

# Illinois Sustainable Investing Act

August 11, 2021

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Michael W. Frerichs  
ILLINOIS STATE TREASURER





## Director of Corporate Governance & Sustainable Investment, Illinois State Treasurer's Office

- Joined the IL Treasury in February 2015
- Lead the Office's Division of Corporate Governance & Sustainable Investment
  - Direct corporate engagement, sustainable investing, and proxy voting activities, all of which seek to advance our mission to protect and grow the Treasurer's \$35 billion investment portfolio
- Manage the equity, diversity and inclusion goals relevant to the investment division
- Oversee various investment operations (e.g. communications, reporting, online data portal, performance management, etc.)



**Max Dulberger**

# AGENDA

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- 1. Background on the Sustainable Investing Act**
- 2. Definitions – What is sustainable investing?**
- 3. Why? What is the intent of the legislation?**
- 4. How do governments comply and implement?**
- 5. What resources are available to assist?**
- 6. Q&A**



# Illinois Sustainable Investing Act – Background



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- The [Sustainable Investing Act \(PA 101-473\)](#) was signed into law by the Governor in August 2019 with an effective date of January 1, 2020.
- Applies to all state and local government entities in Illinois that hold and manage public funds
- Relates to the integration of material sustainability factors into investment policies and decision-making processes
- First of its kind in the nation.



# Definitions – What is Sustainable Investing?



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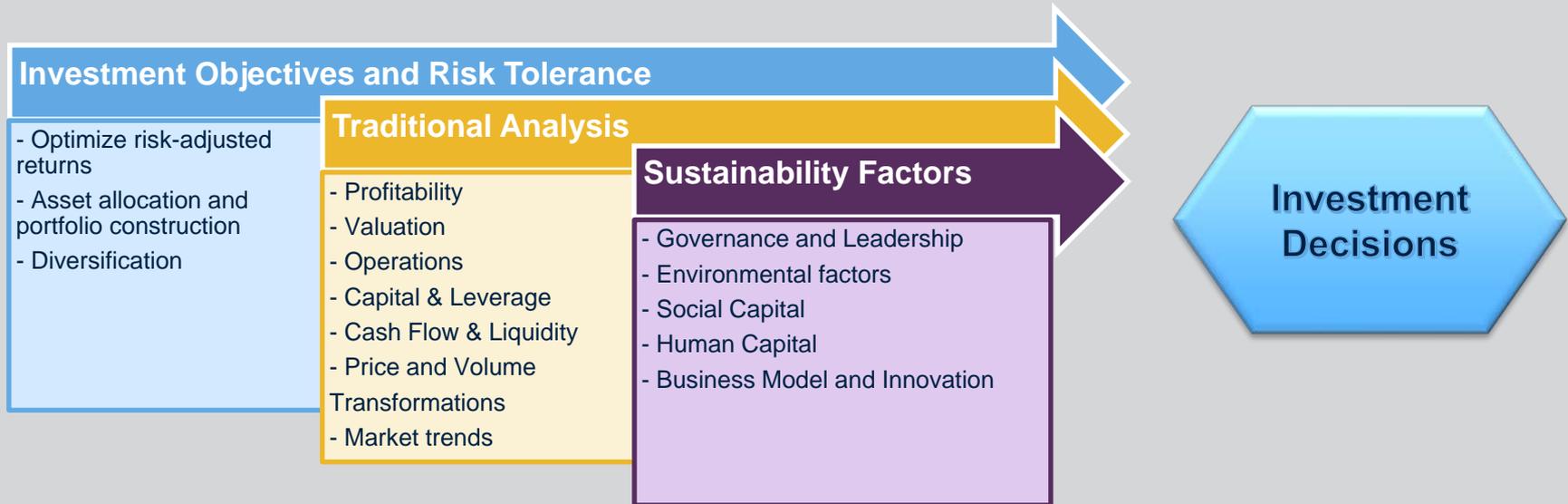
- An approach to analyzing investment quality and risk in a more rounded and expansive manner, with an emphasis on long-term value.
- Uses the integration of additional factors, beyond traditional financial and technical indicators, that are material and relevant to investment performance. This includes:
  - **Governance and leadership factors** (e.g. competence/skills of board directors, oversight structures)
  - **Environmental factors** (e.g. energy management, GHG emissions, biodiversity impacts)
  - **Social capital** (e.g. product quality & safety, data security, human rights, and community relations)
  - **Human capital** (e.g. how companies manage their workforce, employee health & safety)
  - **Business model and innovation** (e.g. supply chain management, business resiliency in crises)
- **This is not ethical investing, but grounded on a focus on financial impact** – identifying additional risk factors and value opportunities that may have a material impact on the financial condition or operating performance of a company, investment fund, or another investment vehicle.

