Peninsula Clean Energy

*Environmental, Social, and Governance Investment Solutions*

June 8, 2020
Agenda

- Introduction to ESG Investing
- PFM’s Fixed Income ESG Investment Approach
- ESG Investment Criteria Options
- Appendix: Measuring & Monitoring ESG Risk Exposure
Introduction to ESG Investing
Approaches to Sustainable Investing

SRI
Avoid socially adverse industries like fossil fuels, tobacco, alcohol, and weapons

Impact
Seek companies that have a direct impact on positive social change like clean energy

ESG Integration
Systematically consider environmental, social, and governance performance

Negative Screening  Positive Screening  Risk Mitigation
What is ESG Investing?

- ESG investing is a sustainable investment approach
  - More inclusive than Socially Responsible Investing (exclusionary approach)
  - Broader in scope than thematic and impact investing
- Incorporates **measurable non-financial ESG factors** into an investment analysis

**ENVIRONMENTAL**
How a company limits its environmental impact and carbon footprint

**SOCIAL**
How a company treats its employees, customers, community, and other companies with which it interacts

**GOVERNANCE**
How a company is led, including executive pay and any internal controls
PFM’s Fixed Income ESG Investment Approach
PFM’s Fixed Income ESG Investment Solution

Our approach provides our clients with the tools and methodology to implement a customized ESG fixed income investment solution for their Separately Managed Accounts.

Evaluate
- Determine objectives of each fund
- Analyze cash flow requirements
- Review IPS and bond resolutions
- Understand ESG investment objectives

Strategize
- Construct custom portfolios
- Establish duration targets
- Develop strategic asset allocation
- Select benchmarks

Define ESG investment parameters
- Set ESG risk ratings
- Screening
- Identify approved issuers

Implement & Manage
- Evaluate market conditions
- Implement strategy
- Actively manage and monitor

Measure & Report
- Provide comprehensive reporting
- Measure quarterly performance

Criteria Applied to Identify Permitted Investments

1st: State Law
2nd: Investment Policy
3rd: PFM’s Approved Credit List
4th: ESG Investment Parameters (Applied to Corporate Obligations)
Our ESG Solution Offers Many Advantages

- Flexibility to implement customized ESG strategies (based on Sustainalytics framework)
- Transparent, practical, not overly complicated
- “Rules-based” approach eliminates ambiguity by setting defined ESG parameters (based on Sustainalytics framework)
ESG Investment Criteria Options
## Potential ESG Approaches

<table>
<thead>
<tr>
<th>ESG Approaches</th>
<th>ESG Evaluation Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Approach #1</strong></td>
<td>• Issuers with significant exposure to material environmental risks, such as:</td>
</tr>
<tr>
<td><strong>Limit Environmental Risk Exposure</strong></td>
<td>• Emissions, Effluents, and Waste</td>
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<td></td>
<td>• Carbon Output &amp; Impact</td>
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<td>• Land Use &amp; Biodiversity</td>
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<td></td>
<td>• Resource Use</td>
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<tr>
<td><strong>Approach #2</strong></td>
<td>• Limit exposure to fossil fuel industries.</td>
</tr>
<tr>
<td><strong>Limit Fossil Fuel Exposure</strong></td>
<td>• Limit exposure to issuers with significant exposure to material social risks, such as:</td>
</tr>
<tr>
<td></td>
<td>• Community Relations</td>
</tr>
<tr>
<td><strong>Limit ESG Risk Exposure</strong></td>
<td>• Data Privacy &amp; Security</td>
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<tr>
<td></td>
<td>• Human Rights &amp; Human Capital Management</td>
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<td></td>
<td>• Occupational Health &amp; Safety</td>
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<td></td>
<td>• Evaluate corporate governance practices</td>
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</tbody>
</table>
## ESG Investment Approach Summary

<table>
<thead>
<tr>
<th>ESG Approach</th>
<th>ESG Criteria</th>
<th>Strategy Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ESG Approach #1</strong>&lt;br&gt;Limit Environmental Risk Exposure</td>
<td>An eligible issuer’s environmental risk exposure can be no greater than 7.5 points of its ESG risk score</td>
<td>• Broader based environmental risk management approach.&lt;br&gt;• Would significantly reduce exposure to issuers and industries with materially higher environmental factors.</td>
</tr>
<tr>
<td><strong>ESG Approach #2</strong>&lt;br&gt;Limit Fossil Fuel Exposure&lt;br&gt;Limit ESG Risk Exposure</td>
<td><strong>Exclusions</strong> – Exclude issuers in the Energy Services, Oil &amp; Gas Producers, Refiners &amp; Pipelines Industries</td>
<td>• Reduces environmental risk exposure by excluding issuers involved in the exploration, direct production, refinement, and transportation of fossil fuels.</td>
</tr>
<tr>
<td></td>
<td><strong>Issuer ESG Risk Category</strong> - Medium or lower&lt;br&gt;<strong>Top ESG Performers Exception</strong> – Issuers in the “High” ESG risk category that are also in the top quartile (25%) of their subindustry may be included in the portfolio</td>
<td>• Incorporates broader ESG assessments, including socially related risk exposure.&lt;br&gt;• Top ESG Performers exclusion rewards top performers in industries with higher ESG risk exposure.</td>
</tr>
</tbody>
</table>
Impact on Eligible Issuers

