

Private Bank



Navigating sustainable investing & ESG exposure for family offices



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Foreword:

Why should sustainable investing be a key priority for family offices?

Wealthy families and their family offices have often shown remarkable awareness and desire for social impact. Typically for them, philanthropic donations to select causes and impact foundations are deemed to be sound methods for addressing social and environmental challenges the world faces.

While historically they may have separated the notion of “wealth creation” through the family operating business and traditional investments from social impact, which was addressed by “pure philanthropy”; profound changes in the investment landscape are resulting in a material shift in thinking. For many, investing that also achieves social impact has now become a viable alternative to “traditional” investing. It has variously been referred to as social impact investing, sustainable investing, or Environmental, Social, Governance (or “ESG”) investing.

Regardless of how it is characterized, we find that many family offices are now incrementally ensuring that their investment portfolios and operating businesses also reflect their values. The move entails a well thought out process of defining a family’s values, financial goals, investment parameters and key outcomes.

Sustainable investment pathways also bring about a refocusing of portfolio performance from pure risk-adjusted returns to dual or treble returns encompassing financial return, as well as a measurable social and environmental impact. That’s because financial motivations can be aligned with motivations hitherto served by pure philanthropy ranging from tackling climate change to a personal sense of duty to the community, from leaving behind a legacy to aligning intergenerational passion for a particular cause.

Whatever those motivations may be, capital allocations from family offices can move the needle given their ability and willingness to invest in sustainability driven ventures with patient capital, and flexibility in allocation of capital across themes and sectors. Additionally, investment capital from family offices can be catalytic, both in terms of impact as well as motivating other investors through their influence.

We believe interest in sustainable investments started taking off meaningfully in 2018 with ESG-labeled assets under management (AUM) hitting \$30 trillion. The momentum continues to expand with asset managers bringing a range of new methodologies to the investment process to meet increasing demand. By some estimates¹, the amount of ESG investment needed going forward presents an opportunity that is four times over the aforementioned AUM level noted three years ago.

With immense opportunities ahead of us, the objective of this white paper is to explore key influences shaping sustainable investing for families, how its potential returns match those of traditional investments, and unravel the often confusing terminology used in the global market. We will also walk you through six key steps that can assist in a family office’s journey towards a sustainable portfolio.

Once family offices have defined their values-based behaviors, they can decide the best investment themes and vehicles for meeting their objectives from social impact bonds to listed equities. Whether you have already embarked on your journey or are thinking of entering the fray for the first time, this paper will address why sustainable investing should be a key priority.

¹Financing a greener planet, Vol. I, Citi Global Perspectives & Solutions, February 2021

<https://ir.citi.com/26LTxa27UoFUOb0fbNI3GtQewMG8eq1dLLtLa9Q5JLPppG%2BNiSbHGVABW5Y2KYJhzFR0mpu81E%3D>



Key influences and trends shaping a family office's approach to sustainable investing

As we have often noted², society believes sustainability is important and investor sentiment has started reflecting this. There is a case for envisioning climate risk as investment risk and finding opportunities in an evolving landscape. We believe enterprises embracing and driving the winds of change are the ones providing the true macro trends of where to invest in.

Family offices and high net worth individuals can accelerate that investment, and at the same time bring about a fundamental change in society, be purposeful and indulge in stakeholder capitalism. Outlined in the following pages are key influences and trends that may shape a family office's approach to sustainable investing.

² Citi Private Bank Outlook 2021 <https://www.privatebank.citibank.com/outlook.html>

A. Threat of climate change, societal impact of COVID-19 pandemic and the evolving energy mix

Climate change, which includes both global warming driven by human emissions of greenhouse gases and the resulting large-scale shifts in weather patterns, has become a topic of increasing relevance. Global authoritative voices as diverse as NASA³ and the World Economic Forum⁴ have lent their weight to addressing the impact of this risk, while requesting a deployment of private capital in step with the efforts of global policymakers.

Concurrently, the COVID-19 pandemic has laid bare the severity of societal, health, and financial inequities, leading to a sense of urgency and resolve. These devastating shifts caused by the pandemic have also heightened awareness of the breadth and variety of risks that can influence asset values. It has also triggered a broader dialogue and sense of urgency around how extensively these systemic risks can affect investment portfolios. For many, existing risk models are not well suited to identifying or addressing such shocks.

There is increased attention from all investor segments not only on the systemic risk posed by inequity, but also the opportunity for economic and human potential across markets.⁵ This sizable challenge offers motivation and opportunities to redress the imbalances via direct or indirect investment.

Additionally, the world's energy mix was already undergoing profound changes before the pandemic hit in Q1 2020. Incremental electrification of the developing world, proliferation of electric vehicles in Organization for Economic Cooperation and Development (OECD) markets, rising climate change

awareness and the general public mood in favor of reducing reliance on fossil fuels have been very visible for the past half-decade.

This palpable drive was given an unlikely impetus by the outbreak of the pandemic which wiped out nearly a decade's worth of oil demand growth⁶, a development that is unlikely to be reversed over the near-term. Oil demand may never fully recover, according to the International Energy Agency⁷, pointing to a gradual shift away from fossil fuels. Meanwhile, renewable energy became the cheapest new source of power in many of the world's major economies⁸ in 2020. For example, solar is the least expensive new source in the US, China and India. In nations with less abundant sunlight such as the UK and Germany, wind is the least expensive new source.

Global policymakers also appear to be cognizant of the need to remove the barriers preventing a greater flow of investment into green projects and have responded with a range of interventions. Major global economies such as the UK, Germany and France have outlined their pathways to net-zero carbon emissions, alongside a phasing out of petrol and diesel vehicles by the turn of the decade. China, which had previously said its CO2 emissions would peak "around" 2030, now has an ambition of achieving "absolute carbon neutrality" before 2060. Such developments are a harbinger of things to come in this rapidly evolving energy landscape.

All three factors alluded to in this section are worthy of consideration when it comes to assessing portfolio risks and returns, and bringing in ESG risk mitigation as a forethought.

³ NASA: Vital Signs of the Planet <https://climate.nasa.gov/evidence/>

⁴ Climate change will be sudden and cataclysmic. We need to act fast, WEF, 21 January, 2021 <https://www.weforum.org/agenda/2021/01/climate-change-sudden-cataclysmic-need-act-fast/>

⁵ From Evolution to Revolution: ESG considerations beginning to reshape investment management published by Citi Business Advisory Services, September 2020.

⁶ Coronavirus Downturn May Nullify 10 Years of Oil Demand Growth, By Gaurav Sharma, Rigzone, 5 May, 2020 https://www.rigzone.com/news/coronavirus_downturn_may_nullify_10_years_of_oil_demand_growth-05-may-2020-161978-article/

⁷ Oil Market Report, December 2020, International Energy Agency <https://www.iea.org/reports/oil-market-report-december-2020>

