to address ESG issues in full alignment with its fiduciary duty.

Our ESG programs and our investment disciplines are gradually evolving to reflect Board policies, improved data availability and gradually developing standards in the investment industry.

WSIB'S ESG FRAMEWORK

ASSET STEWARDSHIP

- ⊙ Proxy voting
- ⊙ Engagement with companies
- ⊙ Industry engagement on corporate governance initiatives

ESG INTEGRATION

- ⊙ Standards evaluation
- ⊙ Mapping/measurement methods
- ⊙ Input to due diligence and portfolio management

INVESTMENT PROCESS

INDUSTRY ADVOCACY

ASSET STEWARDSHIP PROGRAM

Beyond simply investing into markets, the WSIB must act as a responsible steward for the assets that ultimately belong to our beneficiaries. Part of this responsibility involves addressing our priorities on ESG issues through the fundamentals of corporate governance:

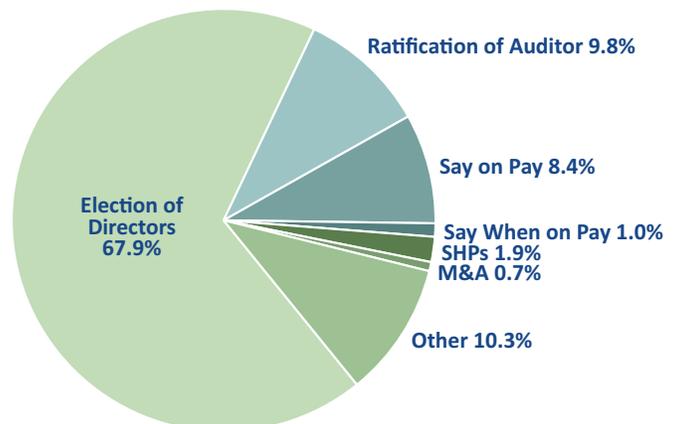
- ⊙ Proxy voting on issues that pertain to public companies
- ⊙ Evaluating and voting on issues raised by shareholders
- ⊙ Engaging with industry groups that share our interests and views
- ⊙ Engaging constructively with the companies in which we invest
- ⊙ Watching out for our beneficiaries' interests as new rules and regulations take shape

OUR PROXY VOTING RECORD

In 2019, the WSIB voted in a total of 3,058 shareholder meetings. WSIB cast votes on a total of 26,832 individual proxy proposals dealing primarily with:

- ⊙ Election of directors
- ⊙ Ratification of auditor
- ⊙ Advisory votes on executive compensation
- ⊙ Frequency of say on pay (say when on pay)
- ⊙ Shareholder proposals (SHPs)
- ⊙ Other corporate issues, including equity compensation plans and mergers/acquisitions

Where the WSIB Casts Its Votes



SHARPENING OUR PROXY VOTING PRIORITIES

In order to maximize the impact of our resources and our investor voice, our Board has approved several topical priorities that guide the WSIB's proxy voting and engagement practices.

Shareholder rights and long-termism

We support proposals that will help ensure constructive shareholder input to companies, especially when such input encourages company management to focus on long-term growth rather than short-term valuations.

Diversity of boards and company management

We have strengthened our voting policies around a general belief that diversity on company boards and management teams is in the best long-term interests of companies and investors.

Climate issues

We often support proposals that seek improved disclosure and reporting of risks associated with long-term climate change. We assess these issues on a case-by-case basis, and evaluate a company's existing reporting and progress, relevance to the industry, and emerging standards for climate impact.

ENGAGING WITH COMPANIES AND THE INVESTMENT INDUSTRY

In order to best represent the long-term interests of our beneficiaries, we believe engagement on ESG issues can be far more effective than simply allocating capital to or away from particular companies or market sectors. Our engagement work is done on two levels: with select companies and more often with collective industry organizations that are aligned with our mission and beliefs.

During 2019, the WSIB launched its first direct engagement efforts with a careful selection of Washington-based corporations. The company meetings were part of the WSIB's work with Climate Action 100+, a group dedicated to addressing and reducing global carbon emissions.

