



2019 Annual ESG Manager Survey



A deep dive into the integration of ESG in
investment practice



Contents

Executive Summary	3
Survey population	3
Introduction	4
Responsible Investment Policy	4
Why consider ESG factors	5
How ESG factors are integrated	6
Engagement activities	8
How ESG assessments impact investment decisions	8
Product offerings and reporting	9
Diversity and inclusion	10
Summary and Conclusions	12



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Note: The source of all information contained in this report, unless otherwise stated, is Russell Investments.

Executive summary

Russell Investments conducted its 2019 Annual ESG Survey across equity, fixed income and private markets asset managers from around the globe to assess their attitudes to responsible investment and how they integrate environmental, social and governance (ESG) issues into their investment processes. The ESG Survey (the Survey) consisted of 25 questions with 31 sub-questions. It addressed a wide range of topics including the respondents' responsible investment policy implementation, how ESG considerations are incorporated into the asset manager's investment process, the use of quantitative ESG data, dedicated ESG resources, engagement activities, product offerings, and diversity and inclusions. We conducted a similar survey in the past few years and were able to highlight some trends.

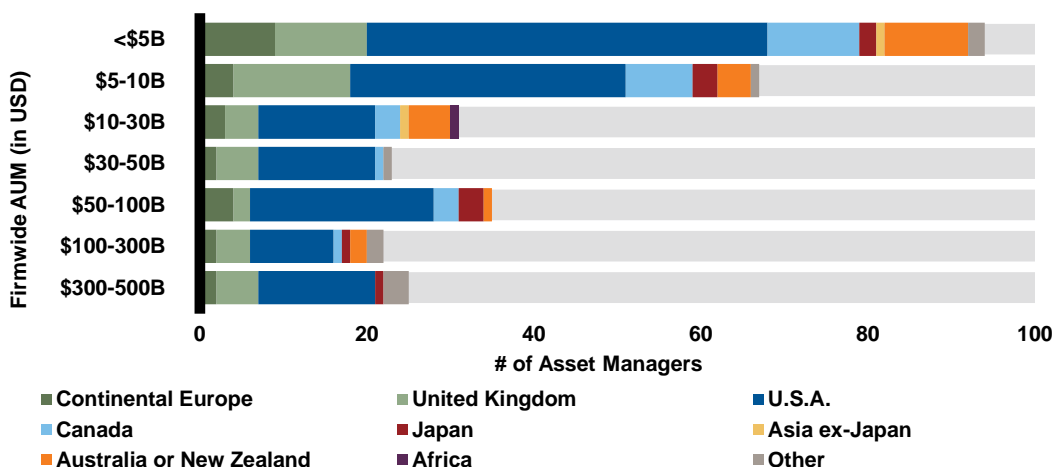
Russell Investments incorporates ESG factors into its investment process. As a component of our research process, manager research analysts assign an ESG rank to individual strategies. The ESG Survey results contain a rich source of information about how each asset manager approaches ESG. As such, the survey results serve as important reference points when evaluating investment strategies.

From the Survey results, we observed an increasing level of ESG awareness and a widespread willingness to incorporate ESG factors into the investment process across the asset classes. However, we observed a varying degree in the way asset managers integrate these ESG factors into investment considerations. The use of explicit ESG factor assessments has become an increasingly common practice. While governance remains the dominant factor when it comes to ESG considerations, there are signs that asset managers are looking beyond governance in ESG considerations, especially with the environmental factor – albeit from a low base, compared with governance.

Survey population

We had 300 asset managers from around the globe who participated in our 2019 ESG Manager Survey (The Survey). The Survey participants have broad representations by asset sizes, regions and investment strategy offerings. 67% of the participants are managers offering equity and/or fixed income only. 18% of the respondents had equity, fixed income and private market offerings. 56% of the respondents are headquartered in U.S. and 23% of them are based in Europe. 35% of the respondents have assets under management less than U.S.\$10 billion. Conversely, 26% of the participants had over U.S.\$100 billion in assets. The region and firmwide assets under management breakdowns are shown in **Exhibit 1**.

