



San Mateo County Transportation Authority

ESG for Public Funds Update

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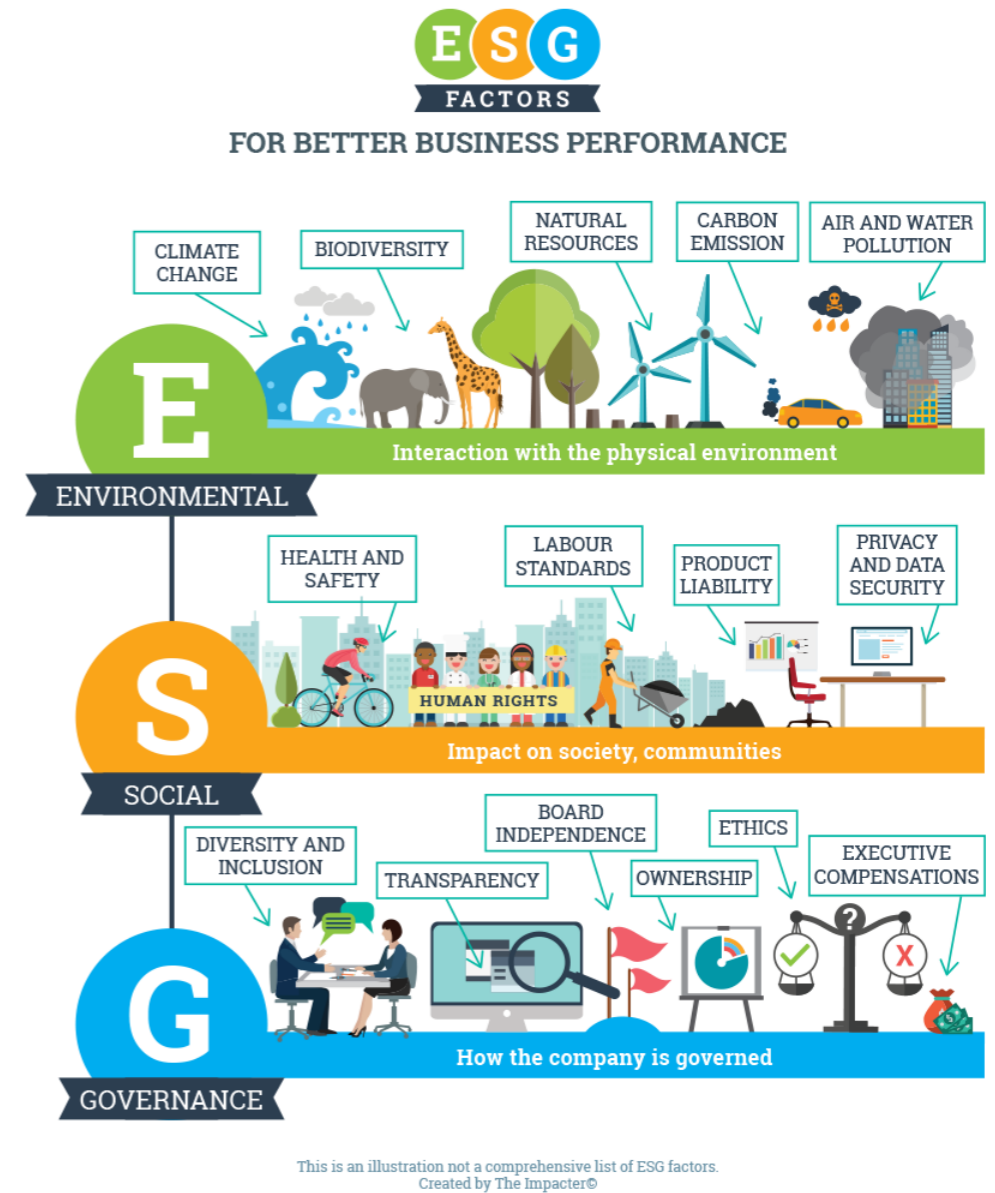
Mark Creger | Director, Public Trust Advisors



