

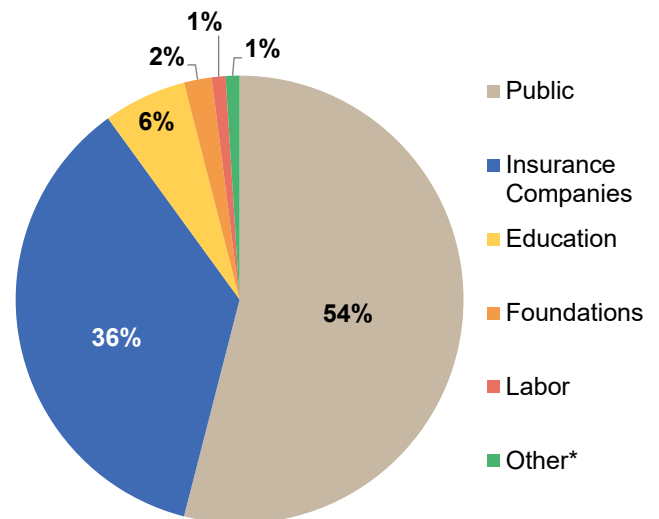
Fixed Income Investing: ESG Strategies & Key Considerations for Implementing an ESG Approach

InvestEd | March 2021



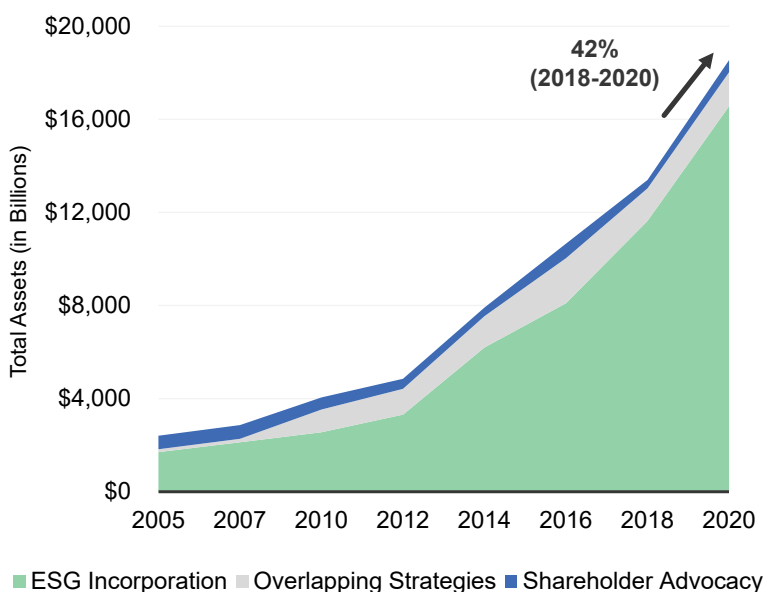
In the United States, sustainable investing continues to grow at a healthy pace. According to the 2020 Forum for Sustainable and Responsible Investment (U.S. SIF) report on U.S. Sustainable and Impact Investing Trends, domestic assets that incorporate sustainability into the investment process totaled \$17.1 trillion in 2020, which is a 42% increase since 2018. Incorporating Environmental, Social and Governance (ESG) is the primary sustainable investment approach with \$16.6 trillion of U.S. assets using this strategy to help achieve their sustainable investment objectives. The public sector is leading the way, representing 54% of institutional investor ESG assets.¹

Institutional Investor ESG Assets, by Investor Type, 2020¹



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

Sustainable Investing in the United States 2005-2020¹



There are several factors driving this substantial growth in ESG investing, including:

- The alignment of investment objectives with investor values
- A reduction in the investor impact on the environment, such as climate change and carbon output, pollution, and resource use
- Concerns about investor impact on social issues, such as community relations, human rights, and labor standards
- An increased focus on corporate governance
- Leveraging ESG to evaluate and help mitigate investment risk
- Addressing concerns raised by stakeholders
- Seeking to increase investment returns

¹ U.S. SIF 2020 Report on Sustainable and Impact Investing Trends.