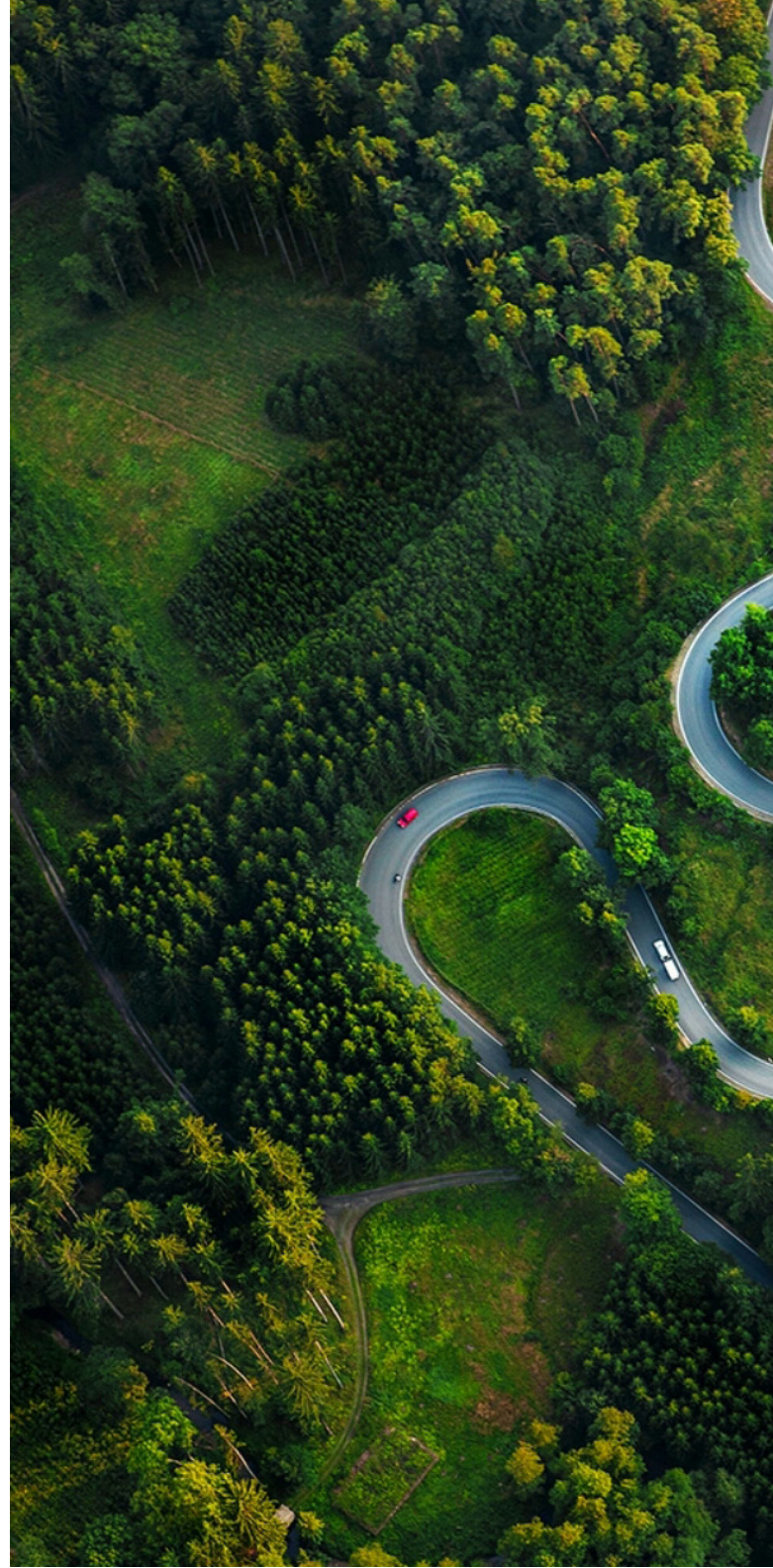
⁸ Bloomberg New Energy Finance data (as of 28 October, 2020)

B. Viable return opportunities and intergenerational engagement

Sustainable investments have shaken off their “fad” image. There is growing evidence and supportive data pointing to competitive returns, although results can vary. For instance, a recent study by the International Finance Corporation noted that private equity-backed ESG investments in emerging markets and developing economies outperformed the S&P 500 index by 15% over a comparable six-decade window to 2019⁹. It is also worth noting that in Q1 2020, 70% of US sustainability-focused public market funds delivered top-half performance¹⁰.

The Global Impact Investing Network’s (GIIN) latest survey¹¹ had an overwhelming majority of respondents noting that their dual or treble assessment benchmarks predicated on financial return, social impact, and environmental impact gave them a viable return balance they seek. Nearly 88% of those polled said that their portfolios “meet or exceed” their expectations for returns.

Alongside offering a viable alternative to traditional investments, ESG opportunities could assuage the legacy desires of family principals, and enhance intergenerational engagement within wealthy families. For instance, sustainable investing could address the twin objectives of wealth preservation often deemed prudent by family principals, and portfolio growth via positive impact initiatives deemed closer to younger generations. The investment strategy that subsequently emerges and its execution could bring about a confluence of thinking, and enhance family cohesion.



⁹ Long-run Returns to Impact Investing in Emerging Market and Developing Economies, IFC, August 2020, <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/171981598466193496/long-run-returns-to-impact-investing-in-emerging-market-and-developing-economies>

¹⁰ Sustainable Funds Weather The First Quarter Better Than Conventional Funds, By Jon Hale, 3 April, 2020 <https://www.morningstar.com/articles/976361/sustainable-funds-weather-the-first-quarter-better-than-conventional-funds> (For illustrative purposes only. Past performance is no guarantee future results.)

¹¹ Global Impact Investing Network (GIIN), 2020 Annual Impact Investor Survey, 11 June, 2020 <https://thegiin.org/research/publication/impinv-survey-2020>



C. Maturing ESG metrics and increasing reporting standards

As family offices reconcile investment returns with an expanding view of responsible portfolio management, there is internal pressure on CIOs to re-think the use of data to consider ESG metrics and impact reporting at a more granular level.

The disclosure of data itself is maturing to meet initiatives like the European Union's regulations on corporate and asset management disclosures. Broader moves in this direction should lead to a standardized methodology of collecting and reporting ESG data, offering more transparency to asset owners than has existed previously.

As metrics and reporting standards mature and a broad-based view emerges, many CIOs might come to regard the non-mitigation of ESG concerns to be an incremental portfolio risk.

D. Impact to operating companies

Finally, there is rising market recognition that sustainable operating businesses with explicit social and/or environmental goals, and those better prepared to manage the ongoing energy transition, will likely emerge stronger. Clearer board oversight and understanding of ESG issues and opportunities that follow will likely hold such operating companies in good stead.

Furthermore, the rising tide of public opinion suggests investors are indeed seeking out such companies with long-term, sustainable strategies that demonstrate resilience with the backing of their boards.



Unraveling the terminology and evolution towards sustainable investing

Based on our work with clients who are either on the cusp of, or who are just entering the sustainable investing space, we believe there is a significant amount of ambiguity around the various terms such as “sustainable investing”, “socially responsible investing” (SRI), “ESG investing”, “impact investing” and in many cases the terms are used interchangeably.

