



# Environmental, Social & Governance (“ESG”) Investing

## Considerations and Approaches

**August 2021**

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## Learning Objectives

Gain a broader and clearer understanding of the following:

- 1 ESG and other sustainable investment options
- 2 ESG trends, challenges, and concerns
- 3 The information, tools, and resources utilized by investors to perform ESG analysis
- 4 The risks evaluated through an ESG approach and how these risks vary by issuer
- 5 The performance of ESG fixed income and equity indices and sustainable investment funds
- 6 Steps, factors, and objectives to consider when developing an ESG investment approach



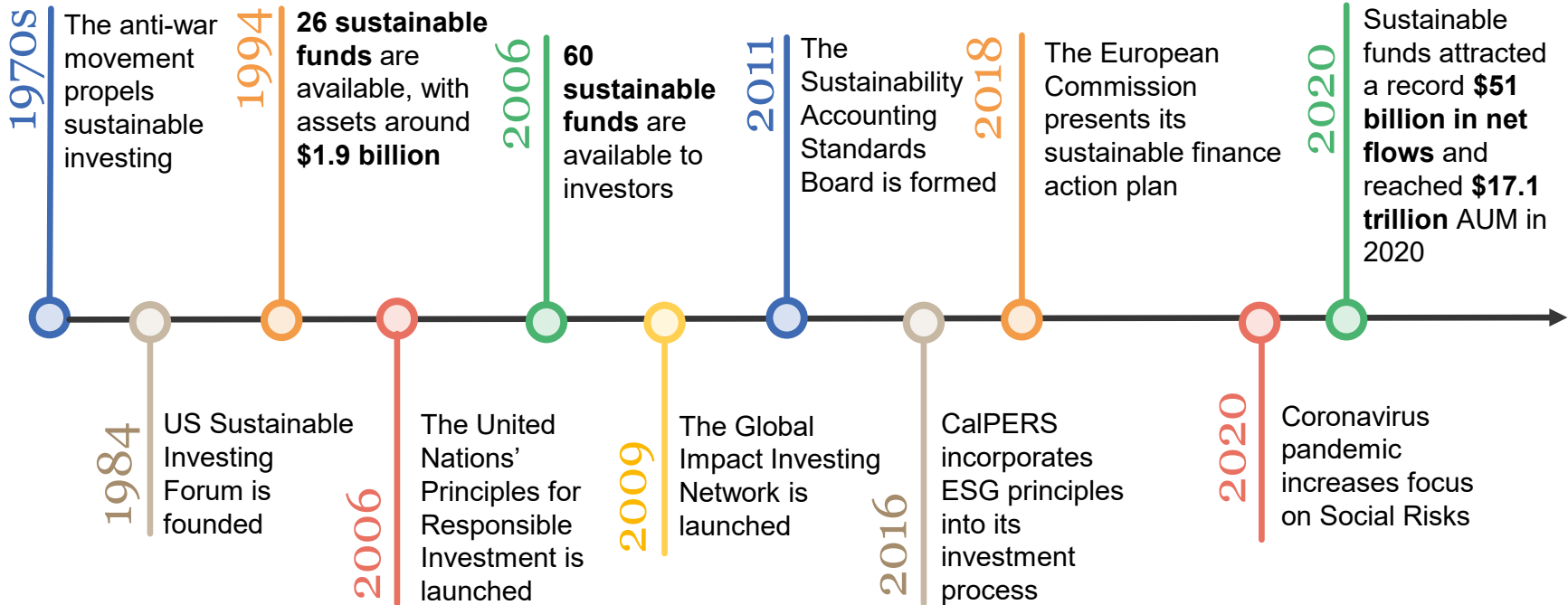


# Introduction to ESG & Sustainable Investing





## The History of Sustainable Investing





## Approaches to Sustainable Investing



### SRI

Avoid socially adverse industries like fossil fuels, tobacco, alcohol, and weapons

Exclusionary



### ESG Integration

Systematically consider impact of environmental, social, and governance risks

Risk Management



### Thematic

Align objectives with values, such as UN PRI Sustainable Development Goals

Goals Driven



### Impact

Seek companies that have a direct impact on positive societal change (clean energy)

Social Outcome



## What is ESG Investing?

- ESG investing is a sustainable investment approach
  - More inclusive than Socially Responsible Investing (exclusionary approach)
  - Broader in scope than Thematic and Impact investing
- Incorporates **measurable non-financial ESG factors** into an investment analysis

### ENVIRONMENTAL

How a company limits its environmental impact and carbon footprint



Climate Change



Air Pollution



Deforestation



Water Pollution

### SOCIAL

How a company treats its employees, customers, community, and other companies it interacts with



Data Protection



Human Rights



Gender & Diversity



Community Relations

### GOVERNANCE

How a company is led and managed, including executive pay and any internal controls