Eligible Issuers (# of Issuers)

- IPS Approach: 134
- Approach #1: 109
- Approach #2: 112

Credit Quality Comparison (# of Issuers)

- IPS Approach: 63
- Approach #1: 45
- Approach #2: 54

- A rated: 26
- AA rated: 23
- Money Market Securities: 24
## Evaluating & Comparing Direct Costs and Potential Opportunity Costs

<table>
<thead>
<tr>
<th>Direct Costs &amp; Opportunity Costs</th>
<th>Approach #1 (Environmental Approach)</th>
<th>Approach #2 (Environmental Exclusions &amp; ESG Approach)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PFM Fee Impact</td>
<td>1.0 additional basis points (+0.01%) on AUM</td>
<td>1.5 additional basis points (+0.015%) on AUM</td>
</tr>
<tr>
<td>Custody &amp; Trading Costs</td>
<td>N/a – Change in approach would not change custody fees or significantly impact trading activity</td>
<td></td>
</tr>
<tr>
<td>Diversification Opportunities</td>
<td>Reduction in approved issuers. Remaining approved issuers provide diversification opportunities</td>
<td></td>
</tr>
</tbody>
</table>
| Yield & Investment Return Impact| Undetermined. Dependent on a number of factors, including:  
• Portfolio composition  
• Liquidity  
• Credit quality  
• Change in yield spreads  
• Direction of interest rates |                                                      |
Next Steps

- Work with the PCE to determine ESG investment objectives & parameters and incorporate any changes to the Investment Policy Statement

- Execute an amended investment advisory agreement

- Identify ESG eligible permitted investments based on ESG investment parameters

- Monitor the ESG risk ratings of the investments in the PCE’s portfolio

- Review, discuss, and refine the investment approach as needed
Appendix: Measuring & Monitoring ESG Risk Exposure
Who is Sustainalytics & What is the ESG Risk Rating?

- A firm dedicated to independent ESG and corporate governance research, ratings, and analysis
  - Supports investors around the world with the development and implementation of responsible investment strategies, as it has done for over 25 years
  - Continuously conducts in-depth research and analysis on over 16,000 public and private companies

- Sustainalytics’ ESG Risk Ratings enable investors to evaluate different organizations, using a consistent methodology, by quantitatively defining a company's material ESG exposure on a scale of 0-100

**ESG Risk Rating Scale**

<table>
<thead>
<tr>
<th>Negligible</th>
<th>Low</th>
<th>Medium</th>
<th>High</th>
<th>Severe</th>
</tr>
</thead>
</table>

**Lower scores = lower ESG risk**
How is ESG Risk Exposure Determined?

- The ESG Risk Rating measures **economic value** at risk based on exposure to **unmanaged ESG Risks**.

- An organization’s ESG risk assessment is based on two primary factors:
  
  - **ESG Risk Exposure** – Determined at the subindustry level with adjustments for company-specific risk exposure levels.
  
  - **Management of ESG Risk Exposure** – Based on policies, programs, quantitative performance, controversies, and corporate governance.

\[
\text{ESG Risk Rating} = \text{Unmanageable ESG Risk} + \text{Management Gap}
\]

Source: Sustainalytics
ESG Risk Rating Decomposition

- **Total Exposure** is the starting point for a company’s exposure to material ESG issues.
- Some companies have **Unmanageable Risks**, e.g. an oil company will always face risks related to carbon until it changes its business model.
- Of the **Manageable Risk**, a portion is managed through a company’s policies, programs, management services, etc.; the remainder is considered unmanaged (**Management Gap**).
- The **ESG Risk Rating** evaluates unmanaged ESG risk.
ESG Risk Rating Example Calculation – Apple Inc.

Total Possible Rating = 100

- Total Exposure: 39.6
- Manageable Risk: 36.6
- Management Gap: 20.8
- Managed Risk: 15.8
- Unmanageable Risk: 3.0
- Unmanaged Risk: 23.8

Total Exposure: 39.6

Managed Risk: 15.8

Management Gap: 20.8

Unmanageable Risk: 3.0

Unmanaged Risk: 23.8

ESG Risk Rating: 23.8

ESG Risk Rating Example Calculation – Chevron Corp.

