Socially Responsible Investing

An impactful strategy for individuals, retirement plans and nonprofits

Investing for Yourself and Humankind

Heightened social awareness. Demand for greater corporate accountability. Advanced investment screening tools and resources. This powerful combination is fueling explosive growth in socially responsible investing (SRI). And it's not just younger investors leading the charge. Family offices, retirement plan participants and nonprofit boards are all seeking ways to make an impact with their investment dollars.

The question is how? How do you blend the desire to both accomplish your financial goals and create the changes you want to see in the world?

As with most financial decisions, there is no cookie-cutter answer. It depends on your unique circumstances. This paper explores how you can incorporate SRI into your personal investment strategy or retirement plan investment lineup to drive better outcomes.

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Section 1: Overview of Socially Responsible Investing (SRI)

Through rallies, shareholder proposals and lobbying efforts, people are using their voices to advocate for change. They're also using their wallets. Given the significant amount already allocated to socially responsible strategies and the rapid rise in adoption (highlighted in the callout box), this investment philosophy is here to stay. More and more, socially responsible investing is becoming a core part of investment portfolios and plan investment lineups.

Source: USSIF, 2020 Report on U.S. Sustainable and Impact Investing Trends

The Universe of SRI

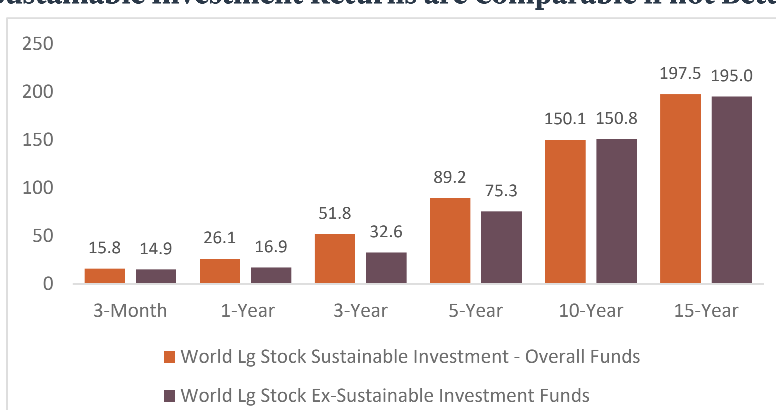
Just like "the arts" can mean anything from painting to acting, socially responsible investing has become the catchall phrase for investing for the common good. Because SRI means different things to different people, the first step in adopting this strategy is adopting an actionable definition. Is it climate change? Gender equality? Social issues in general? Your answer will influence which types of investments and investment managers you select. Below is a brief description of the different investment strategies that fall under the SRI umbrella.

Investment Strategy	Description
Environmental, Social and Governance Investing (ESG)	Investing in companies that are ecofriendly, promote the health and safety of employees and the community, and support ethical business practices
Impact Investing	Investing in companies and causes that will have a measurable, positive impact on society and the environment
Mission-Based Investing	Choosing investments that align with a nonprofit's mission or support specific philanthropic goals
Program-Related Investing	Investing in charitable activities with a specific purpose, such as investing in organizations that provide interest-free loans to low-income families
Socially Responsible Investing	Choosing companies that promote positive social and environmental change, such as gender equality or clean energy, and avoid companies having a negative impact
Sustainable Investing	Investing in companies that have the ability to maintain their operations for the long term while minimizing any adverse effects on the environment and the world

Debunking the Performance Myth

In its infancy, socially responsible investing struggled to gain traction. Many people believed that investing according to your conscience meant sacrificing performance. Even though demand for socially responsible investments has increased dramatically, this perception persists, creating discord among family members, plan committees and board members. As advisors, one of our roles is to facilitate the performance conversation and demonstrate that it is possible to achieve equivalent investment returns while making a difference. We will look at specific investment strategies in Section 2.

