State of Illinois
Office of the Illinois State Treasurer
ENVIRONMENTAL, SOCIAL AND GOVERNANCE INVESTMENT POLICY
Approved November 22, 2016

1.0 PURPOSE

This document sets forth the Environmental, Social and Governance ("ESG") Investment Policy ("Policy") for the Office of the Illinois State Treasurer ("Treasurer").

The purpose of the Policy is to outline the ESG factors that shall be applied by the Treasurer's internal and external investment managers in evaluating investment decisions and ongoing business relationships.

This Policy is designed to allow for sufficient flexibility in the execution of ESG investment responsibilities while setting forth specific ESG factors and industry-recognized best practices that are relevant to the Treasurer's investment portfolio and the evolving marketplace.

The Treasurer establishes and executes this Policy in accordance with applicable local, state, and federal laws.

2.0 AUTHORITY

Pursuant to the State Treasurer Act (15 ILCS 505), Deposit of State Moneys Act (15 ILCS 520), and the Public Fund Investment Act (15 ILCS 235), the Treasurer is authorized to serve as the fiscal agent for public agencies and specific program participants for the purpose of holding and investing assets.

The investment policy statements for the assets under the stewardship of the Treasurer specify that the Treasurer, while acting in accordance with its fiduciary duty, shall seek to integrate ESG factors into investment decision-making, risk management, due diligence, and investment ownership.

3.0 PHILOSOPHY

The Treasurer seeks to invest all funds under its control in a manner that maximizes the safety of principal and provides the highest investment return for beneficiaries using authorized instruments. To achieve this objective, the Treasurer has a responsibility to recognize and evaluate risk factors that may impact the safety or performance of its investments.

An essential part of effective investment stewardship and risk management is identifying good governance practices. Good governance mitigates investment risks and may provide collateral benefits to the beneficiaries of the assets under the Treasurer's stewardship.

In addition to governance attributes, environmental and social issues are to be weighed very seriously from a fiduciary and financial perspective. Environmental and social factors may pose short-term and long-term risks to investments, and as such, the Treasurer is focused on environmental and social factors that may have a material impact on the safety of principal and investment performance.

4.0 CORPORATE GOVERNANCE FACTORS

The Treasurer supports board accountability, transparency, sensible executive compensation programs, robust shareholder rights, and ethical conduct as key governance factors. The Treasurer advocates for policies and practices in support of these factors.

a) **Board Accountability**

   The board of directors is elected by the company's shareowners and is accountable to them. The role of the board is to represent shareowners' interests in their oversight of management.

   The board of directors must maintain a level of independence from management to exercise proper oversight. The Treasurer considers an independent director to be one who: (1) is not an executive of the company, (2) does not have direct familial ties with executive management, (3) does not have significant business ties to the company, and (4) is not a significant shareholder.

   A board comprised of diverse directors is better equipped to ensure multiple perspectives are taken into account. Diversity is inclusive of skill sets, professional backgrounds, gender, race/ethnicity, and sexual orientation.

b) **Transparency**

   With due respect to proprietary information, companies should strive to be transparent in their business operations. Disclosure concerning matters of shareowners' interest, such as those items outlined in this Policy, provides useful information and mitigates risks inherent with undisclosed matters.

   Transparency and accuracy in the reporting of fees to the Treasurer from service providers is also essential to secure competitive rates.

c) **Sensible Executive Compensation Programs**

   Excessive executive compensation programs may signal board entrenchment and exacerbate income inequality. Executive compensation should be reflective of company performance and within a reasonable range of compensation levels at peer companies.

The Treasurer believes an annual vote on executive compensation is a better option than a biennial or triennial vote because it affords shareholders the opportunity to provide the company's compensation committees more timely feedback about the appropriateness of executive pay levels, which typically are decided on an annual basis.

d) **Robust Shareholder Rights**
Shareholders should be given tools to convey their perspectives to the board of directors, which serves as their representative body. Tools that provide shareowners with the appropriate mechanisms for communication include the ability to (1) call a special meeting, (2) act by written consent, and (3) have access to the proxy to nominate their own candidate(s) for the board assuming certain threshold requirements.

