

FIRMA 2023

An Inflection Point for the ESG Investing Industry



May 3rd, 2023

GLENMEDE

Shareholders above all else?

*“Corporations have **no higher purpose than maximizing profits for their shareholders**”*

-Milton Friedman, “Capitalism & Freedom”, July 1962



181 CEOs walk into a room

*“We share a commitment to **not just shareholders – but all stakeholders:** communities, customers, employees, and suppliers.”*

-181 CEOs, “Business Roundtable,” August 2019





2016-2021:

Growth

Drivers in

ESG

Secular drivers to the first leg of growth

64%

Choose jobs based on a company's performance on environmental and social issues

73%

Are willing to pay more for products from sustainability minded companies

77%

Cite ESG as their top priority in **choosing to invest** in a company



Secular drivers to the first leg of growth

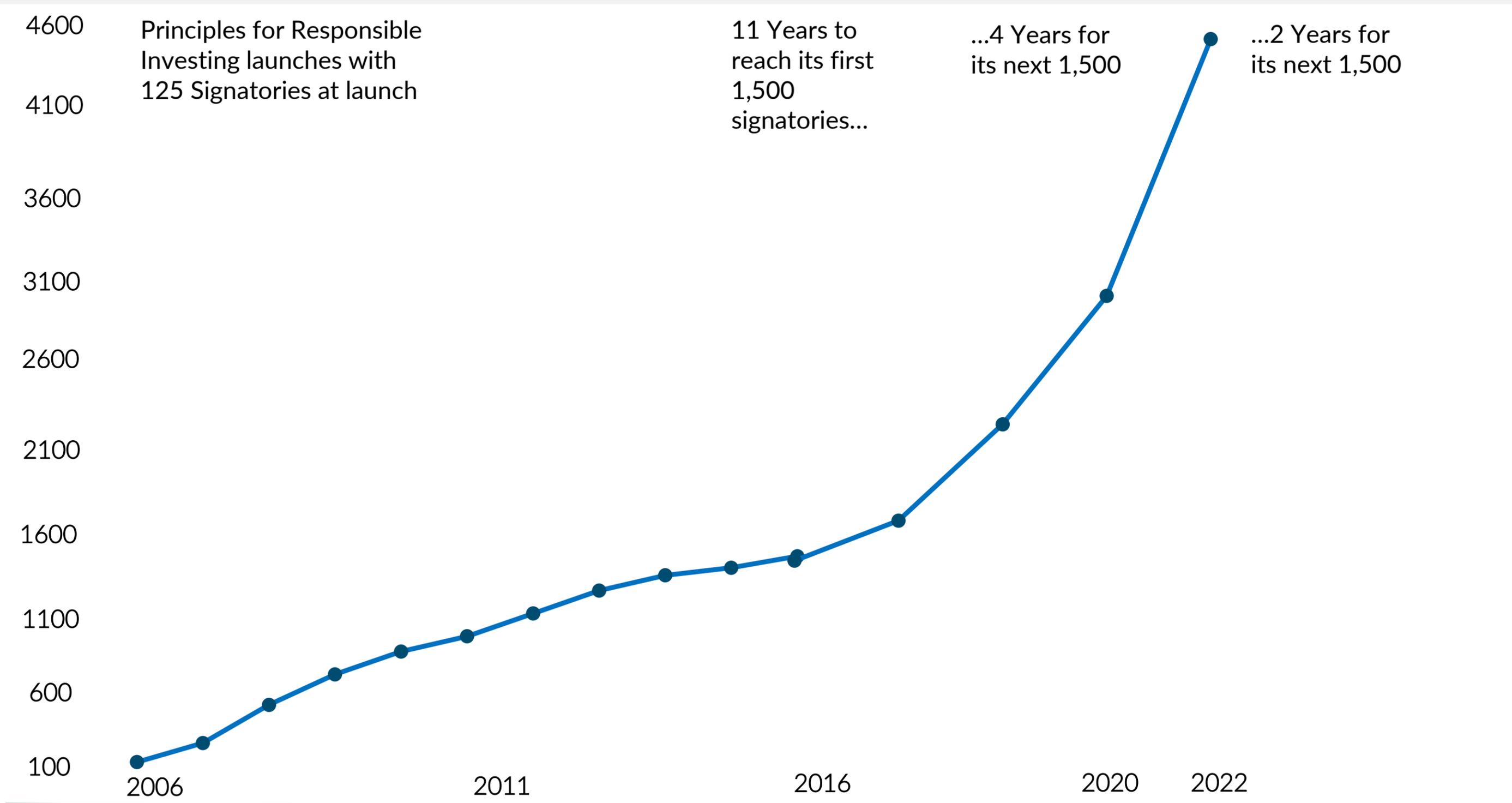


Research linking tilting
towards companies with
strong ESG characteristics

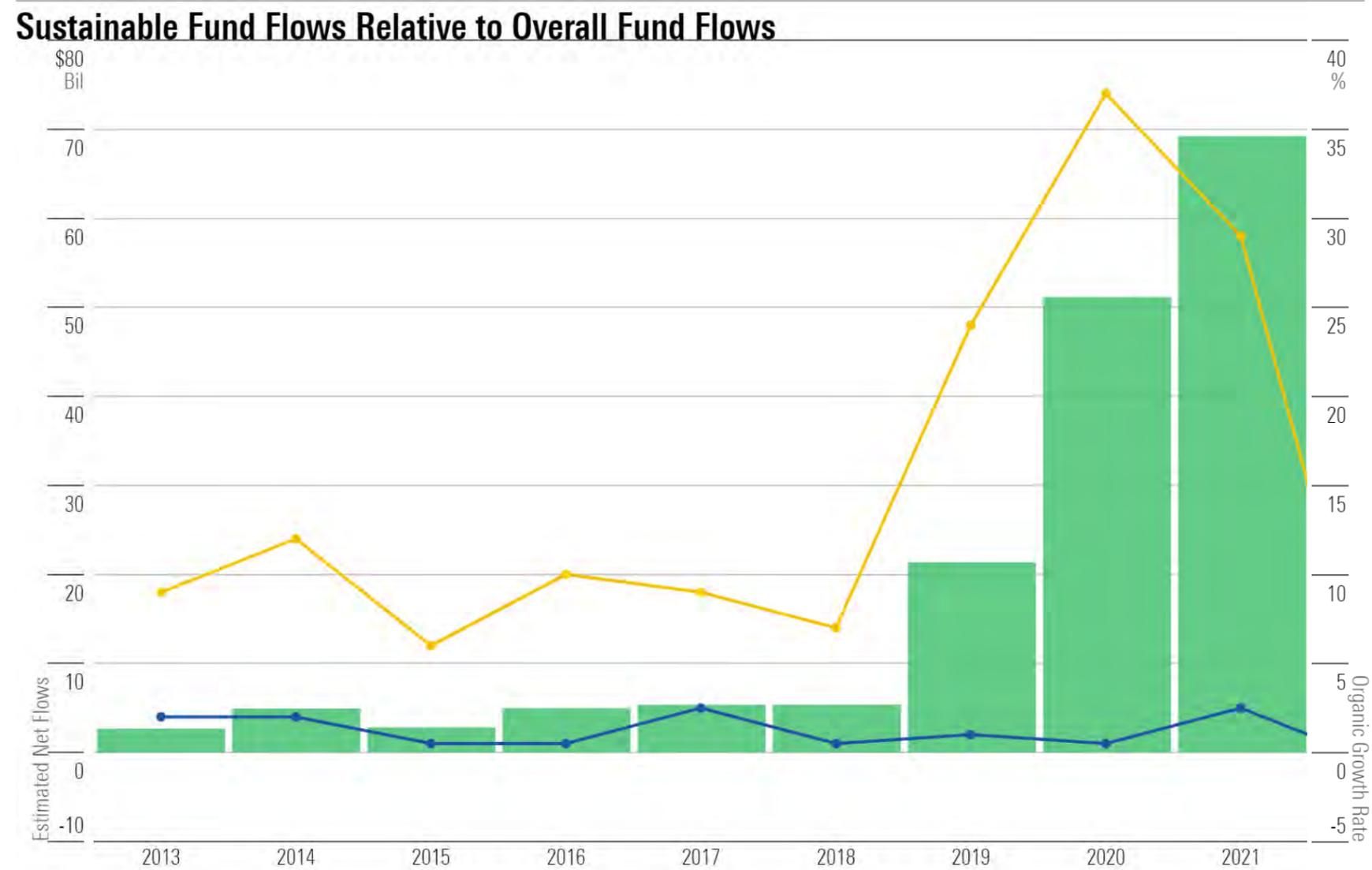
63% | 29% | 8%

Positive / neutral / negative
effect on risk-adjusted return of
incorporating ESG into financial
analysis as per academic study

