HEALTH WEALTH CAREER

THE ABC OF ESG

2018

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CONTENTS

INTRODUCTION

1.1

At Mercer, we define responsible investment (RI) as an investment approach that includes environmental, social and corporate governance (ESG) factors and broader systemic issues — for example, climate change and sustainable development — along with active ownership (stewardship). These considerations can have a material impact on financial performance, and their inclusion is more likely to lead to sustainable investment outcomes, such as a greater ability to sustain pension payments in the future.

Mercer's own investment beliefs state that ESG factors can have a material impact on long-term risk and return outcomes. We also believe:

1. Taking a broader and longer-term perspective on risk will lead to improved risk management and new investment opportunities.

2. Climate change poses a systemic risk given the low-carbon transition and physical impacts of different climate outcomes.

3. Active ownership provides opportunities for investors to enhance the value of companies and the market.

RI is distinguished from ethical, norms-driven investing, an investment philosophy dating to the 1800s guided by moral values, ethical codes or religious beliefs and originally rooted in negative screening of investments in sensitive sectors, such as slavery-derived goods, alcohol, tobacco, pornography and firearms. Under this approach, ensuring investment was limited to companies that met the investor's moral criteria was the focus. Socially responsible investing (SRI) is another approach, intended to balance an investor's ideals with performance considerations, and typically seeks to achieve a trade-off between social and financial objectives.

That said, proponents of RI, SRI and ethical, norms-driven investment may share many underlying beliefs, and there is often overlap in the strategies implemented in pursuit of these investment approaches. Mercer's RI advice prioritizes risk and return implications, but we also help many clients balance their reputation considerations and align both *value* and *values*.

1.2

In recent years, RI has attracted significant attention among institutional investors around the world. Drivers behind this increased focus include the following:

- A general acceptance that ESG factors are relevant to companies and investors facing related risks and opportunities in aligning their capital allocations with the interests of their clients and beneficiaries is reflected in the increasing number of signatories to the UN Principles for Responsible Investment (PRI).[1] This increase represented more than US$80 trillion in 2018 — equal to the size of assets managed by the global asset management industry — compared to approximately US$12 trillion in assets 10 years earlier.

- Awareness of the growing array of social inequalities, environmental impacts and negative externalities affecting companies is increasing. Unprecedented environmental and social pressures, driven by population growth and consumption-pattern pressures on food, water and energy security; access to natural resources; climate change; human rights; and supply-chain labor standards, are creating material issues for business and the corporate world.
- The impact of poor corporate governance practices on shareholder value — accentuated by direct examples of individual company financials and the indirect impacts of the global financial crisis — has also brought issues such as transparency, corruption, board structure, shareholder rights, business ethics, risk management and executive compensation to the top of the investor agenda.

- ESG integration has increased along with the applicability of integration techniques in asset classes other than listed equity, including bonds, emerging markets and alternative asset classes.

- Changes are occurring in global legislation and legislative guidance that either require or encourage consideration of RI as part of a statement of investment principles or similar in an investor's investment strategy documentation. Changes in normative and best-practice expectations that stipulate RI considerations are also a factor.

- In some cases, stakeholders and beneficiaries are putting pressure on investment decision makers to adopt an RI investment approach or consider particular issues.

1.3

No definitive list of ESG issues exists, but they typically display one or more of the following characteristics:

- Have a medium- to long-term time horizon with a forward-looking perspective

- Are often qualitative and not always readily quantifiable in monetary terms

- Represent externalities (costs borne by other firms or by society at large) not captured by market mechanisms

- Result from normative shifts and changing regulatory or policy frameworks

- Represent former "event risks" that are becoming more predictable

The table on the next page highlights some of the issues considered as E, S or G factors, which can have financial impacts for operational and/or reputational reasons.

[1] Principles for Responsible Investment (PRI). "About the PRI," available at https://www.unpri.org/pri/about-the-pri.

WHAT IS ESG?

