



Applying Mission Focus to Your Investment Policy Statement through

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) INVESTING

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Introduction

This paper serves as a guide to those of you within foundations and other mission focused organizations looking to construct an Investment Policy Statement (IPS) that aligns investment policies with your core mission and values.

An IPS is designed to serve as a strategic guide in the planning of any investment approach and offers an overarching investment philosophy as well as a management plan for the life of your investments. The IPS also allows your organization to establish its long-term goals to ensure that in times of market volatility, the path forward is clear. While it is important to define specific financial parameters pertaining to risk, liquidity, and asset allocation within an IPS, it is equally important to ensure that the mission of your organization powerfully aligns with your investments.

Defining ESG, Impact, and SRI

For the purposes of this paper, we will use the term ESG to describe mission focused investing by institutions. There are a range of environmental, human rights, diversity, consumer protection, and health issues that are covered under the broad heading of environmental, social, and governance (ESG) issues. We view *SRI investing* as synonymous with ESG investing, using the definition of US SIF, the member association for practitioners of this type of investing.

Sustainable, responsible and impact investing (SRI) considers environmental, social, and corporate governance (ESG) criteria to generate long-term competitive financial returns and positive societal impact. – US SIF

In our view, *impact investing* means focusing on ESG issues through capital deployment with the specific goal of improving outcomes related to these issues. Impact is possible across all asset classes.

While mission focused investors may have different sets of issues they choose to focus on to align investments with values, they are generally a subset of core ESG issues. In many cases institutions choose a broad approach to ESG investing, even if they are programmatically a single issue focused organization, because so many of these issues are inextricably connected, such as gender empowerment, access to education, human rights, and climate change.

COMPONENTS OF AN IPS TO SHAPE FOR MISSION

The following components of an IPS can include a focus on impact or values:

| TOPIC | DEFINITION | ESG RELEVANCE | ESG ISSUE |
|--|--|---------------|--|
| Statement of Investment Philosophy | Provides a review of key thoughts that guide the overall purpose of the investment program for the institution | Yes | Include explicit mention of how ESG investing can align with organizational mission |
| Delegation of Responsibilities | States who is responsible for various aspects of financial management and review | Yes | Include how ESG research, advocacy, and monitoring is conducted by various parties including external managers |
| Spending Goals | Outlines spending approach | No | N/A |
| Investment Goals/ Portfolio Guidelines | Determines investment objectives and the appropriate diversification of assets, including the target mix of equities, fixed income, and cash equivalents | Yes | Allocation targets may be influenced by impact goals |
| Environmental, Social, and Governance Guidelines | Directly addresses the institution's approach to the incorporation of ESG criteria | Yes | Identify any specific ESG investing approaches that are to be used, including ESG criteria, advocacy, and public policy |
| Risk Tolerance | Specifies the level of risk willing to be taken by the institution | Yes | Identify ESG risks that may influence organizational thinking related to your overall risk tolerance, such as climate change |
| Income Needs | Identifies immediate income requirements | No | N/A |
| Liquidity Needs | Specifies the institution's liquidity needs | Yes | Discuss the degree to which certain impact investments may require lower liquidity, such as private investments |
| Time Horizon | Specifies the time horizon of the institution | Yes | Include a discussion of how ESG issues may play out over a longer-term time horizon and how this aligns with portfolio positioning |
| Framework for Rebalancing | Set clear guidelines for how and when to rebalance to keep target asset allocation | No | N/A |

Statement of Investment Philosophy

The Statement of Investment Philosophy is a general review of the key elements guiding the investment program for the institution. Within this Statement, this is your opportunity to ensure that your investment portfolio clearly supports the mission and views of your organization. If you have a specific interest or goal that you are working towards, it should be clearly stated here to guide any questions that may develop throughout the life of your investment.

Questions to ask:

- » What general beliefs guide your investment approach that relate to ESG investing?
- » What approaches to ESG investing make sense for your organization?
- » What ESG issues are most important to your organization? Are they issues that can be addressed through investing in all asset classes, or do they better align with certain asset classes?

Example:

We believe our investments should reflect our values and mission as a nonprofit and intend to use our portfolio to address Indigenous Peoples Rights through negative screening, positive integration, and shareholder advocacy.

Delegation of Responsibilities

The Delegation of Responsibilities section helps provide clarity around who is responsible for various aspects of financial management and review. This section should provide clear and create concrete expectations for reporting and monitoring, including as it relates to ESG issues.