Board Composition



Bribery & Corruption



Lobbying



Executive Compensation





# ESG Trends, Challenges, and Concerns

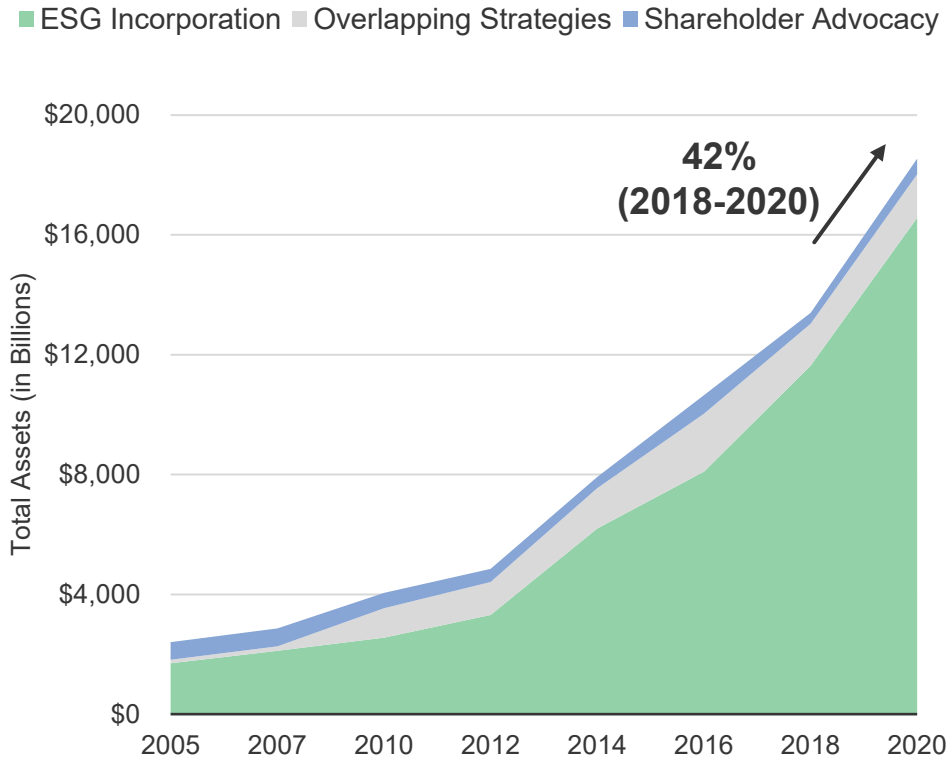




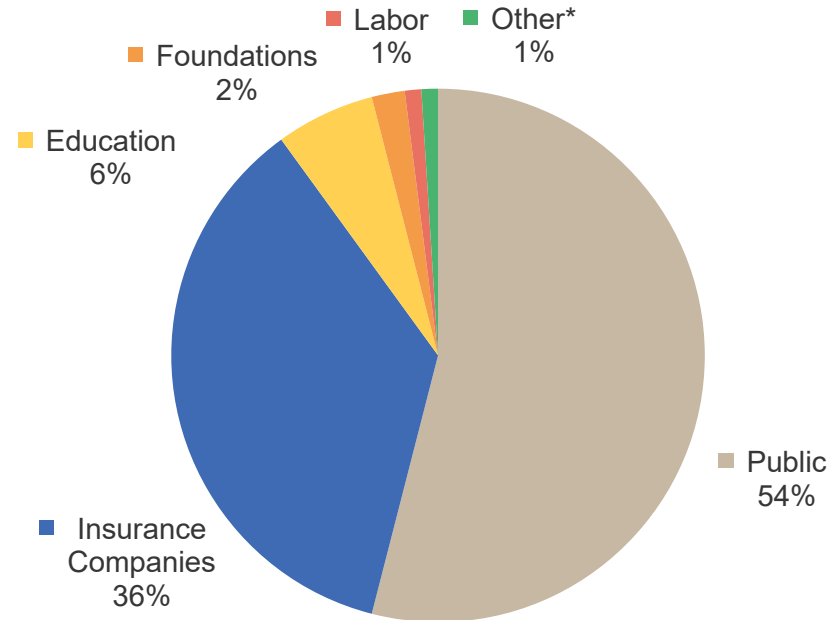


# Sustainable Investing Continues to Grow Rapidly

## Sustainable Investing in the United States 2005-2020



## Institutional Investor ESG Assets, by Investor Type, 2020

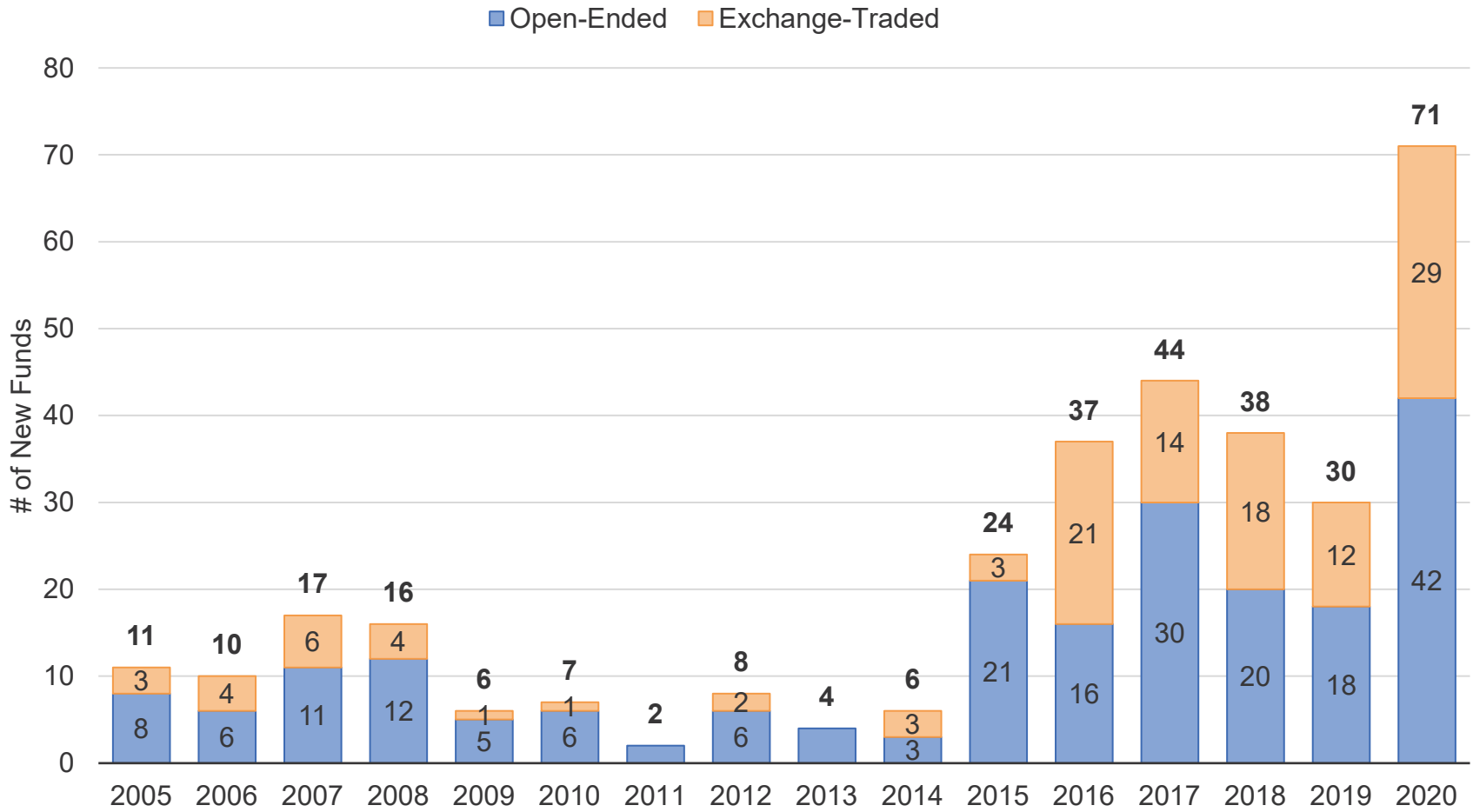


\*Other consists of family offices, healthcare institutions, faith-based institutions and other nonprofits that collectively represent about 1 percent of ESG assets in 2020

Source: US SIF Foundation 2020 Report on US Sustainable and Impact Investing Trends



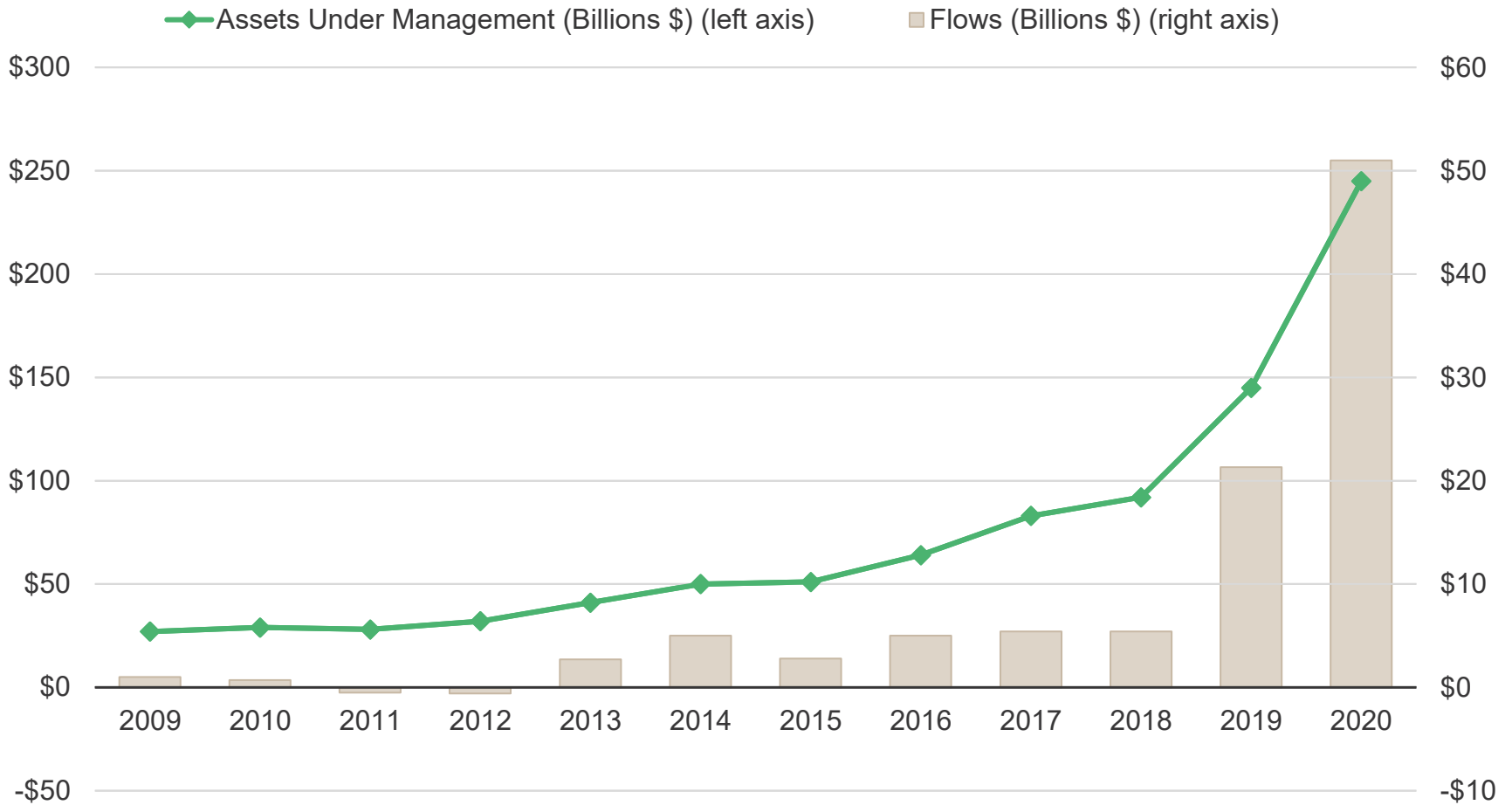
## ESG Trends: New Sustainable Fund Launches



Source: Morningstar, "Sustainable Investing: The Evolving Landscape & the Path Forward." Published 2021.  
Note: 40 open-end funds in the report were launched between 1971 and 2004. The earliest ETF launch was in 2005.  
Includes 20 funds that subsequently have liquidated. Does not include original launches of funds that have subsequently repurposed.



## ESG Trends: Fund Flows and Assets



Source: Morningstar, "Sustainable Investing: The Evolving Landscape & the Path Forward." Published 2021. Data as of 12/31/2020. Includes Sustainable Funds as defined in Sustainable Funds U.S. Landscape Report, Feb. 2020. Includes funds that have been liquidated; does not include funds of funds.