ESG issues to consider

ENVIRONMENTAL CONCERNS

- Climate change
- Energy efficiency
- Waste and pollution
- Water and resource scarcity

SOCIAL CONCERNS

- Health and safety
- Stakeholder concerns
- Demographics
- Labor and supply

CORPORATE GOVERNANCE CONCERNS

- Audit quality
- Board structure
- Remuneration
- Shareholder rights

1.4

This paper provides a brief introduction to RI implementation.

Section 2 discusses the four main approaches:

1. **Integration** — ESG factors incorporated into the investment process for risk/return reasons
2. **Stewardship** — voting and engagement with underlying companies and/or investment managers and engagement with policymakers for risk/return reasons
3. **Investment:**
   - Themed investing — funds that focus on the risk and return opportunities in ESG themes, typically related to sustainability solution trends
   - Impact investing — investments that seek to balance financial returns with a positive impact on society and/or the environment, including investments in companies that meet such criteria
4. **Screening** — typically implemented by excluding investments in companies that are perceived to have a negative impact on society, where investors do not want to profit from the product or activity for reputational and/or ethical reasons

Section 3 addresses historical concerns related to RI and fiduciary duty.

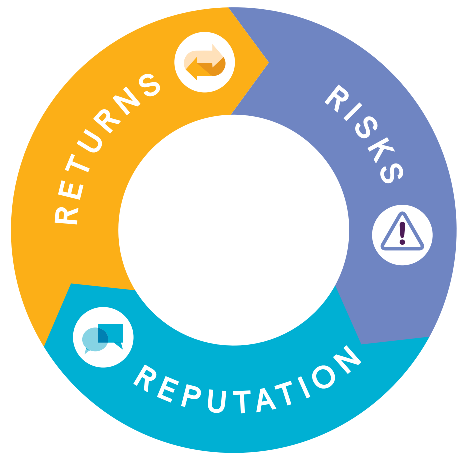
Section 4 discusses the relationship between RI and investment performance.

Section 5 provides some suggestions for next steps and a potential action plan.

INVESTMENT APPROACHES

There are many ways in which institutional investors approach RI and applicable ethical considerations — aiming to balance the risk/return requirements for investors (particularly those with fiduciary duties) and reputational considerations with the needs of beneficiaries and other stakeholders.

In this section, we describe the main approaches that can be implemented individually or in combination. The majority of investors employing a comprehensive RI program would have elements of most if not all of these.



FOUR APPROACHES TO RI

INTEGRATION

Include ESG factors in investment decisions, with an explicit approach to climate change transition and physical risks, which are portfolio-wide.

AIM:
Financial objectives
+ risk management improvement

STEWARDSHIP

Exercise active ownership/stewardship through voting and engagement with underlying companies and by engaging with policymakers.

AIM:
Financial objectives
+ financial system improvement

INVESTMENT

Allocate to sustainability themes or impact investments for new opportunities — for example, renewable energy, water and social housing.

AIM:
Financial objectives
+ positive social and environmental impact

SCREENING

Screen out sectors or companies deemed to be irresponsible or not acceptable to profit from.

AIM:
Alignment with values/reputation/risk management or longer-term financial expectations

Include ESG factors in investment decisions, with an explicit approach to climate change transition and physical risks, which are portfolio-wide.

AIM:
Financial objectives
+ risk management improvement

2.1 ESG INTEGRATION

At the forefront of recent developments in RI is an integration approach to considering ESG factors as part of the investment process. Managers adopting this approach are typically traditional fund management companies that have begun to actively take ESG issues and themes into account in their fundamental research, analysis and decision-making processes. Typically, no sector or investment opportunity is automatically excluded from a portfolio. Integration determines the ESG "traits of a security that may not have been taken into account by that security's price but which may affect its desirability"[2] as an investment.

The rationale is twofold:

1. Managers believe investors that do not consider these issues are ignoring significant extra-financial factors that may materially impact the value of their holdings, either negatively or positively.

2. Companies that ignore sustainability issues expose themselves to a range of risks, including physical, regulatory, competitive, litigation and reputational risks that will impact their long-term corporate performance, and that by ignoring these issues, they will miss out on associated opportunities.

