# Mission-Aligned Investing
Define Approach **Implement** Measure

## Implement

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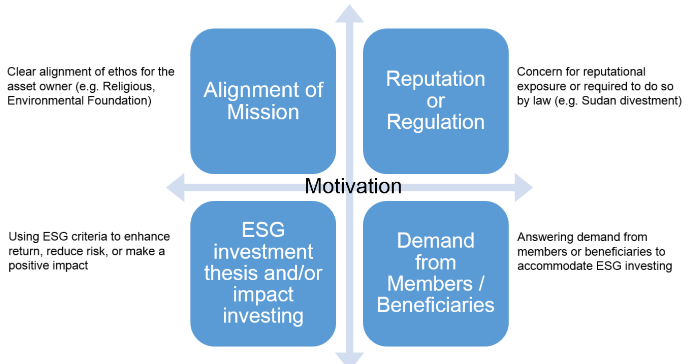
There is no one-size- fits- all portfolio for Mission-Aligned Investing as established in our previous two papers. The first explored the varying "definitions" of values and the second "approaches" available to investors in this emerging space. In this, our third paper, **Mission-Aligned Investing: Implement,** we answer the question: **"How do you 'implement' a mission-aligned portfolio?"**

***From a practical standpoint, any investor can benefit from the following step-by-step process.*** Any investor, from a retirement plan, endowment, family office or individual, can benefit from implementing this efficient step-by-step process.

## Step-By-Step Process

1. **Identify Your Motivation:** The motivation to commence Mission-Aligned Investing is different for every investor. For some it stems from the focus of the organization (i.e., religious, medical and environmental), for others it is public pressure (i.e., educational endowment and 401(k) plan) and for others its personal values. While the motives may differ, the common theme among investors goes far beyond just delivering a financial return. In identifying the motivation, the investor establishes the starting point to identify the mission. The diagram to the right outlines some motivational elements:



2. **Define Your Values:** Having identified the underlying motivation, the next step of defining values begins the alignment process. At times, this step in the process is very clear because investors know exactly what values they would like to build into their portfolio. Others may start this process knowing they want to do more, but lack direction. This uncertainty can be a struggle and will require work to get to the answer. For an institution or organization, many start with their mission statement and from it build greater specificity. Whereas an individual may start with broad topics important to them. A logical starting point is to explore nonprofit organizations they have an affinity for and extrapolate from their missions. With even broad ideas in hand (e.g., women's rights, climate change, bio-ethics) the path forward can quickly follow. At this point, specificity and practicality come in to focus.

   For example, an investor may begin the process "against tobacco". However, as details emerge this position is likely to be refined. Is the desire to eliminate investment in tobacco producers and manufacturers, or does this extend more broadly to tobacco retailers, including Walmart? By nature, these questions are iterative and help translate principles into investment language. The chart below outlines several levels of restrictions an investor may consider for an "anti-tobacco" portfolio[1]. Each entity must answer these questions for its own portfolio. While sometimes time-consuming, this process allows the investor to explore, debate and decide on the best application of principles.

| LESS RESTRICTIVE | MODERATELY RESTRICTIVE | ZERO TOLERANCE |
|---|---|---|
| • Producer ≥ 10% | • Producer ≥ 5%<br>• Supplier ≥ 10%<br>• Distributor ≥10%<br>• Retailer ≥ 10%<br>• Total ≥10% | • Ownership Of / By<br>• Producer ≥ 0%<br>• Supplier ≥ 0%<br>• Distributor ≥ 0%<br>• Retailer ≥ 0%<br>• Total ≥ 0% |
| Excluded Securities in ACWI: **13** | Excluded Securities in ACWI: **16** | Excluded Securities in ACWI: **215** |

*("ACWI" = MSCI All Country World Index)*

3. **Rank Your Values:** In the event of multiple goals, it is crucial to rank values to ensure investment alignment with the motivation and defined objectives. For many, this is the most challenging step of the process because it can be contentious and even esoteric. If a committee is involved, arriving at a consensus is often easier said than done.

   For example, if a committee defines three sets of specific values for a gender lens portfolio, including equal employment, equal pay and women friendly workplace policies, what is the specific ranking of these three values? In this instance, it is unlikely that one investment approach/strategy achieves an equal level of

[1] "Executive Summary: Tobacco: A Practical Guide For Institutional Investors." *MSCI*, Sept. 2018, www.msci.com/www/research-paper/executive-summary-tobacco-a/01115504946.

impact for each of these values. In ranking and ultimately identifying the more important values to the organization, the more straightforward it becomes to choose an appropriate approach.

