FUND SELECTION METHODOLOGY – ESG FUNDS

Environmental, Social, and Governance ("ESG") Funds

Below please find an explanation of the methodology by which Vita Planning Group ("Vita") determines socially responsible fund (aka "ESG" fund) recommendations. Vita bases its quantitative metrics on the Plan's Investment Policy Statement with fund classification and risk/return data from the independent fund rating firm, Morningstar. This data drives our in-house analytical tools and allows for the regular, consistent and systematic analysis of fund performance. In meeting the desire for ESG funds, we use Morningstar's sustainability measures to then evaluate and recommend the best performing, highest ranking ESG fund available.

Guiding Principles

The Vita fund selection process follows two guiding principles:

- ➔ Adherence to the Investment Policy Statement ("IPS")
- ➔ Providing a diverse array of investment options

There are two primary aspects of diversification when considering a fund array as a whole:

- ➔ Asset class, as established by Morningstar:
    - Domestic equities, one each in of the nine Morningstar style boxes
    - International Equity funds in both developed and emerging markets
    - Bond funds covering US Government debt, investment grade and high yield corporate bonds
    - Stable value or money market fund for capital preservation
- ➔ Investment Strategy:
    - Passively managed index funds
    - Actively managed equity and bond funds
    - Asset allocation, target date funds

All funds considered are analyzed through the use of our Investment Performance Spreadsheet ("IPS"), which is based upon the criteria established in the Investment Policy Statement. At its base, the process is quantitative. However, this is not a binary process. Failure in any one performance criteria does not automatically result in a fund being removed from consideration. There is a qualitative aspect to the analysis of a fund that is based on analyst reports, discussions with fund management companies, adherence to a specific investment strategy or market sector, and any other factor deemed to be relevant.

Fund Selection Methodology

The starting point is the universe of funds available within a particular market sector as defined by Morningstar. This can be as many as 1,700 funds (domestic equity large cap blend) to as few as 200 (inflation-protected bond). An initial screen is used to verify basic criteria are met. The criteria for the initial screen are:

- ➔ 10-year return in the top half of peers within the category
- ➔ Net expense ratio less than the category average
- ➔ Minimum manager tenure of 3 years

This basic screen reduces the universe into a more manageable number of funds to analyze in more detail. The IPS spreadsheet allows for the evaluation of short-listed funds in light of the performance criteria established in the Investment Policy Statement.

FUND SELECTION METHODOLOGY – ESG FUNDS

(Methodology *continued)*
The IPS spreadsheet contains primarily quantitative measures:

- ➔ Returns relative to peers in the category – category ranking and absolute return, over multiple time periods
- ➔ Risk taken to achieve returns relative to other funds in the category – Sharpe ratio
- ➔ Consistency of returns – batting average

The IPS spreadsheet allows us to identify areas for further exploration. In order to develop a comprehensive view of a fund and its suitability, we will look at other quantitative measures not necessarily included in the IPS, such as but not limited to:

- R-squared to establish the degree of active management
- Alpha and beta as measures of performance relative to the market
- Sortino Ratio and downside capture to more fully understand risk profile

As well as qualitative measures:

- ➔ Investment strategy – does the prospectus of the fund offer something participants cannot achieve through other funds in the array?
- ➔ Style drift – does the fund stay in its desired category?
- ➔ Manager dynamics – is success institutionalized?

When confronted with funds with very similar performance measures, long-term performance is emphasized over short-term performance; preference is placed on consistency of returns and strategy over volatile returns and style drift; protection in bear markets is more important than outperformance in bull markets.

Using this process, we feel we can meet the plan sponsor's responsibility to provide participants with a diverse array of well-performing, cost-efficient funds.

ESG Funds
When we look at meeting a client's desire to include ESG funds in the investment array, we follow the same principles described and overlay them with measures of ESG adherence.

DOL Guidance
The Department of Labor has stated quite clearly that performance is the over-riding responsibility of the Committee in meeting its responsibility with regards to fund offered to participants:

> "…fiduciaries may not accept lower expected returns or take on greater risks in order to secure collateral benefits but may take such benefits into account as "tiebreakers" when investments are otherwise equal with respect to their economic and financial characteristics." (DOL Interpretive Bulletin 2015-01)

This means that every ESG fund we recommend must first adhere to the Plan's IPS and then to standard measures of ESG adherence, which we take from Morningstar ratings.

FUND SELECTION METHODOLOGY – ESG FUNDS

(ESG Funds – *continued*)

ESG Example – Fossil Fuel Free Funds

We recently had a client request the inclusion of fossil-fuel-free funds in the investment array. Our starting point is Morningstar's definition of ESG options. These are funds that take into consideration certain non-economic factors in deciding how to invest. Generally, ESG funds fall into these main categories:

- Religious – either through a church affiliation or an ethical code such as Sharia Law
- Environmental Stewardship – including sustainability
- Social – focusing on human rights, worker's rights, and diversity
- Corporate Governance – including shareholder advocacy, consumer protection, and community involvement

ESG funds act on their investment mandates by either:

- Proactively investing in companies, for example, that promote sustainability or good employee relations or
- Avoiding companies or industries such as alcohol, tobacco, gambling or defense, which are seen as harmful to society or contravening religious principles

Morningstar identifies 507 funds, from 59 separate fund families, as ESG funds. These funds are first analyzed based on the performance criteria within the plan's Investment Policy Statement. Of the 507, 41 funds passed initial screens in the US equity large cap blend sector (where we are most likely to see well-capitalized oil, gas and coal companies).

We then applied Morningstar's sustainability ratings, provided by Sustainalytics, to find the funds that most closely achieve the ESG goal of not-supporting fossil-fuel companies. Those 41 large cap funds were then further screened to have a minimum "Above Average" Morningstar Sustainability Rating, which resulted in a short list of eight funds on the attached ESP IPS Spreadsheet.

Of those, only one was listed by Morningstar as completely fossil-fuel free: the State Street SPDR S&P 500 Fossil Free Reserve fund. However, our second screen, Morningstar's Portfolio Sustainability Score, shows that the fund with the least risk from ESG factors is the **Parnassus Core Equity Investor**. It is the Parnassus fund that we would recommend the Committee consider if it wishes to add a US domestic large cap equity with IPS standard performance and high ESG measures.

If the Committee determines that there is significant demand for ESG funds, we would use the same fund selection process to make recommendations for an appropriate ESG international equity fund and bond fund.