Questions to ask:

- » Who is responsible for monitoring adherence to ESG criteria?
- » What types of impact reporting do you expect from managers?
- » How are external managers required to integrate ESG criteria into aspects of the investment process (for example, obtaining data used for exclusionary screening)?

Example:

The investment committee will review on a quarterly basis the shareholder advocacy activities of each manager employed by the organization. The committee expects annual impact reports from all current managers that include a carbon footprint. External managers are expected to use their own database or data from an external research vendor to determine the application of specific ESG issues to the investment process.

Investment Goals and Portfolio Guidelines

Appropriate asset allocation should be driven your needs, risk tolerances, and suitability. An ESG focus may influence an allocation decision. For example, a focus on community investing may require an additional cash component to the strategy or certain environmental goals may be best achieved through an allocation to specific types of green bonds.

Your organization should decide what the appropriate diversification of assets consists of, generally including a mix of equities, fixed income, and cash equivalents. Investment in each class of securities should fall within defined ranges set in the IPS. You may provide specific guidance as it relates to exposure of certain types of impact investments, such as green bonds or community investments.

Questions to ask:

- » What allocation decisions may be influenced by a focus on ESG issues?
- » Should we set specific parameters for ESG investments taken together or by sub-segment?

Example:

The organization will allocate \$100 million to impact investments, with at least 15% of the fixed income portfolio dedicated to green bonds.

Environment, Social, and Governance Guidelines

Many mission-focused organizations are now including a specific section in the IPS that directly addresses an approach to Sustainable, Responsible, and Impact investing to deliberately invest portfolios in a manner that increases programmatic impact.

This ESG section should cover:

Negative ESG Criteria

Many mission-focused organizations will determine a list of specific companies they want to exclude from their portfolio that directly conflict with their mission. These may be based on specific business involvement, such as tobacco or weapons production. They may also be based on specific policies and practices, such as companies with major discrimination cases or with no board diversity.

Questions to ask:

- » Are there specific no-go areas for your organization based on specific companies or issue areas?
- » What level of involvement are you willing to tolerate for the issues that matter (i.e. % of revenues)?
- » Do you want to maintain a list of exclusions or rely on research from your external managers?

Example 1:

Our policy is to invest in opportunities that are consistent with the mission of our foundation and the clients we serve. Certain corporate securities that are deemed incompatible with our basic values (list basic values) shall be excluded from the long-term investment

funds. Specifically, we will avoid any companies with 5% or more revenues derived from tobacco production, weapons production, and nuclear power production. We will also exclude companies with major product safety, environmental, and discrimination related controversies. We will rely on the research of our external managers to determine the list of companies excluded.

Example 2:

We seek to avoid companies we assess as having systematically failed in protecting the environment, human rights, workers, or that prove unwilling to engage in a meaningful process of change and will typically avoid investment in companies with egregious environmental profiles, direct involvement with severe human rights abuses, pervasive or longstanding patterns of discriminatory behavior, a record of not addressing sweatshop labor issues, significant operational exposure to the mining or to the nuclear power industries, and companies that derive significant revenues from producing, distributing or marketing firearms, tobacco, gaming, pornography, or military weapons systems.

EXAMPLES OF EXCLUSIONARY ESG CRITERIA

Remove companies with material involvement in businesses that have higher risk, such as:

- » Agricultural Biotechnology
- » Coal Mining
- » Hard Rock Mining
- » Nuclear Power
- » Tar Sands
- » Tobacco
- » Weapons/Firearms

Remove companies with major recent or ongoing controversies in areas such as:

- » Animal Welfare
- » Environment
- » Governance
- » Human Rights
- » Product Safety
- » Workplace

HOW TO IMPLEMENT A DIVESTMENT APPROACH

Many mission focused organizations are deciding to implement exclusions related to oil and gas holdings. Many of these investors believe that climate change poses the greatest risk to the issues they care about. Different investors can choose different approaches to divestment, varying from a best in class approach to complete exclusion of all companies involved in fossil fuel production.

OPTION 1 | Best in Class with Advocacy

We look to employ a “best in class” approach as we identify energy and utility companies that demonstrate they are actively managing environmental risks and opportunities. We will also use shareholder advocacy to push these companies to improve their carbon risk exposure.