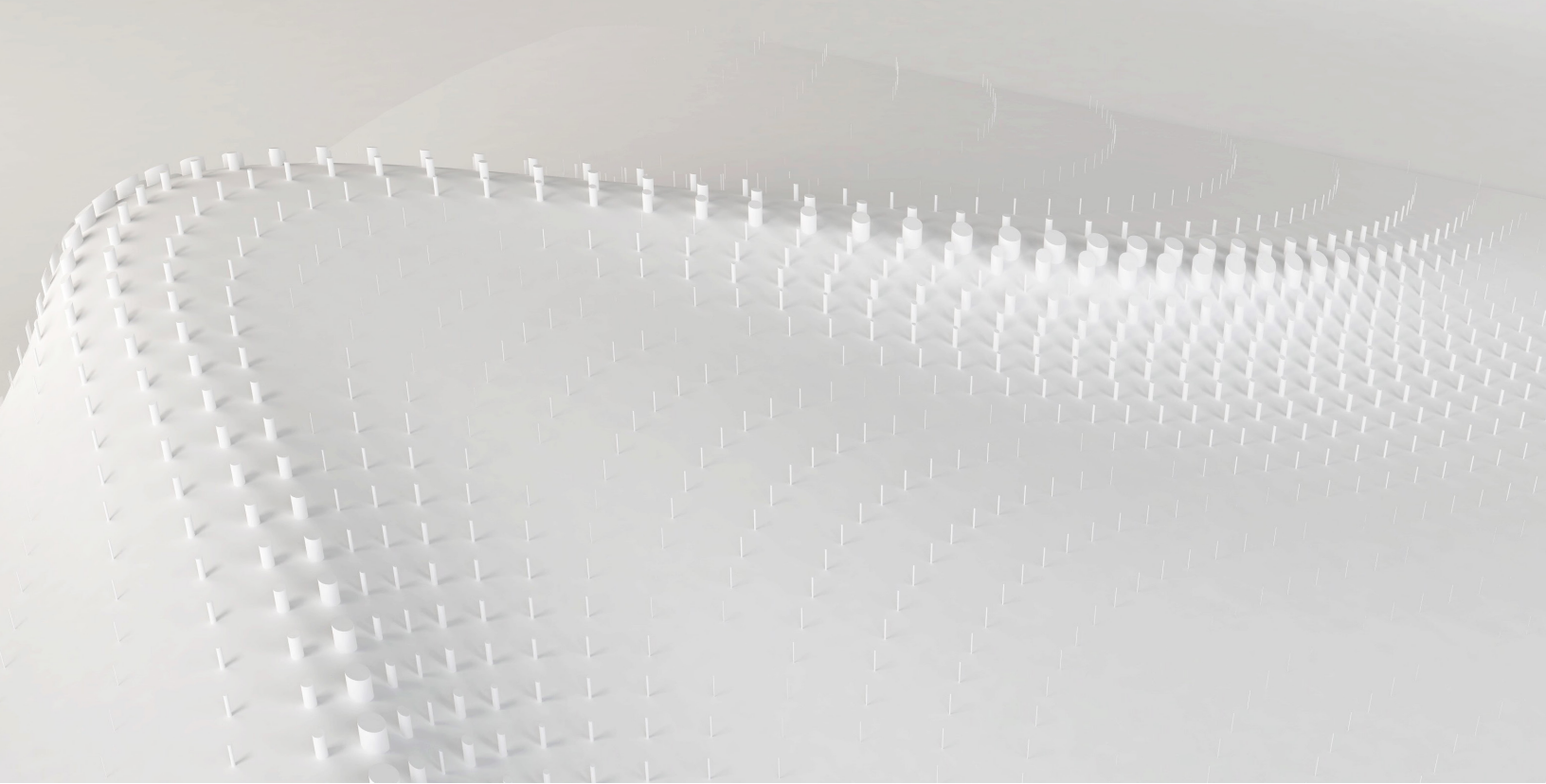
The more direct end of the sustainable investment spectrum is impact investing, where investments are made that directly tackle social or environmental challenges. On the other hand, divestments to mitigate ESG concerns could revolve around firms whose production processes or operations are deemed to cause environmental or societal damage.

Increasingly, investors are seeking to integrate E, S, and G metrics across all investments, irrespective of direct impact. Investments that integrate ESG data in this way offer a more complete picture of the underlying security. Of course, the existing complexity from a taxonomic standpoint is furthered by various stakeholders pursuing, publishing, and promoting actual and proposed rules, frameworks, goals, and standards.

Overall, we find it helpful to outline various investment approaches that fall within sustainable investing landscape. In **Figure 1**, we have included some options an investor whose primary concern is the environment, for example, might choose. It is important to note that sustainable investing approaches can and frequently do overlap.

Figure 1: Approaches to investing with purpose

	OBJECTIVE	EXAMPLES FOR INVESTOR WITH AN ENVIRONMENTAL FOCUS
SOCIALLY RESPONSIBLE	Exclude strategies one believes negatively affect society	Invest in strategies that do not include fossil fuels
ESG INTEGRATION	Integrate ESG data and metrics with goal of mitigating risk and generating additional alpha	Select a manager who invests in companies with best footprints in their sectors and who engages with portfolio companies to drive improvement
THEMATIC	Select investments that forward a goal of one's own choosing	Invest in a customized capital markets strategy linked to a renewable energy index
IMPACT	Prioritize investments by their impact on a particular issue alongside market rate returns	Invest in renewables companies or a niche/new company, e.g., a sustainable plastics company



Six steps towards a sustainable investment portfolio for family offices

Two factors largely influence both the choices families make in their approach to sustainable investing and the investment strategies available to them. The first factor is the degree to which the families wish to achieve their portfolio goals and objectives. Some families seek to maximize the impact of all investments while seeking a financial return. For example, some foundations choose to forgo annual tax deductions so that they can combine grant making and investing outside the legal structure of a foundation. This enables it to function much like a venture capital fund but with focus on providing seed capital, bridge financing, loans and equity capital to entities that aim to do good, while also seeking financial success. Others seek to maximize the financial return of all investments while seeking a positive impact.

The second factor is the extent to which families want their investments to align with their values. Many families separate wealth management decisions from their philanthropic interests or social passions, but

others feel that integrating ESG data as a determinant of risk should be incorporated across all portfolio decisions.

Ultimately, families that want exposure to sustainable investments must decide how much of their financial capital should be allocated to these investments versus more traditional investments. Some families strive for 50% to 75% exposure while others may restrict it to a very small fraction of their portfolio.

Of course, these choices are neither binary nor static. Family members may decide to dedicate their time and capital to support a single cause for extended periods. Others find themselves moving along the investment spectrum over time as they identify investment opportunities that both resonate with their personal endeavors and financial goals. Additionally, as the investment landscape continues to evolve and see innovation, new products may steer a family to different ways of investing. The choice is one to be made by the family and should be reviewed periodically.

To simplify the process, we have outlined six steps that a family office can take towards the creation of a sustainable strategy for the entire family's assets including its core investments and operating companies.

Figure 2: Sustainable investing roadmap for families





Step 1: Create a social and financial mission

The journey begins with ascertaining the family's interests. Family offices should examine the key characteristics of their current investments, via an official portfolio review, and philanthropic activities via a family meeting. A regular dialogue between the key stakeholders - on both the investment and philanthropic decisions - regarding the family's collective areas of impact interest, geographic focus and investment goals can give insights into where both the investment and donor pools of capital may meet.

A portfolio mission statement could synthesize the family's interests and financial goals. The document could address important questions including but not limited to:

- a. How do we envision the future and what resources do we need to deploy to make that a reality?
 - b. What causes would the family like to impact? Is this specific to a certain geography, population or demography?
 - c. What sort of outcomes would we expect in the short and long term?
 - d. What sectors or businesses do we want to avoid in the family's portfolio?
- a. Carving out a dedicated section for a sustainable investment strategy and its application across asset classes.
 - b. Mapping the goals of the family to appropriate investment strategies.
 - c. Documenting specific adherence to metrics such as carbon reduction goals or alignment to SASB and sustainable development.
 - d. Documenting asset allocation, risk tolerance and liquidity requirements.

Step 2: Align the mission to the investment policy

This stage of the process involves solidifying the family's vision to manage accountability, establish a framework and set guardrails for validating outcomes and goals. It would involve:

Choosing appropriate thematic and sector focuses:

Family Office CIOs or principals should help families refine general areas of interest. The United Nations Sustainable Development Goals (SDGs) could serve as a framework to map interest areas to goals. Launched in 2015, the SDGs are a collection of 17 global goals that call for private sector support and partnership to end poverty, protect the planet and ensure prosperity for all by 2030¹². Many families will find common ground with these goals which need the support of private sector capital in order to be achieved. It is estimated that \$2.5-3 trillion of investment dollars are needed every single year to close the financing gap to achieve these goals by 2030.

