



BOARD OF INVESTMENT TRUSTEES

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MEMORANDUM

October 17, 2024

TO: Board of Investment Trustees and Board of Trustees

FROM: Eli Martinez, Executive Director
Kevin Killeavy, Chief Investment Officer

SUBJECT: Environmental, Social, Governance – Required Annual Update – 2024

As detailed in the Board’s Governance Manual, the Boards are required to annually provide a comprehensive report describing the implementation and outcomes of the Boards’ ESG policy, including recommendations for updates or revisions to this policy, as part of the year-end reporting process.

This report includes the following:

- I. Industry Developments
- II. Current Manager ESG Updates and Corporate Engagement
- III. Consultant Initiatives
- IV. Staff/Board Actions and Research

I. Industry Developments

- **New Hampshire Defeats Anti-ESG Legislation**—The New Hampshire Employees Retirement System voted unanimously against proposed legislation that sought to ban the consideration of ESG factors in investment decisions. The Board pushed back on the legislation, arguing that banning the inclusion of ESG considerations would hinder its ability to execute its fiduciary responsibility.
- **Ivy League Endowments Face Calls for Israel Divestment** – Several Ivy League endowments are facing pushes for their endowment funds to divest from any companies deemed to be doing business with Israel. While many of the Ivy endowments are facing scrutiny, Brown’s endowment is the most far along in the process as a committee of students, faculty, and alumni is putting forth a bill to be voted on by the Board of Trustees that would force the fund to divest from “companies complicit in human rights abuses in Palestine.”
- **Texas Facing Lawsuit for Anti-ESG Bills**—The American Sustainable Business Council is suing the State of Texas, arguing that the 2021 state law restricting state pension funds from investing in funds that incorporate ESG factors is unconstitutional. Since the law passed, several Texas pension

funds have been forced to terminate contracts with BlackRock, given that the firm has some strategies that exclude oil and gas investments.

- **Australian Regulators Crackdown on “Greenwashing”** – The Australian Securities and Investment Commission has taken action in several cases against asset managers and institutional investors where the regulator felt the investor was making false or misleading statements about their ESG practices, or greenwashing. Some groups that face action in the country are Vanguard Investments Australia and Mercer Superannuation Australia, as the regulator believes their disclosures of climate-related risks were inadequate.
- **ESG-Oriented Funds Facing Outflows – According to a report from Morningstar**, in 2023, investors pulled \$5 billion out of ESG-focused sustainable investment funds. Morningstar has been tracking this data for ten years and 2023 marked the worst calendar year for outflows since they began tracking the data.

II. Current Manager ESG Updates and Corporate Engagement

In 2021, Staff and our investment consultants began reporting to the Boards on impact/sustainable investments within the private market portfolio. The portfolio currently contains several funds with impact investment strategies. Some examples include strategies focused on renewable power development, sustainable forestry, water infrastructure, and real estate. The segment of our portfolio with the highest concentration of impact investments is private real assets, where 35% of the ERS portfolio is allocated to impact/sustainable investments.

- **Emerging Markets Manager** – In 2024, this manager engaged and analyzed an Indian energy company to understand their energy mix between traditional energy and renewable. The manager ultimately got comfortable with the investment given the attractive outlook for energy demand in India, particularly on the renewable side. This company currently operates 61GW of renewable power with 10GW under construction and plans for an additional 16.8GW over the next three years.
- **Global Equity Manager** – This quantitative manager chose to sell a Chinese technology company during the year in part due to weakening ESG scores. While the company’s social score remained positive, its environmental and governance scores fell.
- **Emerging Markets Debt Manager** – During the last year, this manager met with a Chilean company’s management team and senior government officials discuss the progress and pace of the company’s transition from hydrocarbons to cleaner energy sources. In addition to discussing renewable energy, they engaged broadly on property rights, the rule of law, and the business environment.
- **International Equity Manager** – During the year, this manager purchased an Australia-based minerals company in part due to positive expectations stemming from the company’s ownership of a top-tier lithium resource in Australia. As the world continues to reduce its reliance on fossil fuels, the manager expects lithium demand to outstrip supply, largely driven by electric vehicles but with additional demand from areas such as energy storage.
- **Fixed Income Manager** – This manager sold a food company in part due to weakening ESG metrics. On the environmental side, the company’s scope 1 and 2 emissions were flat versus the

prior year despite aggressive efforts to reduce them. They also fell short in reducing their water consumption relative to previously communicated expectations. On the social side, employee safety remains a concern, with a total recordable injury rate of 2.6 in 2023, dropping to the bottom quartile in the investment-grade consumer goods industry.

- **International Equity Manager** – During the year, the manager made an investment in a Japanese real estate company that created the country’s first zero-energy rental office and has continued to promote zero-energy buildings or ZEBs. Additionally, the manager believes this company has strong potential to deliver better shareholder returns in the future given the push for corporate governance reforms in Japan.
- **Public Real Assets Manager** – During the year, this manager engaged with a waste management business to help them further decarbonize their operations. Diesel truck collection fleets are the largest driver of energy use for environmental services companies that collect solid waste and recycling. The manager, along with other leading asset managers, has been engaging with the company to push them to continue converting their fleets to compressed natural gas (CNG), which generates lower emissions.
- **Public Real Assets Manager**—This manager engaged with a UK-based student housing company on its environmental targets. The company has a stated pathway to net zero carbon across both operations and development by 2030. The manager engaged with the company to encourage them to adopt compensation targets linked to these goals.
- **Emerging Markets Equity Manager** – This manager held a position in a UK mining company and was heavily engaged with the company to improve carbon reporting transparency, coal reduction plans, and future capital expenditure plans. However, during the hold period, the security increased to the manager’s measure of fair value, so the position was sold.
- **Domestic Equity Manager** – During the year, this manager invested in an oil and gas water solutions business that provides the energy industry with handling and recycling services for water produced from oil and gas wells. Instead of disposing of this produced water, the company provides a solution where it recycles this water and transports it back to a customer for them to use in the drilling and completion of new wells.
- **Domestic Equity Manager** – This small-cap manager invested in a company that provides solar tracking equipment to the utility solar industry. The manager’s investment in this company is a play on the continued energy transition away from greenhouse gas-intensive sources of energy towards cleaner and greener sources like solar.

