



BOARD OF INVESTMENT TRUSTEES

BOARD OF TRUSTEES

MEMORANDUM

November 19, 2021

TO: Board of Investment Trustees and Board of Trustees

FROM: Linda Herman, Executive Director

SUBJECT: Environmental, Social, Governance – Required Annual Update – 2021

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 Board’s 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. Recent Board Actions
- V. Staff Research

I. Industry Developments

- **Department of Labor Proposal Opens Door for ESG Considerations** – On October 13, 2021, the Department of Labor (DOL) proposed a new rule that will explicitly permit retirement plan fiduciaries to consider climate change and other environmental, social, and governance factors when selecting investment options and exercising shareholder rights such as proxy voting. This proposal, the “Prudence and Loyalty in Selecting Plan Investments and Shareholder Rights” states that ESG factors often pose material risks to the return and risk profile of investments and can be used as factors when selecting investments. This trend is consistent with the past 20 years of DOL stances where Republican administrations are more restrictive of ESG factors being used in investment selection while Democratic administrations are more permissive.
- **Maine Passes Divestment Legislation** – On June 16, 2021, Maine enacted a new law that directs the state pension system to divest Carbon 200 fossil fuel holdings within five years. This law is a first of its kind across state pensions nationwide. However, there is no plan for the pension system to actually divest of fossil fuels currently as the law requires that any divestment must be “consistent with the Board’s fiduciary obligations.” While there are no immediate plans to divest, the State is convening a group to study the financial risks of fossil fuels that has the potential, although unlikely, to result in their divestment of Carbon 200 holdings.

- **Endowments Continue to Announce Fossil Fuel Divestment Plans** – Over the last year, several university endowments across the country have announced fossil fuel divestment plans, including Loyola University Chicago, Dartmouth College, and Boston University. In each of these cases, the divestment plan is expected to take place over the next several years and allows for fossil fuel businesses to remain in the portfolio if they are committed to investing in the ongoing energy transition. Other universities such as Harvard that have not committed to divesting have pledged to not commit new capital to the sector going forward.
- **State Department Urges Endowments to Divest Chinese Holdings** – The U.S. State Department is asking universities to divest of their Chinese holdings due to the potential for more onerous stock exchange listing standards on Chinese companies listed on U.S. exchanges. This call came towards the tail end of the President Trump’s tenure in office as tensions escalated between the United States and China.
- **CalPERS and CalSTRS to Report Emerging or Diverse Asset Manager Exposure** – Governor Gavin Newsom of California recently signed a bill requiring CalPERS and CalSTRS to report to the State Legislature the participation of emerging or diverse asset managers in their investment portfolios. Montgomery County passed similar legislation in 2011 requiring similar reporting.
- **PRI Signatory Growth** – The number of signatories to the Principles for Responsible Investment reached 4,235 by the end of September 2021. Over the last year, this group has grown by 26%, which includes an addition of 84 institutional investors, 779 investment managers, and 117 service providers. Montgomery County became a signatory in October 2019.

II. Current Manager ESG Updates and Corporate Engagement

In 2021, the Staff and our investment consultants began reporting to the Boards on impact 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 24% of the portfolio is allocated to impact-oriented funds.

- **Private Equity Manager** – The Trust Funds recently hired an industrial-focused private equity manager that creates key performance indicators (KPIs) to track the firm’s energy usage and carbon footprint. The firm also belongs to an environmental group that is focused on cleaning harmful debris from oceans, rivers, and coastlines in addition to advocating an end to the world’s reliance on single-use plastics. At the investment level, the firm believes that a strong focus on environmental attributes will help increase returns and allow them to be a steward for the environment. Some of the key areas they focus on are: carbon emissions, energy efficiency, waste management, natural resource preservation, and the environmental impact on the supply chain. For current investments, they have KPIs that are reviewed at each board meeting that address energy intensity, water usage, and carbon footprint. One of the key investment themes for the firm is investing in companies that focus on the electrification of the auto industry. A recent investment made by the firm is an automotive company that makes battery trays for some of the largest electric vehicle manufacturers in the world. The firm also creates KPIs to track social considerations which can assist in their responsible management of relationships with employees, suppliers, customers, and communities. They focus on providing fair wages to employees, health and safety, diversity,

and executive compensation. They have also implemented software that can track the level of minorities and women in the workforce at the company, supplier, and individual plant level.