Amending or developing an Investment Policy Statement (IPS):

The IPS could broadly pin the investment thought processes, amend guidelines and provide a governance structures to incorporate sustainable investing goals. Some best practices for IPS updates and creation for sustainable investing include:

¹² Unlocking SDG Financing: Findings from Early Adopters, UNSDG, July 2018 <https://unsdg.un.org/resources/unlocking-sdg-financing-findings-early-adopters>

Step 3: Assess the existing portfolio

An initial portfolio diagnostic should follow to evaluate the current state of the family office's investment portfolio against desired goals. The analysis and assessment process should be repeatable and inform investment decisions. Components of a diagnostic should include:

1. An impact view of the existing portfolio and ESG risk factors relative to the relevant benchmarks. This allows for an initial health check and sets the base for ongoing monitoring.
2. Identification of company and sector exposures that add the most ESG risk to the portfolio, as well existing positive exposure within current holdings.
3. Deviations from the benchmarks across geography, sector and market cap along with allocation risks based on sector, geography, etc. along with over- or underweights compared to recognized benchmarks.
4. Compliance with UN Global Compact Principles at an individual security level.
5. Reviewing portfolio ESG risk scores compared to MSCI ACWI benchmark*.

	PORTFOLIO	BENCHMARK: MSCI ACWI
ESG risk score ¹	21.4	22.7
Percentile rank	27.9	32.1
Percentage of the portfolio with ESG risk scores	95.9	97.5

¹ESG Risk Categories: Negligible = ESG risk score under 10, Low = ESG risk score 10 - 20, Medium = ESG risk score 20 - 30, High = ESG risk score 30 - 40, Severe = ESG risk score over 40

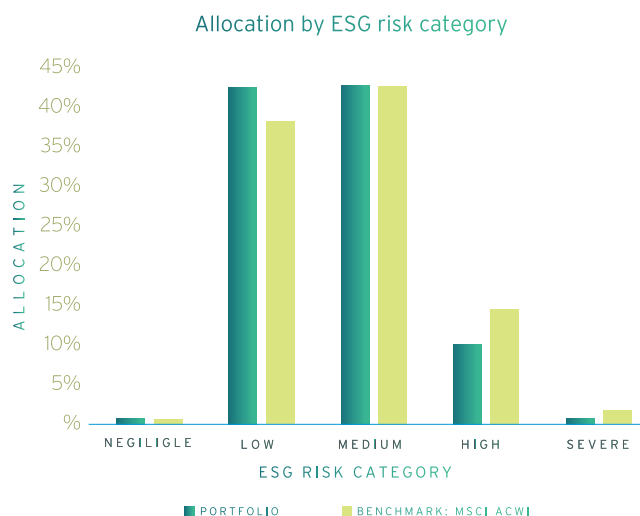


Figure 3: See sample illustration of assessment of ESG risk scores¹³ from Citi Private Bank's Global Investment Lab

¹³ Source: Citi Private Bank - Global Investment Lab as of [illustration only]. Powered by Sustainalytics. Copyright © 2020 Sustainalytics.

*The MSCI ACWI Index is MSCI's flagship global equity index designed to represent performance of the full opportunity set of large- and mid-cap stocks across 23 developed and 27 emerging markets. As of November 2020, it covers more than 3,000 constituents across 11 sectors and approximately 85% of the free float-adjusted market capitalization in each market. The index is built using MSCI's Global Investable Market Index (GIMI) methodology, which is designed to take into account variations reflecting conditions across regions, marketcap sizes, sectors, style segments and combinations.

Step 4: Build a sustainable portfolio

The IPS guides the CIO's efforts to build a sustainable portfolio within pre-defined risk thresholds to limit over allocation to riskier alternatives and asset classes. The key goals outlined by the family in the IPS could include, but not be limited to, angles such as "alternative energy focus," "reducing carbon footprint," "quality education," and "clean water." This provides a great launch-pad for the building process.

For core portfolios, integrating ESG data across asset classes can be done through both discretionary and non-discretionary portfolios. Investors are increasingly seeking satellite investments to complement their core holdings to deliver higher impact or offer specific thematic exposure that may not appear in broad market strategies.

Most strategies that integrate ESG factors into core exposure mimic benchmark sectors and strive to invest in companies that are either leaders by way of ESG metrics or have strong momentum in those areas as part of their normal course of business. This is achieving a sustainable portfolio by measuring how a company does business. And for many investors, there is an additional upside in what kind of business companies are doing. For example, companies that are creating education technology platforms, biotech and clean tech, to name a few sustainable business streams.

Some of the emerging products and options for building a sustainable portfolio include:

- **Dual-return equity thematic and impact investment products:** As the name implies thematic investments concentrate in an E, S, or G area, for example, renewable energy or cybersecurity. Impact investments endeavor to achieve a measurable environmental, social or governance return alongside a financial return. Impact measurement and reporting allow investors to quantify this "double bottom line" where the E, S, G impact is as important as the financial return.
- **Green bonds and structured loans with contractually guaranteed key performance indicators (KPIs):** While dual-return equity products are one area of innovation and equities today account for over 50% of total ESG investments, bonds and structured loans that contractually build in metrics and goals provide a more direct route to creating change.
- **Multi-asset class dual return products:** Combining equities and bonds in multi-asset class solutions (MACS) is one of the fastest growing product areas in the investment management industry today averaging an 11% CAGR for the past five years. These solutions aim to replace a core portfolio by integrating ESG data to better inform decisions. They also frequently include strong stewardship strategies, both by way of proxy voting and direct engagement with companies on their ESG performance.
- **Private and alternative assets:** Investors seeking to fulfill their expanding view of responsible asset ownership are looking beyond publicly traded equity and bond offerings to include a larger share of alternatives, private companies and real assets. These strategies allow the potential to influence contract terms of deals to desired value outcomes.

A few other best practices for consideration at this stage include:

1. Enhancing the in-house due diligence investment process to accommodate both traditional fundamental analysis and additional emphasis on combining ESG data set and sustainability goals. It is equally critical to develop expertise to avoid “impact-washing” or “green-washing”- i.e. the practice of using the word “impact” or “green” in the name of the fund or company to attract capital in an increasingly sought after investing space, without actions to match such a branding.
2. Projecting families’ near-term and long-term liquidity needs, is an essential step in ensuring optimal utilization of available cash.
3. Taxes are a key component of portfolio management in many jurisdictions around the world. Steps should be taken to ensure that there is no excessive trading activity in the portfolio that causes capital gains which results in tax liabilities.
4. Ongoing and regular monitoring and feedback is important to keep the family’s social mission and financial goals aligned.

As family office CIOs execute their allocation strategy at this step, it is worth noting that sustainable investing is still, to a degree, a developing approach to investing, with growing metrics, frameworks and standardized reporting requirements. As sustainable investing matures, we expect to see continued outperformance from companies with high ESG standards, not only as the COVID-19 pandemic plays out but for generations to come.

Figure 4



Figure 4 highlights the historical case for ESG returns¹⁴.

