Mission-Aligned Investing

December 2015

Introduction

Rapid advancements in technology have brought the world to our doorstep, bringing to light many of the social injustices that occur across the globe. Simultaneously, recent studies have shown that companies with diverse representation on boards and gender diversity at the executive level are linked to a company's financial success, and new releases of climate change data have caused heightened awareness concerning the warming of the globe. Meanwhile, the word "sustainable" has entered our daily lexicon and become engrained in modern culture, while also becoming a vital component of the evolving "corporate conscience" throughout the world.

These social and environmental issues have led a growing number of institutions to grapple with the question, "What should be the relationship between our institution's goals and values and its investment activities?"

This report broadly outlines the history of mission investing—which encompasses socially responsible investing (SRI); environment, social, and governance (ESG) investing; and impact investing—with a focus toward more recent events, and explores the following considerations:

- Financial performance
- Fiduciary responsibility
- Questions to consider before aligning a portfolio with a mission
- Investment options available to align a portfolio with a mission
- Incorporating mission into the investment policy statement (IPS)
- Understanding portfolio exposure to companies that are not in line with a mission
- Implementation and potential costs
- Furthering a mission beyond changes to investment portfolios

History of Responsible Investing

1960s: Socially responsible investment (SRI) as we know it today emerges in the form of shareholder activism around civil rights, the Vietnam War, and environmental causes.

1980s: Apartheid, Chernobyl, and the Exxon Valdez oil spill accelerate interest in socially responsible investment.

Nov. 1991: Bishops' Conference adopts and begins to implement SRI guidelines.

Nov. 2003: USCCB updates SRI guidelines.

Apr. 2006: UN Principles of Responsible Investment launched.

Oct. 2012: Sustainability Accounting Standards Board (SASB) formed to quantify the value of corporate non-financial information.

Shareholder Advocacy — *Negative Screening* — *ESG Investing* — *Impact Investing*

1960 — 1970 — 1980 — 1990 — 2000 — 2010

1950s: Trade unions deploy multi-employer pension fund money for targeted investments.

1970s: First socially screened mutual funds are made available.

Nov. 1986: National Conference of Catholic Bishops releases "Economic Justice for All: Pastoral Letter on Catholic Social Teaching and the U.S. Economy."

1990s & 2000s: Increased transparency and advances in investment tools allow for integration of social and environmental criteria into the investment process.

2012: Coalition of *350.org*, As You Sow, Better Future Project, Energy Action Coalition, Responsible Endowments Coalition and others launch campaign to freeze any new investment in fossil fuels and divest from any holdings in commingled funds and corporate bonds within five years.

Recent Events

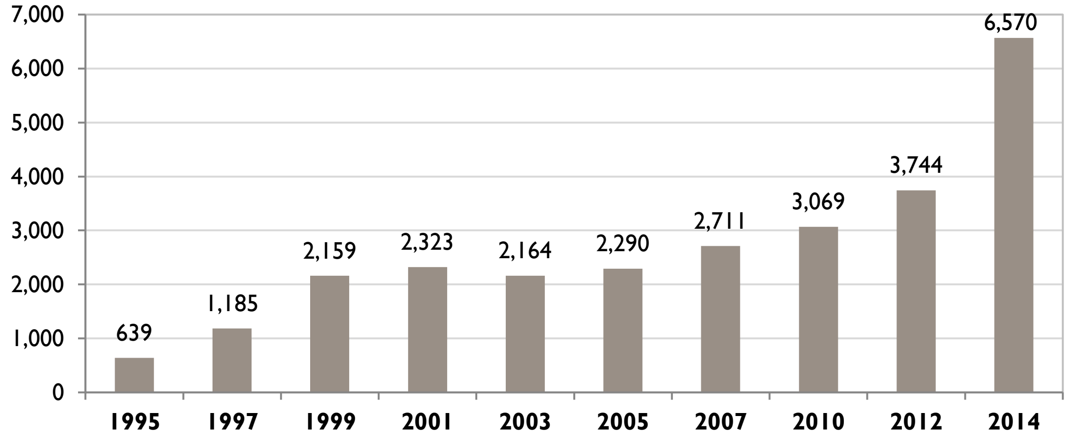
The Last 15 Years: A Growing Movement

2002	The Carbon Disclosure Project launches, petitioning thousands of companies to report on issues related to climate change. Now known as CDP, the project is currently supported by more than 750 institutional investors representing over $92 trillion in assets.
2003	Ceres creates the Investor Network on Climate Risk (INCR)to recognize and educate about the financial risk implications of climate change.
2006	Six Principles of Responsible Investment (PRI) launched as a result of a U.N. initiative. Today, PRI signatories total over 1,300 investors, representing $45 trillion in assets (as of January 2015). The six principles are: • We will incorporate ESG issues into investment analysis and decision-making processes. • We will be active owners and incorporate ESG issues into our ownership policies and practices. • We will seek appropriate disclosure on ESG issues by the entities in which we invest. • We will promote acceptance and implementation of the Principles within the investment industry. • We will work together to enhance our effectiveness in implementing the Principles. • We will each report on our activities and progress towards implementing the Principles.
2009	Bloomberg begins collecting ESG data. Five years later, reports 41.5% annual growth in investors using that data from 2009 through 2013.
2012	A group of organizations, including 350.org, launch a campaign calling for institutions to divest from direct ownership and any commingled funds that include fossil fuel public equities and corporate bonds within five years. Over the next few years, many colleges and universities respond, While many of the most prestigious schools in the U.S. opted not to divest fully from fossil fuel companies (eg. Harvard, Yale, Stanford, University of California) , they took action by adding staff with experience in sustainability, incorporating carbon metrics into portfolio assessments, divesting from coal, and launching initiatives to allocate significant resources to direct investments in solutions to climate change. Other colleges and universities including San Francisco State University, University of Dayton and SUNY ESF joined the now 500 institutions globally, representing $3.4T in assets, that have committed to divest from fossil fuels.
2014	Ceres releases the “Clean Trillion” Report calling for an average of $1 trillion in increases in annual clean energy investments.
2015	In his Encyclical, “Laudato Si” in May, Pope Francis called on all people of the world to begin a dialogue about caring for “our common home.” In November, 400+ institutional Investors, representing $24 trillion in assets, signed on to the Global Investor Statement on Climate Change, a coordinated effort of world wide organizations, including INCR, UNPRI, IIGCC, and Asia Investor Group on Climate Change ahead of the Conference of the Parties (COP) talks in Paris. The statement lays out a plan that involves working with policy makers, investing in low carbon solutions, developing the capacity to assess and address climate risk in investment portfolios, and engaging with companies on the risks and opportunities presented by climate change.