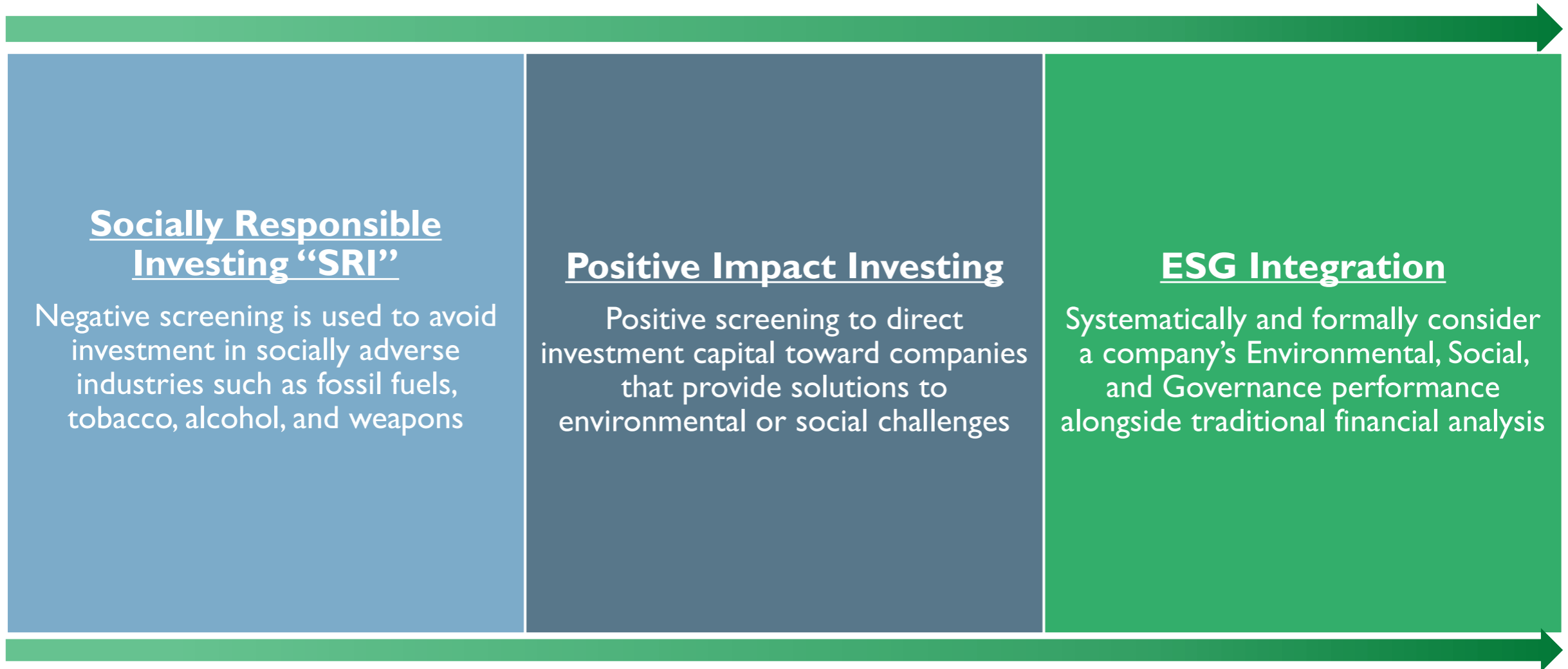
February 2, 2023

What Exactly is ESG?

- ESG Investing is a form of sustainable investing that integrates a company's performance in certain Environmental, Social, and Governance factors with traditional financial analysis as part of the investment decision-making process.
- While ESG can mean different things to different people, it generally represents the desire of investors to consider and align their ethical beliefs and values with their investment portfolio and generally takes one of the following forms:
 - Socially Responsible Investing "SRI"
 - Impact Investing
 - ESG Integration
- According to Bloomberg Intelligence's latest ESG 2022 Midyear Outlook report, ESG assets are on track to exceed \$50 trillion by 2025, representing more than a third of the projected \$140.5 trillion in total global assets under management.