In addition, a majority voting standard for the election of directors ensures that directors have the confidence of their constituents.

Boards of directors should also be declassified to enable shareholders to weigh-in on each director on an annual basis.

e) **Ethical Conduct**
Companies conducting business with or in receipt of investments from the Treasurer must comply with all laws and regulations under which they are governed. Further, the Treasurer expects companies to meet (if not exceed) all applicable ethical and professional standards of conduct.

5.0 ENVIRONMENTAL FACTORS

Environmental stewardship is a shared responsibility. Furthermore, environmental and climate-related factors may have adverse impacts on the Treasurer's investment portfolio. Accordingly, the Treasurer recognizes that climate change, sustainability, and environmental innovation are key factors for consideration in mitigating risk exposures.

a) **Climate Change**
Climate change has serious risk implications for investors and the businesses in which they invest. Shifts in temperature, weather patterns, and rising sea levels impact supply chain, consumer demand, physical capital, and communities. Extreme weather events are occurring on a more frequent basis and with increasing intensity. Events such as droughts, floods, and storms may lead to scarce resources and disruptions in operations and workforce availability.

b) **Sustainability**
Companies should consider how the environment and related regulation will impact operations and vice versa. Routine assessment of the nexus of operations, natural resource dependency, and the environment may be communicated to investors through sustainability reports. Quantitative reporting on environmental risks,

policies, performance, and goals assures investors that companies are aware of potential risks and seeking to mitigate them appropriately.

c) **Environmental Innovation**
A company's awareness of environmental risks and opportunities may have a significant impact on its operational capacity, financial position, and long-term sustainability. With new environmental technologies, regulations, and business strategies rapidly developing (e.g.,. carbon pollution regulations and energy efficiency opportunities), it is important that companies maintain the knowledge and innovation to capitalize on these evolving changes. This may include, among other strategies, maintaining a board member or senior executive with expertise or ample experience with environmental science and technology.

6.0 SOCIAL FACTORS

Social factors may impact investment returns, particularly if companies become involved in controversies that pose risks to their reputation. Human capital management, human rights, and community reinvestment are key social factors that warrant particular attention.

a) **Human Capital Management**
Companies that consider their workforce to be an important asset should manage their human capital with as much care and analytical insight as they manage their physical and financial capital. The value of the workforce should be measured and improved through company investment.

Employers also should respect the right of their workers to organize under collectively bargaining agreements.

Employers should provide a working environment that upholds health and safety standards.

b) **Human Rights**
Companies have a legal duty to adhere to internationally recognized labor and human rights standards. Beyond the legal requirements, companies risk losing their social license to operate if they contribute to human rights abuses throughout their supply chain. The United Nations' "Guiding Principles on Business and Human Rights" sets out corporations' responsibility to respect human rights. Companies should regularly assess and seek to minimize any negative impact caused by their operations.

c) **Community Reinvestment**
The Treasurer wants to encourage an open and effective banking system that grows local communities and boosts Illinois' economy. Pursuant to the Deposit of State Moneys Act (15 ILCS 520/16.3), the Treasurer is authorized to consider a financial institution's record and current level of financial commitment to its local community

when deciding whether to deposit State funds in that financial institution. As such, the Treasurer shall consider applicable firms' level of community reinvestment when undertaking investment decision-making.

7.0 POTENTIAL ACTIONS

The Treasurer may undertake various activities to advance the aforementioned key factors, including, but not limited to:

1. Casting proxy votes in accordance with fiduciary duty and within policy guidelines;
2. Engaging corporate decision-makers on ESG concerns;
3. Working in coalition with other institutional investors and with thought-leadership organizations;
4. Submitting shareholder proposals to companies for inclusion in the annual stockholders' general meeting;
5. Weighing in on the public policymaking process as it pertains to the investment landscape generally and ESG issues specifically;
6. Tracking and evaluating investment managers on ESG criteria; and
7. Tracking and evaluating counterparties and debt securities issuers on ESG criteria.