REFERENCE GUIDE

ILLINOIS SUSTAINABLE INVESTING

GREAT LAKES ADVISORS

A WINTRUST WEALTH MANAGEMENT COMPANY

Illinois' Sustainable Investing Act came into effect on January 1, 2020.

SUSTAINABILITY FACTORS

Corporate governance and leadership factors

Environmental factors

Social capital factors

Human capital factors

Business model and innovation factors

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OVERVIEW

Illinois' Sustainable Investing Act (Public Act 101-0473) was signed into law by Governor Pritzker in August, 2019 and came into effect on January 1, 2020. The Act requires Illinois public funds to develop and implement sustainable investment policies and to integrate material, relevant, and decision-useful sustainability factors into their investment process:

> *A public agency shall prudently integrate sustainability factors into its investment decision-making, investment analysis, portfolio construction, due diligence, and investment ownership in order to maximize anticipated financial returns, minimize projected risk, and more effectively execute its fiduciary duty. (Section 20.a)*

The Act is not referring to socially responsible or ethical investing. Instead, it is specifically referring to sustainability issues that can be expected to affect investment performance and long-term shareholder value and that therefore fall within the realm of a board's fiduciary responsibility. The analysis of material sustainability factors compliments traditional financial investment analyses.

ISBI INVESTMENT POLICY

The Investment Policy of the Illinois State Board of Investment (ISBI) includes a separate section entitled "Sustainability and Corporate Governance". In addition to discussing proxy voting, the section states that:

> "...ISBI shall include material, relevant, and decision-useful sustainability factors that will be considered by the Board, within the bounds of financial and fiduciary prudence in evaluating investment decisions. These factors consist of but are not limited to:
>
> - Corporate governance and leadership factors
> - Environmental factors
> - Social capital factors
> - Human capital factors
> - Business model and innovation factors
>
> In addition, ISBI's efforts will include the following:
>
> - Periodic evaluation of sustainability factors to ensure the factors are relevant to the ISBI's investment portfolio and the evolving marketplace;
> - Periodic monitoring of investment managers to encourage implementation of the aforementioned factors."
>
> (ISBI Investment Policy, amended September 20, 2019)

What is required to be in compliance with the Sustainable Investing Act?

Investment Policy: The investment policies of all Illinois public funds must contain language addressing the consideration of sustainability factors in the investment process. Funds are given the flexibility to adopt or modify language so that it best reflects the specific needs of the fund and is balanced with other important considerations such as investment risk, asset allocation, and management fees. This can be accomplished by adding a couple of sentences or by inserting a new section in the policy.

One example is that found in the Investment Policy Statement of the Chicago Teachers' Pension Fund (CTPF), updated (November, 2019):

D. Sustainability Goals

The CTPF Board and Staff shall consider the prudent integration of sustainability factors into its investment decision-making, investment analysis, portfolio construction, due diligence and investment ownership in the execution of CTPF's investment goals to fulfill its fiduciary duty, to maximize anticipated financial returns and to minimize projected risk.

Sustainability analysis will include additional reviews of investment accounts, funds or Portfolio Company's performance on material factors likely to impact its long-term value. The analysis will also consider other relevant factors such as financial, legal and regulatory risks that contribute to an optimal risk management framework and are necessary to create long-term investment value.

Funds are expected to have made any necessary changes to their investment policies by January 1, 2020, the effective date of the Act.

Updated investment policies are required to be filed with the Department of Insurance within 30 days after their approval.

Investment Managers: The Act does not prescribe how funds should implement sustainable investing since the circumstances and investment goals of each fund are unique. The Act provides funds the discretion to pursue sustainable investing how they see fit consistent with serving the best interests of the fund's beneficiaries.

One option is to have conversations with investment managers to determine how they are considering sustainability factors in their investment processes consistent with the sustainable investing language in the investment policy statement. The State Treasurer's Office has observed that several funds have reported having fruitful conversations with managers about sustainable investing. The Office underscores the importance of documentation of these conversations or other actions in order to demonstrate compliance with the policy.

