

ESG INVESTING IN YOUR RETIREMENT PLAN

By Nancy Rimington, Innovest

ESG investing has been a popular topic in recent years as companies pursue more initiatives to align with employee and customer values. While the landscape is evolving, there are signs of buy-in from companies, investment managers, and regulatory bodies that these factors will be important to long-term success. Investors are increasingly interested in factors beyond those most traditionally cited in investment risk and return assessment. The industry labels these in various ways, the two most common being socially responsible investing (SRI) and environmental, social, and governance (ESG) investing.

Historically, socially responsible investing has avoided “morally reprehensible” companies by screening out organizations that derive revenues from industries deemed to be harmful. Common examples of these industries include tobacco, alcohol, and weapons. On the other hand, ESG investing has taken a more inclusionary approach by seeking to identify companies that are “best-in-class” related to a specific theme. Examples of these themes include climate change, resource use, labor standards, and more.

As fiduciaries of the Plans, the County’s Deferred Compensation Advisory Committee (DCAC) recognizes that they are guided by a duty of loyalty and prudence and must act solely in the interest of all plan beneficiaries. Given the subjective nature of SRI and ESG investing, the DCAC requested Innovest Portfolio Solutions provide the DCAC with more insight as to how current investments incorporate these topics.

A case study was presented by our Consultant on the various levels of ESG already incorporated in the County’s current fund lineup. This includes measurements of the current funds’ sustainability ratings, carbon use, and fossil fuel involvement. As a result, the DCAC found that although the investments within the core lineup may not be labeled as ESG, many of the funds incorporate ESG criteria into the investment process and scored very well, as seen in the attached chart.

Our consultant further advised DCAC to inform plan participants that while many of the current funds offered may not be ESG-labeled, the ESG ratings demonstrate a focus. It is also important to note that retirement plan fiduciaries oversee plan assets, not employer funds, and are tasked with providing investment options in the best interests of all plan participants. In all cases, best practice is to establish investment strategies based on stated plan objectives and to document the decision-making process.

As a result, for plan participants who are even more interested in directing their investments to ESG/SRI specific funds, the County will direct plan participants to the self-directed brokerage option within the Deferred Compensation plan for access to a broader array of investment options that may better fit their specific interests, where appropriate. DCAC will also incorporate ESG information into employee education, as many are unaware that some factors already play a role in many actively managed funds. Further, DCAC will look to incorporate ESG/SRI topics into education sessions provided by Empower.

ESG Integration – County of San Mateo

Fund Name	UNPRI Signatory	Firm ESG Integration	ESG Focused	Morningstar Sustainability Rating**	Morningstar Low Carbon Designation***	Fossil Fuel Involvement****	MSCI ESG Rating*****
Fidelity® 500 Index	Yes	Yes	No		No	9.14	AA
American Funds American Mutual R6	Yes	Yes	No		No	14.17	AAA
American Funds Fundamental Invs R6	Yes	Yes	No		No	8.93	AA
American Funds Growth Fund of Amer R6	Yes	Yes	No		Yes	5.87	AA
American Century Mid Cap Value R6	Yes	Yes	No		No	11.22	AA
Fidelity® Mid Cap Index	Yes	Yes	No		No	10.48	AA
MassMutual Mid Cap Growth I	Yes	Yes	No		Yes	2.60	AA
Boston Partners Small Cap Value II I	Yes	Yes	No		No	6.69	AA
Fidelity® Small Cap Index	Yes	Yes	No		No	7.62	BBB
Harbor Small Cap Growth Instl	Yes	Yes	No		No	5.10	BBB
Fidelity® International Index	Yes	Yes	No		No	11.39	AAA
American Funds Europacific Growth R6	Yes	Yes	No		No	9.82	AA
Invesco Developing Markets R6	Yes	Yes	No		Yes	4.42	A
Vanguard Total Bond Market Index I	Yes	Yes	No		-N/A	3.95	A
PIMCO Total Return Instl	Yes	Yes	No		-N/A	2.88	N/A
Fidelity® US Bond Index	Yes	Yes	No		-N/A	3.65	A
Parnassus Core Equity Institutional	Yes	Yes	Yes		Yes	2.73	AA
Vanguard Target Retirement 2030 Fund	Yes	Yes	No		Yes	7.24	AA*

*This is the average MSCI ESG rating for all Vanguard Retirement Target Date Funds

**"The Morningstar Sustainability Rating is a measure of how well the portfolio holdings are managing their ESG Risk relative to the portfolio's Global Category peer group. Higher ratings are better and indicate that an investment has, on average, more of its assets invested in companies that have lower ESG risk as characterized by Sustainalytics."

***"To receive the Low Carbon designation, a fund must have a 12-month average Portfolio Carbon Risk Score below 10 and a 12-month average Fossil Fuel Involvement % of less than 7% of assets."

****The Fossil Fuel Involvement % uses date from the most recent quarter; it is not a 12-month average that is used in the Low Carbon designation.\

***** CCC B BB BBB A AA AAA
LAGGARD **AVERAGE** **LEADER**