Doing Well by Doing Good: Fiduciary Investing with Purpose

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Doing Well by Doing Good

Investing with Purpose

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Evolution of sustainable investing

1500 – 1960

Ethical Investing

Birth of Negative Screening

Religious organizations aimed to avoid investing in stocks that did not align with their values or were "sinful"; investments in alcohol, tobacco, firearms, adult entertainment were excluded

1928: Launch of Pioneer Fund

One of the first mutual funds to deploy socially responsible investment criteria, avoiding companies in alcohol, tobacco and gaming industries

1960 – 1990

Early Socially Responsible Investing (SRI): Values-based investing

1970s: Shareholder Activism

Ralph Nader has socially based resolutions added to the General Motors proxy ballot

1980s: Apartheid and South Africa divestment movement emerges as an issue

Several mutual funds catering to SRI are launched (Calvert and Parnassus)

1990 – 2005

Current SRI: Shift away from values-based investing towards incorporating ESG factors into decision making

1990s: First SRI Index

MSCI KLD 400 Social Index applies negative screening excluding products with negative social or environmental impact

2003 – Today

ESG integration and positive sustainable investing incorporated frequently alongside traditional security analysis

2003: ESG

UN convenes asset management working group to study the financial materiality of ESG on securities valuation

2005: ESG

The term ESG is first coined in a landmark study entitled "Who Cares Wins"

2006: UN PRI

UN Principles of Responsible Investing were launched

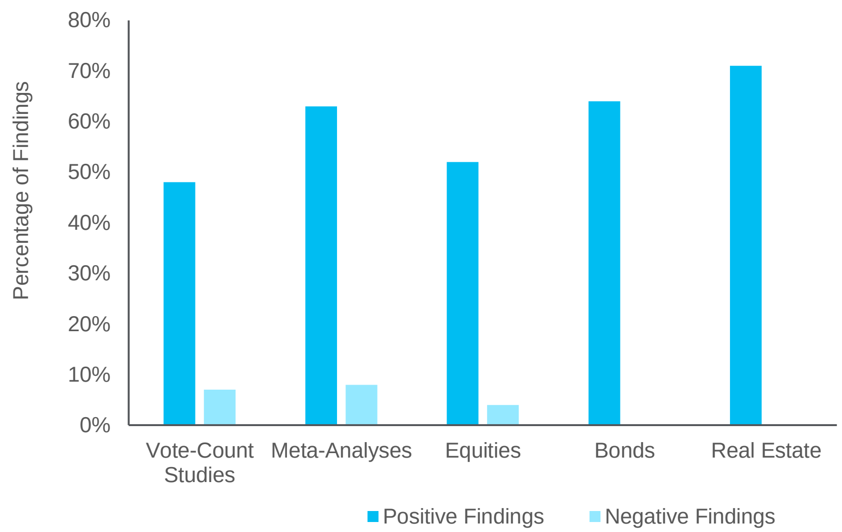
The range of investment products incorporating ESG factors grows exponentially

The case for sustainable investing

Citi Private Bank reviewed an analysis of the results of more than 2,000 different academic studies carried out since the early 1970s

- Over half of these studies found a positive correlation between companies that score well when evaluated based on factors that align with environmental, social and governance (ESG) principles and corporate financial performance
- Less than 10% identified a negative relationship between high scoring ESG factors and corporate financial performance
- Companies that scored well when evaluated based on ESG factors typically had better financial results than companies with lower ESG scores

Companies that adhere to high ESG standards tend to have stronger financial performance



Source: Friede, Busch, and Bassen; ESG and financial performance, 2015. **Past performance is no guarantee of future returns.** Real results may vary. Note: The results shown towards the left are based on 723 vote-count studies and 1,214 meta-analyses. The asset class results towards the right involve 334 vote-count studies of which 36 pertain to bonds and 7 to real estate. Vote-count studies assign findings into significant positive, negative and non-significant categories. Meta-analyses involve econometric reviews. Please see Glossary for definitions.

