Schroders

Schroders Institutional Investor Study

Institutional perspectives on sustainable investing

2017

Contents

About this study

This study was commissioned by Schroders[1] to study institutional investors across North America, Europe, Latin America and Asia to analyse their attitudes towards sustainable investments, investment objectives and risk.

Respondents represent a variety of institutions, including pension funds, foundations, endowments and sovereign wealth funds.

The research was carried out via an extensive global survey during June 2017. The 500 institutional respondents were split as follows: 115 in North America, 200 in Europe, 150 in Asia and 35 in Latin America. Respondents were sourced from 15 different countries.

Executive summary

This study of 500 institutional investors globally finds that investing sustainably[2] remains a significant challenge for institutional investors globally, despite the majority recognising this approach will grow in importance over the next five years.

Performance, transparency and risk concerns were the main hurdles to sustainable investing, indicating that a large proportion of investors remain unconvinced about the merits of adopting a more sustainable investment approach.

These issues investing sustainably were particularly acute in Asia with 82% of assets owners reporting that this approach was challenging, compared to 69% in the United States. Globally, less than a quarter of investors (23%) said that investing sustainably was straightforward.

Specifically, just under half (44%) of investors globally cited performance concerns as an obstacle to investing sustainably, highlighting that many remain unconvinced of the long-term returns of this approach. Furthermore, a lack of transparency and reported data was flagged by 41% of investors, while the difficulty of measuring and managing risk was picked out by 28% of investors as a hindrance to investing sustainably.

This is despite a large proportion of investors (67%) acknowledging that investing sustainably will become increasingly important over the next five years. This sentiment was strongest in Latin America and Europe with 85% and 84% of investors respectively in these regions sharing this opinion.

At the other end of the spectrum however, 20% of investors globally stated that they did not believe in investing sustainably. Europe was the least sceptical region with this figure falling to 15%.

1 This study was undertaken by an independent research agency, CoreData Research.

2 Sustainability in this study was defined as a 'forward-looking, holistic approach to investment. There are various styles of sustainable investing, including full integration, exclusionary screening and best-in-class investing'.

The bigger picture

Institutional investor investment in sustainability has increased the world over. Globally, almost half (48%) say they've increased their allocation to this area over the past five years.

Evidence of the growing commitment to sustainability is the rising number of signatories to the UN Principles for Responsible Investment.

Launched in 2005, the six principles, which help guide investors to incorporate ESG issues into investment practice, now have 1,750 signatories, from over 50 countries, representing approximately US$70 trillion.

According to this study, the increase in sustainable investment jumps to 60% in Europe and drops to 33% in Asia. Around a fifth of institutional investors both in North America (22%) and Asia (23%) say they do not allocate to sustainable investments. The compares to a global average of 17%.

Institutional investment in sustainability increasing over the past five years

	Overall	North America	Europe	Latin America	Asia
Decreased	3%		1%	3%	9%
No change	31%	30%	28%	34%	34%
Increased	48%	48%	60%	43%	33%
We used to invest in sustainable investments but don't any more	1%		1%	3%	1%
We do not invest in sustainable investment funds	17%	22%	10%	17%	23%

The increased investment in sustainability is mirrored in the percentage of institutions' which believe the importance of sustainable investing is increasing. Globally, over two thirds (67%) say sustainable investment is due to become more important over the next five years. This is echoed across all regions under review with Europe and Latin America registering the highest levels with 29% of investors in each region saying sustainability will become significantly more important going forward.

