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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

Read first time 01/17/24. Referred to Committee on Appropriations.

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

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

6            NEW SECTION.    **Sec. 1.**    The legislature finds that climate change  
7 presents significant risks to financial stability including to  
8 Washington state's public funds investment portfolios. Integration of  
9 sustainability factors such as corporate governance and leadership,  
10 environmental, social, and human capital factors relating to  
11 investments is vital for evaluating risk and maximizing the  
12 performance of public funds. Such sustainability factors are  
13 indicative of the overall performance of an investment and strong  
14 indicators of its long-term value. Investors of public funds have a  
15 duty to recognize, evaluate, and address sustainability factors that  
16 may affect investment performance.

17            The legislature recognizes that the Washington state investment  
18 board regularly outperforms peer states and delivers returns that  
19 exceed benchmarks and benefit retirees and public funds. The  
20 Washington state investment board has a long history of integrating  
21 financially material sustainability factors into their investment

1 practice as a part of their fiduciary duty. The Washington state  
2 investment board's 2023 sustainability report recognizes that the  
3 financial risks of climate change are already materializing,  
4 especially in industries like insurance, and that the transition to a  
5 low-carbon economy offers many opportunities for investing.

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

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

20 **Sec. 2.** RCW 43.33A.110 and 1994 c 154 s 310 are each amended to  
21 read as follows:

22 (1) The state investment board may make appropriate rules and  
23 regulations for the performance of its duties. The board shall  
24 establish investment policies and procedures designed exclusively to  
25 maximize return at a prudent level of risk. However, in the case of  
26 the department of labor and industries' accident, medical aid, and  
27 reserve funds, the board shall establish investment policies and  
28 procedures designed to attempt to limit fluctuations in industrial  
29 insurance premiums and, subject to this purpose, to maximize return  
30 at a prudent level of risk. The board shall adopt rules to ensure  
31 that its members perform their functions in compliance with chapter  
32 42.52 RCW. Rules adopted by the board shall be adopted pursuant to  
33 chapter 34.05 RCW.

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

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

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

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

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

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

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

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

38       **Sec. 3.** RCW 43.33A.140 and 1998 c 14 s 1 are each amended to  
39 read as follows:

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

6 The board shall:

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

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

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

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

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

35 (2) At least annually, the board shall report on the board's  
36 investment activities for the department of labor and industries'  
37 accident, medical aid, and reserve funds to the senate financial  
38 institutions and insurance committee, the senate economic development

1 and labor committee, and the house commerce and labor committee, or  
2 appropriate successor committees.

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

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

16 NEW SECTION. Sec. 5. A new section is added to chapter 43.09  
17 RCW to read as follows:

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

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

31 (2) The instances where the proxy votes being cast were effective  
32 in directing or maintaining guidance to directors to pursue the goals  
33 established in the proxy voting guidelines adopted in RCW  
34 43.33A.140(3) and the board's adopted proxy voting guidelines; and

35 (3) The overall efficacy of the climate risk proxy voting  
36 guidelines, based on the established goals of chapter . . ., Laws of  
37 2024 (this act).

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