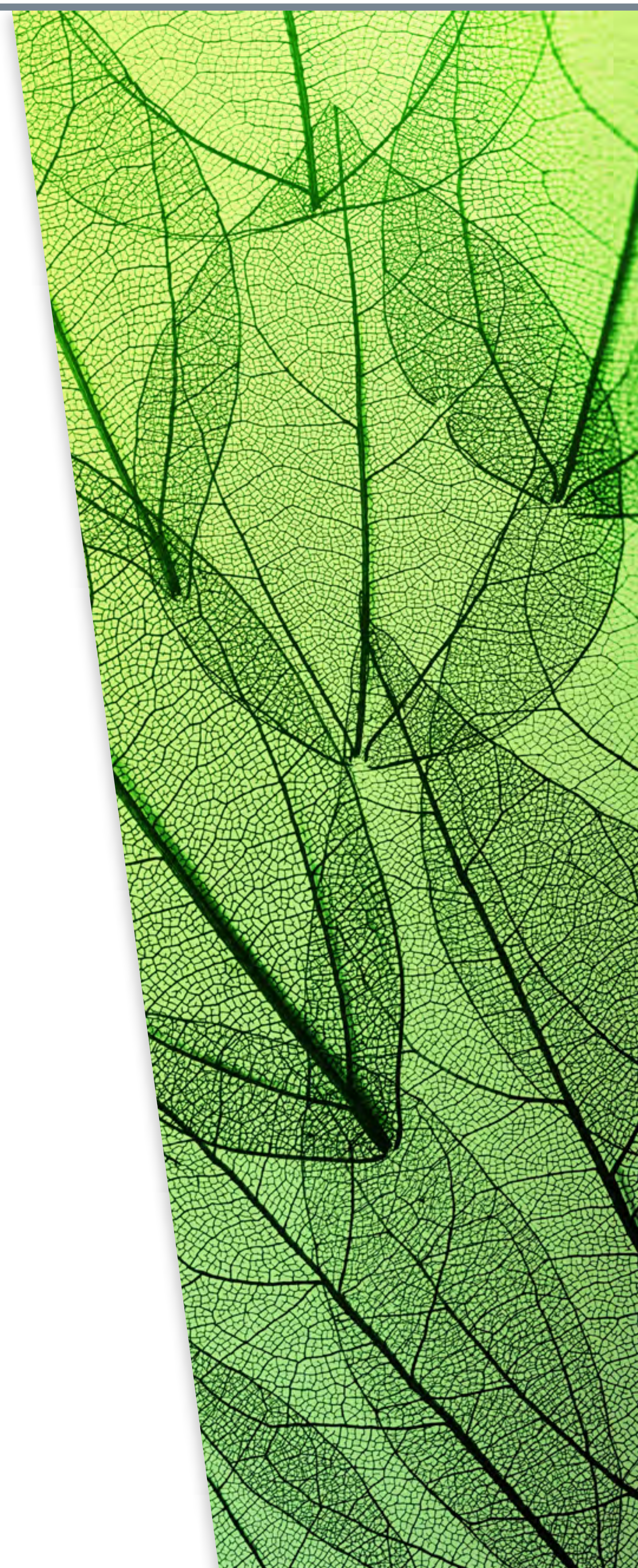
Global Asset Management

CHARTING A SUSTAINABLE ADVANTAGE



2018 Responsible Investing Survey

Executive Summary

Responsible Investing Defined

ESG Integration

Inclusion of environmental, social and governance (ESG) factors as a component of fundamental analysis to identify potential sources of alpha or risk reduction

Socially Responsible Investing

Impact Investing
Allocating funds to earn a financial return alongside measurable social and environmental impact

Positive Screening
Using ESG factors to select specific companies or sectors

Negative Screening
Using ESG factors to exclude specific companies or sectors

Sustainability Themed
Building portfolios that only include investments that meet specific ESG criteria

Engagement

Seeking to influence corporate behavior through direct engagement, proxy voting and/or shareholder proposals

Introduction

Responsible Investing Accelerates as Acceptance Overtakes Skepticism

Adoption of responsible investing principles continues to grow at a steady pace. And new data indicates that the majority of institutional investors and consultants have shifted from asking whether to adopt environmental, social and governance (ESG) principles to looking at how to implement them.

RBC Global Asset Management's 2018 Responsible Investing Survey reveals the latest views, actions and intentions of institutional investors and consultants related to responsible investing and ESG. The survey reveals that ESG-based investing continues to steadily gain credibility and establish a solid position alongside other fundamental investment approaches. This trend is based on an increased level of acceptance about the investment merits of responsible investing, and an interest in applying its principles to more diverse asset classes, including fixed income and infrastructure.

The survey data hints that, while adoption of ESG investing principles has been increasing steadily in recent years, this trend has the potential to accelerate further as longstanding barriers to more widespread adoption, such as concerns that incorporating ESG principles could hurt returns or conflict with fiduciary duties, fall away.

The survey also demonstrates that responsible investing is solidifying its position not only in the minds of institutional investors but in the minds—and strategies—of investment consultants. And while ESG skeptics remain, their ranks are shrinking rapidly, particularly in the United States.

