

PNC's Approach and Key Considerations for Responsible Investing Asset Manager Evaluation



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At PNC, we define responsible investing (RI) as a goals-based strategy that aligns our clients' portfolios with their missions and values. It is a process that identifies specific RI issues in order to:

- **Avoid harm** by excluding or restricting portfolio exposures that conflict with a set of values and/or an organization's mission
- **Benefit stakeholders** by supporting certain values related to environmental, social, and governance (ESG) factors, and/or
- **Contribute to solutions** by defining a targeted impact and allocating capital toward that objective

**GLOBAL
RI AUM
\$2.7T**

The rapid adoption of RI across the financial services industry, estimated to represent \$2.7 trillion¹ assets under management globally, has also ushered in a healthy dose of

skepticism and concerns of "greenwashing." Greenwashing is a term used to describe products and investments that may mislead customers on their environmental or "responsible" attributes. In

response, the Securities and Exchange Commission (SEC) issued a Risk Alert in April 2021 highlighting certain RI-related deficiencies and internal control weaknesses from examinations of ESG investment advisors and funds. The SEC indicated it would continue to examine investment advisors and funds engaging in ESG investing in the future, focusing on several key areas, which could include²:

- Portfolio management practices inconsistent with disclosures about RI approaches
- Controls inadequate to maintain, monitor, and update clients' RI-related investing guidelines, mandates, and restrictions
- Proxy voting inconsistent with advisers' stated approaches
- Unsubstantiated or potentially misleading claims regarding RI approaches
- Inadequate controls to confirm that RI-related disclosures and marketing are consistent with the firm's disclosures and practices

At PNC, responsible investing is a process — not a product or distinct investment philosophy. Therefore, it is important that we understand how managers integrate RI into their investment and portfolio management practices. Two teams within the PNC Asset Management Group Investment Office (AMG IO) collaborate during the due diligence process for RI investment managers: Investment Advisor Research (IAR) and Responsible Investing.

**RESPONSIBLE
INVESTING IS
A PROCESS —
NOT A PRODUCT
OR DISTINCT
INVESTMENT
PHILOSOPHY**

1 - Morningstar [2021 Global Sustainable Fund Flows](#) (As of 12/2021)

2 - SEC 2021 Risk Alert: [The Division of Examinations' Review of ESG Investing](#)

Responsible Investing Manager Evaluation

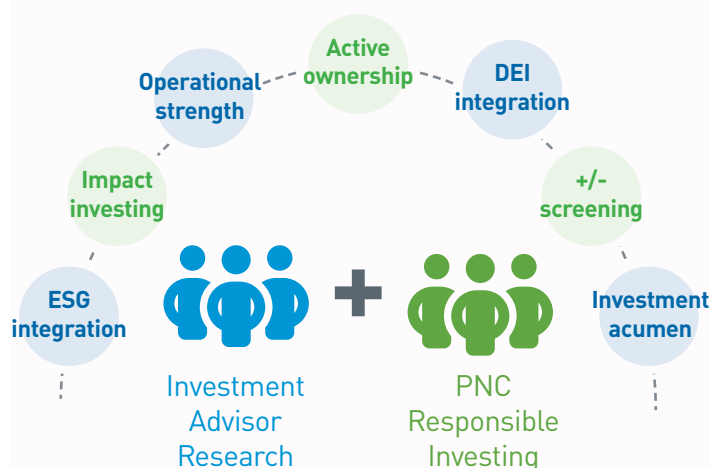
A Team Approach to Evaluating Responsible Investing Strategies

IAR's 30+ investment and operational due diligence professionals oversee PNC Asset Management Group's third-party investment platform and provide specialized expertise across asset classes, styles and geographies. For dedicated RI searches, IAR works with the RI team to leverage its robust research and expertise on ESG and impact issues to implement a data-forward framework for selecting managers.

IAR's manager search and due diligence processes reflect our duty as fiduciaries, and that remains true for our RI-related searches. We assess the investment acumen and operational strength of a firm, as well as evaluate them against RI best practices across exclusionary and positive screening, ESG integration, impact investing and active ownership.

With every search, IAR implements a peer review process, where strategies under consideration are scrutinized by both the investment and operational due diligence analysts (IDD and ODD, respectively). This means that even if there is high conviction in the investment thesis supported by a strong track record of the investment team, if the ODD analysts have concerns about the firm's ability to execute on the strategy, it would not be approved for use on the platform.

At PNC, we approach things differently — we don't have a separate ESG research team. Our teams work together to assess ESG and DEI for all managers on the platform.



RI Assessment Process

For RI searches, there is an additional assessment of the manager's RI claims. Only when investment solutions meet both the IAR and RI teams' standards are they recognized as a responsible investing strategy.

Our process begins with an assessment of the current PNC investment manager platform offerings within the style of the asset class of the investment manager we seek to identify. We also assess the need within the context of our Investment Strategy team's long-term views.

An analyst reviews the search rationale with the IAR and RI teams. Then the team provides feedback, and the analyst develops a list of prospects by screening various industry databases and PNC's extensive networks. At this stage, managers that simply claim RI integration could still enter the pipeline of viable options.

Next, the IAR analyst narrows the prospects through assessments aligned with the search rationale. For instance, this could include concerns for liquidity risk, or specific ESG exposures, such as Scope 1 and 2 carbon emissions, in the manager's portfolio. Engaging in peer review with IAR colleagues and the RI team, the analyst uncovers insights, including previous experiences with firms and managers, and creates a list of prospective managers called the Focus List.