Total Possible Rating = 100

- Total Exposure: 76.2
- Managed Risk: 64.3
- Management Gap: 28.1
- Managed Risk: 36.1
- Unmanageable Risk: 11.9

ESG Risk Rating: 40.0

Unmanaged Risk: 40.0

### Apple Inc.

**ESG Risk Rating: 23.8**

<table>
<thead>
<tr>
<th>ESG Breakdown</th>
<th>Material ESG Issue Scores</th>
</tr>
</thead>
</table>

#### Environment (1.3): 5%
- Social (11.8): 50%
- Governance (10.7): 45%

<table>
<thead>
<tr>
<th>Issue Score</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data Privacy and Security</td>
<td>5.2</td>
</tr>
<tr>
<td>Human Rights - Supply Chain</td>
<td>1.1</td>
</tr>
<tr>
<td>Human Capital</td>
<td>5.3</td>
</tr>
<tr>
<td>Product Governance (S)</td>
<td>0.2</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>3.6</td>
</tr>
<tr>
<td>Business Ethics</td>
<td>7.1</td>
</tr>
</tbody>
</table>

#### Governance (10.7): 45%

<table>
<thead>
<tr>
<th>Issue Score</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Governance</td>
<td>3.6</td>
</tr>
<tr>
<td>Business Ethics</td>
<td>7.1</td>
</tr>
</tbody>
</table>

### Chevron Corp.

**ESG Risk Rating: 40.0**

<table>
<thead>
<tr>
<th>ESG Breakdown</th>
<th>Material ESG Issue Scores</th>
</tr>
</thead>
</table>

#### Environment (18.3): 45%
- Social (11.4): 29%
- Governance (10.3): 26%

<table>
<thead>
<tr>
<th>Issue Score</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emissions, Effluents and Waste</td>
<td>5.0</td>
</tr>
<tr>
<td>Carbon - Own Operations</td>
<td>5.2</td>
</tr>
<tr>
<td>Carbon - Products and Services</td>
<td>5.4</td>
</tr>
<tr>
<td>Land Use and Biodiversity</td>
<td>1.0</td>
</tr>
<tr>
<td>Resource Use</td>
<td>1.1</td>
</tr>
<tr>
<td>Occupational Health and Safety</td>
<td>0.7</td>
</tr>
<tr>
<td>Community Relations</td>
<td>4.8</td>
</tr>
<tr>
<td>Human Capital</td>
<td>1.7</td>
</tr>
<tr>
<td>Occupational Health and Safety</td>
<td>4.9</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>4.0</td>
</tr>
<tr>
<td>Bribery and Corruption</td>
<td>3.9</td>
</tr>
<tr>
<td>Business Ethics</td>
<td>2.4</td>
</tr>
</tbody>
</table>

*Source: Sustainalytics. Last updated March 31, 2020. Illustration not drawn to scale. MEI scores might not add up to ESG breakdown scores due to rounding.*
Sustainalytics Industry Categories

- Sustainalytics has categorized each rated organization into 42 different industries and 137 subindustries.
- ESG criteria may include an exclusionary component with exclusions based on specific industries and subindustries.

<table>
<thead>
<tr>
<th>Aerospace &amp; Defense</th>
<th>Construction &amp; Engineering</th>
<th>Electrical Equipment</th>
<th>Industrial Conglomerates</th>
<th>Precious Metals</th>
<th>Technology Hardware</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auto Components</td>
<td>Construction Materials</td>
<td>Energy Services</td>
<td>Insurance</td>
<td>Real Estate</td>
<td>Telecommunication Services</td>
</tr>
<tr>
<td>Automobiles</td>
<td>Consumer Durables</td>
<td>Food Products</td>
<td>Machinery</td>
<td>Refiners &amp; Pipelines</td>
<td>Textiles &amp; Apparel</td>
</tr>
<tr>
<td>Banks</td>
<td>Consumer Services</td>
<td>Food Retailers</td>
<td>Media</td>
<td>Retailing</td>
<td>Traders &amp; Distributors</td>
</tr>
<tr>
<td>Building Products</td>
<td>Containers &amp; Packaging</td>
<td>Healthcare</td>
<td>Oil &amp; Gas Producers</td>
<td>Semiconductors</td>
<td>Transportation</td>
</tr>
<tr>
<td>Chemicals</td>
<td>Diversified Financials</td>
<td>Homebuilders</td>
<td>Paper &amp; Forestry</td>
<td>Software &amp; Services</td>
<td>Transportation Infrastructure</td>
</tr>
<tr>
<td>Commercial Services</td>
<td>Diversified Metals</td>
<td>Household Products</td>
<td>Pharmaceuticals</td>
<td>Steel</td>
<td>Utilities</td>
</tr>
</tbody>
</table>

Source: Sustainalytics
Disclosures

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Sample portfolio is provided for illustrative purposes only and is not a recommendation.

As economic and market conditions may change in the future, so may PFM’s recommendations as to the sale and purchase of securities in the portfolio.

There is no guarantee the investment objectives will be achieved as the investment portfolio will only include holdings consistent with the applicable Environmental, Social, and Governance (ESG) guidelines. As a result, the universe of investments available will be more limited. ESG criteria risk is the risk that because the investment portfolio ESG criteria excludes securities of certain issuers for nonfinancial reasons, the investment portfolio may forgo some market opportunities that would be available to investment portfolios that do not apply ESG criteria.