Responsible/Sustainable Investing:

A Summary with Implementation Considerations

WHAT IS RESPONSIBLE/SUSTAINABLE INVESTING?

The strategy and practice to incorporate environmental, social and governance (ESG) factors along with traditional financial factors and analysis within the investment decision-making process.

STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

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Executive Summary

- **Responsible/Sustainable investing is not a separate asset class; rather, it refers generally to strategies that consider traditional financial analysis in combination with ESG factors weighted by each organizations' goals, values, and/or priorities.**

- One significant challenge of ESG is the absence of a universally-adopted framework for measurement and reporting, though many third parties are working to address this.

- The value of global assets applying ESG data to drive investment decisions has almost doubled over four years, and more than tripled over eight years, to $40.5 trillion in 2020. ESG is a hard trend with long-term impact that continues to gain momentum and acceptance across the global investment landscape.

- ESG investing, as defined, is **NOT** a political concept or construct.

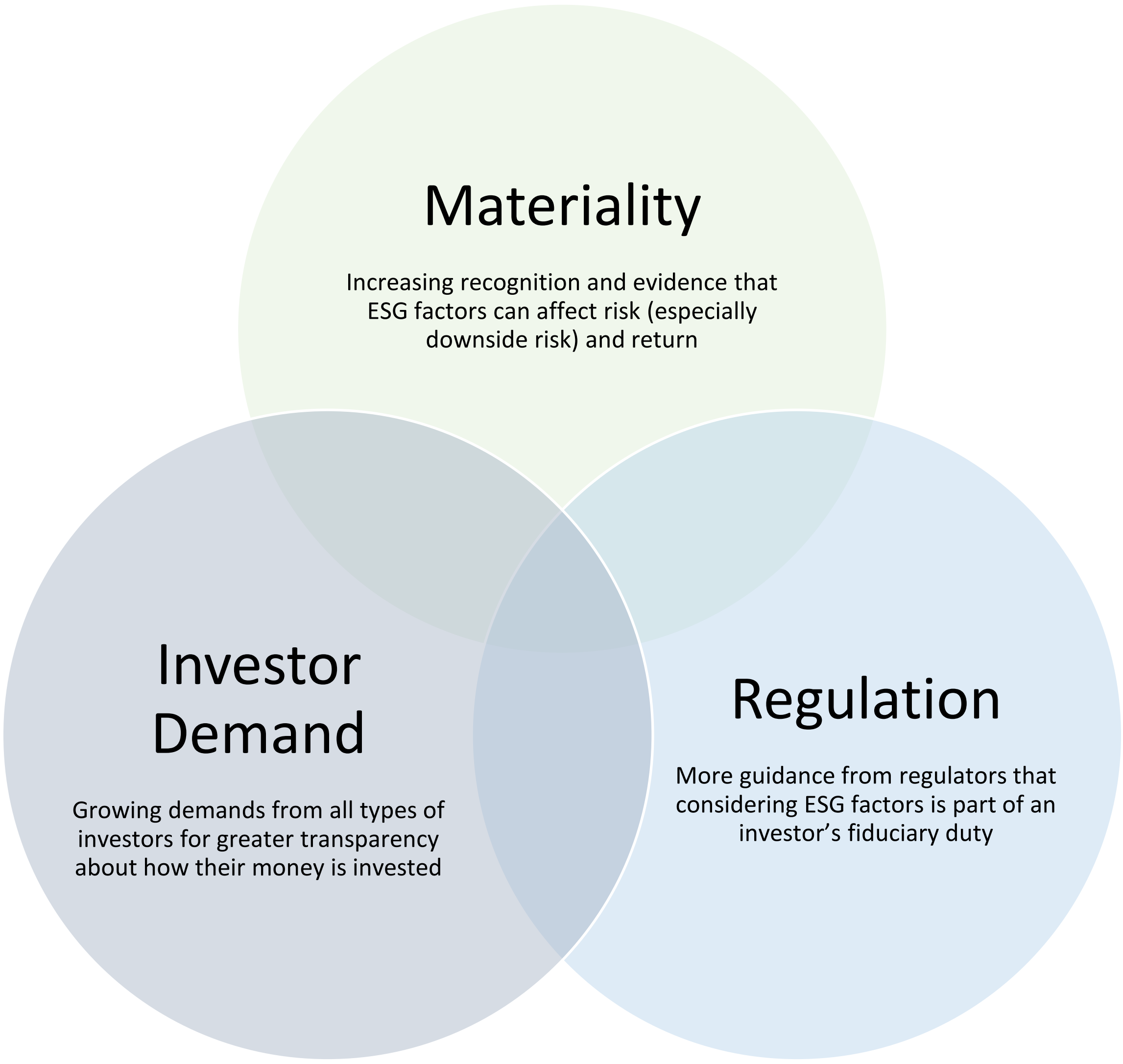
  - *However, any organization contemplating responsible/sustainable investing will need to be respectful and fully consider unique constraints that may be related to its constituents.*