Adoption of ESG

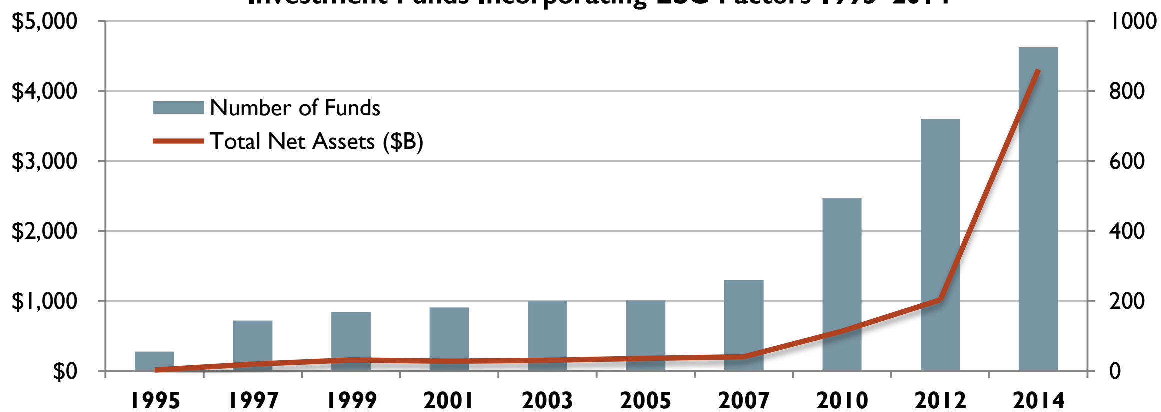
There has been considerable growth in SRI investing in recent years, according to a recent study by the U.S. SIF Foundation. From the beginning of 2012 to the start of 2014, total U.S.-domiciled assets vaulted from $3.7 trillion to $6.6 trillion—a 76% increase. Since the Foundation started tracking the U.S. SRI industry in 1995, the universe has increased tenfold (or 929%) with a compound annual growth rate of 13.1%. According to the study, one out of every six dollars under professional management in the U.S. is dedicated to sustainable, responsible, and impact investing.

Socially Responsible Investing in the U.S. 1995–2014*



The number of money managers and community-investing institutions incorporating ESG factors more than tripled from 2012–2014, from $1.4 trillion to $4.8 trillion. Among the factors cited fueling this change are growing market penetration by SRI products, the development of new products, the broader use by large asset managers, and greater commitment by institutional investors to integrate these principles.

Investment Funds Incorporating ESG Factors 1995–2014



Sudan divestment and community-related investment accounted for the majority, $4.3 trillion of the $6.6 trillion of the SRI-related investments.

Specific product exclusions such as tobacco and alcohol accounted for another $1.5 trillion of those assets.

Source: US SIF Foundation (2014)

**Overlapping assets involved in some combination of ESG incorporation (including community investing) and shareholder advocacy are subtracted to avoid potential effects of double counting. Separate tracking of the overlapping strategies only began in 1997, so there is no datum for 1995. Prior to 2010, assets subject to ESG incorporation were limited to socially and environmentally screened assets.*

Adoption of ESG

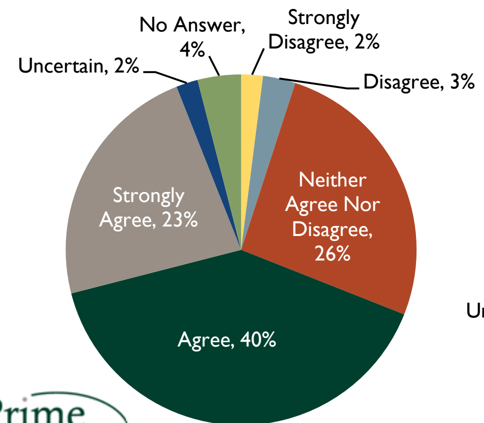
Use of ESG criteria in investor portfolios is difficult to quantify because of the various definitions and the significant ambiguity that exists. Recent survey data from endowments (NACUBO-Commonfund Study) and foundations (Council on Foundations-Commonfund Study) suggest that—even though few would argue about the rise in awareness and implementation—application of ESG criteria has remained steady over the past four years, ranging between 14% and 18% for both endowments and foundations.

In 2015, NACUBO-Commonfund conducted a follow-up study of 200 U.S. colleges and universities that participated in the initial survey. Of those institutions, 53 (26.5%) reported to have implemented at least one of the four types of responsible investment practices addressed in the study.

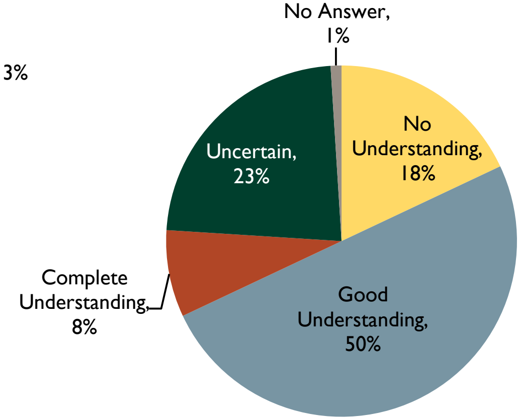
Approximately half of those adopting criteria identified themselves as faith-based institutions. The study suggests that this may be indicative of the larger issue of whether ESG strategies require entities to sacrifice performance to achieve certain social goals. While consideration of certain moral/ethical behaviors may be commonplace and accepted by faith-based institutions, a public college, for example, may be fearful of breaching their duty as a fiduciary.

		Adopters			Non-Adopters		
	Institutions	Total	Private	Public	Total	Private	Public
Responding Institutions (#)	191	52	41	11	139	77	62
SRI (%)	21	77	85	45	0	0	0
ESG (%)	8	31	29	36	0	0	0
Impact (%)	3	10	7	18	0	0	0
Fossil-Fuel Divestment (%)	2	6	5	9	0	0	0
None (%)	69	2	0	9	94	92	97
Uncertain (%)	3	0	0	0	4	5	3

Do long-term investors have an obligation to consider impact of their current investments on future generations?



