



WASHINGTON STATE INVESTMENT BOARD

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE REPORT 2018

TABLE OF CONTENTS

INTRODUCTORY MESSAGE (3)

ENVIRONMENTAL SUMMARY (4)

CLIMATE CHANGE (5)

FOSSIL FUELS (7)

RENEWABLE ENERGY (9)

INVESTMENTS (10)

SOCIAL SUMMARY (12)

GUNS (13)

INVESTMENTS (14)

GOVERNANCE SUMMARY (16)

PROXY VOTING (17)

ENGAGEMENT VERSUS DIVESTMENT (19)



RESPONSIBLE INVESTING INITIATIVES

A REASONED AND WELL RESPECTED VOICE OF OUR TIME

WELCOME TO OUR ENVIRONMENTAL, SOCIAL, AND GOVERNANCE REPORT

This 2018 report represents the Washington State Investment Board's summary of asset stewardship initiatives related to environmental, social and governance (ESG) issues. The purpose is to provide our stakeholders with an accessible annual look at the WSIB's current and future ESG practices and considerations.

Asset stewardship efforts can be summarized into two categories:

- ⊙ Investment process – Understanding where and how ESG factors will create material risks and opportunities so that we may maximize investment results at prudent levels of risk.
- ⊙ Engagement practices – Advocating for the long-term financial interests of our beneficiaries by voting proxies, engaging with companies, and working collaboratively with well-informed industry groups.



It's clear that ESG factors such as climate change, pay equity, labor practices and human diversity can impact investment outcomes, and therefore should be considered integral to investment decision-making. Companies that find effective ways to address these issues are more likely to thrive; companies that sidestep or disavow these issues are more likely to struggle. As improvements are made in how ESG factors are measured, analyzed and integrated into investment thinking, our investment discipline will advance.

We also recognize the difference between policy-making and investment discipline; therefore our investment strategies will remain aligned directly with our mission of seeking the best possible risk-adjusted investment returns for our beneficiaries. State law and our own professional obligation to our beneficiaries require that we take a "fiduciary first" position when considering any investment plan. All our investment strategies are designed with this outcome in mind.

ESG issues are finding their legitimate place at the table, in both our investment processes and our engagement practices. Likewise, we must be ready to recognize ESG issues not as ideological agendas, but when they become material and meaningful as investment risks or opportunities. By making ESG factors part of our investment mindset and analytics, we will be better prepared to uphold our fiduciary promise to the WSIB's beneficiaries for the long run.

Sincerely,
Theresa Whitmarsh, Executive Director



ENVIRONMENTAL

KEY ISSUES

- ⊙ Climate change-related risk
- ⊙ Energy investing: fossil fuels and renewables
- ⊙ Resource management
- ⊙ Sustainability advancement, reporting and tracking

OUR STRATEGIES

- ⊙ Engage with companies and investment managers
- ⊙ Vote on ESG shareholder proposals
- ⊙ Collaborate with like-minded peer funds and industry groups
- ⊙ Report both approach and results (bi-annual Proxy Voting and annual ESG Reports)
- ⊙ Influence the industry via select thought leadership and outreach
- ⊙ Invest via due diligence on financial and non-financial risks

MEMBERSHIP ORGANIZATIONS

- ⊙ CERES
- ⊙ Climate Action 100+
- ⊙ CDP (formerly Carbon Disclosure Project)

OUR RESULTS

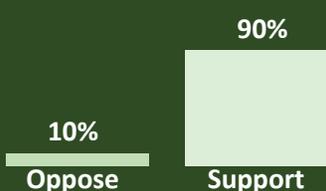
- ⊙ Assessing climate-related risk within the investment process
- ⊙ Supported 90% of climate change-related shareholder proposals
- ⊙ Calling for SEC direction on disclosure standards
- ⊙ Employing due diligence questionnaires and manager/partner disclosures
- ⊙ Prioritizing our corporate governance oversight

FUTURE AIMS

- ⊙ Reduce carbon emissions through focused engagement
- ⊙ Advocate clear, measureable and consistent standards for addressing climate-related investment risks

ENVIRONMENTAL - CLIMATE CHANGE

The WSIB supported 4,620 of the 5,127 (90.11 percent) of the climate change-related shareholder proposals in our proxy voting system for U.S. companies.



Voting in 2017 included support for three landmark shareholder proposals related to climate change reporting by major oil and gas companies: Exxon, Occidental and PPL.

We will be updating proxy voting policies in December 2018 to reflect strengthened positions on: diversity; ESG disclosures.