## Why Do Investors Implement an ESG Investment Approach?

Alignment of Objectives  
With Values

External Pressures

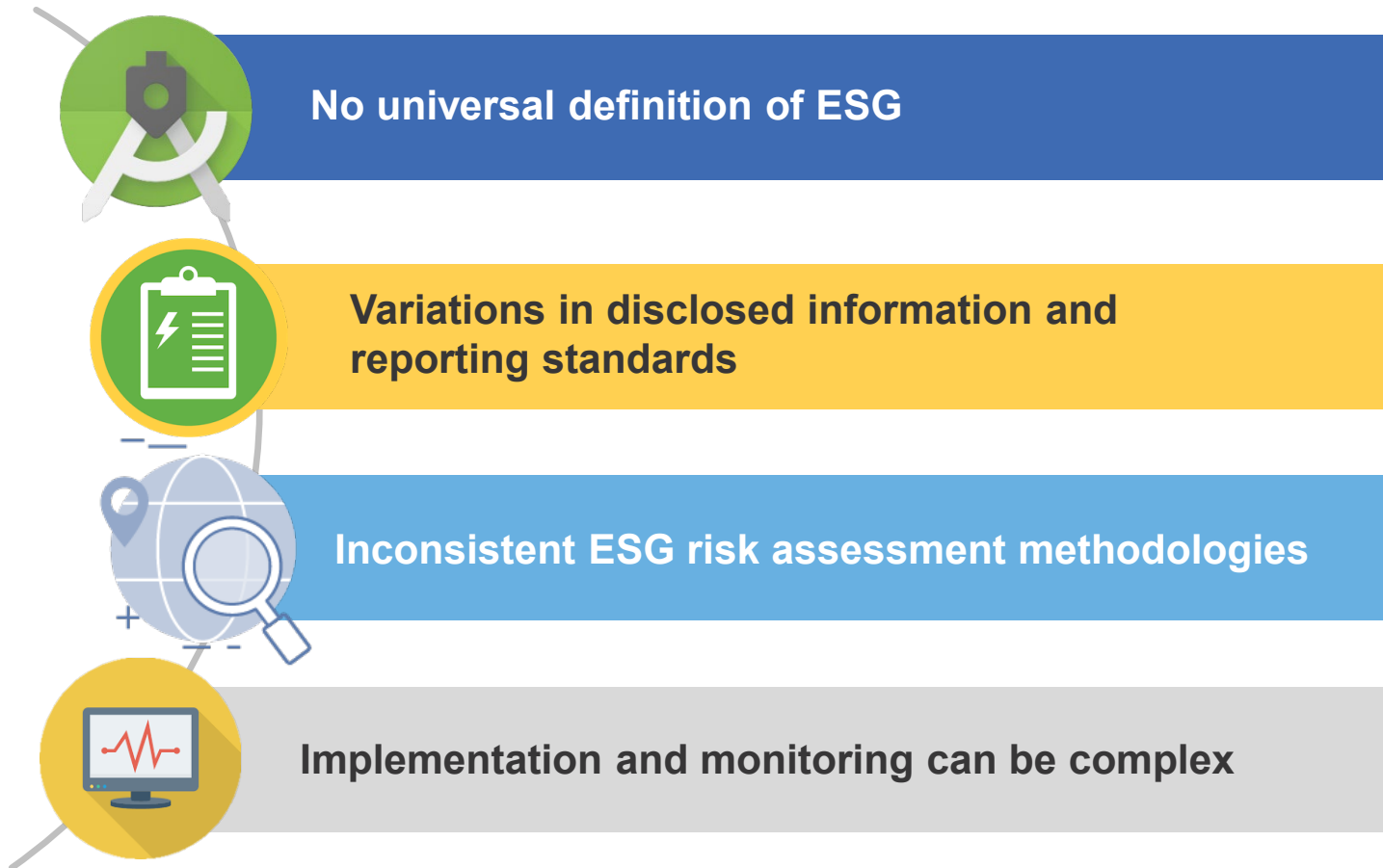
Risk Management

Seek Competitive Returns





## ESG Challenges and Concerns for Investors

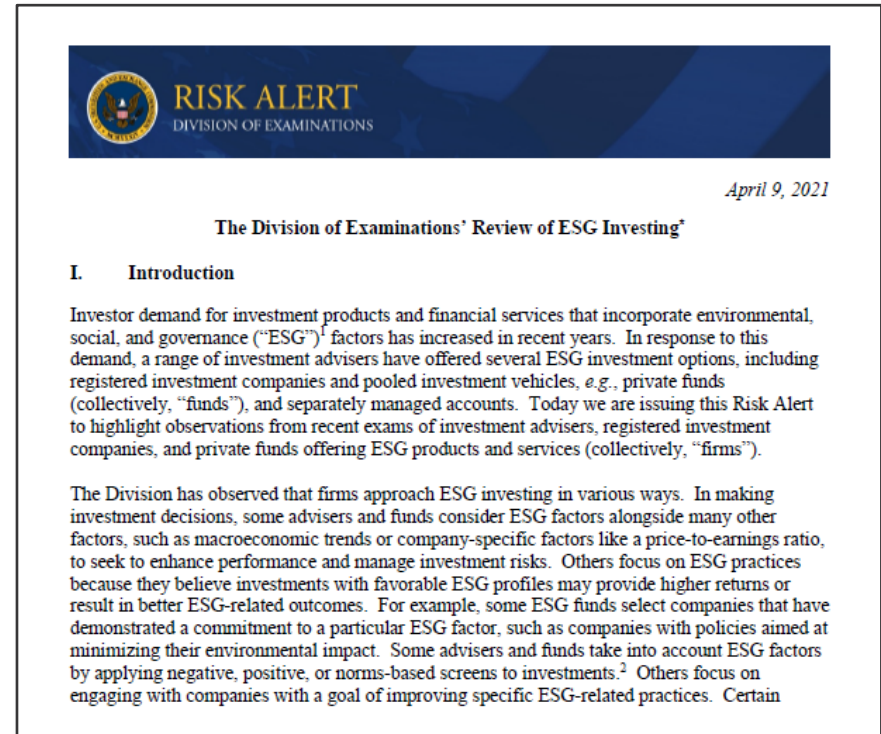






## The SEC Is Paying Close Attention to ESG Investing

- The SEC issued a Risk Alert on April 9, 2021 that raised the following concerns related to ESG investing:
  - Inconsistent portfolio management practices
  - Inadequate internal controls
  - Inconsistent marketing materials and disclosures
  - Proxy voting practices that are not consistent with stated approaches
  - Unsubstantiated or potentially misleading claims regarding ESG approaches
  - Compliance programs that did not adequately address ESG issues
- **SEC is encouraging investment managers to “say what you do, do what you say.”**



Source: SEC Risk Alert, April 9, 2021.



# Information, Tools, and Resources





## ESG Tools & Resources

### Disclosure Frameworks & Standards

TCFD



### Data Collectors & Information Providers

FACTSET

REFINITIV

Bloomberg



### Analytics Providers



S&P Global

MOODY'S

### Non-Profits



THE WORLD BANK



US | SIF



# ESG Tools & Resources Continued (continued)

## Individual Issuers

**2019 BUSINESS & SUSTAINABILITY REPORT**

THE Coca-Cola COMPANY

BETTER SHARED

**WORLD WIDE**  
We are honored to get our energy and resources from a diverse range of local suppliers. We are committed to reducing our environmental footprint through responsible sourcing and waste management. Our goal is to ensure that our products are made with the highest standards of sustainability.

**2019 BUSINESS & SUSTAINABILITY REPORT**

THE Coca-Cola COMPANY

BETTER SHARED

88% of our packaging is made from recycled materials.

10% recycled material in PET plastic packaging globally.

500+ Brands, 4,700+ Products

2019 GLOBAL LIGHT CASE VOLUME BY REGION

2% Global Volume

18% North America, 27% Latin America, 29% Europe, 24% Asia Pacific

**Honda Sustainability Report 2020**

HONDA

**Strategy**

Honda's 100th Anniversary

2020 Vision

Direction for 2030

Mid-term

Honda's 100th Anniversary

Sustainability Strategy

Stakeholder Engagement

Research and Development

Innovation Management

Business for sustainable growth

Continued growth as a company

Creation of new value

New Transformation

Transformation

Existing business

Forecasting perspective

Mid-Range

Backcasting perspective

2020

2030

Honda's Initiatives and the SDGs

Sustainability Management Structure

Stakeholder Engagement

Research and Development

Innovation Management

Product Diversification

Manufacturing Innovation

Customer Innovation

Customer Innovation

Customer Innovation

**SUSTAINABILITY REPORT 2019**

ROYAL DUTCH SHELL PLC

**DELIVERING ENERGY RESPONSIBLY**

**HUMAN**

Visit [www.shell.com/sustainability/transparency/humanrights](http://www.shell.com/sustainability/transparency/humanrights) for more on our policy and procedures towards human rights.

Approach to human rights

Commitment to human rights

Labour rights

Access to remedy

Focus areas

Supply chains

Communities

Security

Shell General Business Principles

Code of Conduct

Shell Supplier Principles

Community Feedback Mechanisms

Shell Global Helpline and Internal Channels

For more information on our approach, see Contribution to society.

SUSTAINABLE DEVELOPMENT GOALS

Goal 13: Climate action

The world needs to take action to battle climate change. The Paris Agreement set a goal of holding the rise in global average temperature this century to well below two degrees Celsius above pre-industrial levels.

Everyone in society has a role to play to achieve the Paris goals, and Shell intends to play its part. We continue to work towards delivering on our Net Carbon Footprint ambition to cut the intensity of the greenhouse gas emissions of the energy products we sell by around 20% by 2025, and 20% by 2035 compared with our 2016 levels.

Sources (left to right): Coca Cola 2019 Sustainability Report, Honda 2020 Sustainability Report, and Shell 2019 Sustainability Report.



