ESG in the News - FAQs

1. **<u>What does ESG stand for?</u>**

   Environmental, Social, and Governance.

2. **<u>How is this different from SRI, Impact, Sustainable, or mission-aligned investing?</u>**

   ESG encompasses all the actions and behaviors of socially responsible investing (SRI), impact investing (measuring a direct impact of capital investment, such as job creation and waste reduction), sustainable investing (good for the environment and society longer term), and mission-aligned investing that is connecting the investment directly to the desired ESG outcome.

3. **<u>Is there one industry standard or best practice? If not, why? How many?</u>**

   There is no one industry standard, and the problem lies in the opportunity. The reason for this is there is no one single definition of remedies or approaches to environmental issues such as climate change, water conservation or pollution control; social inequality issues such as gender diversity, workplace safety, and social justice; and good corporate governance such as community involvement and shareholder transparency. Areas of concern include climate change. There are over 600 sets of standards.

4. **<u>What are the main issues with multiple standards? What standards do you adhere to?</u>**

   The problem with multiple standards is a wide divergence in ESG ratings across rating providers. It is problematic for integrating and executing ESG factors into the investment management process with any consistency or credibility. As a guideline, we follow the GRI reporting standard, which has the longest track record and most significant marketplace acceptance. Even with this, we have adopted a consensus approach to using rating data to minimize the erroneous effects of wide divergences of the rating providers and several standards.

5. **<u>Does ESG integration into portfolios detract from or enhance performance?</u>**

   The answer to this question depends on how you reference or compare performance. Investing in ESG has a dual-purpose objective; 1.) investors are seeking a long-term financial outcome that best meets their specific goals and needs, and 2.) investors are seeking to make a societal difference with their investments that is very personal to them. Integrating ESG into the investment process to expect superior returns to the market is folly. Any introduction of E, S, and or G is a "constraint" on the market portfolio (market benchmark); hence, it can potentially detract from performance. However, as with any dual mandate, you cannot have your cake and eat it too, but you can satisfy both economic and social objectives with a thoughtful long-term dual-purpose plan.

6. **<u>How do I best measure and monitor performance in ESG portfolios if there are multiple standards?</u>**

   First, one should make sure that their financial objective benchmark (asset-liability; not the market benchmark) is managed with concern for risk, and secondly, because of multiple standards, one should not rely solely on ESG rating data alone, but instead make sure their investment advisor knows the companies and their track record on ES&G, even that cannot be quantified. Specific key performance indicators (KPIs) can be developed to measure, track, and monitor particular ESG benchmarks.

7. **<u>What is greenwashing?</u>**

   To intentionally mislead investors that the investment solution integrates ESG or any element of ESG when it does not. This is usually done for pure business (economic) reasons without considering the investor's true objective.

8. **<u>What is Dual Purpose Investing™?</u>**

   Dual Purpose Investing is the phrase that Palladiem has adopted (trademarked) to convey that investing in ESG is about achieving two objectives in the investment process: financial and societal.

9. **<u>What is the best approach for integrating ESG into the investment process? How does it impact the risk profile?</u>**

   The best approach to integrate ESG into the investment process is to consider ESG as a single factor incorporated into the portfolio optimization process. We would assign a ranking to risk and return to each consensus subfactor for ES&G along with pure investment-related factors. We believe this can only be done with thorough analysis at the individual company level and then aggregated to the portfolio level. Remember, when investing in ESG, it is dual purpose. There is a potential risk-return tradeoff when adding any constraint to the investment process, and the investor should understand these tradeoffs before investing in a dual-purpose mandate.

10. **<u>Can I or should I offer a uniform approach for integrating ESG into my investment portfolios? If so, how and what are the key criterion to consider?</u>**

    Yes, we believe a uniform approach should be adopted for integration into the investment process. This helps to ensure consistency of process and allows for ongoing monitoring and documenting the process relative to the investor's investment policy statement. The key criterion should be specified in the investor's investment policy statement. It should be specific as possible, including exclusions of controversial investments and proactive impact investments, including a record of proactive proxy voting.

11. **<u>If an advisor was considering outsourcing this process, what should they look for in a partner?</u>**

    The perquisites should be a definable and repeatable process for integrating ESG and monitoring the key KPIs related to ESG objectives. Experience and a demonstrated track record should also be required for consideration and the ability to vote proxies on behalf of shareholders proactively. An advisor must also know that this process is customized to each client's objective and mission and is not well suited for an "off the shelf" investment solution.

12. **<u>What are the most significant ESG topics of concern for advisors? their clients?</u>**

    Based on several investor surveys (Pew Research as an example), the two most important topics of concern to investors are climate change and inequality.

13. **<u>Are there biases that I should be aware of when expanding my process?</u>**

    ESG investing is very bespoke, and because there is no single standard, there will be biases.

14. **How does innovation cross over into ESG?**

There is certainly a crossover between innovation and ESG, especially when considering the "E". Numerous companies that follow the net-zero reduction of greenhouse gas emissions and focus on renewable energy, for example, are usually granted sizeable government subsidies (incentives) to invest in renewable energy technology, water conservation, and carbon credits.

15. **What are Net Zero and Paris Accord?**

Net-zero is the goal of balancing greenhouse gas emissions produced with reduced ones. Several countries have agreed to bring this balance to zero by 2050, with specific global average temperature change thresholds over the same period. The Paris Accord or the Paris Agreement is a legally binding international treaty on climate change. 196 Parties adopted it at the COP 21 conference in Paris in 2015. Its goal was to set the stage for limiting global warming to well below 2, preferably to 1.5 degrees Celsius.

16. **What has the SEC focused on in their review in terms of ESG disclosures?**

The primary focus has been greenwashing, looking for evidence of a process, and monitoring each client's ESG objective with its results. The SEC is focused on advertising claims of "integrating" ESG, etc., and disclosures.

17. **How do you measure ESG KPIs such as greenhouse gas emissions, job creation, waste management, and water pollution?**

Greenhouse gas emissions have focused on the effects of a company's action towards reduction measured in dollar cost savings and gigatons. Examples of other KPIs include net new jobs, average compensation, and the compensation gap between C-suite and lower level jobs. Waste management and water pollution KPIs include carbon emission and extraction and chemical reduction measurements for water.

18. **What do advisors mostly misunderstand about the concept of ESG and how to evaluate it?**

In our opinion, the most significant misunderstanding with ESG investing is failing to recognize that it is very personal, hence requiring customization on a client-by-client basis. Commingled investment products such as mutual funds and ETFs may expose these requirements but are not the best answer. ESG investing is similar to tax-efficient investing in terms of customization. We believe the best approach to both strategies is a customized separately managed account (SMA). Evaluation is also tied to the investor's ESG mandate's specifics via appropriate KPIs.

19. **How can I expand my investor qualification profile to include ESG investing?**

There are several ways one can raise their profile concerning ESG investing. For example, one can become more knowledgeable in sustainability by completing the (Global Reporting Initiative) GRI professional certification program. The other is to align one's advisory practice with professionals that can take the lead on this as fiduciary.

20. <u>Are the approaches to ESG different for active vs. passive investing?</u>

ESG can apply to both active and passive approaches, but whether it's used as a passive benchmark or not, it's an active portfolio management decision.