WSIB'S INDUSTRY ENGAGEMENT AND OUTREACH

ORGANIZATION	WSIB'S ROLE	PURPOSE OF ORGANIZATION
CERES www.ceres.org	Active member; Collaborate on advocacy and education efforts; attend CERES Climate Summit	Ceres is a sustainability nonprofit organization working with the most influential investors and companies to build leadership and drive solutions throughout the economy. Ceres tackles the world's biggest sustainability challenges, including climate change, water scarcity and pollution.
Climate Action 100+ www.climateaction100.org	Recently joined and participating in outreach advocacy	Five-year initiative led by investors to engage with the world's largest corporate greenhouse gas emitters to curb emissions, strengthen climate-related financial disclosures and improve governance on climate change.
International Corporate Governance Network (ICGN) www.cii.org	Shared influence and education efforts	Investor-led organization that promotes standards of responsible asset stewardship globally.
Council of Institutional Investors www.cii.org	Active member and organizational leader (Theresa is past chair)	Partner with CII members on legislative and governance issues, including improvement of corporate governance practices and shareholder activism issues. Environmental and social issues are becoming a central theme.
Principles for Responsible Investment (PRI) Network www.unpri.org	Collaborate with peer funds for education and issues management	PRI is an education and networking group that encourages investors to use responsible investment to enhance returns and better manage risks; it is supported by, but not part of, the United Nations.
U.S. SIF – Forum for Sustainable and Responsible Investment www.ussif.org	Education on ESG issues, metrics and approaches	US-SIF's mission is to rapidly shift investment practices toward sustainability, focusing on long-term investment and the generation of positive social and environmental impacts.

WSIB INVESTMENT BELIEFS

The Board has adopted 17 investment beliefs as core guideposts for its investment strategies and decision-making.

The latest addition to these belief states that the WSIB is...“subject to complex and systemic global risks that unfold over time, including financial risks resulting from global climate change.

WSIB requests that its managers and portfolio companies assess and disclose such risks as part of its investment process.

In publicly traded markets, the WSIB votes its corporate proxies to seek climate risk disclosures from energy companies and others.

A complete list of the WSIB Investment Beliefs is provided in the Appendix.

“Climate Action 100+ is a new five-year initiative to engage with the world’s largest corporate greenhouse gas emitters to curb emissions, strengthen climate-related financial disclosures and improve governance on climate change.”

- ⊙ Launch date: December 11 - 12, 2017.
- ⊙ Sponsors: The Ceres Investor Network, IIGCC (Europe), IGCC (AU/NZ), AIGCC (Asia) and the PRI
- ⊙ Website: <http://www.climateaction100.org/>

AIMS

“The initiative aims to engage and obtain commitments from more than 100 of the largest carbon emitting companies to:

- ⊙ Implement strong governance measures to address climate risks and opportunities
- ⊙ Reduce climate risks by aligning their emissions, operations, supply chains and business strategies with the Paris Agreement’s goal of limiting global warming to well below 2 degrees C
- ⊙ Disclose their climate related risks, opportunities and strategies consistent with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).”

WSIB COMMITMENT

Our role as “Participant”:

- ⊙ Publicly support the sign-on statement, initiative objectives and agenda
- ⊙ Commit to engage with at least one company annually, either collaboratively or individually
- ⊙ Provide a high level report back to other participants of the initiative, progress and next steps

ALIGNMENT WITH WSIB STEWARDSHIP PRIORITIES

- ⊙ Collective with respected industry groups and peers
- ⊙ Key focus area: climate change risk management
- ⊙ Well-articulated methodology and tracking process
- ⊙ Reasonable time commitment
- ⊙ FAQs specify that the initiative will not “act or speak on behalf of the investors participating”

METHODOLOGY/TRACKING

- ⊙ 100 initial companies based on scope 1 to 3 emissions; additional companies identified via an investor survey asking participants to identify others they believe present risk to their portfolio
- ⊙ These top 100 companies are estimated to contribute 15% of global scope 1 (direct) emissions and 85% indirectly of annual global greenhouse gas emissions
- ⊙ Tracked via bi-annual investor updates, investor-led annual report and third party assessments

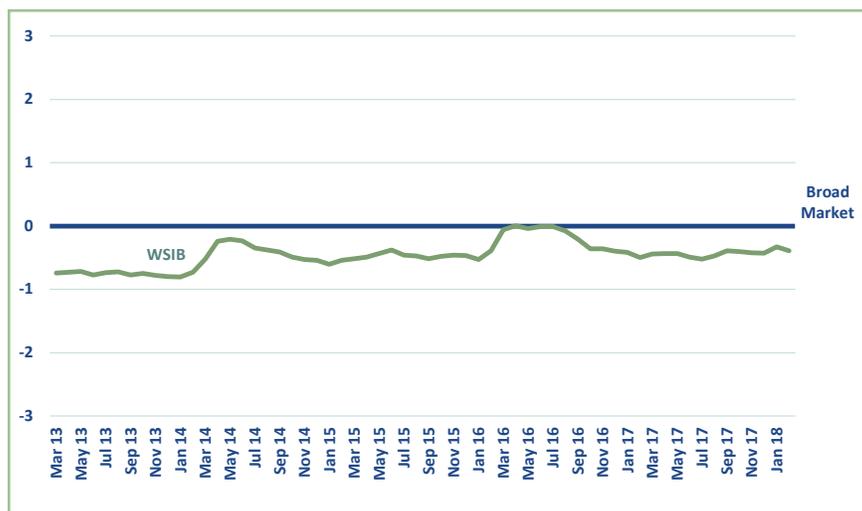
ENVIRONMENTAL - FOSSIL FUELS

As of March 31, 2018, WSIB's estimated total fossil fuel exposure is \$8.0 billion, which is 6.2% of the total \$129 billion in assets managed by WSIB across all mandates. For comparison, approximately 5.8% of the MSCI ACWI IMI would be classified as fossil fuels investments using the same definition.

