THE STRUGGLE TO IDENTIFY ESG BEST PRACTICES IN THE U.S.
ESG PRODUCT SCREENS ON THE EVESTMENT PLATFORM

![Bar chart showing ESG product screens over time, with categories for Missing Data, Criteria Not Met, and Passed Screens.]
Today’s Session Will Cover

- How does Environmental, Social & Governmental (“ESG”) Investing fit within the broad universe of Socially Responsible Investing ("SRI")?

- Why are institutional investors talking about ESG and how are they allocating?

- General considerations for ESG investing
  - Investment selection and criteria
  - Legal and fiduciary ramifications

- Portfolio and performance considerations for ESG investing
  - Universe of investments
  - Performance of investments
  - Appropriate benchmarks
The Universe of SRI is Wide, but not Well-defined

All ESG is SRI, but not all SRI is ESG.

Key Takeaway
## What is ESG Investing?

<table>
<thead>
<tr>
<th>Socially Responsible Investing</th>
<th>ESG Investing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Selection Process: Negative</strong></td>
<td><strong>Selection Process: Positive or Negative</strong></td>
</tr>
<tr>
<td>▪ Attempts to screen out investments in stocks, companies or industries based on a set of ethical values.</td>
<td>▪ Integrates environmental, social and governance criteria into fundamental investment analysis to the extent they are material to investment performance.</td>
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<tr>
<td>▪ (Anti-pornography, private prisons, carbon, coal, Iran, Sudan, fossil fuel, etc.)</td>
<td>▪ (Shorting or not investing in company with governance issues such as bribery, tax evasion)</td>
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</tbody>
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<th>Impact Investing</th>
<th>Mission Related Investing</th>
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<td><strong>Selection Process: Positive</strong></td>
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<td>▪ Looks for investments that have a positive investment return as well as desired social, economic or environmental outcome.</td>
<td>▪ Places investments with companies or funds that complement the investor’s mission.</td>
</tr>
<tr>
<td>▪ (MWBE, alternative energy, micro-funding)</td>
<td>▪ (Healthcare, senior issues, child issues, religious)</td>
</tr>
</tbody>
</table>
Investment Selection Criteria

**SRI: Fundamental Values Drive Investment**

- **Values**
- **Impact**
- **Mission**

**ESG: Fundamentals + Values Drive Investment**

- **Fundamentals**
- **ESG (if material)**
- **Buy or Sell**

An ESG consideration would be considered “material” to the extent it is believed to impact (positively or negatively) the investment’s current or future value.
What Does ESG Encompass?

Corporate Governance
- Transparency
- Disclosure
- Reporting
- Incentives

Environmental Factors
- Use of water
- Alternative energy
- Climate change
- Clean technology

Social Challenges
- Improving working conditions
- Fair treatment of minorities and ethnic groups
- Investments focused on improving the lives of women and girls

Deutsche Bank 2012 Study “Sustainable Investing: Establishing Long Term Value & Performance”
Eight studies linked strong corporate governance to financial outperformance versus five Environmental and one Social.
Who Cares About ESG Investing?

Source: Spectrem Group, Paxworld Investments, Calvert Investments
ESG In The News

Exclusive: World Bank's pension investments clash with principles

By AMANDA WHITE | MAY 22, 2015

In what promises to be a transformational moment for ESG integration and investment manager accountability, CalPERS will require all of its managers to identify and articulate ESG in their investment processes.

Source: Top1000Funds.com, Reuters
Type of Investors and ESG Mandates – 2009-2015

- Largest SRI/ESG investor group is foundations with 38 total.
- 103 total SRI/ESG mandates out of roughly 3040 per year on average.

Note: ProCoal is shorthand for firms that considered divesting of fossil fuels but decided not to do so.

Source: Aon Hewitt Analysis of mandates reported to FinSearches database.
Growth of Broad Socially Responsible Investing RFPs 2009-2015

Number of Investor Mandates By Year

Out of roughly 21,282 searches over the period

Source: Aon Hewitt Analysis
Are Institutional Investors Choosing ESG?