Board/Committee understanding of the distinction between ESG and SRI



Other key points from the study :

- While 96% of respondents have written an IPS, only 28% have language related to the stated responsible investment practices.
- Of the institutions reportedly using SRI and ESG screens, two-thirds of SRI adopters were faith-based institutions and nearly half for ESG.
- The most common SRI screens were abortion, alcohol, weapons, gambling, pornography, tobacco, and unfair labor practices.
- Nearly twice as many private institutions referred to SRI in their IPS as public institutions (85% vs. 45%).
- For impact investing, two activities specifically cited were community economic development and serving less developed/underprivileged communities.
- Adopters in the Midwest (36%) exceeded those in the West (24%), Northeast (21%), and South (19%).
- 36% of total responders cited concern about the possibility of lower investment performance.
- 15% were concerned about violating their fiduciary duty.

Performance

Numerous studies have been conducted comparing performance results of ESG strategies versus that of the market at large. This is largely an effort to combat or confirm the idea that investors seeking a socially responsibly mandate must sacrifice portfolio performance in order to effectively implement such strategies.

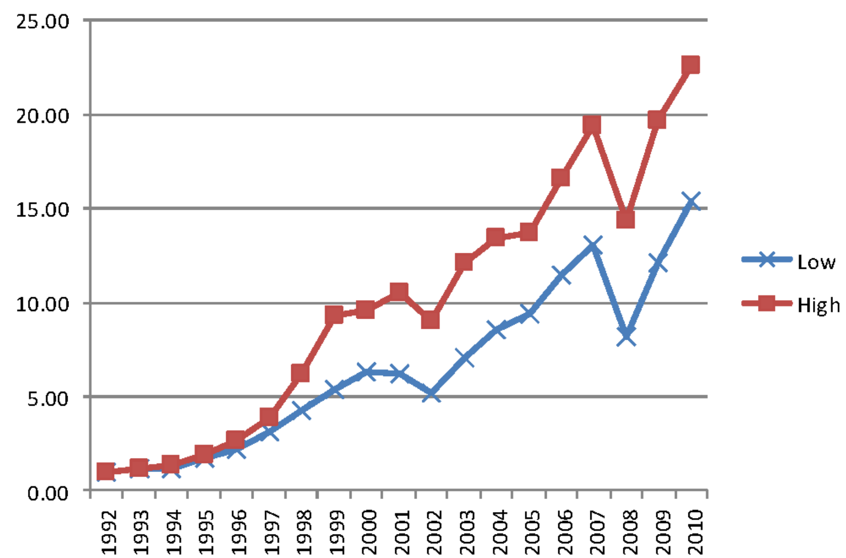
While there are a number of factors that influence returns, most studies concluded ESG index performance was largely consistent with broad market indices, with some even concluding socially responsible mandates may result in slight outperformance. Potential drawbacks include greater short-term volatility and risk (higher standard deviation).

At the company level, several studies identify a positive correlation between environmental and financial performance, including a 2012 study led by Harvard Business School professors. The study looked at the performance of 180 companies in the U.S. over a 14-year period—90 "high sustainability" companies (those which had developed and adhered to detailed environmental and social policies) and 90 "low sustainability" companies (those with few policies).

The study concluded high sustainability companies outperformed their low sustainability counterparts over the long-term. The chart to the right shows that the cumulative stock market performance of value-weighted portfolios for high sustainability companies significantly outperformed the same performance measure for companies in the low sustainability group. One dollar invested in high sustainability companies in 1993 would have grown to $22.60 by the end of 2010 vs. $15.40 for low sustainability companies, according to the study.

A working paper *The Financial Performance of SRI Funds between 2002 and 2009* published in 2010 examined the performance of 151 SRI funds in bear and bull markets. The funds were based in Europe, North America, Asia-Pacific, South America and Latin America. The study showed SRI funds were correlated to—and outperformed—the MSCI World Index. However, researchers also found the influence of social responsibility on performance is not strong enough to avoid the influence of general market tendencies. The study concluded that "socially responsible investing needs to be based on in-depth financial analysis to create a positive return for the investor."

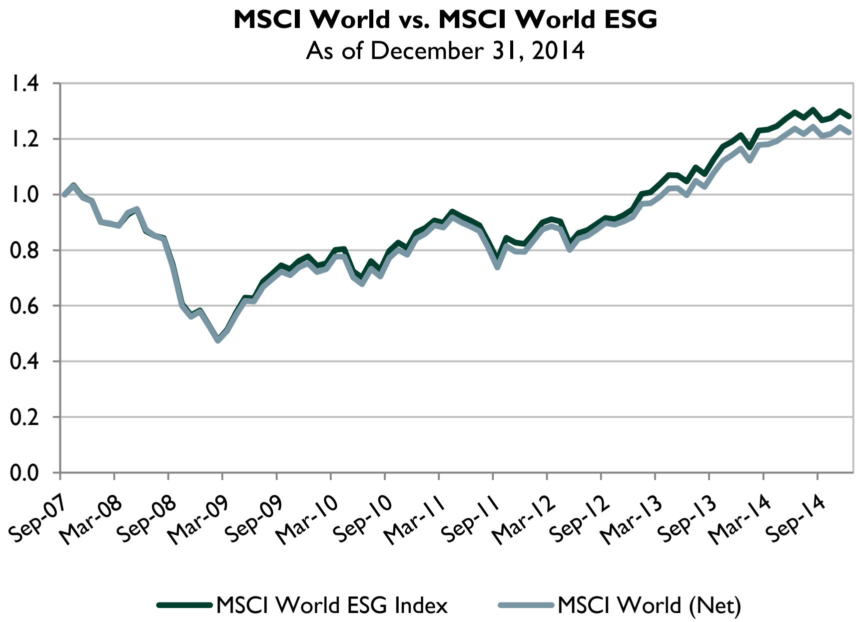
Evolution of $1 Invested in the Stock Market in Value-Weighted Portfolios