# What is sustainable investing?



**Sustainability factors provide an additional layer of rigor to investment analysis and decision-making.**

As a complement to financial and technical analysis, **the integration of material and relevant sustainability factors provides a more holistic view of an investment fund or portfolio company's performance and risk profile** on factors that may impact long-term value.





## Environment

- GHG Emissions
- Air Quality
- Energy Management
- Water & Wastewater Management
- Waste & Hazardous Materials Management
- Ecological Impacts

## Leadership & Governance

- Business Ethics
- Competitive Behavior
- Management of the Legal & Regulatory Environment
- Critical Incident Risk Management
- Systemic Risk Management



## Business Model & Innovation

- Product Design & Lifecycle Management
- Business Model Resilience
- Supply Chain Management
- Materials Sourcing & Efficiency
- Physical Impacts of Climate Change

## Social Capital

- Human Rights & Community Relations
- Customer Privacy
- Data Security
- Access & Affordability
- Product Quality & Safety
- Customer Welfare
- Selling Practices & Product Labeling

## Human Capital

- Labor Practices
- Employee Health & Safety
- Employee Engagement, Diversity & Inclusion

Source:

*Sustainability Accounting Standards Board (SASB)*



# What are the world's largest managers doing?



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**Vanguard**

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Home > Investment stewardship >

## Policies and guidelines

Responsible investment policy

### Policy overview

At Vanguard, our core purpose is "to take us in this mission, we rely on our core values integrity is foundational to our character" term perspective and disciplined approach is reflected in a commitment to keep cost Vanguard's culture and is consistent with Vanguard supports responsible investment

- Voting in support of proxy proposals that
- Advocating for responsible corporate governance
- Acting on material environmental, social

### Proxy voting

The most visible sign of Vanguard's engagement our Investment Stewardship team that we designed to promote long-term shareholder providing a basis for decision-making. In company management, shareholder group developments in governance standards or

### Advocating through engagement

Our funds typically hold companies' stock corporate governance is key to helping them

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About Us > Corporate Social Responsibility > Socially Responsible Investing

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NEWS

HISTORY AND CULTURE

INVESTOR RELATIONS

CORPORATE SOCIAL RESPONSIBILITY

- Community Affairs
- Environment
- Ethics
- Government
- Government Relations and political Contributions
- Socially Responsible Investing**
- Diversity and inclusion
- US Modern Slavery Act Transparency Statement

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Sustainable investing is simply smart investing

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Sustainable investing is simply smart investing

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### PERFORMING FOR THE FUTURE

Performance characteristics are a key driver of interest in ESG for many investors. Find out more about their motivations and challenges in our latest survey of global institutional investors.

READ MORE

### Latest Thinking

**Next Generation ESG for Better Alpha**

SSGA's quants describe the more tailored approach they are taking to ESG metrics for specific sectors in order to create uncorrelated alpha signals for their active equity strategies.

**Harnessing ESG as an Alpha Source in AQE**

How our Active Quantitative Equities team uses ESG factors to seek additional portfolio returns.

**UBS** Asset Management - Global

Products and capabilities Investment themes Insights About us

Equities Fixed Income Hedge Funds Liquidity and Cash Multi Assets Real Assets/PE Private/ETEs Platform Services UBS Funds Sustainability

## Sustainable and Impact Investing

Redefining the way you think about sustainable investing

### Investing with a new set of eyes

Modern sustainable investing is all about that providing our clients with new important new tools to help build stronger portfolios and generate better, more sustainable returns.

### Why is this so?

Sustainable investing is about broadening the use of material, non-financial data in the investment analysis process to include ESG - or environmental, social and governance - metrics. By adding these metrics to the investment process, investors can get a broader view of the potential upside and downside of their investments. With that, they can make better informed investment decisions.