¹⁴ Source: Morningstar; January 1, 2010 – December 31, 2020. (*Past performance is not indicative of future results*). Office of the Chief Investment Strategist, Citi Private Bank. We used data on 528 US equity funds with data back to 2010 from the Morningstar database. Of these, 58 were assigned to the high ESG score universe based on Morningstar’s methodology; all others totaled 470 funds. We compared the high ESG funds and all others on an equal-weighted basis for return and standard deviation. The Sharpe ratios shown were calculated on the aggregated returns and standard deviations. Sharpe ratio is the measure of risk-adjusted return of a financial portfolio. A portfolio with a higher Sharpe ratio is considered attractive relative to its peers.



Step 5: Engage operating companies

Once your family office has committed to, and taken steps to implement a sustainable investing framework in core portfolios, the discussion needs to shift to evaluating the risks and opportunities for operating companies.

Family offices can play an influential role as board members and executives, as companies continue to face growing pressure to manage environmental and social issues, and demonstrate alignment with stakeholder concerns. Investor requests for greater disclosure, transparency and traceability, along with clear board oversight and ownership of risks are growing. The impact of climate change, natural resource depletion, supply chain management and human rights are some of the material themes for companies.

ESG issues are more likely to become financially material in industries where:

- It is easier for stakeholders to receive information about a misalignment between societal and business interests
- Media and NGOs have significant influence
- Companies lack effective governance and new regulations come into force
- There is a material impact in cost (for e.g. renewables cheaper than coal)
- Regulatory frameworks impact business operations (e.g. push to force net zero targets).

Step 6: Timely and disciplined review of results

In the attached workbook we have outlined key engagement questions to help you evaluate operational risks and challenges across what we believe are the most critical sustainability dimensions. Additionally, we have covered an emerging trend of family offices seeking B-Corp certification. A brief preview of these topics is noted below:

1. Climate risk: Net zero ambition, greenhouse gas reduction targets, carbon pricing/offsets etc.
2. Biodiversity loss and environmental limits: Potential impact and mitigation strategies on the forest risk commodities like timber, deforestation challenges etc.
3. Supply chain resilience and human rights: Ability to trace suppliers' source and treatment of workers.
4. Governance: Understanding who is responsible at board level, and whether climate resilience and governance is effectively embedded into board and committee structures.
5. B Corp certification: These certified businesses meet the highest standards of verified social and environmental performance, public transparency, and legal accountability to balance profit and purpose. B Corps are accelerating a global culture shift to redefine success in business and build a more inclusive and sustainable economy¹⁵.

Finally, a rounding up of the process entails a timely and disciplined review of results, and the progress that has been achieved. Such a periodic assessment would provide regular insight into the portfolio's ESG recalibration towards established goals. Additionally, the exercise would also provide a glimpse of how incorporating sustainability risk into your core portfolio construction is panning out.

Citi Private Bank can provide you with an agnostic and holistic view of sustainable investing approaches. We also offer a whole range of services designed to assess and meet your sustainable investment needs, accentuated by the Citi franchise offering via a global network.

These include managed opportunities, alternative investments and tailored exposure to capital markets, thereby enabling family offices to pursue their sustainable investment objectives through multi-asset class core portfolios or through single strategy opportunistic or thematic investments.



¹⁵ About B-Corps <https://bcorporation.net/about-b-corps>

Conclusion:

Investment avenues are growing in line with the appeal of sustainable investing

As sustainable investing becomes mainstream, Citi Private Bank anticipates sustainability and impact investing to be key considerations for family offices, be it in their core investment portfolios or their operating companies.

It will be in sync with what we have described as 'Greening the world'¹⁶ – how we see market forces increasingly driving the transition to renewable energy supplies, ongoing gains in technological innovation, electrification and efficiencies we expect on a global scale.

The arrival of the worst global pandemic in more than a century moved every asset price in the world and its departure will do the same. It is time to position portfolios to exploit what comes next. Therein lies the opportunity to tilt portfolios along a green tangent in a post-COVID world.

Family offices are in a unique position where they have tremendous pools of capital and flexibility over how it is deployed. Furthermore, sustainable investing, unlike pure philanthropy, delivers both financial returns as well as direct societal or environmental impact.

As we have noted throughout this paper, the evolution and refinement of ESG metrics advancing at a rapid pace as are the technologies and ecosystems tackling

climate and social change. We have also explored the basic principles of sustainable investing and its potential returns, touched on why it is so popular in many family offices, highlighted common pitfalls, and offered our thoughts on your approach if you are new to it.

As sustainable investments have become viable alternatives to 'traditional' investments, there are many investment options for family offices who often have a wider range of opportunities and greater freedom to invest than retail investors. In many ways, this makes them more similar to institutional investors. This gives family offices access to innovative financing models and more room to be able to make investments based upon both quantitative factors, such as alpha and liquidity, and qualitative factors such as social causes and intergenerational engagement.

The range of investment avenues continue to expand in line with the growing attractiveness of ESG investing. Liquidity, risk diversification, and geographical considerations can be aligned to match social and environmental goals allowing family offices to assume leadership in new sustainable investment products that have entered the market.

In many respects, Citi Private Bank's embrace of sustainability derives from our values and belief that private sector capital can and should effect positive change. To explore more on this topic, discuss ESG avenues and get assistance with an objective evaluation of your family office's sustainable investing pathways, please contact your Citi Private Banker or Family Officer advisor.

Citi has long been a leader in the sustainability space, from co-founding the Equator Principles in 2003 to supporting the Paris Agreement in 2019. On 1 March 2021, Jane Fraser, Chief Executive Officer of Citigroup, committed the Citi global franchise to a net-zero carbon emissions target by 2050. For us, the transition to more sustainable business practices mitigates risk, unlocks value over the long term and can be another competitive advantage.

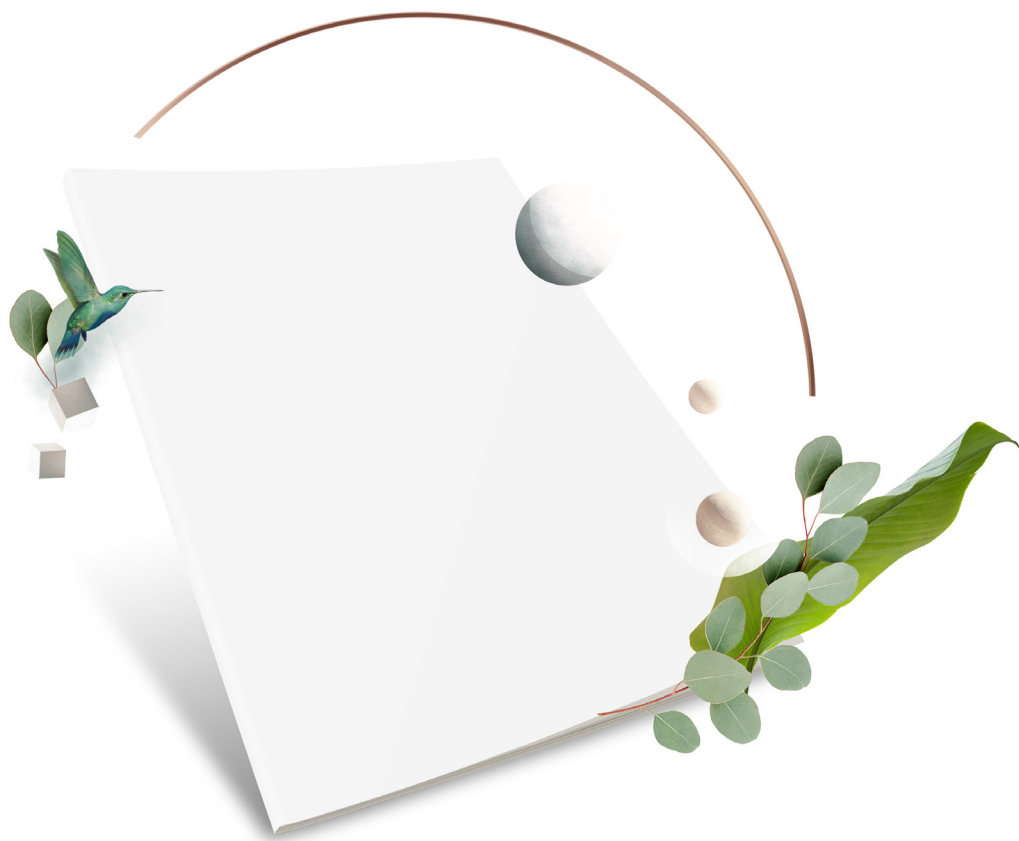
¹⁶ Unstoppable Trends - Greening the world, Citi Private Bank, December 2020 <https://www.privatebank.citibank.com/ivc/docs/Unstoppable-Trends-Outlook-2021.pdf>

