Insights
Environmental, Social & Governance (ESG)

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ESG Investing
Developing The Right Approach

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At State Street Global Advisors, we have a more than 30-year legacy in environmental, social and governance (ESG) investing. As an extension of our firm-wide commitment to ESG investing, we have developed a series of educational modules to guide you on how to incorporate ESG considerations across your investment portfolios.

State Street Global Advisors (SSGA) is a signatory of the United Nations Principles for Responsible Investment (UN PRI), and therefore we have developed these modules to align with the guidance offered by the UN PRI.

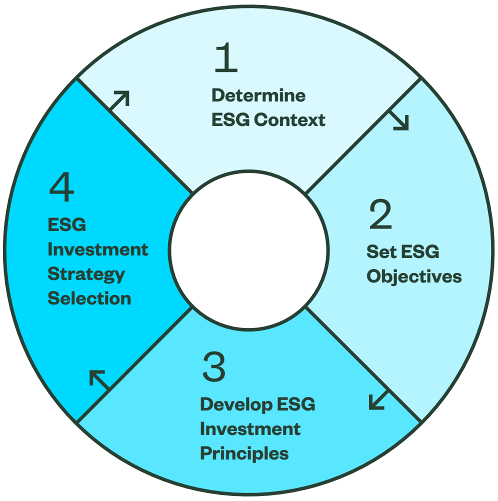
The goals of this education series are to:

- Introduce investors to the practice of incorporating ESG factors into investment decisions
- Discuss common approaches to ESG investing and manager selection
- Provide access to additional resources for further research

This second module provides investors with guidance on how to develop a comprehensive ESG investment strategy that is relevant to your investment portfolios.

Figure 1
Implementing ESG in Investment Strategy

Developing an ESG investment strategy is a four-step process:



Sources: UN PRI, State Street Global Advisors.

The process should focus on two primary objectives:

1 Developing and defining specific ESG investment objectives and goals

2 Ensuring these ESG considerations are embedded into your core investment processes, and not done in siloes

ESG considerations are more important than ever before. We live in a global economy and ESG risks like climate change and employee diversity can have material financial effects on the operations and viability of companies. Therefore, a sound long-term investment strategy that assesses both financial and material non-financial metrics is necessary to maximize returns and mitigate risk.

There is no one-fits-all approach. Each investor should focus on the ESG aspects that are most relevant to their vision, mission, and investment goals. Nevertheless, all investors, regardless of business, sector or region should ensure they have a comprehensive communication plan to connect with all the stakeholders throughout the process of establishing an ESG integration strategy.

Stakeholders can include management, boards, business heads and external stakeholders such as trustees, beneficiaries, customers and shareholders. We will discuss the communication plan towards the end of this guide.

Determine ESG Context

Each investor should identify the relevant ESG considerations covering both external and internal perspectives:

External	**Internal**
Focus on how your assets could be impacted by political, economic and other developments in the short, medium, and long run. Consider stakeholder reactions to such developments.	Understand your ESG capabilities
Trends to consider	**Investment convictions**
Social Technological Economic Environmental Political Regulatory	What are your views on ESG investing? Are your views aligned, or are there conflicting viewpoints?
Example questions to consider (not exhaustive)	**Self-assessment**
What are the potentially disruptive trends that could impact your portfolio? Which trends are already being addressed by the investment community?	What is your current knowledge level on ESG investing and key issues? What level of time and resources can/will you use to integrate ESG into your investment strategy?

Sources: UN PRI, State Street Global Advisors.

The goals of the internal assessment are to understand your current ESG position and capabilities, and the steps you may need to take to realise your desired future state. Different investors will be in different stages regarding ESG integration. It's important to understand where you are before you can effectively plan for the future.

The external assessment should include an evaluation of the ESG factors most material to your investment portfolios in the short, medium and long-term.

One way of understanding the importance of ESG issues to companies is to look at the Sustainability Accounting Standards Board's (SASB's) Materiality Map. Investors can use this framework to better understand the financially-material sustainability issues of their portfolio companies and assess how these issues are communicated to stakeholders. More information on SASB's Materiality Map can be found here.

Setting ESG Objectives

Once you have evaluated the internal and external material ESG factors relevant to you, you can then set your ESG mission and objectives.

Ideally, you will develop an ESG mission statement that can be tied to the core purpose of your portfolio. In turn, this can be translated into clear and distinct ESG objectives.

Rather than setting a specific number of ESG objectives, it's more important that these objectives reflect your ESG preferences, goals and resources. As discussed, your objectives can be driven by external force or reflect internally-held beliefs, including those based on ethical ideals.

Below is a summary of some considerations when setting common ESG objectives:

Common Investor Objectives	Questions to Consider
Aligning Values Preferences based solely on your ethical and moral ideals, frequently related to political, religious and/or other ESG concerns	Are there any sectors, industries, or geographies that you want to entirely avoid?
Alpha Generation/Risk Mitigation An abundance of research suggests that integrating ESG factors alongside traditional financial metrics leads to outperformance in the long-term	Do you view ESG factors as material in risks and/or opportunities?
Regulatory Requirement As ESG investing evolves, regulatory changes/requirements will continue to develop and expand	Do you expect emerging regulations to impact you and your financial service providers?
Real World Impact Some investors are interested in using their investment dollars for ESG-related positive change and/or action	Is positive real-world impact an explicit part of your primary objective?

