

# Illinois Sustainable Investing Act

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# Topics

- Sustainable investing context
- [Illinois Sustainable Investing Act, PA \(101-0473\)](#)
  - Description
  - Goals and purpose
  - Duties of public agencies and governments
- Practical implementation tips

# Poll Question 1

# Background

- Sustainable investing
  - Responsible investing
  - Green investing
  - Ethical investing
  - Impact investing
- 
- Despite distinctions between terms, all emphasize two points:
    - Long-term investment horizon
    - ESG issues(investing with intention for the long-term)

# Background

- Sustainability or ESG (environmental, social and governance) factors are used to more comprehensively analyze an investment based on its risk profile and return potential
- This analysis complements traditional and technical analysis
- Inclusion of sustainability factors has been shown to minimize risk and maximize returns
- Inclusion of sustainability analysis is considered best practice in the investment industry
- Integrating these factors helps public funds better fulfill their fiduciary duty

# Background

- Improved performance – empirical studies <sup>(1)</sup>
- Better performance when looking to the future
  - Maximizing return
  - Minimizing risk
- Controversies
  - Historical
  - Recent DOJ attempt to curb the rise of ESG
- No one-size-fits all approach

# Background

## (1) Empirical studies

- Fulton, Mark, Bruce Kahn, and Camilla Sharples. "Sustainable Investing: Establishing Long-Term Value and Performance." Deutsche Bank Group. June 2012. Accessible at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2222740&rec=1&srcabs=2508281&alg=1&pos=2](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2222740&rec=1&srcabs=2508281&alg=1&pos=2).
- <sup>2</sup>Friede, Gunnar, Timo Busch, and Alexander Bassen. "ESG and financial performance: aggregated evidence from more than 2000 empirical studies." *Journal of Sustainable Finance & Investment*, vol. 5, no. 4, 2016, pp. 210-233. Accessible at: <https://www.tandfonline.com/doi/full/10.1080/20430795.2015.1118917>.
- <sup>3</sup>Verheyden, Tim, Robert G. Eccles, and Andreas Feiner. "ESG for all? The Impact of ESG Screening on Return, Risk, and Diversification." *Journal of Applied Corporate Finance*, vol. 28, no. 2, 2016., pp. 47-55. Accessible at: <https://onlinelibrary.wiley.com/doi/abs/10.1111/jacf.12174>.
- <sup>4</sup>Kotsantonis, Sakis, Chris Pinney, and George Serafeim. "ESG Integration in Investment Management: Myths and Realities." *Journal of Applied Corporate Finance*, vol. 28, no. 2, 2016., pp. 10-16. Accessible at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2808219](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2808219).
- <sup>5</sup>Eccles, Robert G., Ioannis Ioannou, and George Serafeim. "The Impact of Corporate Sustainability on Organizational Processes and Performance." *Management Science*, vol. 60, no. 11, 2014, pp. 2835-2857. Accessible at <https://www.hbs.edu/faculty/pages/item.aspx?num=47307>.

# Background

- A recent study by Morningstar concludes that there is “no evidence that investors need to sacrifice returns when they invest in good ESG companies globally compared with bad ESG stocks.”
- In a well-known meta-study of over 2,000 academic studies, 90% showed a non-negative relationship between incorporation of ESG criteria and corporate financial performance, and 63% identified a positive link.
- Harvard University has found that firms with good performance on material sustainability issues — as defined by SASB — significantly outperformed firms with poor performance on these issues.
- HSBC measured the performance of shares in 613 public companies globally valued at more than \$500 million, where climate solutions generate at least 10% of revenues. HSBC also looked at the 140 shares with the highest ESG scores and values above the global average. The study ran from 10 December 2019 to 23 March 2020, and from 24 February 2020 to 23 March 2020, the latter period being when market volatility spiked. The climate-focused stocks outperformed others by 7.6% from December and by 3% from February. The high ESG-scoring shares beat others by about 7% for both periods.
- In another study, Morningstar found that sustainable and ESG equity indices outperformed conventional indices in the Global, Europe and US Large-Cap categories in the month to 20 March 2020. These studies suggest that portfolios with ESG integration provide good downside protection when markets are struggling

\*State Street Global Advisors report ESG, April 20, 2020

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# Background

- Combined holdings of city, county, state treasuries \$3.1 trillion + <sup>(1)</sup>
- Primarily short-term and fixed income
  - Operating funds – further restricted to investment-grade
- Sleeping giant – can have real impact advancing public policy initiatives

<sup>(1)</sup> December 2018

# Polling Question 2

# Background

- Recap – primary concern must always be to protect moneys in your care
  - Traditional metrics – credit quality, duration, yield, low expenses, diversification
- Inclusion of sustainability or ESG (environmental, social and governance) factors is additive
  - Not meant to take away from but build on standards
- In Illinois, ESG factors - additional value-added factors that may have material, relevant financial impact
- Not only do we maximize value, but help foster a business culture more attentive to social trends, societal impacts and long-term growth

# Background

As sustainability factors are increasingly being incorporated into the underlying investment processes at the corporate, manager, and investor levels, it is not surprising that the Illinois General Assembly has taken up the issue in this recent legislation.