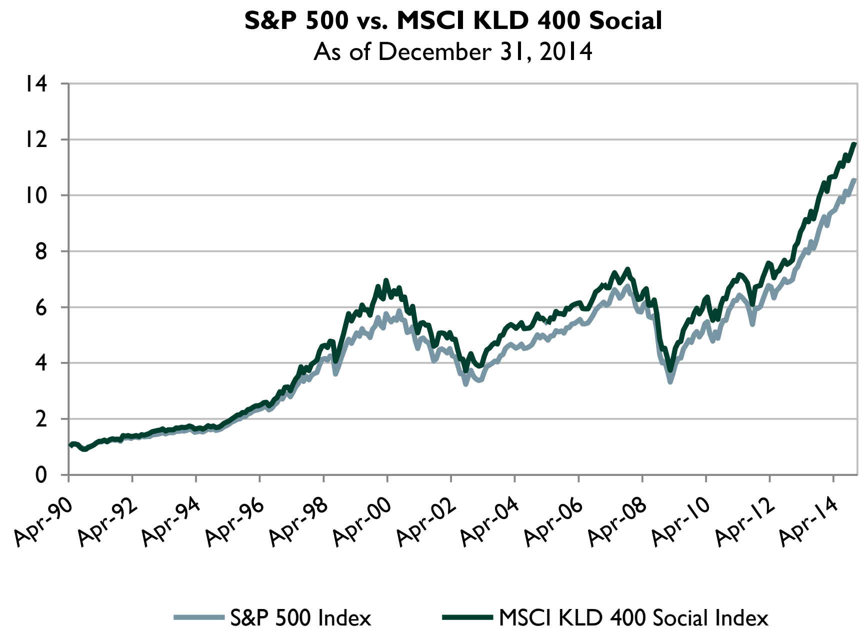


Index Performance

The MSCI World ESG Index takes as its universe the MSCI World Index, and through research on a number of ESG factors, selects what are deemed the best in class companies in each sector to include in the MSCI World ESG Index, which is sector-neutral to the parent index. Using back-tested data from 2007 through 2010, performance of the MSCI World ESG Index provided mild outperformance versus its parent index from September 2007 through December 2014.

The MSCI KLD 400 Social Index is the oldest available socially and environmentally screened index for U.S. stocks. It has similarly modestly outperformed the S&P 500 Index from the its launch in 1990 as the Domini 400 Social Index.





The MSCI KLD 400 Social Index comprises companies with high Environmental, Social and Governance (ESG) ratings and excludes companies involved in Alcohol, Gambling, Tobacco, Military Weapons, Civilian Firearms, Nuclear Power, Adult Entertainment, and Genetically Modified Organisms (GMO).The history for the MSCI KLD 400 Social Index includes historical data for the Domini 400 Social Index that was launched in 1990.

The MSCI World ESG Index was launched in October 2010.

The MSCI AC World ESG and MSCI Emerging Markets ESG Indexes were launched in June 2013. Data prior to the launch date is back tested data (calculations of how the index might have performed over that time period had the index existed).

Prime BUCHHOLZ

Fiduciary Responsibility

Nonprofit Institutions

- As stewards of endowments and foundations that support non-profit institutions, investment committee members and trustees must understand whether intentional investing—in all of its forms—is consistent with their responsibilities as fiduciaries.
- With little case law available, legal advisers turn to the Uniform Prudent Management of Institutional Funds Act (UPMIFA) for guidance. UPMIFA permits the consideration of a charity's purpose or mission as one factor a prudent investor may consider. UPMIFA requires that any investment be evaluated in terms of:
  - context of the total portfolio,
  - donor's intent as expressed in the gift document,
  - costs incurred, and
  - portfolio diversification.
- The U.N. Environmental Programmes' Finance Initiative (UNEP FI) *Freshfield's Report* also addressed the legality of responsible investing in the European Union, Australia, Canada, the U.K., and the U.S. UNEP FI concluded:
  - The modern prudent investor rule allows for "a wide range of diversified investment strategies" as long as the "choice of investments is rational and economically defensible."
  - "There appears to be no bar to integrating ESG considerations into the day-to-day process of fund management, provided the focus is always on the beneficiaries/purposes of the fund and not on unrelated objectives."
- In the fall of 2015, the IRS provided key guidance in Notice 15-62 that paved the way for foundations to consider mission when making investment decisions. The guidance clarified IRC Section 4944 as it pertains to investments made by private foundations to further the charitable purposes while also having the potential to appreciate or earn income, stating:

> *"When exercising ordinary business care and prudence in deciding whether to make an investment, foundation managers may consider all relevant facts and circumstances, including the relationship between a particular investment and the foundation's charitable purposes. Foundation managers are not required to select only investments that offer the highest rates of return, the lowest risks, or the greatest liquidity so long as the foundation managers exercise the requisite ordinary business care and prudence under the facts and circumstances prevailing at the time of the investment in making investment decisions that support, and do not jeopardize, the furtherance of the private foundation's charitable purposes."*

Fiduciary Responsibility

Private Trusts

- The Uniform Prudent Investor Act (UPIA) outlines the responsibilities of trustees for private trusts. The management of such trusts involves the considerations of several factors, including the wishes of the settlor of the trust, as well as the wishes of all the beneficiaries of the trust, which need to be considered equitably. We recommend consulting legal counsel for clarity on the legality of mission-aligned investing in the case of private trusts.

ERISA Plans

- In October 2015, the Department of Labor (DOL) issued an interpretive bulletin that replaces a 2008 release. The 2008 release had created uncertainty for ERISA plans around whether applying ESG analysis was contrary to its fiduciary duty to maximize the risk-adjusted return of an ERISA plan portfolio. The uncertainty caused many ERISA plan sponsors to avoid investments that incorporated ESG factors in their analysis due to a fear of violating their fiduciary duty.
- Given a growing body of evidence that ESG analysis can identify risks and opportunities that are not adequately priced in by the markets, the DOL bulletin acknowledged that ESG issues may have a direct relationship to the economic value of a plan's investments. The bulletin also makes the following points:
  - No additional documentation or evaluation is required for ESG investments versus general plan investments.
  - Fiduciaries may incorporate ESG factors into an IPS for an ERISA plan.
  - ERISA does not prohibit the integration of ESG metrics or tools in the evaluation of the risk or return of an investment.
  - ESG considerations are not merely "tie-breakers" between competing investments, but can be an important component of the investment process itself.

The Partnership with Prime Buchholz

Client		Prime Buchholz
Meets with stakeholders to define mission and determine how/if it wants to express its mission through its investments.	←	Provides guidance based on experience with other entities.
Defines mission and process in an Investment Policy Statement.	←	Provides sample language for Investment Policy Statement.
Analyzes current portfolio relative to mission.	←	Analyzes portfolio exposure to excluded stocks or industries, if applicable, and uses knowledge of investment landscape in each asset class to help determine where best to begin.
Reviews implementation options and determines a path toward aligning investments with mission.	←	Assists with asset allocation decisions and provides investment options.

Where to Start: Questions to Consider

What is your entity's mission?