III. Consultant Initiatives and Approach to ESG

- **NEPC (General Consultant)** – During the last year, NEPC has continued to refine their approach to ESG manager ratings and impact investing. They have an Impact Investing Committee that was formed to display their commitment to being a best-in-class consulting partner for impact-oriented investors. Additionally, NEPC completed their 2023 DEI Progress Report, which is the fourth annual edition they have produced. They reported that diverse manager representation across the firm continues to increase and is in line with their goal of reaching 15% diverse exposure by the end of 2024.

- **Franklin Park Associates (Private Equity & Debt Consultant)** – During the last year, Franklin Park engaged with a healthcare buyout manager to evaluate how their strategy is helping improve the access, affordability, and quality of care for underserved and vulnerable populations. They also engaged with a telecom growth equity manager to evaluate how their strategy is creating green jobs, reducing carbon emissions, and helping rural and lower socio-economic areas access high-speed internet. Additionally, Franklin Park added a new team member to their Corporate Citizenship Committee. The Committee is responsible for overseeing ESG, DEI, and corporate citizenship matters. Throughout the year, they engaged with private market general partners to gain better insights into their ESG efforts, such as reporting, impact investment strategies, responsible investing, and DEI initiatives.
- **Albourne (Private Real Assets Consultant)** – Over the last year, Albourne completed their second annual Albourne Sustainability Integration Score (SiQ Score), which is a survey-based evaluation of the extent to which environmental, social, and governance considerations are incorporated into a fund’s risk management and investment decision-making process. Funds are scored between 1-100. This past year, Albourne surveyed more than 1,100 funds on sustainability integration through this scoring methodology. Albourne also significantly increased their level of sustainability investment due diligence and has now engaged with 1,293 investment managers across 4,193 underlying funds. Further, Albourne engaged with nearly 1,000 investment managers on DEI through their annual DEI questionnaire.

IV. Staff/Board Actions and Research

- **Portfolio DEI Analysis** – Staff completed a third annual diversity and inclusion analysis of the underlying funds within the portfolio to understand the level of diverse ownership across the portfolio and within various asset classes. This analysis revealed that the portfolio has roughly 32% invested in women- or minority-owned investment organizations with exposure across public markets, private equity, private debt, and private real assets, a slight increase from last year. Staff will continue to track this metric on an annual basis and will explore ways to further enhance our approach to DEI. Albourne, NEPC, and Curcio Webb have significant levels of diverse ownership and management. For example, Curcio Webb, our defined contribution plan consultant, is a women-owned business.

Staff has also been collecting DEI data across multiple levels (board, executive, and mid-level investment staff) in the organizations of the public funds we invest in. Staff collects this data to gain more granular insights and to analyze managers at a level that more accurately reflects diversity across their organizations. By collecting this data across multiple years, Staff can also better monitor and report on the impact that our managers’ diversity initiatives are having. After analyzing data collected through the questionnaire for all managers that provided statistics for 2021, 2022, 2023, and 2024, we found that:

- The largest improvements were in our equity managers, who had year-over-year increases in almost every category. Equity managers saw the most significant increases in ethnic diversity across board-, executive-, and mid-level.
- On average, year-over-year increases in gender diversity were observed in every category (board-, executive-, and mid-level), with gender diversity at the board-level seeing both the largest percentage increase this year and since 2021.

- On average, year-over-year increases in ethnic diversity were observed at the executive- and mid-level. Ethnic diversity in all categories has improved since 2021 with ethnic diversity at the executive-level seeing the highest increase.
- **Portfolio PRI Signatory Portfolio Analysis** – Both Boards became signatories of the Principles for Responsible Investment (PRI) in October 2019. The Boards believe this is the premier organization for asset owners and investment managers in terms of ESG integration. While it is not required that investment managers be signatories, it is highly encouraged. Staff recently conducted an analysis to see the proportion of investment managers within the portfolio that are signatories. As of June 30th, 2024, 49% of the managers within the portfolio are signatories, while roughly 75% of the portfolio by market value is invested with signatories. Whereas most of the public market managers within our portfolio are signatories, the adoption level on the private market side remains somewhat low. Additionally, all three of the Boards’ core investment consultants – Franklin Park, NEPC, and Albourne are signatories.
- **Portfolio ESG Analysis** – Staff recently analyzed the entire ERS and CRHBT investment portfolio to understand the level of ESG exposure. As of June 30th, 2024, the ERS and CRHBT had ESG investments totaling 12.4% and 9.3%, respectively. The vast majority of this ESG exposure is found within the two plans’ private market portfolios. The components of ESG where the funds have the largest exposure are renewable energy, health and wellness, affordable/workforce housing, and education.