IOR | The New Option
Investment Office Resources

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TO ESG OR NOT TO ESG - DON'T LET TERMINOLOGY GET IN THE WAY OF INVESTING WITH YOUR VALUES

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IOR'S VALUES-BASED INVESTING PERSPECTIVE– A 3 PART SERIES

'Critical concerns' are representative of what an organization cares most about based on its purpose, values and mission. In this paper, we introduce and further define the concept of 'Critical Concerns.' We explain why an organization's investment strategy should include the clear identification of, and agreement on, the integration of the organization's 'Critical Concerns.'

> ***Terminology Clarification***
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> *One of the challenges in our industry is that the terminology related to this topic is confusing. Standard definitions have not yet emerged, so terms often get blurred and/or have different meanings across investors. Terms such as 'Values-Based Investing', 'ESG', 'Impact Investing' and 'SRI' are frequently used interchangeably, yet each of these terms have a distinct definition. In this paper, we will provide definitions and explain the differences between these terms as we delve into the topic of 'values-based investing' using 'Critical Concerns' as a foundation.*

There is so much noise, confusion, and polarization around the term 'ESG' today. Just mentioning 'ESG' can create controversary. There is even growing momentum that the term itself should no longer be used. Against this backdrop, we sympathize with the investment offices that have been asked to navigate the 'ESG' complexities while also seeking to achieve superior risk/return outcomes.

In this three-part series, we provide our perspective on how an investment office can approach these complexities and illustrate why it can be additive to the investment process.

Our philosophy does not advocate for or against 'ESG', but rather incorporates our belief that each organization has a responsibility to establish processes that:

1) Define and clarify what it cares most about (define its 'Critical Concerns'), and
2) Find alignment on implementation and measurement of these concerns.

Creating consensus around key priorities may not be easy, but we believe adopting a process to identify your institution's 'Critical Concerns,' including your return objectives and how your organization intends to seek returns, will empower you to create the investment program that is right for you.

Not doing so often leads to uncertainty and subjectivity, which could result in sub-optimal implementation that could be costly both financially and reputationally.

By taking steps to define and clarify what your organization cares about and to align stakeholders around implementation, much of the potential noise, confusion, and polarization can give way to calm, clarity and unity.

- **Part I – 'Critical Concerns'**
    - *We introduce the concept of 'Critical Concerns' and explain why the process of clarifying 'Critical Concerns' is an important step for an organization. We are building toward our view that defining your organization's 'Critical Concerns' is as important to the investment process as setting risk tolerance, time horizon and liquidity needs.*

- **Part II – History of 'Values-Based Investing'**
    - *We provide a brief history of 'values-based investing' and we illustrate how this history has informed the spectrum of values-based investment techniques utilized by investors today. By looking back, we can better understand the context for our current landscape and can better map our future. The term 'ESG' has morphed over the years into a confusing term which has fueled some of today's misunderstanding and divisiveness.*

- **Part III – Integrating Critical Concerns into the Investment Process**
    - *We explain why an organization's 'Critical Concerns' should be one of the building blocks when forming a comprehensive organizational investment strategy. We encourage investors to undertake a process to identify what matters most to their organization – 'Critical Concerns' – and to invest with that intent.*

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PART I: Defining 'Critical Concerns' and their part in Values-Based Investing

We introduce the concept of 'Critical Concerns' and explain why the process of clarifying 'Critical Concerns' is an important step for an organization. We are building toward our view that defining your organization's 'Critical Concerns' is as important to the investment process as setting parameters such as risk tolerance, time horizon and liquidity needs.

Many organizations have a purpose, a mission, and a values statement. Stakeholders of these organizations have (1) a fiduciary duty to know and understand these statements and (2) then act in the 'best interest of the organization'.

It can be difficult to establish consensus around which priorities are in an organization's 'best interest' especially with investment decision-making, but doing so creates clarity for organizational stakeholders. In order to enhance clarity around this process we encourag stakeholders to:

> ***Establish processes that help your organization define what it cares about most ('Critical Concerns') and create alignment on the implementation and measurement of these priorities.***

These 'Critical Concerns' are a way for organizations to summarize its purpose, mission and values into a short list of key priorities that can be integrated throughout.

For the investment office, lack of clarity around organizational priorities can lead to misalignment, misallocations, and confusion which have the potential to be costly – both financially and/or reputationally.

Examples of 'Critical Concerns' are:

1) Advocating for Human Dignity
2) Improving the Environment
3) Protecting the Earth's Natural Resources
4) Addressing Inequities in Healthcare
5) Promoting Community Safety
6) Advancing Equity, Diversity & Inclusion.

The consensus-building process does not belong to the investment office alone. To develop organizational 'Critical Concerns,' we encourage creating a team to work together (e.g., C-Suite, a mission/ethics department, other organizational leaders, including the investment office, and members of the Board and/or the Investment Committee, etc.) to aid in this process. A third-party facilitator can also be helpful for mediating discussions. This assembled team can then decide what is in the best interests of the organization, including if/how organizational values need to be represented in the investment function.

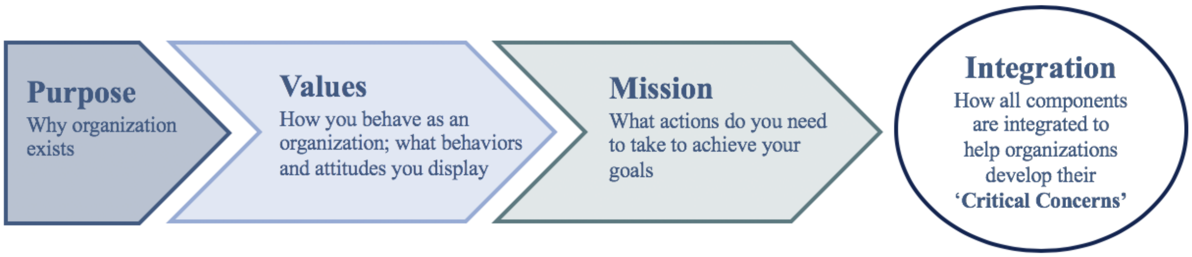
Many investment offices may face challenges rallying participation from stakeholders, but in our experience working with institutional investors we have observed the following:

- When an organization *has* full, cross department participation, the organization is typically able to create clear consensus on its key priorities. This provides the investment office a concrete foundation for investment decision-making and a framework to rationalize its choices.

- When full, cross department participation *does not* happen, investment decision-making and oversight of the investment function can become subjective, creating the opportunity for misalignment around implementation and measurement. In this case, the investment office can still pursue a consensus-building process with the understanding that it may need to take the lead. Small, incremental steps are better than no steps at all.

Whatever steps can be made, the results are well worth the effort – just imagine how simple investment decision making can be once your organization has consensus on what it cares about most and alignment on how ‘Critical Concerns’ can be implemented.

Process & Components for Defining Organizational ‘Critical Concerns’



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You may then be asking: What are the next steps after ‘Critical Concerns’ are identified? In Part II we will reflect back on the evolution and milestones of ‘values-based investing’ to provide context for implementation techniques available today. We will explain the three different techniques investors can consider when deciding how to represent their ‘Critical Concerns’ in the investment function.