# Example Resources – ESG Analytics Provider

## Risk Rating Report

**Company Name**  
Diversified Banks United States NYS:WFC

**ESG Risk Rating**  
**33.1** +2.3 **High Risk**  
Updated Aug 5, 2021 Momentum

**ESG Risk Rating Category Distribution**

**ESG Risk Rating Ranking**

UNIVERSE	RANK	PERCENTILE
Global Universe	9448/13581	75th
Banks Industry	638/1003	63rd
Diversified Banks Industry	219/293	66th

**Peers Comparison**

Peers (Market cap \$160.3 - \$212.1bn)	Exposure	Management	ESG Risk Rating
1. Sberbank Russia PJSC	47.9 Medium	57.8 Strong	21.7 Medium
2. China Construction Bank Corp.	47.8 Medium	34.9 Average	32.1 High
3. Agricultural Bank of China	48.2 Medium	35.6 Average	32.1 High
4. China Merchants Bank Co., Ltd.	45.1 Medium	29.5 Average	32.4 High
5. Wells Fargo & Company	56.6 High	44.6 Average	33.1 High

SUSTAINALYTICS a Morningstar company © 2021 Sustainalytics. All rights reserved. Page 1 of 79

## Product Involvement

**PRODUCT INVOLVEMENT REPORT**

**Company Name**  
Marketcap: 399,446 mm. USD Updated: 19 October 2020  
Domicile: United Ticker: NYS:WMT Employees: 2,300,000

**Product Involvement**

- Abortion
- Adult Entertainment
- Alcoholic Beverages
- Animal Testing
- Arctic Oil & Gas Exploration
- Cannabis
- Contraceptives
- Controversial Weapons
- Fur and Specialty Leather
- Gambling
- Genetically Modified Plants and Seeds
- Human Embryonic Stem Cell and Fetal Tissue
- Military Contracting
- Nuclear
- Oil & Gas
- Oil Sands
- Palm Oil
- Pesticides
- Pork Products
- Predatory Lending
- Risk Control
- Shale Energy
- Small Arms
- Thermal Coal
- Tobacco Products
- Waste Meat

**Alcoholic Beverages**

The company derives revenues from the distribution and/or retail sale of alcoholic beverages.

Range: 64.3%  
Revenue Percentage: 2.5%  
Revenue Analysis Source: Estimated

Walmart Inc. engages in the retail and wholesale operations in various formats. Among its grocery products, the company also offers alcoholic beverages, such as wine and beer. Given the wide range of products offered, according to Sustainalytics' revenue estimation rules, it is estimated that revenues from alcohol retail accounted for 2.5% of total revenues in FY2019.

SUSTAINALYTICS a Morningstar company 1 | 3

## Controversy Report

**CONTROVERSY REPORT**

**Company Name**  
Marketcap: 187,209 mm. USD Updated: 28 February 2021  
Domicile: United States Ticker: NYS:WFC Employees: 268,531

**Controversy Summary**

**Qualitative Performance - Controversies**

5 Highest Controversy Business Ethics Incidents Business Ethics  
1 Low Product & Service Incidents Business Ethics  
2 Moderate Product & Service Incidents Business Ethics  
3 Significant Employee Incidents Business Ethics  
4 High Customer Incidents Business Ethics  
5 Severe Customer Incidents Business Ethics

**Distribution of Controversy Assessments**

Operations Incidents Environmental Supply Chain Incidents Product & Service Incidents Employee Incidents Social Supply Chain Incidents  
Customer Incidents Society & Community Incidents Business Ethics Incidents Governance Incidents Public Policy Incidents

Incidents  
Headquarters

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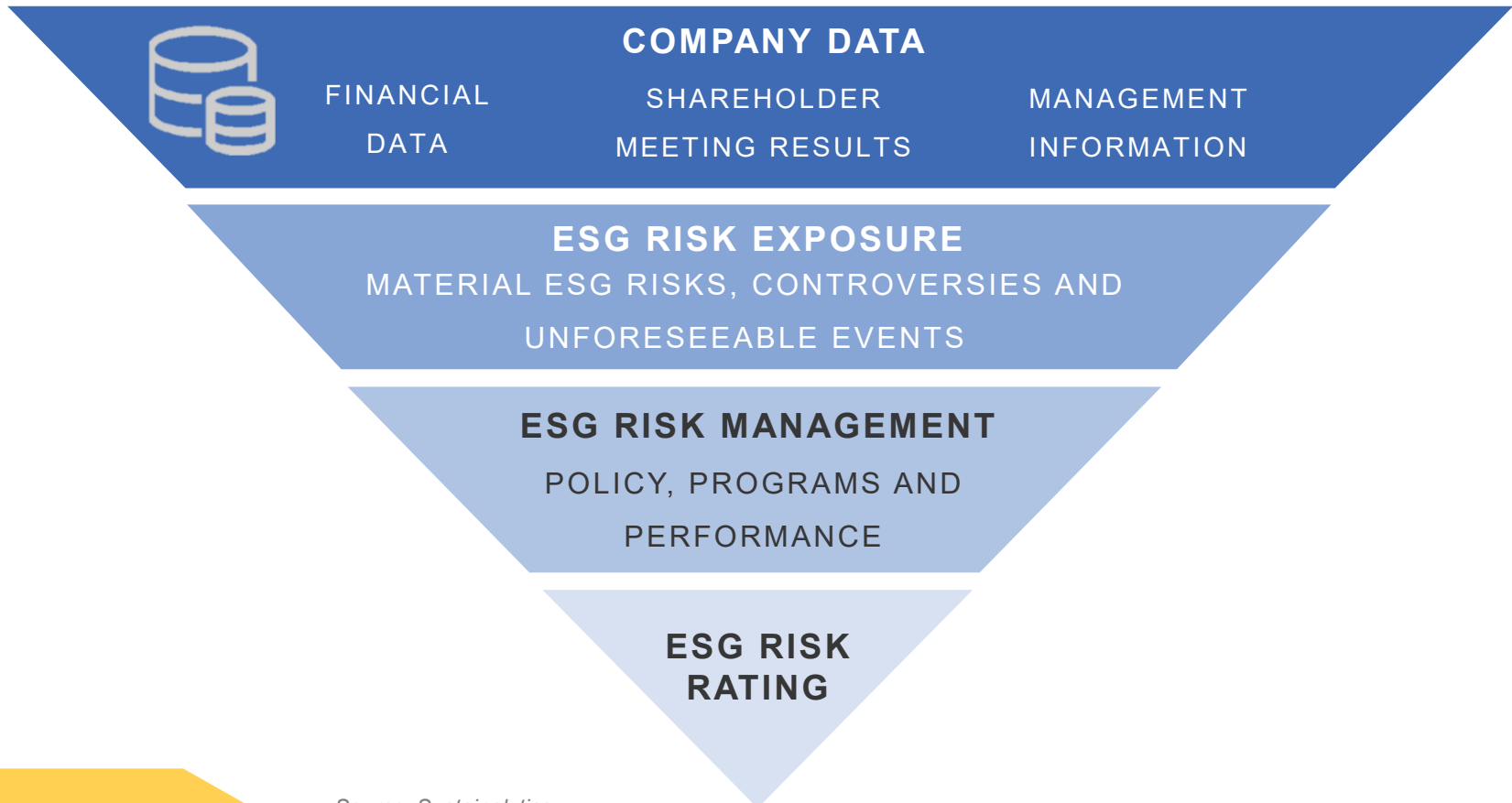
# Evaluating ESG Risks





## How is ESG Risk Measured?

- Evaluation focuses on exposure to, and management of, **material ESG risks**
- Ineffective management of material ESG risks could have a significant financial impact on company performance and enterprise value



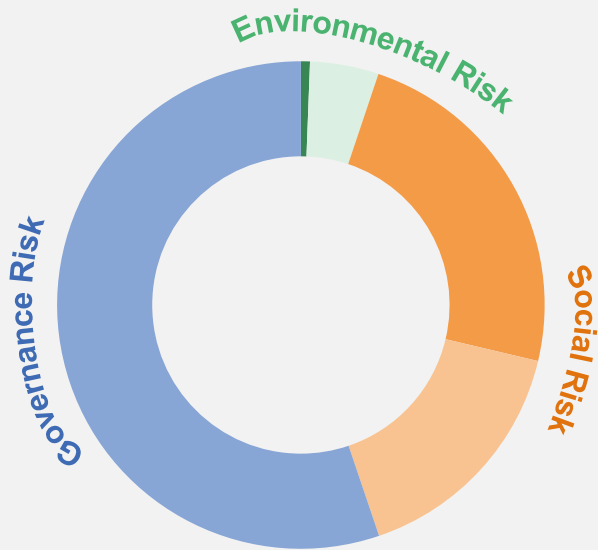


## Example: Comparing & Evaluating ESG Risks

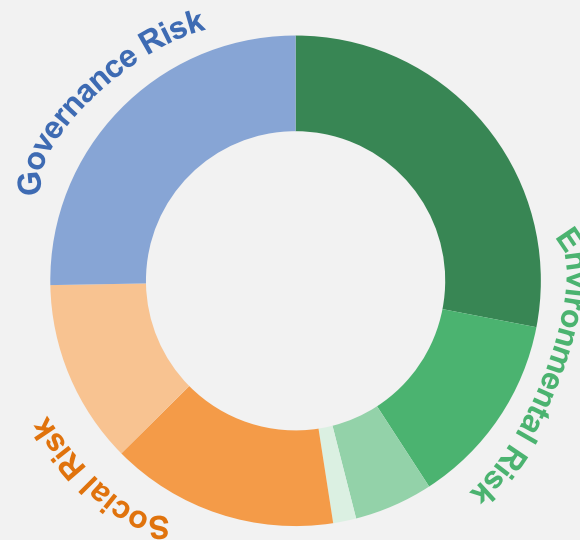
- ESG risks differ by industry and are driven by the nature of each industry's business operations



Apple Inc.