Sources: UN PRI, State Street Global Advisors.

Develop Investment Principles

Once you gain buy-in from relevant stakeholders, you can then craft a specific set of investment principles/beliefs which will serve to inform investment decisions.

For some investors, these principles will be used as very high-level parameters, whereas others will seek to develop principles and potentially align them with widely-accepted initiatives/goals.

ESG topics to consider

- Will your principles be applicable to the entire portfolio or will there be different principles for specific groups of assets?
- Do you have a thematic focus (e.g. low-carbon investing)?
- Do you consider the impact on people/planet? How is this translated into investment decisions?
- Do you view ESG factors as material to investment returns (through risk or opportunity)?

Examples

"I seek the most attractive investment opportunities that have positive ESG effects that do not require a financial trade-off."

"Complying with the United Nations Sustainable Development Goals will enhance returns in the medium to long term."

ESG Investment Strategy Evaluation

Once you have set your ESG investment principles, you can begin to evaluate specific existing investment strategies or develop new strategies. First, set specific ESG criteria to help evaluate and compare different investment scenarios.

Among other things, ESG criteria will be based on return expectations, risk budgets, and any desired alignment with industry associations or initiatives such as the Task Force on Climate-related Financial Disclosures (TCFD). Investors can utilize ESG data from numerous providers to evaluate various options that align with their respective objectives, until they find the optimal strategy.

Below we summarize how you can set and evaluate an ESG investment strategy.

Set Specific ESG Criteria	Select the Optimal Strategy	Create Scenario
Specific criteria are based on your ESG principles and used to evaluate the investment strategy scenarios **Examples** • Risk/return targets • ESG as primary or secondary investment objective • Alignment with specific goals • Targeted themes (e.g. climate)	Evaluate and compare the options, including relevant combinations of asset allocations. Each scenario should be run through a financial model, risk model and ESG impact/scoring model, when available.	Determine range of investment opportunities to take under consideration, such as: **Asset classes** • Sectors/geographies • Types of investments • Time horizon • Size/ownership stake Consider your internal capabilities and preferences, such as: • In-source/out-source investment management • Active or passive investments • Partnerships for greater impact

Sources: UN PRI, State Street Global Advisors.

Essential to selecting the optimal investment strategy is selecting an appropriate investment manager. Module 3 in this series provides guidance in identifying and evaluating investment managers for ESG mandates and in selecting investment strategies.

Communication and Key Players

Depending on your business model, you will want to develop an effective communication plan to implement your ESG approach.

Your plan should be flexible and able to quickly adapt to changes in your ESG approach and/or preferences. The plan needs to cover internal and external communications, and you should seek feedback continuously throughout the process to gain buy-in from key stakeholders.

Board	C Suite	Project Sponsor & Team	Investment Committee	Investment Team	Supporting Departments	External Stakeholders
Confirms the strategy can be implemented and aligns with the organization	Drives the implementation of the strategy	Leads the execution of the strategy	Supports the process by providing guidance & feedback	Provides insights on how the strategy will impact on other investment activities	Consult relevant other departments within the organization	Identify external stakeholders that may need to be consulted

Sources: UN PRI, State Street Global Advisors.

Be Aware of Common Pitfalls

As mentioned, effective communication is paramount, so it's important in the initial stage of the communication plan, to identify the key stakeholders and decision makers, and build in a feedback loop, so all issues are addressed as they occur.

Investors should be aware of common pitfalls, including a lack of rigor in developing and/or executing an ESG strategy and challenges with implementation. By following a formal process and considering potential hurdles in your planning stages, such issues can be avoided.

Some common pitfalls and suggested actions to mitigate them are below.

Common Issues		**Mitigating Actions**
Communication	Failing to include key internal & external perspectives	Identify and engage the key players regularly and in a timely manner to ensure buy-in
	Lack of a consensus among key players	Build a feedback loop into the process to ensure differences are addressed
Lack of Rigor in Process	Developing an ESG strategy without following a defined process	Develop a formal process that aligns with your needs
	Lack of robustness in the ESG strategy crafting process itself	Ensure you have sufficient time and resources to successfully execute your ESG investment process
Implementation	Difficulty in implementing because the crafted strategy is too high-level	Define the level of detail required and monitor throughout the planning process
	Difficulty in implementing because the crafted strategy is too rigid to execute	Build flexibility into the strategy through optionality and include investment teams

Sources: UN PRI, State Street Global Advisors.

Next Steps

The next step is to translate the ESG investment strategy into initiatives for implementation. The implementation stage will vary depending on an investor's ESG approach.

Some key initiatives will ensure both internal and external stakeholders have a clear understanding of the organization's ESG position:

1. Integrate ESG investment strategy into your investment policy
2. Develop governance and monitoring of the plan
3. Determine tactical and operational asset allocation
4. Revise request for proposal (RFP) questions reflecting ESG position, as applicable
5. Select & monitor ESG investment managers

The next module in this educational series will expand on guidance for implementation and the next steps in your ESG journey.

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- Start with rigour
- Build from breadth
- Invest as stewards
- Invent the future

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* This figure is presented as of December 31, 2020 and includes approximately $75.17 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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