Growth in sustainable and impact investing is accelerating



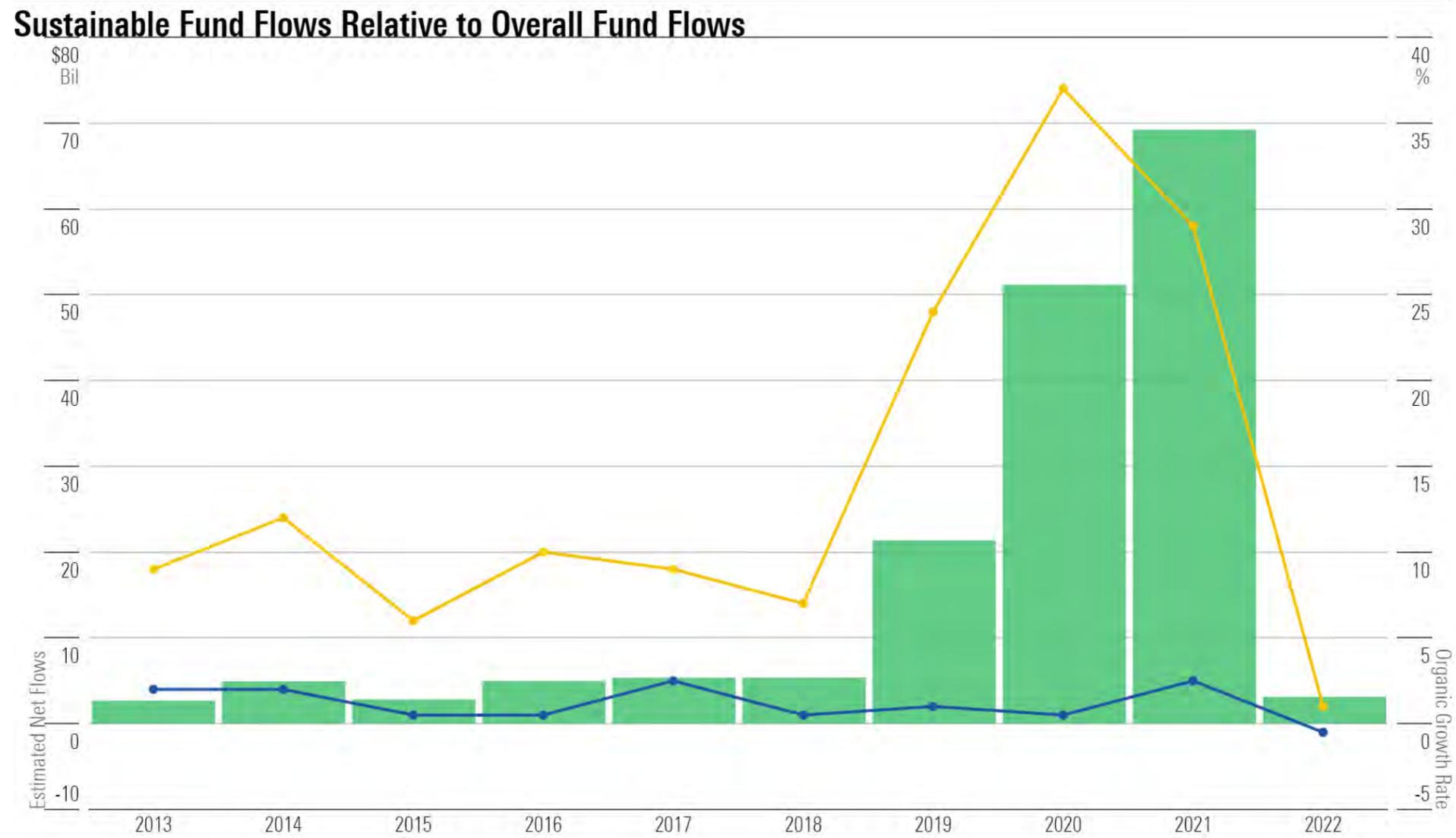
Significant growth in public funds market





2022-2023: An Inflection Point for ESG

Q4 2022 – AUM Update



Source: Morningstar Direct. Data as of Dec. 31, 2022. Includes sustainable funds as defined in Sustainable Funds U.S. Landscape Report, February 2023.

Q4 2022 – A selection of Headlines

Poor Performance

BARRON'S

ESG INVESTING

ESG Funds Are Having a Lousy Year. What to Do Now.

CITYWIRE

ESG funds hit by first month of outflows in three years amid wider withdrawals

CITYWIRE

Russia, rising interest rates and backlash: Can ESG survive?