Chevron Corp.



- Carbon Output & Energy Use
- Waste & Pollution
- Resource Use & Biodiversity
- Community Impact (Environmental)
- Human Capital Management
- Product Governance
- Community Impact (Social)
- Corporate Governance





# ESG Assessment Comparison

Microsoft      Procter & Gamble      Wells Fargo



## Bloomberg



## MSCI

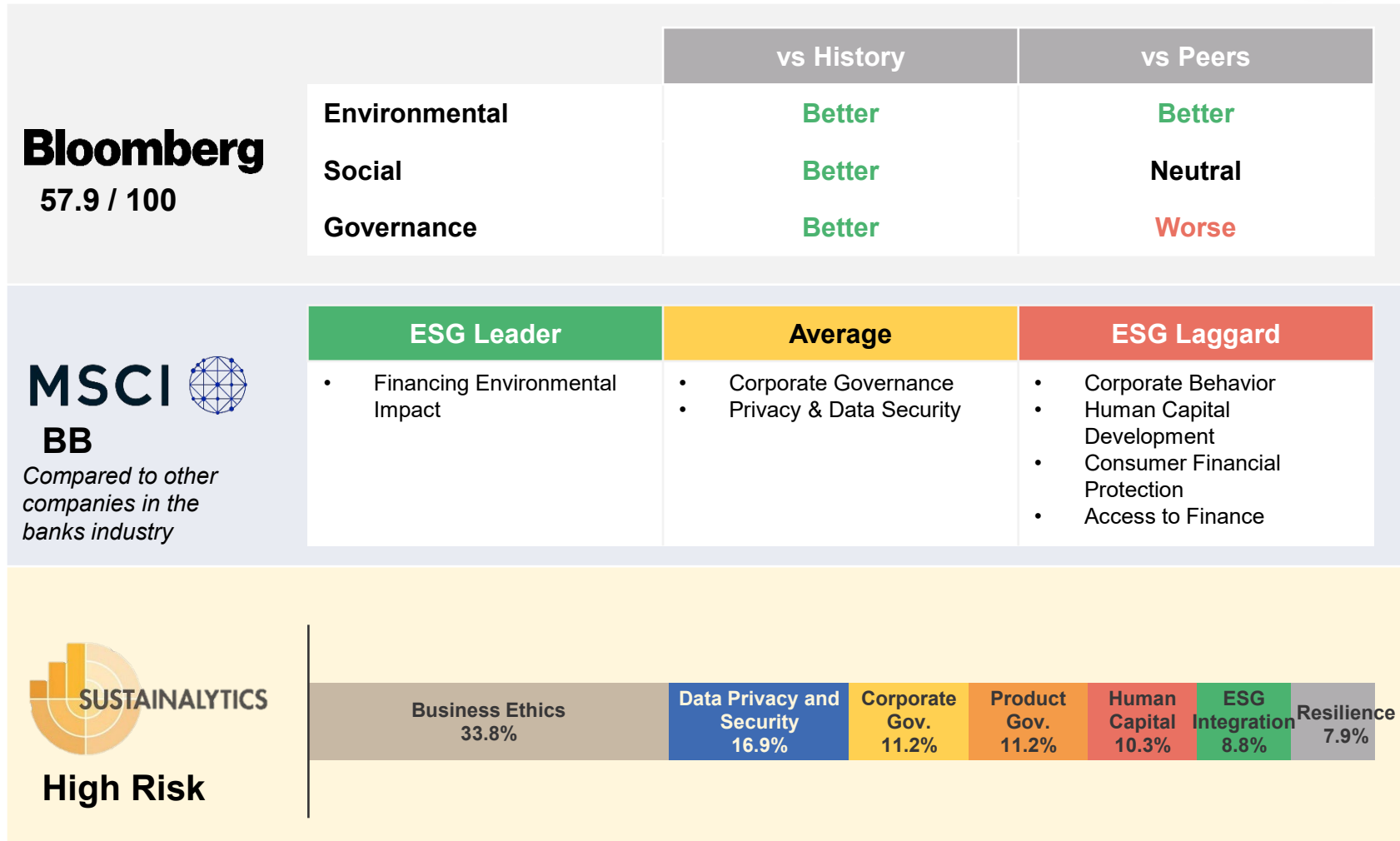


## SUSTAINALYTICS





## ESG Assessment Comparison: Wells Fargo & Co.



Source: Bloomberg ESG Disclosure Scores, MSCI ESG Ratings, and Sustainalytics ESG Risk Ratings. All data is as of August 11, 2021. Use of logos does not represent an endorsement of any kind.



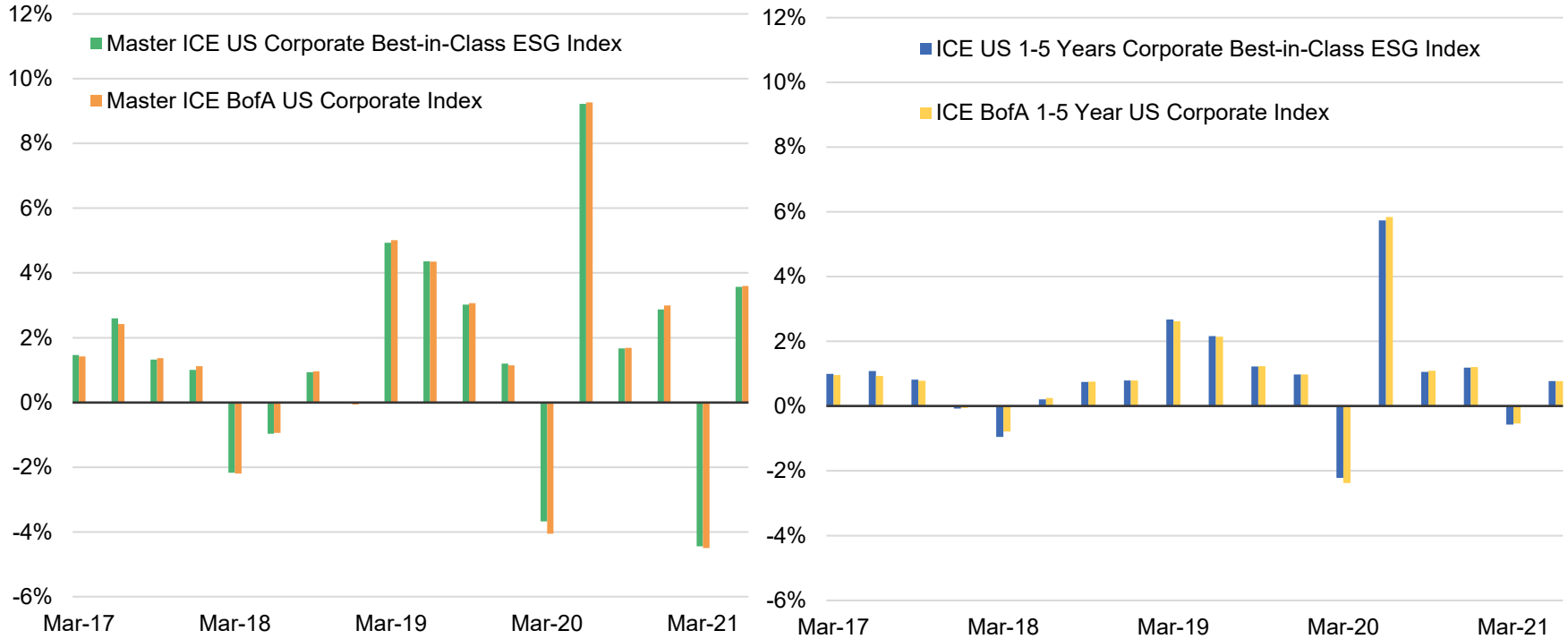


# ESG Investment Performance





## Fixed Income ESG Index Performance Aligns with Non-ESG Index



Historical Return Comparison (January 1, 2017 – June 30, 2021)				
	Master ESG Corporate Index	Master Non-ESG Corporate Index	1-5 Years ESG Corp Index	1-5 Year Non-ESG Corporate Index
Annualized Return	5.92%	5.86%	3.69%	3.69%
# of Quarters Outperformed	8 of 18	10 of 18	7 of 18	11 of 18