Other highlights of 2019 engagement efforts:

- ⊙ We called on the world's top public company greenhouse gas emitters to take real action on climate in alignment with the aims of the Paris Agreement. The WSIB joined more than 450 investors representing more than \$40 trillion in assets under management, as part of the Climate Action 100+. This helped to constructively raise climate-related issues on a global scale.
- ⊙ We urged public companies to improve diversity on corporate boards. The WSIB co-signed 237 letters as a part of the Thirty Percent Coalition's "Adopt-a-Company" campaign. The message from investors focused on improving diversity beyond a one-dimensional focus on gender.
- ⊙ We joined the members of the Council of Institutional Investors by speaking out on vital regulatory proposals that threaten to weaken our corporate governance and proxy voting practices.
- ⊙ We spoke out at industry gatherings to express our views and raise questions about how ESG factors should become integral to fiduciary duty rather than being in conflict with such duty.
- ⊙ In 2019 and into early 2020, the WSIB evaluated ESG service providers such as MSCI and Sustainalytics to better understand how such platforms may inform both our asset stewardship work and our ESG integration efforts (see next section).
- ⊙ We also strengthened our focus on ESG-related questions and issues as part of the WSIB's ongoing evaluation of investment managers and partners.

ENGAGEMENT IN ACTION

During 2019, the WSIB has taken a new lead role on engagement with two Washington state-based companies in conjunction with a broader Climate Action 100+ effort.

In this role, the WSIB co-signed a specific letter on climate lobbying, asking targeted U.S. companies to align their lobbying activities with the aims of the Paris Agreement, including through their core trade association relationships. This was modeled on an earlier European initiative. This focused outreach campaign is relatively new in the U.S. market, and the Climate Action 100+ has partnered with InfluenceMap to track progress.

In our limited but direct engagement with companies in our region, we are encouraged that both of our engagement companies responded to this campaign with initial written responses to our requests. We intend to track progress on this over time.





INTEGRATING ESG INTO INVESTMENT PROCESS

The WSIB's investment process considers the risks and opportunities associated with ESG. In 2014, the agency formally adopted an investment belief calling on companies, fund managers and investment partners to disclose anticipated risks associated with climate change. These disclosures have become a regular part of the WSIB's investment process.

Along with analyzing performance, people and investment process, our investment officers consider how various investments and investment managers will perform when faced with the uncertain externalities of ESG factors.

A NEW ROLE FOR SUSTAINABILITY

In 2019, the WSIB increased its commitment to focusing on ESG integration by creating and filling a new position of Sustainability Officer. This new investment officer will be integral to the WSIB's Investment Committee and will focus specifically on the emerging metrics and measurements that can help determine how ESG factors may influence or affect long-term investment decisions.

How will commercial enterprises create efficient supply chains and reduce waste to gain competitive advantage? Which energy companies are best equipped to benefit from a shift from fossil fuels to renewables? How will technology companies balance the value of user data versus the need for user privacy? Which investment managers or partners are paying attention and effectively strategizing around these issues?

More than ever, these questions are seen as material to investment performance. The combination of new technologies and a growing recognition of ESG factors within the investment community means that sustainability is becoming bigger part of the conversation among those managing companies and those managing investment assets.

WHERE TO FROM HERE

Looking ahead, the WSIB plans to stay on pace with this focus on sustainability by pursuing:

- ⊙ Preservation of independent strategic thinking within our asset class teams
- ⊙ Thoughtful integration of ESG factors within the investment process
- ⊙ Deliberate research to determine how ESG metrics complement investment strategies
- ⊙ The WSIB in 2020 became a member of the Sustainability Accounting Standards Board (SASB) in an effort to increase ESG data access and to evaluate material ESG factors that may inform the investment process
- ⊙ Development of a mapping and analysis framework to measure ESG risk at a total portfolio level
- ⊙ Continued alignment with WSIB's mission and investment beliefs

Over time, this approach will allow the WSIB to remain committed to maximizing returns at prudent levels of risk while working to better integrate ESG factors into a successful investment program.

INVESTMENT BELIEF

Adopted by the WSIB on September 18, 2014

The WSIB has a long investment horizon and therefore is subject to complex and systemic global risks that unfold over time, including financial risks resulting from global climate change. Many of these risks are difficult to quantify, but nevertheless, we consider all identifiable risks in our investment process and believe thoughtful consideration of these evolving global challenges is inseparable from long-term investment strategy and performance.



A MESSAGE FROM OUR NEW SUSTAINABILITY OFFICER

Throughout my career working in institutional investment management, my focus has been on delivering value-added performance to clients, doing so with non-negotiable integrity. It is with this lens that I am approaching my role as Sustainability Officer at the WSIB.

In my first year in this newly created role, my objectives are both bottom-up and top-down. First, I will work closely with asset class teams to learn their current approach to investing and suggest ways to improve their bottom-up ESG integration efforts in a way that is additive to their own investment process. Second, I will work with our Investment Committee and other internal teams to create effective ways to review ESG exposures at a total portfolio level. Over the long run, this can help inform strategic asset allocation and portfolio risk management.

I am grateful and excited for the opportunity to be part of the WSIB's effort to create and improve upon sustainable investment processes that will benefit public employees for years to come.