4. **Choose an Efficient Approach:** While anything is possible, certain decisions are not always practical especially when factoring effort, cost, minimums and liquidity into environmental, social and governance (ESG) related investments. Additionally, each goal defined may have approach limitations given certain inherent data trends, inadequate data, etc. **As the exhibit below demonstrates, there is a natural scale between the intended return outcome and the intended social impact of different approaches**. As you would expect, each approach has its own characteristics, each with its own set of outcomes.

| | Conventional Investing | Exclusion | Shareholder Engagement | Integration | Impact Investing | Philanthropy |
|---|---|---|---|---|---|---|
| Intended Return Outcome | Seeking Market Rate of Return | | | | | Seeking Positive Social Impact |
| Motivation/Objective | No explicit consideration for ESG factors other than those that occur naturally as part of investment research | Limiting or excluding a subset of securities that do not align with investment criteria or mission | Use of shareholder rights (proxy voting and shareholder resolutions) to implement change within firms via engagement. | Use ESG criteria as part of investment research along with traditional investment criteria. This can also include shareholder engagement | Intention to prioritize market rate returns or social impact becomes ambiguous and varies based on portfolio | No consideration for financial return with a sole focus on social impact |
| Pro/Con | <u>Pro</u>: Sole focus on traditional relative performance to traditional benchmarks. <u>Con</u>: No mission alignment objective. | <u>Pro</u>: Meets very specific mandate (often faith/belief based) in order to adhere to specific guidelines. <u>Con</u>: arguably least impactful and may lead to relative underperformance if traditional benchmarks used. Labelling securities as bad actors could have PR consequences | <u>Pro</u>: Very proactive approach, well-documented and specific. <u>Con</u>: Requires very specific planning and timing. | <u>Pro</u>: Incorporates several methods of implementation increasing likelihood of meeting return objective and mission alignment. <u>Con</u>: Very customized (potentially expensive) in nature, requires specific and focused ESG research. Labelling securities as good/bad actors could have PR consequences | <u>Pro</u>: The most targetted route from a mission alignment standpoint and potentially return standpoint. <u>Con</u>: Private in nature, often more expensive, higher minimums, specific criteria. | <u>Pro</u>: Pure direction of dollars towards mission alignment. <u>Con</u>: No investment return |
| **Examples** (See Case Studies) | Traditional Investments | Tobacco, alcohol, adult entertainment, weapons, fossil fuels, hydraulic fracturing, etc. | Asset owner must own the securities directly to be able to vote shares based on their objective. Engaging a third party with expertise is important | Portfolios that include ESG criteria in their investment process, e.g.higher ESG ratings, thematic investments, etc. | Portfolios designed with impact first. Ex. Community development funds | Charitable organization and foundations |
| Cost / Details | Standard | Funds/ETFs normally less expensive. Separatre account minimums could be resrictive | Hiring a third party for expertise has a cost but often has most value | Funds/ETFs normally less expensive. Separatre account minimums could be resrictive | Generally private debt/equity. Investment minimums will apply. Costs are higher than traditional investments | Varies |

5. **INVESTMENT POLICY REVIEW:** Ideally the policy should include a short description/definition of what types of mission-aligned investments are permitted, how performance would be benchmarked, how managers would be evaluated and ultimately, how impact would be measured.

So why is this step-by-step process a pragmatic implementation strategy? There is no one-size-fits-all implementation strategy when it comes to values-based investing, but by thoughtfully engaging upfront to identify the motivations for mission aligned investing and defining and ranking values will both help inform policy language and ultimately portfolio approach. This process of defining the true mission upfront empowers the investor to limit risk, maximize return and fulfill the mission.

Look for our fourth paper **Mission-Aligned Investing: Measure**, where we will assess how to "measure" the portfolio's success.

As we outline in the Mission-Aligned Investing hypothetical scenarios below, each approach has its strengths and weaknesses. Where divestment may work for one client, a specific impact investment may be best suited for another.

## The Mission-Alignment Decision Process Hypothetical Scenarios

While underlying values vary in magnitude and specificity from person-to-person and group-to-group, the question ultimately comes down to what approach best aligns with your values. Mission-aligned investors utilize a variety of methods and we provided the following case studies for additional implementation examples.

**SHAREHOLDER ENGAGEMENT** allows the investor the most direct avenue to voice their values. As the scale below illustrates, the level of shareholder engagement commitment can vary significantly, from lower commitment actions such as proxy voting, to higher commitment actions, such as filing shareholder resolutions and advocating politically for public policy changes. Given shareholder engagements hold no legally required action from a company, actions such as proxy voting allows an investor to engage directly with the company on its operations, corporate governance and at times, its social responsibility.