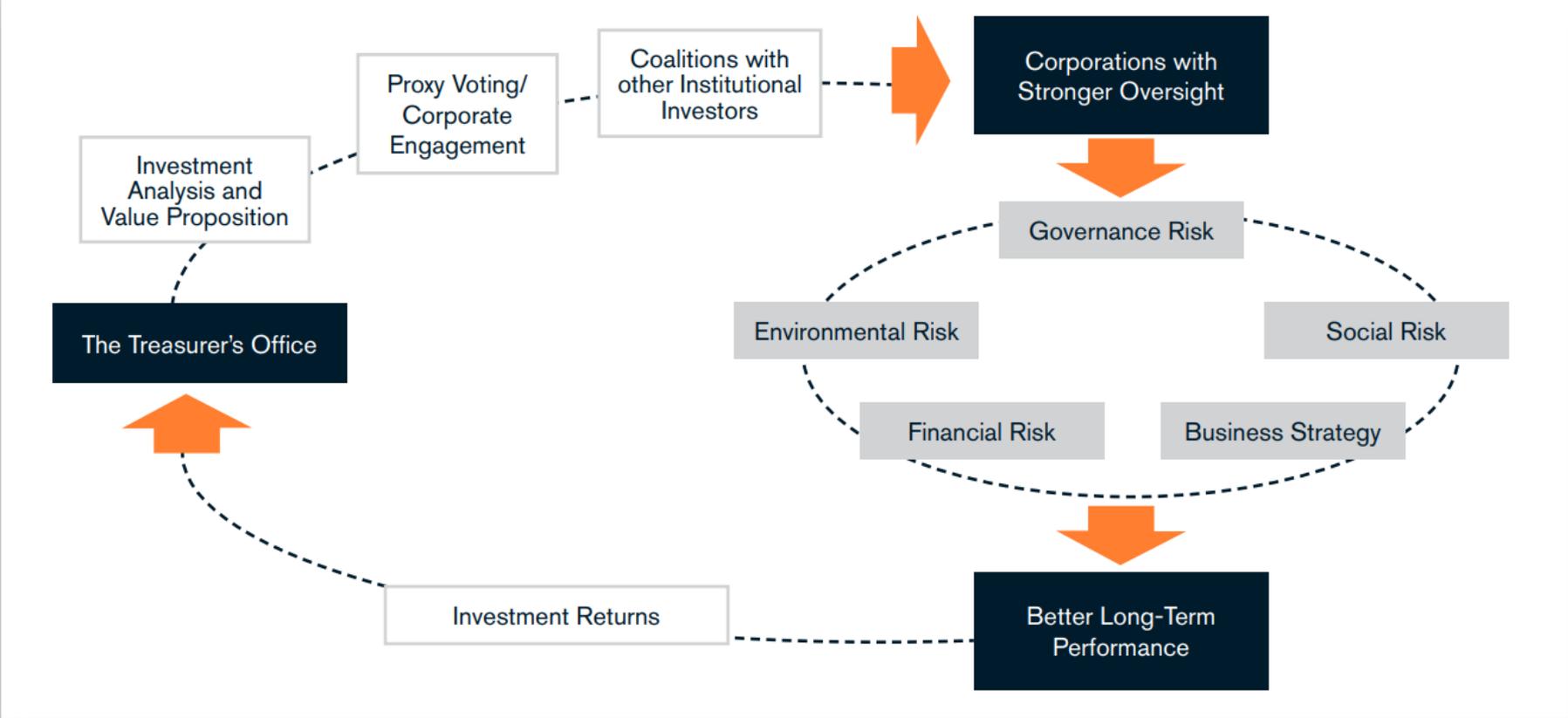
### Seeing more clearly

Sustainable investing provides a new kind of transparency into our investments - achieved through a new set of metrics that give investors material, often quantitative, data into how well a business is run, where its real risks lie, and how sustainable to business model and practices really are. If fully embedded in the investment decision-making process.

### No compromise

At UBS, we believe that sustainable investing adds value to portfolios within the same risk-return profile. That is why UBS Asset Management has made a strategic decision to bring sustainable investing into the mainstream of our offering to all of our clients.

# How we think about sustainable investing



# Value of Sustainability Integration in Today's Context



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- **2020 was a turbulent year.** Perhaps more than ever before, we witnessed how companies and their investors are impacted by the onset of **unconventional factors.**
- When investors only examine a company's financial condition, they may not discern whether that company is prepared to withstand an acute shock, like a global pandemic, or manage a systemic risk, like climate change.

 The Guardian

[ExxonMobil and Chevron suffer shareholder rebellions over climate](#)

US oil giants ExxonMobil and Chevron have suffered shareholder rebellions from climate activists and disgruntled institutional investors ...

May 26, 2021



 Bloomberg.com

[BlackRock Voted Against 255 Directors for Climate Issues](#)

BlackRock Inc. rejected almost five times more board directors at companies, including Berkshire Hathaway Inc. and Exxon Mobil Corp., ...