Warm regards,
Sherrie Trecker, CFA
Sustainability Officer

ENVIRONMENTAL SUMMARY



KEY ISSUES

- ⊙ Climate change risks
- ⊙ Energy sector transition: fossil fuels and renewables
- ⊙ Management of natural resources (water/air quality)
- ⊙ Reporting and tracking of environmental factors

OUR STRATEGIES

- ⊙ Engage with companies and investment managers
- ⊙ Vote proxies and evaluate relevant shareholder proposals
- ⊙ Collaborate with like-minded peer funds and industry groups
- ⊙ Evaluate company data disclosures and response to issues
- ⊙ Explore environmental factors for materiality to investment decisions
- ⊙ Invest via due diligence on financial and non-financial risks

MEMBERSHIP ORGANIZATIONS

- ⊙ CERES
- ⊙ Climate Action 100+
- ⊙ CDP (formerly Carbon Disclosure Project)
- ⊙ Sustainability Accounting Standards Board (SASB)

OUR RESULTS

- ⊙ Assessing climate-related risk within the investment process
- ⊙ Supporting majority (90%) of climate change-related shareholder proposals
- ⊙ Calling for SEC direction on disclosure standards
- ⊙ Employing due diligence questionnaires and manager/partner disclosures
- ⊙ Prioritizing climate risk in our engagement efforts
- ⊙ Launching research into materiality of ESG factors in and across our asset classes

FUTURE AIMS

- ⊙ Reduce carbon emissions through focused engagement
- ⊙ Advocate clear, measurable and consistent standards for addressing climate-related investment risks
- ⊙ Evaluate investment risk and opportunities amid the transition of the energy sector

SOCIAL SUMMARY

KEY ISSUES

- ⊙ Diversity
- ⊙ Workers' rights and safety
- ⊙ Labor relations
- ⊙ Supply chain management
- ⊙ Income inequality
- ⊙ CEO/workers' pay ratios
- ⊙ Executive compensation

OUR STRATEGIES

- ⊙ Engage with companies and investment managers
- ⊙ Vote proxies and evaluate relevant shareholder proposals
- ⊙ Collaborate with like-minded peer funds and industry groups
- ⊙ Evaluate company data disclosures and response to issues
- ⊙ Explore social factors for materiality to investment decisions
- ⊙ Invest via due diligence on financial and non-financial risks
- ⊙ Influence the industry via select thought leadership and outreach

MEMBERSHIP ORGANIZATIONS

- ⊙ The 30% Percent Coalition
- ⊙ Coalition for Inclusive Capitalism
- ⊙ International Limited Partners Association (ILPA)
- ⊙ World Economic Forum (WEF)
- ⊙ Focusing Capital on the Long Term (FCLT Global)
- ⊙ Sustainability Accounting Standards Board (SASB)

OUR RESULTS

- ⊙ Advocacy for SEC direction on standards
- ⊙ Governance/board-level oversight of these issues
- ⊙ Increased engagement among investment managers and partners

FUTURE AIMS

- ⊙ Evaluation of response/resiliency to COVID-19 pandemic crisis
- ⊙ Advocate for clear and consistent standards for addressing socially driven investment risks

GOVERNANCE SUMMARY



KEY ISSUES

- ⊙ Shareholder rights
- ⊙ Board independence
- ⊙ Multi-class voting rights
- ⊙ Majority director elections
- ⊙ Proxy access/universal ballots
- ⊙ Proxy-related regulations

OUR STRATEGIES

- ⊙ Engage with companies and investment managers
- ⊙ Vote proxies and evaluate relevant shareholder proposals
- ⊙ Collaborate with like-minded peer funds and industry groups
- ⊙ Evaluate company responses to issues
- ⊙ Explore governance capabilities for materiality to investment decisions
- ⊙ Invest via due diligence on financial and non-financial risks
- ⊙ Influence the industry via select thought leadership and outreach

MEMBERSHIP ORGANIZATIONS

- ⊙ Council of Institutional Investors (CII)
- ⊙ Investor Stewardship Group (ISG)
- ⊙ International Corporate Governance Network (ICGN)
- ⊙ Focusing Capital on the Long Term (FCLT Global)
- ⊙ World Economic Forum (WEF)
- ⊙ Millstein Center
- ⊙ Sustainability Accounting Standards Board (SASB)

OUR RESULTS

- ⊙ Increased company uptake in majority voting/proxy access
- ⊙ Protected shareholder voting rights; limits on multi-class structures
- ⊙ Enhance shareholder-company relations based on common growth objectives

FUTURE AIMS

- ⊙ Lead collaboration across the value chain to promote responsible advancement of governance practices