

# ESG: A path to fulfilling fiduciary duty

Investors are excited about ESG. There is gathering momentum for how data and viewpoints on ESG factors can impact the real world. The three letters that literally stand for environmental, social, and governance, are often used synonymously with “responsible investing.” Both are broad labels to which today’s investors attach a diverse set of meanings, motivations, and goals.

Whether you see ESG as a driver of investment performance, a risk-management tool, a reflection of your values, or a moral obligation, Principal Global Investors has established the capabilities to help implement these factors into your portfolios.

Principal Global Investors has always advocated for long-term solutions. There are myriad factors that can make up environmental, social, and governance concerns. This complexity requires an asset manager that can offer ESG solutions that integrate with an established investment philosophy and process to support clients’ belief systems. The careful consideration and long-term focus that ESG investing principles require are a natural fit with the research-driven character of the investment boutiques of Principal Global Investors.

As part of one of the 2018 World’s Most Ethical Companies, we understand the importance of ESG and will continue to develop investment integration options and research in order to best serve the needs of our clients.

## > Client focus

Our client-first focus is central to integrating ESG factors across our investment boutiques and asset classes. Our main goal with ESG is empowering our clients with choice and confidence. We use a flexible approach to ESG to recognize that there is no single one-size-fits-all approach to something as individual as views on environmental, social, and governance issues. A sovereign wealth fund in Asia will take a different approach to ESG than a pension fund in The Netherlands would take. Because of this, we want to collaborate with our clients on ESG in a personal, customized way to achieve the dual outcome of safeguarding assets and protecting the future. Knowing this, and knowing everyone can do their part, we want to work closely with our clients to help determine what type of engagement best supports their values and goals.

A flexible approach also recognizes that the ESG landscape is evolving. We eschew a rigid definition of and approach to ESG. A broader conception of ESG allows us to offer our clients those options that follow

a repeatable investment process while conveying their values and achieving their financial goals. It also keeps open opportunities for new pathways in the future.

## > What does ESG integration mean to us?

Some investors are skeptical when they hear about responsible investment or ESG investing. Their view is that an asset manager must drastically change how they manage money and thereby sacrifice investment results. However, when the focus is on ESG integration, adding ESG considerations can become an investment-performance driver and a risk-management tool. ESG integration within our established investment process is just a matter of doing what we are already doing—focusing on repeatable and achievable, long-term outperformance for our clients. For Principal Global Investors, ESG means incorporating those issues that are material and relevant to the evaluation of sustainable earnings trends, sentiment, and valuations. Any prudent analyst would recommend underweighting or avoiding companies with poor management, expensive environmental issues, or poor safety records. This just makes sense.

Integrating ESG factors takes place across all asset classes that the boutiques of Principal Global Investors manage. The integration approach is determined by the specific boutique investment process and the underlying asset class, regardless of whether that asset is equities, fixed income, or real estate.

While we can integrate ESG factors into our investment process, Principal Global Investors also currently manages client mandates with specific ESG exclusions. Our capabilities allow us to overlay exclusions based on clients' religious, social, or sustainability concerns. Other exclusions are expressly required by the clients' countries of domicile. We want to partner with our clients to understand what ESG concerns they need incorporated into their client agreements.

## > Working beyond governance

Historically, the governance aspects of ESG have been the primary focus across the broadest swath of our clients. Governance factors and good governance practices affect equities, fixed income, and real estate. Focusing on governance is one of the universally accepted ways an asset manager can affect investment outcomes for their clients. This is especially true when you combine a focus on governance with engagement. Direct communication between investors and companies on ESG matters is an important element of the portfolio management services provided to our clients.

But governance is only part of the ESG story. As a signatory to the Principles for Responsible Investing (PRI) since 2010, we understand that ESG factors play a material role in determining risk and return, and should be considered as part of our duty to clients and our fundamental investment process. We value the voice that being a PRI signatory provides in defining and shaping the ESG discussion, the development of best practices, and ultimately the potential to enhance the outcomes for our clients, and for those who depend on them.

## > Our ongoing commitment to ESG

Regular meetings of our firm-wide ESG working group help coordinate ESG efforts across the organization. This group also engages with our investment boutiques to help them determine how to leverage current ESG best practices.

With an ongoing focus on ESG research and education, our investment boutiques gather valuable insights that are crucial to the evaluation of sustainable competitive advantages. In addition, we use recognized third-party proxy-research providers. This research, taken together with our analysts' fundamental company analysis and the additional perspective of our portfolio managers, provides for informed decision making in navigating proxy issues.

With a strong focus on being good stewards of our resources and those of our clients, our investment teams work to integrate ESG factors across all asset classes. Our multi-boutique approach allows each investment boutique to determine how to integrate ESG factors into their investment processes, based on the needs of their clients. This provides a broad spectrum of integration options.

## > How do we live ESG?

Helping clients incorporate ESG issues into their portfolios is only part of the story. We also try to live to a high standard of environmental, social, and governance principles. Principal Global Investors and our parent firm, Principal, have established a Corporate Environmental Policy covering the firm's environmental focus in several areas:

- ▶ carbon footprint
- ▶ water efficiency
- ▶ waste and recycling
- ▶ environmental preferable purchasing
- ▶ employee awareness



At the enterprise level, Principal scored an A- on our response to CDP's 2017 Climate Change questionnaire.

This is a leadership score and higher than 70 percent of all respondents in the United States and higher than nearly 60 percent of all U.S. financial sector respondents. CDP (formally Climate Disclosure Project) is the only global disclosure system for companies, cities, states, and regions to manage their environmental impacts. Via CDP, we have committed to publicly disclosing and reporting environmental information for the benefit of investors. CDP also allows us to connect our environmental performance to our overall strategy, performance, and prospects. Only 160 firms have currently made this commitment.

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