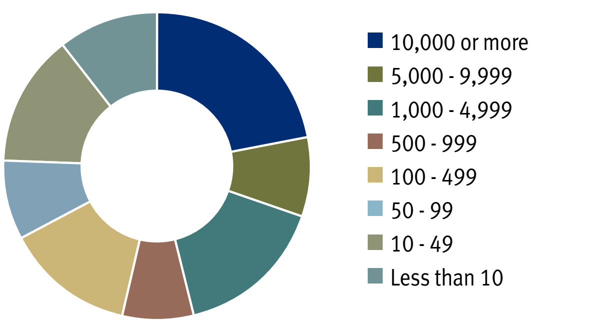
Offering a clearer view into specific responsible investment themes, the survey shows that impact investing and gender diversity continue to rank high on investors' priority lists. At the same time, investors report little satisfaction with the quantity and quality of information from companies on issues such as sustainability and governance. And if anything is holding back greater adoption of ESG-integrated investing by institutional investors, it's a lack of resources needed to do the work necessary to make it happen.

Survey Reflects a Broad Cross-Section

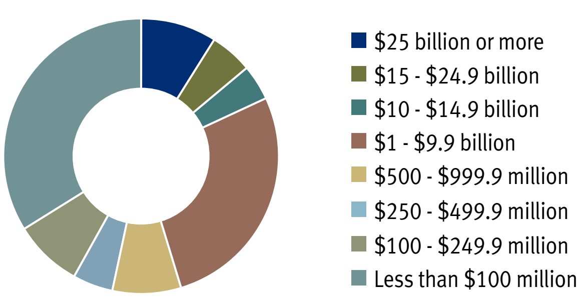
The 2018 RBC Global Asset Management Responsible Investing Survey drew responses from more than 540 participants around the world, including the US, Canada, Europe and Asia. Respondents come from all corners of the investment business.

Nearly 150 of the respondents represent organizations with $1 billion to $9.9 billion in assets and a similar number from organizations with more than $10 billion. A fifth of the respondents work at organizations with 10,000 or more employees, while the survey also encompasses smaller family offices and Registered Investment Advisors. More than 50 consultants were included to give a better sense of how they are integrating ESG principles into manager selection.

Please estimate the number of employees in your entire organization, that is, the total in all plants, divisions, branches, subsidiaries - national and international.



Which of the following best represents the current total pension retirement assets of your organization? Endowments and foundations please indicate total fund assets.



What is the primary structure of your employer's business?

	Overall %
Pension Plan Sponsor	14.6
Consulting Organization	11.8
Foundation, Non-Profit, Charity	11.3
Government Organization	7.9
Wealth Management/Wealth Platform	7.6
Educational Institution/Endowment	7.2
Investment Manager	7.2
Non-Financial Corporation	6.8
Insurance Company	5.5
Union	3.9
RIA	3.3
Family Office	1.1
Financial Planning Firm	0.7
International Organization/IMF/World Bank/Development Bank	0.4
Other Asset Owner	2.0
Other Consultant, Advisor, Professional Service Provider to Asset Owner	4.2
Other	4.4

Responsible Investing Goes Mainstream

In 2017, RBC Global Asset Management's annual global survey of institutional investors and consultants found that a majority of respondents incorporate ESG factors in their investment approach. The 2018 survey shows a strong uptick in adoption as past resistance is diminishing.

The 2018 survey found that at a global level, 72% of respondents either somewhat or significantly use ESG principles as part of their investment approach and decision making, up from 66% last year. The percentage of respondents who do not adopt ESG principles at all fell globally to 28%, down from 33% in the 2017 survey.

Institutional investors in the US continue to view the application of ESG principles more cautiously, but the percentage who reject ESG outright shrank dramatically year over year, from 51% to 34%. The fact that the number of respondents who do not apply ESG principles fell by a third indicates that resistance is rapidly eroding at the same time that significantly more investors are adding elements of responsible investing to their toolkits.

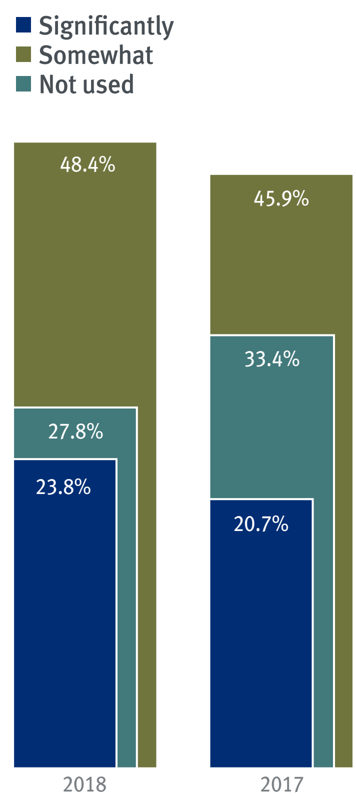
Continental Europe has long led the movement toward responsible investing, and that trend continues according to the survey data. Forty-seven percent of respondents from Europe (excluding the UK) said they used ESG factors significantly in their investment process. In the UK, 29.5% of respondents said they used ESG significantly, followed by 20.5% in Canada and 18% in the US. Investors in Asia lagged on this metric.