Exhibit 1: Asset manager coverage by region and AUM among the Survey participants



Introduction

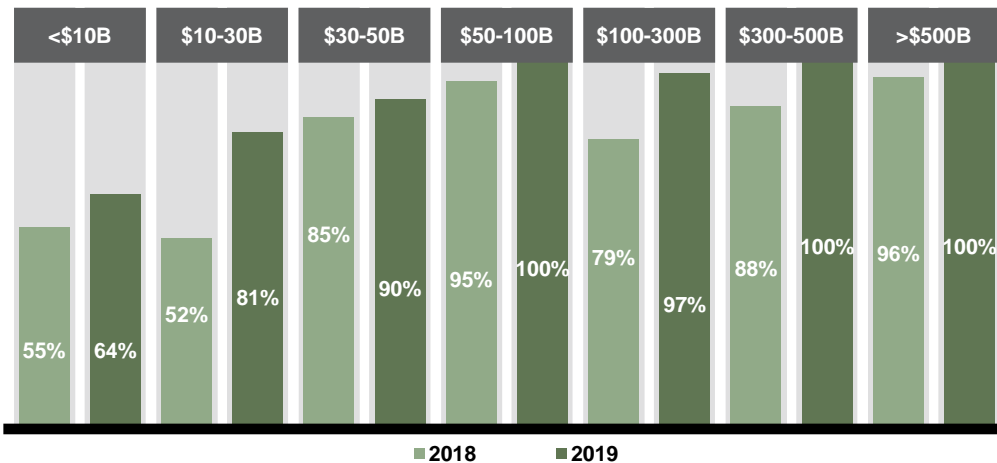
ESG factors are becoming commonplace. Furthermore, a general acceptance that ESG considerations provide asset managers a more comprehensive picture of their investment opportunities is increasing. In 2015, we started our ESG Manager Survey to better understand how the asset managers are engaging in ESG considerations. Russell Investments has observed that the ESG trend, which started among equity investors, has rapidly expanded into the fixed income investors and in more recent years, private markets. This is due to the ESG consideration concepts evolving as a way of analyzing underlying companies or government entities.

We segment the ESG approaches into three categories: negative or positive screening; ESG integration; and impact/thematic investing. In the case of negative or positive screening, the manager is seeking to avoid, or advance securities based on client values or ESG value potential, while achieving investment goals. ESG integration is seeking to generate strong investment outcomes with the recognition that ESG factors are a material component of the investment process. Impact or thematic investing is designed to capture measurable positive ESG impact goals alongside the investment returns. The primary focus of the Survey is ESG integration and to assess how asset managers are tackling this aspect.

Responsible Investment Policy

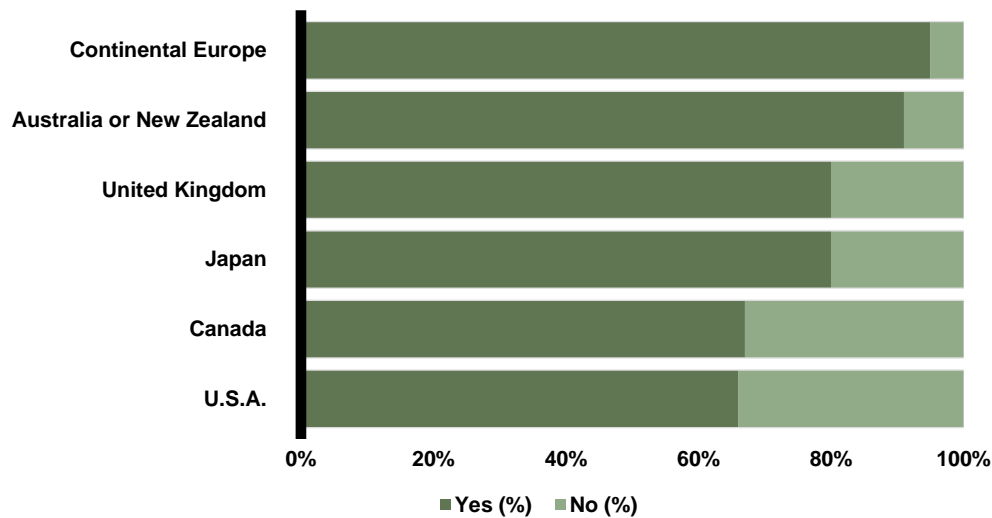
We believe that having a Responsible Investment Policy on a firmwide basis is one of the first steps in assessing ESG integration. We ask this question every year and we were positively surprised to see that 82% of the respondents have a formalized policy, compared with 71% from the prior year. 5% of the respondents currently don't have any responsible investment policy but plan to develop one within the next 12 months. **Exhibit 2** illustrates the changes by asset size, highlighting the highest year-over-year percentage increases came from smaller firms, especially firms with U.S.\$10-30 billion in AUM. This indicates an increased commitment to ESG considerations among the smaller firms, even though such firms tend to lack in resources, compared with larger firms.