- Although still evolving, the academic evidence that ESG factors may help better manage risk and improve returns, coupled with investor demand and regulatory pressures, supports ESG awareness and investment policy inclusion.

  - *If investment returns are enhanced by ESG factors relative to other factors, then ESG investing, respectful of an organization's constituents, has a place in all investors' portfolios.*

- Given the magnitude and persistence of the ESG trend, it is worthwhile to observe that if the world's issuers of debt and equity continue to utilize ESG factors within their organizational decision-making and management processes, the world's capital markets will, by definition, become more ESG-oriented and, perhaps, sooner than people may think.

Why Consider Responsible/Sustainable Investing?



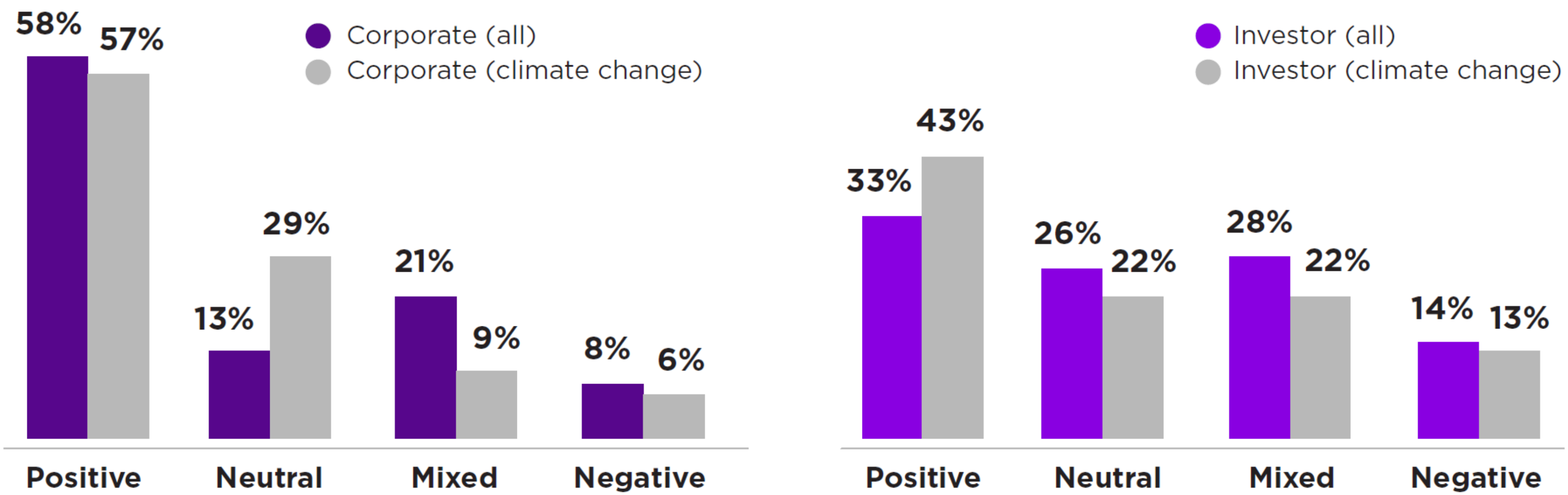
The Bottom Line: Although still evolving, the increasing academic evidence that ESG factors may help better manage risk and improve returns coupled with investor demand and regulatory pressures (either explicit or implicit) clearly support, at a minimum, ESG awareness and reference within the investment policy.