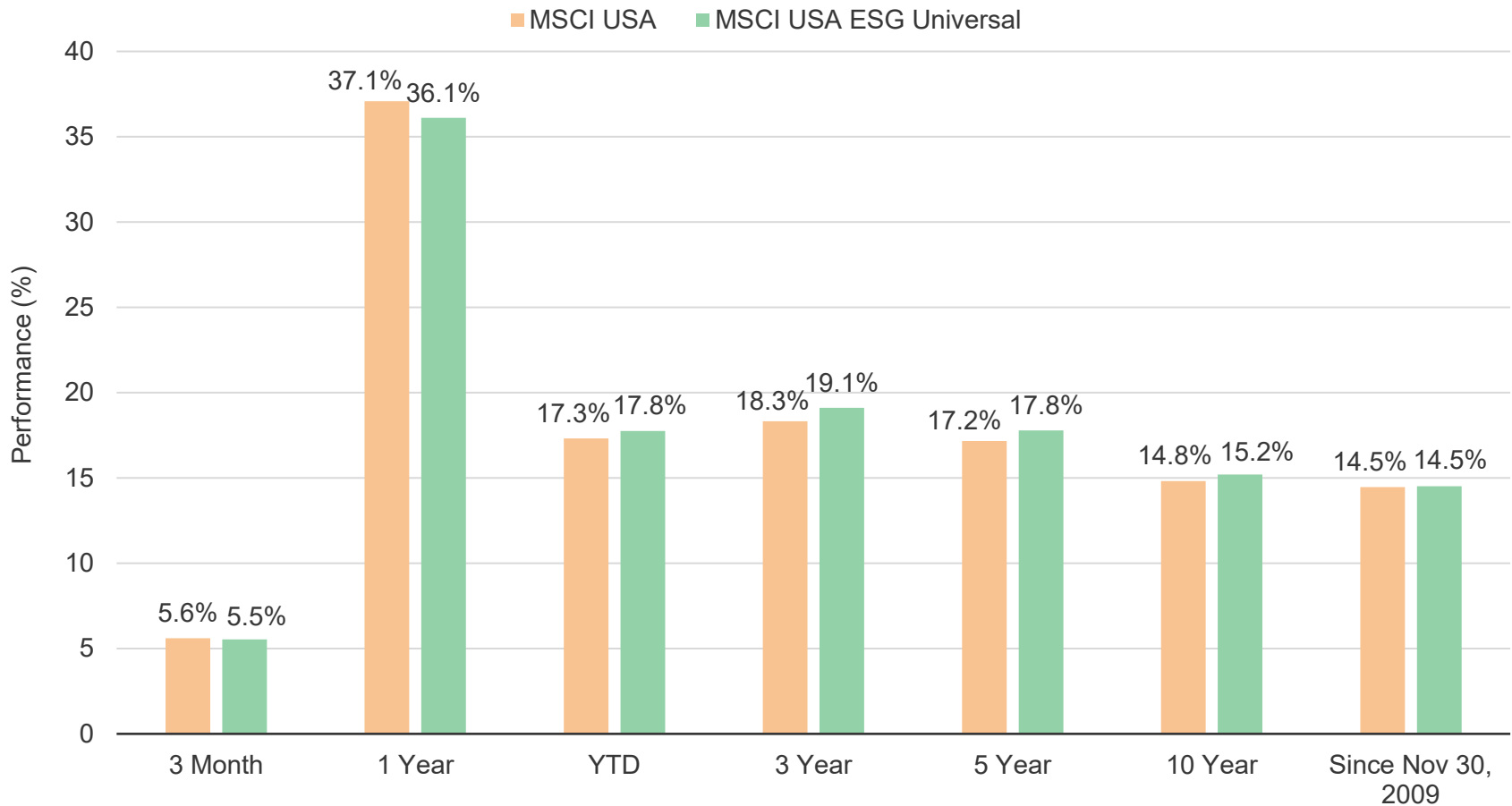
Source: Bloomberg data from January 1, 2017 – June 30, 2021. Number of quarters outperformed compares the two sets of the respective ESG and non-ESG benchmarks to each other.



## Public Equity ESG and Non-ESG Index Historical Performance

### MSCI Large Cap Price Returns

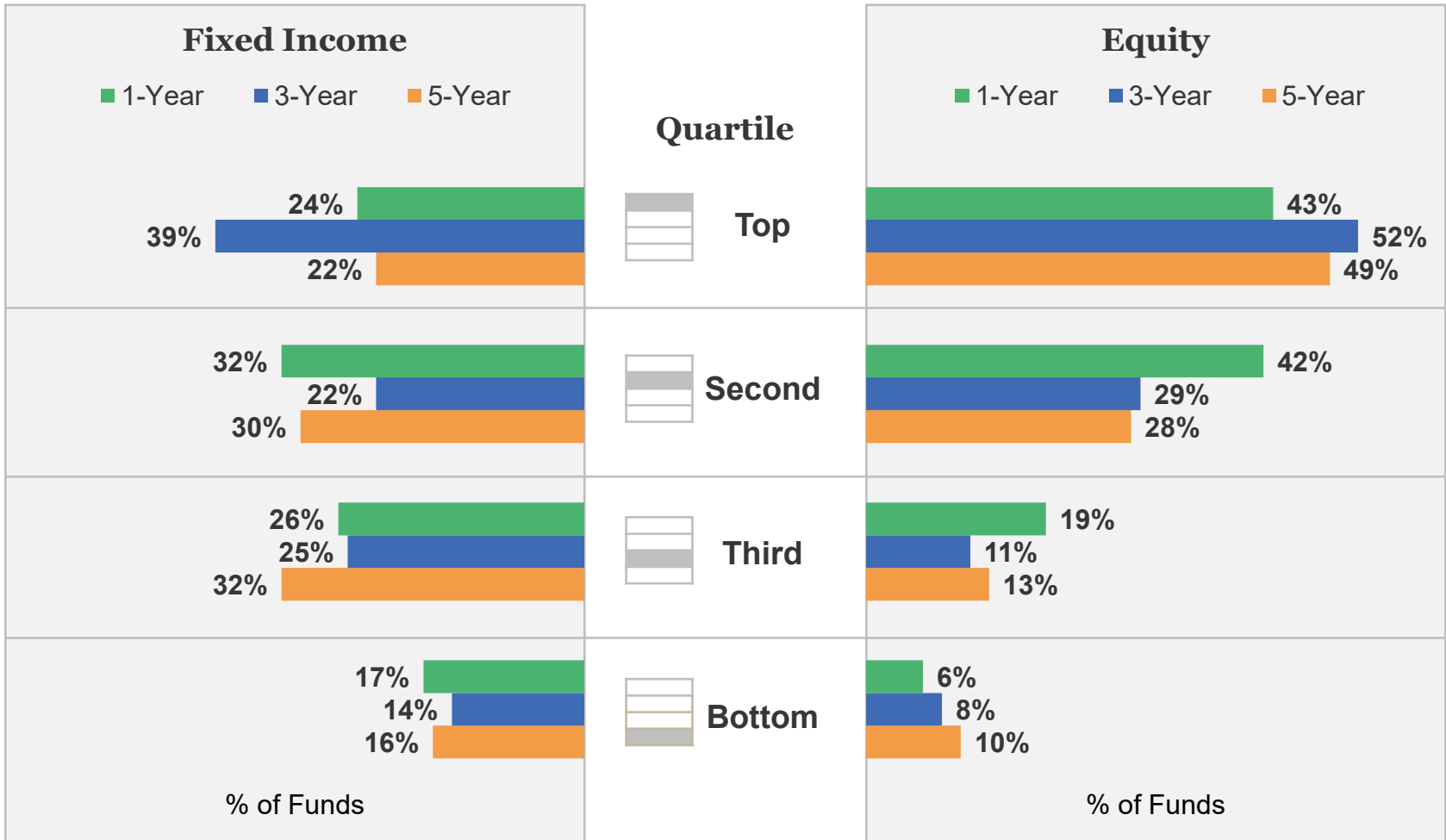
July 31, 2021



Source: MSCI USA Large CAP ESG Leaders information sheet, as of July 31, 2021. Returns greater than one year are annualized.



## Sustainable Fund Performance: Ranked by Category Quartile



Source: Morningstar Direct. Data as of 12/31/2020. Note: Funds with full-year records only. Funds repurposed in 2020 not included.



# Designing & Managing an ESG Investment Strategy







## **Key Steps in Implementing an ESG Approach**



**Identify ESG Priorities & Objectives**



**Define ESG Investment Criteria**



**Evaluate Strategy & Investment Vehicle Options**



**Analyze ESG Integration Impact**



**Update Investment Policy with ESG Parameters**



**Integrate ESG Into the Investment Process**



**Monitor Results and Revise Approach as Needed**



## Determine ESG Investment Objectives & Considerations

### Key Investment Factors

#### Sustainable Investment Objectives & Priorities

- Align investment approach with sustainable investment objectives
- Consider ESG risks in the investment process
- Reduce environmental risk exposure
- Adopt an ESG approach that is objective and transparent

ESG strategy options that align with objectives

Maintain appropriate diversification options

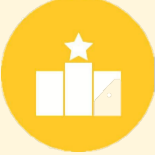



Impact on investment performance

Flexibility to revise the ESG approach

Evaluate additional costs and resources to monitor



## Evaluate ESG Investment Approaches

ESG Approach	ESG Investment Criteria Overview
<b>Top Performers</b> 	<ul style="list-style-type: none"><li>• Eligibility based on issuer ESG risk assessments</li><li>• Limit eligibility to issuers that maintain medium or lower ESG risk ratings</li></ul>
<b>Hybrid Approach</b> 	<ul style="list-style-type: none"><li>• Base eligibility on top performer ESG investment criteria</li><li>• Exclude specific issuers or industries, such as fossil fuels</li></ul>
<b>Industry Tilts</b> 	<ul style="list-style-type: none"><li>• No exclusions. Apply higher allocations to issuers with better ESG risk ratings</li></ul>
<b>E, S, or G Focus</b> 	<ul style="list-style-type: none"><li>• Limit exposure to issuers with higher environmental, social, or governance risk based on industry exclusions and ESG risk drivers</li></ul>



## Review ESG Investment Vehicle Options

### ETFs / Mutual Funds

### Separately Managed Accounts

Investment manager employs an integrated one-size-fits-all ESG approach.