Importantly, investment consultants appear to be endorsing responsible investing in greater numbers, with most saying that over the coming year, they expect to increase allocations to managers who incorporate ESG factors into their investment process.

72%

of respondents either somewhat or significantly use ESG principles as part of their investment approach and decision making.

Exhibit 1: To what extent are ESG principles used as part of your investment approach and decision making?



Performance: Now a Selling Point

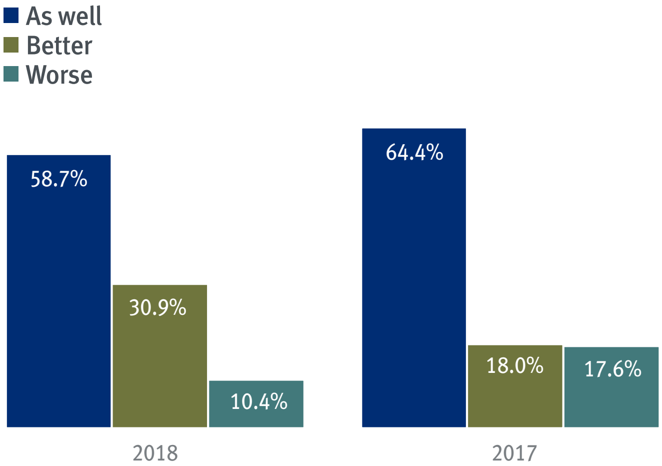
Investment performance has long been a primary concern of institutional investors considering the adoption of ESG principles. In last year's survey, more than 80% of consultants said clients asked whether ESG would hurt investment returns, by far the most common client question they reported.

Those worries appear to be subsiding. When asked how they believe an ESG-integrated portfolio is likely to perform relative to a non-ESG-integrated portfolio, nearly a third (31%) of investor respondents in this year's survey said the former would perform better. (Last year, only 18% reported that viewpoint.) And on the flipside, the proportion of investors who believe an ESG-integrated portfolio is likely to underperform dropped from 17% last year to 10% this year. A key signal of acceptance is the 59% of respondents who believe the two portfolios would generate equal performance; that response rate narrowed from 64% in 2017, as more investors migrate to the belief that ESG integration will produce tangible investment benefits.

90%

of respondents believe ESG-integrated portfolios are likely to perform as well or better than non-ESG-integrated portfolios.

Exhibit 2: How do you believe ESG-integrated portfolios are likely to perform relative to non-ESG-integrated investments?



A dramatic shift in attitudes toward ESG analysis is visible among US institutional investors, as 24% now say they believe an ESG-integrated portfolio would outperform its counterpart, nearly five times the percentage in last year's survey. About 18% of US respondents still believe the ESG-integrated portfolio would perform worse, but that negative sentiment is down from 26% in the 2017 survey.

One of the key issues in the responsible investing debate is whether ESG analysis should be considered a source of alpha. The latest data shows strengthening conviction among institutional investors that ESG is in fact an alpha source, although a significant amount of skepticism remains. A full 38% of 2018 survey respondents believe integrating ESG factors can help generate alpha – nearly double the percent who said last year that they think of ESG as an alpha source. Notably, US investors reported sharply higher confidence in 2018, with 39% now saying ESG analysis generates alpha, more than double last year's 17%. As the US has been one of the biggest holdouts against wider adoption of ESG principles, this increase is a meaningful indication that opposition is eroding. In Canada, 30% of respondents now say ESG can generate alpha, up from 21% last year. This sentiment was also strong in the UK but less so in Asia.

On the other hand, the level of uncertainty about ESG's merits as an alpha source remains strong: 42% of respondents continue to say they aren't sure. This uncertainty was highest in Canada (49%), followed by the UK (43%), Europe (35%) and the US (33%).

The other side of return is risk, and most respondents, by a wide margin, think ESG can help mitigate risk in a portfolio. Overall, 67% of respondents view ESG as a risk mitigator, 14% do not, and the remaining 19% aren't sure. That's a dramatic change from 2017, when only 48% of respondents said they thought ESG could help mitigate risk in a portfolio, and 32% didn't think so. Once again, the data shows strengthening confidence in ESG analysis as a tool for improving portfolio performance.

Breaking these numbers out by region again shows dramatic changes in how institutional investors in the US think about the impact of ESG. In 2017, just 28% of respondents said they thought ESG could be a risk mitigator; this year, that number climbed to 54%. The number of US respondents who said no nearly halved: to 24% this year from 50% last year. In Canada and Europe, the percentage of investors who believe ESG can mitigate risk also increased over last year, but the trend is less dramatic.

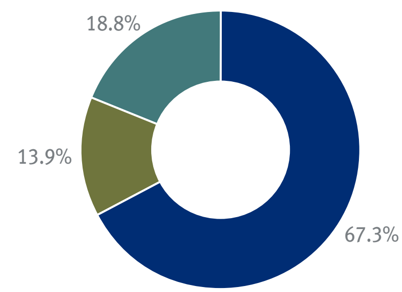
67%

of respondents said they believe that integrating ESG factors can help mitigate risk.