Exhibit 2: Firms with Responsible Investment Policy by AUM (USD)



We observed an increase in the number of signatories to the Principles for Responsible Investing (PRI). 72% of the respondents are signatories to the PRI, compared with 64% from the previous survey results. **Exhibit 3** shows PRI signatory participation comparison by regions, highlighting the U.S.-based asset managers having a lower participation. This is understandable, given that a larger portion of U.S.-based asset managers are smaller firms.

Exhibit 3: PRI Signatory status by region

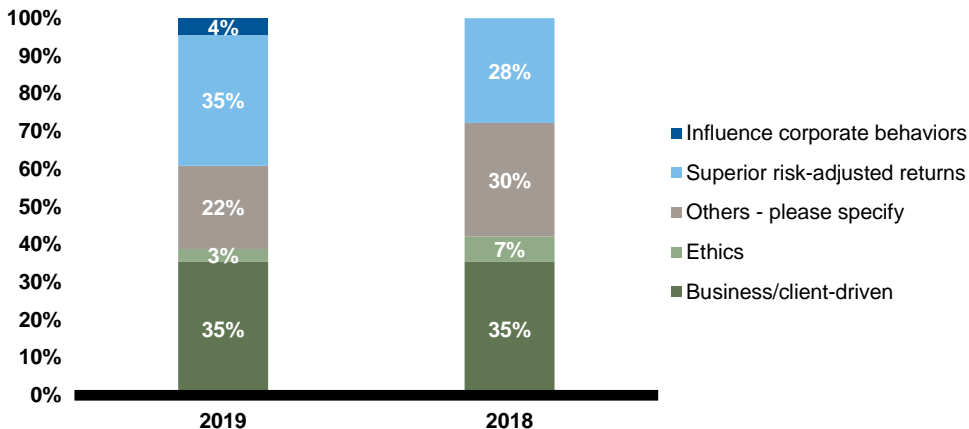


Why consider ESG factors

When asked about the drivers of the ESG considerations and whether they have conducted specific capital market research on how ESG factors might have impacted investment results, 34% of the respondents had conducted some form of capital market studies related to ESG topics. This was increased slightly, compared with 31% from the previous year. Looking at various asset manager types with asset class coverage, such as, asset managers who offer multiple strategies (i.e. equity and fixed income), or each asset class only, managers with multiple strategies have the highest proportion in conducting those capital market studies, compared with those managers who offer single asset-class strategies. Again, this dominance by multiple strategy providers may tie to resourcing as these firms tend to be larger firms and can afford more dedicated resources.

As for the motivation, roughly one-third of the respondents admitted that ESG integration is a business-driven exercise. 35% of the respondents claimed that the ESG integration motive is to seek superior risk-adjusted returns. This was up from 28% the previous year. However, only a handful of capital market studies had been done in assessing the materiality of the individual ESG factors in driving security returns and assessing the efficacy of whether ESG factors in general impact market/individual security returns. That being said, the Survey suggests an increased acceptance to connect the consideration of ESG factors into the economic value of the underlying entity's enterprise value.