#### Flexibility/ Approach

Customized ESG objectives and approach based on investor's ESG goals.

Less transparency in fund management or security selection process.

#### Transparency

Greater transparency in the security selection process.

Passively managed funds may have lower expense ratios. Actively managed fund expenses tend to be higher.

#### Cost

Fees may vary by manager and approach. May be lower or greater than Fund expense ratios.

- Easier to open an account
- Ideal for "smaller" investors
- No ESG customization needs



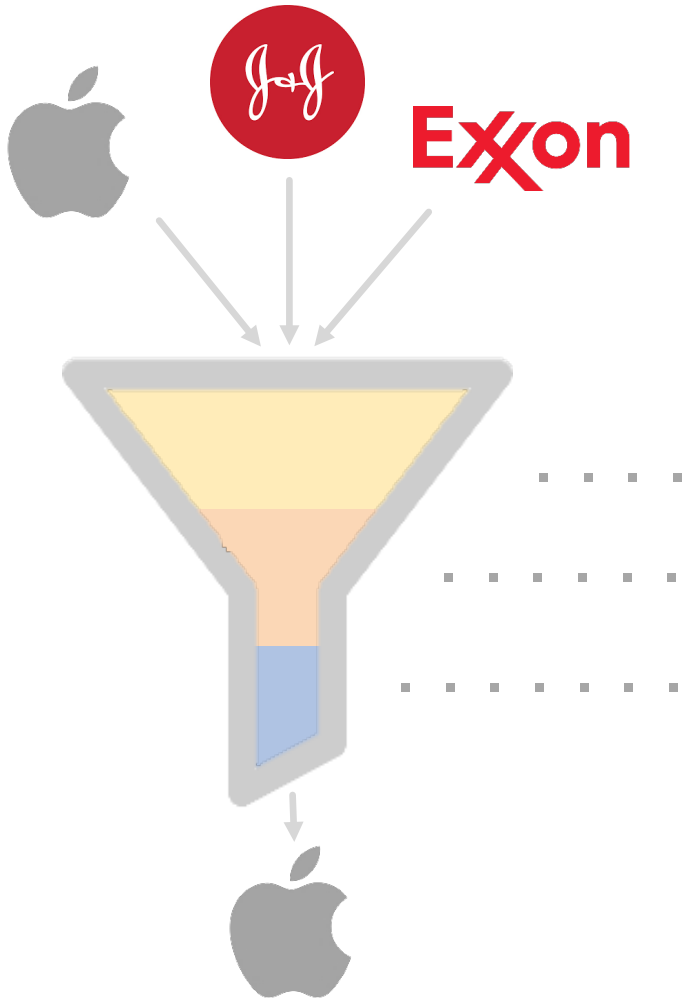
#### Best Suited Investor



- Greater customization. Approach based on investor values & ESG objectives
- Investors that prefer the flexibility to adjust their ESG approach



## Separately Managed Account: Example Application of ESG Investment Parameters



### Example ESG Investment Parameters

1. Maximum ESG Risk Rating of *medium* or lower risk
2. Industry Exclusions – Oil & Gas Producers

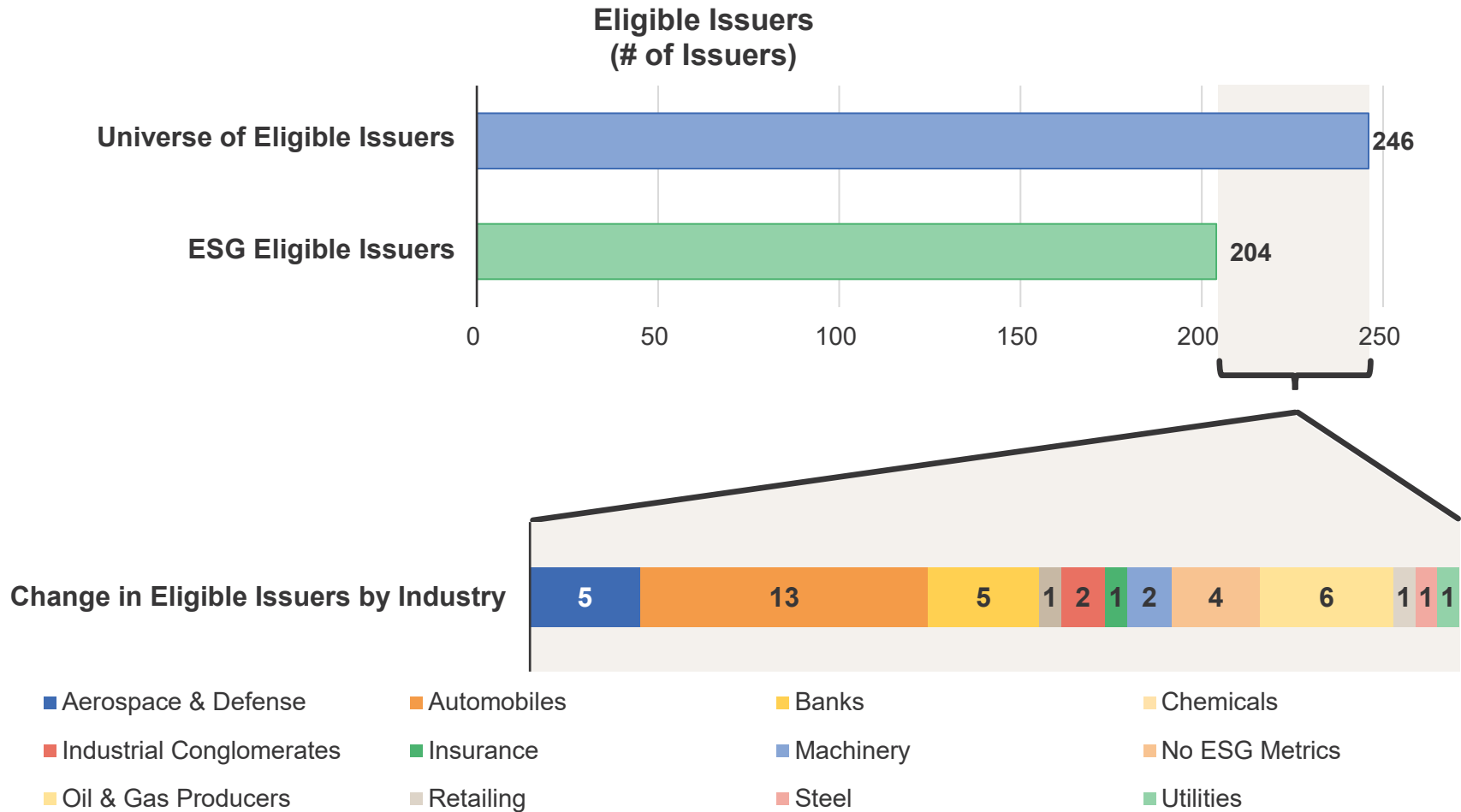
Issuer	Apple	Johnson & Johnson	Exxon Mobil Corp
Credit Ratings	AA+	AAA	AA
ESG Risk Rating	Low Risk ✓	High Risk ✗	High Risk ✗
Industry	Technology Hardware ✓	Pharma ✓	Oil & Gas Producers ✗
Eligible Investment	YES	NO	NO

Source: Sustainalytics. ESG risk ratings and subindustry rankings are as of July 31, 2021. For illustrative purposes only.





## Analyze Impact of the ESG Approach on Eligible Issuers



Based on Sustainalytics framework and PFM's Approved Issuer List as of 7/31/2021. Issuers without ESG risk ratings (No ESG Metrics) are not treated as eligible issuers in the sample ESG approaches.



## Update ESG Investment Policy Language (“IPS”)

- Considerations when amending an IPS for ESG requirements include:
  - Specific ESG criteria/metrics that will be applied to determine issuer eligibility
  - Frequency of ESG criteria application (e.g., monthly, quarterly)
  - Exclusion of any industries or specific issuers
  - Investment sectors that the ESG criteria applies to

### **SUSTAINABILITY**

Wherever possible, investment decisions shall take into account environmental, social, and governance (“ESG”) factors.