What are the key concern(s) of the entity? Is this expressed in the entity's IPS?

Who are the stakeholders?

It is often helpful to assemble a small group representing each of the stakeholder groups to discuss how an entity's mission should be reflected in its investments, if at all.

Do you already have responsible investment guidelines in place as part of your IPS?

If so, does the IPS accurately reflect the direction the entity wants to take?

Where will efforts be focused in promotion of this mission?

There are a variety of methods to promoting through investment:

GRANTS → *DISCOUNTED LOANS* → *PORTFOLIO & GRANTS* → *SHAREHOLDER ACTIVISM*

What approach, or combination of approaches, will you take in aligning investments with your ESG mission?

Potential Approaches
• **Negative screening**: Excludes specific stocks or industries; this can be pure exclusion or exclusion based on a percentage of revenue.
• **Positive screening**: Choosing best in class investments—those that have the best overall history of attending to environmental and social good and having a strong governance structure relative to their sector, industry, or country piers.
• **Shareholder advocacy:** Joining other groups (ICCR, As You Sow, Ceres, or investment managers or other entities with similar missions) to affect change through proposing and supporting resolutions at stockholder meetings.
• **Voting proxies:** Voting in accordance with the entity's mission (typically available in separate accounts only).
• **Below market rate loans:** Provides funds and promote projects that support the entity's mission.
• **Separate pool of funds for donors:** Create a separate pool for donors who prefer their investments be made in line with the entity's mission.
• **Revolving loan funds:** These help support directives for energy efficiency in the entity's own operations. Returns are measured as a decrease in operating costs, which potentially free more funds to support mission-related projects.

Where to Start: Questions to Consider

What resources can you devote to implementation?

This may include defining mission, developing investment guidelines, voting proxies, choosing service providers to assist in rating or screening the portfolio, and advocating as a shareholder.

What networks or resources can you access to provide guidance?

Example include: PRI, US SIF, MSCI, IW Financial, Sustainalytics, Bloomberg, Second Nature, Ceres, ICCR, As You Sow, CDP, among others.

Do you want to invest solely in managers with socially responsible approaches?

Many investors are only comfortable applying guidelines to asset classes where there are a reasonable number of investment options, in an effort to avoid sacrificing asset class diversification.

MOST: Willing to deviate from recommended implementation in order to invest solely in ESG approaches, and to take on greater portfolio risk in order to have greater social impact.

MIDDLE: Invest in ESG approaches only when performance is competitive with other options, or when they offer more potential impact than simple negative screening.

OPPORTUNISTIC: Create an allocation within the policy portfolio for mission-aligned or impact investments with target ranges of exposure.

LEAST: Will not invest in ESG approaches, opting to support mission through shareholder advocacy, grants, or other distributions to projects/entities that further the stated mission.

How much are you willing to accept in additional costs for monitoring and managing your portfolio?

How concerned is the entity with performance that deviates over the short term from broad market benchmarks?

Over the long term, there is no definitive proof that an approach using ESG criteria will underperform or outperform other investment mandates. However, over the short term, these investors should expect deviations from broad market benchmarks just as there are with any form of active management.

Tolerance for Short-Term Deviations

- ***HIGH:*** *Accept long-term deviation and a certain level of underperformance if the impact benefit is significant.*
- ***MEDIUM:*** *Tolerant of deviations that are similar to deviation that results from any form of active management.*
- ***LOW:*** *No tolerance for short-term deviations as a result of ESG focus.*

Where to Start: The Investment Policy Statement

Once an entity clearly defines its mission and how it intends to reflect that mission in its investment portfolio, these details will need to be outlined in the IPS. We recommend the guidelines provide as much specificity as possible while allowing the flexibility needed to navigate changing market environments and take advantage of a growing universe of investment opportunities.

While each entity's mission and approach will be unique, we assembled excerpts from various institutions as examples:

EXAMPLE #1 *(Private Foundation)*

"As a philanthropic institution, (the Foundation) is required to manage its assets for maximum public benefit and in compliance with its fiduciary duties of care and loyalty to the Foundation and of obedience to its mission…

By moral and legal imperative, the Board's fiduciary duty encompasses three central obligations:

Duty of care to ensure prudent stewardship of the Heron Foundation's capital, and to extend that duty of care to beneficiaries by providing capital to enterprises that are aligned with our mission and contribute broadly to society's capital;

Duty of loyalty to ensure the impartial execution of all the Foundation's dealings; and

Duty of obedience to public benefit and to the mission of the Foundation, as declared in the mission statement and encompassed by the corporate charter.

These duties, taken together, underlie Heron's investment policy. Thus, portfolio performance on broad social dimensions is as important to fulfilling our fiduciary duty as portfolio performance on financial dimensions."

Source: www.fbheron.org

EXAMPLE #2 *(Faith-Based College)*

"In addition to the primary objective to maximize return, the College's Investment Committee acknowledges that there can be compelling moral and social considerations in the administration of the Funds. As a result, the College will make reasonable efforts to seek investment opportunities that are consistent with the ethics and teachings of the Catholic Church.

The portfolio will be reviewed annually utilizing the United States Conference of Catholic Bishops guidelines for investments inconsistent with the ethics and teachings of the Catholic Church."

EXAMPLE #3 *(Diocese)*

"The Diocese, mindful of the United States Conference of Catholic Bishops socially responsible investment guidelines, will select separate account investment managers that will make every reasonable effort not to invest in companies whose products or policies are not consistent with the ethics and teachings of the Catholic Church. In general, no investments will be made in companies which have significant involvement with armaments, alcohol, gambling, abortion, contraceptives, or in the exploitation of workers, or which are instrumentalities of political repression."

Where to Start: The Investment Policy Statement (cont'd)

Example #4 *(College Endowment)*

"The Trustees of the College are ultimately responsible for the management of the College's financial resources. One fiduciary obligation is to optimize the financial return to the College, both currently and in the future, in order to advance the long-term financial interests of the College and support its mission. It is a core value of the College, and consistent with its historical practice, that the College invest in a socially responsible way. This Policy on Environmental, Social, and Governance (ESG) Investing provides guidelines for the Trustees and those to whom specific investment decisions may be delegated.

Consideration of environmental, social and governance practices of the companies the College invests in is consistent with its fiduciary duties given that such practices can have a material impact on the investments. Business practices that include safe and supportive work environments, products that build economic strength, and activities that benefit the disadvantaged, including charitable giving, enhance the financial security and long term sustainability of companies in which the College invests. Poor business practices related to human rights, the workplace and the environment pose reputational, financial, operational and legal risks to the College's investments and therefore the future financial security of the College."