- **Private Equity Manager** – In September 2021, the Trust Funds invested in a private equity fund focused on special situations, distressed, and value private equity investments in companies with strong potential that have fallen into financial or operational distress. On the environmental side, the firm has partnered with Staples Business Advantage to drive “green” spend across geographies and encourage employees at the portfolio companies to operate sustainably. In particular, the firm has created and promoted an Eco-Conscious/Recycled Product list to make it more convenient to shop for eco-conscious products. One of the firm’s recent investments has an energy management software offering that improves customers’ energy efficiency as this solution allows customers to track energy usage more effectively across their enterprise. This software has helped customers reduce their energy footprint over time resulting in cost savings and contributing to global sustainability. The firm also places strong emphasis on diversity and equal opportunities. They believe that fostering a diverse and inclusive work culture has led to the adoption of a formal Diversity Policy, which has led to 79% of the firm being classified as diverse and 50% female. Additionally, charitable giving is an important activity for both the firm and their portfolio companies. The firm sponsors the Children’s Bureau of Southern California, Southern California Minority Supplier Development Council, Toigo Foundation, and the Venice Boys & Girls Club. The firm’s new relationship with an ESG investment consultant will allow them to better monitor and influence labor conditions, environmental issues, diversity and equal opportunity employment practices, and health and safety issues at their portfolio companies.
- **Private Natural Resources Manager** – In 2021, the Trust Funds hired a private natural resources manager that targets control positions in energy infrastructure assets, primarily in the power generation industry. The manager seeks to minimize and manage environmental impacts through their investment activities, which includes sustainable methods of energy production including wind and solar projects. The manager’s commitment to environmental sustainability is directly evident in the types of investments that they are seeking to make, as nearly all current pipeline opportunities exhibit strong ESG attributes. A large component of the firm’s strategy revolves around investing in renewable power generation and other assets focused on the energy transition. The firm also seeks to maintain power generation assets that can sustain long-term, stable jobs in localities where their portfolio companies’ projects are located.
- **Private Natural Resources Manager** – In 2021, the Trust Funds hired a private natural resources manager that targets control positions in middle-market renewable assets and projects, primarily wind and solar, between 10 and 80 megawatts. Through the Fund’s investments in renewable energy infrastructure, specifically solar and wind power generating assets, the firm is helping to support a more sustainable future of clean energy. Each investment into a renewable energy source serves to reduce society’s carbon footprint and the amount of air pollution caused from the reliance on traditional fossil fuels. As an example, the firm estimates that once fully deployed, their portfolio will generate 2,800,000 MWh of renewable energy annually which will offset approximately 683,000 metric tons of CO₂ from polluting the air. This is roughly equivalent to the removal of 148,000 cars from the roads. In addition, while solar and wind projects are inherently good for the environment, prior to the construction of any new asset, the firm will evaluate any potential environmental impact and ensure that any necessary prevention and mitigation efforts are implemented.
- **Private Real Estate Manager** – In late 2020, the Trust Funds hired a private real estate manager that invests in lower middle market industrial and logistics properties in the Southwest. At the

investment level, the firm seeks to minimize the impact of its investments on the land, waters and air that support the communities. The firm is committed to sustainability projects that enhance the environmental performance of the assets if they maximize investment returns. Thus, many of their development projects are LEED certified. Furthermore, all development projects comply with the California Green Building code (CalGreen) guidelines which include extensive sustainability requirements. For example, CalGreen has guidelines around site development to promote bicycle parking and EV charging spaces, water and energy conservation and efficiencies, general material conservation and resource efficiency as well as environmental and pollution control. The company also donates 10% of the firm's net profits to established and credible nonprofit groups focused on supporting children and families throughout California, Arizona, and Nevada. Several examples include FosterAll, HomeWorld, Free Wheelchair Mission, International Justice Mission, Building Block Foundation Fund, and Big Brothers / Big Sisters of America. Furthermore, many of the firm's developments are union friendly and the firm has signed several agreements with the Laborers International Union of North America (LiUNA), which is a union prevalent in Southern California committed to providing living wages to non-skilled labor.