IAR and RI conduct a due diligence process of the managers on the Focus List to assess the prospective managers among multiple criteria: firm, people, philosophy, process, portfolio, performance and RI integration. In addition to direct conversations with the manager, the RI team will use a mix of third-party data providers and internal research methodologies to assess the credibility of the ESG claims of a manager.

After an initial round of conversations, the RI and IAR teams debrief and seek peer review to create a Short List. Once we identify Short List candidates,

OUR PROCESS
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WITH AN
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OF CURRENT
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ASSET CLASS

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we conduct further interviews, diving into outstanding questions and requesting additional documentation to confirm their claims. Before the COVID-19 pandemic, these conversations often took place in person, but have since migrated to a virtual or hybrid model.

Once the search team provides a final recommendation, the prospective manager is reviewed for operational risk by our ODD team. They review an investment firm's procedures, controls and infrastructure to determine whether it can support its strategies for future return generation. Performing operational due diligence minimizes the chance that selected strategies will suffer from significant capital loss, mispricing or fraud due to operational issues. Upon review and sign-off from our operational team, the recommended investment managers are presented to our Investment Policy Committee (IPC). The IPC is comprised of senior members of PNC Asset Management Group, including others from the AMG IO, our Private Bank and Institutional Asset Management groups.

Only when this extensive process is complete and approved by the IPC is the investment strategy identified as a responsible investing strategy on the PNC investment platform and made available to our clients.

Our comprehensive search process is completed in three stages, with multiple peer reviews along the way.




Our search provides clear records so in the future we can understand:

- Why a strategy was added
- What others were considered
- Why they weren't selected



Peer reviews facilitate collaboration, knowledge sharing and quality control.

- 1 Narrow Focus List to Short List**
1-4 weeks
 - 2 Narrow Short List to finalist**
1-2 months
 - 3 Finalist operational due diligence**
4-6 weeks
-  **Investment Policy Committee Approval**

What does responsible investing due diligence look like in practice?

To clarify the process, let's use the example of a search for a global equity strategy focused on investing for climate change resiliency:

- ✓ For example, the IAR and RI teams find that a manager in a climate change search has exposure to a copper mining company. The manager rationalizes its conclusion because copper is a key input in electric vehicle production, and the company will benefit from production increases in the transition to electric vehicles.
- ✓ The RI team then questions the manager on the environmental impact of waste materials left from the process of extracting ore, how the local water supply might be impacted and other downstream considerations.
- ✓ In this instance, the manager offers a less than satisfactory response, citing that as a U.S.-owned mining company, it does a better job taking environmental considerations into account than non-U.S. companies.
- ✓ This leads to further questions on the manager's research conducted to measure the portfolio's climate impact.
- ✓ RI's knowledge of the climate change landscape then helps to identify companies in the manager's portfolio that may also rouse environmental concerns, bringing the manager's broader process for evaluating companies' impact on the environment into question.

Assessing ESG characteristics of Non-RI-focused Investment Strategies

WE SET A HIGH BAR FOR INCLUSION ON OUR PLATFORM FOR BOTH RI-FOCUSED AND TRADITIONAL STRATEGIES.

We set a high bar for inclusion on our platform for both RI-focused and traditional strategies. In addition to RI-specific solutions, we assess all strategies on our platform through a broader ESG and diversity, equity, and inclusion (DEI) lens as part of the IDD

and ODD processes. All managers, as part of the search and in on-going monitoring and evaluation, receive our ESG and DEI due diligence questionnaires on a regular basis.

We do not expect all managers to integrate ESG factors into their investment or portfolio management practices, but through our work, we find that some active managers merge ESG into their own processes, even if they do not characterize themselves as a responsible investing strategy. Additionally, managers could have exposures to specific ESG issues, such as renewable energy generation, that clients implementing RI may seek in their portfolios. For this reason, we also analyze on-platform strategies for a variety of ESG issues to assess their fit within client portfolios. We explore whether the exposure is accidental or intentional, and if the holdings are expected to change significantly that it could alter the manager's ESG profile. We have seen a notable uptick in ESG-related product offerings, as well as strategies that historically did not claim ESG considerations, now doing so. We believe active strategies should intentionally and systematically integrate ESG into the investment process and

optimize for specific ESG factors. For equities, this may also include actively engaging management at portfolio companies. There is no one-size-fits-all approach to implementing RI. Instead, we align the right investment tools and solutions to help our clients meet their goals.

We don't score active managers on ESG integration. In our view, clients who want to invest with RI values shouldn't have to make decisions on how a strategy scores as it relates to RI evaluation. We identify the best-in-class active strategies that integrate RI into the investment process and those that pursue engagement activities with companies in which they invest. Only this caliber of RI active strategies will receive a RI label on the PNC investment platform.

THERE IS NO ONE-SIZE-FITS-ALL APPROACH TO IMPLEMENTING RI.

Benefits of the PNC Approach

Our investment advisors and clients can feel confident that they are investing in leading RI strategies that have been thoroughly vetted for the ESG practices the strategy claims to implement. Our understanding of ESG extends to non-RI-focused managers to provide ESG insights across our entire platform. With the increase in greenwashing claims and the attention from the SEC, it is paramount that we vet all RI products before they find their way into client portfolios.



Only products that are thoroughly evaluated to our IAR and RI teams' standards are given the RI label on the PNC platform.

Responsible Investing Manager Evaluation

For more information, please contact your PNC advisor.

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