Achieving True ESG Integration Throughout Our Investing Process

By incorporating sustainability and corporate governance factors into our fundamental analysis, we're working to create a more complete picture of the risks and opportunities facing companies today and in the future.

As an active manager whose heritage is built on rigorous, fundamental analysis, environmental, social, and governance (ESG) considerations have always informed our investment decisions. We have long realized that these factors have a meaningful impact on a company's ability to create sustainable value, so our core investment philosophies and processes are naturally aligned with ESG integration and sustainable investing principles.

But as the link between off-balance-sheet risk factors and a company's financial performance has become exceedingly clear over the past decade, we realized our need to be even more intentional and systematic in how we integrate ESG factors into our investment process. These efforts, which are still in their early stages, are being driven by our relentless pursuit of creating a fuller picture of the risks and growth opportunities facing the companies we invest in as well as our desire to further align our capabilities with our clients' evolving objectives.

We work with some of the world's most sophisticated institutional investors across Europe, North America, and Asia, and their input has been instrumental in guiding our continuing journey to develop an approach to ESG integration that aligns with our unique view of quality, materiality, and sustainable value creation.

Enhancing Our Search for Sustainable Value Creation

Across our fundamental equity strategies, our investment philosophy is based on identifying quality companies that are able to produce excess returns on invested capital over time and use those returns to control their destiny—a concept we refer to as sustainable value creation. We believe that a company's ability to do this is inextricably and increasingly linked to ESG factors, whether it's developing environmentally sustainable new products, improving safety for workers across the supply chain, or enhancing transparency at the board level.

ESG integration is also increasingly relevant to our fixed income strategies. As fixed income investors, ESG factors provide a valuable lens through which to evaluate the quality of company management and corporate culture, in addition to cash flows, the balance sheet, and overall business strength. Most important, we believe companies can use sustainable practices to reduce their operating risk, enhancing the risk-adjusted returns of their bonds.

> The journey to deeper, authentic ESG integration at William Blair is a continuing one—and it's central to our mission to continually improve as investors.

Sustainable Sources of Growth

Historically, the financial benefits for companies of implementing sustainable practices tended to involve mitigating exposure to off-balance-sheet risks or reducing operating costs—at least that was the perception by investors. But increasingly companies and investors realize that sustainability can have powerful implications for growth.

For example, a global athletic apparel and footwear company recently started commercializing more recyclable materials in its products. This not only improved the company's risk profile from both an environmental and social perspective, but also gave the company more pricing power with consumers who value environmentally conscious brands. This type of product innovation and brand positioning is particularly important for millennial consumers.

While third-party ESG ratings frameworks provide valuable high-level data and promote increased transparency, we know that these metrics don't tell the whole story. Because they are based largely on corporate disclosures, publicly available data, and headlines, these ratings aren't able to convey the nuance of the factors that are affecting a company's ESG profile—or assess how material these factors are to financial performance. Furthermore, both the quality and availability of ratings data vary significantly by region and market capitalization. In fact, approximately 50% of William Blair's small-cap emerging markets universe isn't covered by traditional ESG ratings frameworks.

The limitations of third-party ESG ratings create challenges for investors—while also creating tremendous opportunities for active managers like us. Digging deeper to find information that isn't readily available and scrutinizing that information to determine what it truly means for a company's prospects is the essence of fundamental, bottom-up research. That's why we believe that by developing a more thoughtful, nuanced approach to ESG research, we can create significant value for our clients.

Rather than simply relying on third-party ESG ratings to shape our view on a company's exposure to extra-financial risks and opportunities, our research analysts are developing relationships with corporate management teams in different sectors to understand how culture and sustainability align with longer-term strategy and financial performance.

Some traditional ratings frameworks may penalize majority-owned companies simply because their ownership structure doesn't align with global corporate governance standards. We have found, however, that many of these companies—particularly founder-led firms in developing markets—have a history of prudent management and strong value creation. Corporate culture and behavior are important elements of the broader governance assessment, so they should be factored into fundamental analysis.

Limitations of Third-Party ESG Ratings

Third-party ESG ratings provide valuable data points, but they don't tell the whole story. That is why we conduct rigorous, fundamental analysis to look beyond the ratings to assess a company's true risk exposure and growth opportunities related to ESG factors.

Inconsistent Coverage

Disclosure of ESG data is more consistent and extensive among large-cap companies and in developed markets. As a result, a large portion of the small-cap and emerging markets investible universe lacks ESG ratings.

Short Histories

Widespread initiation of ESG ratings is a relatively recent phenomenon. This lack of historical data limits the ability to back-test ratings to find correlations with stock performance.

Immateriality

Many ratings systems don't appropriately weigh the factors that are most or least material for specific industries and companies.

Lack of Nuance

Because ratings are based largely on corporate disclosures and other publicly available data, they often provide an inappropriately black-and-white view of a company's sustainability practices.