Example #5 *(Private Foundation)*

"The Fund has multiple investment objectives that it seeks to achieve in parallel. Fundamentally it seeks to provide support for the Fund's mission while achieving an annualized return from market rate investments that meets or exceeds a Policy Index that consists of reasonable market benchmarks in a weighting that is consistent with the target asset allocation as approved by the Board. The Fund also seeks to provide an appropriate level of liquidity as it winds down. In meeting these objectives, the Fund may make certain investments with compelling mission impacts that it does not expect to meet or exceed market benchmarks. Given the Fund's charitable objectives, its understanding of the range of capital that it can deploy to advance them, and its finite life, the Fund believes that these types of investments when executed prudently and strategically can significantly advance the Fund's ability to accomplish its charitable objectives, rather than jeopardizing those objectives."

Where to Start: Your Current Portfolio

Specific environmental issues such as climate change, and societal concerns that are highlighted by events—such as the 2012 shootings at Sandy Hook Elementary School in Newtown, CT—have spurred a desire to understand institutional exposure to companies that may be negatively impacting our society. Using quarterly updates to the holdings in our clients' traditional stock and bond portfolios, we are able to analyze an institution's exposure to a variety of issues.

Example Exposure Summary

Manager	Exposure?	% of Total Fund	Fossil Fuels	Coal	Alcohol, Gaming, Tobacco	Reviewed By	As of
DOMESTIC EQUITY							
Domestic Equity Fund	Y	8.52%	6.88%	0.30%	1.34%	PBA	9/30/2014
S&P 500 Index Fund	Y	0.75%	0.64%	0.11%	0.00%	PBA	9/30/2014
Mid Cap Value Fund	N	0.00%	0.00%	0.00%	0.00%	PBA	9/30/2014
SMID Cap Growth Fund	N	0.00%	0.00%	0.00%	0.00%	PBA	9/30/2014
INTERNATIONAL EQUITY							
International Value Fund	Y	8.49%	4.31%	0.00%	4.18%	PBA	9/30/2014
International Equity Fund	Y	8.14%	3.97%	0.00%	4.17%	PBA	9/30/2014
International Small Cap Fund	Y	0.60%	0.60%	0.00%	0.00%	PBA	9/30/2014
International SMID Cap Fund	Y	1.83%	1.83%	0.00%	0.00%	PBA	9/30/2014
EMERGING MARKETS EQUITY							
Emerging Markets Value Fund	Y	4.87%	4.87%	0.00%	0.00%	PBA	9/30/2014
Tax-Managed Emerging Markets Fund	N	0.00%	0.00%	0.00%	0.00%	PBA	9/30/2014
FIXED INCOME							
Bond Yield Fund	Y	3.12%	2.68%	0.01%	0.44%	PBA	9/30/2014
Bond Market Index Fund	Y	3.44%	1.97%	0.21%	1.27%	PBA	9/30/2014
Treasury Index Fund	N	0.00%	0.00%	0.00%	0.00%	PBA	9/30/2014
Global Fixed Income Fund	N	0.00%	0.00%	0.00%	0.00%	PBA	9/30/2014
PUBLIC REAL ASSETS/INFLATION-HEDGING							
TIPS Index Fund	N	0.00%	0.00%	0.00%	0.00%	PBA	9/30/2014
Commodities Fund	N	0.00%	0.00%	0.00%	0.00%	PBA	9/30/2014
Securities Fund	Y	1.22%	0.00%	0.00%	1.22%	PBA	6/30/2014
TOTAL							

Where to Start: The Responsible Investing Landscape

The landscape for investments that integrate ESG factors into investment analysis is expanding, However, there remain significantly fewer investment options than those available in mainstream investing:

- As of October 31, 2015, there were 174 distinct mutual funds that described themselves as "socially conscious" out of a universe of 8,515 distinct mutual funds, according to Morningstar.
- Mission Investors Exchange, a national membership of foundation and mission investing organizations, counted 88 impact private equity investments, of which 37 were described as market rate investments.

Asset Class	Investing Landscape
Equities	Public stock investments provide the most opportunities for investors who want to align their mission with their portfolios. There is a sufficient number of managers that offer funds with a track record of five years or more and that have equal experience factoring ESG factors into their assessment of a company's financial picture. It is important that managers are able to clearly describe this process, as there are managers that claim to integrate ESG but cannot clearly define how it is integrated.
Bonds	Investments in sovereign bonds provide an option for many investors who are concerned about the environmental and social impact of their portfolio. There are also a sufficient number of options that are able to screen out select industries, and a few that invest in a combination of impact bonds (such as green bonds or HUD bonds) and corporate bonds (the issuer's approach to ESG risks is incorporated into the credit analysis).
Hedge Funds	There are few options with relevant performance histories beyond one year and/or assets greater than $30 million, and most of those are direct hedge funds. A few options have launched in 2014–2015. One hedge fund manager with more than 15 years of experience managing funds of funds launched an ESG fund of funds in July 2015.
Private Equity	Anecdotally, we have found that private capital managers, who tend to have a longer-term perspective due to their 10- to15-year terms, are more likely to have developed ESG policies and to consider the potential risks these factors pose. However, there are currently limited options that have a double or triple bottom line (considering financial, environmental, and/or social impact) with a sufficient track record with which to assess management skill. Fund size tends to be smaller than that of institutional private equity funds.
Inflation Hedging Assets	TIPS and REITs provide an acceptable option for many investors who are concerned about the environmental and social impact of their portfolio. Some investors are comfortable with commodities as a play on prices rather than an investment in a company, but some are not. Traditional public natural resources equity investments have been problematic for investors concerned about the environment, as many of the larger companies in this sector have poor environmental records. Some investors consider private options in water, agriculture, infrastructure, and timber, which are limited in number similar to private equity.

Where to Start: Investment Vehicle Type

Long-only stock and bond portfolios—in both separate accounts and commingled fund vehicles—provide transparency and liquidity. Separate accounts also allow an investor to assess and adjust exposures.

However, equities and bonds are only one component of the typical institutional investor portfolio. Hedge funds often provide limited transparency and few allow for investor influence on holdings.   Private investments offer little optionality to divest from unwanted exposure once obtained, but some allow for side letters to be written at the time a commitment is made. Private investments designed to have a triple bottom line (financial, social, and environmental) have the potential for greater environmental and social impact.