Breakdown of WSIB's total fossil fuel investment exposure by asset class.

ASSET CLASS	MARKET VALUE (\$ BILLIONS)	PERCENTAGE OF WSIB AUM
Fixed Income	\$2.7	2.3%
Public Equity	\$2.2	1.8%
Private Equity	\$1.4	1.2%
Tangible Assets	\$1.6	1.4%
Totals	\$8.0	6.7%

WSIB's public equity carbon footprint compared to a the broad market over time.



CONTROL STRUCTURE	MARKET VALUE (\$ BILLIONS)	PERCENTAGE OF TOTAL AUM
Passive	\$1.5	1.3%
Active	\$3.4	2.8%
Limited Partnership	\$3.1	2.6%
Totals	\$8.0	6.7%

Passive Strategy

WSIB is a large investor in passively-managed equity products, e.g., index-tracking funds, across all of its mandates. WSIB believes that the public equity markets of some developed countries, such as the United States, are very efficient, and favors low-cost passive equity funds over actively-managed funds in these markets.

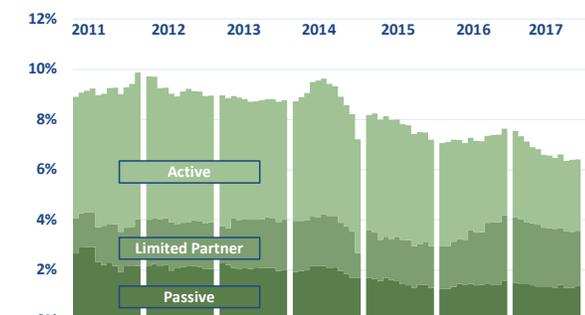
Active Strategy

On the other hand, WSIB believes that active management is warranted, on both a cost- and risk-adjusted returns basis, in fixed income, some emerging markets, and in private markets investments. In private markets, WSIB invests as a limited partner in funds with investment horizons of 10 years or longer; these funds are generally illiquid.

Fossil Fuel Investments 6.2%



WSIB's fossil fuel investments over time, in both market value and percentage of total assets.



Coal reduction

The WSIB has sold most of its investments in coal, including all exposure in fixed income. Remaining investments in coal consist of approximately \$35 million (public equity) invested in thermal coal companies. This represents less than 0.03% of WSIB's assets under management.

Growth and contraction of value

During the past five years, the dollar value of WSIB's fossil fuels investments has been as low as \$6.9 billion (in January 2016) and as high as \$9.6 billion (in June 2014). As a percentage of total AUM, fossil fuels have generally declined from nearly 10% of all investments in June 2014 to 6.7% of all investments today. The increase in the market values of information technology companies held through WSIB's portfolios has outpaced the growth of other industry sectors like energy, thereby shrinking the relative weights of non-tech sectors in WSIB's portfolios.

ENVIRONMENTAL - RENEWABLE ENERGY

As of March 31, 2018, WSIB's portfolios contained a total of \$258 million in "clean energy" investments per the above definition, across all mandates

The CTF has nearly **\$252 million** in clean energy assets and thus accounts for nearly all of WSIB's investments in clean energy

\$237 million comes from investments related to power generation via clean energy

\$19 million from investments related to primarily solar and wind-related

\$2 million from investments related to the production of biofuels

WSIB's clean energy investments by asset class

ASSET CLASS	MARKET VALUE (\$ MILLIONS)	PERCENTAGE OF TOTAL AUM
Tangible Assets	\$166	0.14%
Private Equity	\$55	0.05%
Public Equity	\$37	0.03%
Totals	\$258	0.22%

WSIB's clean energy investments by investment of control structure

CONTROL STRUCTURE	MARKET VALUE (\$ MILLIONS)	PERCENTAGE OF TOTAL AUM
Passive	\$28	0.02%
Active	\$9	0.01%
Limited Partnership	\$221	0.19%
Totals	\$258	0.22%

In WSIB's \$4 billion Tangible Assets investment portfolio (minerals, mining, energy and agriculture), the portfolio's upstream energy investments currently include nearly equal exposure to renewable power generation (solar, wind, hydro, bio fuels) when compared to oil and gas-related investments.



DEFINING ENERGY INVESTMENTS AS "RENEWABLE"

The WSIB uses a conservative definition when designating its investments as "renewable energy." We apply the "renewable energy" label only when all or nearly all of a company's business activity comes from power generation via wind, solar, hydroelectric, or biofuel sources.

ENVIRONMENTAL - INVESTMENTS



LARGEST-EVER RENEWABLE ENERGY DEAL

Global Infrastructure Partners to buy Equis Energy, a Singapore-based developer of renewable power plants, for \$5 billion. Bloomberg reports it's the largest deal to date in the renewable energy space. The WSIB has committed \$500 million to GIP Fund II. Equis Energy assets include:

- ⊙ Solar power facilities: 2.4 GW of generation capacity; 4.3 GW under development.
- ⊙ Wind power facilities: 2.3 GW of generation capacity; 2 GW under development.
- ⊙ Hydroelectric power facilities: 0.3 GW of generation capacity.