Sustainable Investment Returns are Comparable if not Better



Morningstar Category Average Cumulative Total Returns for the period ending 12/31/2020, World Large Stock Category (%)
Source: Natixis Investment Managers and Morningstar Direct

Screening Potential Investments

These competitive returns reflect the natural evolution of this investment strategy. Increasing demand for SRI has led to the creation of SRI-specific investment tools. Professional investment managers and advisors now have a host of resources at their disposal to effectively evaluate investment opportunities, including corporate annual sustainability reports and independent rating systems like MSCI ESG Research and Morningstar Sustainability Ratings.

The analysis typically focuses on environmental, social and governance (ESG) factors to determine if an enterprise is involved in detrimental activities or promoting positive change. It is widely believed that the way a company addresses ESG factors can directly impact long-term operations, profitability and competitiveness.

Environmental

How well does a company manage its natural resources and ecological footprint?

Considerations:
- Greenhouse emissions
- Waste & pollution
- Water conservation

Social

How does a company engage with its employees, vendors, clients and communities?

Considerations:
- Workplace health & safety
- Diversity & inclusion
- Philanthropy

Governance

Are policies in place to promote transparency and avoid conflicts of interest?

Considerations:
- Executive compensation
- Board structure
- Political lobbying

Keep in mind that just because a company is committed to clean energy or gender equality doesn't automatically make it a good investment. You have to view ESG factors in conjunction with financial records and other criteria to get a complete picture of an investment's potential risk and return.

ESG & Risk Management

Incorporating ESG factors into the investment due diligence process can help uncover systemic risks that may adversely affect an individual's or organization's investment in that company. Think:

Texas

When weaknesses in the ability of the state's public utilities to withstand extreme weather were not addressed, the 2020 winter storm turned into a social crisis.

Wells Fargo

The lapse of oversight and unethical business practices resulted in 3.5 million fake accounts being set up in clients' names to achieve sales goals.

Six Principles for Responsible Investment

Another factor that may influence your investment decisions is whether a particular investment manager has signed the six Principles for Responsible Investment.[1] These principles, created by an international group of investors to encourage a more sustainable global financial system, are endorsed by the United Nations. It's important to note that participation is voluntary, so this agreement should not be the sole factor for choosing where to invest. An investment manager may have valid reasons for not adopting the principles even though it supports socially responsible initiatives. If the agreement is important to you, add it to your list of questions for potential investment providers to learn why they have or haven't signed it.

Measuring Impact

In addition to competitive investment performance, people want to know if their investment is having the intended effect. Like screening techniques, impact measurement and reporting continue to improve. The challenge is determining the relevant metrics to measure, collect and assess. Certain causes are just naturally easier to quantify than others, such as a reduction in carbon gases. Your advisor can help you identify the metrics and the third-party reporting tools that align best with your cause.

With this information as a backdrop, let's turn our attention to specific considerations for family offices, retirement plan committees, and nonprofits.

Top Three Reasons for Measuring Impact

- To better understand whether the impact demonstrates progress towards the goal
- To proactively report impact to key stakeholders
- To improve impact performance

Source: Global Impact Investing Network (GIIN), The State of Impact Measurement and Management Practice, Second Edition, 2020

Six Principles for Responsible Investing

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

Source: https://www.unpri.org/pri/about-the-pri

Section 2: SRI Considerations for Individual Investors and Family Offices

Once thought to be a fad, socially responsible investing has become mainstream and is now being incorporated to some degree by most institutional money managers. This availability makes it easier to apply your socially conscious values to your investment strategy. But it can also make the decision-making process harder, especially if not all family members are on board or have differing opinions.

The key is to treat SRI like any other investment, meaning you need to discuss the viability of the strategy as a family and create a formal process for evaluating potential investment opportunities.

The following framework can foster constructive conversations about SRI and help you identify the best approach for your family. We also encourage you to invite your investment advisor to the meetings. They can facilitate discussions, answer questions and keep emotions in check.