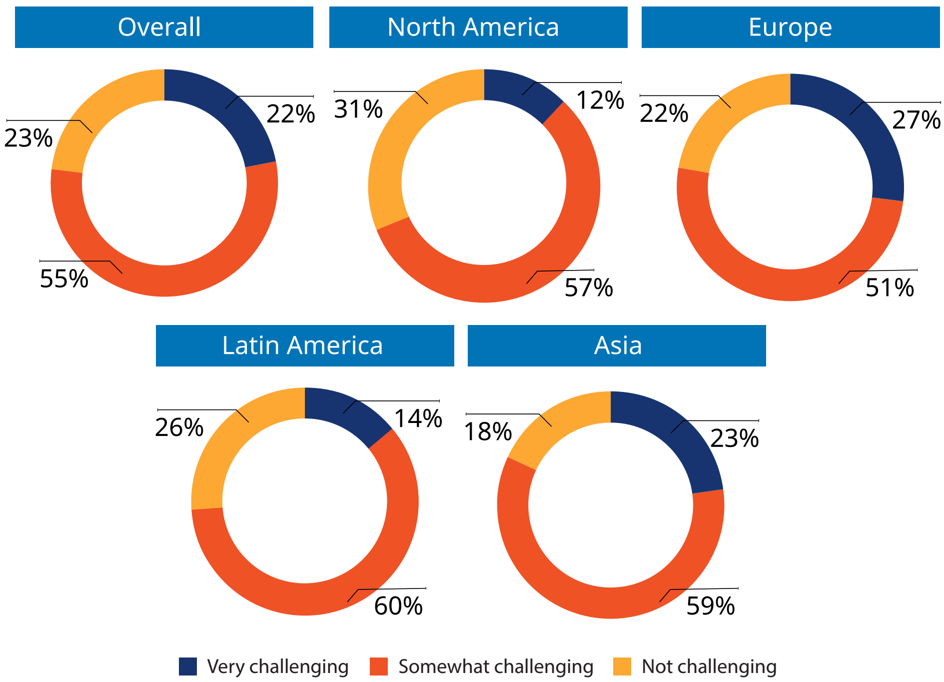
Importance of sustainability on the rise over the next five years

	Overall	North America	Europe	Latin America	Asia
Significantly less important	2%		4%		3%
Somewhat less important	7%	11%	6%	5%	5%
No change	24%	26%	16%	20%	33%
Somewhat more important	45%	42%	45%	46%	46%
Significantly more important	22%	21%	29%	29%	13%

The bigger picture

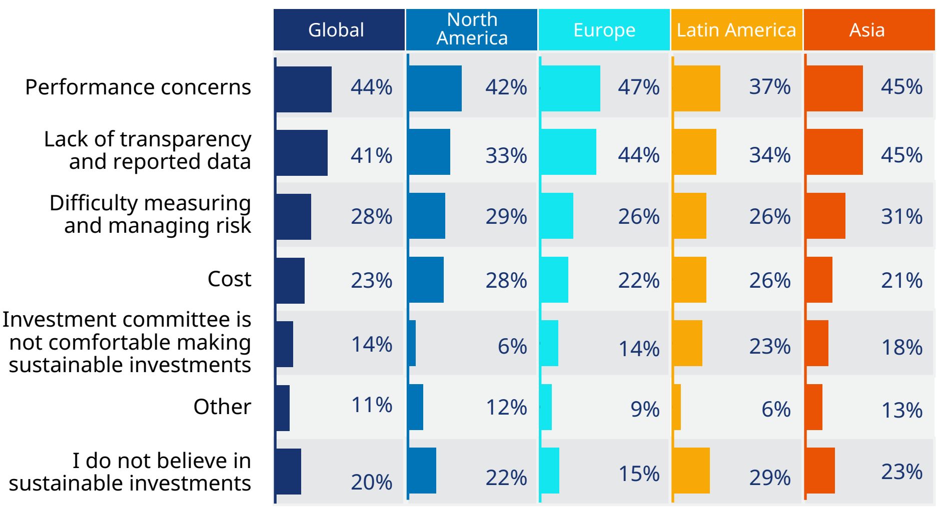
Despite the general consensus around the increasing importance of sustainability, investors consider this type of investment a challenge. Globally, 77% find sustainable investment a challenge (22% say it's very challenging). Interestingly, the highest percentage of investors who find it very challenging can be found in Europe (27%). This is also the region where sustainable investing saw the biggest increase, indicating institutions are facing and overcoming the challenges posed by investing with ethics and governance in mind.

