Responsible Investing:

The Implementation Challenge

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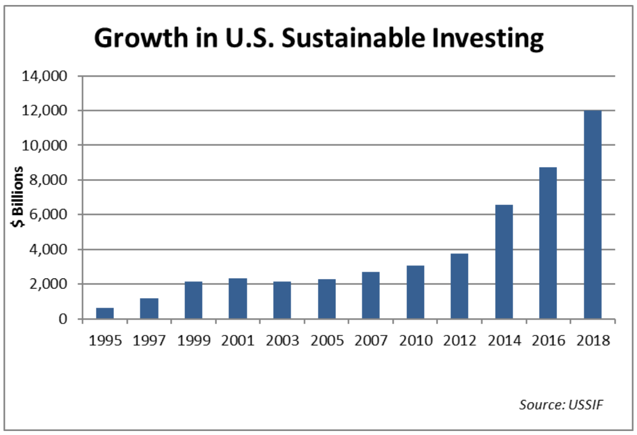
Due to the more recent shift towards the 24-hour news cycle and social media, public awareness of global, national and even regional events has increased. This recent proliferation of information into our daily lives has put a spotlight on weather calamities, structural and cultural gaps across society, as well as the challenges still being faced by underserved populations. While many organizations and institutions have been keenly aware and involved historically, the broader population is now more widely exposed to these issues. That exposure, and the emergence of a younger, more 'woke' population, has driven an eruption of investment products that allows investors the chance to help address those issues. Now, more than any other time, investors have the ability to invest with closer alignment to their social, religious or personal views. This change also encourages investors to view markets through a longer-term lens, opening capital markets to aid in bringing about structural changes in society. The challenge for investors, however, lies in sorting out those investment strategies that are a true alignment of interests, which possess an intentional and thoughtful approach to responsible investing.



Taking a holistic view, the Responsible Investment market is vast and broadly-defined. According to The Forum for Sustainable and Responsible Investment (US SIF), the U.S. Sustainable and Responsible Investment universe is comprised of more than $12 Trillion. That amounts to more than one-quarter of all professionally managed assets, a 38% increase since 1995. This data set includes investment products catering to all varieties of environmental, social and governance (ESG) issues, and also includes those that practice shareholder advocacy. Responsible Investing has come a long way from its origins of straightforward portfolio exclusions as a way to express a view within an investment portfolio. As a result, and unlike the long-standing, traditional investment style boxes (i.e., large cap, value, etc.), Responsible Investing has become more difficult to define due to its rapid growth and a lack of standardization. The phrase Responsible Investing is, in itself, a catch-all phrase. Ultimately, it is the broad variation and nuanced approaches that make Responsible Investing such a complex and challenging investment endeavor.

With all these challenges, and opportunities, how do investors implement a responsible investment framework for their institutions? In the event your institution has made a commitment to align portfolio dollars with the interests and mission of the organization, the initial step involves clarifying the focus of that mission. These decisions may seem simple on the surface, but an investment committee may have conflicting opinions of where the priorities lie. At the highest level, examples of mission-alignment might include climate issues (i.e., carbon emission reduction, fossil fuel divestment, sustainable agriculture, etc.), corporate governance (board diversity, women in leadership, executive pay, fair labor standards, etc.) as well as larger, global issues such as education, affordable housing, infrastructure, and water scarcity. As mentioned above, these areas of focus can be achieved rather simplistically through exclusionary methods, tilting a portfolio towards companies that have a favorable record towards achieving a sustainable objective, and even tilting a portfolio away from the worst offenders in these areas. Some investment approaches may favor strategies that attempt to address a number of sustainability areas through a broader lens, while others may prefer a more focused tactic, isolating one issue to address within an investment strategy. Other routes available are strategies that focus on more specific, measurably impactful investments. A popular example would be microfinance, which is an investment in a firm that offers lending and capital to small business owners, often female, in underserved regions, that are unable to access traditional banking systems.

All of these efforts can be further extended through shareholder engagement activity. Once the realm of so-called "activist investors" attempting to effect change in portfolio companies related to management efficiencies and operational costs, shareholder engagement efforts more recently have shifted towards pressuring companies to implement changes specifically related to the climate or board diversity, etc.

It is precisely this wide avenue of approaches that makes a clearly-defined objective, as well as self-reflection, most important. In reality, the marketing scripts offered by most asset management firms leaves investors with the feeling that the managers are effecting a difference and being impactful to society, only making the choice between them ever more difficult. Institutions must be able to determine and articulate the priorities of the organization to best align their intentions with their portfolio investments. While all the responsible issues outlined above would likely benefit from an infusion of capital, there are risks and uncertainties introduced by the breadth of products, many of which may not be for the benefit of investors, or their sustainable objectives, but for the benefit of the asset manager capitalizing on a market trend. In short, not all products are created equally and the intentions behind an investment product or asset manager are vital for successful implementation of a responsible investment program.

Viewing these investments within the context of standard institutional portfolio implementation is paramount, and includes considerations for traditional asset allocation, vehicle appropriateness, and overall implementation/costs. Incorporating an organization's responsible objectives within their investment framework will ensure continuity over the long-term, especially as committee members and preferences change over time. The determination of whether and/or where these investments fit within an institutional investment portfolio should be no different than a traditional large cap value allocation, etc. Attention should be given to the asset class and overall asset allocation, based on an investment policy statement, to determine the scope of the responsible investment(s). While it may be tempting to deploy a sizeable allocation in pursuit of a mission, it may not be prudent from a fiduciary standpoint, depending on the type of organization, its lifecycle, and the needs of its constituents. Allocating more than half of an organization's assets to a renewable energy-focused global equity strategy is compelling in an effort to mitigate climate change, but it may not be prudent from a risk/return perspective.

Key Steps for Portfolio Implementation

1. Outline value system / core principles
2. Identify a responsible investment approach
3. Revise IPS to reflect values and asset allocation
4. Determine investment vehicle standards and preferences
5. Establish effective monitoring and oversight process

Conclusion

In summary, responsible investing is an opportunity for investors and organizations to more closely-align their mission, goals and objectives within their investment portfolios. However, the explosion of product, information and data has added complexity. Implementation of a responsible investment strategy takes thorough and thoughtful research. Once the mission and objectives are defined and used to narrow the universe of products, questions remain:

- Is the investment strategy suitably aligned in its intentionality?
- Does the strategy reasonably invest in companies with a thoughtful and intentional process to address the issue?
- And, crucially, is it accomplishing that feat from an institutional perspective and meeting the pre-determined return objectives?

These decisions are time consuming and complex but will ultimately foster an environment of responsible and sustainable investing that will provide a path towards meeting long-term investment objectives.

Terminology:

Exclusionary: the removal or underweighting of securities of certain companies from a portfolio based on a set of criteria, as defined by an investor's beliefs. Also known as divestment.

ESG: the consideration of environmental, community, other societal and corporate governance criteria in investment analysis and portfolio construction.

Shareholder Engagement: owning shares in a company to raise environmental, social and corporate governance issues of concern via management.

Shareholder Resolutions: proposals submitted by shareholders for a vote at a company's annual meeting to address corporate governance issues and practices.

Community Investing: seeks to explicitly finance projects or institutions that will serve poor and underserved communities.

Impact: investments made into companies, organizations, and funds with the intention to generate a measurable, beneficial social or environmental impact alongside a financial return. *USSSIF.org*