The Family Office Perspective

73%	39%	62%
currently invest a portion of their assets sustainably	intend to allocate most of their portfolios to SRI over the next five years	believe impact investing is important for their legacy

Source: UBS, Global Family Office Report 2020

Important Note for Individual Investors

This framework is not just for family offices. It's also an effective way for you to make informed decisions about your own investment portfolio.

What's Your Vision?

As we discussed on page 3, socially responsible investing means different things to different people. So, before anything else, you need to establish common ground amongst family members. Your loved ones' goals, motives and reasoning will be the foundation for your decisions. Here are some questions to get the conversation flowing:[2]

- What is your perspective on the role of philanthropy and investment?
- In what ways have philanthropic efforts been effective or limited?
- What problems are you passionate about resolving?
- What societal issues is the family office best positioned to address given the time horizon and investable assets?
- How do you see impact investing fitting with the family's current and long-term financial goals and shared values?
- What considerations, trade-offs and constraints are you willing or not willing to accept?
- What do you hope the long-term impact of incorporating SRI will be for family members, the broader community and future generations?

Who's Your SRI Champion?

Appoint a family member who can act as the "SRI specialist" in conjunction with your investment advisor. This individual can help facilitate the conversation, balance competing priorities, and offer an objective opinion grounded in facts and data, not emotion.

Once you reach a consensus, consider formally documenting your vision. A written policy can help minimize discord if questions arise in the future. You'll also want to periodically review your vision to make sure it remains in sync with your family's priorities.

How Much Do You Want to Allocate to SRI?

The next step is to decide the percentage of your portfolio that will be dedicated to socially responsible investments. Ten percent? Twenty-five? Fifty or more? There is no right or wrong amount. Ultimately, it's the percentage that makes you feel like you're making a difference while pursuing your goals. That said, you don't want your passion overshadowing basic investment tenets. You still want a diversified portfolio that can help you withstand changing economic and market conditions.

Some best practices for incorporating SRI in your portfolio include:

- Asking your investment advisor to evaluate existing investments to see if they already have an element of SRI.
- Starting with a smaller percentage to "test the waters" and give family members time to adjust to the investment strategy
- Choosing less aggressive investments initially, like a socially responsible index fund to ease into this asset class.

What are the Investment Ground Rules?

Like your vision, you'll want to document your investment parameters. Reach out to your advisor to discuss and add SRI goals, target allocations, risk preferences and benchmarks to your Investment Policy Statement. These parameters will guide all decisions related to the SRI portion of your portfolio, including investment selection, monitoring and removal.

How Will You Execute Your Investment Strategy?

Your advisor can work with you to evaluate and narrow down the list of potential investments based on your Investment Policy Statement and overall financial landscape. Depending on your circumstances, the strategy might include one or more of the following:

Passive Investments

- Mutual funds and exchange-traded funds (ETFs) that screen for SRI factors
- These funds tend to replicate a specific market index such as the MSCI World SRI Index
- The managers take a more hands off approach

Active Investments

- Mutual funds and exchange-traded funds (ETFs) that screen for SRI factors
- These funds strive to outperform the financial markets
- The managers take a more hands on approach, actively buying and selling based on market conditions

Custom Solutions

- A diverse portfolio of stocks that reflects your vision
- The investment manager selects companies that meet your criteria and offer the best return potential
- For example, if your goal is to promote gender equality, they might choose stocks of women-led businesses

Alternatives

- A niche oriented strategy, where you invest for a tangible impact
- Investment vehicles include private equity, hedge funds, venture capital, and real estate, including opportunity zones
- For example, if you're concerned about climate change, you might invest in a clean energy private equity fund

How Often Will You Review the Investments?

Your life and the world are ever-evolving, and your portfolio needs to keep pace with both. Most families meet with their advisors quarterly to monitor progress and discuss any changing circumstances, such as the death of a loved one or a new social cause. At the very least, you should conduct annual investment reviews. Consider setting aside time at one of your regularly scheduled family meetings to discuss your portfolio. That way, it doesn't require an additional time commitment from family members.

