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**HOUSE BILL 2405**

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**State of Washington 68th Legislature 2024 Regular Session**

**By** Representatives Duerr, Doglio, Ramel, and Berry

AN ACT Relating to sustainability factors in investment strategies and proxy voting by the Washington state investment board; amending RCW 43.33A.110, 43.33A.140, and 43.33A.150; adding a new section to chapter 43.09 RCW; and creating a new section.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec.**  The legislature finds that climate change presents significant risks to financial stability including to Washington state's public funds investment portfolios. Integration of sustainability factors such as corporate governance and leadership, environmental, social, and human capital factors relating to investments is vital for evaluating risk and maximizing the performance of public funds. Such sustainability factors are indicative of the overall performance of an investment and strong indicators of its long-term value. Investors of public funds have a duty to recognize, evaluate, and address sustainability factors that may affect investment performance.

The legislature recognizes that the Washington state investment board regularly outperforms peer states and delivers returns that exceed benchmarks and benefit retirees and public funds. The Washington state investment board has a long history of integrating financially material sustainability factors into their investment practice as a part of their fiduciary duty. The Washington state investment board's 2023 sustainability report recognizes that the financial risks of climate change are already materializing, especially in industries like insurance, and that the transition to a low-carbon economy offers many opportunities for investing.

The legislature further finds that transparency and accountability are essential parts of Washington state's history and governance. Providing clear guidance and access to information are fundamental to fostering public trust and ensuring that government entities are held accountable now and into the future.

The legislature intends to provide transparency to the public regarding the guidance, definitions, and use of sustainability factors in investment strategies and proxy voting by the Washington state investment board. This will build upon the work of the Washington state investment board to ensure that public fund investments prudently integrate sustainability factors into their decision making in order to maximize financial returns, minimize risks, and contribute to a more just, accountable, and sustainable state.

**Sec.**  RCW 43.33A.110 and 1994 c 154 s 310 are each amended to read as follows:

(1) The state investment board may make appropriate rules and regulations for the performance of its duties. The board shall establish investment policies and procedures designed exclusively to maximize return at a prudent level of risk. However, in the case of the department of labor and industries' accident, medical aid, and reserve funds, the board shall establish investment policies and procedures designed to attempt to limit fluctuations in industrial insurance premiums and, subject to this purpose, to maximize return at a prudent level of risk. The board shall adopt rules to ensure that its members perform their functions in compliance with chapter 42.52 RCW. Rules adopted by the board shall be adopted pursuant to chapter 34.05 RCW.

(2) In determining a prudent level of risk for investment policies as required in subsection (1) of this section, the board must integrate sustainability factors into its investment decision making, investment analysis, portfolio construction, due diligence, and investment ownership.

(3) When updating and reviewing existing sustainability frameworks, the board should strive to incorporate at a minimum the following sustainability factors:

(a) Corporate governance and leadership factors, such as the independence of boards and auditors, the expertise and competence of corporate boards and executives, systemic risk management practices, executive compensation structures, transparency and reporting, leadership diversity, regulatory and legal compliance, shareholder rights, and ethical conduct;

(b) Environmental factors that may have an adverse or positive financial impact on investment performance, such as greenhouse gas emissions, air quality, energy management, water and wastewater management, waste and hazardous materials management, and ecological impacts;

(c) Social capital factors that impact relationships with key outside parties, such as customers, local communities, the public, and the government, which may impact investment performance. Social capital factors include human rights, customer welfare, customer privacy, data security, access and affordability, selling practices and product labeling, community reinvestment, and community relations;

(d) Human capital factors that recognize that the workforce is an important asset to delivering long-term value, including factors such as labor practices, responsible contractor and responsible bidder policies, employee health and safety, employee engagement, diversity and inclusion, and incentives and compensation; and

(e) Business model and innovation factors that reflect an ability to plan and forecast opportunities and risks, and whether a company can create long-term shareholder value, including factors such as supply chain management, materials sourcing and efficiency, business model resilience, product design and life-cycle management, and physical impacts of climate change.

(4) Sustainability factors may be analyzed in a variety of ways including, but not limited to: Direct financial impacts and risks; legal, regulatory, and policy impacts and risks; against industry norms, best practices, and competitive drivers; and stakeholder engagement.

**Sec.**  RCW 43.33A.140 and 1998 c 14 s 1 are each amended to read as follows:

The state investment board shall invest and manage the assets entrusted to it with reasonable care, skill, prudence, and diligence under circumstances then prevailing which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an activity of like character and purpose.

The board shall:

(1) Consider investments not in isolation, but in the context of the investment of the particular fund as a whole and as part of an overall investment strategy, which should incorporate risk and return objectives reasonably suited for that fund; ((~~and~~))

(2) Diversify the investments of the particular fund unless, because of special circumstances, the board reasonably determines that the purposes of that fund are better served without diversifying. However, no corporate fixed-income issue or common stock holding may exceed three percent of the cost or six percent of the market value of the assets of that fund; and

(3) Develop and publish proxy voting guidelines that recognize climate change as both a business and systemic risk, and use ownership authority to mitigate these risks. The board should support shareholder resolutions that call for entities to reduce activities that contribute to climate change, and when the board does not support such shareholder resolutions, provide public, written comments as to why the board chose not to support them.

**Sec.**  RCW 43.33A.150 and 2007 c 215 s 4 are each amended to read as follows:

(1) The state investment board shall prepare written reports at least quarterly summarizing the investment activities of the state investment board, which reports shall be sent to the governor, the senate ways and means committee, the house appropriations committee, the department of retirement systems, and other agencies having a direct financial interest in the investment of funds by the board, and to other persons on written request. The state investment board shall provide information to the department of retirement systems necessary for the preparation of monthly reports.

(2) At least annually, the board shall report on the board's investment activities for the department of labor and industries' accident, medical aid, and reserve funds to the senate financial institutions and insurance committee, the senate economic development and labor committee, and the house commerce and labor committee, or appropriate successor committees.

(3) At least annually, the board shall report on the board's investment activities for the higher education permanent funds to the house capital budget committee and the senate ways and means committee.

(4) At least annually, the board shall report on the environmental sustainability of the board's investment decision-making process, in particular the board's process for identifying climate change-related risks and assessing the financial impact that the climate change-related risks have on the board's operations. The environmental sustainability report must include actions that the board is taking to manage the risks that climate change poses to the board's investment portfolio, investment strategies, operations, and federal climate-related reporting requirements.

NEW SECTION. **Sec.**  A new section is added to chapter 43.09 RCW to read as follows:

By December 1, 2027, and every two years thereafter, the state auditor must conduct a comprehensive evaluation of the Washington state investment board's proxy voting guidelines on climate risks adopted in RCW 43.33A.140(3). The evaluation should include the board's conformance with the guidelines adopted in RCW 43.33A.140(3) and the board's adopted proxy voting guidelines and deliver a report, including a conclusion and recommendations for improvement to the legislature regarding:

(1) The instances of proxy votes being cast in ways that promoted emissions targets required for keeping global temperature increases below 1.5 degrees Celsius, including votes on relevant shareholder resolutions, director elections, auditor approval, or executive compensation;

(2) The instances where the proxy votes being cast were effective in directing or maintaining guidance to directors to pursue the goals established in the proxy voting guidelines adopted in RCW 43.33A.140(3) and the board's adopted proxy voting guidelines; and

(3) The overall efficacy of the climate risk proxy voting guidelines, based on the established goals of chapter . . ., Laws of 2024 (this act).

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