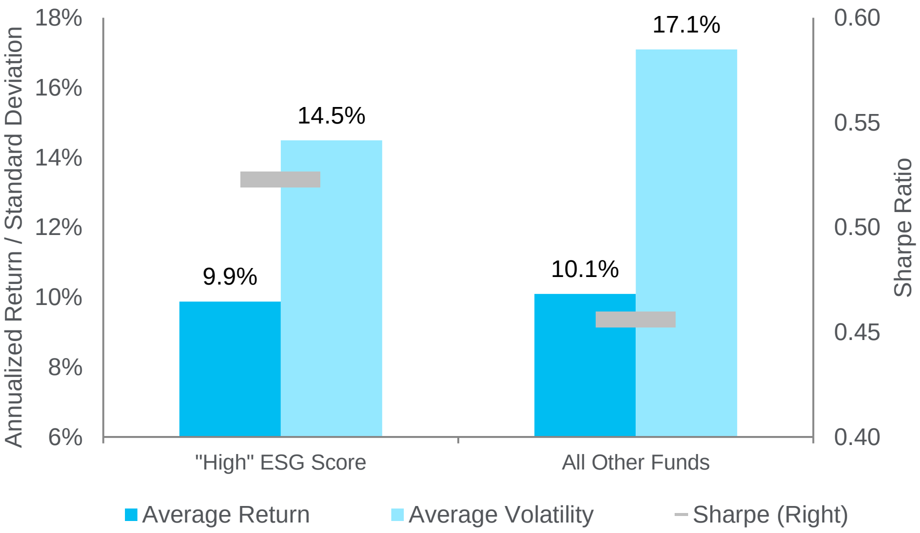
Environmental, social and governance (ESG) principles should not be the only consideration when making an investment decision. Selecting investments based on ESG principles will not guarantee positive future returns. There can be no assurance that any Socially Responsible Investing (SRI) screening process will achieve its goals or that an investment will not incur losses.

The case for sustainable investing

When compared to traditional managers, ESG-focused managers had comparable returns with lower risk, resulting in superior risk-adjusted returns between January 2010 through December 2018

Mutual funds with high ESG scores delivered better risk adjusted returns

January 1, 2010 – December 31, 2018



Source: Morningstar; January 1, 2010 – December 31, 2018. **Past performance is not indicative of future results.** Office of the Chief Investment Strategist, Citi Private Bank. We used data on 528 US equity funds with data back to 2010 from the Morningstar database. Of these, 58 were assigned to the high ESG score universe based on Morningstar's methodology; all others totaled 470 funds. We compared the high ESG funds and all others on an equal-weighted basis for return and standard deviation. The Sharpe ratios shown were calculated on the aggregated returns and standard deviations. Sharpe ratio is the measure of risk-adjusted return of a financial portfolio. A portfolio with a higher Sharpe ratio is considered superior relative to its peers.

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Opportunities today

Sustainable investing does not require you to sacrifice returns nor is it a philanthropic endeavor

Today's approach may enhance investment returns for our clients

HISTORICAL MODEL

LIMITED FINANCIAL BENEFIT

Responsible

Socially Responsible Investing (SRI) negatively screens firms based on adherence to accepted environmental, social and governance (ESG) principles

TODAY

FOCUS ON FINANCIAL BENEFIT

Sustainable

Evaluates firms on adherence to accepted **ESG** principles

PLUS A SOCIAL BENEFIT

Impact

Investments with an **intended focus** on positive ESG impact typically seeking to achieve a societal benefit as well as a financial return, resulting in double-bottom line reporting[1]

[1]Measuring performance in terms of profit/loss as well as in positive social impact.
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State of the industry

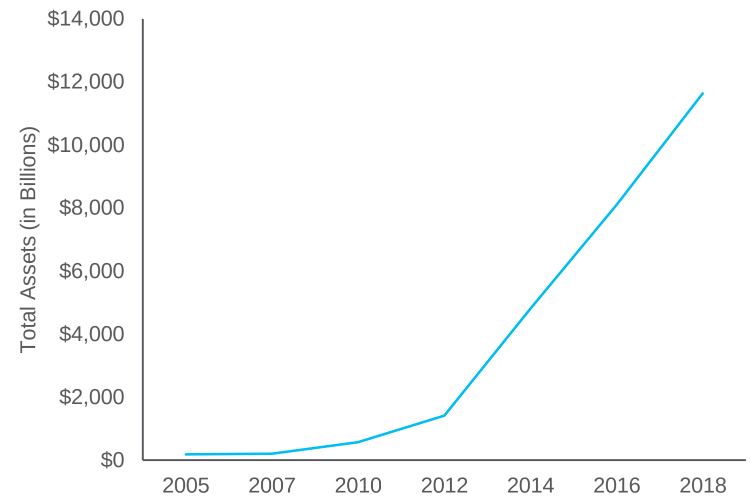
DEMAND FOR SUSTAINABLE INVESTING BUILDS GLOBALLY

Growth of Sustainable Investment Assets by Region 2014-2016[1]

Region	2014 ($B)	2016 ($B)	Growth over Period	Compound Annual Growth Rate
Europe	10,775	12,040	11.7%	5.7%
US	6,572	8,723	32.7%	15.2%
Canada	729	1,086	49.0%	22.0%
Australia/New Zealand	148	516	248.6%	86.4%
Asia	52	526	911.54%	218.05%
Total	**18,276**	**22,891**	**25.3%**	**11.9%**

…AND INVESTMENT OPTIONS ARE EXPANDING RAPIDLY

Growth of ESG Incorporation by US Money Managers 2005-2018[2]



[1] Source: 2016 Global Sustainable Investment Review, *GSIA;* Asset values are expressed in billions. GSIA uses an inclusive definition of sustainable investing, without drawing distinctions between this and related terms such as responsible investing and socially responsible investing. These are collectively referred to as sustainable investing.
[2] Source: Report on US Sustainable, Responsible and Impact Investing Trends 2018, US SIF Foundation.