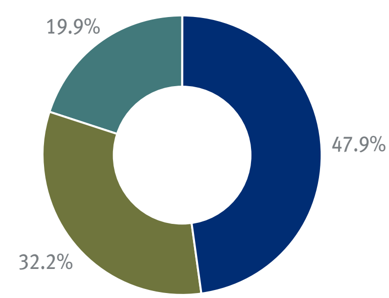
Exhibit 3: Do you believe that integrating ESG factors can help mitigate risk?

- Yes
- No
- Not sure

Total Respondents - 2018



Total Respondents - 2017



Fiduciary Responsibility: From Barrier to Catalyst?

Along with questions of return and risk, a pressing question on institutional investors' minds is fiduciary duty. Here the 2018 survey reveals a startling turnaround. More than half of all respondents who incorporate ESG factors into their investment approach now say that doing so is part of their fiduciary duty, double last year's level. Combined with the increasing conviction that ESG factors will lower risk and increase returns, this suggests the majority of institutional asset owners and those responsible for guiding investment strategy no longer approach ESG as a public relations or marketing exercise, but rather as part of their fiduciary responsibility.

Two other common reasons for applying ESG principles – mandates from boards or stakeholders and inclusion in investment guidelines – held steady year-over-year, with about one-third of all respondents citing them as reasons.

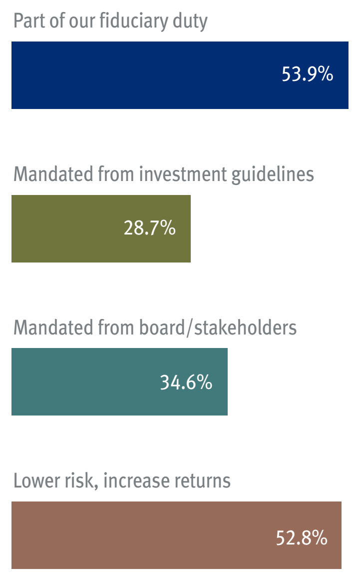
There is evidence that leadership thinking among institutional investors is changing: a year ago, more than 50% of respondents who were not incorporating ESG analysis into their investment decision-making attributed it to lack of demand from their boards or stakeholders. This year, more than a third of respondents who are using ESG principles cited board and stakeholder requirements as the reason, while another 29% said ESG was built into their investment guidelines. These percentages were consistent across the US, Canada and Europe, illustrating how ESG is becoming more integrated into the investment process.

54%

of respondents said they believe integrating ESG factors is part of their fiduciary duty.

Exhibit 4: What are your reason(s) for incorporating ESG in your investment approach?

All respondents



ESG Beyond Equities

Equities have long been the primary focus of ESG analysis and investing and that remains true among many institutional investors according to this year's survey: 84% of respondents who incorporate ESG factors into their process do so in equities. However, the survey also indicates that ESG analysis is moving beyond equities, as 60% of respondents incorporate it into their fixed-income portfolios, 43% with real estate, 36% with infrastructure and 34% with alternative assets.

Regionally, this pattern held steady, but applying ESG factors in infrastructure investing was particularly popular in Canada, the UK and Asia. And alternatives, which ranked fifth overall in ESG integration, came in third in the US behind equity and fixed income and ahead of infrastructure and real estate.

The growing integration of ESG principles into fixed-income management should perhaps be no surprise, since in 2017, 43% of investors said it was important to incorporate ESG into fixed-income, including 30% in the US, 50% in Canada and 72% in Europe. This year, asked directly whether they incorporate ESG into fixed-income management, 52% of US investors who use ESG said yes, compared with 64% in Canada and 73% in Europe.

To gain further insight into how institutional investors view the importance of ESG in fixed-income management, we asked whether ESG should be integrated into both equity and fixed-income portfolios. Roughly half said yes, including 42% in the US and higher percentages in Europe and Canada. Another 35% said both were important but ESG was more material for equities.

These numbers suggest that while more institutional investors believe ESG factors can be important in fixed-income portfolio strategies than don't, a healthy percentage of investors remain less than fully convinced.

Here, the data points to a particular problem (or opportunity): while institutional investors see value in incorporating ESG into fixed-income strategies, many do not think there is enough product on the market. Forty-three percent of respondents said there were not enough fixed-income product offerings that incorporate ESG factors, and nearly the same number said they weren't sure. Just 14% said they thought there was enough product in the market. These results were consistent across the world, although more Canadian respondents were not sure. Whether this is truly an issue of available product or merely one of investor perception, it appears there is work to do by investment managers who are active in this space.

In terms of issuers of fixed-income securities, institutional investors believe ESG factors have the most materiality for either corporations or a combination of corporations and sovereigns. Roughly one-third of respondents cited these two groups.

