Gary: Welcome to *Sustainable Minds: Exploring the Interplay of Corporate Brand, Core Beliefs, and ESG*. Brought to you by Baker. In every episode, we'll investigate how purpose, vision, and values can guide your company's sustainability actions, behaviors, and mindsets.

Rocket: We'll discuss their impact with the help of ESG-focused guests from around the globe. I'm your host Rocket.

Gary: I'm your host, Gary. Let's get started. Today we're speaking with Sarah Bratton Hughes. Sarah is the new head of ESG and Sustainable Investing at American Century. Previously, she was the global head of sustainability solutions at Schroeders. You earned bachelor's degrees, in business administration and management in economics from St. Francis College, and you've been recognized for your achievements by Crain's New York Business in the list of notable women on Wall Street in 2021. There's a longer list, but I'm going to stop there.

Congratulations, and welcome to *Sustainable Minds*. I want to jump into this where you talk about your passion topics are quality jobs, DEI, and biodiversity, and you say you're a firm believer that sustainability and impact drive alpha. Can we start there? Can you elaborate on that?

Sarah: Sure. First of all, thank you for having me. I'm super excited to be here today. I always start by saying if someone tells you they're an expert in all things sustainability, right off the bat you know they're lying. It's too broad of a area. Although I lead a team, I stand on the shoulders of giants and we take a very thematic framework here, but I do have my specialties, myself or my areas of passion with quality jobs, many of the social issues, diversity, equity, inclusion being them. I take a little bit of a controversial view in a sustainable investment community.

Not that I don't think climate risk is a systemic risk. I think it is a massive systemic, both investment risk as well as societal risk, but when you're allocating capital, you can isolate yourself from much of that climate risk based on the sectors that you choose to allocate. However, if you're invested in a company, a municipality, sovereign bond, you cannot isolate yourself from human risk, or people risk, or human capital management risk. Right now we are seeing an environment where human capital is one of the ultimate scarce resources we have, and I am a believer that it is something that continues to drive significant amounts of value to investments, particularly when we think about corporate investments and corporate culture.

I'm a huge believer in the concept of treating your employees as an asset rather than a liability, and that may mean some additional cost upfront, but over the longer term, what you get in reduced turnover, higher engagement will eventually lead to greater profitability, greater sales, lower incidents of health and safety problems. These are all areas I believe in and I believe create good societal outcome, but also great investment outcomes as well.

Gary: My comment is amen, sister.

[laughter]

Gary: As a corporate brand agency, we help a lot of people in these areas. I've seen a long, long time ago, companies that put their people first. Corporations always want to talk about, oh, we put our customers first, but they're probably equal, but you got to take care of your people, and it's a pretty simple equation. If you really take care of your people, they'll take care of your customers. They'll take care of your business. They'll go that extra mile for you. I think that's what you're saying.

Rocket: Yes, and what you're saying that interests me is that intersection of culture, and how culture, what is it? How can you identify companies' cultures to know that they're really thriving? Because we face that all the time. We have potential clients that come to us and say, "Oh, we've got great culture. We have these values," and then you look at it and it's not operationalized. They're not really open to change to make that happen. It all needs to be aligned. When you talk about ESG strategies and not being able to be an expert at all of them, I'm like, "Yes," because we've moved from it being the siloed little of department that everybody had nothing to do with, and to the CEO's round table with all of these different people doing cross functional work together for the first time.

That's what's so exciting to me about the ESG movement is, they're all sitting at the table talking about these things, HR, which is what you're saying with the great resignation and having the labor shortage and how the companies that are going to be able to attract talent, they're going to win. It's interesting. I don't think any of these things were really investment criterias that long ago.

Sarah: No. We'll go back to the culture thing, but I also think how we value companies has completely changed. If you go back and you just look at the S&P 500, and you go back to 1975, only 13% of the S&P's market value was in intangibles, that's in people, that's in patent, and that's in brand. That number today is over 90%.