Workbook 1: Building a sustainable portfolio



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Introduction

The following questions are meant to help guide your family's approach to sustainable investing. We recognize that there are several approaches with many combinations, and each family has its own unique combination of risk, return and sustainability goals. The questions are designed to help you reflect on your current approach and consider what changes might help you achieve your long-term goals. These questions are a starting point for a deeper conversation, and one that needs to be revisited as your goals change and the investment universe matures.

Family interests and reflection

- Why is this important to the family and how is it consistent with the family legacy?
- What does sustainable investing mean to the family?
- How far down the journey are we and what have we learned from past efforts?
- Which of the following best describes the family's attitude towards ESG data?
 - › Skeptical
 - › Opportunistic
 - › Overwhelmed
 - › Inquisitive
- When choosing between two investments with similar expected risk/return profile, do environmental or social factors, such as carbon emissions or supply chain management, impact our decision making?
- Did ESG characteristics play a greater role in the family's investment decision making during the last 12 months and if so, what drove this? (For example - COVID-19, climate change, demand decline for fossil fuels, social inequality, water scarcity, biodiversity, etc.)
- What might be the top choices for thematic and impact investing? (For example - rising levels of plastic waste, water pollution, women empowerment, gender diversity, health and nutrition, etc.)
- Which of the following best describe the family office's plans over the next three years when it comes to sustainable investing?
 - › Maintain
 - › Decrease
 - › Or, increase allocation to sustainable strategies
- Which of the following factors are preventing us from investing in sustainable investments?
 - › Concerns about performance and fees
 - › Difficulty in evaluating investment products and strategies
 - › Other investments deemed as higher priority areas
 - › Lack of family office committee agreement
 - › Concerns over deviation from investment policy statement (IPS)
 - › Concerns about lack of transparency and reported data
 - › Risk measurement and management difficulties
 - › Difficulty in benchmarking strategies



Values

- Are there key values we expect to be reflected in our portfolios?
- Are there any explicit exclusions that we currently use or are evaluating - sectors/geographies/companies?
- Are there any specific factors that are important to adopting sustainable investments? Financial return, social impact, social and environmental return, risk management, generating alpha, policy regulation, etc.

Intentions

- What do we hope to achieve with our investment portfolio?
- Do we intend to include sustainable investments across asset classes or is this a carve-out for specific investment opportunities as they arise?
- Are there thematic areas of impact where we would seek to drive investments?
- How closely do we want these investments to align with our philanthropic goals?
- If relevant, how are the assets in the family foundation invested? Is there alignment?
- Do we feel that shareholder engagement is an important factor to achieve societal or environmental goals? If so, which of the following shareholder activities are most effective for influencing companies to adopt positive social or environmental policies?
 - › Active ownership
 - › Supporting shareholder resolutions
 - › Shareholder activism
 - › Targeted investment (impact investing)
 - › Divestiture from investment portfolio
- Do we currently engage with portfolio companies, either directly or via external portfolio managers?

Financial goals

- What are the family's short- to long-term financial goals?
- Could these goals be helped by adding a sustainability lens?
- For any return driver to be treated as a risk factor, it needs a long performance history over multiple cycles in multiple regions, within a replicable investment process. Given that there is a limited dataset on sustainable investing, would that prevent the family from investing?
- Do we envision sustainable investments aimed at delivering a specific and measurable set of positive social impact alongside market financial returns?
- Do we envision sustainability factors influencing the entire portfolio, or do we consider these factors/goals to be a portion of your overall portfolio?
- If we already incorporate sustainability factors in investment decision making, what is the source of the data? For example - newswires and data providers, ESG score providers, annual reports, word of mouth, etc.
- Is there a plan to fund a private enterprise focused on sustainability?
- How do generational needs vary as they relate to the incorporation of sustainability factors?
- What type of investment vehicle do we currently use or would use to implement sustainable investing? For example - Separately managed, commingled, private, overlay and direct securities.



Liquidity needs

- What are our short- and long-term liquidity needs?
- Are tax payments to be included in the liquidity needs?
- Should we allow for unplanned expenditure payments?



Outcomes

- How do we define success? Financial return, social or environmental impact, reduction of portfolio volatility, alignment with values.
- What are the key metrics for reporting?
- What is the expected frequency?

Influence

- Do we envision being a leader in the sustainability space and part of its evolution?
- Are you willing to leverage your capital and influence to test and fund “cutting edge” products? Or are you seeking more time-tested and mature options?

Portfolio construction

- Do we see this as a self-directed activity or prefer to have it managed by external financial advisors?
- Are we willing to consider one off investments?
For example - a new issuance by the World Bank, structured notes, etc.?
- Do we have access to the best investment managers and the ability to undertake due diligence?

Sample language / examples of sustainable investing guidance in Investment Policy Statements

1. The family is choosing to adopt the six *UN Principles for Responsible Investing*¹⁷, recognizing that doing so is an effort to better align itself as an investor with broader objectives of society, like-minded institutional investors, and with the values of the family and its heirs. These principles are:
 - *Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.*
 - *Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.*
 - *Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.*
 - *Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.*
 - *Principle 5: We will work together to enhance our effectiveness in implementing the Principles.*
 - *Principle 6: We will each report on our activities and progress towards implementing the Principles.*
2. The family office / CIO / Investment Committees will not make direct or, as far as possible, indirect investments in equities or bonds issued by companies engaged in tobacco and armaments manufacture, and/or companies significantly engaged in the extraction of thermal coal and tar sands, considered the most polluting of fossil fuels.
3. The family office / CIO / Investment Committees, where possible, aim to switch its passively managed equity investments into funds, which track indices, which more closely meet its responsible investing objectives.
4. The family office / CIO / Investment Committees, will not invest in “black box” investment vehicles where it is not possible to identify the nature of underlying assets.

For assistance with drafting your customized Investment Policy Statements and creating a sustainable investing roadmap, please reach out to your Citi Private Bank relationship officer or a member of the Citi Private Capital Group Family Office Advisory team.