# Illinois Sustainable Investing Act

- “The investment decisions we make today will have a profound, lasting impact on our economy, environment, and our quality of life for generations to come.”
- Making prudent choices
  - risk-appropriate, high-performing investments that meet or exceed the benchmark
  - Investments that reflect our commitment to sustainability, inclusion, sound governance

# Polling Question 3

# Polling Question 4

# Illinois Sustainable Investing Act

- Signed into law – 2019 and became effective January 1, 2020
- All state and local government entities that hold and manage public funds should integrate material, relevant and useful factors into their policies, processes and decision-making
- Amends Deposit of State Moneys Act, the Public Funds Investment Act, and the Illinois Pension Code



# Illinois Sustainable Investing Act

The Act defines sustainability factors to include:

- (1) corporate governance and leadership
- (2) environmental
- (3) social capital
- (4) human capital (including responsible contractor and responsible bidder policies) and
- (5) business model and innovation

Collectively, these are commonly referred to as ESG (environmental, social, and governance) factors.

# Illinois Sustainable Investing Act

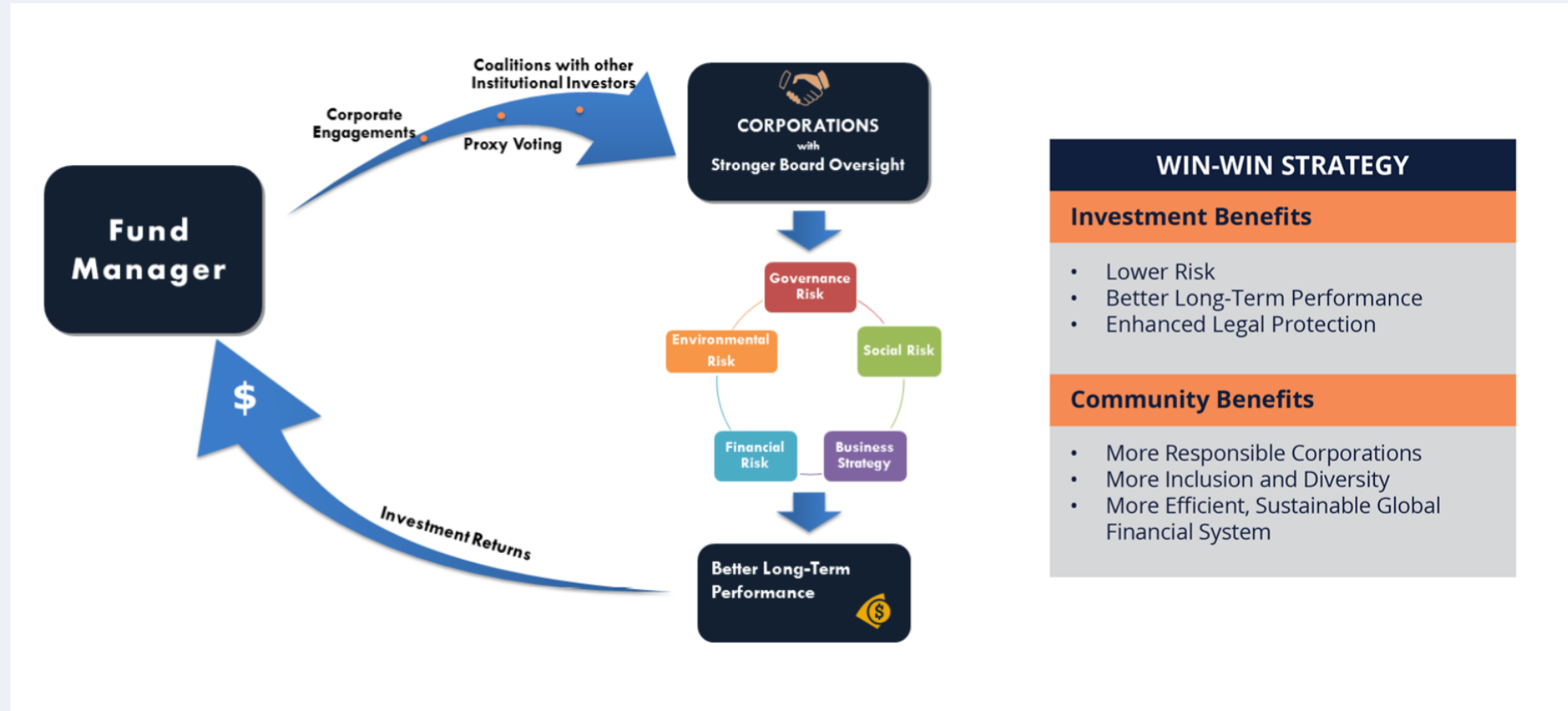


# Illinois Sustainable Investing Act



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# Illinois Sustainable Investing Act



