RBC Global Asset Management

ESG in a pandemic world

Executive summary

Responsible Investment Survey 2021

Definitions:

Responsible Investment:

An umbrella term describing the broad range of approaches that can be used to deliberately incorporate environmental, social and governance (ESG) considerations into the investment process

ESG Integration:

The systematic integration of material ESG factors into investment processes

Socially Responsible Investing (SRI):

The application of positive or negative screens to include or exclude potential investments based on a defined set of values

Impact Investing:

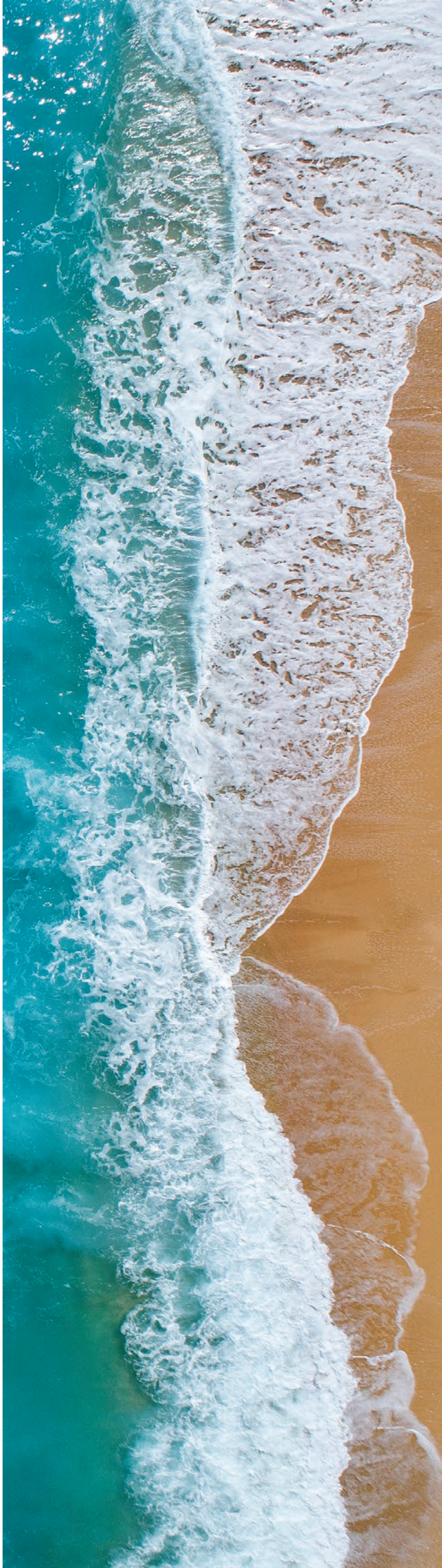
Investing with the intent to generate a measurable positive social or environmental impact

Thematic Investing:

Investing with a focus on broader, macroeconomic ESG themes

Engagement:

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



Demographics

Survey reflects a broad cross-section

The 2021 RBC Global Asset Management Responsible Investment Survey was answered by over 800 participants from around the world, including the U.S., Canada, Europe and Asia. Respondents come from all corners of the investment business.

Nearly 45% of the respondents represent organizations with $1 billion or more in assets with the highest number, or 20%, coming from organizations with $1 to $10 billion in assets. Nearly one fifth, or 17%, of the respondents work at organizations with 10,000 or more employees, while a quarter, or 24%, are from much smaller firms of less than 50 employees.

Which of the following best represents the current total pension retirement assets of your organization?

$25 billion or more	15%
$15 - $24.9 billion	6%
$10 - $14.9 billion	4%
$1 - $9.9 billion	20%
$500 - $999.9 million	7%
$250 - $499.9 million	7%
$100 - $249.9 million	7%
Less than $100 million	17%
Not applicable	17%

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

10,000 or more	17%
5,000 - 9,999	10%
1,000 - 4,999	15%
500 - 999	5%
100 - 499	16%
50 - 99	7%
10 - 49	11%
Less than 10	13%
Does not apply	6%

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

Pension plan sponsor	14.4%
Government organization	12.4%
Foundation, non-profit, charity	10.2%
Non-financial corporation	9.6%
Consulting organization	8.7%
Investment manager	8.7%
Educational institution/endowment	7.0%
Other	5.0%
Wealth manager/wealth platform	4.5%
Other consultant, advisor, professional service provider to asset owner	4.3%
Union	3.7%
Broker/dealer	2.7%
Registered investment advisor	2.6%
Insurance company	2.5%
Family office	2.0%
Other asset owner	0.9%
International organization/IMF/World Bank/ Development Bank	0.5%
Financial planning firm	0.4%

Key highlights

Adoption of ESG principles remains at peak levels: 72% of global investors integrate ESG principles in their investment approach and decision-making.