Separate accounts, commingled funds, or direct private investment?

Implementation	Benefits	Hurdles
Mutual Funds and Commingled Funds	Daily or monthly liquid access with high transparency	Inability to customize
Separate Accounts	Customizable, full transparency	May be higher minimums to access
Private Investments (Debt and Equity)	Potentially more impact	Heightened monitoring resources required and liability risk

Where to Start: Your Current Portfolio

Some investors do not want to exclude stocks from their portfolio, but want to improve the ESG performance of their portfolio. For these entities, a more nuanced evaluation of their portfolio may be warranted. Although the collection of ESG data remains challenging, there have been significant advances in the last decade.

The following is a list of some of the research providers in the ESG space that can provide such an evaluation.

	MSCI	Sustainalytics	IW Financial
Overview	Provides an overall portfolio score, as well as ESG scores, relative to broad market indices.	Provides an overall portfolio score, as well as ESG scores, relative to broad market indices. Customization of issue weightings is possible.	Creates customizable ESG solutions to provide an overall portfolio score.
Company Coverage	U.S.: 2,800 Int'l Developed: 1,950 EM: 850 Total: 5,600	U.S.: 2,700 Int'l Developed: 1,000 EM: 800 Total: 4,500	U.S.: 3,000 Int'l Developed: 1,500 EM: 0 Total: 4,500
Key Issues	Companies are scored on 4-6 key industry ESG issues, and ranked relative to other companies in their sector. There are 35 total key ESG issues.	Companies are scored on a broad range of ESG issues relevant to their specific industry.	Investors can determine which issues to include in the portfolio score, and how to weight the importance of each issue.
Enviromental Issues	Score is based on four categories: climate change, natural resource use, waste management, environmental opportunities.	Score is based on four categories: preparedness (policies), disclosures, quantitative factors (fines/emissions), and qualitative factors (incidents/controversies).	Issues include: emissions, energy/water use, environmental fines/trends, and environmental disclosures.
Additional Information	In addition to the sample presentation, MSCI will provide company level data on the top 10–20 worst-rated companies.		
Approximate Cost	$8,000	$10,000	$10,000

Implementation: Structure

Redesigning a portfolio to align with an institution's mission requires the same level of due diligence and care that goes into the portfolio's original development. However, the process faces the additional challenge of a more limited universe of high quality investment options.

The matrix below shows a portfolio analysis that helps guide the process. The darker blue box indicates investment vehicles in the portfolio that can be replaced with high quality investment options in the near term, and have holdings that are also 100% transparent. The last row of the matrix lists investments for which we continue to seek replacements that are better aligned with the investor's environmental and social values.

	Holdings are 100% Transparent	Holdings are not 100% Transparent
Can replace with socially responsible option	Equity Mutual Fund 1(D) Equity Mutual Fund 2 (D) Equity Mutual Fund 3(D) Real Asset Commingled Fund (M)	
Limited opportunities to replace with socially responsible option, but exposure unlikely due to strategy	Treasury Mutual Fund (D) Sovereign Debt Mutual Fund (D) Real Estate Mutual Fund (D)	
Limited opportunities to replace with socially responsible option, exposure possible	Equity Mutual Fund (D) Long Short Mutual Fund(D) Fixed Income Mutual Fund (D)	Equity Commingled Fund (Q) Hedge Fund (Q) Hedge Fund (Q) Hedge Fund (Q)

(D) - Daily transparency
(M) - Monthly transparency
(Q) - Quarterly transparency

Implementation: Indexing

As mission investing has increased, so has the number and variety of index products available. In general, indexing is a low cost, low active management risk approach to investing. Many investors seeking to align their investments with their mission have sought out indexing and passive screening as a first step.

Adding ESG considerations to traditional indexing gives rise to some important questions:

- Where is the trade-off between tracking error and values optimization?
- Is the objective to mimic the traditional reference benchmark or an SRI/ESG reference benchmark?
- How is relative performance measured? Is tracking risk to the traditional reference benchmark active management?

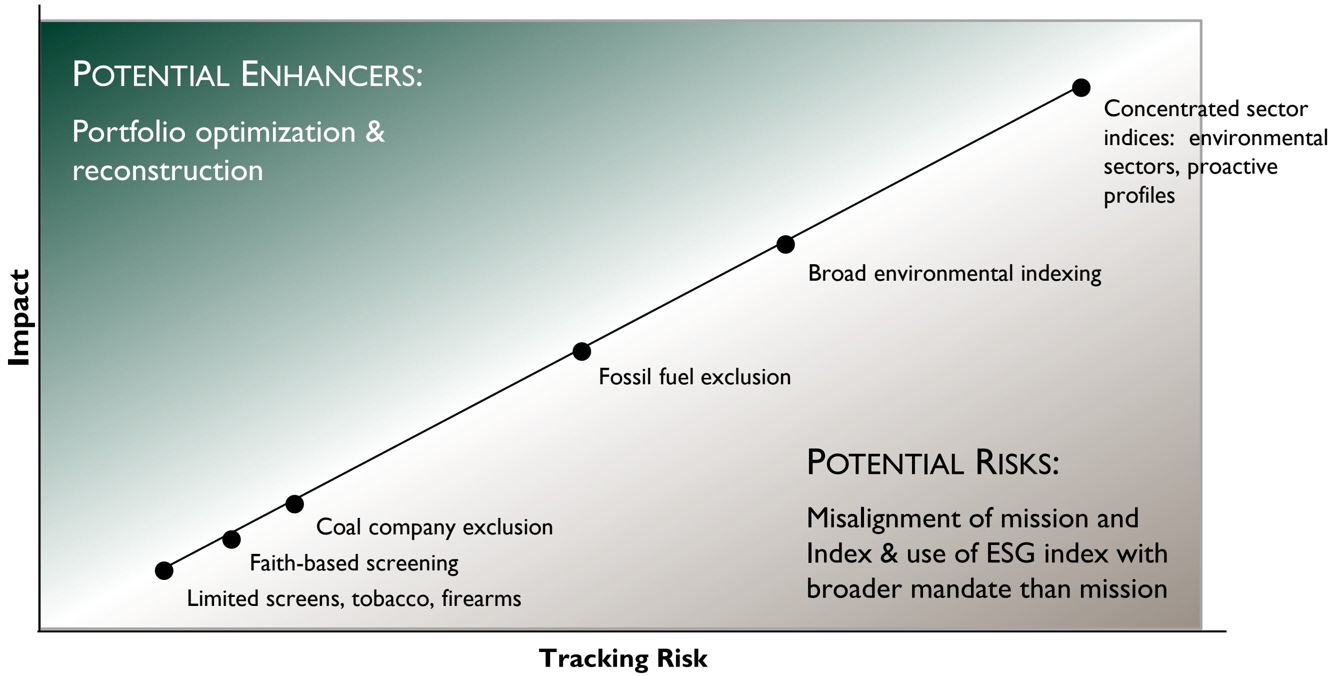
Products currently available in the marketplace include:

- Traditional index investments with product or industry exclusions:
  - SSgA S&P 500 Tobacco Free Fund
- ESG index investments:
  - iShares MSCI KLD400 Index
  - Northern Trust Global Sustainability Index (benchmarked to MSCI World ESG Index)
- Asset managers that provide custom index optimization based on individual investor mission with specific tracking error constraints. These managers can target either a traditional index or an ESG index.
  - Aperio Group
  - Parametric Portfolio Associates

Implementation: Indexing

Mission alignment can increase tracking error to a traditional benchmark resulting in short-term deviations from those benchmarks. Tracking error can be derived from two sources:

- Positive and negative screens applied to a traditional index.
- Construction methodology of an ESG index.



Combining optimization with customized portfolio construction can improve a portfolio's environmental and social impact, while minimizing tracking risk. Clearly identifying the financial and mission objectives of an investment, including tolerance for tracking error, and building an appropriate vehicle structure can help decrease the likelihood of unintended risks.

Implementation: Costs

Due to the additional research involved in gathering, analyzing, and understanding sometimes difficult to obtain environmental and social metrics, ESG investing can be more costly than non-ESG investing. This impact is most pronounced in passive investment options, where index fund providers such as The Vanguard Group have been able to offer U.S. broad market investment options such as the Vanguard Institutional Index Fund for as low as 4-5 bps vs. the Vanguard FTSE Social Index institutional shares, which has a 16 bps expense ratio.

As indicated in the table below, the expense ratios for actively managed options that incorporate ESG factors are generally comparable to those that do not consider these factors. We utilized the Morningstar mutual fund database to calculate an average fee for non-index institutional funds, both with and without socially conscious objectives. For both the U.S. stock and international stock mutual funds, we combined all market capitalizations and styles.

	Socially Conscious Universe Average (bps)	Entire Institutional Universe Average (bps)
Passive Stock (Index)	6–40	4–20
Active U.S. Stock Mutual Fund Average	87	94
Active International Stock Mutual Fund Average	93	100
Active Bond Average	61	64

- *Passive Stock Index range provided for ETFs, mutual funds, and separate accounts.*
- *Active U.S. Stock and International Stock data based on Morningstar averages for large, mid and small growth, blend and value non-Index institutional share class mutual funds.*
- *Active Bond based on intermediate term and multi-sector bond non-Index institutional share class mutual funds.*

Beyond Portfolio Implementation

An institution may decide not to express their values through their investment portfolio, but still want to move beyond grants and distributions to further its mission. Alternatively, an institution may already have implemented a portfolio that considers environmental and social impact, as well as financial return, and want to do more. Shareholder advocacy, program-related investments, and green revolving loan funds are effective ways to further an entity's mission in ways that do not directly impact the corpus of the investment portfolio.

- *Shareholder Advocacy*

  Shareholder engagement or advocacy is a tactic of using ownership in a company in an effort to improve that company's social and environmental behavior by voting at shareholder meetings (or by proxy), filing shareholder resolutions, and/or establishing ongoing dialogues with companies. Often, such action is taken in concert with other shareholders and may be organized by groups such as Ceres, As You Sow, and ICCR. Asset managers such as Boston Common Asset Management and Walden Asset Management also engage in such efforts. In order to participate, an investor needs to have held $2,500 of company stock for over one year.

- *Program Related Investments (PRIs)*

  PRIs have a specific IRS definition for private foundations, but have garnered a broader meaning for other types of institutional investors. For private foundations, PRIs count toward the foundation's required annual 5% distribution, provided that:

  - The primary purpose is to accomplish one or more of the foundation's exempt purposes,
  - Production of income or appreciation of property is not a significant purpose, and
  - Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose.

  More broadly, PRIs are considered investments that offer the potential return of principal, as well as some profit. They are sometimes seen as "recyclable grants" and often not considered part of the investment portfolio. A PRI is different from a traditional investment in that the primary objective is programmatic, and the financial terms of the investment are below market. PRIs include financing methods commonly associated with banks or other private investors, such as loans, loan guarantees, linked deposits, and even equity investments in charitable organizations or in commercial ventures for charitable purposes.

- *Green Revolving Loan Funds*

  Green revolving loan funds provide dedicated funding to invest in energy efficiency or resource efficiency projects while capturing the cost savings from the reduced energy and/or resource use. Such funds provide the upfront capital, which allows departments to upgrade the energy efficiency of their facilities without incurring any capital costs. Departments then repay the fund via savings achieved by project-related reductions in utility consumption, waste removal, or operating costs.

Beyond Portfolio Implementation

Another way to have investments reflect societal concerns about climate change is to urge investment managers to consider the potential impact of climate change on their holdings. In so doing, investors encourage a dialogue about the financial risks and opportunities around climate change and marry financial and societal impact.

Below are questions that can provide institutional investors a sense of how their managers are responding to climate change and incorporating environmental and social considerations into their investment strategy.

- Are you a signatory of the PRI? If so, please give examples of how you have addressed the six objectives of the Principles of Responsible Investing.
- Do your analysts integrate ESG considerations into their estimates of a company's value? Please provide examples.
- Do your analysts incorporate the potential impact of climate change, including environmental and regulatory changes as a result of climate change into their assessment of a company's value? Please provide an example.
- In your meetings with company management do you meet with the company's Chief Sustainability Officer (CSO)? What do you look for in a CSO? (Answers provided should include the CSO's background – operational vs. human resources or marketing and CSO's direct reports.)
- Are you familiar with the Sustainability Accounting Standards Board (SASB)? Do you reference their work to help understand the material sustainability issues in an industry? (SASB created Materiality Maps for health care, financials, technology and communications, and non-renewable resources).

Disclosures

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Indices referenced are unmanaged and cannot be invested in directly. Index returns do not reflect any investment management fees or transaction expenses.

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