Source: PRI

The Biggest Myth About Responsible/Sustainable Investing: Underperformance

The NYU Stern Center for Sustainable Business and Rockefeller Asset Management, collaborated to examine the relationship between ESG and financial performance in more than 1,000 research papers from 2015 – 2020. Positive and/or neutral results for investing in sustainability dominate. Very few studies found a negative correlation between ESG and financial performance (based on 245 studies published between 2016 and 2020).

The meta-analyses found a positive relationship between ESG and financial performance for 58% of the "corporate" studies focused on operational metrics such as ROE, ROA, or stock price with 13% showing neutral impact, 21% mixed results (the same study finding a positive, neutral or negative results) and only 8% showing a negative relationship. For investment studies typically focused on risk-adjusted attributes such as alpha or the Sharpe ratio on a portfolio of stocks, 59% showed similar or better performance relative to conventional investment approaches while only 14% found negative results. We also found positive results when we reviewed 59 climate change, or low carbon, studies related to financial performance. On the corporate side, 57% arrived at a positive conclusion, 29% a neutral impact, 9% mixed and, 6% negative. Looking at investor studies, 65% showed positive or neutral performance compared to conventional investments with only 13% indicating negative findings.



The Bottom Line: For ESG and non-ESG investors alike, if investment returns are enhanced by ESG factors relative to other factors, then ESG investing, respectful of an organizations' unique constraints, has a place in all investors' portfolios.

Definition: Meta-analyses is the examination of data from a number of independent studies of the same subject, in order to determine overall trends.

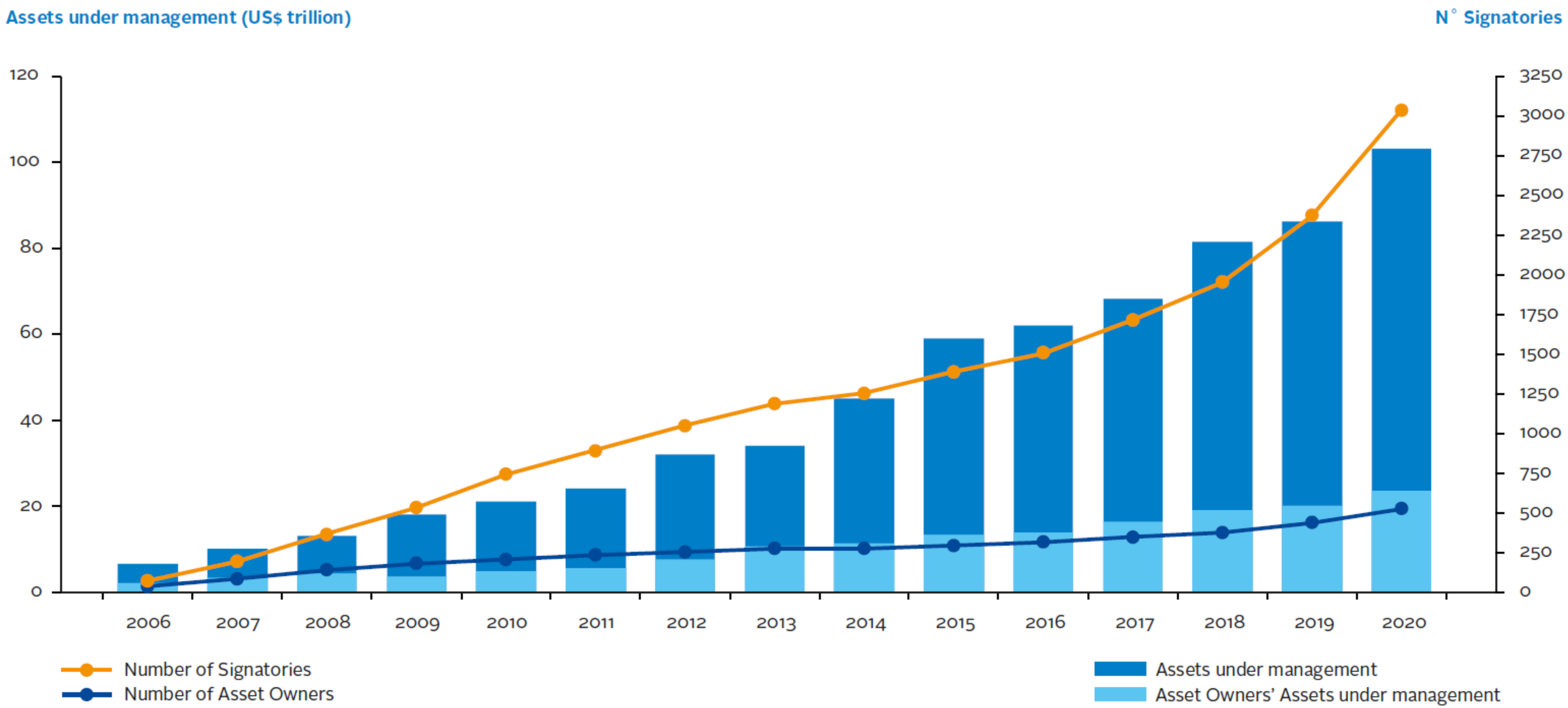
***Source*: NYU Stern Center for Sustainable Business and Rockefeller Asset Management, *ESG and Financial Performance,* By Tensie Whelan, Ulrich Atz, Tracy Van Holt and Casey Clark, CFA, Oct 2020.**