- **Private Debt Manager** – In late 2020, the Trust Funds hired a private debt manager focused on making structured capital investments in North American middle market businesses, particularly within growth-oriented sectors of technology-enabled services, healthcare IT, and educational IT and services. When conducting environmental diligence, the firm analyzes the level of emissions and pollution, climate change risks, energy efficiency, treatment of hazardous materials, waste management, and other sustainability factors. When conducting social diligence, the firm analyzes the potential investment's ability to retain and attract talent, diversity and discrimination statistics and policies, consumer protection considerations, product safety and liability, supply chain management, and data protection and privacy. When structuring investments, governance is a key consideration and the manager focuses on board composition, business ethics, compliance and risk management, accounting standards, stakeholder engagement, and management succession planning.
- **International Equity Manager** – The firm did not invest in a widely held Indian utility due to their reliance on thermal coal-based power generation, which results in excessive carbon emissions that could likely impact the valuation of the company negatively. Also, the manager did not invest in a large and widely held Indian steel company due to poor scoring on ESG metrics, most notably labor standards. The company has experienced a high number of health and safety incidents, including most recently a fatality of a contract worker. In the last year, the firm also engaged with management of a Brazilian agricultural producer to better outline the impact of physical climate risk on earnings variability. In June 2021, the firm also hired a Director of Diversity and Inclusion (D&I), who is responsible for leading the firm's D&I global strategy, including setting realistic and aspirational goals and expanding the firm's existing strategy that is specifically tailored to support the overall business objectives of the firm. The firm also reports equal employment opportunity (EEO) statistics to key stakeholders including clients.
- **Global Equity Manager** – The firm has recently formed a Diversity, Equity & Inclusion Committee (DE&I) that is responsible for defining and advancing strategic DE&I initiatives for the firm as well as aiding in the implementation of their investment programs. The Committee reports to an Advisory Panel comprised of senior leadership across the firm. They recently had an external DE&I consultant complete a firm wide cultural assessment and also create a strategic action plan for diversity initiatives. At the investment level, the firm has invested heavily in better understanding ESG concepts and characteristics such as climate and carbon related risks and how

to address them in their portfolio construction process. In May 2021, the firm added a risk factor based on carbon emissions to their risk model.

- **Domestic Fixed Income Manager** – This index-based manager has strong engagement and collaboration with peer index providers on matters of index design and broader industry participation on ESG principles. While the manager is required to track the index and cannot tilt the portfolio based on ESG metrics, they are increasingly engaging directly with companies, particularly on proxy voting as a way to integrate and advance material sustainability insights to enhance long-term risk-adjusted returns for investors. The firm takes an active engagement approach to ESG by having ongoing dialogue with companies to express views and better evaluate relevant ESG issues over time. The firm averages approximately 2,000+ engagements a year on a range of ESG issues. In instances when these discussions are not fruitful, the manager will stand ready to vote against proposals from the management or the board.
- **Global Inflation-Linked Bond Manager** – Researches ESG issues that they believe may have a material impact on financial performance, and the research is integrated into their broader investment research process. They have also added impact investment criteria for certain clients that have requested it. For these portfolios, the manager partners with clients to consider not only how ESG-related issues might affect return and risk, but also how aligned these portfolios are to environmental and social outcomes. The example shown below highlights how this manager has incorporated ESG considerations in their supply and demand estimates for the commodities sector:
 - As part of the manager’s existing process for trading commodities (and all assets), they map out the buyers and sellers, seek to deeply understand their behaviors, and assess what the likely price moves are as a result. For example, their holistic measures of oil supply and demand consider current climate policies countries have implemented, along with what future production would have to look like to achieve net zero emissions, in order to understand and prepare for the range of potential outcomes. The manager has done a similar exercise with copper and nickel demand estimates, incorporating both a base case estimate into their process and estimates that reflect an aggressive shift to electric vehicles.