Europe continues to outpace the rest of the world in ESG adoption, with 96% of respondents in Europe saying they use ESG in decision making; Canada shows a softening with 81% in this category, down eight points from last year; and in the U.S., the level of respondents saying they use ESG in decision making has remained in the 64% to 66% range for three consecutive years, indicating a potential plateau.

A select group of respondents (29%) who placed more importance on ESG considerations due to COVID-19 show the greatest conviction on ESG principles – they are significantly higher than the norm in maintaining that ESG helps to improve returns and lower risk and that ESG-integrated portfolios perform better than non-ESG-integrated portfolios.

This year, 83% of global investors said ESG-integrated portfolios are likely to do as well or better than non-ESG-integrated portfolios, about the same as last year. Almost all European investors (97%) believe ESG-integrated portfolios perform as well as or better than non-ESG-integrated portfolios. Three-quarters of U.S. investors feel the same, and of the remaining quarter of U.S. investors, most believe ESG-integrated portfolios will do worse than non-ESG-integrated ones.

There may be a slight waning of the impact of the pandemic as a responsible investment issue, as just over a quarter of investors said the pandemic has made them focus more closely on specific ESG factors, versus 36% last year. The top three ESG factors respondents were most closely focused on were climate risk, cyber-security & data privacy, and supply chain risk.

When it comes to ESG concerns overall, the top three issues selected by global investors were: anti-corruption, cyber-security, and climate change, in that order. Other areas of interest included shareholder rights/voting and water.

Diversity issues and metrics garnered a mixed reaction, with a softening in conviction about the value of minority and gender diversity targets on corporate boards by respondents in the U.S. and Canada, while there was continued strong support in both Europe and Asia for these targets as well as for more diversity, equity and inclusion (DEI) and ESG-related disclosures overall.

In a world that has continued to see-saw in an uneven recovery from the impact of the COVID-19 pandemic, ESG adoption by global institutional investors this year has remained close to its peak level of last year, according to the 2021 RBC Global Asset Management Responsible Investment Survey.

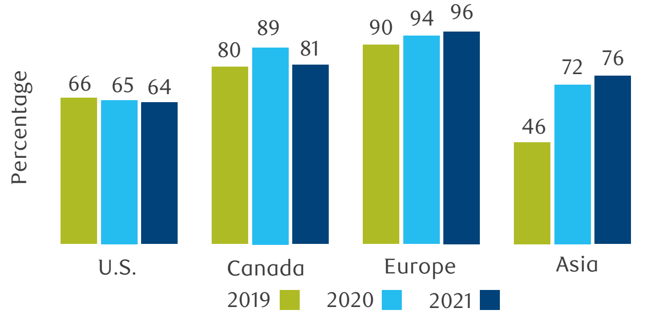
The growth trajectory in ESG adoption has leveled off, with 72% of global respondents this year saying they use ESG principles in their investment approach and decision making, versus 75% in 2020 and 70% in 2019.

Europe is the clear leader in ESG adoption, with 96% of respondents using ESG in their investment approach, up from 94% in 2020. In contrast, the U.S. remains the laggard, with 64% of respondents using ESG, which is relatively consistent with the 65% and 66% of respondents from the prior two years.

A strong majority of Canadians are adopting ESG; however, there was a slight reversal this year, as 81% of respondents said they used ESG principles, down from 89% last year. The potential softening in Canada is also referenced this year by less conviction that ESG principles can mitigate risk (80% of respondents versus 87% last year) and that it can help to generate alpha (63% of respondents versus 70% last year).