Exhibit 4: Current motivation of ESG Integration

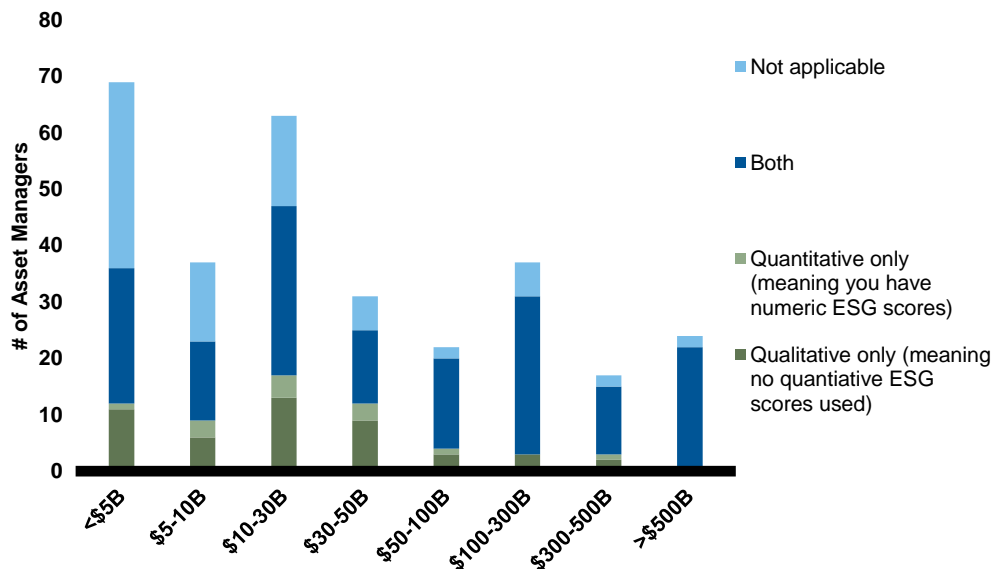


How ESG factors are integrated

In order to incorporate ESG considerations, we believe an asset manager needs to conduct explicit ESG factor assessments in the investment process on a regular basis. 73% of the respondents have explicit qualitative or quantitative ESG factor assessments at a corporate or sovereign level systematically. The large portion of the respondents who don't have such a process are smaller U.S.-based asset managers. When comparing the response by regions, we observed that the European managers are further ahead of the U.S.-based asset managers in incorporating ESG considerations.

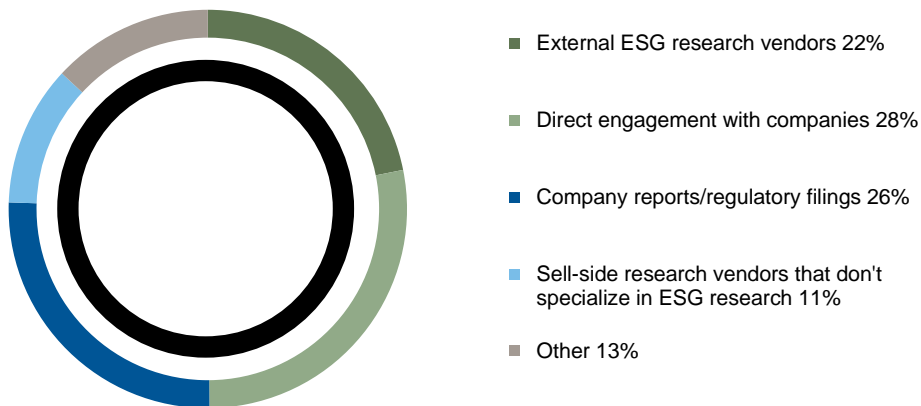
Most of the respondents with explicit ESG factor assessments apply both qualitative and quantitative inputs. **Exhibit 5** illustrates how larger-asset managers tend to apply both quantitative and qualitative ESG assessments, compared with smaller managers. Furthermore, of the managers who apply explicit ESG factor assessments, 40% of them primarily rely on their internally-produced quantitative data but augment it with externally-produced quantitative data.

Exhibit 5: How do asset managers use ESG factor assessments



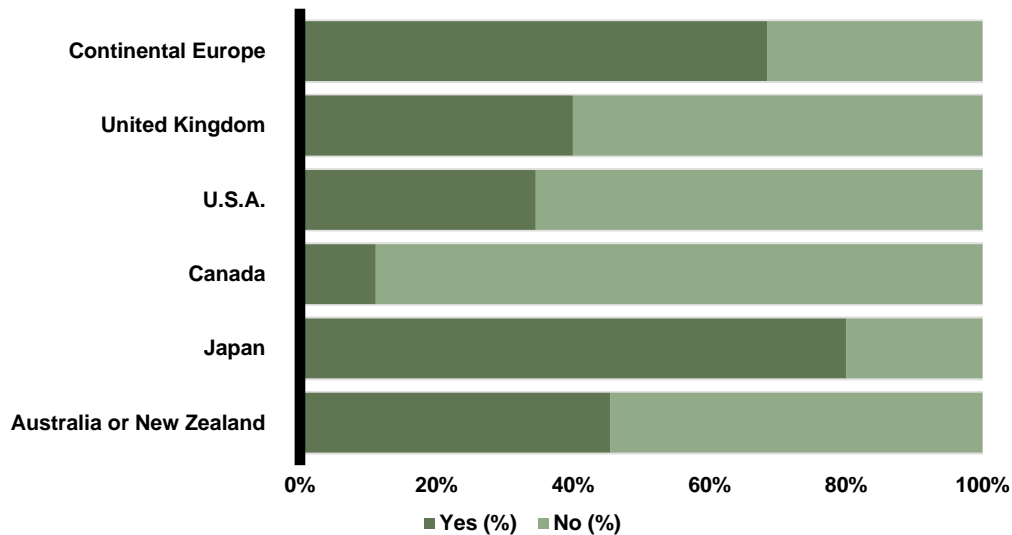
In terms of external ESG data providers, 23% of the respondents who subscribe to external ESG data providers use MSCI ESG Research, followed by 18% who use Sustainalytics. The respondents were able to select multiple items and the question was designed to identify primary sources of their ESG information. 28% of the information comes from direct engagement with underlying companies, followed by 26% in company report/regulatory filings. External ESG data providers accounted for 22% of the ESG information source (**Exhibit 6**).