DEVELOPING THE FIRST SOLAR-POWERED CITY IN THE U.S.

In Florida, the WSIB invests with a master-plan community developer who is building the country's first solar-powered city, in conjunction with Florida Power & Light. The array covers 440 acres and produces 75 megawatts of electricity, enough to power approximately 15,000 homes and the equivalent emissions prevention of removing 12,000 cars from the road every year. FP&L plans to add an additional 420 acres on the site, producing another 75 megawatts of power. They also recently installed the largest solar-to-battery storage facility in the country. Their goal is ultimately to add enough battery storage to take Babcock Ranch completely off the grid if desired. The power produced by the solar arrays will exceed the electricity consumed by the community. The city will also utilize a smart grid digital electric distribution technology to optimize efficiency and lower energy costs.

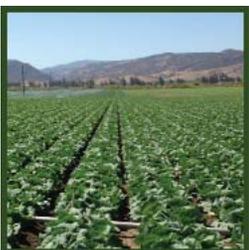
This new city will ultimately include more than 19,000 residences and will serve as a "living laboratory" for innovative technologies to combat climate change. Other environmentally-friendly features such as the proposed implementation of shared, autonomous electric vehicles where individuals can hail driverless cars using their smartphones will be used. The community layout will provide basic amenities and facilities in neighborhood commercial centers within walking distance of homes. An important but little discussed approach incorporated into the city is the fully-integrated conduit system for all utilities—water, sewer, gas, power, and data.

In addition, approximately 73,000 acres of land have been preserved for wildlife sanctuary.



REPLACING COAL IN POWER PLANTS

Stonepeak Infrastructure Partners invested in a \$75 million conversion of the Eastman Kodak Park, in Rochester, N.Y., from a coal-fired power plant to natural gas. The plant provides electricity, steam, compressed air and sewerage services for the Kodak company. It was one of only three remaining coal-fired plants in New York state. The final supply of coal arrived at the plant in March 2018. The WSIB has committed \$400 million to Stonepeak Fund II



ENHANCED AGRICULTURE EFFICIENCY

Arable Capital Partners purchased Hydratec, a California irrigation business that is pioneering the use of micro-irrigation technology as a more efficient use of water resources for tree and vine growers. These drip-watering systems are helping row-crop customers in California's farms, vineyards and orchards. The WSIB has committed \$300 million to the Arable Fund that is making this investment.



BUILDING RENEWABLE ENERGY INFRASTRUCTURE

Geronimo Renewable Infrastructure Partners is investing in construction-ready wind and solar energy assets in North America. The company has 1,600 megawatts of wind and solar energy projects that are either operational or under construction as of 2017, and expects to develop an aggregate capacity of more than 2,000 megawatts of additional clean energy. In 2017, the WSIB committed \$300 million to Geronimo Infrastructure Partners as part of this wind/solar infrastructure buildout.



PROVIDING CLEAN DRINKING WATER

Stonepeak Infrastructure Partners owns The Claude "Bud" Lewis Carlsbad Desalination Plant, the largest seawater desalination plant in the U.S. Each day, the plant delivers nearly 50 million gallons of fresh, desalinated water to San Diego County – enough to serve approximately 400,000. In 2012, the WSIB committed \$250 million to Stonepeak Partners Fund I and was a cornerstone investor and first pension fund to invest alongside this partner.



OFFSHORE WIND POWER FOR EUROPE

Global Infrastructure Partners has invested €780 million with DONG Energy to help fund a German offshore wind farm project known as Gode Wind I. Construction consisted of 55 wind turbines in the German North Sea, generating 330 megawatts of power under a 20-year operations contract. DONG Energy built the world's first offshore wind farm in 1991 and is a world leader in this technology. In 2012, the WSIB committed \$250 million in the fund that is backing this project.



OPERATING ENERGY-SMART BUILDINGS

Most of the WSIB's real estate partners focus on developing or owning energy-efficient buildings, incorporating simple but effective features such as low-flow plumbing, green walls and rooftops, automatic light-controlled LED fixtures, and high-efficiency variable air control heating/cooling systems. While these may not necessarily be the sexiest items, in combination they are powerful tools to dramatically reduce energy and/or water consumption. Adding to locational factors such as proximity to public transport, the result is impactful.



COOL INNOVATION IN AIR CONDITIONING

WSIB's longstanding partner in private equity investing, KKR, recently awarded its Eco-Innovation Award to Qingdao Haier, a Chinese designer and manufacturer of energy-efficient air conditioners for global markets. Increased use of air conditioners (expected to leap from 600 million units in 2015 to 1.5 billion by 2030, globally) is a significant factor in carbon emissions. Haier Intelligent Air Conditioners rely on 70% less refrigerant, cutting ozone impact to virtually zero, and consume 7% less in energy overall.