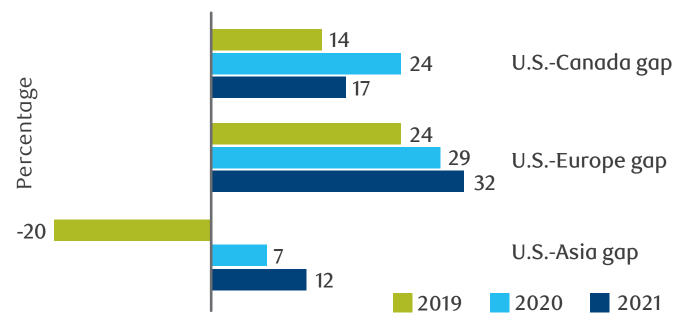
Asia showed a relatively steady level in ESG adoption, with 76% respondents using ESG principles in 2021 compared to 72% respondents last year.

Institutional investors who use ESG factors



ESG factors used significantly or somewhat as part of investment approach and decision making

U.S. investors lag global peers in ESG adoption



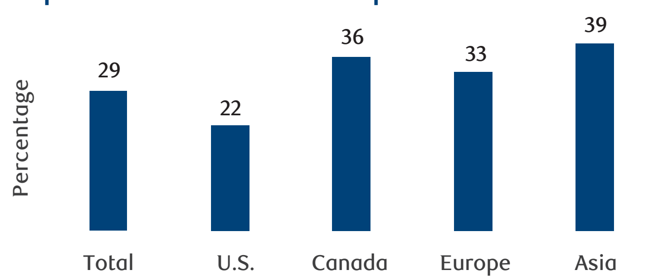
Percentage difference of investors who use ESG factors significantly or somewhat in their investment approach and decision making

A select group with greater conviction

A significant group of global investors (29%) in the survey said they had increased their emphasis on ESG considerations as a result of the COVID-19 pandemic.[1] Regionally, that group was most prominent in Asia and least prominent in the U.S.

This group belongs to companies that manage significantly larger pension portfolios: an average of over $18 billion, compared to the $14 billion average for the overall group of respondents.

Institutional investors who increased their emphasis on ESG due to the pandemic



Global investors that increased their emphasis on ESG considerations due to the pandemic

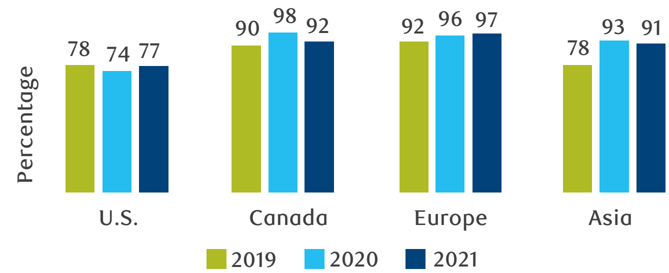
This group has the most vigorous supporters of ESG principles. It exhibited markedly higher ESG adoption (89%) versus the total group of survey respondents (72%). It also showed greater conviction on ESG-related investment merits: 80% believe ESG integration helps generate long-term sustainable alpha (versus 51% of the total group); and 88% believe that ESG integration helps mitigate risk (versus 61% of the total group).

The group also showed greater conviction for corporate board diversity: 56% of them said boards should adopt minority targets – a 15-percentage point increase over the 41% of the total group who supported this goal. Also, 39% of this group selected shareholder proposals as the way to achieve board diversity, versus 30% of the total group who selected this reason.

Conviction in ESG investment merits remains high, but wavers

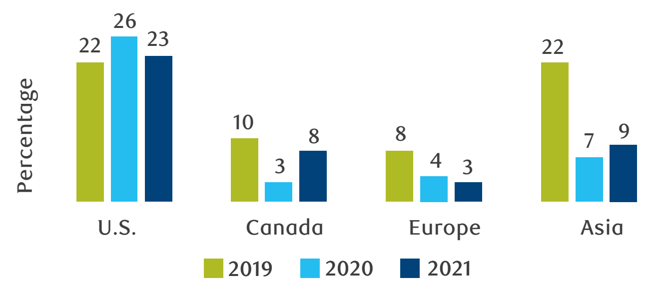
This year, 83% of global investors said ESG-integrated portfolios are likely to do as well or better than non-ESG-integrated portfolios, about the same as last year. That number was 97% for the select group of investors who said they had increased their emphasis on ESG considerations as a result of the pandemic.