Exhibit 6: Primary sources of ESG information



ESG specific considerations are increasingly being used in the market place, partly because there are expansions of third-party ESG data providers and dedicated ESG resources. We have observed that there are some asset managers who have dedicated ESG professionals to gather ESG considerations, while others mostly leverage their existing investment platforms. We asked managers if they have dedicated ESG professionals who spend more than 90% of their time on ESG specific matters, 40% of the respondents have dedicated ESG professionals. Again, size comes to play where 85% of asset managers with greater than U.S. \$100 billion in assets under management have dedicated ESG resources. There are also regional biases where European-based asset managers are more likely to have such dedicated resources (**Exhibit 7**).

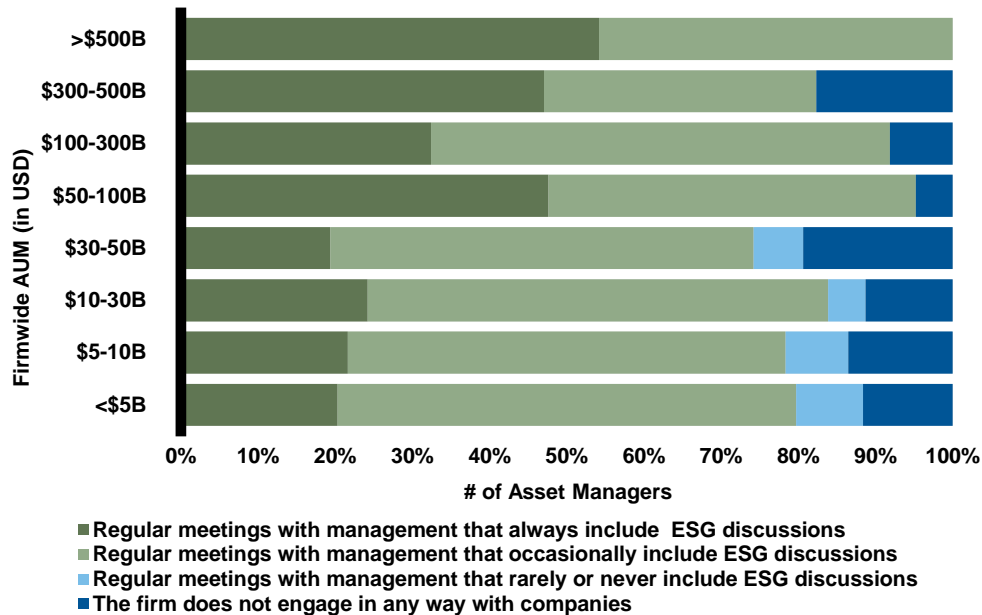
Exhibit 7: Dedicated ESG professionals who spend more than 90% of their time in ESG specific matters



Engagement activities

Asset managers are increasing their engagement activities with underlying companies, or governments in some cases, in an attempt to influence entities' potential outcomes which include greater transparency, improved behaviors, reduced uncertainty and risk. **Exhibit 8** shows 100% of firms with assets under management greater than U.S. \$500 billion that either always or occasionally include ESG discussions in meetings with management, whereas 79% of firms with asset size less than U.S.\$10 billion do the same. 10% of the respondents cited they don't engage in any way with companies and those firms include systematic equity managers, fixed income or private market managers.

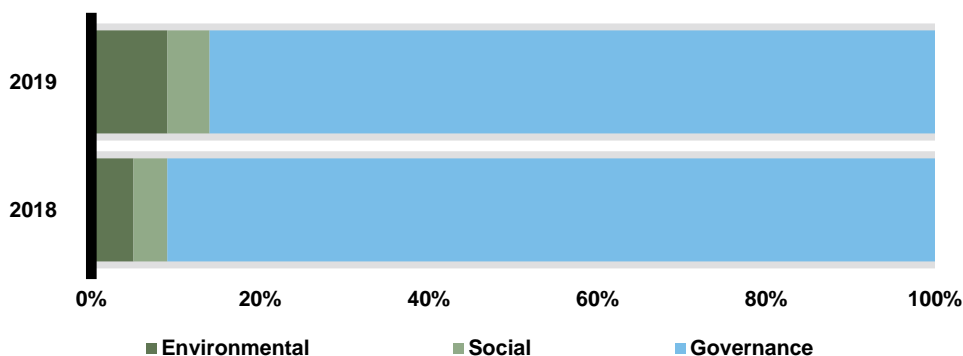
Exhibit 8: Engagement activity with ESG discussion