2 weeks ago



 Reuters

[Exxon loses board seats to activist hedge fund in landmark ...](#)

Exxon loses board seats to activist hedge fund in landmark climate vote · Tiny activist fund challenging Exxon board · Climate change central at ...

May 26, 2021



# What is the intent of the legislation?



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- **Enhanced Risk Management for Public Funds in Illinois** – Material sustainability factors represent investment risk. The integration of sustainability factors can help safeguard public funds’ abilities to mitigate investment risk, maximize returns, and effectively execute their fiduciary duties.
- **Standardization** – Establishes a uniform framework for public fund managers to integrate sustainability factors in their investment processes and it lays out a method for implementation.
- **Institutionalization** – Requires the establishment an investment policy that recognizes sustainability factors.
- **Flexibility/Customization** – The law is flexible enough that individual public funds can adapt and customize how sustainability factors are considered. The law sets a standard of practice while maintaining managerial independence.



- **Who does this apply to?**

- All public entities in Illinois that have public funds within their custody are subject to this law. Applies to entities with current operating funds, special funds, interest and sinking funds, and funds of any kind.
  - This Act does not apply to time deposits held at a financial institution or financial institution processing services.

- **Explicit Requirement of Law: Modify Your Investment Policy**

- All public agencies in Illinois that have public funds within their custody must update their investment policies to reflect that sustainability factors are being incorporated and considered in investment decision-making related to funds in their custody. Not doing so might create exposure to audit or litigation risk.
- Entities subject to the Illinois Pension Code must also file a copy of the updated investment policy with the IL Department of Insurance within 30 days after adoption.

# Examples of Investment Policy Changes



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## ISBI INVESTMENT POLICY, AN EXAMPLE

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)

**Could be as simple as inserting a few new sentences, or as complex as developing a stand-alone policy on sustainability.**

**The [Illinois State Board of Investment \(ISBI\)](#) added a short new section to its policy, while the [Illinois State Treasurer](#) created a stand-alone policy.**

**Work with your investment management team to decide on the most appropriate changes for your organization.**



## Implementation of this new policy can vary based on how funds are managed.

- 1. Best Practice: Integrate sustainability factors into investment practices.** For those agencies making investment decisions on the security or company level, sustainability factors should be incorporated into the overall decision-making process.
  - [Sample Security Analysis Due Diligence Questionnaire](#) – This document provides a sample framework and set of questions for the evaluation of sustainability risks and opportunities at individual publicly traded companies.
  - [Raising The Bar](#) – This webpage details the Illinois State Treasurer's approach to sustainable investing and sustainable investing activities.
  - Many organizations provide guidance on sustainable investing, including:
    - Sustainability Accounting Standards Board [[sasb.org](https://www.sasb.org)]
    - United Nations-supported Principles for Responsible Investment [[unpri.org](https://www.unpri.org)]
    - US SIF: The Forum for Sustainable and Responsible Investment [[ussif.org](https://www.ussif.org)]



## Implementation of this new policy can vary based on how funds are managed.

- 2. Best Practice: Talk to your fund managers.** Your asset managers can work with you to consider appropriate investments for your agency with sustainability factors in mind.
  - Many fund managers already integrate sustainability factors into their investment practice and no changes will be required, as it is common among large asset managers such as BlackRock, Vanguard, State Street, Fidelity, UBS, and others.
  - [Sample Sustainability Due Diligence Questionnaire](#) – This document provides a sample framework and set of questions for the evaluation of investment managers on sustainability integration.
  - [The Illinois Funds](#), a local government investment pool managed by the State Treasurer's Office, currently employs sustainability factors in its fund management. It is open to local governments including cities and towns, counties, special taxing districts, municipal corporations, housing authorities, community and technical colleges, and four-year universities. ***If you are a participant in The Illinois Funds, your investments are already aligned with the Sustainable Investing Act.***



- **Illinois State Treasurer's Website**
  - [Webpage on the Sustainable Investment](#)
  - [Illinois Treasurer's 2020 Annual Sustainable Investment Report](#)
- **Sample Investment Policy Statements (for our office, and ISBI)**
  - [Illinois State Board of Investment \(ISBI\)](#)
  - [Illinois State Treasurer created a stand-alone policy](#)
- **Staff at the Illinois Treasury**
  - Max Dulberger, Director, [Mdulberger@illinoistreasurer.gov](mailto:Mdulberger@illinoistreasurer.gov), (217) 843-0132
- **Sample Fund Investment Due Diligence Questionnaires**
  - Questionnaire related to [Investment Manager Evaluation](#)
  - Questionnaire related to [Security Analysis](#)

Thank you!



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Questions?