ENERGY-EFFICIENCY MEETS ELEGANCE

Taylor Morrison Home Corporation is one of the portfolio companies acquired by TPG, a WSIB private equity partner. As a national developer/builder of residential homes, the company stepped up to the challenge of energy efficiency. In select California communities, the company is installing solar systems as part of the standard home package for no extra out-of-pocket costs. Under the leadership of CEO Sheryl Palmer, the company has generated revenue growth while strengthening its brand by blending elegance and forward-thinking energy efficiency.



SOCIAL

KEY ISSUES

- ⊙ Gun manufacturing
- ⊙ Diversity
- ⊙ Labor relations
- ⊙ Supply chain management
- ⊙ Income inequality
- ⊙ CEO/workers pay ratios
- ⊙ Executive compensation

OUR STRATEGIES

- ⊙ Engage with companies and investment managers
- ⊙ Vote on ESG shareholder proposals
- ⊙ Collaborate with like-minded peer funds and industry groups
- ⊙ Report both approach and results (annual Proxy Voting and ESG Reports)
- ⊙ Influence the industry via select thought leadership and outreach
- ⊙ Invest via due diligence on financial and non-financial risks

MEMBERSHIP ORGANIZATIONS

- ⊙ The 30% Percent Coalition
- ⊙ Coalition for Inclusive Capitalism
- ⊙ International Limited Partners Association (ILPA)
- ⊙ World Economic Forum (WEF)
- ⊙ The Rise Fund

OUR RESULTS

- ⊙ Assessing social risks within the investment process
- ⊙ Calling for SEC direction on standards (e.g. pay ratio, say on pay)
- ⊙ Reduced pay inequalities through engagement
- ⊙ Governance/board-level oversight of these issues

FUTURE AIMS

- ⊙ Reduce pay inequalities through engagement
- ⊙ Advocate for clear and consistent standards for addressing socially driven investment risks

SOCIAL - GUNS

Investment exposure and response to an acute concern

- ⊙ In early 2018, the WSIB began receiving inquiries concerning investment exposure to gun manufacturers.
- ⊙ WSIB research into U.S. public equity holdings showed extremely light exposure (\$5.3 million or .004% of total assets) to four U.S. gun manufacturing companies as a result of these companies being included in passive, total-market index funds. Some fund choices in PERS Plan 3 allow retirement plan participants to opt for zero exposure to gun manufacturing, assuming they are invested in the defined contribution plan.
- ⊙ In anticipation of interest in this issue, the WSIB posted this information on its web site during February 2018

WSIB Investments Involving Gun Manufacturers

As part of the WSIB's \$128 billion investment portfolio, some of the funds are public equity index funds that are constructed by including a small, proportionately weighted share of essentially every publicly traded company in the U.S. stock market. The WSIB's U.S. public equity index funds currently result in approximately \$5.3 million of investments (as of December 31, 2017) in U.S. companies whose businesses include some form of gun or ammunition manufacturing. This represents investment exposure of .004 percent (about 4 cents of a \$1,000 investment). These investments do not represent any actively selected investment in these companies; they are a byproduct of passive index funds.

WSIB Investment Funds Void of Gun Manufacturing Exposure

In some cases, retirement plan beneficiaries have selected defined contribution retirement plans that allow the individual investor to select their own funds from a provided list of fund options. Among those options, the following funds currently include no exposure to gun manufacturing companies:

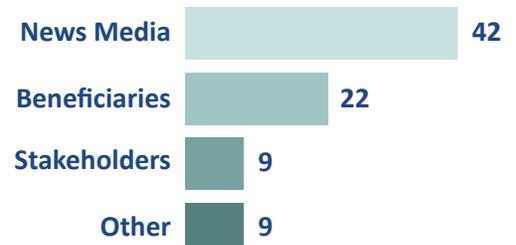
- ⊙ Short-Term Investment Fund
- ⊙ Washington State Bond Fund
- ⊙ Socially Responsible Balanced Fund
- ⊙ U.S. Large Cap Equity Index Fund
- ⊙ Savings Pool

WSIB's Approach to Social Issues

As a public fiduciary, the WSIB invests to generate maximum returns at prudent levels of risk. The WSIB does not divest or screen out specific companies or segments of the market in response to social or political mandates. The WSIB takes a purposeful approach to its fiduciary responsibility, and therefore engages closely with select industry groups and like-minded peer funds to advocate for desired changes. The Board also diligently exercises its shareholder rights by voting proxies on key corporate governance issues where its influence can help bring about positive change that aligns with its fiduciary mission.

WSIB INFORMATION REQUESTS, Q1 2018

The WSIB received an influx of gun-related questions from national and local news media (15 of 42 inquiries) and retirement plan beneficiaries (8 of 9 inquiries) during February 2018, in the wake of the Parkland, Florida school shooting. This chart shows a breakdown of total information requests for the first three months of the year.



SOCIAL - INVESTMENTS



BUILDING PUBLIC-TRANSIT ORIENTED HOUSING

The WSIB invests with an apartment developer in London that built the first ever purpose-built for-rent residential building in the city on top of a subway transit stop. This property provides residents with easy and convenient access to public transport, eliminating car-based commutes.

The WSIB has local investment partners in other cities around the world with similar strategies for locating residential property in close proximity to public transport nodes.



