PGAA Responsible Investment (ESG) Policy

Assessing the Building Blocks

PGAA builds ESG awareness into each step of the asset allocation investment process. As asset allocators, the building blocks, or betas, that we select when constructing portfolios can be very influential in determining the overall ESG sensitivity of a strategy. As such, when building portfolios, we first determine the ESG rating for each asset class in our investment universe, using the representative indices as our baseline. This analysis allows us to understand, at a high level, what the ESG implications might be of emphasizing certain asset classes in order to achieve a desired investment outcome.

Implementing

Once we progress to the implementation of those selected asset classes, we rely on multi-pronged approach to ensure that we are building portfolios that reflect our ESG philosophy. We prefer that our sub-advisors be signatories to the United Nations Principles for Responsible Investment (UNPRI). This ensures that we are engaging with investment partners that share our belief that ESG issues can impact the performance of investment portfolios. Further, we require that each sub-advisor submit an ESG policy, which details their individual philosophy and ESG methodology.

Finally, all sub-advisors must complete our annual ESG questionnaire, which delves into the level that ESG is being incorporated into the day-to-day management of the portfolio. The questionnaire is a proprietary tool developed by PGAA that allows us to compare the ESG awareness across sub-advisors, disciplines, and asset classes. This comparison is formalized in our internal ranking system which assesses each sub-advisor according to their level of ESG integration.

This ESG integration ranking is primarily qualitative in nature and attempts to capture the intentions of the sub-advisors in adhering to an ESG discipline. To complement this qualitative assessment, we employ a holdings based ESG analysis across all our portfolios. Specifically, we rely on ESG Manager from MSCI ESG Research, LLC as our primary tool to evaluate ESG criteria. We use the MSCI analysis to gain a detailed understanding of how an individual holding (company) is rated according to ESG principles. We examine the overall ESG rating and the individual E, S, and G, ratings in absolute measure as well as index- or peer-group relative, as applicable. We focus specifically on the trend of those ratings over time versus any one reading. To gain a better understanding of the trajectory of future ratings, we review the allocation to security issuers that are considered ESG leaders or laggards.

This qualitive and quantitative assessment of the ESG profile of a sub-advisor or a strategy allows us to favor superior ESG profiles, without veering from our primary investment objective. For example, when selecting a large cap value manager for our equity allocation, we could prefer one that has the higher ESG rating or alternatively, the option that may have a lower overall rating but has higher exposure to ESG leaders that may improve their ratings trajectory in the near-term.

Monitoring

Monitoring is the final stage of the asset allocation process and it is a crucial component in ensuring that we have a comprehensive ESG aware asset allocation process. Each month we review the overall ESG rating of every investment option on the Principal platform, as well as any of the indices or betas in our investment universe. Any significant movers are flagged for follow-up. The analyst/portfolio manager covering that strategy will investigate what caused the change in the ESG tool and then ask the underlying sub-advisor to provide more detail as necessary. Many of our sub-advisors have developed a proprietary methodology for reviewing and quantifying ESG risk in their portfolios. A comparison of our third-party assessment to their proprietary assessment can often be informative in understanding the trajectory and overall ESG sensitivity of the portfolio.

We have integrated the MSCI ESG tool into our holdings-based attribution system (FactSet) and our holdings-based risk system (BarraOne). This allows us to examine the performance attribution that was generated from the ESG sensitivity within the portfolio. Similarly, we can understand how the ESG profile is contributing to the risk of a strategy in absolute space, or in comparison to a market index. We can then use that information to better understand how our asset allocation and manager selection decisions impact our ESG bias and ultimately our desired investment outcome. This analysis is continuous as the underlying rankings are evolving in real time.

In most cases we do not have any hard restrictions on ESG investing (meaning, no explicit exclusions or minimum quality) at the portfolio level. From the sub-advisor perspective, we do monitor adherence to their ESG policy as part of our standard quarterly due diligence monitoring. Any significant deviations would be flagged and could result in placement on the Qualitative Watch List and ultimately, termination.

Feedback: ESG reporting process

The sixth UNPRI Principle states that we will report on our activities and progress towards implementing the Principles. To this end, the PGAA team can provide the reporting and feedback on current ESG/SRI positioning across all existing strategies as well as the performance attribution and risk contribution according to ESG rating.