Challenges remain despite increase in investment



The following chart gives further insight into the specific challenges institutional investors face when allocating to sustainable investments. The primary concern centres on performance with 44% citing this as an issue. A lack of transparency and reported data (41%) is another prevalent challenge investors come up against when investing in this way. Difficulty measuring and managing risk is the third hurdle investors face with 28% saying this is a concern. However, there is a considerable gap between this and the first two factors suggesting it is less of an inhibitor than performance and transparency.

Performance and transparency greatest sustainability challenges



(multiple answers allowed)

Investment specifics

When discussing sustainability within the broader context of a portfolio, institutional investors say it is of greatest relevance in the sphere of equities investment (76%).

Infrastructure investment should also have sustainability considerations according to 49% of investors. A greater number of institutional investors in North America feel sustainability should be a consideration when investing in alternatives, as compared to the global average (43% vs 29%).

	Overall	North America	Europe	Latin America	Asia
Equities	76%	77%	83%	63%	69%
Infrastructure	49%	49%	51%	49%	48%
Credit	44%	45%	48%	40%	38%
Real Estate	40%	42%	41%	43%	37%
Alternatives	29%	43%	26%	34%	21%
None of the Above	17%	20%	13%	34%	18%

% Yes (*multiple answers allowed*)

When investigating the reasons for the sustainable funds selected, we found the potential positive impact was the greatest motivation to invest in social welfare funds (32%) and those that apply sustainability to all their investment decisions (28%). Institutional investors seek potential profit from investing in funds focused on biotechnology or medical science (40% say they invest in such vehicles for the potential profit).

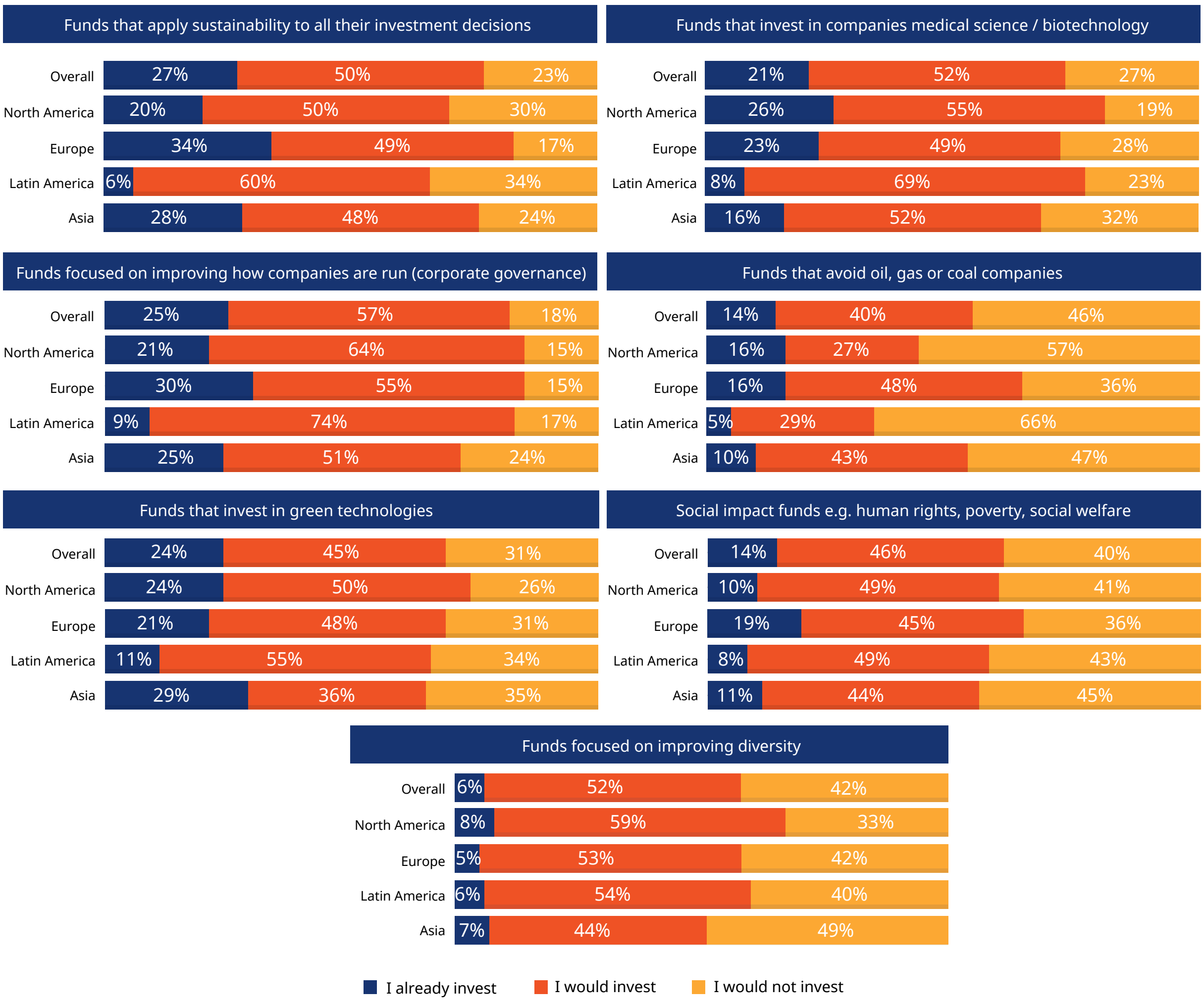
Motivations to invest in sustainable investment funds