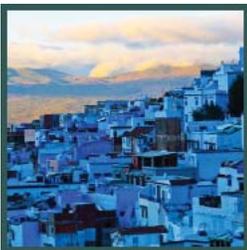
INVESTING IN IMPROVING OUR FOODS

The WSIB, through its private equity program with TPG, has helped to fund the success of Chobani, a leading producer of Greek yogurt in the U.S. Beyond yogurt, Chobani has created a Food Incubator Program to help other companies bring better food offerings to more people across the economy. The program looks for early-stage food innovators, provides access to free start-up capital, and places mentors with the companies they can tap into Chobani's own network of experts, retailers and investors. This is an investment with positive impacts across the food supply chain.



SUSTAINABILITY IN PET CARE

When the pet care chain Petco was purchased by one of WSIB's investment partners, part of the deal included an aggressive series of sustainability initiatives. This led to increased efficiencies and industry leadership toward better pet food/care products. The program included the hiring of an "energy manager," which enhanced recycling and reduced waste at the stores. New lines of natural products were introduced, and ethical sourcing of animals was increased dramatically. The company also began collaborating with the World Wildlife Foundation to bring together influential stakeholders seeking pet food sustainability and supply chain improvements.



STARTER HOUSING IN MOROCCO

In Casablanca, the largest city in Morocco, WSIB has a real estate partner that is building viable "social housing" for low-income residents. These homes are often the first "organized" housing in which these residents will have lived. The price point for these homes is the equivalent of US\$25,000, and the structures provide two- or three-bedroom residences.



HOME FINANCE/EDUCATION IN SOUTH AFRICA

WSIB's local investment partner in South Africa is providing home financing to lower-middle to middle-income housing to residents for which traditional mortgage financing is unavailable. The alternative for these people—many of whom are in professions not unlike some of WSIB's beneficiaries—is to save for many years to be able to pay cash for a home. In addition to financing, our partner provides required financial training, such as budgeting and banking, for people who previously may not have had bank accounts.



RISE: GLOBAL SOCIAL RESPONSIBILITIES

The WSIB's Innovation Portfolio is invested in the Rise Fund, a \$1 billion-plus social impact fund that is using its scale and global reach to generate positive financial and human results. This portfolio includes these entrepreneurial companies:

- ⊙ **Improving people's personal savings:** Acorns is a mobile-first personal savings and investment platform that educates users on financial topics while empowering them to save money, generate investment returns and improve their understanding of household finances. A micro-investing app provides services based on a flat-fee subscription model, so fees are low-cost and transparent. The idea is to make basic wealth building accessible to anyone with cell phone.
- ⊙ **Training coders for a New Economy:** Digital House Coding School is an educational company that is training workers in Latin America to become the next generation of computer coders. They offer learners of all ages the technical coding and digital skills necessary to participate in today's fastest growing economic sector.
- ⊙ **Data aid for relief organizations:** A tech company known as Dharma is creating a data platform that helps social/healthcare relief organizations by providing simplified, real-time data collection and analytics. By harnessing better data, NGOs gain actionable insights that improve frontline impacts for relief workers in the field. One of WSIB's private equity investment partners is funding this global company.

GOVERNANCE



KEY ISSUES

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

OUR STRATEGIES

- ⊙ Engage with companies and investment managers
- ⊙ Vote on ESG shareholder proposals
- ⊙ Collaborate with like-minded peer funds and industry groups
- ⊙ Report both approach and results (bi-annual Proxy Voting and annual ESG Reports)
- ⊙ Influence the industry via select thought leadership and outreach
- ⊙ Invest via due diligence on financial and non-financial risks

MEMBERSHIP ORGANIZATIONS

- ⊙ Council of Institutional Investors (CII)
- ⊙ Investor Stewardship Group (ISG)
- ⊙ Asian Corporate Governance Association (ACGA)
- ⊙ Focusing Capital on the Long Term (FCLT Global)
- ⊙ The Embankment Project
- ⊙ World Economic Forum (WEF)
- ⊙ Millstein Center

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

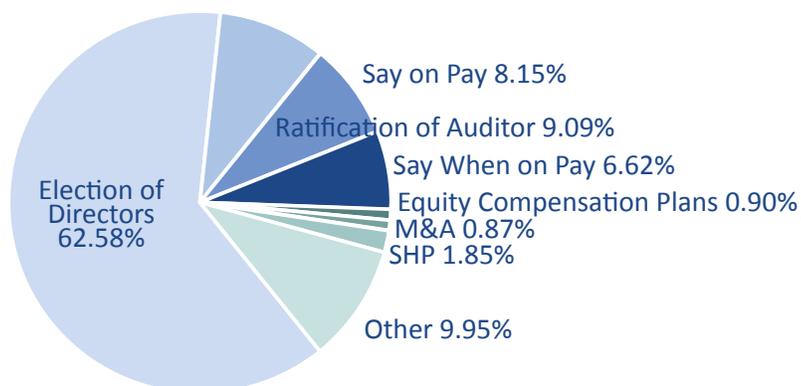
- ⊙ Lead collaboration across the value chain to promote responsible advancement of governance practices.