Greenwashing and Regulatory Action

FINANCIAL TIMES

SEC investigating Goldman Sachs for ESG claims

wiley

ALERT | May 17, 2022

SEC's First ESG Enforcement Action Is Latest Move In Agency's ESG Efforts

Bloomberg

ESG Backlash Has Fund Clients Demanding Proof It Works

- Nuveen says there's 'a lot of pressure' from ESG clients
- Change in mood comes amid growing skepticism around ESG

Political rumblings...

BARRON'S

There is a struggle to define ESG, and opponents are using that to their advantage.

WSJ | OPINION

OPINION | REVIEW & OUTLOOK

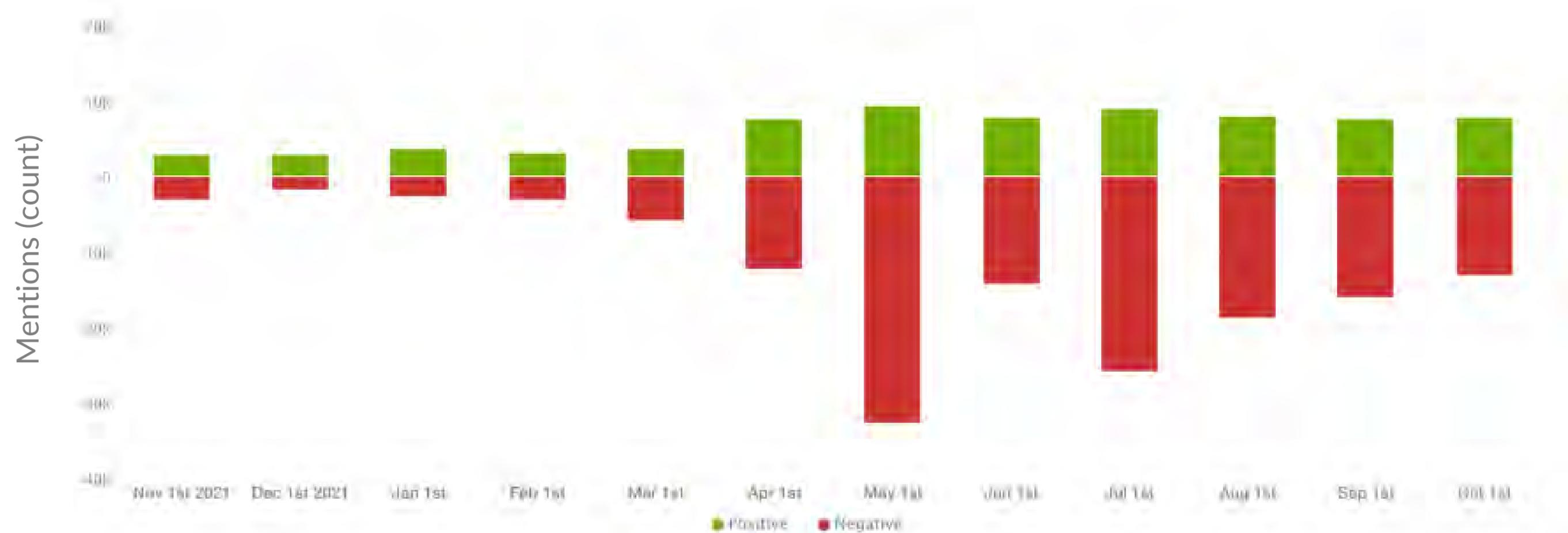
The ESG Investing Backlash Arrives

State AGs seek answers from BlackRock, and a new firm offers alternative investments funds. Strive's first fund raised more than \$100 million in a week.



4Q 2022: Politicization begins to accelerate...

Sentiment across Social Media related to “ESG”: November 2021-October 2022



Q1 2023 – A selection of headlines

- “ESG” investing has become an **increasingly politicized topic**, playing out in state legislatures, proposed 401(k) plan related laws, and U.S. presidential campaigns

S&P Global
Market Intelligence

Florida adopts anti-ESG rule for state's \$186B pension plan

CITYWIRE

Kentucky pension plans push back against state's ESG blacklist

MarketWatch

Senate passes measure to block ESG in 401(k)s, Biden poised to veto

FUNDfire

No Politics at Dinner: Many Advisors Aren't Talking ESG

Challenges most cited into 2023 by allocators

Asset owners' biggest challenges (CFA Institute 2022 Survey)

- Confusion over terminology / definitions / fund labels

- Performance skepticism

- Perceived greenwashing across industry

- Uncertainty over fit with fiduciary duty

In 2023, regulators are seeking to:

Clear set of definitions

Root out greenwashing

Clarify fiduciary duty / performance merits

- We have designed frameworks to enable investors to get ahead of these challenges



Regulatory Movement & Suggested Frameworks

Framework: Clearly defining the ESG approach strategies

Confusion over terminology and definitions



Integrated

Explicit consideration of financially material ESG factors

Focus on risk/return



Mandated

Avoid companies with poor ESG criteria / tilt toward companies with strong ESG criteria

Focus on risk/return, with impact generated as a by-product



Thematic

Invest in companies aligned with an environmental or social theme



Concessionary High Impact

Invest in local opportunities to achieve impact, while willing to sacrifice returns to do so

Focus on impact; willing to accept below market rate returns

Regulation: The SEC's proposed ESG naming framework – for asset managers to utilize

Confusion over terminology and definitions

- **New industry-wide SEC rule proposal for investment advisors and mutual funds issued May 2022 proposes increased disclosures for fund managers operating three categories of strategies: “*ESG integrated*”, “*ESG-focused*” and “*impact*” funds, with the following rules:**

1. Naming Rule

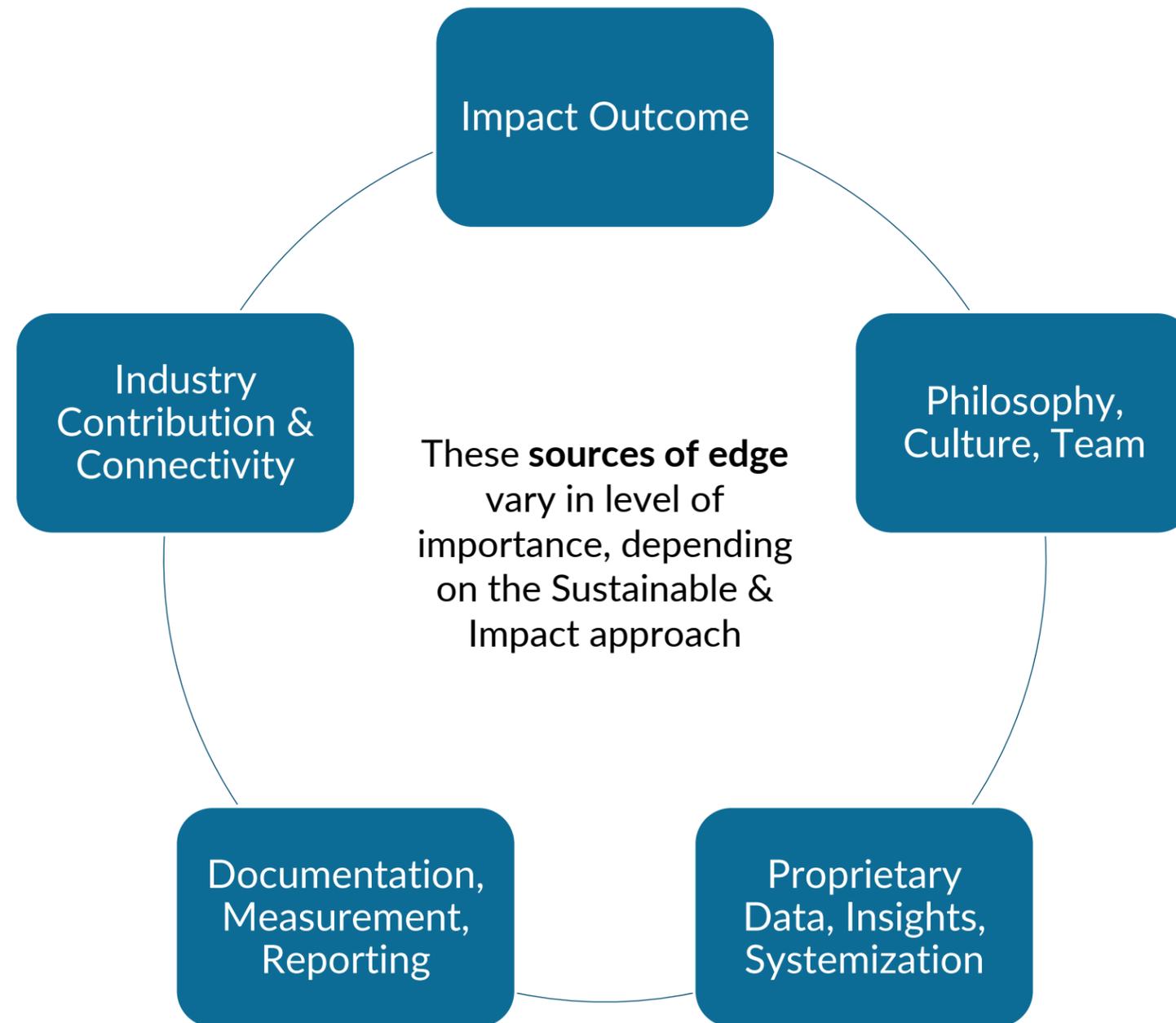
- 80% of assets need to align with what is included in the name.
- ESG integrated strategies cannot be labeled “ESG”, “Sustainable” or “Impact”