	Overall			North America			Europe			Latin America			Asia		
Funds that apply sustainability to all their investment decisions	28%	54%	18%	16%	59%	25%	30%	57%	13%	22%	57%	21%	36%	44%	20%
Funds focused on improving how companies are run (corporate governance)	17%	47%	36%	20%	45%	35%	15%	53%	32%	14%	48%	38%	18%	39%	43%
Funds that invest in green technologies (e.g. wind farms, energy efficient products)	15%	51%	34%	12%	55%	33%	16%	53%	31%	9%	52%	39%	17%	46%	37%
Funds that invest in companies medical science / biotechnology	15%	45%	40%	16%	38%	46%	13%	55%	32%	15%	33%	52%	17%	41%	42%
Funds that avoid oil, gas or coal companies	23%	57%	20%	18%	43%	39%	24%	63%	13%	25%	58%	17%	23%	55%	22%
Social impact funds e.g. human rights, poverty, social welfare	32%	59%	9%	15%	71%	14%	45%	50%	5%	15%	75%	10%	29%	60%	11%
Funds focused on improving diversity	20%	61%	19%	26%	43%	31%	20%	67%	13%	10%	57%	33%	17%	70%	13%

For the potential positive impact | Equal intent | For the potential profit

Investment specifics

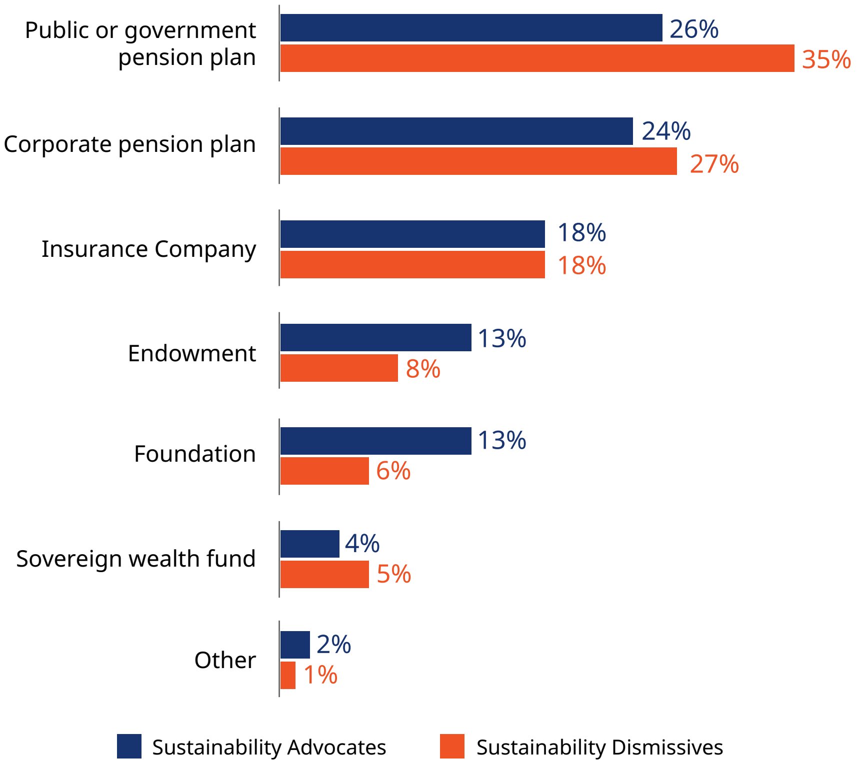
Existing investment in sustainability is highest in funds which apply sustainability to all their investment decisions (27%), which focus on how companies are run (25%) and those which invest in green technologies (24%). For those who do not invest, funds which focus on governance have greater appeal as 57% say they would invest in such vehicles. Interest is also high for funds investing in medical science and diversity (52%). Funds which avoid oil, gas or coal hold the least appeal with 46% of investors saying they would not invest in such funds.