Rocket: Wow.

Sarah: How we've traditionally valued businesses has fundamentally shifted, given how much more of company's business' market value is held up in intangibles. I loved your comments about culture, because from an investment perspective, no company that we're going to invest in ever comes into us and is like, "Our culture is terrible." You'd never hear that. You always hear about the great things they're doing. For us, it's about understanding. There is one figure I think, that gives us a very high initial indication of culture. It does not nearly tell the whole story. Actually, ascertaining company corporate culture from the outside is one of the hardest things to do, but it's turnover.

We're constantly looking at a company's turnover and we just don't want to know just high-level turnover numbers. We want to understand turnover by position in terms of level, are you having a lot of analysts or associates or vice presidents or turnover at
the senior level? I also want to understand turnover by gender, and this is, I would say, a much more emerging field where people are just starting to track some of this

is, I want to understand turnover by ethnicity and minority status, because I think that also gives you an indication of you can have the diversity, but if you have a significant amount of turnover, do you have the inclusion? Do you have a culture where people feel like they cannot all speak up and all have their own voice? I would say there's other ways while we would never trade off of a review that we've potentially seen on a glass door or alike, it's an area where we do look at it.

Rocket: You do, it fits along.

Sarah: You see a lot of negative reviews, but there are certain metrics in there that you can look at saying, "Oh, would you recommend this company to a friend?" That takes away some of the qualitative and you can put a quantitative framework around it a little bit. While it's never data we trade off of, it would definitely be something I'd say, "Hey, we need to speak to this company." We need to engage. We need to understand, do we really have an issue here? What policies and procedures do they have in place and how are they thinking about these things?

Gary: Yes. Agreed.

Rocket: I was just going to ask you, I know that your roles and responsibilities with your team members that you have a lot, but what I was interested in is that active ownership practices, like you were touching on that right there. What is your role when you invest in a company you

Sarah: Every day you own a company, you rebuy it.

Rocket: Oh, wow, what a statement.

Sarah: One investor has said to me, and I wish this is my quote because I love it, but it's not. He said, "Sarah, it's not buy and hold, it's buy and homework." We here at American Century, we are not activists, but we are active owners, and we use engagement as a lever to help us understand and more fully understand aspects of a company. We approach two different ways. We'll do it on a bottom-up, company by company basis, but also we have a top-down thematic sustainability framework where we've identified five mega trends that we think are going to be key to defining the sustainable future economy for the next 20 or 30 years, and that is healthcare, empowerment, climate, sustainable living and digitalization. Those are large mega trends, underneath them we have subtrends that are looking out 10 to 20 years and underneath that we have themes. Our theme will be most likely to change based on whether we have new emerging themes, regulatory requirement coming in, new technologies, we have to think about, and what we do is our analysts will look at each one of them. They'll do research on them and we'll look across our entire book here and say, "Do we have certain areas where we want to engage with a lot of companies because we think we have additional risk?" We need to find out from a disclosure perspective, how they're thinking about things and then how do we really influence positive change in corporate behavior that will also lead to not just alpha in a environmental or social prospect, but always alpha from a financial prospect.

Our fiduciary duty as long-term stewards of our client's capital is to maximize returns and maximize risk adjusted returns. We think that sustainability provides us with a key lever and additional insights and how to do this for our clients.

Gary: I'm going to go back. You were at Schroeders for 10 years and now you're at American Century. Why did you make the move? What was interesting? What attracted you?

Sarah: Because they seem like very different companies when you look at the website.

Gary: I'm going to go there in a while, but I'm just curious what attracted you over to American Century?

Sarah: Yes, they are different companies, but there's also trends of similarities in between them. I had a wonderful 10 years at Schroeders, and I'm very thankful for the opportunities that I had been given over there. I think what really attracted me to American Century was its deep fundamental investment-led culture. They had a strong foundation within sustainable investing. I think also though we're not an impact manager, we have a very purpose-driven business model. Our founders, Jim and Virginia Stowers, back in the late '90s, early 2000s, essentially donated themselves out a billionaire status. This was way before it was the cool thing to do. At the time there was only maybe two or three that had done it.