¹⁷ What are the Principles for Responsible Investment? By UNPRI <https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment>

Workbook 2: Engaging operating companies & B Corp certification for family offices

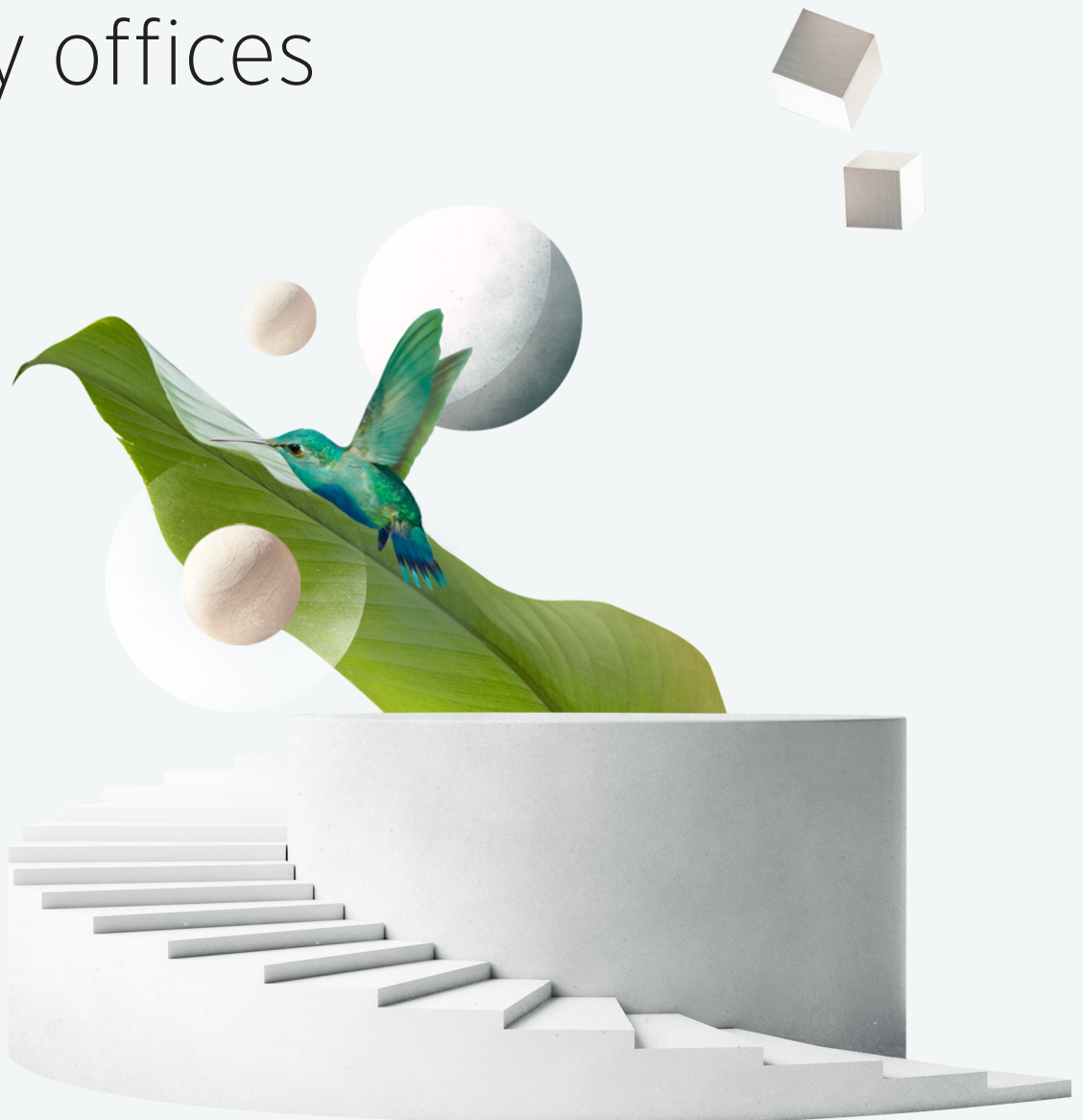


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Introduction

As we indicated in the accompanying white paper, there is a clear recognition that sustainable operating businesses, which are purpose-driven with explicit social and/or environmental goals, are likely to emerge stronger. They will likely engage in more robust risk mitigation efforts, clearer board oversight and understanding of ESG issues and opportunities than those who have chosen to sidetrack the issues.

We believe investors are seeking out companies with long-term, sustainable strategies that demonstrate resilience supported by competent boards. The effort of evaluating ESG risk exposure

for operating companies may seem daunting with significant jargon and a constant shift of reporting requirements from various stakeholders.

To assist with the task, we have outlined some key engagement questions¹⁸ that CIOs and CEOs of family offices can leverage as a starting point for an evaluation of those risks as part of navigating the overall sustainable mission of their family's portfolio. We have also touched on the emerging trend of family offices seeking B Corp certification and outlined some of the key considerations within the certification process.

¹⁸ Adapted from Citi Research publication "No Going Back: Investing in an ESG World: A Decisive Decade for Humanity" by Anita McBain et al, published November 2020.



Engagement questions: Climate risk

- a. Has the company already declared a net zero ambition? (Net zero or carbon neutrality refers to achieving net zero carbon dioxide emissions by either removing or eliminating carbon dioxide emissions.)
- b. If yes, what were the key drivers behind the adoption of the company's net zero ambition target?
- c. Does the company feel confident that it will meet targets and how often does it expect to disclose progress? Is there an executive sponsor?
- d. Are the company's greenhouse gas reduction targets science-based and in line with a 1.5 degree scenario¹⁹?
- e. If the company has adopted a science-based target what were the key learning outcomes from the science-based target initiative for the company?
- f. Who has ultimate responsibility to deliver? Has the company communicated to key stakeholders such as investors, suppliers and consumers?
- g. Does the company use carbon offsets as part of its emission reduction strategy? If yes, what sort of offsets and how did it reach a decision?
- h. Is the company willing to disclose the average price it pays for a carbon offset and is this in line with the use of a shadow price on carbon? Does the company envisage that carbon offsets will continue to play a role in part of its strategy to either achieve carbon neutrality or net zero emissions?
- i. If the company does not have a public net zero ambition / science-based target / Scope 3 disclosure²⁰ / carbon offsets / carbon intensity - does it consider this a likely outcome in the next two years?

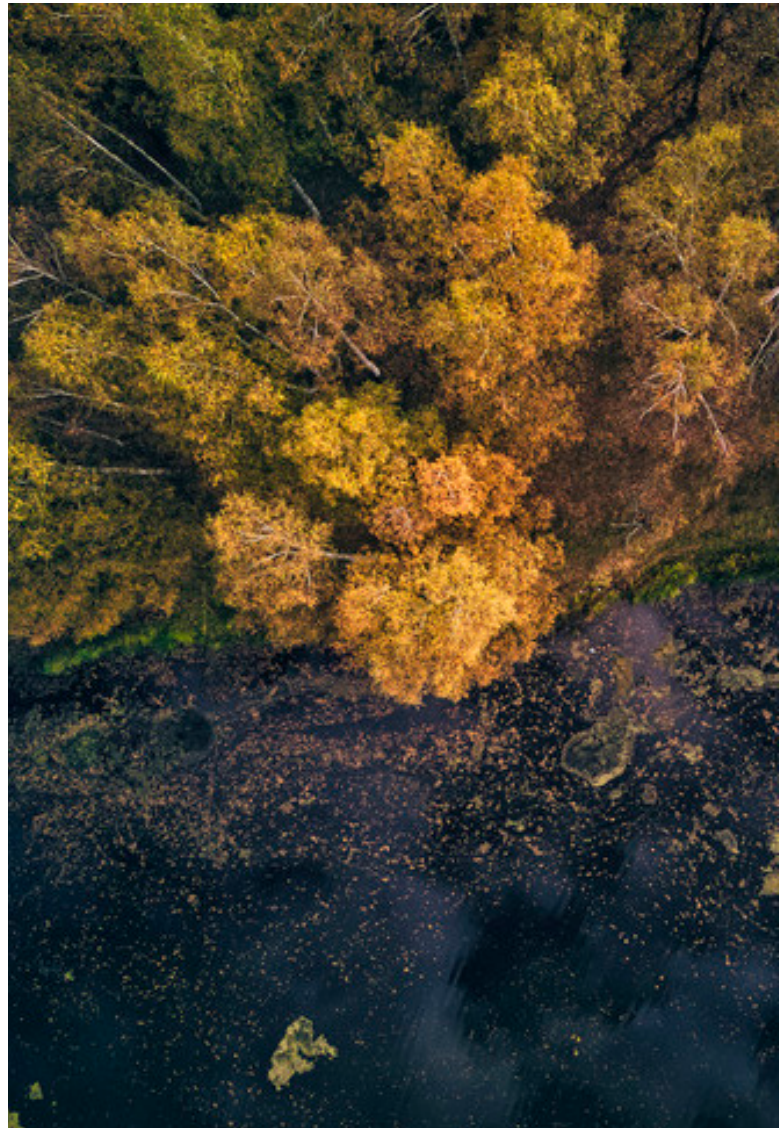
¹⁹ Global Warming of 1.5C: Special report by IPCC <https://www.ipcc.ch/sr15>