GOVERNANCE - PROXY VOTING

VOTING RECORD

In 2017, the WSIB voted in a total of 3,602 shareholder meetings. WSIB cast votes on a total of 35,681 individual proxy proposals dealing primarily with:

- ⊙ Election of Directors
- ⊙ Ratification of Auditor
- ⊙ Executive Compensation
- ⊙ Frequency of Say on Pay (Say When on Pay)
- ⊙ Others :Equity Compensation Plans and Mergers/ Acquisitions



EXECUTIVE COMPENSATION

Beginning in 2018, and as required by the Dodd-Frank Wall Street Consumer and Protection Act, companies are required to disclose the median annual total pay of all employees except the CEO, relative to the CEO.

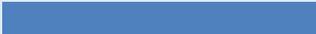
Proxy advisors, investors and academics are collecting and evaluating these disclosures, but there is not yet clear consensus for on how these disclosures will be used to form proxy advisory research or investor voting policies.

Key issues are:

- ⊙ Industry reluctance because reported data are “too new”;
- ⊙ Accounting methodologies vary widely, resulting in “apples” to “oranges” comparisons;
- ⊙ Variances in exchange rates, part-time workers, seasonal employees, and overseas employees; the SEC has purposefully allowed for varied approaches.

The WSIB recognizes that a large pay gap ratio is an investment risk and a sustainability/societal factor, and can further signal leadership succession issues and reputation risk. As such, we may consider flagging large ratios (i.e. 500:1 or more) for closer scrutiny when forming our executive compensation proxy voting decisions in future years.

Say On Pay Resolutions

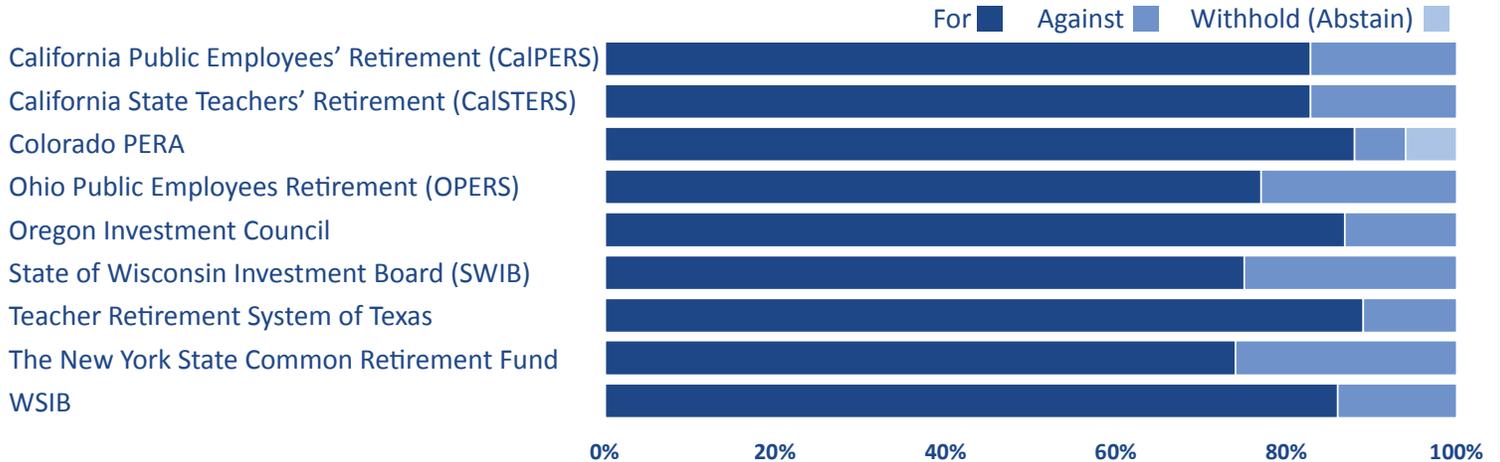
Yes  86%

No  14%

In 2017, of the 2,328 management proposals regarding advisory votes on executive compensation (Say on Pay), the WSIB voted against 337 (14%).

The WSIB voted against more than 113 compensation committee members for compensation-related issues.

This 2017 peer analysis shows how the WSIB's voting on "Say on Pay" compares to other leading state pension funds.

**ELECTION OF DIRECTORS**

- ⊙ Of the total 16,363 director votes in 2017, the WSIB voted "against" or "withhold" from 1,367 nominees (approximately 8 percent).
- ⊙ Primary concerns: lack of independence; egregious compensation practices; poor attendance; over-commitment to other board/executive roles.
- ⊙ Since 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act has required publicly traded companies to ask shareholders for an advisory vote on the company's compensation plans. Since the inception of this "say on pay" requirement, the WSIB has voted on the "no" side in 328 out of 1,975 advisory votes on management proposals for executive compensation (about one out of five times). When the WSIB voted against compensation plans, it was primarily due to a failure to align pay with performance.