Both them and their daughter were cancer survivors and they established the Stowers Institute for Medical Research in Kansas City. They took an older hospital and built out a world class medical research institute, that's focused on doing basic on foundational research. For me as someone who has had cancer in their family, gene-based disabilities, it was-- we often say finance is not about a life and death proposition, but this actually brings it to a little bit of a different level. If we can find foundational cures and reasons for this, I think it's really important.

American Century is 40% owned by the Stowers Institute for Medical Research. It allows us to really take a longer term view when we're looking out at these things, and I think sustainability number one, that purpose-driven business line, but that longer term view is also really key when you're looking at these issues. These are things that don't manifest themselves overnight. It takes a longer term time horizon and an investment on the frontend to understand as well. For me it was about that.

There were also family aspects to it that I wanted to be headquartered a little closer to home as I was expecting my second child. We talk a lot about corporate culture as women. Although we have ways to go, we've come a really long way, and for me, I joke around, I said this was investment-led. I report into Victor Zhang, who's the Chief Investment Officer. It was very important for me. The role was structured that way. I joke around with people, like Victor knew I was pregnant before my parents did. It was actually the truth and the fact that Victor was like, "We don't hire people for a year. We hire people for careers over here." And

Rocket: Wow.

Sarah: -our CEO, Jonathan Thomas got on the phone and told me same thing. It was really indicative to the type of culture. Culture was a very important thing to me because I was also living what I considered a strong culture as well.

Gary: Yes. It looks that way. For 38 years we worked with the Capital Group and the American Funds Division. We helped them with a lot of their reports. Back in the day, the annual reports they did for the mutual funds was their marketing tool and the Capital Group, which is privately owned like American Century. When you worked at the Capital Group, you were a lifer. They had that mentality back in the day. They're super large today, and I'm not sure that that exists anymore. When I was reading about you and American Century, it reminded me of the capital group, but I just thought that was such a unique business model, that 40% of the profit goes to that medical institute. Just at the core, that is just such a living it. Walking it, living it, that's terrific.

You previously were head of sustainability solutions at Schroeders. You were there for over 10 years, and it looks like you really worked your way up there. I'm going to come back to this one question, but first I want to ask, Schroeders has a very bold corporate brand expression. It's on the website. I was looking around, the images they use, the way they express themselves, the things they say, and they talk about their values and their winning culture. We always strive for excellence. We promote innovation and teamwork. We have passion, integrity. How do they connect their values and purpose with their sustainability?

Sarah: I think it's the same thing. We're very conscious here at American Century. It's to ensure that when we are your values and your purpose that you have, and particularly from an asset management construct, and we talked about engagement. It's ensuring that we're behaving the same way that we're expecting other companies to behave. It's also continuing to put your money where your mouth is. If we truly believe that these are issues or behaving in a certain way is going to drive long-term shareholder value, we believe it's going to drive long-term value for our companies to behave this way as well.

I think that regardless of whether you're very outspoken about it, or maybe a little Midwest modest about it, it's about looking at these things within your own organization and saying, "We truly believe that investing in our employees and living our value, if we are going to drive value for us, as well as the companies that we are investing our client's capital on behalf of." If you truly do believe it, why wouldn't you be authentic and behave like it yourself?

Rocket: What do you think about companies, like how do you judge if they're learning and development departments are really contributing all that they could to develop or viewing their employees as assets rather than liabilities or profits?

Sarah: Yes. I think it's a big part of it. Forget asset management industry for a second. We're invested in all different types of companies. We got a retailer we're invested in here. How do we ensure that a retailer is focused on the concept of quality jobs? You think about a retailer or restaurant. What's the biggest issue that they've got right now? Turnover, labor, finding people and then inflation, but we'll put

that to the side for a second, but labor is a huge issue. What are they doing to continue to attract talent? You have got some real companies that have essentially built their business model on the concept of quality jobs.