²⁰ In the computation of carbon footprint, three types of emissions are identified: Scope 1 are direct emissions produced by the burning of fossil fuels of the emitter; Scope 2 are indirect emissions generated by the electricity, steam, heating and cooling consumed and purchased by the emitter; Scope 3 are indirect emissions that occur in a company's value chain. Refer to <https://ghgprotocol.org>

Engagement questions: Biodiversity loss and environmental limits risk

We recognize that companies are all on different journeys with regard to the impact of environmental degradation and biodiversity loss, but with the huge amount of focus on these issues today, we cannot ignore their importance and relevance.

- a. Has the company started to think about its impact on biodiversity and if so how far has it progressed?
- b. Does the company have exposure to any green forest risk commodities such as palm oil, soy, timber and beef? If so, what policies are currently in place to address transparency and traceability?
- c. Does the company calculate emissions including emissions from deforestation and land use change?
- d. Does the company have greenhouse gas reduction targets for Scopes 1, 2, and 3 emissions, including emissions from deforestation land use changes?
- e. Does the company have a no-deforestation policy that is publicly available?
- f. Does the deforestation policy cover all forest risk commodities, especially key commodities such as beef and cattle, soy, palm oil and pulp/paper? Does the policy apply to all geographies that the company sources from and all markets where the company operates? Are there time-bound commitments with an executive sponsor?





Engagement questions: Supply chain resilience and human rights

- a. Does the company disclose supplier locations and, if not, what are the challenges in providing this disclosure? If the company has identified and traced its full supply chain, what issues has it uncovered and where are the climate hotspots?
- b. How has this climate mapping of the supply chain informed strategic decisions and the sourcing of key commodities?
- c. How has the company managed relationships with its suppliers through the pandemic and how did the company manage the disruption of key components?
- d. Could you describe the company's supply chain tracing processes and does the company publicly disclose the names and locations of first-tier suppliers, and information on suppliers beyond the first tier?
- e. Has the company made a formal commitment (e.g. policy) to address human trafficking and forced labor? How does company deal with breaches to policy and work with suppliers to meet best-practice? Does the company provide any education or training programs for suppliers on risks, policies, standards related to human trafficking and forced labor?
- f. Does the company have a supply chain standard that requires suppliers to uphold workers' fundamental rights and freedoms, including elimination of forced labor and can it give examples of how this is implemented?
- g. Which individual within the company is responsible for implementation of the company's supply chain policies and standards relevant to human trafficking and forced labor? Who has overall executive oversight? Is there a committee, team or officer responsible and what is the scope of their responsibility?

Engagement questions: Governance

- a. Has the board determined how to effectively integrate climate considerations into board committee structures? Are they integrated into an existing committee? Or, are they addressed by a dedicated specific climate/sustainability committee? If it is a separate climate or sustainability committee, is this relatively new and/or how long has it been in existence?
- b. Has the board considered appointing a climate and/or biodiversity expert, or creating an informal or ad-hoc climate/biodiversity advisory committee of internal and external experts? We are seeing evidence of substantial of upskilling on climate and environmental issues and the development of new committee structures.
- c. Does the company recognize climate change and ecosystem degradation as a significant risk and/or opportunity for the business and, if so, what have been the key learning outcomes so far?
- d. To what extent are climate risks and opportunities incorporated into the board's understanding of directors' duties (fiduciary duty)?
- e. Does the company have a policy (or equivalent) commitment to action on climate change? For example to meet Net zero ambition or deliver on the UN Sustainable Development Goals?
- f. Is the board aware and informed about potential mandatory climate-related reporting requirements and how is it planning to respond?
- g. Are any environmental and/or climate targets and/or goals integrated into management's incentive model? If so, how do these targets and/or goals relate to other management incentives?
- h. How does the company address and improve the communication between the environmental/sustainability, finance and investor relations teams to ensure that the company is effectively communicating on its sustainability efforts and financial materiality of its ESG strategy?



Is B Corp a family office model of the future?

Typically, the B Corp certification is associated with consumer brands such as Patagonia or Ben & Jerry's and rarely with financial firms, asset or wealth managers. So, what is a B Corp and why should family offices consider the B Corp certification for their own operations and operating companies?

What is a B Corp?

The B Corp Certification is a third-party certification administered by the non-profit B Lab, based in part on a company's verified performance on the B Impact Assessment. According to the B Lab, certified B Corporations are "businesses that meet the highest standards of verified social and environmental performance, public transparency, and legal accountability to balance profit and purpose".²¹

In other words, a B Corp balances the needs of all stakeholders, measures a company's entire social and environmental performance, and evaluates the impact of its operations and business model on employees, community, environment, and customers.

The three step process entails:

1. Filling out an online B Impact Assessment that evaluates how your company interacts with employees, customers, community, and the environment.
2. Integration of stakeholder consideration into the governance structure by amending the 'Purpose' clause to include "creating a material positive impact on society and the environment, taken as a whole, from the business and operations of the company"²².
3. In the final step, the B Lab team verifies the assessment score and whether the 80-point bar is met for certification.²³

Key considerations for family offices:

A quick survey of certified B Corp companies reveals several interconnected layers of motivations and drivers. These range from a desire to demonstrate leadership on environmental issues (e.g. Patagonia) to being part of a community that believes business can solve social problems (e.g. Ben & Jerry's).

Additionally, the certification process for a family office would further codify the overall family's vision of sustainability and sustainable investing. It would also give evidence of the family's commitment to environmental and social justice and create a powerful magnet to engage other like-minded families, be that for investing or philanthropic endeavors. B Corp certification is also increasingly becoming a must have designation for participation on public-private partnership projects.

The transparency requirement of the certification process may seem to be at odds with desire of privacy of many family offices. However, we believe more family offices are opting to make a statement of their core values, intention to deliver a positive impact to their employees and the community at large. The B Corp certification would provide an independent and authoritative seal of approval.

Finally, adopting the necessary governance requirements family office would not only serve as a solid foundation for the next generation of wealth inheritors but also likely motivate a higher degree of pride and sense of ownership in continuing the mission and vision of the principal.

For further guidance or more information, please reach out to your Citi Private Banker.

²¹ <https://bcorporation.net/about-b-corps>

²² <https://bcorporation.net/certification/legal-requirements>

²³ For complete information on the B Corp certification process, legal requirements, verification steps, please refer to <https://bcorporation.net/certification>

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The Citi Equities research paper titled 'No Going Back: Investing in an ESG World' authored by Anita McBain, and her Citi Research team are the primary sources for Step 4 'Engage Operating Companies' and the accompanying workbook.

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