GOVERNANCE - ENGAGEMENT VERSUS DIVESTMENT

What do we mean by “engagement”? As the 13th largest U.S. retirement fund in 2017, WSIB opts to engage with numerous companies, investment managers, other asset owners and influential industry coalitions. Engagement with these entities allows WSIB to cost-effectively leverage its financial impact and its influence in areas where real progress and change can occur. Examples of recent productive engagement include:

Advocating long-term investment disciplines as sustainability strategies, so companies, managers and asset owners will avoid reactionary use of “noisy” quarterly earnings reports.	Actively researching and committing to investments that promise to achieve financial outcomes while being positioned for long-term sustainability.	Voting WSIB’s proxies 90% in favor of climate change-related shareholder proposals during 2017, for U.S. public equity holdings, including key oil and gas company disclosures.	Industry leadership with the Millstein Center for an initiative promoting the “Changing Role of Corporations” (including broader community and environmental roles).
	Industry leadership on the need to improve diversity as a means to generating diversification of talent, along with diversification of investments.	Asking directly about climate change risks and diversity as part of the WSIB’s due diligence process with investment managers, general partners and companies.	Asking our investment partners: How do you assess climate risk?

WSIB VIEW: ENGAGEMENT/DIVESTMENT IN RESPONSE TO CLIMATE RISK?

ISSUES	ENGAGEMENT	DIVESTMENT
Investment performance	Allows broader diversification across all sectors; allows less constrained investment strategy; aligns with WSIB investment beliefs	Reduces diversification; creates market timing risks; other investors fill void in capital; encourages “green” concentration without regard to financial sustainability
Investment risk	Minimizes concentration of risk; allows investor to address risk issues directly with specific companies	More concentration of risk; erodes our ability to address risk issues with specific companies
Corporate governance and positive ESG influence	Exercises shareholder voting rights and allows directing of influence where it’s needed	Decreases shareholder voting ability and reduces opportunities to influence change
Integrity of investment process	Allows integration of climate risks factors as manageable and measurable part of investment process	Allows investment strategies to become beholden to varying political and social viewpoints, which may not represent fiduciary interests
Long-term discipline	Achievement of long-term investment discipline takes into account climate risks	Increases susceptibility to short-term swings in political and social views

The WSIB sees engagement practices as fully aligned with its duty as a public asset owner and fiduciary for Washington state's broad-based beneficiary population. Conversely, the WSIB views divestment practices as potentially costly, strategically impractical and largely in conflict with fiduciary responsibilities.

The fossil fuel divestment movement has grown over the last 6 years, with 837 institutions overseeing more than \$6 trillion in assets having committed to divest (or partially divest) according to divestment advocacy group Fossil Free. But it's worth noting:

- ⊙ The \$6 trillion number reflects total assets of institutions that have announced divestment; actual dollar amount sold is a fraction of this.
- ⊙ Divestment can be full (all fossil fuel), partial (coal only, separate accounts only), or a commitment to divest some share of fossil fuel holdings over time.

EXAMPLES OF WHAT "DIVESTMENT" ACTUALLY MEANS WHEN IMPLEMENTED

- ⊙ CalPERS sold 14 coal companies worth \$14.7 million (out of \$173.6 billion equity portfolio, 0.01%).
- ⊙ CalSTRS sold thermal coal companies worth \$9.8 million (out of \$128.9 billion equity portfolio, 0.01%).
- ⊙ NY City Employees plans to divest \$5 billion in fossil fuel holdings within 5 years (out of \$103.7 billion equity portfolio, 4.8%).
- ⊙ Stanford sold 3 coal companies held in separate accounts (commingled funds excluded); Yale sold 2 companies identified in discussions with external managers.

DOCUMENTED STUDIES

Numerous studies have documented the penalty in returns that investors have suffered as a result of fossil fuel divestment:

- ⊙ Cornell (2015) ran more than 2,000 simulations of university endowment portfolios over the last 20 years and concluded that divested portfolios had a risk adjusted return shortfall versus the market in 91% of cases.
- ⊙ Fischel (2015) concludes divestment results in much lower diversification and higher levels of risk in portfolios given the low correlation that energy tends to have with other sectors.
- ⊙ Bessembinder (2016) studied the frictional cost of divestment (transaction, monitoring, active management fees) and found a return drag of between 10 bps and 60 bps per year for a typical endowment portfolio.
- ⊙ Davies and van Wesep (2017) conclude divestment is counter-productive. Since most companies compensate managers with long-term options or stock grants, a temporary depression of the stock price actually increases managerial total compensation.

SUMMARY OF WSIB'S DIVESTMENT RESEARCH

- ⊙ Announced divestment actions have become increasingly visible during recent years.
- ⊙ Academic research concludes the effectiveness of divestment is questionable at best and highly detrimental at worst.
- ⊙ In the most optimistic scenarios—assuming large equity allocations and aggressive levels of divestment—well below 1% of total energy market cap has been divested.
- ⊙ Looking below the surface at what announced divestment actually means—separate accounts only, a fraction of all fossil fuel holdings, implementation over a number of years—true selling has likely been a fraction of perceived divestment.
- ⊙ Even with a high degree of selling, as long as profit-maximizing investors exist in the market, fossil fuel stocks will not suffer a permanent "divestment discount".
- ⊙ Earnings are what will drive stock returns.
- ⊙ Perhaps the best chance for divestment is to spur political action—such as a carbon tax—which would then likely impair earnings and stock prices.