The impact on time horizons and investment

The Sustainability Advocates[3] identified in this report are those institutional investors who say that improving the sustainability of their portfolio is an important investment objective for the next 12 months. Overall, out of all institutional investors surveyed, 35% were classed as Advocates.

The following charts give a better indication of the types of investors they are.



Time horizons

Institutional investors who are focusing on sustainability over the coming year have a greater propensity to be long-term investors. Of these Sustainability Advocates, 14% stick to an investment strategy for more than 10 years. This compares to 8% of those for whom sustainability is not a priority.

Assets of the Sustainability Advocates

Assets	Sustainability Advocates	Sustainability Dismissives
Less than $1 billion	14%	10%
$1 billion to less than $5 billion	18%	15%
$5 billion to less than $10 billion	12%	10%
$10 billion to less than $50 billion	31%	35%
$50 billion to less than $100 billion	6%	13%
$100 billion to less than $250 billion	8%	7%
$250 billion to less than $500 billion	8%	8%
$500 billion to less than $1 trillion	3%	2%

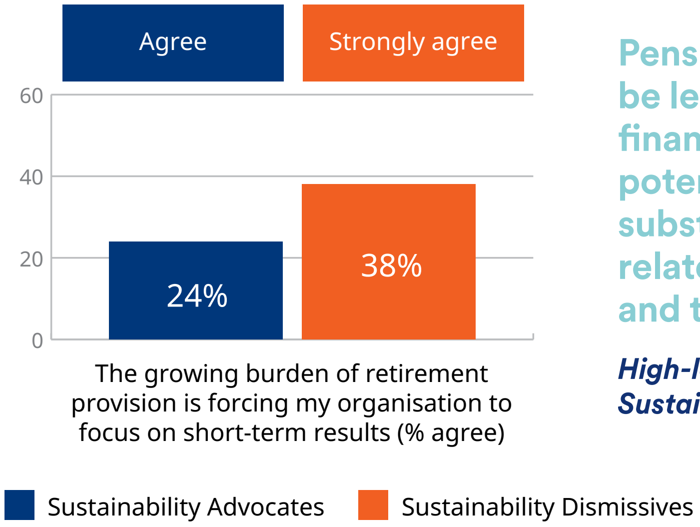
3 Sustainability Advocates are identified as the institutional investors who responded "4" or "5" on a scale of zero to five to the following question: How important are the following investment objectives for your organisation over the next 12 months? [Improve the sustainability of my portfolio's investments]. Those who gave a score of "0" or "1" are classed as the Sustainability Dismissives.

The impact on time horizons and investment

The data further indicates investors with a sustainability focus feel less pressure to concentrate on short-term results (24% of Sustainability Advocates agree vs 38% of those who say sustainability is not important) lending a more long-term lens to their investment strategy overall.