Client Story

Aligning Investment with Values - Clients have Manager Options with ESG focus

A prospective client was concerned that his existing equities being managed by another firm weren't aligned with his personal values. We were able to transition the holdings in a tax-sensitive manner to an Active Global Equity Manager that considers ESG factors as a primary driver of their investment process. Additionally, we restructured the remaining equities in line with a Global Equity Index while incorporating a custom ESG screen that better aligned with the clients personal values.

We hope this framework has shown that choosing to invest in socially responsible investments is no different from investing in U.S. stocks. You want to follow a prudent process and create a diversified portfolio that aligns with your goals, time horizon and risk tolerance. Adopting this mindset may ease the concerns of any skeptics in the family.

Your Investment Action Plan

- Schedule a family meeting to discuss your SRI philosophy.
- Ask your advisor to analyze your existing investments for any SRI elements.
- Create a plan for adding or expanding the SRI portion of your portfolio.

Section 3: The Role of SRI in Defined Contribution Investment Lineups

61% of workers said they would be more likely to contribute, or increase contributions, to their workplace retirement savings plan if they knew their investments were doing social good.[6]

Demand for SRI is not limited to individual investors and family offices. There is a growing cry from many retirement plan participants to add environmental, social and governance (ESG) funds to plan investment lineups. Like their personal investments, they want their retirement savings to do good while earning reasonable returns.

Despite this demand, only a small percentage of workplace retirement plans offer ESG funds. How small? Less than 3%, according to the Plan Sponsor Council of America.[3] What's holding employers back? For many, it's a lack of clarity around their fiduciary responsibilities for selecting and monitoring these investment vehicles.

Flip-Flopping Guidance

For years, it was generally believed that all else being equal, a plan committee could use ESG factors to choose between two investment choices, essentially using them as a tie-breaker. That said, Department of Labor (DOL) guidance often shifts depending on which political party is in the White House. The ESG rules are a prime example of this shift.

June 2020 (Trump Administration)	October 2020 (Trump Administration)	March 2021 (Biden Admininstration)	TBD (Biden Administration)
DOL released proposed rules limiting the use of ESG funds in retirement plans and requiring additional documentation.	Due to the overwhelming number of comments, the DOL revised the final rule. All investment decisions (ESG & non-ESG) have to be based on pecuniary factors, which are things that affect an investment's risk & return.	DOL announced it is reviewing the current policy and won't enforce it. View the press release explaining the rationale for this decision.	DOL may revise or eliminate the 2020 guidance.

No Reason to Wait

Just because we don't know if or when the DOL may issue new ESG guidance doesn't mean these vehicles aren't a prudent choice right now. If you want to add an ESG fund in the interim, the best approach is to follow the same due diligence process and metrics that your committee uses to evaluate any new investment vehicle. In the eyes of the courts and regulators, process usually matters more than results.

You'll typically find these parameters in your plan's Investment Policy Statement(IPS). Be sure to engage your advisor in the discussion as they can provide valuable advice and guidance. At Cerity Partners, we use our disciplined investment process to help clients narrow down the list of possible investment choices based on their IPS, goals and workforce.

Additionally, if your plan offers a self-directed brokerage option, participants can use it to invest in ESG funds. In this case, they would be responsible for conducting their own due diligence as they would for any investment in their self-directed brokerage account.

Client Story

Employees Spur ESG Discussion

The highly educated, younger employee population of a consulting firm wanted an ESG investment added to the firm's $600 million 401(k) plan. So, the plan committee reached out to Cerity Partners to identify several viable options.

We believe an educated committee is better equipped to make sound decisions. That's why our support went beyond basic investment analysis. We created a report outlining the pros and cons of adding an ESG-specific fund to the core lineup, which was used to lead an informed discussion about how to define, select and monitor an ESG investment. Armed with this information, the committee felt confident in its decision.