# Illinois Sustainable Investing Act

## Environment

- GHG Emissions
- Air Quality
- Energy Management
- Water & Wastewater Management
- Waste & Hazardous Materials Management
- Ecological Impacts

## Leadership & Governance

- Business Ethics
- Competitive Behavior
- Management of the Legal & Regulatory Environment
- Critical Incident Risk Management
- Systemic Risk Management



## Business Model & Innovation

- Product Design & Lifecycle Management
- Business Model Resilience
- Supply Chain Management
- Materials Sourcing & Efficiency
- Physical Impacts of Climate Change

## Social Capital

- Human Rights & Community Relations
- Customer Privacy
- Data Security
- Access & Affordability
- Product Quality & Safety
- Customer Welfare
- Selling Practices & Product Labeling

## Human Capital

- Labor Practices
- Employee Health & Safety
- Employee Engagement, Diversity & Inclusion

# Sustainable Investing Act – How to implement

1. Internal and External Investment Management
2. Proxy Voting
3. Engagements
4. Shareholder Proposals
5. Policy Advocacy
6. Coalitions
7. Identify and integrate sustainability factors into your investment practices
  - ✓ Example – corporate securities
  - ✓ Divestment

# Poll Question 5

# Poll Question 6



# Sustainable Investing Act – How to implement

- Update investment policy
  - [State Treasurer's Investment Policy Statements](#)
  - [ISBI's Investment Policy Statement](#)
- Commit to follow Principles of Responsible Investment

# Sustainable Investing Act – How to implement



# Sustainable Investing Act – How to implement

## Investment Policy

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# Sustainable Investing Act – How to implement

## [City of Chicago Environment, Social and Corporate Governance \(ESG\) Statement](#)

The primary objective of the Treasurer's Office is to ensure the safety of principal while achieving the highest investment returns possible using authorized investments. While securing and growing taxpayer dollars is the main mission of the office, it is equally important to make an impact with that money through investing decisions centered around an environmental, social and governance (ESG) approach. ESG investing is a way to ensure that the city's investments align with the values of the Chicagoans we represent.

# Sustainable Investing Act – How to implement

Investment Policy – add a section to your existing policy

Sustainability

“Consistent with achieving the investment objectives set forth in the Objectives section, government will seek to prudently integrate sustainability factors into its investment decision-making, investment analysis, portfolio construction, due diligence and investment ownership in furtherance of its goals to fulfill its fiduciary duty, to maximize anticipated financial returns and minimize risk. The government will evaluate its sustainability efforts annually, in conjunction with review of this investment policy.”

# Sustainable Investing Act – How to implement

Investment Policy – add a section to your existing policy (continued)

## Sustainability

- “Material, relevant and decision-useful sustainability factors have been or are regularly considered by the government, within the bounds of financial and fiduciary prudence, in evaluating investment decisions.”

# Sustainable Investing Act – How to implement

- Leadership – your own and your vendors’
  - Adopt formal risk management review, approach
  - Adopt formal ethics policy
  - Ensure that your investment adviser implements competition for your portfolio
  - Robust shareholder rights
  - Conscious management of regulatory and political environment

# Sustainable Investing Act – How to implement

- Governance – your own and your vendors’
  - Board accountability
  - Board diversity
  - Transparency
  - Sensible executive compensation
  - Robust shareholder right
  - Ethical conduct



# Sustainable Investing Act – How to implement

- Social Capital – your entity's and your vendors'
  - Labor relations and fair labor practices
  - Recruitment, development, retention
  - Diversity and inclusion

# Sustainable Investing Act – How to implement

- Human Capital – your entity's and your vendors'
  - Human rights
  - Data security
  - Community relations
  - Customer or stake-holder welfare
  - Community reinvestment

# Polling Question 7

# Principles of Responsible Investment

- The PRI is the world's leading proponent of responsible investment. It works:
  - to understand the investment implications of environmental, social and governance (ESG) factors
  - to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions.

# Principles of Responsible Investment

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

# So what can you do today?

- Update your investment policy
- Adopt ethics policy and ethical business practices
- Consider your risk – adopt systematic risk management approach
- Adopt community relations & community reinvestment policies
- Be careful of political influence
- Require your investment adviser/ vendors to address: ethics, board diversity, social factors – community relations and community reinvestment)

# Questions?



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