Why this is possible today

Technology and innovation are strengthening investment processes and adding new dimensions to the evaluation of investment opportunities

Advancements in technology

Data availability

Information advantage

Adding value via favorable ESG factors

How it makes an impact

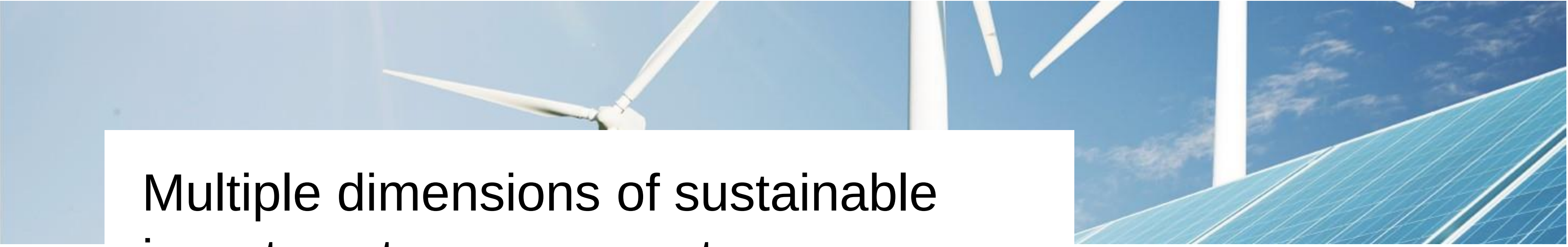
The explicit incorporation of environmental, social or governance criteria and considerations into investment decision making seeks to advance positive change around a wide range of issues

Investors who attribute value to companies that manage their businesses sustainably can help influence and transform how companies behave over time

SAMPLE OF ESG CONSIDERATIONS

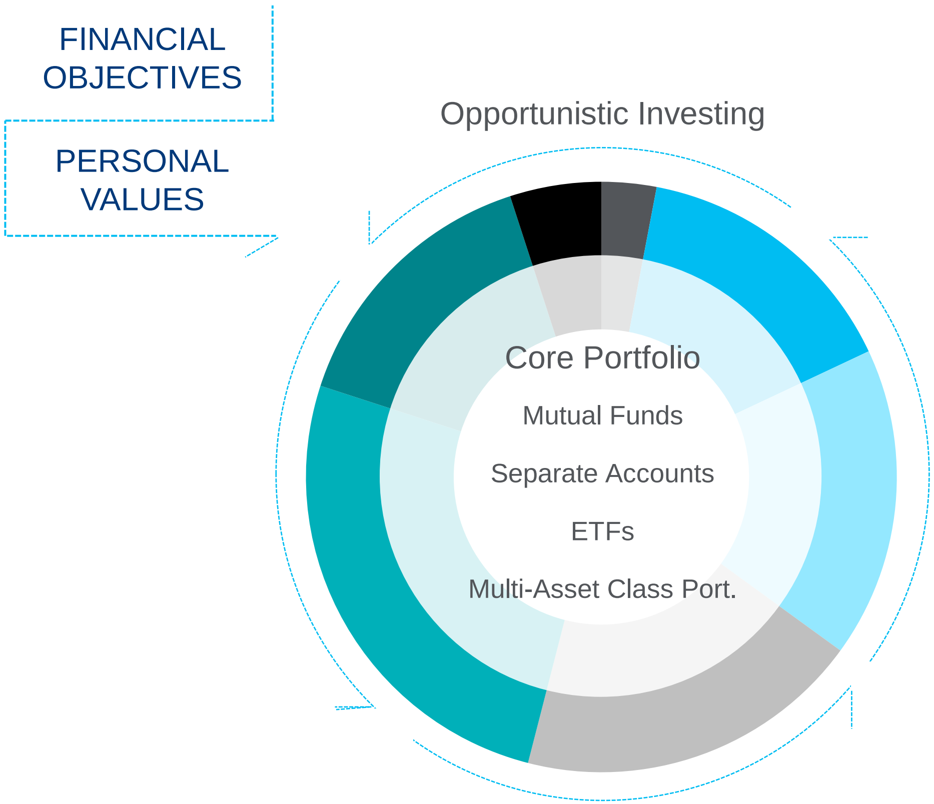
ENVIRONMENTAL			SOCIAL		GOVERNANCE		
Biodiversity	Clean Technology	Pollution & Waste	Community Mindset	Human Rights	Privacy & Data Security	Accounting Transparency	Business & Ethics
Carbon Emissions	Climate Change		Gender Equality	Product Liability	Workplace Environment	Board Composition	Executive Compensation
Energy Use	Water Scarcity		Health & Safety	Stakeholder Interests		Conflicts of Interest	Ownership & Voting Rights