OPTION 2 Carbon Risk

We look to employ a carbon aware investment approach, which includes active exclusion of companies with material involvement in tar sands and coal mining. We also look to conduct carbon foot-printing of the entire portfolio and expect favorable overall positioning versus the benchmark.

OPTION 3 Carbon Reserves

We avoid all companies with material carbon reserves, such as those identified by the Carbon Underground report maintained by Fossil Free Indices (<http://fossilfreeindexes.com/research/the-carbon-underground/>).

OPTION 4 All Fossil Fuels

We avoid any companies materially involved in fossil fuel energy production and distribution (>5% of revenues), as well as utility companies that generate energy from fossil fuels (>10% of generating capacity).

Positive ESG Criteria:

Many organizations will choose to identify positive traits for companies or other securities they would like to identify for portfolio selection. For example, they may select companies based on a ‘best-in-class’ approach to find companies that stand out against their peers in the same industry, such as minimizing the environmental impact of their operations. Some organizations may choose a thematic approach to ESG investing, focusing on themes such as energy efficiency or healthy living to identify companies with better long-term opportunities for growth.

Questions to ask:

- » What positive ESG characteristics do we expect from companies we invest in?
- » Are there any thematic areas we would like to identify as part of our investment approach?

Example:

To the extent possible, our policy is to seek companies demonstrating sustainable business practices, including a strong commitment to environmental leadership, progressive workplace policies, responsible overseas operations, and strong corporate governance practices. In particular, we seek investment in companies that innovate and develop new technologies to provide renewable energy and enhance efficiency, value workers and uphold human rights in their global supply chains, support organic/ sustainable agriculture and forestry, and have visionary leadership.

EXAMPLES OF POSITIVE ESG CRITERIA

Seek companies with strong management of ESG opportunities and risks in areas important to their industry including:

- » Board Diversity
- » Chemical Management
- » Clean Tech Opportunities
- » Climate Change Policy
- » Employee Relations
- » Executive Compensation
- » Healthier Products
- » Life Cycle Analysis
- » Product Safety
- » Resource Use
- » Supply Chain and Human Rights
- » Sustainable Agriculture
- » Water Use
- » Worker Safety

Proxy Voting:

Each year, companies seek votes from shareholders on items that are pending on their annual proxy ballots. The issues on which shareholders can vote range from the approval of boards of directors to social and environmental issues. Regrettably, too many investment managers and traditional mutual funds fail to responsibly vote their clients proxies, either by not voting at all or always voting exclusively with managements' recommended positions. The U.S. Securities and Exchange Commission requires investment managers to disclose to clients their policies for voting proxies and their voting records.

Many organizations have a fiduciary responsibility to vote proxies as they are an asset of the organization. This responsibility includes considering support of shareholder proposals related to key, material ESG issues, such as board diversity and executive compensation. Organizations should develop proxy voting policies and determine a way to handle issues that are "referred" — those not directly covered by the existing policy.

Questions to ask:

- » Who votes our proxies and are they using guidelines we have developed?
- » If we use an external service, do they offer an option to recommend votes based on SRI principles?
- » What specific ESG issues would we like to support through our proxy voting guidelines?
- » How often will we update our proxy voting guidelines?
- » How will we decide "referred" votes?
- » How will we monitor proxy voting by our external managers?
- » Will we disclose our proxy voting policies and/or voting?

Example:

Our organization will develop internal proxy voting policies that will support most ESG focused shareholder resolutions, particularly those focusing on executive compensation and political contributions transparency. We expect our managers to follow these proxy voting guidelines or to use a service that will follow these guidelines. We will develop an internal proxy voting committee to oversee the development and ongoing maintenance of our guidelines, including deciding any "referred" votes. We will review and update the proxy voting guidelines annually.

Shareholder Advocacy:

There are several ways to engage your portfolio and leverage your role as a shareholder so that your mission has further reach. Being a shareholder carries the responsibility to be an active owner on environmental, social, and governance issues. You are provided an opportunity to engage companies on their ESG performance using all of the tools at your disposal: direct dialogue with senior company leadership, filing or co-filing shareholder proposals, working within multi-stakeholder institutions, convening company/stakeholder meetings, investor education, proxy advisory discussions, speaking publicly about issues of concern, and many other tools. In doing so, you are able to encourage companies to take positive and impactful environmental and social actions that are consistent with company and shareholder interests or in the interests of your core holdings.