How ESG assessments impact investment decisions

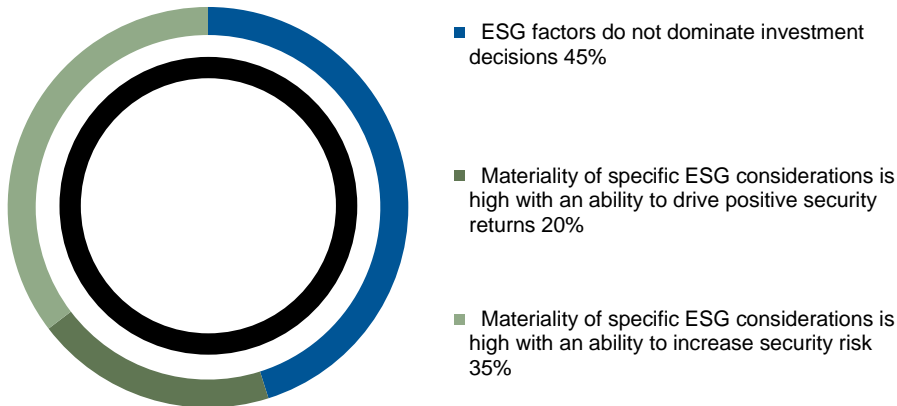
We asked which ESG factor impacts the most in the asset manager's investment decisions. The majority of the respondents continue to state *governance*. However, we have noticed a reasonable uptick in *environment* and even *social*, when compared with the previous year's response (**Exhibit 9**). Perhaps this reflects asset managers making conscientious efforts to look beyond *governance* for the climate change concern and social impacts – albeit still at a lower base.

Exhibit 9: Which ESG factor impacts your investment decision the most?



We asked when ESG factors should dominate the asset manager's investment decisions, outside of investment guideline considerations, materiality of ESG factors is a focal point of the decision-making process. 55% of the respondents stated that ESG factors dominate investment decisions when the materiality of specific ESG factors is high. Furthermore, 35% of the respondents attribute the materiality of specific ESG considerations to security risk, instead of positive security returns. Whilst one can argue risk and return concepts can be interchangeable, more respondents selected materiality associated with security risk, as opposed to positive security return. This response suggests that more asset managers may treat ESG factor considerations as a risk management exercise, rather than a return generating feature.

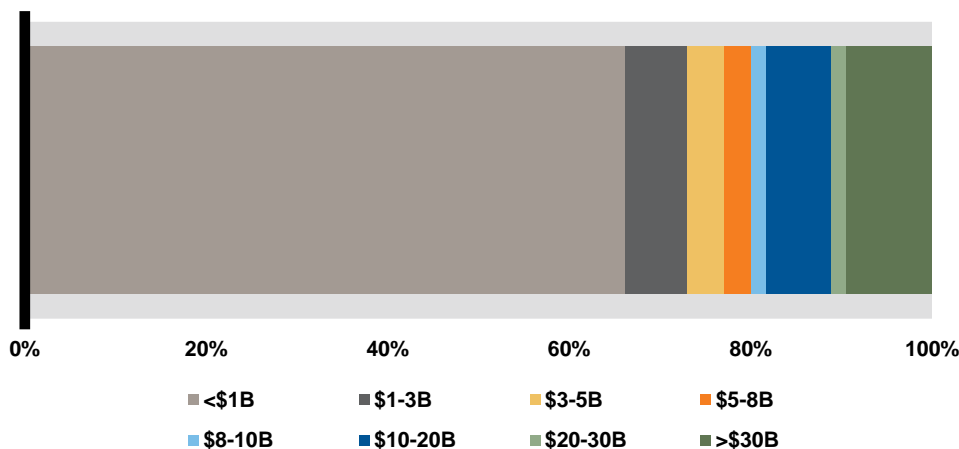
Exhibit 10: When ESG factors should dominate investment decisions