ESG portfolios will do as well or better than non-ESG portfolios



Global investors who said ESG portfolios will perform as well as or better than non-ESG portfolios

ESG portfolios will underperform non-ESG portfolios



Global investors who said ESG portfolios will perform worse than non-ESG portfolios

Europe far outpaced the rest of the world in this regard. In Europe, 97% of respondents said ESG-integrated portfolios are likely to perform as well or better, a response rate that was similar to last year. That position was held by 92% of respondents in Canada, 91% in Asia, and 77% in the U.S.

The overall belief that ESG-integrated portfolios will do better than non-ESG ones has retreated from peak levels: 35% of global investors held that sentiment this year, versus 43% last year. In Canada, this sentiment softened from last year but, at 41%, remains higher than the global average.

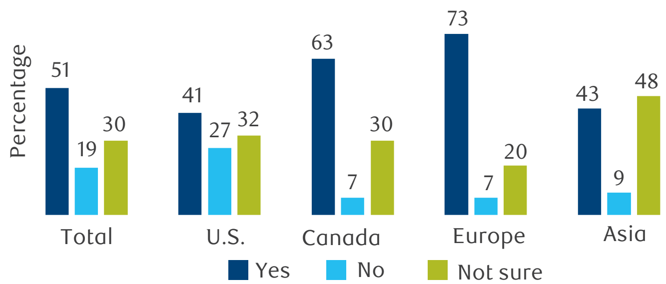
Also significant was that close to a quarter (23%) of U.S. investors believe ESG-integrated portfolios will do worse than non-ESG-integrated portfolios, compared to the single-digit percentages in this category for the other regions.

[1]This select group answered in the affirmative to the question, 'Has the importance you place on ESG considerations changed due to the COVID-19 pandemic?'

Serving risk-return objectives

When it comes to ESG's impact on performance, the overall sentiment was similar to last year. A slight majority, 51% of all respondents, said ESG factors can help generate long-term sustainable alpha, compared to 55% of all respondents in 2020. Both results far exceeded the 36% respondents with the same sentiment in 2019.

Can ESG-integrated portfolios help generate long-term sustainable alpha?

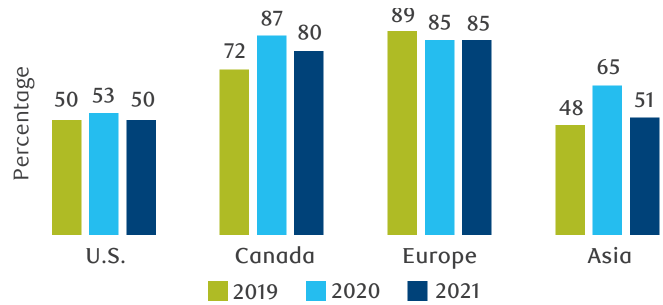


The largest number of proponents of the impact of ESG on performance were in Europe: 73% believe ESG-integrated portfolios generate long-term alpha. In Canada, 63% of respondents said the same. Asia and the U.S. lag in this regard, with 43% and 41% of respondents who agree on this issue.

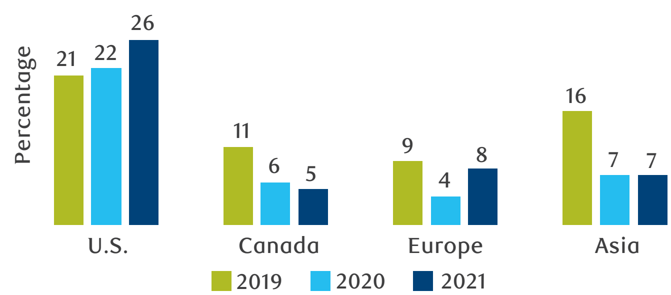
Overall, institutional investors in the undecided camp are about the same: 30% respondents this year are not sure if ESG factors can help generate long-term alpha, versus 28% last year.

ESG integration can help to mitigate portfolio risk, according to 61% of all respondents, compared to 67% last year and 58% in 2019. For the third year in a row, U.S. investors (50%) significantly trailed their European (85%) and Canadian (80%) counterparts in this view, which are relatively similar levels to last year. Asian respondents who said ESG can help mitigate portfolio risk dropped sharply by 14 points, to 51% this year, versus last year.