MATERIALITY OF SUSTAINABILITY FACTORS

Not all sustainability factors are germane to all investments. For example, employee health and safety is a more critical issue for coal mining companies (legal and regulatory risks) than for apparel retailers; energy efficiency is more relevant for steel producers (operational costs) than for commercial banks.

It is important to determine what sustainability factors are relevant to the performance of a particular investment, which is then followed by an analysis of those factors in order to gain a better understanding of an investment's risk and return potential.

The Act describes five categories of sustainability factors that may be pertinent to investment performance and provides examples of each:

1. Corporate governance and leadership factors, such as the independence of boards and auditors, the expertise and competence of corporate boards and executives, systemic risk management practices, executive compensation structures, transparency and reporting, leadership diversity, regulatory and legal compliance, shareholder rights, and ethical conduct.
2. Environmental factors that may have an adverse or positive financial impact on investment performance, such as greenhouse gas emissions, air quality, energy management, water and wastewater management, waste and hazardous materials management, and ecological impacts.
3. Social capital factors that impact relationships with key outside parties, such as customers, local communities, the public, and the government, which may impact investment performance. Social capital factors include human rights, customer welfare, customer privacy, data security, access and affordability, selling practices and product labeling, community reinvestment, and community relations.
4. Human capital factors that recognize that the workforce is an important asset to delivering long-term value, including factors such as labor practices, responsible contractor and responsible bidder policies, employee health and safety, employee engagement, diversity and inclusion, and incentives and compensation.
5. Business model and innovation factors that reflect an ability to plan and forecast opportunities and risks, and whether a company can create long-term shareholder value, including factors such as supply chain management, materials sourcing and efficiency, business model resilience, product design and life cycle management, and physical impacts of climate change. (Section 20.b)

NEXT STEPS

Great Lakes Advisors can work with clients to review investment policy statements and suggest sustainable investing language in order to fulfil the requirements of the Sustainable Investment Act.

Great Lakes Advisors can also discuss with clients how well aligned their current portfolios are with their sustainable investing goals and, if appropriate, suggest additional or alternative investment products consist with their investment objectives.

RESOURCES

Sustainable Accounting Standards Board (SASB)

The SASB has developed a materiality framework that identifies the most relevant sustainability factors for each of 77 unique industries.

www.sasb.org

Principles for Responsible Investment (PRI)

The PRI, whose members represent more than $86 trillion of assets under management, provides a number of resources and collaborative initiatives supporting investors.

www.unpri.org

Illinois State Treasurer's Office

The Illinois State Treasurer's Office has prepared a detailed explanation of why sustainability factors are an important component of investment decision-making.

www.illinoisraisingthebar.com and click on Sustainable Investing

ABOUT GREAT LAKES ADVISORS

Founded in 1981, Great Lakes Advisors is headquartered in Chicago, Illinois with an additional office in Tampa, Florida. We offer a wide range of fixed income and equity strategies across all market capitalizations and have deep portfolio management capabilities within ESG, Socially Responsible, Tax Managed, and Customized account solutions. Our clients include public funds, multi-employer plans, corporations, religious communities, endowments/foundations, health care plans, and private wealth management clients.

We are proud to have been the first quantitative investment team to sign the Principles for Responsible Investment, and we continue to be a pioneer and innovator in the ESG investment community. We've been providing investment advisory services for more than 35 years, Socially Responsible Investing strategies since 1989, and full ESG integration since 2008. We work closely with our clients to develop portfolios that align with their values and beliefs through customized screening, positive values-based portfolio tilts, and environmental, social, and governance (ESG) integration.

Financial Advisors please contact us at
sma@greatlakesadvisors.com

Institutional Investors please contact us at
cr@greatlakesadvisors.com