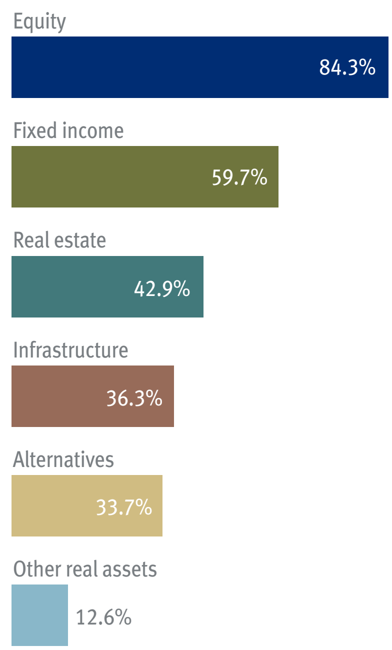
ESG analysis is moving beyond equities, as

60%

of respondents incorporate ESG factors into their fixed-income portfolios.

Exhibit 5: For which of the following asset classes do you incorporate ESG factors into the portfolio management process?

All respondents



Engagement vs. Divestment

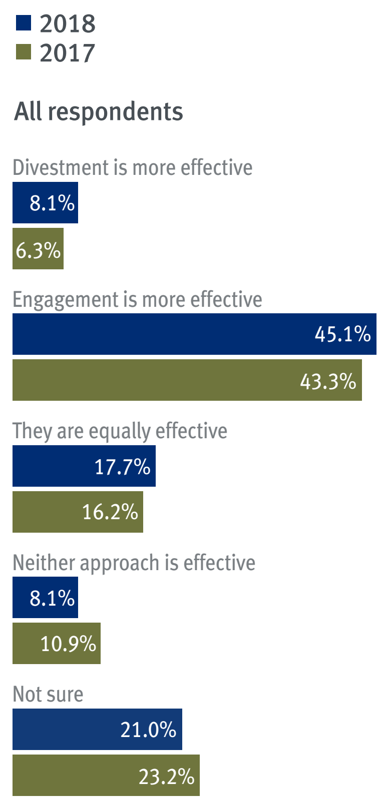
As responsible investing has developed, the discussion about how to apply the principles in a portfolio has evolved from negative screens (often excluding so-called 'sin' stocks such as alcohol, tobacco and firearms companies) to a range of approaches that are more nuanced and more multi-faceted. Discussions about exclusion have in many cases evolved and now encompass a range of different approaches to responsible investing. Indeed, when we asked if respondents required asset managers to apply socially responsible screens to portfolios, 76% of survey respondents said no. Resistance to such screens was higher in North America and the UK, where no more than 20% of respondents use screens, versus about half in Europe. Among those who do screen, companies associated with cluster munitions and landmines were the most likely to be excluded, at 75% (96% in Europe), followed by weapons generally (66%), tobacco (60%) and fossil fuels (42%). The interest in screening out fossil fuels exposes some pointed differences by region: fossil fuel screens are unpopular in Canada (23%) while in the US they are among the most widely used screens (62%) – in line with weapons and tobacco, and even slightly ahead of cluster munitions. In the UK, screens are more broadly across the board.

Corporate engagement is becoming more prominent in responsible investing. When asked in the context of the Fossil Fuel Free movement whether it was more effective to divest or engage, for example, 45% of the 2018 survey respondents said engagement is more effective. This response marks the second year in a row that investors came down squarely on the side of engaging in dialogue with companies instead of simply selling their shares. Only 8% of respondents favor divestment, with the balance (18%) saying both approaches are equally effective.

Investors also strongly support greater shareholder involvement in improving ESG-related disclosure, with 46% of respondents saying shareholders should take the lead in this area, ahead of government regulators (27%), industry groups (17%) and stock exchanges (5%). Support for shareholder involvement strengthened from last year and is particularly robust in the US, where 52% of investors favor it, compared with 43% last year.

This is the second year in a row that investors came down squarely on the side of engaging in dialogue with companies instead of simply selling their shares.

Exhibit 6: In the Fossil Fuel Free context when thinking about ESG investing, do you consider divestment to be more effective than engagement?



Gender Diversity: Market Forces are Not Enough

A large majority of institutional investors continue to believe that it is important to bring gender diversity to corporate boards. Globally, in both 2017 and 2018, about three quarters of investors said board-level gender diversity was important. The US saw a notable spike in this view, rising from 71% last year to 84% this year (on par with the UK).

This year, among investors who favor greater gender diversity, the No. 1 method for achieving it was shareholder action, cited by 42% of those respondents. This response replaced "market forces," the top choice last year, which fell from 43% support to 36% in 2018. In both years, relatively few investors cited government intervention as a good way to increase gender diversity on boards.