Building Good Will

As you weigh the potential benefits and risks of adding an ESG fund to your plan's lineup, be sure to factor in participant demand. The ultimate goal is to provide diverse investment offerings that enables employees to accumulate meaningful retirement savings. There's no reason to add a fund that participants won't use. On the other hand, adding an investment that participants have requested can go a long way in increasing loyalty. Employees appreciate employers that listen to and value their opinions.

Your Investment Action Plan

- Survey employees to gauge their interest in socially responsible investments.
- Schedule a plan committee meeting to review the results.
- Meet with your advisor to discuss investment parameters if you decide to move forward.

Section 4: SRI and Your Nonprofit's Mission

While retirement plans are treading cautiously into the world of socially responsible investing, the opposite is true for nonprofits and endowments. Many of these organizations have fully embraced SRI to better align their core missions and investable assets. From 2018 to 2020, philanthropic foundation ESG assets increased 43%, according to The Forum for Sustainable and Responsible Investment.[4] This isn't surprising. After all, this type of investing seems like a natural fit for institutions committed to doing good.

Top Issues for Nonprofits

- Tobacco
- Conflict Risk
- Climate Change/Carbon
- Clean Technology
- Affordable Housing

Source: USSIF, 2020 Report on U.S. Sustainable and Impact Investing Trends

Devoting a portion of your nonprofit's portfolio to SRI can help amplify your mission. It sends a powerful message to current and potential contributors that your nonprofit is doing everything in its power to "vote with its checkbook." Of course, as we've said repeatedly in this paper, you don't want to jump in without having a formal process for evaluating, selecting and monitoring these investment vehicles.

Pairing Your Mission & Investments

As we discussed in Section 1, the first step is to identify which type of socially responsible investing aligns best with your nonprofit. From there, your board will want to discuss investment parameters and strategy. Here are a few examples to help facilitate the conversation.[5]

Nonprofit Mission	Potential Investment Strategy
Health	• Avoid companies that profit from unhealthy products such as tobacco. • Vote shares to support resolutions that call on corporations to improve the health and safety of their products.
Environment	• Avoid carbon-intensive companies. • Invest in private equity and venture capital funds that finance companies providing clean technology.
Human Rights	• Use investment managers that assess companies on human rights policies and risks. • Support shareholder initiatives aimed at ensuring multinational companies take steps against human rights abuses in their operations and supply chains.

Executing Your Investment Strategy

Once you've reached a consensus, the next step is to incorporate the SRI parameters into your investment decision-making framework, which typically includes an Investment Policy Statement. This framework will serve as a road map for conducting due diligence on the various investment vehicles.

Unless your foundation board includes members with the investment expertise to conduct this analysis, we encourage you to leave the due diligence to your organization's investment advisory team. Based on your philosophy, goals and IPS, they can help you identify the right solutions that make the most sense for your circumstances.

Additionally, your advisor can benchmark the investments you select and provide performance reporting to help the board make ongoing decisions about the SRI portion of the nonpofit's portfolio.

Client Story

University Investment Committee Educates Themselves on the Benefits of ESG

The Investment Committee of a large university was approached by a group of students and faculty proposing a fossil fuel-free approach to their investment policy.

After consulting with the key stakeholders (students, faculty and staff, committee directors, board trustees, and the university's president), a more comprehensive approach was implemented. The investment policy statement was redrafted to incorporate specific ESG guidelines, the objective being to have an evergreen approach that would reach beyond a fossil fuel-related restriction.

Of course, one of the concerns was the impact the ESG program might have on future performance. But after consulting with Cerity Partners, the university decided to continue measuring the portfolio against the same benchmarks used prior to ESG implementation to provide a proof statement that ESG investing can be good for both the world and their portfolio.