ESG-integrated portfolios can help mitigate risk



ESG portfolios cannot help mitigate risk



Why ESG?

Since 2018, institutional investors have cited two top factors – fiduciary duty and the belief that ESG integration helps lower risk and increase returns – as the reasons for incorporating ESG in their investment approach. Overall, 57% of global investors selected fiduciary duty (versus 58% in 2020), and 52% selected lower risk/increased returns (versus 56% in 2020).

Europe and Canada outpace the U.S. and Asia on both criteria. Fiduciary duty was selected by 77% of respondents in Europe and by 73% in Canada, versus 48% in the U.S. and 41% in Asia, Similarly, risk/return was selected by 63% of respondents in Europe and 62% in Canada, versus 46% in the U.S. and 55% in Asia.

Interestingly, a significant 45% of investors in Europe selected government regulations as a reason for incorporating ESG – the first time this was asked in the survey. Overall, 13% of global respondents selected this reason; 19% selected it in Asia, 6% in Canada and just under 6% in the U.S.

45%
of European investors said government regulations are a top reason for incorporating ESG in investment portfolios.

For the smaller pool of respondents who said they do not use ESG principles in their investment approach, the highest number of respondents (39%) said it was because it is not consistent with the fiduciary duty to maximize returns. This reason persists from prior years as the top reason for not using ESG, and more respondents cited this reason this year versus the 33% selecting it in 2020 and in 2019. As in prior years, the U.S. led (44%) on this criteria, followed by 29% in Canada and 14% in Asia.

Of the other reasons for not incorporating ESG, 36% of respondents in Asia said they don't believe ESG factors will materially impact investment returns, versus about a quarter of respondents in the U.S. and Canada. Europe had no nay-sayers to the use of ESG in their investment approach.

Top ESG concerns

The top three ESG concerns cited by respondents in 2021 were anti-corruption, cyber-security and climate change, in that order.[2]

Anti-corruption as a key governance issue continues to be the top priority, selected by 58% of respondents.

With the backdrop of recent headlines on data-hacking incidents and ransomware attacks around the world, **cyber-security**, as the second-highest priority, was selected by 56% of respondents. It ranked fourth last year, selected by 50% of respondents.

Climate change was the third-highest priority, selected by 55% of respondents, a similar level to last year when it was ranked second in priority.

[2] That is, respondents who selected levels 4 and 5, from a scale of 1 (immaterial) to 5 (it will make or break my investment decision) on each ESG theme.

The biggest movers on the list of 18 ESG concerns included:

Issues with increased interest this year:

- Supply chain risk (46% this year versus 40% last year)
- Cyber-security (56% this year versus 50% last year)

Issues with decreased interest this year:

- Health and safety (43% this year versus 49% last year)
- Workplace diversity (33% this year versus 39% last year)

Interestingly, for the select group of respondents who placed greater importance on ESG considerations due to the pandemic, the top ESG concerns were climate change (79%), anti-corruption (68%), and renewable energy (64%). This group also showed greater interest, by 10%+ more than the full group, in other environmental issues (water and land use).

In addition, far higher numbers of the select group who place greater importance on ESG as a result of the pandemic are concerned with social issues. For instance, 49% selected income inequality (versus 33% of the full group); 50% selected workplace diversity (versus 33%), 55% selected health and safety (versus 43%) and 50% selected community impact (versus 35%), suggesting higher and more committed interest overall in environmental and social justice issues.

Taking the regional view of top ESG concerns for the full sample of global investors, Europe continues to be more focused on climate change, with 85% saying it is a major concern; this was followed by 68% in Canada, 52% in Asia, and 44% in the U.S. Among the other environmental concerns, renewable energy was important for 46% of respondents, the same level as 2020. This year, renewables were a significantly higher concern in Europe (67%) and Canada (52%). Overall, for Canadian investors, environmental concerns were more significant than were the social and governance concerns.

When looking at social concerns, cyber-security was a bigger concern in Canada (62%) and Europe (63%) compared to the rest of the world.

Of the governance issues, Europe led the way with 76% of respondents selecting anti-corruption as a concern; that compared to 68% in Canada, 52% in the U.S., and 51% in Asia. Another key governance concern expressed by 50% of global respondents is shareholder rights/voting; that was also highest in Europe with 63% selecting this issue.