The Three Key Factors of Responsible/Sustainable Investing

The Bottom Line: Responsible/Sustainability investing is not a separate asset class; rather, it refers generally to strategies that consider traditional financial analysis in combination with the three factors noted below, weighted by each organizations' goals, values, and/or priorities.

ENVIRONMENTAL (E)	SOCIAL (S)	GOVERNANCE (G)
Climate Change	Human Rights	Board Diversity
Energy Efficiency	Labor Standards	Executive Compensation
Waste Management	Stakeholder Relations	Board Behavior

Responsible/Sustainable Investing Trends By Asset Managers/Owners

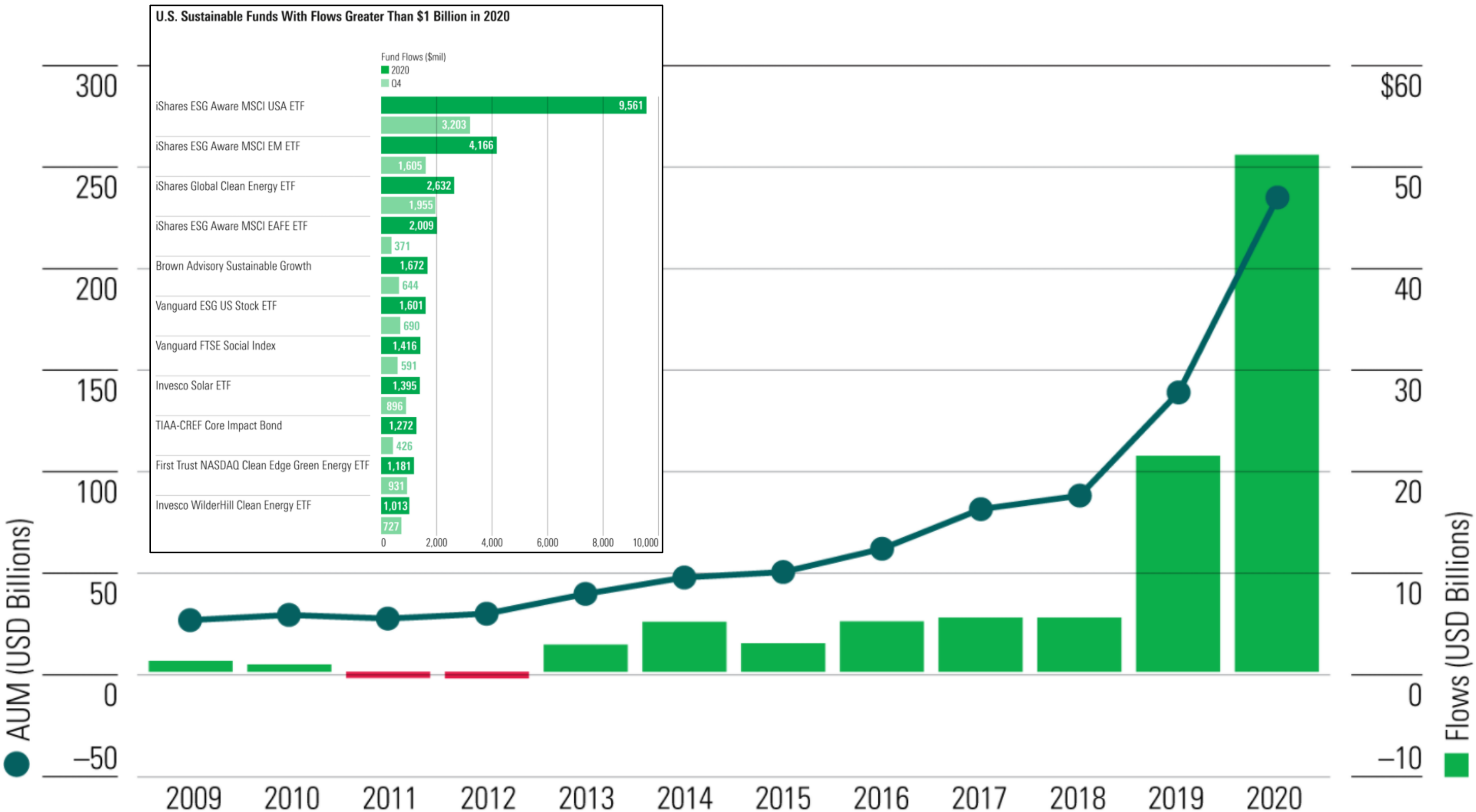


- The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices.
- Former United Nations Secretary-General Kofi Annan, in early 2005, invited a group of the world's largest institutional investors to join a process to develop the Principles for