The manager will also actively engage with companies they are invested in to ensure that companies manage their ESG risks appropriately, including operational, regulatory, and reputational risks. They have also built a systematic sustainability assessment process to evaluate whether securities are aligned to the UN Sustainable Development Goals (SDGs). They use that process to identify relevant ESG risks for their portfolios and targets for potential thematic engagement.

In addition, the manager monitors their diversity statistics and noted that women hold 20% of senior management positions and 19% of senior investment positions at the firm. Additionally, minorities hold 17% of senior management positions and 15% of senior investment positions. Regarding new hires, over the last two years, 41% of new hires were women and 36% of new hires were minorities. The firm also recently established a Diversity, Equity, and Inclusion initiative and created senior positions to serve this initiative including a Chief Diversity Officer and Head of Diversity and Inclusion.

- **Global Listed Infrastructure Manager** – Opted to avoid a large, midstream energy stock given what the manager perceives as the company management’s passive approach to the broader energy transition and its approach to ESG. While the company was making marginal adjustments to corporate strategy to reflect the energy transition, the manager did not believe they were approaching these issues with the sense of urgency it deserved. On the positive side, the manager

increased their exposure to a offshore wind business as this sector has become increasingly desirable. Additionally, offshore wind is the segment of the renewables space with the highest barriers to entry, so their competitive advantage uniquely positions the business for greater upside relative to other renewable operators. The manager continues to significantly engage with company management teams, with a particular emphasis on the energy infrastructure space, with efforts proving fruitful as many of these companies are accelerating disclosure levels and offering shareholders more frequent, sustainability-focused meetings. The manager recently pushed a midstream energy company to benchmark themselves to the broader universe of equities on ESG issues rather than simply measuring themselves against other midstream energy firms, thus raising the bar for sustainability. The firm also launched a Diversity Council that is comprised of senior executives that help set diversity policies and report their results on an ongoing basis.

- **Emerging Markets Debt Manager** – Sovereign risk assessment approach has had a long-standing focus on ESG issues, such as ethics and corruption, transparency, judicial independence, public sector accountability and performance, and overall institutional strength. Countries with weak scores on these measures of transparency and governance will display weaker scores both in their sovereign and quasi-sovereign risk processes and face a higher hurdle for inclusion in the portfolios. This past year the firm concluded their research on integrating an explicit ESG pillar within the sovereign credit risk assessment process. In doing this, they were focused on maintaining continuity and consistency in their existing investment process while retaining a degree of flexibility to the core ESG issues relevant to emerging markets. They also paid attention to the fact that there is meaningful overlap between some of their existing measures of sovereign quality and standard ESG scores. As a result, they constructed a proprietary ESG pillar drawing from aspects of E, S and G they deem relevant to the emerging market asset class, focusing on elements that were independent of their current information set. In the case of E for example they focused among other items on climate transitional risk and physical risk. In the case of G, they included measures of institutional quality and financial capacity. This resulted in a fourth pillar that is now part of their sovereign credit assessment process. They are now able to see a clear attribution to this ESG factor.

On the engagement front, this manager met with representatives from Uruguay’s Finance Ministry and Central Bank during the year to inquire about changes to their regulatory framework for energy markets. The firm is also committed to diversity, equity, and inclusion initiatives across the financial services industry. They believe that in order to source candidates from a diverse pool, they need to participate in programs like Girls Who Invest, YearUp, Northeastern Women in Finance, and other groups.

- **Emerging Markets Equity Manager** – Integrates ESG factors in equity valuation assessments on a case-by-case basis when the factor is deemed material to the investment thesis for a company. A notable case involves a fast-growing coffee chain based in Asia. One of the firm’s analysts, a former investigative journalist, took a deep dive into the company. She found multiple governance red flags with its shareholding structure that seemed to disproportionately favor a tight group of insiders centered around the founder and his family members. The analyst’s work was a key part of the firm passing on this investment, despite its popularity among investors and share price performance. Roughly four months after passing, the bullish narrative collapsed, and the company admitted to fabricating hundreds of millions of dollars in revenues. The stock fell more than 80% on that announcement. Another example relates to environmental remediation liabilities linked to mining and energy assets. A member of the manager’s non-traditional analyst team investigated the issue of environmental liabilities stemming from inactive oil wells. The analyst interviewed experts and founds flaws in their legal and regulatory framework. The research indicated a higher-than-expected risk that self-reported estimates of future remediation costs could underestimate the company’s true liabilities. The analyst found that the company in question was highly sensitive to