You have a very big warehouse, big box retailer that's known for giving out wonderful samples and having a delicious food court. That actually, if you go in there, they're paying some of the highest wages in the retail space, but how have they done it? They make sure operationally they've been super, super efficient. You're going in there, nobody's stocking the shelves because you the customer are pulling it off on pallets. You're not going to go down the aisle and have 47,000 different cereals to choose from. Here's the cereals you have, you have the basics you choose for them.

What's more important is the people that are-- they've really invested in, they've cross-trained their employees as well. They can operate with that flex. The same person who's cutting your deli meat can write happy birthday on your birthday cake and then check you out. But then also what you see is that they have significant promotion rates from within as well. They're investing certain hours of training for their employees. They're encouraging their employees to go back to school. What we're seeing really encouraging is that these companies, their business model was built that way.

There's other retailers whose business model was not built that way. Their business model was actually built off of cheap labor, but what I'm seeing very encouragingly is that you're seeing some really unique programming coming out of those companies
as well. I'm not a half glass empty or half full, and can the glass be refilled again? That's what I care about from a sustainability perspective in more ways than one. It's about you're seeing some of these big retailers come out with university programming, encouraging their employees to get degrees, moving them up into management. What they're doing now is really tracking, what is the usage of them? Who is taking advantage of them the most? How can we make this more friendly to mothers or single mothers that often have caregiving opportunities? You're seeing some really unique things happen out there right now, where companies that maybe were traditionally laggards are really stepping up to the plate and leapfrogging.

Rocket: How important do you think it is for the companies to be educating and training their people on their sustainability strategy?

Sarah: I think it's super important, because if you really want to inflict change, you have to move an entire organization at once. That's everyone from your frontline workers to your management, your C-suite, your board. You need your technology people to understand what you're doing, you need your legal, your compliance, embedded within your enterprise risk systems, because you can't just move. We talked about this. Sustainability used to be a very siloed function. Now it's going across and permeating across everything within an organization.

You have to have everybody on board and understanding not only the how, but also the why. I think sometimes the why gets lost as you move down an organization and it's just seemed as a how. I think you have to really ensure that you're also embedding it within your corporate values as well. The third part is, people behave how they're incentivized. That's human nature.

Gary: That's true.

Rocket: Thank you.

Sarah: If you really want to incentivize, if you really want to move the needle, you have to sometimes ensure that firm values and firm sustainability is embedded within your compensation system.

Gary: Yes, absolutely. I wrote a post yesterday about, we worked with what's one leadership team on the health care company and the COO became the CEO and he talked about that they have to disrupt and pontificate at all this new jargon. They wanted to go from here to there, but didn't realize that something had to change to get them there, and their values is what got them here. What's going to take them there, they have to rethink what that is and what that means to this company.

Rocket: Then operationalize that, which is just where a lot of people just miss the boat. That reward is got to be part of the plan to really sustain the change, I think, on all levels.

Gary: Sarah, what I found was really fascinating was the contrast between just how I interpreted the website of American Century which feels conservative and traditional, and Schroeders what seems bolder and more contemporary feel. I got a feeling that they're both just trying to do good in this world, but they're just so different. I believe
in individuality as people and as corporations, but can you speak a little bit to these different companies, how they're different cultures, but there's a lot of similarities perhaps between the two?

Sarah: I would say both are very, very strong investment-led culture, and both have very strong corporate values. Both are very purpose-driven. Both believe that over time, sustainability and incorporating sustainability systematically into investment processes is key to us delivering better outcomes to clients.