Most Common ESG Implementations



Socially Responsible Investing

- Socially Responsible Investing “SRI” is based upon an exclusionary or negative screening approach whereby the investor identifies certain industries or companies it wishes to avoid.
 - SRI is not necessarily an all-or-nothing approach and may be tailored to reflect customized investor tolerances; e.g., 50% revenue limit or top 25% industry performer.



Oil & gas



Armaments



Gambling



Tobacco
& alcohol



Rain forest & old
growth logging



Coal & Uranium
Mining



Intensive animal
farming & aquaculture



Positive Impact Investing

- Positive Impact Investing utilizes positive screening to direct investment toward companies that provide solutions to environmental or social challenges
 - Companies may be selected based upon investor-specific preferences or as part of a formal framework such as the UN Sustainable Development Goals (SDGs).



ESG Integration

- ESG Integration involves the formalized consideration of a company's Environmental, Social, and Governance performance alongside traditional financial analysis in the decision-making process.
 - Often utilizes independent or third-party ESG ratings or scores to differentiate and rank corporate ESG performance across a range of factors and may be tailored to individual investor preferences.



How is ESG Integrated into the Investment Strategy

Evaluate Investment Program

- ✓ Establish investment objectives for each fund and portfolio
- ✓ Evaluate cashflow and Liquidity requirements
- ✓ Review Investment Policy Statement and bond documents
- ✓ **Determine ESG Objectives**

- ✓ **Socially Responsible Investing (i.e., negative screening)**
- ✓ **Impact Investing (i.e., positive screening)**
- ✓ **ESG Integration (i.e., formal ESG evaluation)**

Determine Appropriate Investment Strategy

- ✓ Establish strategic duration and asset allocation targets
- ✓ Select appropriate performance benchmarks
- ✓ **Formalize ESG investment parameters**
- ✓ **Establish approved issuers based upon ESG preferences**

- ✓ **Define ESG risk rating constraints**
 - **Minimum score requirements**
 - **Peer comparisons (e.g., above median or 25th percentile)**

