ESG Investing

Trustees are fiduciaries under ERISA. That requires trustees to act solely in the interests of the plan's beneficiaries and to base investment decisions solely on considerations relevant to the risks and returns of the plan's assets.

The acronym "ESG" stands for Environmental, Social and Governance. ESG-related investment policies consider companies' behavior with respect to ESG-related factors when evaluating investments choices. The table on the following page is sourced from the CFA Society and it shows some of these "factors" or types of criteria considered in E, S and G.

ESG considerations include a spectrum of factors across the global economy. They are not constrained to traditional financial factors such as a company's earnings, balance sheet, cash flows or a stock's momentum, and in some cases may not have a clear link to corporate investment performance.

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Criteria Considered in E, S and G

Environmental

Conservation of the natural world

- Climate change and carbon emissions
- Air and water pollution
- Biodiversity
- Deforestation
- Energy efficiency
- Waste management
- Water scarcity

Social

Consideration of people & relationships

- Customer satisfaction
- Data protection and privacy
- Gender and diversity
- Employee engagement
- Community relations
- Human rights
- Labor standards

Governance

Standards for running a company

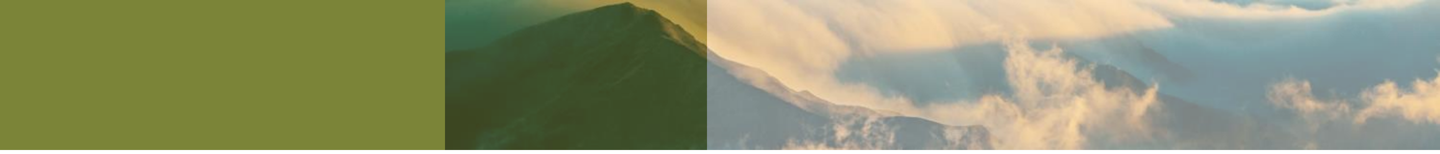
- Board composition
- Audit committee structure
- Bribery and corruption
- Executive compensation
- Lobbying
- Political contributions
- Whistleblower schemes

The concepts behind ESG relate to several investment styles, some of which have been promoted for decades:

- **Sustainable Investing** focuses on the long-term effects of corporate activities on the environment. This term is most closely associated with ESG investing.
- **Socially Responsible Investing (SRI)** originally applied to imposing the investor's social views on topics such as gun control, gambling and tobacco to portfolio holdings. Recently it has been expanded to include more criteria.
- **Corporate Social Responsibility Investing** measures how businesses' practices affect a community, the environment or a society at large.
- **Impact Investing** which can focus on a specific goal for any of the factors outlined above and expects the investment manager to engage with corporate management on the topic.

ESG strategies may involve an exclusionary or divestment approach, tilting towards investments that score higher on ESG-related factors, an inclusionary approach such as becoming an activist shareholder, or a combination.

While most agree that ESG-related considerations may be important to certain investors, controversary arises when ESG-related goals are in conflict with other investment objectives such as growth and profitability.



Consideration of ESG by Pension Plans

The overriding consideration that we want to communicate about the use of ESG by pension plans is that trustees are fiduciaries under ERISA. That requires trustees to act solely in the interests of the plan's beneficiaries and to base investment decisions solely on considerations relevant to the risks and returns of the plan's assets. Current DOL guidance reiterates that ERISA fiduciaries may not sacrifice investment returns or assume greater investment risks as a means of promoting collateral social policy goals. DOL Guidance on this topic has fluctuated over time with a 2016 ruling which allowed for consideration of ESG factors in investment decisions, a 2020 ruling that prohibited consideration of any goals unrelated to investment returns, and a revised ruling in 2021 that removed barriers for plan fiduciaries to consider ESG factors in their investment decisions. This latest ruling is currently in a comment period through December 2022. To clarify, current guidance does not prohibit trustees or investment managers from considering ESG factors such as climate change or data privacy if trustees think specific ESG factors may have a material impact on an investment, of if they can achieve the ESG goals without sacrificing investment performance.

Studies evaluating the performance of ESG factors and comparing the performance of traditional funds vs. their ESG equivalents have been inconclusive. One of the difficulties in measuring performance is that many ESG-related goals take decades to materialize. Even then, it is difficult to disentangle the ESG effects from other factors such as profitability, quality and sector weightings that may be correlated with ESG.

While individual investors should be free to express their ESG views with their investments, we believe that recommending funds with explicit ESG investment objectives would conflict with our fiduciary responsibility.

Ranking Companies on ESG

With the rise of investors' interest in ESG, several data vendors have developed methodologies to rank companies on their ESG policies and / or on their performance on ESG metrics. For instance, they rank companies on board diversity and on carbon emissions. These services allow investment managers and investors to outsource gathering ESG-related data. Managers can then incorporate

Ranking Companies on ESG (cont.)

these data into their investment processes. Some investment managers explicitly include ESG-related metrics in their investment objectives and offer strategies with an explicit ESG component. Stock market indices have also been developed that select and weight constituents according to ESG metrics. For the investor, these data provide a common metric to compare companies when making investment decisions. In addition, managers can manage their portfolios' ESG scores to attract ESG-minded investors.

ESG and Alan Biller and Associates

Under ERISA, investment consultants are fiduciaries. As a result, we do not recommend investment strategies based on their ESG characteristics. However, we do expect all managers that invest assets on behalf of our clients to consider all criteria that may affect an investment's value, including ESG-related factors. Examples include:

- Poor environmental policies which could result in a regulatory crackdown or fines.
- Poor social policies could result in high staff turnover or labor strife.
- Poor governance policies could result in management entrenching or enriching themselves at the expense of shareholders.

For these reasons, we include questions related to managers' ESG efforts in our due diligence process. Alan Biller and Associates is also a signatory to the UN's Principles for Responsible Investment. As a signatory, we have access to a database of investment manager ESG-related information by which we can corroborate managers' self-reported practices.

We view having a policy of preferring investments that score well on ESG criteria to other strategies to be a form of active management, comparable to tilting towards value, quality or low volatility. While such tilts may pay off over the long term, there is likely to be significant volatility of relative performance along the way. Importantly, to prefer them, the investor should have a view of why they believe such investments have higher expected returns and/or lower risks than comparable non-ESG strategies.

ESG and Alan Biller and Associates (cont.)

Despite the caveats outlined above, Alan Biller and Associates remains committed to understanding the investment implications of ESG factors and how these factors integrate into investment and ownership decisions on behalf of our clients.

Resources for Further Information:

Organization for Economic Cooperation and Development (OECD)

https://www.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf

UN PRI (Principles for Responsible Investment)

https://www.unpri.org/about-us/a-blueprint-for-responsible-investment

CFA Institute

https://www.cfainstitute.org/en/research/esg-investing

Securities and Exchange Commission

https://www.sec.gov/oiea/investor-alerts-and-bulletins/environmental-social-and-governance-esg-funds-investor-bulletin

U.S. Department of Labor, latest bulletin
https://www.dol.gov/newsroom/releases/ebsa/ebsa20211013

Independence and objectivity underpin the fiduciary investment consulting services Alan Biller and Associates provides US institutional investors. An employee-owned firm focused exclusively on investment consulting since 1982, we are today one of the largest discretionary consultants in the US. For each of our clients, our experienced investment professionals deliver fiduciary stewardship, risk management, an informed perspective, straightforward communication, and impeccable execution.

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