In its interim report published in July 2017 – Financing a sustainable European economy – the High-Level Expert Group on Sustainable Finance, established by the European Commission, said: "Pension funds' assets should be less prone to short-term financial risks, but they are potentially more exposed to substantial long-term risks related to the real economy and the environment. Failure to consider such long-term risks such as the threat of climate change could lead to pension funds experiencing lower returns and valuation losses if, for example, they are invested in 'stranded assets', such as fossil fuel reserves that may never be exploited."

Less short-termist pressure for Sustainability Advocates



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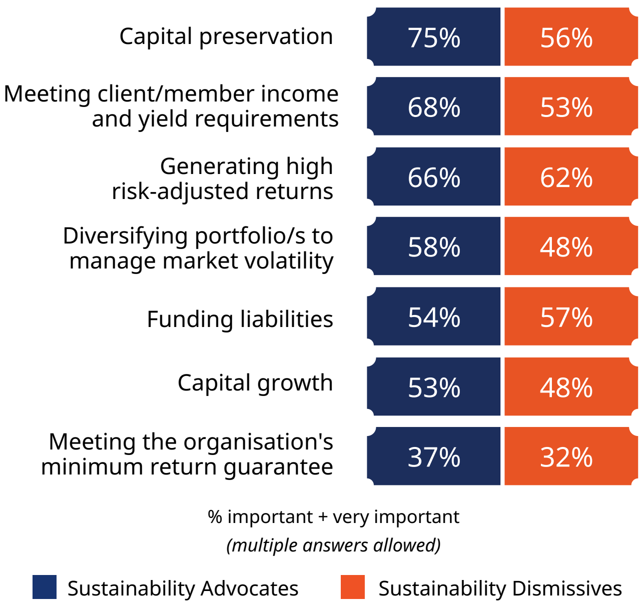
High-level Expert Group on Sustainable Finance

Investment goals and behaviour

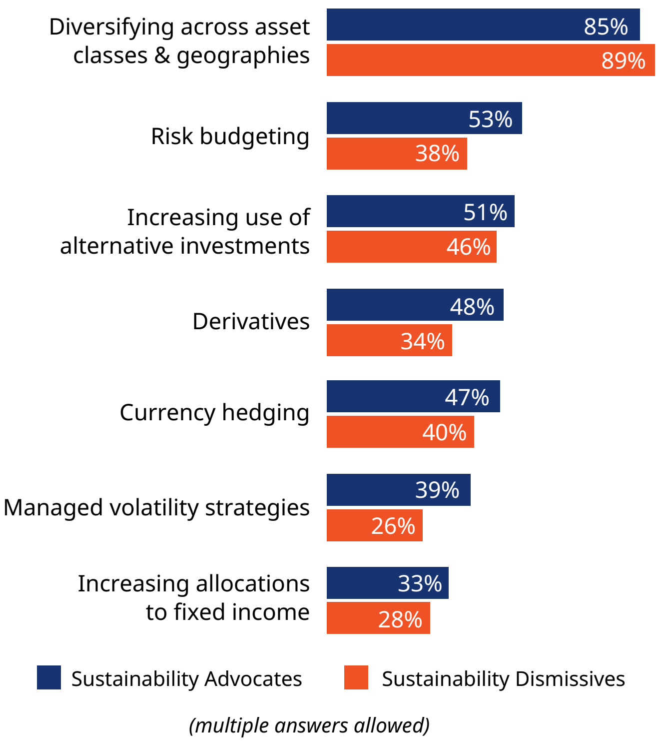
The investment objectives of the Sustainability Advocates differ considerably from the Sustainability Dismissives. Capital preservation is the main goal for the Advocates (75%) with member income and yield requirements coming in second (68%). Generating high returns and diversifying their portfolio remains firmly on their radar (66% and 58%, respectively), however these are slightly less important when considered relative to the other objectives under review.

Although diversification is the primary risk management strategy used by both investor groups, the Sustainability Advocates have a greater propensity to use risk budgeting (53%) – this is the greatest difference observed between the two groups.

Capital preservation a priority for Sustainability Advocates



Sustainability Advocates make greater use of risk budgeting



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