Implementation and Ongoing Management of Strategy

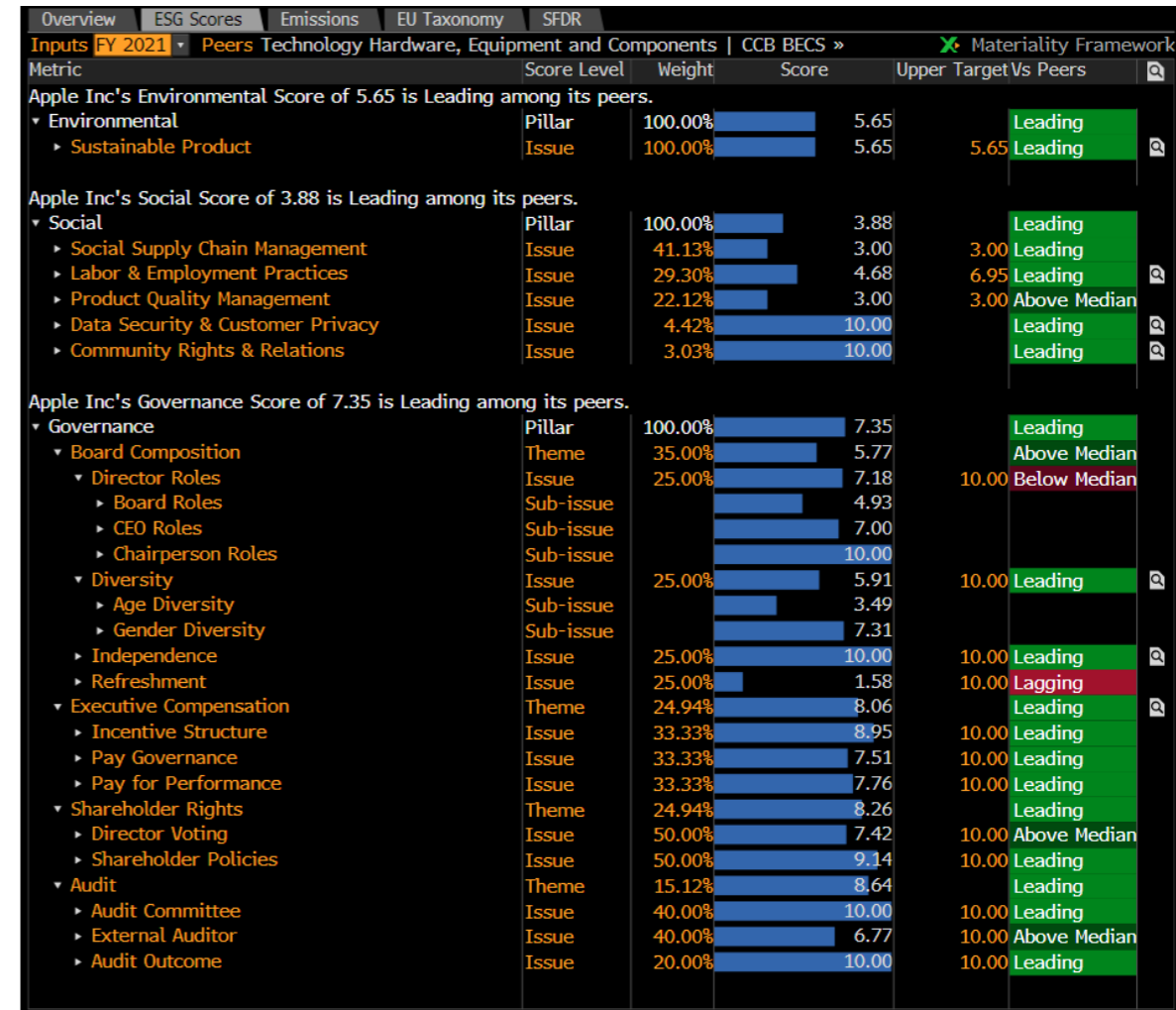
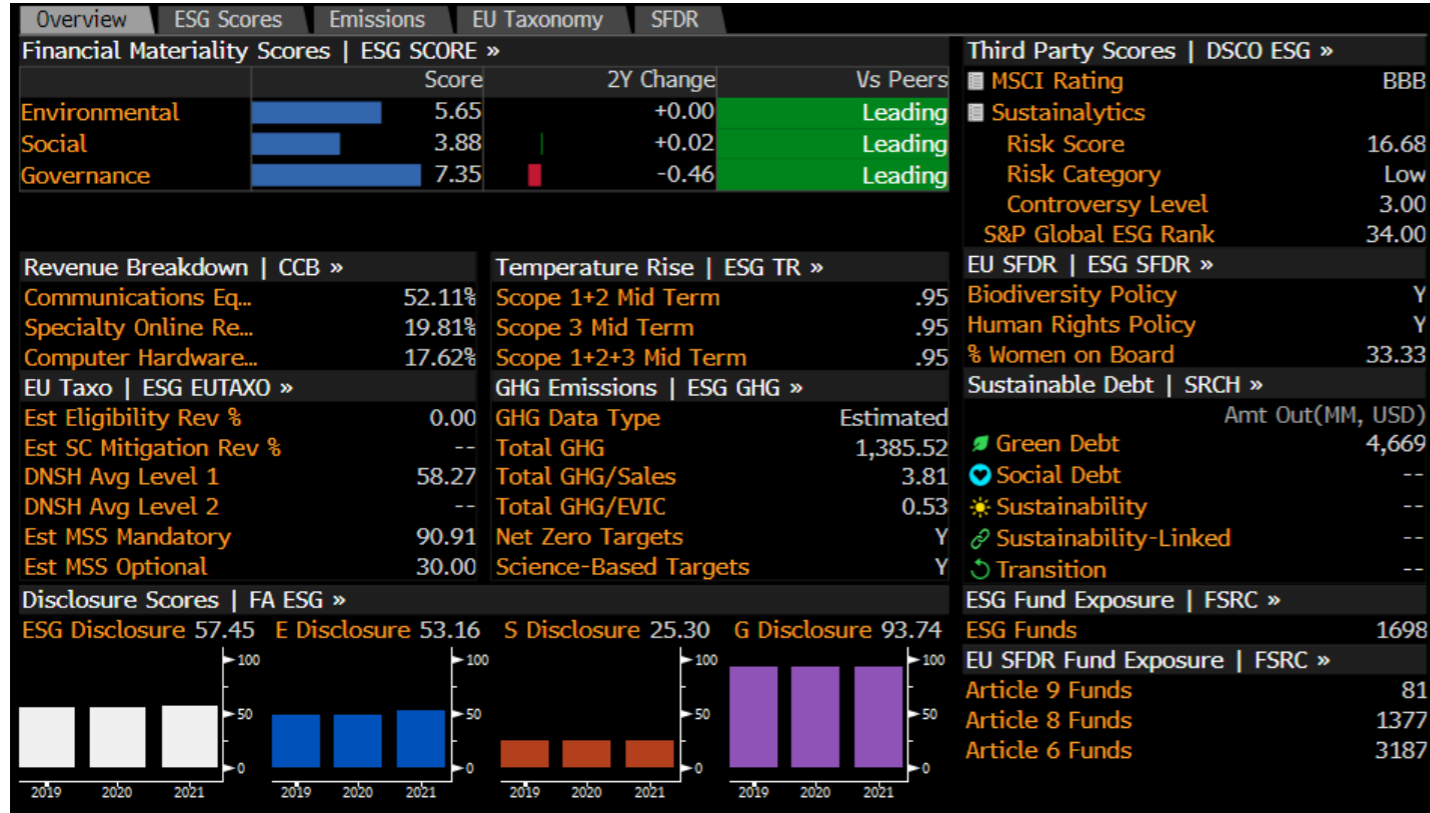
- ✓ Ongoing evaluation of market conditions
- ✓ Actively manage strategic and tactical portfolio positioning
- ✓ Ongoing portfolio evaluation and monitoring