Gary: Yes, I just found it so interesting because this is part of our world, around corporate branding, how they express themselves so differently, and the takeaways were so different. I really got the sense that they were both very purpose-driven and very sincere in what they were saying. That was interesting. Talking about ESG and the frameworks, the standards, the ratings, they're all over the place. There's a lot of talk about different fractions pulling together and the SEC is going to come out with their recommendations. What are your thoughts around that?

Sarah: I think what's good is that we're starting to see some consolidation between the framework. You saw SASB become the value reporting foundation, and now they're merging with IFRS to become ISSB. You're seeing some consolidation happen from that perspective. I think, on the regulatory front, we still have some ways to go. You've seen the SEC's proposal has come out, I would say one of the questions I get a lot is, since we've seen the recent Supreme Court decisions, how could that potentially impact what is going on with SEC, and how much they'll potentially get done?

My opinion on that is, it doesn't really matter. I'll tell you why. It's because of the regulatory environment in the EU and the EU sustainable taxonomy, which is really focused on driving capital to more sustainable business models and sustainable companies. Just two weeks ago, very quietly, in my mind, quietly, the EU Commission had approved having non-EU headquartered companies that have operations in Europe and make over a certain revenue percentage thresholds, have to abide by the EU's corporate sustainability reporting directive.

Rocket: Wow.

Sarah: That is for any large multinational here in the US, is going to have to abide by that. That is a revenue threshold that will probably see moved down over time. I couldn't see that eventually, it would be companies that potentially you could be revenue negative, but are non-earning and have employees.

Rocket: Certain amount of employees.

Sarah: Yes, certain amount employees. That's very similar to what we saw with the asset managers that have to abide by the EU taxonomy. If you had, it was over 500 employees, and you distributed product in Europe, you have to abide by that. That's any mid to large asset manager globally. Here's the thing. Treasury Departments within corporations, particularly large multinational corporations, are used to producing reports for all different countries that they're operating in. Each country has a slightly different financial reporting regime.

I could see a world where that happens with sustainability. The question is, does that reporting move into finance, and out of the sustainability function, and move it into financial reporting? I don't know where that eventually ends, but what I have seen is some positives on the framework side, I don't think we'll ever be one-for-one aligned globally on sustainability reporting, and we're not on financial reporting and we figured that out.

Gary: Yes.

Rocket: We figured that out. As you said, not over 90% of a company's worth being intangibles. It doesn't really make sense for the annual report and the ESG report not to come together. I guess it's just a matter of time. It's getting smaller and smaller, the amount of people who think that they just have to candy coat it. They have to step up and do.

Sarah: You're seeing companies already do it ahead of the SEC ruling, already trying to go out and get their third-party assurance. I think that's an area where you're seeing the big four heavily invest in, but as an area, we still need more investment in that third-party assurance place. You're seeing some of the leaders in this space, from a corporate perspective, already doing this. The trend is somewhat clear. Like I said, if you're a multinational, you might as well just go out and do it because you operate in Europe, it's going to become table stakes over there.

You should probably start looking now. Particularly, I'm hearing that the assurance finders, although again, you're seeing big investments in it is harder at the moment.

Rocket: Very interesting.

Gary: You've been in this business for a while now. You've seen a lot of change. You talked about the mega trends at American Century, but for this industry, what does the next 10, 20 years look like to you?

Sarah: That's a great question. I think the great part of it, the best part of my job is that it's always changing. It's always evolving.

Gary: Always too. [chuckles]

Sarah: I always say this to everyone is, if I do my job right, I don't really have a job in five years. Because that means it's truly embedded throughout an organization. What does a sustainability role look like in five years? I don't know. It could be a strategy role. I'm not quite sure, but it's a much more focus on impact and impact driving value. I'm not sure. I'm also not someone who has had a career path that has gone like this. I've found my own way throughout. I think there is value in maybe not looking out so far and just focusing on what I can do to impact the organization today. I do think it will get to the point where the sustainability community does their job right. It's not called sustainability anymore, and it's embedded throughout organization.