ESG focus separate from pandemic concerns

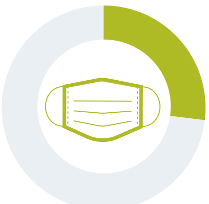
The overall reaction by institutional investors as to whether they place more importance on ESG considerations due to the COVID-19 pandemic has not shifted significantly. Just under two-thirds (62%) said the pandemic had no impact on the importance they placed on ESG considerations, versus 59% last year. The U.S. had the highest percentage (69%) of those saying the pandemic did not change how they viewed ESG considerations, compared with 59% in Europe, 57% in Canada, and 39% in Asia.

Similarly, 63% of global investors said the pandemic did not make them pay closer attention to any specific ESG factors, which is up seven percentage points from 2020. Almost three-quarters of U.S. investors (72%) said the pandemic didn't make them pay closer attention to specific ESG factors, compared with 58% in Europe, 54% in Canada and 37% in Asia.

Fewer global investors this year support the importance and need for corporate disclosure on a range of social factors since the start of the pandemic. Just 46% of respondents said the pandemic had made them think that companies should disclose more details about worker safety, employee health benefits, workplace culture and other social factors, and that companies should continue with these increased disclosures. That was a seven-percentage point drop from the 53% of respondents who said so last year. There was also a sharp bifurcation regionally, with Asia (69%) and Canada (61%) supportive of such disclosures versus fewer of those surveyed in Europe (46%) and the U.S. (36%).

A sub-set looks at specific ESG factors

Just over a quarter of global investors (27%) said the pandemic had made them examine ESG factors more closely, compared to 36% last year, which could indicate a waning of the impact of the pandemic as an investment issue. Notably, 35% of Canadian respondents said they paid closer attention to specific ESG factors due to the pandemic, compared to 27% in Europe and 21% in the U.S.



27%
of global investors said that COVID-19 had made them examine ESG factors more closely.

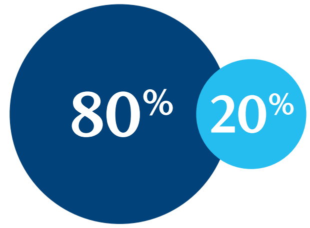
For this group of global investors who said the pandemic led them to examine specific ESG factors more closely, the top three factors were climate risk (52%), cyber-security and data privacy (42%) and supply chain risk (36%). In fact, these first two factors mirror the top ESG concerns of all global investors (see section below).

Climate risk as a top factor for this group rose 15 percentage points from last year. Canada led on this issue, with 70% who said they are paying closer attention to climate risk due to the pandemic, far higher than the U.S. (49%) and Europe (40%). For the U.S. respondents in this group, almost half selected climate risk and cyber-security as top factors, while a third selected supply chain risks and human capital development.

Climate is one of several issues

Despite climate risks dominating the ESG-related headlines, 60% of global investors said they do not address climate risk in their investment policy – which is similar to last year's response. Notably, 80% of European investors said they address climate risk in their investment policy – a 15 percentage point jump from last year. That compares to 32% in Asia, 31% in Canada and 20% in the U.S. who held that policy position this year.

Climate-related investment products are insufficiently available, according to 44% of global investors, with just 22% who said there are sufficient climate-related products while 34% were 'not sure'. A majority of investors in Europe (56%) and Asia (53%) believed there aren't enough climate-related products available, compared to 48% in Europe and 50% in Asia last year.



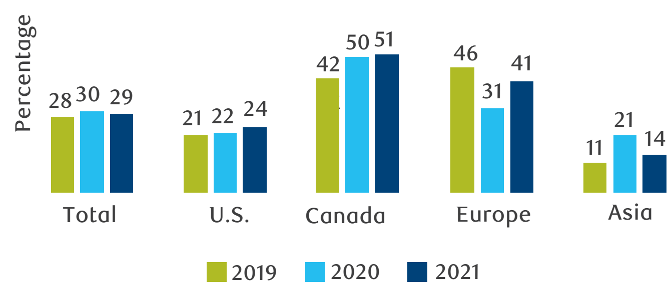
80% of European investors address climate risk in their investment policy versus **20%** of U.S. investors who address climate risk in their investment policy.

