

PFM's Environmental, Social and Governance Capabilities

Frequently Asked Questions

Q&A | April 2020



To provide greater insight into PFM's environmental, social and governance (ESG) fixed income investment capabilities, and to answer some frequently asked questions regarding this increasingly hot topic, we conducted the following Q&A session with Dave Reeser. Dave is a managing director in PFM's investment advisory practice. He is responsible for developing PFM's fixed income ESG solution and for working with public sector and non-profit clients to design and implement ESG investment programs.

What is ESG investing?

Reeser: Broadly speaking, we view ESG investing as the inclusion of measurable non-financial environmental, social and governance factors into an investment analysis. It is intended to be an objective approach to integrate ESG risk analysis into the investment process. It is not intended to be exclusionary in nature, although depending on an investor's perspective and preferences, it may be to some extent.

How has ESG investing evolved in recent years?

Reeser: The early iterations of sustainable investing often utilized an exclusionary approach by identifying specific segments of the market to exclude from a given investment portfolio (such as the ownership of alcohol, tobacco or fossil fuel companies). However, ESG investing is now less focused on an exclusionary component and more focused on organizations that demonstrate a commitment to effectively managing (through proactive policies and procedures) their ESG risk exposure. As a result, the growth in assets that incorporate ESG in the investment process has grown exponentially. For example, according to the U.S. SIF Foundation, assets that incorporate ESG into the investment process have grown from roughly \$2 trillion in 2003 to about \$10 trillion by the end of 2018.¹

What is driving the increased interest in ESG investing?

Reeser: There are a number of factors. For starters, there has been a greater emphasis in recent years on the alignment of investor objectives with values. Also, investors are increasingly concerned with their and their investments' impact on the broader environment. One might also posit that an increase in ESG-related disclosures by publicly traded companies (due to public and stakeholder scrutiny) is driving interest as well. Additionally, Millennials have shown substantial interest in ESG, and their interest cannot be understated.

Finally, many believe that companies that incorporate ESG and sustainability into their management practices have the potential to perform better over time.

What factors should investors consider prior to implementing an ESG investment approach?

Reeser: Investors must first determine what their ESG objectives are. For example, a given investor may be interested in employing a broader ESG investment approach that focuses on issuers with lower ESG risk exposure. Yet another investor might be interested in an exclusionary approach that seeks to avoid specific issuers, industries, or organizations involved in certain business activities, such as ammunition or firearms manufacturing. Other investors may be interested in an approach that incorporates both of these elements. Again, formulating a coherent set of investment objectives and parameters is key to the process.

¹ U.S. SIF Foundation 2018 Biennial Reports on U.S. Sustainable, Responsible and Impact Investing Trends.



When it comes to ESG fixed income investing, what are some of the biggest challenges?

Reeser: Perhaps the biggest challenge is that there is no universally accepted definition of ESG. It means something different to everyone. Also, in the public space, (fixed income) permitted investments for shorter-term funds are typically limited, which narrows investment options. For example, permitted corporate debt is typically limited to obligations with "A" or better credit ratings, which can present industry diversification challenges since a large percentage of investment-grade debt is issued by financial institutions. As such, ESG risks tend to be driven more by social and governance-related issues, as opposed to environmental factors.

What does PFM offer on the fixed income front (in terms of ESG solutions)?

Reeser: We offer a flexible solution that is designed to allow our clients to define their ESG investment criteria. Based on their ESG investment objectives, we work with each client to develop and implement a customized ESG solution. Again, customization and flexibility are at the heart of our approach. With all of that in mind, this approach may evolve over time should a client's views on ESG, or their objectives, change.

What are some of the advantages of PFM's fixed income ESG solution?

Reeser: It is transparent, practical and not overly complicated. We work with our clients to define ESG parameters for purposes of selecting securities and to eliminate ambiguity. But again, the client defines the ESG investment criteria. We do not.

How is PFM's approach to ESG fixed income investing different than other investment managers?

Reeser: Other managers typically offer a more "off the shelf" ESG solution in which they define ESG. This differs from the PFM approach in that we want the client to have a say, and to formulate their own ESG investment criteria. In addition, we remain flexible with regard to the strategy, should our client's objectives evolve over time.

What are some examples of PFM's ESG fixed income investment strategies?

Reeser: We believe that there are several ways to approach fixed income ESG investing. For example, using a quantitative approach, issuers included in a given ESG portfolio must have ESG risk ratings that are below a specified threshold as set by the client. Another strategy we might employ could include both a quantitative component and an exclusionary factor as set by the client (e.g., exclusion of gun manufacturers). Yet another approach may employ an institutional third-party strategy, which focuses on strong performing issuers in each industry from an ESG perspective. Of course, we can design a strategy that incorporates elements of each of these examples.

How can investors learn more about PFM's ESG fixed income ESG solution?

Reeser: Investors should reach out directly to their PFM representative. They should also feel free to contact me to discuss how PFM can assist you with evaluating and implementing a custom ESG fixed income investment approach.

For more information, please contact your PFM relationship manager.



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

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

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