Some investors utilize ESG indicators purely for risk-management purposes, whereas others consider these indicators fundamental to idea generation and portfolio construction for alpha generation. Some approach ESG integration with a "best in class" focus, investing in those companies that display the most positive ESG indicators within their respective sectors. Such integration considerations can typically lead investors to make buy/hold/sell or overweight/underweight decisions.

Integration can be applied, to different extents, in all asset classes. The most well-developed public market examples are found in listed equities, and, often, the private market examples with the greatest level of ESG integration can be found in real estate. Strategies are likely to share the investment characteristics of traditional strategies in the same asset class; typically, they should also be expected to display a longer-term outlook to investing and a responsible approach to stewardship. Placing financial considerations as a driver, this approach overcomes any question of whether incorporating ESG is aligned with fiduciary responsibility.

Furthermore, significant financial regulators as well as educational bodies, such as the CFA, have clarified their stances and indicated that financially material ESG factors should be considered in investment decision-making. (The global regulatory regime will be covered in more detail in section 3.) Integration is therefore being embraced by the broadest set of mainstream investors.

[2] AIMA and CAIS. *From Niche to Mainstream: Responsible Investment and Hedge Funds*, (2017).

Exercise active ownership/stewardship through voting and engagement with underlying companies and by engaging with policymakers.

AIM:
Financial objectives
+ financial system improvement

2.2 STEWARDSHIP

Also referred to as active ownership, and often interchangeably, stewardship is an approach whereby investors seek to use their positions as owners — or, lately, also as creditors — to influence the activity or behavior of investees. The aim is usually to bring a corporation in line with best practice in a particular area, to better understand fundamental business drivers related to ESG issues, and, most commonly, to improve standards of corporate governance.
In combination with other responsible investment approaches, stewardship should better align the time horizon and interests of the corporation with that of its long-term investors.

Stewardship is an integral part of RI. Tools range from using proxy-voting rights and undertaking engagement with companies (through verbal and written communication on specific topics) to collaborative engagement with other shareholders to promote systemic change within a certain sector.

For example: Climate Action 100+ is a multiyear initiative coordinated by global investors with US$30 trillion in assets under management "to engage with the world's largest corporate greenhouse gas emitters to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures."[3]

Stewardship is exercised differently in each asset class. For listed equities, voting and engagement are typical, whereas in asset classes where voting rights do not exist (such as fixed income), variations in engagement practices are emerging.

These tools are increasingly being pursued in an effort to reduce risk and enhance long-term financial value. Studies have shown that companies with good corporate citizenship practices on ESG issues are better-managed overall and therefore more likely to outperform in the long term. The view that stewardship is needed and legitimate[4] has been strengthened by various instances of high-profile corporate governance failings leading to disastrous investment outcomes. Active ownership is clearly encouraged by regulators, which see the systemic value of stewardship in protecting and strengthening investments.

Engagement can be on any issue the investment community believes will protect or enhance shareholder/stakeholder value. Topics may include environmental management, labor standards, director remuneration, corruption and bribery. Engagement activity is often supported by specific research and analysis. The ability to engage and/or vote will vary depending on the specific regulatory processes in place in the location of the holdings.

[3] Climate Action 100. "About Us," available at http://www.climateaction100.org.
[4] Financial Reporting Council. *The UK Stewardship Code,* 2012, available at https://www.frc.org.uk/investors/uk-stewardship-code.

Options for stewardship include the following:

- **Direct voting**: Voting can be coordinated in house by institutional investors. Typically, proxy-voting policies and procedures are developed. The development and implementation of these policies and procedures are often assisted by the use of a third-party proxy-voting researcher (as discussed below).

- **Third-party proxy voting**: If investors conduct voting in house, they may wish to use an external research firm to inform their decisions. Often, these service providers can also offer their own proxy-voting policies or customize voting policies for clients, thereby automating much of the process, including casting their votes.

- **Direct engagement**: Engagement can be carried out by investors directly. This can be either one-to-one (that is, the investor enters into dialogue with individual companies) or collaborative (that is, joining with other investors on a specific issue or joining investor initiatives seeking to influence public policy).