changes in the accounting of and provision for its remediation liabilities. A change in regulations had the potential to meaningfully weaken the company's balance sheet strength and credit profile. As a result of this ESG factor materiality analysis, the manager did not invest in the business. This manager is a minority-owned firm committed to fair and equitable representation with a genuine emphasis on diversity, inclusion and equity. The Founder, CEO and Executive Team share a belief system that various backgrounds and experiences creates a superior outcome from both an investment perspective and as it relates to building a world-class, highly sustainable business

- **High Yield Bond Manager** – Created a new subcommittee of individuals from across the organization to lead the effort to enhance their proprietary corporate engagement database, streamline their engagement documentation process, and collaborate with various industry groups on data and engagement. The high yield team continues to integrate ESG at the portfolio level and now can review third-party and internal ESG characteristics versus benchmarks, as well as the Carbon Intensity of the portfolio versus the benchmark. They have the ability to identify the worst issuers within these categories, can monitor changes over time, and analyze the effect on the issuers' ability to repay their debt. Each high yield sector team has created materiality maps for ESG issues recognizing that ESG risks are significantly different across sectors. The manager heavily engaged with a ridesharing technology business that received very poor ESG grades historically due to data privacy, labor, misconduct, and governance issues. The manager believed that the company's new CEO, who came from a leading online services company, represented the beginning of a top-down change in company culture. The company turned over nearly all of their existing management team and expressed a commitment to transparency and accountability. Given these changes, the manager ultimately opted to invest in the company when they avoided it prior to these changes. The firm also recently created a Diversity, Equity, and Inclusion Committee to better attract, develop, and engage diverse employees. The firm also monitors the hiring statistics and noted that 40% of new employees hired in 2020 were people of color relative to only 14% in 2009 when these statistics started to be monitored.
- **High Yield Bond Manager** – Recently invested in a company that purchases renewable power generation assets in North America, Europe, and South America. The company owns 2.7 gigawatts of solar and wind assets, in addition to carbon free transmission assets and desalination plants. The manager believes that this company will be a beneficiary of the global transition to a decarbonized economy. The manager also invested in a manufacturer and marketer of personal care products that has a clear commitment to ESG considerations, detailed annual sustainability reports, and work toward several meaningful sustainability goals. For example, this company is on track to no longer produce products that contain oxybenzone and octonoxate, and to initiate fragrance component disclosure for all products by 2022. By 2024, the company is on track to no longer produce products containing microplastic and parabens. The business has numerous targets related to sustainable products, packaging, brand impact, energy use, and waste, among other categories. This manager also sold a wholesale distributor of motor fuels and other petroleum products in North America. In addition, the company also operates retail gas stations and refined product terminals and pipelines. The demand for the company's products is expected to decline in the long-run due to energy transition and the increasing share of electric vehicles. The general partners/limited partner ownership structure and incentive distribution rights introduce governance risks because the sponsor is incentivized to keep the distribution high, which could be to the detriment of creditors. The company now faces materially higher insurance premiums and increased permitting risk as they attempt to rebuild.

This manager has a Diversity and Inclusion Steering Committee, comprised of members of the executive leadership team, and a Manager of Diversity and Inclusion. This group is implementing a diversity and inclusion strategy that identifies opportunities to recruit diverse talent. The firm also

runs a variety of support groups for women and minority groups, including mentoring partners for women and minorities. The firm participates in a number of minority and women networks including Out Leadership, OPEN Finance, and Women's Bond Club.