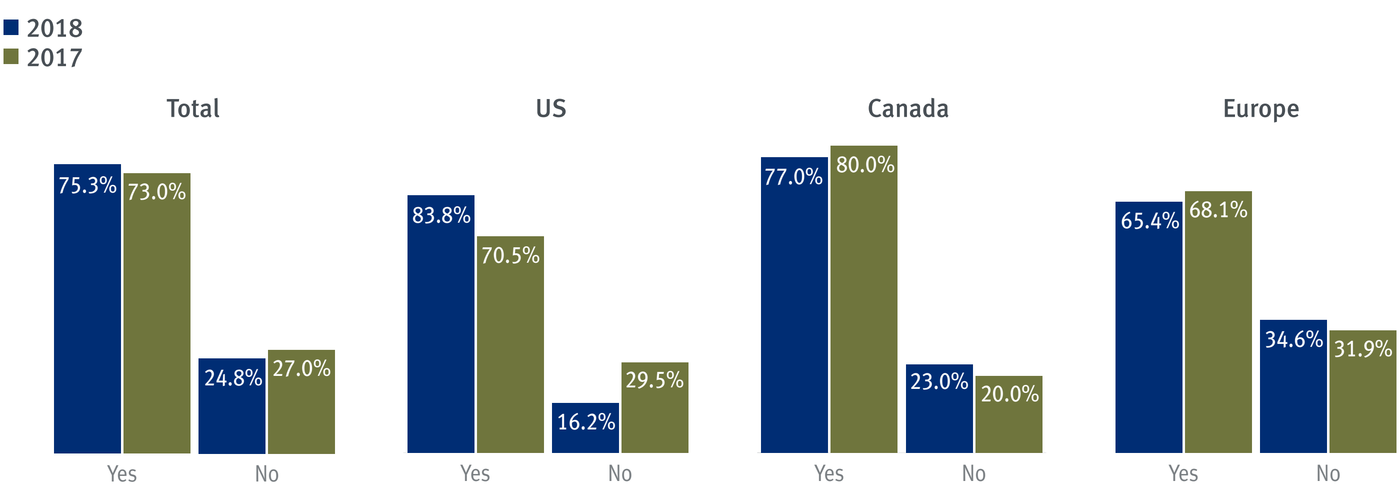
This change in focus, particularly in the US, raises an interesting chicken-and-egg question: did respondents place a higher value on shareholder action to achieve gender diversity following several high-profile proxy campaigns (not to mention the #MeToo movement and spate of high-profile scandals over the past year) or does it reflect a long-term shift in investor thinking?

Most investors responding to the survey – 63% – believe non-binding diversity targets would be reasonable for boards to adopt; 26% of those respondents said a reasonable diversity target would be 31-40%. The second most cited target range was 21-30%, cited by 17% of respondents, while 15% of respondents would like to see a target of more than 40%. However, the sentiment was by no means universal: 37% of respondents said board diversity targets should not be adopted.

75%

of respondents believe that gender diversity on corporate boards is important to their organization.

Exhibit 7: Is gender diversity on corporate boards important to you/your organization?



Impact Investing: Interest Grows Despite Uncertainty

Impact investing continues to capture the attention of some institutional investors, though it still lags ESG integration as a broadly accepted responsible investing strategy.

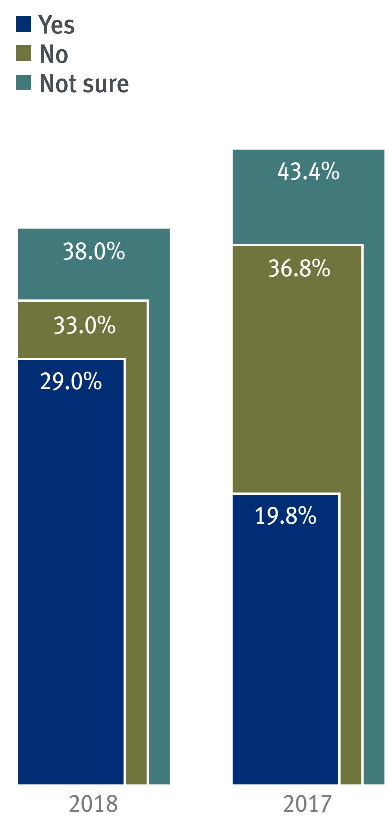
In 2017, nearly 20% of survey respondents said they expected to allocate funds to impact investing in the next one to five years. This year, that level of intent rose to 29%. At the same time, the number who said they were not planning such a move dropped to 33% from 37% in 2017. A key metric here is the large percentage of respondents (38%) who are unsure about their plans when it comes to impact investing (although this declined from 43% last year).

Asked this year if they held any impact products in their portfolio, 26% said yes and 51% said no, a proportion that held across the US, Canada and Europe. Another 23% of respondents weren't sure whether they held impact investments at all. So while a growing percentage of institutional investors are taking a close look at impact investing or getting ready to add such products to their portfolios, the category is dogged by a substantial knowledge deficit.

29%

of respondents said they expected to allocate funds to impact investing in the next one to five years.

Exhibit 8: Do you expect to allocate funds to impact investing as opposed to ESG/ SRI in the next 1-5 years?



Mind the (Data) Gaps

Without relevant data, of course, investors can't implement effective responsible investing policies. Over the last few years, while more companies have recognized the importance of providing ESG-related information to investors, they have yet to reach the point where investors are satisfied with the information. The industry is moving in the right direction, albeit slowly.