Have you incorporated ESG factors into your investment decisions?

- **2015**
  - No 68%
  - Yes 29%
  - Not sure 3%

- **2014**
  - No 72%
  - Yes 26%
  - Not sure 2%

- **2013**
  - No 72%
  - Yes 22%
  - Not sure 2%

Source: Callan Investment Institute ESG Study 2015 (242 institutions / $2.4 trillion)
Why Are Investors Choosing ESG?

Why has your fund incorporated ESG factor into investment decisions?

Source: Callan Investment Institute ESG Study 2015 (242 institutions / $2.4 trillion)
Why Are Investors NOT Choosing ESG?

Why has your fund NOT incorporated ESG factor into investment decisions?

Source: Callan Investment Institute ESG Study 2015 (242 institutions / $2.4 trillion)
The Principles for Responsible Investment ("PRI") is a global organization dedicated to spreading ESG awareness and investment. It is sponsored by two United Nations entities with 1,380+ voluntary signatories representing USD59T in AUM.

Although there is no “industry standard” in ESG investing thus far, the PRI has the most traction as a universal ESG code of investing.

PRI estimates that 14% of pensions are PRI signatories (19% of all asset owners)

While most asset owner signatories are based outside the U.S., U.S. asset owner signatories include: CalPERS, CalSTRS, Harvard, LACERA, Maryland State Retirement, NYC Employees, NY State Local Employees, IL State Retirement System, Teachers Retirement of NY, UAW, World Bank Retirement, United Nations Foundation, University of California

Asset managers are more likely to sign the PRI, either to secure investors or for marketing purposes. Nine-hundred and fifty-five (955) asset managers are PRI signatories, including firms like BlackRock, BMO, AQR, Franklin Templeton, GLG, Goldman Sachs, PIMCO.
Current Geographic Breakdown of PRI Asset Owner Signatories

- US PRI Signatories: 7.9%
- Canada PRI Signatories: 8.9%
- Rest of World PRI Signatories: 83.2%

Source: PRI Website Analysis February 2016
Current Spectrum of ESG Integration

**Full Integration**
- Investor and managers implement ESG policies
- Divestitures may occur
- Examples: CalSTRS, CalPERS

**ESG Guidelines**
- ESG considerations added to investment policy document
- Examples: CRPTF, Harvard

**ESG Allocation**
- Some portion of plan allocated towards ESG investments
- Examples: NY Common ($5bn low carbon, sustainable energy), WSIB (allocation to Walden Asset Management for DC plan)

**Governance**
- Articulation of ESG policies in proxy voting or governance policies OR
- Strong focus on corporate governance
- Examples: PSERS (board diversity), Florida (bought MSCI database to facilitate), NYSTRS (“unsigned” PRI but remain committed to strong governance), Michigan, Colorado PERA

**No Action**
- No action specific to ESG
- Currently largest group of investors

Source: Publicly available information on plan websites, media outlets
U.S. Fiduciary and Legal Considerations for SRI/ESG Investing

- IRS ruling in August 2015 allows that: “Foundation managers were not required to select only investments that offer the highest return, lowest risks or greatest liquidity, though they must exercise the ordinary business care and prudence in making investment decisions that support, and do not jeopardize, the furtherance of the private foundation’s charitable purposes.”

- An October 22, 2015 ruling by the Department of Labor found “that the consideration of ESG factors in investment decisions does not violate a pension plan sponsor’s fiduciary duty and noted that such factors can have financial benefits in addition to social benefits…Fiduciaries need not treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take into consideration environmental, social, or other such factors.”
Meta-data on SRI Performance Studies

Source: AP7 The Performance of Socially Responsible Investment
What Other Issues Can Arise In ESG Investing?

The Vanguard FTSE Social Index Fund includes:

- Paid more in fines than any company in history (2008 financial meltdown)
- Testified before congress for dropping customers when they got sick
- Labor issues, contributor to obesity crisis
- Repeatedly investigated for animal cruelty
- Contributor to obesity crisis

Source: Motley Fool