- **Global Real Estate Investment Trust Manager** – Invested in a self-storage business that leads peers on ESG initiatives. The company has significant transparency around environmental targets that align with the UN Sustainable Development Goals. Notable investments in solar and LED lighting have dramatically reduced energy consumption over the last few years while efficient plumbing devices and irrigation system installations have lowered water use intensity over time. The manager engaged with a UK-based office real estate operator in order to address the company's lack of accountability measures in regard to the company's goal of being net-zero carbon emitters by 2030. The outcome of the engagement was positive as the company has introduced accountability metrics in their regular reporting materials. Improved transparency and public reporting of relevant ESG metrics will provide more effective alignment of these goals and encourage accountability of reaching these carbon-neutral targets. The manager believes this level of accountability improves the fundamentals of company. In 2021, the manager also introduced a proprietary ESG score as part of their fundamental research. Prior to this change, the manager primarily relied on MSCI ESG factor data with some analyst adjustment. The new process requires each REIT to get scored individually across environmental, social, and governance factors. In the past year, the manager announced a series of multi-year corporate responsibility commitments focused on diversity and inclusion. They recently created a proprietary Inclusion Index that measures sentiments of the global employee base and have committed to conducting regular diversity and pay equity studies. This firm's employee base is 58% female and 12% minority, and they noted that the minority share of the global employee base has grown at a 9% annual rate since 2014.
- **International Equity Manager** – Recently purchased a Dutch-based engineering consultant which should benefit from increased infrastructure investment in the U.S. and Europe in the years ahead and from a greater emphasis on ESG/Sustainability aligned asset investment by the enterprise sector. They also recently purchased a Japanese environmental specialist focusing on the treatment, recycling, and safe transportation of industrial waste. The main business for the parent company is sludge recycling and separation into reusable components most of which is then resold back to its industrial customers. Recognition of the importance of ESG and environmental protection, particularly in Japan, leads this company to be poised for long-term growth. The manager also recently sold a position in a French energy company for several reasons, one of which was the company's insufficient ESG disclosure and communication. This lack of reporting was especially critical in light of this company's business in oil and chemical distribution, storage, and support. The manager also engaged with a Finland-based global food packaging specialist to better understand the company's approach to the to (a) the sustainability characteristics of its product mix, given that it manufactures single-use plastics; (b) sustainability accountability within the organization structure; (c) key operational sustainability initiatives; and (d) how the company assesses climate change risk to its supply chain and operations. During the engagement, the manager gained a deeper level of understanding of these topics and will further engage the manager for greater disclosure in these areas. In March 2021, the manager hired a Head of Sustainability with responsibilities that include evaluating current ESG efforts and formalizing ESG policies and initiatives across all aspects of the firm. The firm is in the process of creating a cross-functional Diversity, Equity, and Inclusion (DEI) council to help assess areas of priority and impact. They currently use the CFA Institute's proposed DEI Code to assess their current approach and find areas of improvement.

III. Consultant Initiatives and Approach to ESG

- **NEPC (General Consultant)** – Over the last 12 months, NEPC published their first annual Diversity, Equity, and Inclusion (DEI) Progress Report to track the progress of DEI efforts across several areas of NEPC’s business. The report charts milestones achieved in 2020 as well as ongoing challenges that require additional focus going forward. Some of the progress is highlighted below:
 - NEPC brought on diverse talent in 2020. When looking at gender, ethnicity, and race, more than half (58%) of NEPC’s new hires in 2020 were diverse.
 - DEI improved at the ownership level as diverse partners now own a 30% interest in the firm.
 - Engagement with diverse investment managers increased significantly. The representation of diverse firms on NEPC’s Focused Placement List rose by 45%, fueled by a 72% increase in their Research team’s interactions with diverse-owned and diverse-led firms.

Additionally, NEPC published seven research pieces relating to ESG over the last year, including three pieces on DEI, three pieces on impact investing, and a piece on the ESG DOL ruling. The research team also underwrote several ESG investment funds over the last year across several strategies, including DEI, climate change, and education.