Four common tools in shareholder advocacy are:

- » *Company meetings:* Direct dialogue with companies on key ESG issues often through multi-stakeholder initiatives.
- » *Inquiry letter:* Sent to companies to push them to improve on a specific issue, often related to disclosure. Letter is addressed to key decision maker, such as Chief Sustainability Officer.
- » *Sign-on letter:* Sent to companies to get them to move on a particular issue. These are sporadic, but when they hit assets need to be mobilized quickly. Letter is addressed to a high level decision maker, such as CEO.
- » *Shareholder proposal:* Uses shares to officially ask companies to move on an issue through a formal SEC process that can go to a vote before all shareholders. This is a very public process, and the final outcome is generally either a vote or a "withdrawn resolution" in exchange for getting something concrete from a company.

Questions to ask:

- » Are we comfortable with our organization's name being in the public domain for advocacy work?
- » What investor networks can we join to help promote our core issues?
- » What types of shareholder resolutions are we comfortable filing?
- » Will we file ourselves or work with an external manager to file on our behalf?

Example:

We will engage in company dialogues and file shareholder resolutions related to empowering women, with the goal of filing one or two resolutions per year in coordination with our external managers.

Public Policy:

Many organizations believe it is important to weigh in on public policy issues concerning their areas of focus at the federal, state, and local levels. Working with other investors through investor coalitions, an investor voice through a sign-on letter or meetings with policy makers can have an important impact. Some investment managers will engage in policy work on your behalf.

Questions to ask:

- » What policy outcomes do we believe are critical to supporting our programmatic work?
- » Can an investor voice help create these policy outcomes?
- » What investor networks are working on these policy objectives?

Example:

Our organization will support policy outcomes aligned with our mission by harnessing our investor voice through letter writing and dialogue with policy makers. We will look to collaborate with like-minded investor groups, such as Ceres and ICCR, to broaden our investor voice.

Risk Tolerance

As an organization, you should decide what level of risk you are comfortable with in your portfolio and how you define it. Some of the existential risks facing your portfolio may relate to specific ESG issues, such as climate change.

Questions to ask:

- » What are key ESG risks that should be considered by the investment committee and the investment managers working on behalf of the committee?

Example:

As we believe climate change is a pressing risk to our investment portfolio over the long-term, we believe our investment managers should include carbon risk as a critical component of determining the long-term prospects for company performance.

Liquidity Needs

As an organization, you should decide what level of liquidity you need for the overall portfolio and within different asset classes. Some higher impact investments may require a longer term tie-up period, such as community investments and private equity / debt investments.

Questions to ask:

- » What is the overall liquidity the organization needs at the portfolio and asset class level?
- » Which specific impact investments require additional liquidity and can we off-set that with other investments?

Example:

The investment committee has determined that we will allow lower levels of liquidity in our impact investments in certain asset classes, such as private debt/equity, which should be offset by higher liquidity in other asset classes such as public equities.

Time Horizon

As an organization, you should decide the time horizon for your overall investments, which will help determine asset allocation and performance measurement approaches. Certain ESG issues may play out over a longer term time horizon, such as the physical impact of climate change. Some of these risks should be included in the discussion of how the organization determines time horizon and monitors performance for that period.

Questions to ask:

- » How will specific investments be impacted by ESG risks over the time horizon specified by the organization?

Example:

The investment committee has determined that our time horizon is 20 years, as we will gradually spend down the portfolio over this period. As we believe climate change is a pressing risk to the investment portfolio over the long-term (see Risk Tolerance section), we believe our investment managers should review carbon risk as part of determining the long-term prospects for company performance.

Conclusion

There are many opportunities to integrate ESG issues into your IPS in order to align your investments with your mission. We hope this paper provides a clear road map for the questions to ask and the language to include. This work has never been more important and the opportunities to leverage change through your investments are numerous. Congratulations on taking the first step!

Additional Resources

There are many organizations that provide specific advice to help organizations craft full Investment Policy Statements, beyond just the ESG focus that we outline in this report. Here are a few resources that can be helpful in starting your IPS development:



Commonfund Institute

Investment Policy Statement
www.commonfund.org



Exponent Philanthropy

Investment Policy & Strategy
www.exponentphilanthropy.org



CFA Institute

CFA Institute

Elements of an Investment Policy
Statement for Institutional Investors
www.cfainstitute.org

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