Private Bank



Multiple dimensions of sustainable investment management

ESG investing adds a new dimension to how investment firms work with clients to understand their goals and objectives



This framework provides comprehensive portfolios designed to deliver capabilities in asset allocation, manager selection and portfolio construction

Positioning a diversified **core** portfolio of skillful managers paired with customized structures, complemented with **opportunistic** investments, provides the potential to align personal values while seeking enhanced returns and diversification in a risk managed framework

There can be no assurance that due diligence, manager selection and risk monitoring processes will achieve their goals and that any portfolio or fund will not incur losses. Diversification does not ensure against loss.

Sustainable Investing and Fiduciary Duty

Duties that affect fiduciary investment decision-making

Duty of Obedience

- Fiduciary must comply with the terms of the governing instrument
- Does the governing instrument have specific instructions regarding investment decision making?

Duty of Impartiality

- Fiduciary must treat present and future beneficiaries impartially
- This duty is particularly important in multi-generational trusts

Duty of Loyalty

- Fiduciary acts in the sole interests of beneficiaries and may not consider fiduciary’s personal interests in making interests in making decisions for beneficiaries
- Fiduciary’s decisions about investments must be consistent with the interests of beneficiaries

Duty of Care/Prudent Investor Rule

- Fiduciary has a duty to manage assets with reasonable care, skill and caution
- This duty is expressed in the Prudent Investor Rule, NY EPTL 11-2.3

NY Prudent Investor Act, EPTL 11-2.3

Conduct, not performance

Exercise reasonable care, skill and caution in relation to investments

- Standard of prudence

Evaluate portfolio as a whole

- Each investment cannot be viewed in isolation
- Trade off between risk and return

Diversify

- Minimize investment risk
- Avoid concentrated positions

Evaluate trust purposes and beneficiaries' needs

- Term and purpose
- Time horizon
- Current beneficiary income needs & principal distribution requirements
- Tax considerations for trust and/or for income beneficiaries/remaindermen
- Volatility of portfolio/risk tolerance
- Legal and other special considerations

Incur reasonable and appropriate costs only

Duty of Loyalty

Comment to § 5 (Loyalty) of Uniform Prudent Investor Act (1995)

“No form of so-called ‘social investing’ is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries – for example, by accepting below-market returns -- in favor of the interests of the persons supposedly benefitted by pursuing the particular social cause.”

Restatement (Third) of Trusts (2007)

§ 78, Comments & Illustrations f.
Adds language from UPIA and comments, “Not surprisingly, considerable disagreement continues about what loyalty should require in this context.” The comment cites articles in the context of pension plans and references § 90

§ 90, Comments & Illustrations c. General requirements of loyalty and impartiality
“Thus, for example, in managing the investments of a trust, the trustee's decisions ordinarily must not be motivated by a purpose of advancing or expressing the trustee's personal views concerning social or political issues or causes. Such considerations, however, may properly influence the investment decisions of a trustee to the extent permitted by the terms of the trust or by consent of the beneficiaries.”

2018 Amendments to Delaware Prudent Investor Act

12 Delaware Code § 3302 Degree of care; authorized investments

"(a) … when considering the needs of the beneficiaries, the fiduciary may take into account the financial needs of the beneficiaries *as well as the beneficiaries' personal values, including the beneficiaries' desire to engage in sustainable investing strategies that align with the beneficiaries' social, environmental, governance or other values or beliefs of the beneficiaries."*

12 Delaware Code § 3303 Effect of provisions of instrument

" (a) Notwithstanding any other provision of this Code or other law, the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary any laws of general application to fiduciaries, trusts and trust administration, including, but not limited to, any such laws pertaining to:

. . .

(4) *The manner in which a fiduciary should invest assets, including whether to engage in 1 or more sustainable or socially responsible investment strategies, in addition to, or in place of, other investment strategies, with or without regard to investment performance* …"

Implementation of Sustainable Investing?

Fiduciary Discretion

Directed Trusts

Private Banking for Global Citizens

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Glossary

Meta-Analysis: A meta-analysis is a statistical analysis that combines the results of multiple scientific studies. The basic tenet behind meta-analyses is that there is a common truth behind all conceptually similar scientific studies, but which has been measured with a certain error within individual studies.

Vote-Count Study: Vote counting is a simple but limited method for synthesizing evidence from multiple evaluations, which involves simply comparing the number of positive studies (studies showing benefit) with the number of negative studies (studies showing harm).

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