Backward Looking

Most ratings provide a point-in-time look at a company's sustainability practices without taking into account progress the company has made in resolving any issues or new initiatives that are in development.

Focusing on Materiality

Not all ESG factors are equal in terms of their influence on a company's financial performance. In fact, the materiality of specific ESG factors varies significantly from industry to industry. That's why our approach to ESG integration starts with determining which ESG factors we believe are material for a given industry.

We have spent a significant amount of time exploring industry-specific ESG factors that allow us to make more informed decisions based on our investment philosophy and client objectives. Part of this process involved reviewing the provisional materiality framework developed by the Sustainability Accounting Standards Board[1] and bringing in experts from sustainability-focused research partners to sharpen our analysts' thinking in terms of materiality assessments. Then, industry by industry, we held internal cross-team discussions to identify which ESG factors to consider in our research and decide how we would begin to prioritize those factors.

To ensure that the material factors become ingrained in our research process, analysts address material ESG factors when submitting investment recommendation reports in Summit, our proprietary research platform. Furthermore, our analysts ensure that their discussions with management teams address these questions, focusing on momentum, including improvements and challenges the company has faced in implementing sustainable practices.

Creating Deeper, More Authentic ESG Integration

The risks and opportunities companies face related to factors such as climate change, demographic shifts, regulatory pressures, and new expectations among customers, workers, and other stakeholders are constantly evolving. Thus, we believe it's important to continually evaluate and improve our efforts to fully integrate ESG factors into our fundamental research.

Creating deeper ESG integration in a way that is authentic to William Blair's investment philosophy is a continuing effort that is occurring at all levels of our

1. Sustainability Accounting Standards Board Provisional Standards

Defining Materiality: Healthcare Providers and Services

Summit, our proprietary research platform, includes questions about the ESG factors that our analysts have determined are the most material to the financial performance of each sector we cover. Shown below are the factors we focus on for healthcare providers and services companies.

Customer Well-Being	• Has the company received inordinate observations or citations from the FDA as documented in form 483? • Has a company product been the object of an FDA recall? • Has the company historically been the object of an inordinate amount of FDA/other regulatory violations? • Does the company engage in animal research/stem cell research?
Supply Chain Management	• Does the company have adequate controls/audit procedures to supervise the activities of third-party suppliers/service providers—raw materials, CDMOs, CROs, distributors, HCPs?
Corporate Culture	• Values dissemination — Does the company have a code of ethics? — How does the company define and communicate values and maintain integrity across the firm? — Does the culture create a competitive advantage? • Fraud prevention (risk management) — What tools are in place to prevent, detect, and monitor fraud/bribery and human rights violations within the organization and supply chain? — What is the company's exposure to high-risk geographies as it relates to bribery and corruption (possibly defined by Transparency International's Corruption Perception Index)? • Does the company promote a "patient first" culture?

organization—from Stephanie Braming, William Blair's global head of Investment Management, to our portfolio managers and analysts, who are traveling around the world to meet with corporate management teams to learn about their sustainability practices and strategic priorities.

As we continue making progress on our ESG journey, some of the initiatives that we are investing in or exploring include:

Leveraging our industry materiality framework

Our materiality framework has proved to be a valuable tool for informing our analysts' and portfolio managers' conversations and decision-making about companies and industries. To build on this momentum, we are identifying ways to embed ESG considerations more systematically in investment decisions and ongoing company due diligence.

Further establishing and implementing our proprietary ESG ratings system

Building on our materiality framework, we are developing a proprietary qualitative ratings system that is fully aligned with our views on the ESG factors that affect company performance by industry. In addition to broadening our analysis beyond third-party data, over time our ratings can help track momentum in corporate sustainability profiles and provide additional context for investment performance and risk analytics.

Enhancing our data-capturing tools

The quantity of data about companies' ESG characteristics available to us—through third-party sources and our fundamental research efforts—is increasing rapidly. We are continually investing in Summit and our other technology tools to improve our ability to capture and categorize this information in a way that makes it more useful for our analysts and portfolio managers.

Evolving our approach to proxy voting and promoting good corporate governance principles globally

We take seriously our responsibility to monitor the effectiveness of a company's management and exert influence on governance practices, as well as promote enhanced transparency around material environmental and social factors. In addition to improving our proxy voting activity reporting, we have implemented voting guidelines that are both focused on financial returns and consistent with the objectives of sustainability-minded investors. In 2018 we joined the Investor Stewardship Group to help promote its new framework of basic investment stewardship and corporate governance standards for U.S. institutional investors and boards of directors. This follows our existing commitments to stewardship codes in the United Kingdom, Japan, and Korea. WB