Responsible Investment. A 20-person investor group drawn from institutions in 12 countries was supported by a 70-person group of experts from the investment industry, intergovernmental organizations and civil society.
- The value of global assets applying environmental, social and governance data to drive investment decisions has almost doubled over four years, and more than tripled over eight years, to $40.5 trillion in 2020.

The Bottom Line: ESG is a hard trend with long-term impact that continues to gain momentum and acceptance across the global investment landscape.

Source: PRI, Pension & Investments

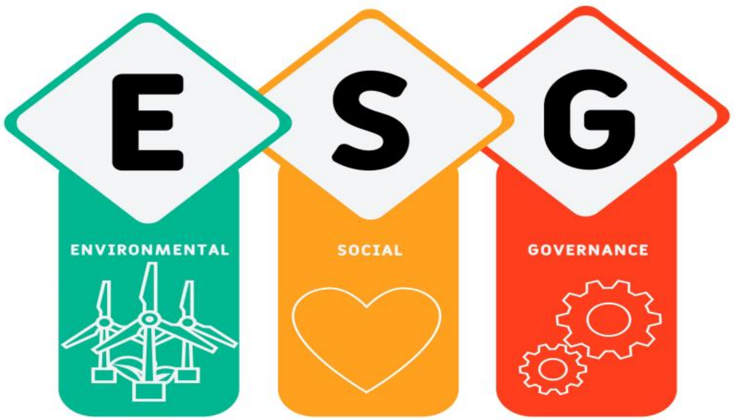
Sustainable Funds in the US - Annual Flows & Assets Under Management (AUM)



<u>The Bottom Line</u>: Wall Street has heard the ESG clarion call and the exponential growth of ESG assets will continue and evolve to support investor preferences.