Product offerings and reporting

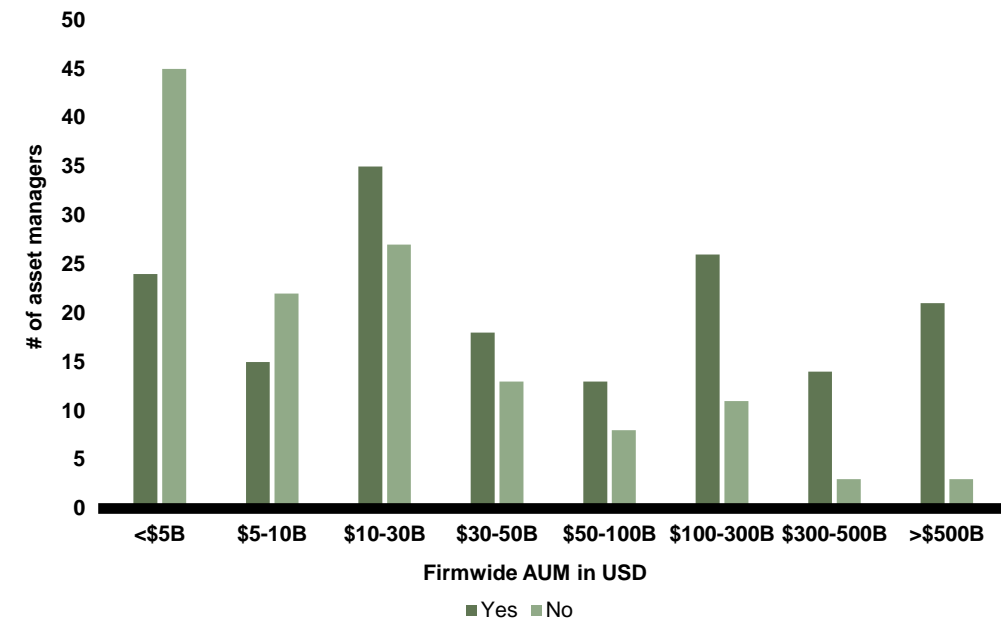
We have observed the ESG related product expansion across asset classes in the recent years. So, we asked asset managers to share the firmwide assets under managements with strategies that are clearly defined as responsible investing or ESG offerings as of December 31, 2018 (**Exhibit 11**). Of the managers who have strategies that are clearly defined as Responsible Investing and/or ESG offerings, 66% of the overall ESG strategy asset base is less than \$1 billion total, indicating the early nature of such product expansion.

Exhibit 11: Firmwide ESG-related AUM in U.S. dollar



We asked respondents about the reporting capabilities specific to responsible investing and ESG product offerings. 56% of the respondents claimed to offer ESG specific reporting to existing clients. Understandably, those larger- asset managers seem to have the better infrastructure to support the reporting capabilities (**Exhibit 12**). In terms of reporting frequency, 42% of those who provide reporting stated that they offer reporting on an ad hoc basis and/or a combination of annually and quarterly reporting. 33% of them report quarterly, 18% of them report annually, and 7% of them report monthly.

Exhibit 12: Do you have ESG-specific reporting to the existing ESG clients?

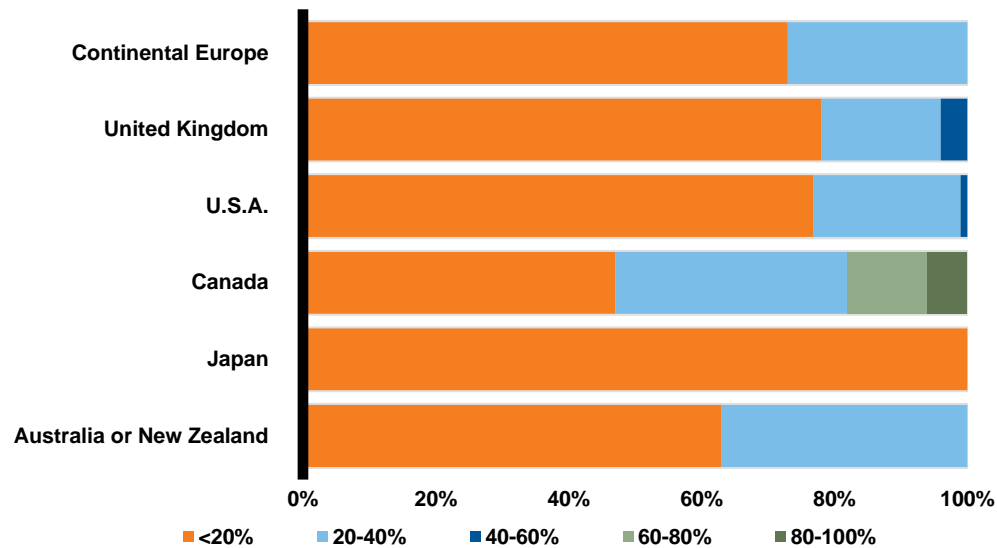


Diversity and inclusion

Last year we introduced questions around diversity and inclusion in our annual ESG Survey. With this report we are sharing an update on the status in this area. When asked if their firm has policies that are intended to increase the level of gender and ethnic diversity among senior level executives and investment decision makers, 51% of the respondents stated yes, compared with 45% from the previous year. Larger asset managers are more likely to have such policies than smaller firms.