- **Third-party engagement service**: Investors can employ a third-party provider offering a standalone engagement overlay service. These providers offer long-term engagement with target companies on strategic issues to enhance shareholder value. Typically, such providers use the combined influence of assets held by several clients. The majority of engagement overlay service providers also offer a voting service.

- **Delegation of voting and engagement to fund managers**: Given its natural fit with the investment process, some investors will also delegate their stewardship and engagement activities to their fund managers as part of the investment mandate. Capacity and capabilities vary considerably between fund managers. Fund managers can then also choose to use direct or delegated routes and research provision for their engagement/stewardship activities.

Allocate to sustainability themes or impact investments for new opportunities — for example, renewable energy, water and social housing.

AIM:
Financial objectives
+ positive social and environmental impact

2.3 INVESTMENT

THEMED FUNDS

The vast majority of themed funds have a sustainability/environmental focus. These funds have proliferated in recent years with the emergence of sustainability as a key societal and investment trend driving long-term growth and returns. Focus funds or activist funds can be seen as themed funds within the governance area. Funds with a social theme can be found in microfinance, urban regeneration, property and social infrastructure projects (these could also be viewed as impact investment approaches).

Sustainability-themed funds can be found most often in:

Listed Equities

Many funds in this category may use positive/negative screening, engagement, integration or best-in-sector approaches to investment. They may also have quite wide investment universes.

As an example, one such equity fund aims to invest exclusively in global companies providing solutions to sustainability challenges in health, waste and public transport. Other, more-focused examples exist in fields such as renewable energy and water.

Fixed Income

Green-bond investment can be seen as a thematic and/or impact investment. The product was created to fund projects with positive environmental benefits with the use of proceeds linked to a specific project or asset. Green-bond funds have emerged as an option for investors to tap into the growth in this market.

Property

A smaller number of specific sustainability-themed funds are emerging in the property sector as high environmental standards become mainstream in real estate investments, reducing the ability to market specialized funds.

Alternatives

Unlisted equity funds have emerged to capture the investment opportunities associated with a broad sustainability theme. Some of these funds may have a venture-capital focus as new technologies emerge to provide solutions to the global environmental challenges. Infrastructure funds can be sustainability-themed or demonstrate a high level of understanding of ESG trends to satisfy end investors' needs. Other funds include pure-play funds focused on natural resources, such as sustainable forestry or agriculture.

IMPACT INVESTING

The meaning of this term has evolved over time; however, the Global Impact Investing Network (GIIN) defines impact investments as “investments made into companies, organizations and funds with the intention to generate measurable social and environmental impact alongside a financial return.” In the context of investment strategies, impact investing has historically referred to private equity, private debt and other alternatives.[5]

A wide variety of potential approaches exist, but a common “traditional” type of impact fund supports small businesses in emerging or underserved markets, either directly or through loans to intermediaries, such as microfinance institutions. Typically, funds investing directly seek companies that are solutions-oriented in terms of directly addressing environmental or social issues. Other strategies may focus on environmental or social themes, such as sustainable agricultural development or affordable housing.

As a recent development, several providers of investment products and data have also started to isolate universes of public securities that are linked to positive impacts, such as a company’s percentage of revenues that could be considered “green.” These products can also be developed with explicit references to applicable United Nations Sustainable Development Goals (SDGs) that they intend to impact.

Measuring the impacts of these investments has become increasingly important as demand from asset owners to understand the impact created by their investments has increased. The Global Impact Investing Rating System (GIIRS)[6] and IRIS[7] are prime examples of the ongoing work in this field, in which a multitude of competing methodologies exist. Mercer observes that investment managers in this space are increasingly self-reporting, as clients request detailed information on the impacts they support.

[5] Global Impact Investing Network (GIIN). “History (Global Impact Investing Initiative),” available at https://thegiin.org/impact-investing/need-to-know/.
[6] GIIN. “B Impact Assessment (and GIIRS Rating),” available at https://iris.thegiin.org/b-impact-assessment-metrics.
[7] GIIN. “IRIS Metrics,” available at https://iris.thegiin.org/metrics.