**THE SPECTRUM OF EFFECTIVE SHAREHOLDER ENGAGEMENT STRATEGIES**

| Lower Commitment | | | Higher Commitment | | |
|---|---|---|---|---|---|
| Letter writing to companies | Proxy voting at annual meeting | Meetings with company | Filing a shareholder resolution | Coalition building and campaigns | Lawsuits or political advocacy |

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Example: Assume an investment committee identified equal pay as its most important value within a gender lens portfolio. In the United States, a woman today makes $0.80 to the dollar compared to her male colleagues.[2] Many other countries outside the United States and many states within the United States have passed legislation requiring gender pay-gap disclosures. Broadly speaking, in the United States, there is still very limited equal pay disclosure data available. As such, it is not practical to implement an exclusion or integration strategy without the required data at hand. The most practical and impactful approach becomes shareholder engagement. In this example, finding a manager that provides a higher commitment to

[2] Carter, Talene M, et al. "Pay Equity across the Globe." *Willis Towers Watson*, Oct. 2018, www.willistowerswatson.com/en/insights/2018/10/finex-observer-pay-equity-across-the-globe.

improving equal pay disclosures would be the most impactful approach.

**EXCLUSION** of certain securities. Many faith-based organizations strive to maintain a specific "sin-free" portfolio and were among the first to adopt this approach. The process of avoiding securities that counter specific beliefs can be an effective tool. Two primary drawbacks are (1) defining the "bad actors" and (2) the resulting influence on what investments are available to them.

Example: For a cancer-research foundation, whose mission is staunchly opposed to any investment in tobacco companies, wants to exclude all tobacco manufacturers from the portfolio. As of September 2018, the MSCI ACWI weighting of companies that could be removed varied from 0.58 percent to 8.94 percent,[3] depending on the definition of acceptable tolerance. Given this insignificant portion of the index, it is reasonable to exclude these specific types of companies from a portfolio without unduly affecting the risk/return profile of the investor. The all-in costs to deploying a separately managed account customized to exclude these specific types of investments are generally slightly higher than a conventional investment vehicle, but manageable.

**INTEGRATION** is a hybrid of the negative and a positive screen technique. By establishing certain sector and industry parameters, an investor can take a pragmatic approach to aligning values and investment returns.

Example: As of October 16, 2018, only 43 companies out of the 2,694 members of the MSCI ACWI had boards that consisted of at least 50 percent women.[4] This equates to just 1.6 percent. If the investor defined a goal for equal employment and set a zero tolerance for companies with less than 50 percent female board representation, a negative screen would require excluding 98.4 percent of the MSCI ACWI index. This would unduly impair the risk profile of the portfolio. In this situation, a combination of less restrictive negative screens and positive screens (tilting) become more appropriate for committees wishing to advance goals pertaining to equal employment. The hybrid screening casts a wide enough net to support all companies that are "moving the needle" on equal employment.

**IMPACT INVESTING** is arguably the most targeted route of investing when it comes to a specific value-set or cause. Impact investing targets certain organizations, funds or securities aligning with their mission alongside financial return. This is often done with private investments so the focus on the impact is made clear. Many times public companies have various divisions or competing social interests within an organization, so an investor's ability to target impact with public securities can be limited.

[3] "Executive Summary: Tobacco: A Practical Guide For Institutional Investors." *MSCI*, Sept. 2018, www.msci.com/www/research paper/executive-summary-tobacco-a/01115504946.
[4] "Women on Boards Progress Report 2018." *MSCI*, Dec. 2018, www.msci.com/www/research-paper/women-on-boards-progress report/01210712745.

Example: For the environmentally focused ultra-high net worth investor wanting to enhance renewable and sustainable technologies, impact investing may be the most potent way to align the portfolio with their mission. The higher investment minimums of this investment structure should be considered in the context of the investor's aggregate portfolio in order to not overly concentrate their portfolio within private market investments.

For additional information, please contact any of the professionals at Fiducient Advisors.

# About the Authors

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Bill provides investment consulting services to nonprofit organizations, corporate executives, family trusts and other private investors. Bill services clients by providing advice and expertise on asset allocation, portfolio design, investment policy statements, manager search process and overall investment management. He is a member of the firm's Mission-Aligned Investing Sub-Committee. Prior to joining the firm, Bill was a Senior Associate in the Sales & Service division of Northern Trust Global Investments where he was responsible for both institutional and wealth client relationships. Earlier in his career, Bill held positions on the trading floors of both the New York Stock Exchange and Chicago Board of Trade. He earned a BA in Philosophy & Political Science from Fordham University, a Master in Business Administration (MBA) from Lewis University and a Master of Science in Finance (MSF) from Lewis University. He obtained the title Certified Investment Management Analyst (CIMA®) from the Investments & Wealth Institute™ accreditation program at the Wharton School of Business. Bill is an avid runner and completed the Ironman Triathlon®. These days he and his wife enjoy chasing their two boys around the backyard.

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