Advocating Change Through SRI

Your nonprofit is already making an impact through its endowments, grants and outreach. Investing in companies that share your vision gives you another outlet for promoting your mission, corporate accountability and positive social change. As a shareholder, you can use your voice and voting proxies to call attention to business practices that could negatively affect the company's workforce, the community and environment. In essence, SRI is really an extension of what your nonprofit does every day.

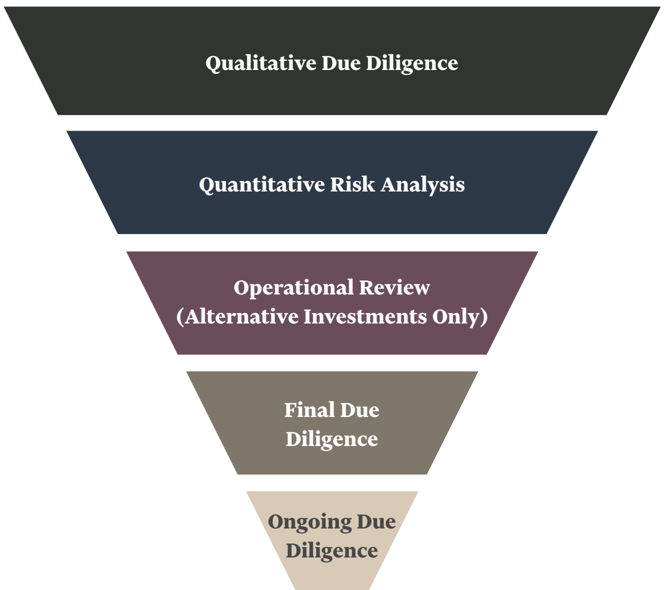
Your Investment Action Plan

- Schedule a board meeting to discuss the nonprofit's SRI philosophy.
- Ask your advisor to analyze your existing investments for any SRI elements.
- Create a plan for adding or expanding the SRI portion of your portfolio.

Section 5: Cerity Partners' Approach to Socially Responsible Investing

Cerity Partners has advisors with a deep understanding of the topics discussed in this paper, including Chartered SRI Counselors that can guide you through the decision-making process, providing objective advice at every stage.

Moreover, we follow our own advice. We treat socially responsible investments like any other investment under consideration—holding them to the same standards and employing a rigorous due diligence process as outlined below.



- Manager experience and track record
- Product, manager and organization characteristics
- Industry review
- Red and yellow flag screen

- Multidimensional comparison of product performance
- Peer group review
- Performance attribution (understand sources of return)
- Individual deal or investment analysis

- Onsite meeting with operational support team
- Review of internal/external operational controls & procedures
- Independent service provider checks
- Financial statement review

- Formal presentation to the Manager Research Group & Investment Committee
- Complete in-house due diligence document & conduct reference checks
- Discussion of any potential red flags
- Portfolio sizing recommendations

- Ensure manager is adhering to mandated strategy
- Re-affirm opportunity set for manager's strategy
- Identify & explain deviations from expected performance
- Track changes to the organization, philosophy, or process

From the narrowed list of potential investment opportunities, we recommend the ones that we believe offer the best expected return potential for your specific circumstances. We are committed to helping you invest in a way that is consistent with your overall social mission, goals and objectives.

Impactful Investing for Your Future and Society

To learn more or for assistance in adding socially responsible investments to your portfolio or investment lineup, contact a Cerity Partners advisor. Together, we will pursue your goals while helping make the world a better place.

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About Cerity Partners

Cerity Partners is one of the nation's leading independent financial advisory firms. We serve high-net-worth individuals and their families, businesses and their employees, and nonprofit organizations from our offices across the country. Our in-house experts of tax advisors, financial planners, investment professionals, and retirement plan consultants are passionate about and committed to providing objective financial advice and oversight. Visit ceritypartners.com to learn more.

Sources:

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6 Natixis 2019 Defined Contribution Plan Participant Survey