Screen out sectors or companies deemed to be irresponsible or not acceptable to profit from.

AIM:
Alignment with values/reputation/risk management or longer-term financial expectations

2.4 SCREENING

Investors that apply screening typically use one or a combination of the following screens:

Negative screen **Positive screen**

Negative screening: This refers to the exclusion of companies involved in activities or products with a perceived negative impact on society, such as armaments manufacturing, tobacco production, gambling, alcohol, and animal testing, or companies with poor records of ESG performance. Although these decisions are most often driven by ethical/ moral considerations, in some cases, a more financial perspective to exclusions is emerging. Some investors argue, for example, that the construction of coal-free and/or fossil-fuel-free portfolios — and more recently, tobacco-free portfolios — will, over the long run, deliver the best investment outcomes, due to shifts in legislative practices and technology.

Positive screening: This refers to the inclusion of stocks/ bonds based on whether the company has a positive ESG trait, such as a high overall ESG score, belonging to a certain industry sector or displaying other favorable characteristics desirable to the investor or its beneficiaries.

A screened approach can be achieved either by investing in a separate investment product or through a segregated account with a manager able to implement customized screens. Usually, the rationale for using a screened approach will be to align the portfolio with an organization's values or its views on stocks that are unacceptable (negative screening) or favored (positive screening) for ethical or reputational purposes.

Highlight on "Ethical"

Negative screening has traditionally been associated with "ethical" funds, particularly those that offer an SRI/ethical version of a mainstream investment strategy. However, even among investors that do not come from a particular ethical perspective, most would support some element of negative screening; that is, based on generally accepted behavioral and legal norms. For example, a strong normative basis exists for the exclusion of companies involved in production of cluster bombs or landmines, nuclear weapons, or the use of child labor or modern slavery. As noted, however, negative screening may also be undertaken for financial reasons. Positive screening can be implemented in a range of ways, such as passive overweighting of high-scoring stocks according to some predetermined criteria or as a defined starting point to establish a universe for themed or ESG-integrated funds.

RESPONSIBLE INVESTMENT, REGULATORY DIRECTION OF TRAVEL AND FIDUCIARY DUTY

3.1

Historically, a key barrier to broader implementation of RI was the assumption that it contradicted fiduciary responsibility, based on the belief that RI reduced the investable universe, defying a "theoretically optimal" solution. As we have outlined in this paper, that belief does not reflect modern reality. RI implementation methods do not necessarily exclude any stocks from consideration (see: integration, stewardship, investment and positive screening).

3.2

From time to time, concerns are still raised regarding the scope of fiduciaries to embrace RI. These concerns typically arise from a failure to distinguish between ethically driven investing and financially driven integration of ESG issues. In practice, RI is often simply a more-comprehensive approach to identifying investment risks and opportunities and is therefore aligned with fiduciary duty.

3.3

A key early development in establishing the legitimacy of RI from a fiduciary perspective was the "Freshfields report"[8] (2005). This report examined the legal implications of integrating ESG issues into institutional investment for those with fiduciary duty. The report found that integrating ESG considerations into investment analysis so as to more reliably predict financial performance is not only permissible but is arguably required. The legal situation continues to evolve on ESG, and key global regulators have, in turn, either regulated and/or provided guidance on the validity of the original Freshfields report. The Pensions Regulator[9] and Department of Work and Pensions[10] in the UK, the Department of Labor[11] in the US, the EU Commission[12] in the EU (with strong support from local regulators like the AMF[13] in France and the DNB[14] in Netherlands) and the APRA[15] in Australia have all actively weighed in on the dialogue. The PRI has provided global research on the fiduciary duty topics for eight jurisdictions,[16] helping to clarify the issue.