2. Required Disclosures

- GHG emissions for environmentally focused strategies
- Standard table for ESG funds*

• *Listing type of ESG approach, proxy policy, and how it impacts investment decisions

Framework: Evaluating ESG managers



Regulation: Approach to manager evaluation by SEC

SEC Proposes to Enhance Disclosures About ESG Investment Practices

- Degree of disclosure varies based on type of strategy:
 - Integrated funds; ESG-Focused funds (i.e. mandated/thematic); Impact funds (outcome focused disclosures)
- Enhanced disclosures:

ESG Integrated Funds

- **Brief disclosure on how ESG factors guide investment process in prospectus**
 - “a few sentences” / “layered approach”
 - “The Advisor considers material environmental, social, and governance (ESG) criteria in the context of long-term investor decision making.”

ESG Focused Funds

- Disclosure on inclusionary/exclusionary screens, outcomes being pursued
- Disclosure on proxy voting relating to ESG matters and ESG engagement meetings
- Disclosure on Greenhouse gas emissions such as carbon footprint and weighted average carbon intensity of portfolio (for environmental portfolios)

Performance Review – 2022 and Beyond

Performance
skepticism

2022 Performance – Aggregated Results



ESG Investing Keeps Pace With Conventional Investing in 2022

The broad Morningstar US Sustainability Index fell 18.9% in 2022, outperforming the 19.5% decline of its parent, the Morningstar US Large-Mid Cap Index. Over the same time, the S&P 500 fell 19.4%.

2019-2022 Performance – Aggregated Results



Quintile	S&P 500 ESG Index		S&P 500			Attribution		Total Effect (%)
	Average Weight (%)	Return (%)	Average Weight (%)	Return (%)	ESG Score	Allocation Effect (%)	Selection Effect (%)	
Totals/Averages	100.00	64.57	100.00	55.42	48.61	2.86	6.29	9.16
High ESG Quintile 1	22.91	-	19.72	50.82	72.07	0.09	-0.21	-0.12
Q2	24.21	-	19.24	53.75	55.76	-0.14	0.56	0.42
Q3	23.13	-	20.07	95.31	47.92	0.78	2.40	3.17
Q4	18.40	-	19.33	46.02	39.95	0.13	1.38	1.51
Low ESG Quintile 5	11.35	-	21.53	38.54	29.39	2.00	2.18	4.18

Source: S&P Dow Jones Indices LLC. Data from Jan. 28, 2019, to Dec. 31, 2022. Table is provided for illustrative purposes. Source for ESG scores: S&P Global. Analysis carried out using S&P Capital IQ Pro. ESG quintiles are determined using the ESG scores and reflect hypothetical historical performance. The S&P 500 ESG Index was launched on Jan. 28, 2019. Please see the Performance Disclosure linked at the end of this post for more information regarding the inherent limitations associated with back-tested performance.

Spotlight on trust law: evolution over time

Uncertainty as to whether ESG investments are consistent with fiduciary duties

Prudent Investor Rule

A trustee shall manage trust assets as a prudent investor would and exercise reasonable care, skill and caution.



Duty of Loyalty

A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.

1980



Social investing is **contrary** to trust law...

John H. Langbein & Richard A. Posner, "Social Investing and the Law of Trusts," 79 Mich. L. Rev. 72 (1980))