In the 2018 survey, institutional investors were asked to rate the quantity of data available on a scale of zero to five, with five being very satisfied and zero being not satisfied. A plurality (40%) landed roughly in the middle, indicating some level of satisfaction. But combining the top two levels showed a response rate of just 8%, suggesting that not many investors are especially satisfied with the level of disclosure. On the other end, 22% of respondents report being dissatisfied. These numbers were largely consistent across geographies.

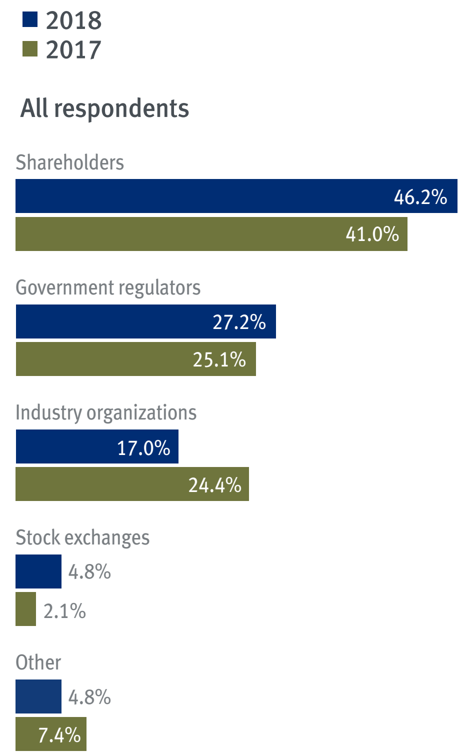
It seems that the level of dissatisfaction and the level of satisfaction are both down from last year. When the question of disclosure was asked in 2017, respondents had a five-point scale to judge their level of satisfaction with companies' ESG disclosure. About thirty-three percent of respondents last year, on a net basis, were dissatisfied with disclosure, while about 26%, also on a net basis, were satisfied.

Relatedly, and unsurprisingly, investors remain likewise unsatisfied with the quality of the ESG-related information that companies disclose. A plurality of investors – 44% of respondents – report being at least somewhat satisfied this year, ranking their satisfaction a 3 or better on the 0-5 scale. But fewer than 7% of investors rated their satisfaction as a 4 or 5, suggesting more work needs to be done. At the other end of the scale, a combined 24% of investors marked either zero or one — either not satisfied at all or barely satisfied. These numbers were consistent across regions.

46%

of respondents believe that shareholders should take the lead in influencing companies to provide better ESG-related information.

Exhibit 9: In your opinion, who should take the lead in influencing companies to provide better ESG-related information?



Consultants Embrace ESG

Investment management consultants have largely accepted the importance of adding ESG principles to their portfolio management mix, with 77% reporting they employ external managers who incorporate ESG factors into their processes. That represents a considerable strengthening from last year's survey, when 54% of respondents said they expected to routinely use ESG as a material criterion for selecting managers in the next 1-3 years, but only 15% considered it a primary criteria.

Consultants who exclusively employ managers that incorporate ESG factors remain in the minority. Globally, only 18% of consultants report that they use ESG-oriented managers for all mandates, with that percentage plunging to 9% in the US, compared with 24% in Canada and 29% in Europe. All of the European respondents said they select at least some ESG managers, versus 82% in the US and 62% in Canada. And as many consultants said they weren't sure whether they selected ESG managers – 11% overall – as those who definitively answered no.

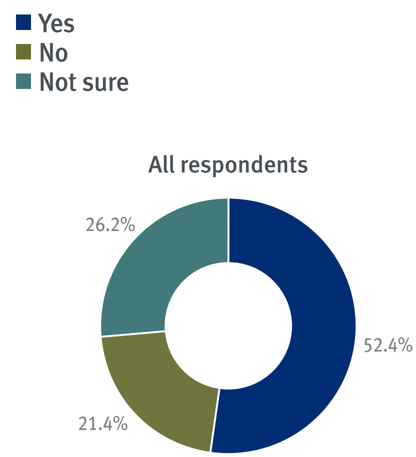
For investment managers that apply ESG principles in their investment process, the survey results suggest there are still significant opportunities to inform consultants about their investment approach.

And there is clearly a strong appetite for better data and reporting on ESG performance and compliance. If more than 10% of investment consultants don't know whether their external managers integrate ESG into their portfolios, clearly a data gap persists.

77%

of consultants responded that they employ external managers who incorporate ESG factors into their investment processes.

Exhibit 10: Over the next year, do you expect to increase your allocation to managers that incorporate ESG factors into their portfolio management process?



Conclusion

Last year's RBC Global Asset Management Responsible Investing survey showed that institutional investors around the globe were adopting ESG principles in greater numbers. This year's survey affirms that trend and reveals that the remaining barriers are mostly logistical, not philosophical. Institutional investors, boards of directors and stakeholders increasingly understand the value of ESG analysis and are increasingly demanding it be incorporated into the investment process. In fact, feedback from consultants and investors suggests ESG is increasingly considered part of an investor's fiduciary duty.