- **Franklin Park Associates (Private Equity Consultant)** – During the last year, Franklin Park formed an ESG Committee with key professionals from across the firm’s functional areas to ensure that ESG is successfully being integrated across their investment process. The committee meets on a regular basis to discuss approaches to ESG, looking for areas where processes can be improved, and monitoring the impact of current ESG activities. Franklin Park has also modified their reporting to Staff and the Board to include summaries of the portfolios’ impact investments. Diversity, Equity, and Inclusion (DEI) is also very important to Franklin Park as a way to hire and retain staff and build a lasting culture. They have worked diligently to build a diverse team as they believe it enriches the work experience of their employees by providing them with opportunity to learn from those who differ from them, help them communicate more effectively, and enhance their competitiveness in an increasingly global marketplace. Currently, more than 50% of the firm’s senior professionals are minorities and women.
- **Aberdeen (Private Real Assets Consultant)** – Over the last year, the Aberdeen Private Real Assets team created a customized ESG questionnaire as well as including a dedicated ESG slide in all of their final Investment Committee presentations. This continues to be an evolving process for Aberdeen as the definition of ESG matures so they expect to continue to seek improvement in their processes related to ESG. This continuous enhancement is consistent with their view that there is an opportunity to identify highly attractive risk adjusted returns in certain situations with managers targeting ESG-oriented segments of the market. They also continue to engage with the broader Aberdeen organization around ESG issues and meet quarterly with the firm’s centralized ESG team. These formalized meetings allow for the sharing of ideas across private markets asset classes so they can continue to enhance their processes over time. Aberdeen has also modified their reporting to Staff and the Board to include summaries of the portfolios’ impact investments. Additionally, DEI is becoming a heightened area of diligence for the Private Real Assets team and they recently performed a comprehensive DEI review for the real estate sector that examined DEI statistics at the firm and investment team level. The firm breaks down their DEI data separately across their U.S. and U.K. units. Currently the U.S. unit is 36% female, and the U.K. unit is 50%. Additionally, the U.S. unit is 26% minority while the U.K. unit is 50% minority.

IV. Recent Board Actions

- **Completed First Annual PRI Report** – As signatories of the UNPRI, the Boards recently completed their first annual PRI Report, which is required of all signatories. This report acts to promote signatory accountability in upholding their PRI commitments. As part of the reporting process, the Boards shared their commitment to integrating sound ESG practices into the investment process, how they have refined the ESG analysis and incorporation, how they collaboratively engage with investment managers or policy makers on ESG, and metrics on how certain areas of their portfolio are progressing when it comes to ESG integration. While the results of this report have yet to be released, this report will allow us to benchmark ourselves relative to our peers and identify areas where our ESG processes can be enhanced.
- **PRI Virtual Conference on the Global Transition to NetZero** – In October 2021, Staff attended the PRI virtual conference leading up to the COP26 Climate Summit. The conference examined ways in which businesses and investors can come together to achieve decarbonization. The conference brought together several global stakeholders to discuss various climate and finance initiatives through the prism of investor corporate engagement. It was clear from this conference that the industrial transition to net zero can only be achieved with very clear and direct engagement between the providers of capital (institutional investors and financial firms) and the users of the capital, the global business community.
- **PRI Annual Asset Owners Summit** – In October 2021, Staff attended the virtual Annual Asset Owners Summit. This annual meeting was a forum where global asset owners (i.e., institutional investors like MCERP) gathered to discuss strategies and challenges for integrating ESG considerations into the investment process. Staff participated in a small breakout discussion with other global investors about responsible investing in emerging markets and heard from several investors on how their ESG approach differs in emerging markets versus developed ones. Staff also developed several relationships with other investment organizations that we will engage with in the coming year.
- **CERES** – The Boards joined the CERES Investor Network in 2018 to gain a better understanding of climate risk within the portfolios, explore opportunities embedded in the clean energy economy, and develop a dialogue with other institutional investors on ESG related matters. Since joining, Staff has been an active participant in the Disclosure Working Group, which seeks to push companies to disclose all relevant sustainability information using the Global Reporting Initiative (GRI) guidelines as well as additional sector-relevant indicators. The goal of this working group is for more companies to disclose material sustainability risks and opportunities within their financial filings.
- **CFA Institute ESG Expert Network** – Investment Staff continues to actively participate in the CFA ESG Expert Network, a diverse working group to share knowledge and resources focused on integrating ESG best practices. The CFA Institute is a leading global association for investment professionals.