Our Global Commitment to ESG

United States

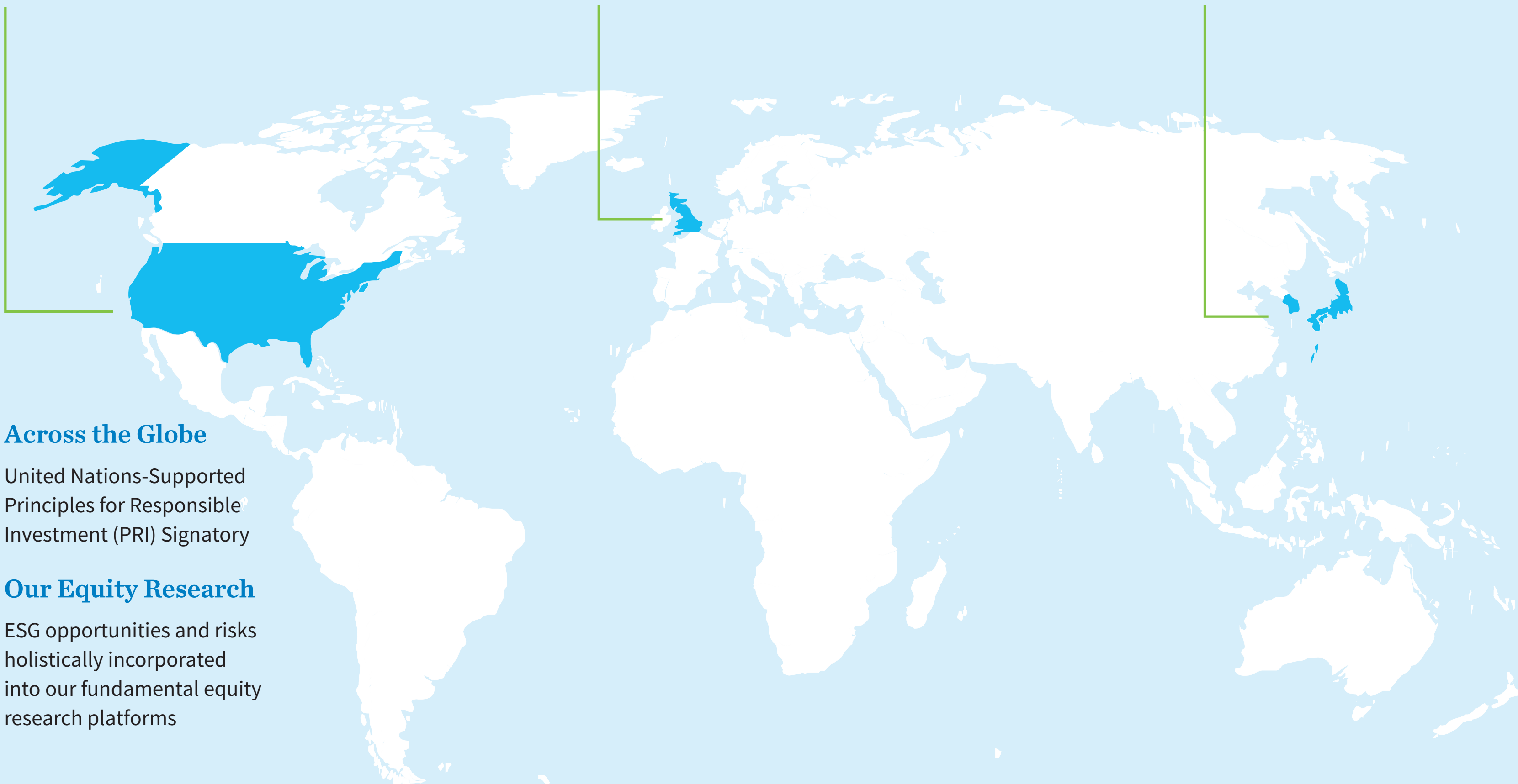
Investor Stewardship Group member
(Framework for U.S. Stewardship and Governance)

United Kingdom

Tier 1 U.K.
Stewardship Signatory

East Asia

Japan and Korea
Stewardship Codes



Across the Globe

United Nations-Supported
Principles for Responsible
Investment (PRI) Signatory

Our Equity Research

ESG opportunities and risks
holistically incorporated
into our fundamental equity
research platforms

Identify the Purpose of Your Capital

At William Blair, we believe that all capital has purpose and that all capital can make an impact. Whether you invest in one of our proprietary strategies, draw insights from our equity research, work with our investment bank for capital-raising and advisory solutions, or entrust our wealth advisors with your personal capital, we are committed to delivering ideas and solutions to help you fulfill the purpose of your capital.

Whatever your vision is for your capital, we invite you to begin a dialogue with William Blair to explore ways that those values can be expressed with your capital and in all aspects of your financial life. WB

Contact Us

Contact William Blair to learn how our professionals around the world can help you with your investment banking, investment management, and private wealth management needs: **info@williamblair.com**