But even as the application of ESG principles expands, investors are running up against lingering barriers including a lack of internal resources, a need for more responsible investment products and better data to verify performance and compliance. As the industry shifts from a position of "whether" to "how," further adoption of ESG principles will hinge on filling these gaps. Respondents cite lack of resources as the No. 1 reason for not following ESG principles, for example. That could reflect both a lack of human capital and expertise to evaluate responsible investment options and a lack of information to help those professionals do their jobs.

The survey also uncovered a gap between what institutional investors want and what they are getting in ESG-incorporated fixed-income; this is important given the vast amounts of institutional assets invested in fixed-income solutions. The survey also found lingering flaws in the understanding of impact investing, where many investors were not sure whether or not they held impact investments.

Perhaps reflecting broader societal shifts, three-quarters of investors following ESG principles favor gender diversity on corporate boards and using shareholder pressure to achieve it. Yet there is no consensus on the importance of the issue, or on how to achieve it.

So while responsible investing clearly remains on a strong upward trend, the gaps in information and resources revealed in this year's survey illustrate that there is more to be done in the effort to build a fully functional, efficient and transparent market around ESG investing that meets the needs of institutional investors and the consultants and managers that serve them.

Methodology

- RBC Global Asset Management (RBC GAM) and BlueBay Asset Management LLP in partnership with Pensions & Investments developed a survey of 23 questions around the topic of responsible investing.
- The survey was distributed during the months of June and July of 2018 to institutional asset owners, consultants, clients, P&I Advisory Panel members, and members of the Pensions & Investments database throughout Canada, Europe, Asia and the United States.
- Signet Research, Inc. collected and analyzed the results of 542 respondents and determined that the findings from the survey could be accepted as accurate at a 95% confidence level within a sampling tolerance of approximately +/-4.2%.

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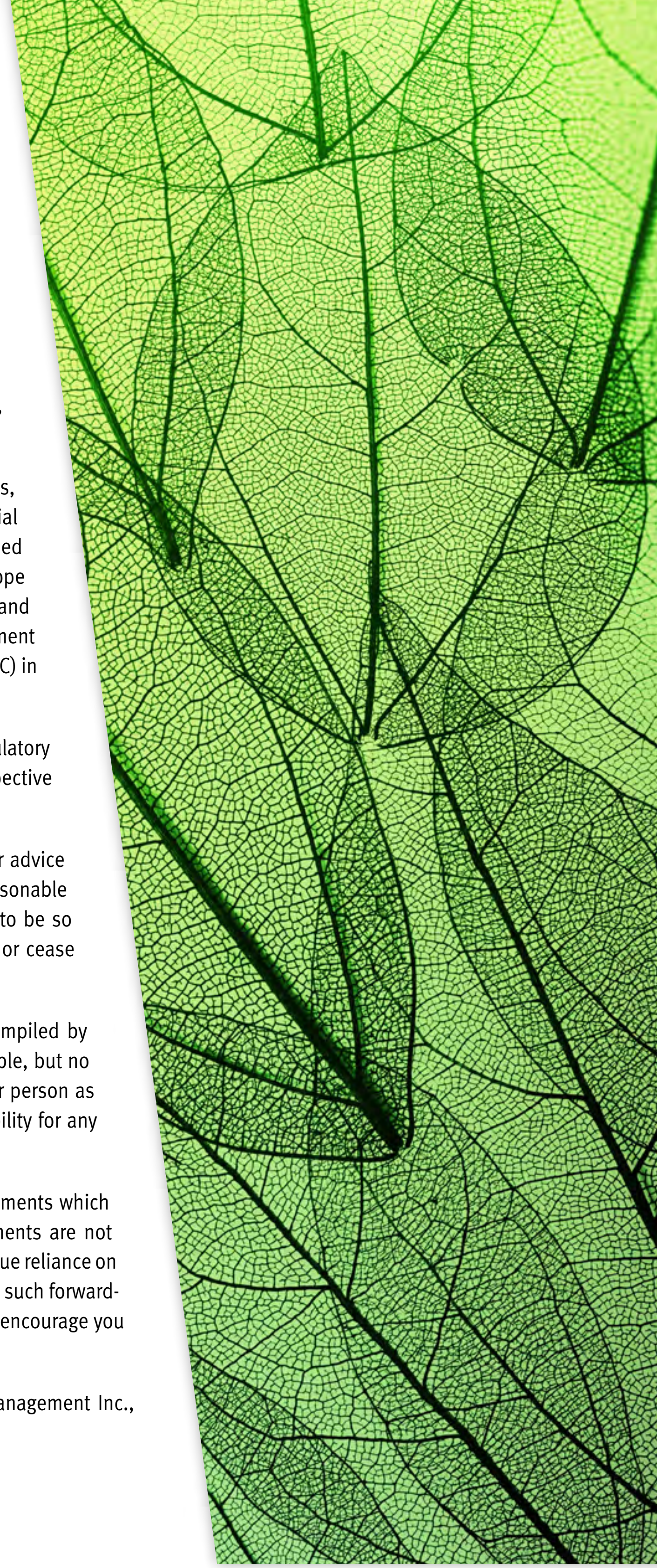

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