V. Staff Research

- **Portfolio DEI Analysis** – Staff completed a 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 21% invested in women or minority owned investment organizations with exposure across public markets, private

equity, private debt, and private real assets. Staff will continue to track this metric on annual basis and will explore ways to further enhance our approach to DEI. For example, this analysis only considers minority ownership, but we will be performing a more extensive analysis next year that looks at the proportion of diverse professionals at senior levels of the firm. In addition to the investment managers within the portfolio, all four of our key consultants, Franklin Park, Aberdeen, NEPC, and Curcio Webb have significant level of diverse ownership and management. For example, Curcio Webb, our defined contribution plan consultant, is a women-owned business.

- **Energy Transition Impact on Inflation** – In recent months, policies to achieve climate goals and lower emissions have contributed to a significant move in commodity prices. Many market participants believe that this trend will continue where our current energy transition path is likely to lead to further inflation, with the commodities contributing most to climate change experiencing significant rallies as supply is choked off. Global policy makers are pushing to make progress towards “net zero” emission goals and the tools they are employing are having large impacts on commodity markets and the global economy. The long emissions reduction path will likely include large decreases in coal, oil, and natural gas production. However, supply of replacement sources of energy such as renewables is likely to come online slower than the increasing level of demand. Currently, policy makers are using two primary methods to curb emissions: 1. Pricing carbon, which seeks to raise the cost of energy sources that emit greenhouse gases and 2. Limiting supply of the “dirtiest” energy sources (e.g., The Chinese government prohibiting new coal capacity or developed world investors being unwilling to finance new coal capacity). While both of these approaches can be successful in curbing emissions, they are both inherently inflationary as they raise the price or restrict production of “dirtier” energy types while the capacity for cleaner energy sources has not been fully built out. One strong example of this dynamic has been the tripling of European carbon credit pricing, which has helped fuel a rally in natural gas of a similar magnitude. Shown below are some examples of electricity supply issues, which are helping to fuel inflation:
 - Coal is the most polluting source of energy and is still dominant in many places like China.
 - Nuclear power, which is a rather clean energy source, is not popular in many places due to “tail-risk” safety concerns.
 - Renewables are continuing to gain adoption but are currently not capable of being the primary means of producing electricity. For this to happen, there needs to be significant advances in battery and storage technology.
 - Natural gas is much cleaner than coal from an emissions standpoint, but the global market is very fractured due to the high cost of transporting and storing.
 - In addition to raising prices for “dirtier” commodities, our energy transition policies can also lead to high inflation in other products that use commodities such as coal in their production. The clearest example of this is the rapid advancement of steel prices this year.
- **Recent Inflation and Fossil Fuel Outperformance** – Up until recently, fossil fuel securities (i.e., energy and mining), had been the worst performing segment of public capital markets as energy supply surged, the U.S. dollar was strong, inflation was muted, and ESG considerations weighed on investor sentiment. Many institutional investors and asset managers that continued to hold these securities noted that they provide diversification and a potential hedge during times of high inflation. The last year of high inflation, surging commodity prices, and rallies in the energy and mining sectors seem to support this stance. Prior to the COVID-19 pandemic, the Consumer Price Index (CPI), the leading measure of U.S. inflation, spent much of the past decade under The Federal

Reserve's 2% target rate. During this period, energy and mining securities underperformed higher growth and sectors benefitting from lower inflation and interest rates such as consumer and technology. However, after the inflation rate touched 0% at the depths of the pandemic, CPI has reached levels not experienced since before the global financial crisis of 2007-2009, reaching 5.4% as of September 2021. Over the last year, the commodity-oriented securities, across both equities and bonds, have significantly outperformed the market and provided an element of inflation protection to those investors who remained invested. Some performance data from this highly inflationary period (October 2020 through September 2021) is shown below:

- The S&P 500 Fossil-Free Index significantly underperformed the S&P 500 with a return of 28.65% vs. 30.00%.
- The BAML US High Yield Index Excluding Energy, Metals, and Mining significant underperformed the BAML US High Yield Index with a return of 9.20% vs. 11.46%.
- The Russell 2000 energy sector significantly outperformed the broader Russell 2000 (domestic small cap equity index) with a return of 136.79% vs. 47.68%