[8] Freshfields Bruckhaus Deringer and UNEP Finance Initiative Asset Management Working Group. *A Legal Framework for the Integration of Environmental, Social and Governance Issues Into Institutional Investment*, 2005.
[9] The Pensions Regulator (TPR). "Investment Strategy Guidance," available at http://www.thepensionsregulator.gov.uk/guidance/db-investment-two-strategy.aspx.
[10] Department for Work and Pensions. *Government Response: Clarifying and Strengthening Trustees' Investment Duties*, 2018, available at https://www.gov.uk/government/consultations/pension-trustees-clarifying-and-strengthening-investment-duties.
[11] US Department of Labor. *Field Assistance Bulletin No. 2018-01*, available at https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.
[12] EU Commission. "Sustainable Finance: Commission's Action Plan for a Greener and Cleaner Economy," available at https://ec.europa.eu/clima/news/sustainable-finance-commissions-action-plan-greener-and-cleaner-economy_en.
[13] AMF. *The AMF Affirms Its Commitment to Sustainable Finance on Climate Finance Day* [press release], 2017.
[14] De Nederlandsche Bank. "Sustainable Finance Platform," available at https://www.dnb.nl/en/about-dnb/co-operation/platform-voor-duurzame-financiering/.
[15] PRI. "Fiduciary Duty in the 21st Century: Australia Roadmap" (2016), available at https://www.unpri.org/fiduciary-duty/fiduciary-duty-in-the-21st-century-australia-roadmap/258.article.
[16] UNEP Finance Initiative. "Fiduciary Duty in the 21st Century," 2015–2017, available at http://www.unepfi.org/investment/fiduciary-duty/.

3.4

An increasing number of market participants (brokers, managers, consultants, investment banks) are integrating RI and evolving their processes accordingly. As a result, fiduciaries now have greater scope to ensure that ESG risks are being managed and associated opportunities pursued.

3.5

RI regulation is currently on policymakers' and civil society's agenda worldwide, and the pace of regulatory intervention is increasing. The PRI identified 300 policy instruments in its survey of the 50 largest economies in the world. All instruments supported long-term investment decision-making, including consideration of ESG factors, and more than half were created between 2013 and 2016.

[17] PRI. "Responsible Investment Regulation Map," available at https://www.unpri.org/.

RELATIONSHIP BETWEEN RESPONSIBLE INVESTMENT AND PERFORMANCE

A growing body of evidence and supporting documentation is turning the tables on common misconceptions in the industry, namely, that RI restricts the investable universe and therefore must hurt returns. More practitioners today are seeking to integrate ESG to add rigor and depth to their investment processes and risk management.

A number of ESG/sustainability indices from providers such as FTSE/Russell,[18] MSCI[19] and S&P/DJI[20] now have substantial track records. Sustainability indices cover a range of potential goals and uses. Indices range from a focus on narrow themes (for example, low carbon or climate indices, water, ESG factors, gender equality, etc.) to core allocations, such as broad ESG indices. Indices may seek to attain impact, express values, seek risk/return outperformance or track parent indices while embedding ESG considerations. In construction, screening continues to be the main method, although reweighting companies based on ESG factors has increased in recent years. Performance differs considerably, as is the case for any other index construct; however, at the broadest level, there is evidence that performance compares favorably to unconstrained portfolios.

4.1

There is now a significant body of work that supports the financial benefits of ESG integration and active ownership. Academic and practitioner research now also covers asset classes beyond listed equities.

4.2

Research into the impact of incorporating ESG factors into investment decision-making has traditionally focused on screening approaches. Although such research is not directly relevant to the merits of morebroadly focused integrated RI approaches, it does provide some insights. It is also notable that much research is carried out at a corporate level, finding links between strong ESG practices and corporate financial performance. Although informative, such research is not directly applicable at the portfolio level in all investment situations.

4.3

In general, the academic literature continues to confirm our belief that the consideration of ESG factors at the company level can lead to outperformance, especially over the longer term. ESG integration into investment decision-making and portfolios requires manager skill, a clearly defined investment style and consideration of appropriate time periods to achieve desired outcomes — as would be the case with any mainstream investment strategy.

[18] FTSE Russell. "ESG Ratings," available at http://www.ftse.com/products/indices/f4g-esg-ratings.
[19] MSCI. "ESG Integration," available at https://www.msci.com/esg-integration.
[20] S&P Dow Jones Indices. "ESG," available at https://us.spindices.com/theme/esg/.