Source: Morningstar as of 12/31/2020

ESG Implementation Step #1 – Understanding The Data & Governance Approach

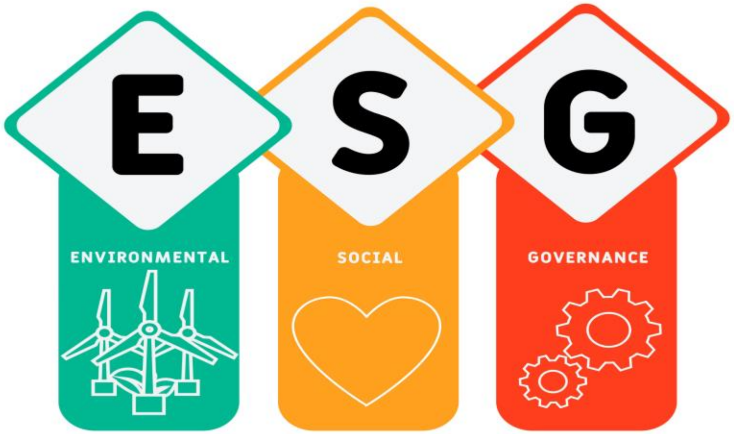


The Bottom Line: One challenge of ESG is the absence of a universally-adopted framework for measurement and reporting, though many third parties are working to address this. Even so, the majority of SAA clients, who pursue responsible/sustainable investing will focus on ESG integration (see below) via the use of mutual funds, exchange-traded funds, and their core fixed income managers' internal ESG integration approaches.

CONSIDERING ESG ISSUES WHEN BUILDING A PORTFOLIO (known as: ESG integration)			IMPROVING INVESTEES' ESG PERFORMANCE (known as: active ownership or stewardship)	
Integration	**Screening**	**Thematic**	**Engagement**	**Proxy Voting**
Explicitly and systematically including ESG issues in investment analysis and decisions, to better manage risks and improve returns.	Applying filters to lists of potential investments to rule companies in or out of contention for investment, based on an investor's preferences, values or ethics.	Seeking to combine attractive risk/return profiles with an intention to contribute to a specific environmental or social outcome. Includes impact investing.	Discussing ESG issues with companies to improve their handling, including disclosure, of such issues. Can be done individually, or in collaboration with other investors.	Formally expressing approval or disapproval through voting on resolutions and proposing shareholder resolutions on specific ESG issues.

Source: PRI

ESG Implementation Step #2 – Investment Policy Awareness & Acknowledgement



<u>The Bottom Line</u>: While an organization's ESG approach is being evaluated, there are a couple of examples of straight-forward investment policy language (see below) that could be immediately inserted merely to acknowledge that ESG factors are incorporated into the overall investment decision-making process:

<u>Example #1</u> – The company/organization recognizes the importance of considering environmental, social and governance (ESG) factors in its investments. Our investment professionals, both internal and external, integrate ESG considerations as well as a range of other relevant factors into due diligence, monitoring, and investment-decision making.

<u>Example #2</u> - The primary objective of the company's/organization's investment approach is to achieve the highest and most stable investment returns over the long term for an acceptable level of risk. In this respect, it is becoming increasingly important to consider environmental, social and governance risks within the investment decision-making process.

ESG Implementation Step #3 – ESG Integration

<u>The Bottom Line</u>: ESG investing, as defined, is **NOT** a political concept or construct. However, any organization contemplating responsible/sustainable investing will need to be respectful and fully consider unique constraints that may be related to its constituents. Furthermore, an organization should openly discuss and prioritize ESG factors (see below) pursuant to its enterprise values, goals and objectives and then develop an implementation timeline for portfolio changes.

Given the magnitude and persistence of the ESG trend, it is worthwhile to observe that if the world's issuers of debt and equity continue to utilize ESG factors within their organizational decision-making and management processes, the world's capital markets will, by definition, become more ESG-oriented and, perhaps, sooner than people may think.

ENVIRONMENTAL (E)	SOCIAL (S)	GOVERNANCE (G)
Climate Change	Human Rights	Board Diversity
Energy Efficiency	Labor Standards	Executive Compensation
Waste Management	Stakeholder Relations	Board Behavior

Additional Resources

The Forum for Sustainable and Responsible Investing (US|SIF): (www.ussif.org)

Principles for Responsible Investment (PRI): (www.unpri.org)

NYU Stern Center for Sustainable Business and Rockefeller Asset Management, ESG and Financial Performance, By Tensie Whelan, Ulrich Atz, Tracy Van Holt and Casey Clark, CFA, Oct 2020: (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3708495)

The NYU Stern Center for Sustainable Business (CSB): (https://www.stern.nyu.edu/sustainability)

A Sampling of Sustainable Development Goals

- No Poverty
- Zero Hunger
- Good Health and Well-Being
- Quality Education
- Gender and Racial Equality
- Clean Water
- Waste Management and Recycling
- Affordable and Clean Energy Alternatives
- Decent Work and Economic Growth
- Sustainable Cities and Communities
- Responsible Consumption and Production of Resources
- Climate-Friendly Business Practices