While more common in equity portfolios, ESG strategies may also be incorporated into fixed income portfolios using investments in corporate debt by leveraging a variety of approaches, including:

Top Performers Approach — This broad-based approach is generally referred to as “positive screening.” With this method, investment eligibility is typically based on an issuer’s ESG risk metrics, relative ESG performance within their industry or subindustry group and/or other criteria that the investor deems appropriate. This approach may also incorporate exclusions.

Industry Tilts — This approach is typically more appropriate for a portfolio that seeks to reduce ESG risk while also investing in accordance with an index. The investor adjusts issuer and industry weightings relative to index weightings based on issuer ESG risk metrics. For example, issuers with lower ESG risk would receive higher weightings, while issuers with higher ESG risk would receive lower weightings than the index weightings.

E, S or G Focused — This is a more narrowly focused ESG risk management approach. Implementation typically involves strategies designed to reduce exposure to environmental, social, or governance risks or specific ESG risk drivers, such as carbon output or human capital management. It may also incorporate exclusions.

Hybrid Approach — This is a combination of two or more of the above approaches, with adjustments based upon an investor’s preferences and objectives.

Selecting an Approach: Key Considerations

The appropriate ESG approach will vary by organization and depend on preferences, ESG objectives and other organizational goals. But how does one ultimately choose? PFM has developed the following process to assist in identifying, developing, and implementing the approach that seeks to meet your organization’s sustainable investment objectives.

Identify Sustainable Investment Priorities & Objectives. An important first step is to determine your organization’s sustainable investment objectives.

Questions to consider include:

- Is the goal exclusionary in nature? e.g., Is the primary objective to avoid investing in certain types of issuers or industries?
- Is the interest in sustainable investing driven by the desire to reduce ESG risk exposure? If so, is your organization interested in an inclusionary approach based on an issuer’s management of its material ESG risks?
- How important is it to align investment objectives with organizational values?
- Would an approach that combines exclusions and ESG strategies work best?

Review ESG Investment Approach Options. Once sustainable investment priorities and objectives are determined, we suggest identifying potential approaches to help your organization achieve its ESG objectives.

Define ESG Investment Parameters. Next, an investor should develop potential ESG investment parameters, which are the criteria or “rules” that will be applied to determine if an investment is eligible for inclusion in the portfolio. Examples of ESG criteria include ESG risk metric thresholds (e.g., limiting eligibility to issuers with medium or lower ESG risk), relative peer group rankings and industry exclusions.





Evaluate ESG Integration Impact. A critical step involves analyzing the impact of potential ESG investment parameters on the portfolio. For example, it is important to assess how potential ESG investment parameters may impact the universe of permitted investments and the ability to achieve appropriate diversification.

Update the Investment Policy. After finalizing the ESG investment parameters, the Investment Policy should be updated to document ESG investment goals and the approach applied to help achieve these goals. This may be accomplished by incorporating ESG specific language in the Policy or an addendum to the existing Policy.

Integrate ESG into the Investment Process. Once the updated Investment Policy language is approved, the ESG strategy may then be integrated into the investment process.

Monitor Results and Revise Approach as Needed. Monitoring results is important to help ensure that the ESG approach is being executed in accordance with the applicable ESG investment parameters. Monitoring also enables investors to determine if changes to ESG investment parameters are needed to better achieve goals or align the approach with their evolving sustainable investment objectives.

Conclusion

PFM works hand in hand with clients throughout this process and helps them develop and implement ESG investment solutions customized to their sustainable investment objectives. This dynamic approach provides our clients with the flexibility to modify their ESG strategy as their sustainable investment objectives evolve.

For more information about how we can help you incorporate your ESG goals into your investment program, please contact us or your PFM representative.

To learn more or discuss in greater detail, please contact us:

Dave Reeser, CTP, EA | Managing Director
reeserd@pfm.com | 717.231.6258

The views expressed constitute the perspective of PFM Asset Management LLC at the time of distribution and are subject to change. The content is based on sources generally believed to be reliable and available to the public; however, PFM cannot guarantee its accuracy, completeness or suitability. This material is for general information purposes only and is not intended to provide specific advice or a specific recommendation. PFM is the marketing name for a group of affiliated companies providing a range of services. All services are provided through separate agreements with each company. Investment advisory services are provided by PFM Asset Management LLC, which is registered with the SEC under the Investment Advisers Act of 1940. For more information regarding PFM's services or entities, please visit www.pfm.com.