A sample of academic and practitioner research papers is included below:

Ambachtsheer J, Fuller R, Hindocha D. "Behaving Like an Owner: Plugging Investment Chain Leakages," *Rotman International Journal of Pension Management,* Volume 6, Issue 2 (Fall 2013), available at https://www.mercer.com/content/dam/mercer/attachments/global/investments/responsible-investment/Behaving-Like-an-Owner.pdf.

Dimson E, Karakaş O, Li X. "Active Ownership," *The Review of Financial Studies*, Volume 28, Issue 12 (2015), pp. 3225–3268, available at https://academic.oup.com/rfs/article/28/12/3225/1573572.

Friede G, Busch T, Bassen A. "ESG and Financial Performance: Aggregated Evidence From More Than 2000 Empirical Studies," *Journal of Sustainable Finance & Investment*, Volume 5, Number 4 (2015), available at https://www.tandfonline.com/doi/pdf/10.1080/20430795.2015.1118917.

Khan M, Serafeim G, Yoon A. "Corporate Sustainability: First Evidence on Materiality," *The Accounting Review*, Volume 91, Number 6 (2016), pp. 1697–1724, available at https://ssrn.com/abstract=2575912.

Kiose D and Keen S. "Understanding the Relationships Between Environmental and Social Risk Factors and Financial Performance of Global Infrastructure Projects," *Scientific Research Publishing* (2017), available at http://www.scirp.org/journal/PaperInformation.aspx?paperID=80890.

Allianz Global Investors. *ESG in Investment Grade Corporate Bonds and Financial Materiality of ESG Factors for Sovereign Bond Portfolios,* 2017.

MSCI. *Foundations of ESG Investing*, 2017, available at http://info.msci.com/foundations-of-ESG-investing-part1.

CFA Institute and PRI. *ESG Integration in the Americas: Markets, Practices, and Data*, 2018, available at https://www.cfainstitute.org/en/research/survey-reports/esg-integration-americas-survey-report, and *Guidance and Case Studies for ESG Integration: Equities and Fixed Income* (2018), available at https://www.unpri.org/investor-tools/guidance-and-case-studies-for-esg-integration-equities-and-fixed-income/3622.article.

Moody's Investor Service. *Heat Map: 11 Sectors With $2.2 Trillion Debt Have Elevated Environmental Risk Exposure*, 2018.

NEXT STEPS AND POTENTIAL ACTION PLAN

5.1

We trust that this paper serves as a worthwhile first step in beginning to consider responsible investment concepts and developing a position on RI. Investors should consider a number of further actions, as outlined in a separate Mercer document, *An Investment Framework for Sustainable Growth*.

A summary of the framework approach for integrating ESG considerations throughout the investment process is shown below. Different approaches can be taken for those at an initial stage of integration compared to those at an advanced stage. Mercer would be happy to discuss the most appropriate bespoke plan and approach with you.

The framework below identifies where ESG and sustainability considerations sit within the typical **"Beliefs, Policy, Process, Portfolio"** approach.

We recommend that you follow a three-step process:

1. Review and, where necessary, update your beliefs on each of the four approaches — Integration, Stewardship, Investment and Screening.

2. Update your investment policy to reflect your institution's beliefs and legal minimum requirements (in jurisdictions where ESG integration is legislated), and embed that policy within your processes.

3. Create a work plan that incorporates selected approaches into portfolio decisions, particularly research, strategy, manager selection and monitoring.

Each investor's approach will be unique, reflecting priorities based on the requirements of stakeholders (including regulators), investment structure and approach, available resources and governance budget. We can help you review your beliefs, policies and processes to capture this additional perspective and develop an implementation approach that suits your requirements.

A more-detailed reference guide on integrating ESG and sustainability-themed investment drivers and opportunities by asset class is also available. Please contact your Mercer consultant or local representative to receive a copy and to discuss how you could implement these approaches within your portfolio.

For further information, visit https://www.mercer.com/our-thinking/wealth/responsible-investment.html or contact your local Mercer representative.

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