Gary: It's called, this is the way it is. Terrific.

Sarah: You write a book about the transition. I don't know. Maybe that, I don't

know. [laughter]

Gary: This has been fantastic. Is there any topic that we didn't address that is passionate for you as well?

Sarah: No, I think we covered the big one. We spent a lot of time on corporate culture, and I'm a true believer it is a very crucial value driver. The other area I really focused on, and I would encourage people to focus on, and we talked about this a little bit is around the just transition and ensuring that as we transition to a decarbonized world, we are not leaving behind any peoples in any societies.

Gary: Right.

Sarah: The reality is, this is just what the numbers show, is that the people in society that are least responsible for climate change are the ones that are most likely to feel the burden of it, but also potentially the most likely ones to be economically left behind. I actually think we've had an example that's happened very recently when we've seen the situation that has happened in Sri Lanka. Well, yes, there were some bad financial decisions there. However, there were very strategic ambitions on the green side. While they were very, very strong ambitions, if you really read into it, people were not allowed to use certain fertilizer that they needed to get the yield on the crops they needed, and it created a food crisis on top of a global food crisis that we're already dealing with.

I think it's an example to all of us on ensuring that we're looking at these issues holistically and not just in an ESRG vacuum. It's much more holistic, and that's why we've taken this top-down approach from a somatic perspective and a trend understanding that many of these issues are intertwined. I do think that's another area where how are we upskilling workers, how are we retraining workers, not just upskilling, but we are retraining them? How are we ensuring no communities are being left behind, whether that's in the developed markets?

The US is a great example here where you tend to see the most negative climate issues in poorly educated areas or areas that have strong minority communities, and making sure what are we doing to make sure that those communities don't get left behind in this transition or feel even more negative impacts from climate change as well as looking at it on a global basis?

Rocket: Well, there are two things I would like to ask you. The type of tools that allow you, it seems so labor-intensive to reach out to companies and find out the real story of what they're all doing within it. Then the second question, once the tools that you use, the other one is, here in the United States, we have many clients who just want to adhere to SASB because they don't really want to go through a materiality assessment, extra expense. They just want to hit what's important to what's materials for investors. Yet what you're talking about to me, I like it when also I read a report and I get much more of the background in connection to the UN Sustainability Development Goals, because they really are the better place for the world and not leaving anyone behind. What are your feelings about trying to open corporations up to maybe providing against both indexes or whatever?

Sarah: I'm going to start very clearly that UN Sustainable Development Goals were not an investment framework. However, it has become the language that everyone speaks when talking about impact for sustainability. If we really want to move capital, drive capital markets and incentivize more sustainable behavior, then we need to move to the language that everyone speaks, which is the UN Sustainable Development Goals. That's having robust analysis or mapping. I could care less whether a company is aligned or not to a sustainable development goal. I want to understand how aligned they are, what percentage of their CAPEX is going towards funding, innovation and solutions for that sustainable development goal. It's not just that aspect of it.

Then to go back to your engagement question, one, I'm a big believer in big data and harnessing the power of big data to provide scale. Number two, sustainability is just not me and my team here at American Century. All of our analysts are fundamental analysts and PMs are engaging with their companies on these sustainability issues. It's not just this core group that we have here and that's actually across the equity and the fixed income side. It goes far beyond that. I'm able to really work with the investment teams to amplify what we're trying to amplify on the engagement side.

Rocket: Interesting.

Gary: Great. Thank you so much. This has been really a rich conversation. We appreciate your time. I think you really touched on a lot of important topics and topics that our audience is interested in. Thank you, Sarah.

Sarah: Great. Thank you so much.

Gary: Okay.

Rocket: Bye, Sarah. Thank you.

Gary: Bye-bye.

Sarah: Bye.

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Speaker 4: See you on the next episode of *Sustainable Minds: Exploring the Interplay of Corporate Brand, Core Beliefs, and ESG*.

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