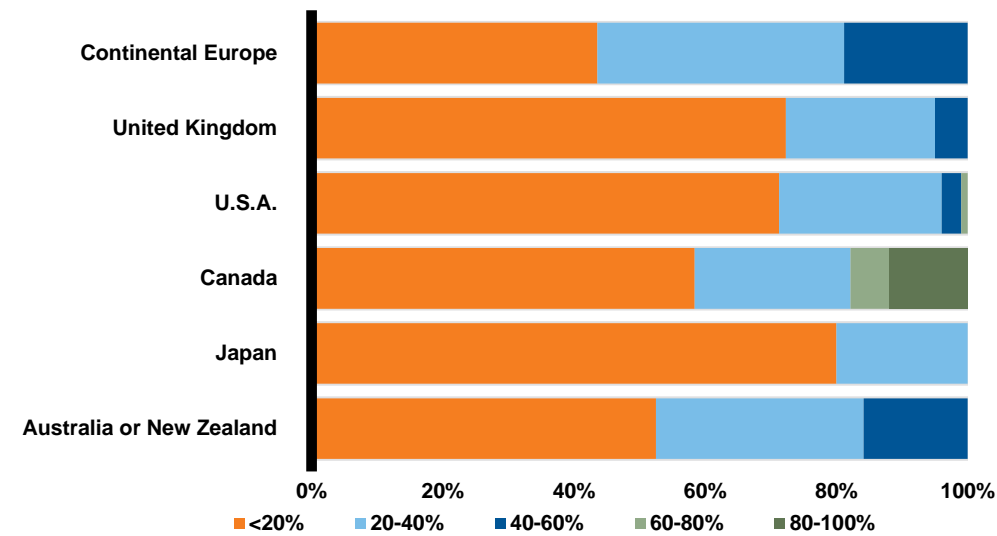
Russell Investments is committed to diversity and inclusion as we believe diversity of experiences and knowledge are important contributors in active management. Therefore, we incorporate both ESG integration and diversity and inclusion as dedicated sub-ranks when we evaluate an asset manager's strategy. To highlight the gender diversity subject, we've asked to identify how many senior investment professionals are female. Female representation has been notoriously challenging in the investment community. This Survey result supports the challenge - 60% of the asset managers who responded to this question indicate that less than 20% of their investment professionals are female. Furthermore, 74% of the respondents to this question indicate that less than 20% of their *senior* investment professionals are female. In other words, female representation becomes even more challenging among senior investors. We've investigated the results by region (**Exhibit 13**). The results show that Canada has the most female representation of senior investment professionals, while Japan has the least.

Exhibit 13: Female representation among the firm's senior investment professionals



When asked to speak about the gender diversity in Board memberships, we found marginally more diversification in Board membership, compared with the gender diversity among senior investment professionals. Continental Europe offered the most gender diversity (**Exhibit 14**).

Exhibit 14: Female representation among the firm's Board members



Summary and Conclusions

Russell Investments 2019 ESG Manager Survey found a high level of ESG awareness and increasing integration of ESG factors among the respondent managers. The concept of ESG integration is evolving into a way of providing more comprehensive analysis of underlying companies than was done in the past. We observed a wide range of methodologies in the way the respondents integrate ESG factors into their investment process. Materiality of ESG factor considerations is getting further attention when it comes to the asset manager's investment decisions. While most asset managers continue to see governance as being the most important factor in the ESG considerations, environmental and social factors are gaining the greater importance – albeit from a lower base.

Much of the ESG product offerings appear to still be in the earlier life cycle, based on the overall asset base. Assets under management continues to dominate with larger firms tending to have broader ESG resources and infrastructure than those of smaller firms. U.S.-based firms, especially with smaller asset size, lag in ESG integration statistics, compared with the other regions.

Russell Investments includes ESG integration as well as diversify and inclusion in its manager research and this ESG Survey helps form our assessment of managers' ESG integrations as a part of the overall manager strategy evaluation. We believe the results of this survey point to a market place that has growing acceptance in ESG considerations as additional investment considerations. The availability of ESG data has helped the asset managers to incorporate these additional inputs. ESG factor considerations are increasingly becoming a standard part of security selection. We observed that ESG integration has rapidly evolved in the recent year into a mainstream practice. The ESG Survey results provide more in-depth understanding of asset managers' ESG integration framework for our manager strategy evaluation.

Source: Russell Investments Research: 2019 ESG Survey



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