### **ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG) INVESTMENT INITIATIVE**

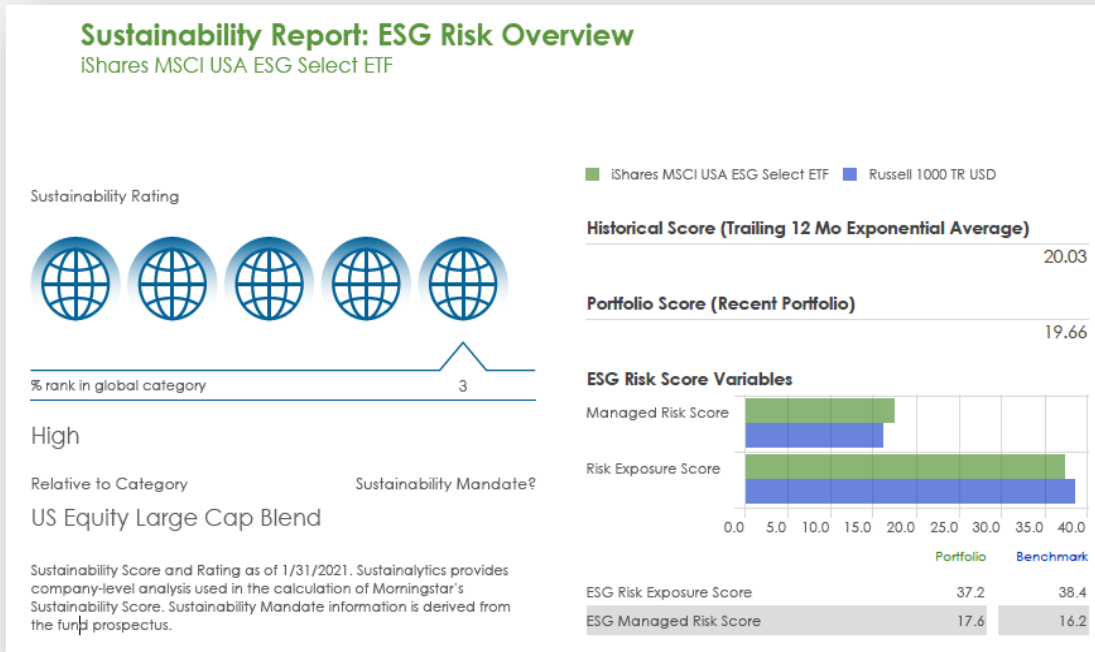
ESG investing is the process of incorporating analyses of non-financial environmental, social, and governance factors into investment decisions alongside more traditional financial criteria. As indicated in SUSTAINABILITY section of this Investment Policy, it is the Treasurer’s objective to integrate environmental, social, and governance (“ESG”) factors into investment decisions to the extent practical and possible. In order to achieve this objective, the Treasurer or the County’s investment advisor, will apply the ESG Investment Criteria as defined herein to the Investments Subject to ESG Investment Criteria as set forth below. The ESG investment criteria will be based on the ESG risk ratings and subindustry rankings provided by Sustainalytics as of the most recent prior-month end date.





# ETF/Mutual Funds – Evaluating ESG Investment Strategy Options

## Morningstar ESG Fund Ratings report





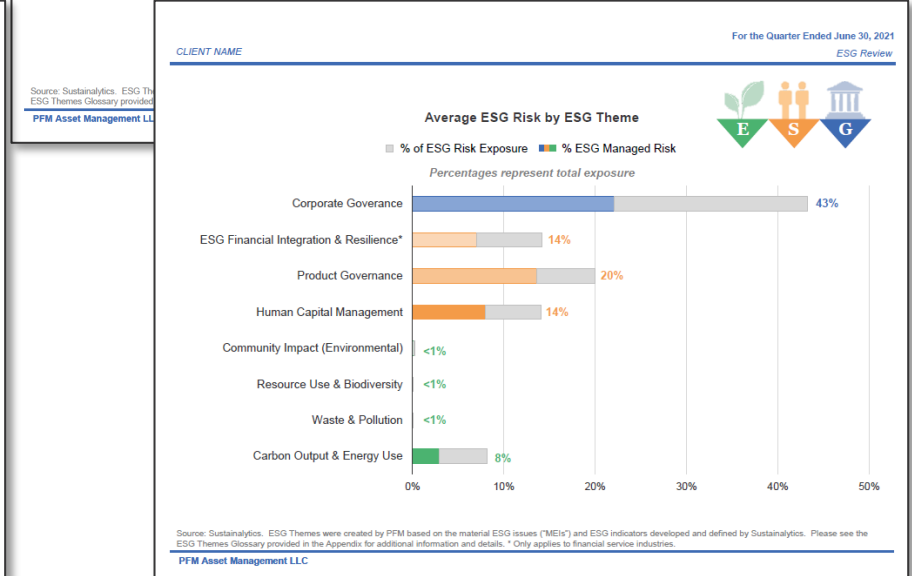
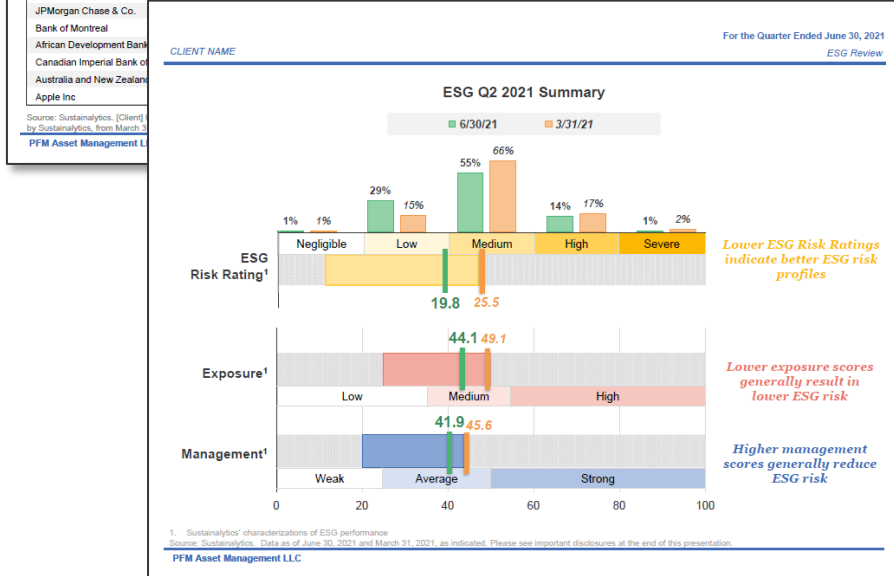
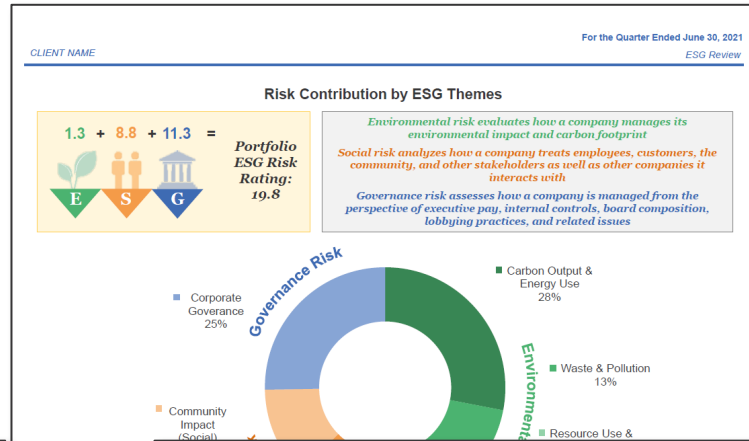
# SMAs - Evaluating & Monitoring ESG Investment Strategies

## Example Portfolio Level ESG Report

CLIENT NAME For the Quarter Ended June 30, 2021 ESG Review

Client Holdings as of June 30, 2021

Issuer	% Weight	Subindustry	Subindustry Percentile	ESG Risk Rating 6/30/20	QoQ Change in ESG Rating	Contributions		
						E	S	G
International Bank for Reconstruction & Development	4.7%	Banks	6	7.5	(3.6)	7%	35%	58%
Inter-American Development Bank	1.8%	Banks	10	8.2	-	13%	29%	58%
Rabobank Nederland	3.0%	Banks	1	9.5	-	8%	47%	45%
International Finance Corporation	4.5%	Banks	19	11.5	-	13%	37%	50%
Cisco Systems Inc	3.3%	Technology Hardware	1	12.4	0.3	4%	46%	50%
DNB ASA	2.9%	Banks	3	16.9	-	3%	47%	50%
Via, Inc.	2.3%	Software & Services	18	17.3	-	0%	56%	44%
International Business Machines Corp	1.5%	Software & Services	9	17.7	0.2	2%	57%	41%
ABN AMRO Bank N.V.	2.9%	Banks	5	19.4	-	3%	42%	55%
Royal Bank of Canada	1.3%	Banks	5	19.4	-	6%	48%	47%
Sumitomo Mitsui Trust Holdings, Inc.	2.9%	Banks	6	19.8	-	5%	42%	53%
Mizuho Financial Group Inc	2.9%	Banks	6	19.9	(0.3)	6%	39%	55%
Mitsubishi UFJ Financial Group Inc	2.9%	Banks	7	20.6	(4.7)	5%	42%	52%
United Parcel Service Inc	0.3%	Transportation	25	21.3	-	26%	44%	30%
The Toronto-Dominion Bank	4.7%	Banks	8	21.7	(0.4)	5%	47%	47%
JPMorgan Chase & Co.								







# Q&A





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There is no guarantee the investment objectives will be achieved as the investment portfolio will only include holdings consistent with the applicable Environmental, Social, and Governance (ESG) guidelines. As a result, the universe of investments available will be more limited. ESG criteria risk is the risk that because the investment portfolio ESG criteria excludes securities of certain issuers for nonfinancial reasons, the investment portfolio may forgo some market opportunities that would be available to investment portfolios that do not apply ESG criteria.

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