1995



No form of 'social investing' is consistent with the duty of loyalty **if...**

Comments to Uniform Prudent Investor Act, 1994

2020

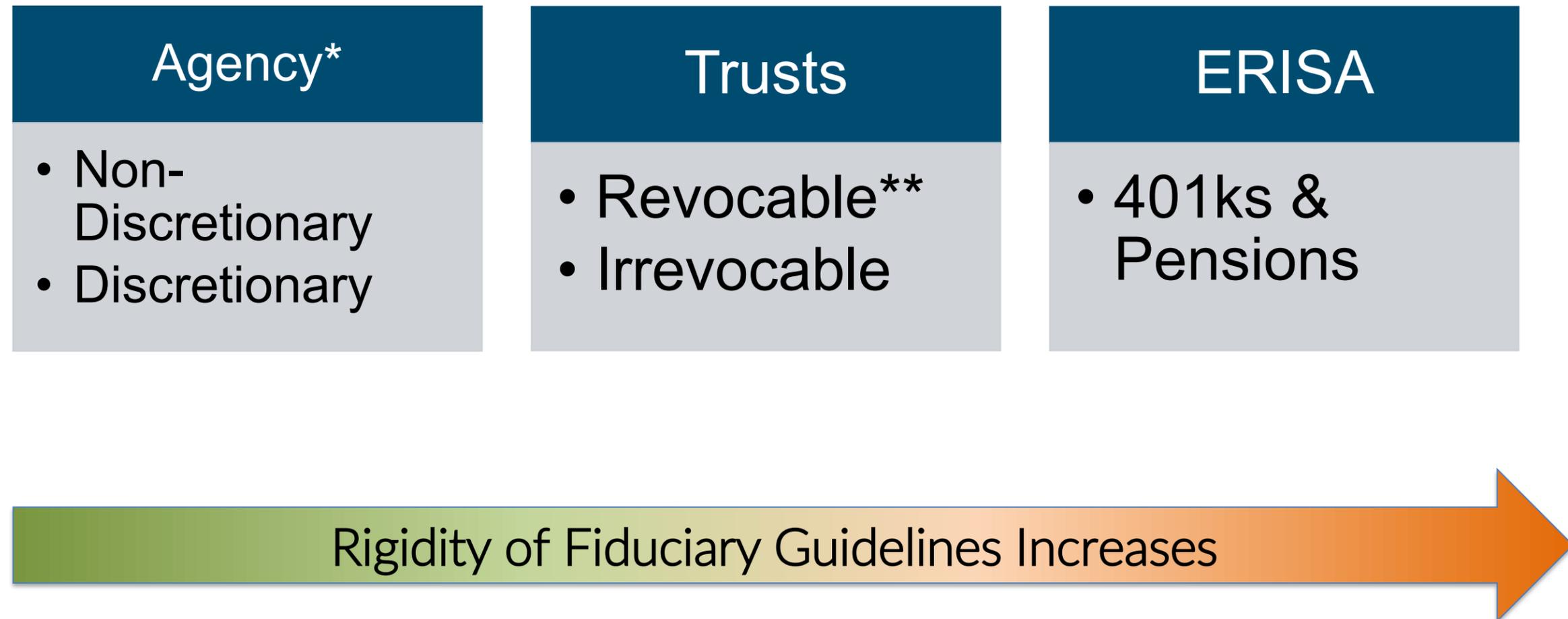


ESG investing **is permissible** by a fiduciary **only if** there is an exclusive focus on doing so to benefit risk/return

Max M. Schanzenbach & Robert H. Sitkoff, "Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee," 72 Stan. L. Rev. 381 (2020))

Does application of these approaches differ by account type?

Uncertainty as to whether ESG investments are consistent with fiduciary duties



*Includes Endowments & Foundations

**Includes IRAs

Framework: Fiduciary Fit by approach and account type

Uncertainty as to whether ESG investments are consistent with fiduciary duties

	ESG Integrated	ESG Mandated	Thematic	Concessionary High Impact
Agency: Non-Discretionary*	✓	✓ +	✓ +	✓ +++
Agency: Discretionary*	✓	✓ +	✓ +	✓ +++
Trust: Revocable**	✓	✓ ++	✓ ++	✓ +++
Trust: Irrevocable	✓	✓ +++	✓ +++	X
ERISA Accounts	✓	✓ +++	✓ +++	X

✓ = Acceptable in line with traditional strategy policies
 + / ++ / +++ = Can be acceptable with stringent procedures, good documentation & thoughtful allocation
 X = Additional considerations required before any investment may be made