- ✓ **CA State Code**
- ✓ **Authority Investment Policy**
- ✓ **PTA Approved Issuer List**
- ✓ **Filtered Based upon ESG Parameters (Corporate Bonds)**

Reporting & Performance Evaluation

- ✓ Monthly investment reporting
- ✓ Ongoing performance measurement and evaluation

Sample ESG Investment Parameters – Apple Inc.



- ✓ Flexibility to establish customized ESG objectives
- ✓ May be rules based to remove ambiguity
- ✓ No common standard as to what are appropriate parameters

Impact of ESG on Investment Program

- **Applicability to Public Funds:** California government code and Authority's investment policy limit corporate bond allocations (the asset class for which ESG may be most applicable) to no greater than 30% of total portfolio market value resulting in limited applicability to non-pension public funds.
- **Diversification:** Universe of eligible and approved corporate issuers is reduced by a magnitude dependent upon parameters (i.e., more stringent restrictions may disqualify a greater number of issuers). Opportunity for diversification is provided by remaining qualifying issuers.
- **Yield and Return:** Indeterminant and depends upon a myriad of market and company-specific factors, including; interest rates, credit quality and credit spreads, market liquidity, and company financial policies (e.g., M&A appetite, dividend policy, shareholder buybacks, financing decisions, and other use of cash deployment preferences).
- **Custody and Transaction Costs:** No impact on custody fees or trade activity.
- **Investment Management Fee:** Additional 1 – 2 basis point (0.01% - 0.02%) on assets under management.
- **How PTA Currently Incorporates ESG Considerations:** PTA currently evaluates ESG risk as part of our credit evaluation process to more fully understand potential sources of credit risk for corporate bond issuers.

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