Portfolio management trends

For the third consecutive year, close to two-thirds of global institutional investors use active management in ESG-related portfolios, with 63% this year who said at least half their portfolio is actively managed (versus 66% in 2020) and 29% who said their entire portfolio is actively managed (in line with 2020).

Canada led the world on 100% actively managed ESG-related portfolios, with 51% of respondents who said they were in this category, versus 41% in Europe, 24% in the U.S. and 14% in Asia. Canada has led its global counterparts in 100% active management of ESG portfolios in two of the last three years.

Institutional investors with a 100% actively-managed responsible investing portfolio



The U.S. had the highest number of respondents (13%) saying their responsible investing portfolio is 100% passively managed, versus 10% for the global pool.

Engaging companies is preferable

By a four-to-one margin, global investors said that engagement (45%) is more effective than divestment (10%) when it comes to the climate-related challenge posed by fossil-fuels. That's up slightly from 43% in 2020 and 39% in the year prior.

Just under 16% of all respondents said that both approaches are equally effective. The largest group who said neither approach was effective was in the U.S. (16%) compared to 11% of all investors.

Europe and Canada continued to lead with 50% and 53%, respectively, in seeing engagement as more effective. They were followed by the U.S. (42%), and Asia (40%).

In addition, of the investors who said they placed more importance on ESG considerations due to COVID-19, just over half (54%) said engagement is more effective, 21% said engagement and divestment are equally effective, and just 3% said neither approach is effective.

Shift in focus for impact

Institutional investors' focus on impact investing has begun to wane across all regions. This year, 33% of investors said they planned to allocate funds to impact investing versus ESG or SRI in the next five years, down from 40% that said they would do so in 2020. Those on the fence or 'not sure' if they would allocate funds to impact investing rose to 41% this year, up from 31% in 2020.

Notably, Europe continued to lead on impact investing, with 59% who said they expect to continue with allocations in this space, down slightly from 63% last year.

Once again, there was stronger overall commitment from the group of investors who placed more importance on ESG considerations due to COVID-19: 57% said they'd allocate to impact investing versus ESG or SRI in the next five years.

Board diversity struggles to gain traction

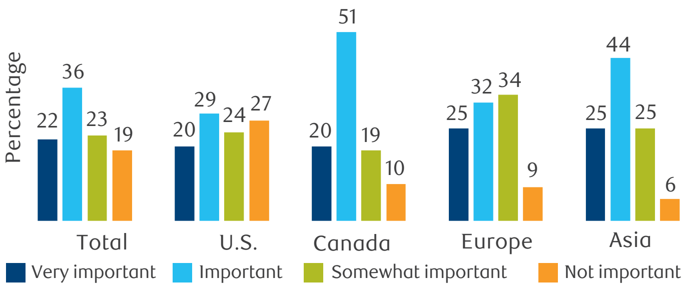
Some 41% of global investors said boards should adopt minority diversity targets, compared to 44% last year. At the other end, investors who said minority targets should not be adopted jumped to 35% this year, versus 28% last year. Those unsure of whether to adopt minority targets declined to 24% from 28% last year.

Notably, in the U.S., almost 40% of respondents said board minority targets should not be included, up from 31% last year.

In a similar trend on diversity targets for women on boards, 48% globally said that boards should adopt gender diversity targets, virtually unchanged from last year. Those opposed to gender diversity targets rose to 33% of all investors this year, versus 26% last year.

Europe and Canada had the strongest support for gender diversity, at 57% and 54% respectively. While Europe gained support compared to last year's 48% who supported gender diversity, Canadian support softened from the 60% who supported gender diversity last year. Gender diversity was favored by 41% of respondents in the U.S. and 49% in Asia.

How important is disclosure of diversity and inclusion policies for companies in which you are planning to invest?



Importance of disclosure of diversity & inclusion

Market forces is the preferred approach to have more diversity on corporate boards according to 37% of global investors. That was followed by shareholder proposals (30% of respondents) and government regulations (12% of respondents). But Europe and Asia were outliers, with 30% in each region who said that government regulations are the preferred approach to bring more diversity to boards.

Europeans were also far more likely (49%) to say that government regulators should take the lead in influencing companies to provide better ESG-related information. That was significantly higher than the 28% of global investors who wanted regulators to lead in this regard. Overall, 43% of global investors – and 47% in the U.S. – said shareholders should lead on providing better ESG information, similar to the 46% who said so last year.