*Includes Endowments & Foundations

**Includes IRAs

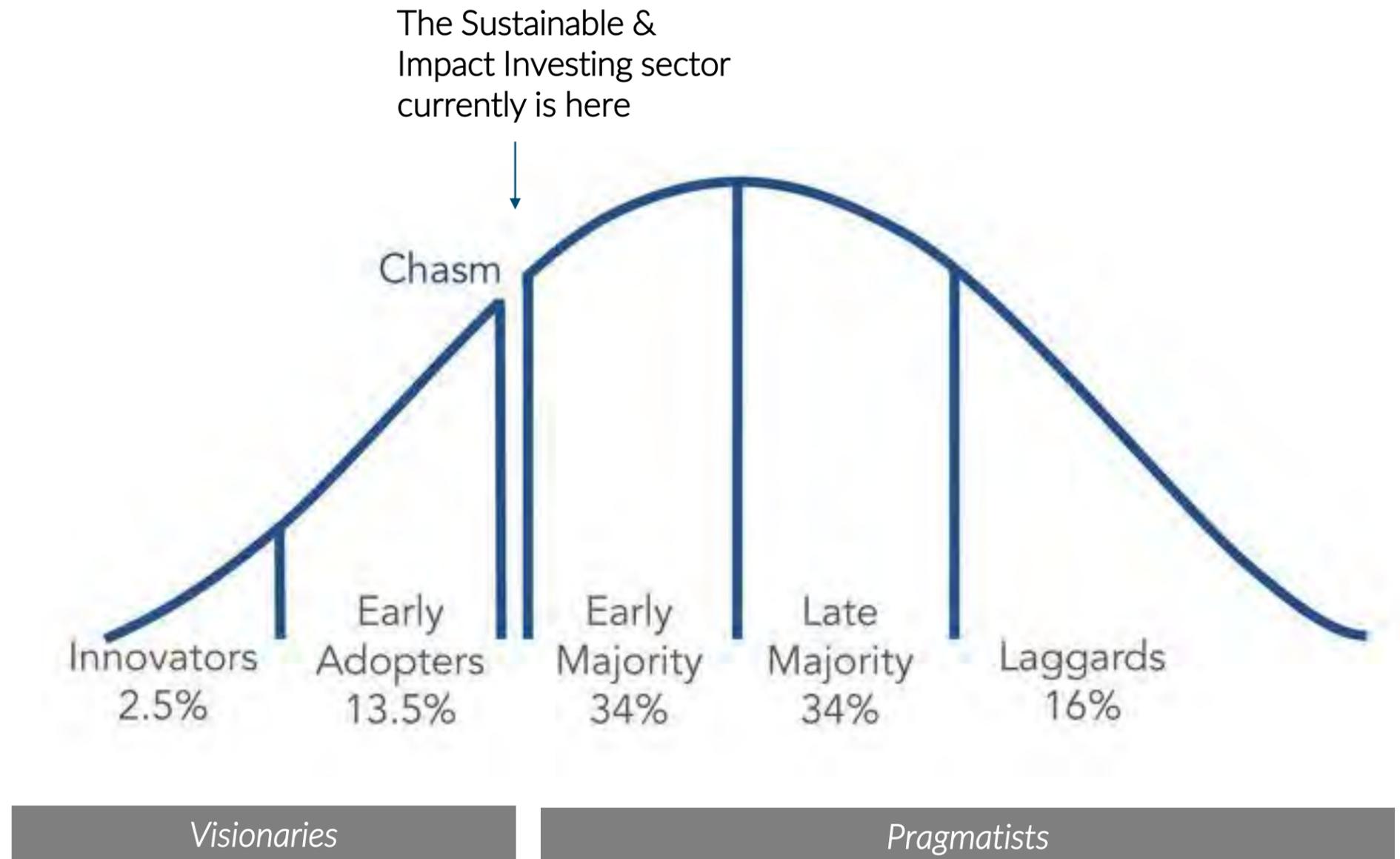
Regulation: The Volatile path of the DOL ERISA Plan Rule

Uncertainty as to whether ESG investments are consistent with fiduciary duties



- New rule announced by Department of Labor to go into effect January 2021 as it relates to inclusion of ESG strategies in ERISA-Plans.
 - Rule notes ESG as “non-pecuniary set of factors”(e.g. not financially material) and places additional burden on ERISA plan administrators to prove positive contribution of ESG factors on risk/return
- DOL announces it will not be enforcing the new rule until a further review of the language
- Department of Labor releases new proposal, noting that “Climate Change & ESG Factors” are no different than traditional financially material risk/return factors
 - Removal of specific additional documentation burden for those administrators who include ESG strategies in ERISA plan
- DOL notes more than 22,000 comments have been submitted thus far for new proposal, with “vast majority” noting support.
 - Ask for additional comments on climate related disclosures via new 22 page set of information supporting rule
- House and Senate vote to block enactment of new DOL rule; Biden expected to veto (as of 3/10/23)

What's Next?



Scrutiny on ESG continues to intensify, creating a push for investors, managers, and regulators alike to better define and standardize the industry

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