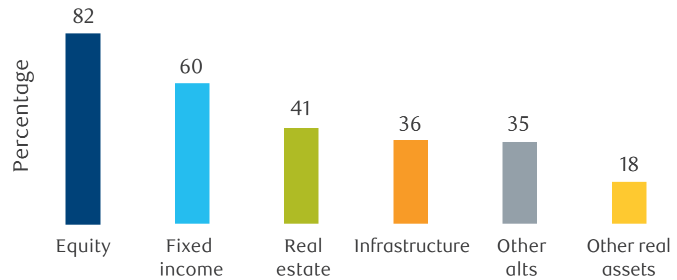
As far as more diversity-related disclosures by companies are concerned, U.S. investors have continued to show less support for such disclosures versus the rest of the world. At least a quarter (25%+) of U.S. respondents said it's not important to have corporate disclosure of DEI policies, diversity metrics, reports on racial- and gender-pay gaps, or corporate diversity targets. For all other regions – Europe, Canada, and Asia – all these types of diversity-related disclosures were considered important (defined by somewhat important, important, and very important) by at least 80% of investors – and closer to 90% on a majority of the disclosures.

Spotlight on equities

For the third year in a row, the vast majority (82%) of global respondents that use ESG principles employ them in equities, more than any other asset class. More than half (60%) incorporated ESG principles in fixed income, and less than half (41%) did so in real estate.

Regionally, the use of ESG principles in equities was highest in Canada (89%), followed by Asia (86%), Europe (85%), and the U.S. (79%). In fact, Canada had the most respondents who incorporate ESG in all asset classes except for the 'other alternatives' category where Europe had 44% respondents.

For which asset classes do you incorporate ESG factors into the portfolio management process?



Also, 41% of investors believed there are not enough fixed income products that incorporate ESG factors, and 45% said they are 'not sure' – similar to the levels on this issue last year. A third of investors (33%) said ESG issues are equally material to sovereign and corporate fixed income, with under a third (28%) saying ESG issues are more material for corporates – levels similar to prior years.

Consultants support ESG integration

A majority of consultants continue to use external asset managers who incorporate ESG factors in investment management, at 79% this year, which is in line with last year. Of those reporting, 62% use this criteria for some mandates (versus 65% last year) and there was a slight uptick in consultants who use this criteria for all mandates (17% versus 14% last year).

Of the combined consultants who use external managers with ESG integration for some or all mandates, 79% of them required regular reporting on ESG practices and integration (68%), proxy voting (57%) and diversity and inclusion (43%). While more consultants, across all regions, required reporting on these areas, there was one outlier: engagement activities, which was high on consultant priorities last year, fell by 20 percentage points to 30% this year. That may have occurred due to the lack of travel and shift to more virtual interactions in the past year, during the pandemic.

Closing comments

The 2021 Responsible Investing Survey uncovered a group of institutional investors who are paying increased attention to ESG consideration as a result of the on-going COVID-19 pandemic, and they are the most committed to ESG adoption globally.

The pandemic's impacts on governments, companies and individuals have been massive and sustained over a long period of time, with still no certainty of an end date. Among investors of all types, understanding of ESG and commitment to it appear to have grown across different dimensions.

Over the past five years, RBC GAM's Responsible Investment Survey data has reflected that a strong majority of institutional investors across the globe are convinced of the merits of ESG adoption, and are committed to incorporating ESG in their investment approach. However, there are many nuances and sub-themes within this overall trend that continue to evolve and that deserve ongoing analysis in the years to come.

Respondents' profile

The RBC Global Asset Management 2021 Responsible Investing Survey, conducted from May 11, 2021, through July 9, 2021, reflects the views of institutional investors and consultants globally. The U.S. accounted for over half (61%) of responses followed by Canada (16%), Europe (10%), and Asia (7%).

In total, the survey reflects responses from 805 survey participants. The findings of this survey may be accepted as accurate, at a 95% confidence level, within a sampling tolerance of approximately +/- 3.5%.

RBC Global Asset Management

For more information on RBC GAM and our approach to responsible investment, visit institutional.rbcgam.com/responsible-investment/our-approach

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