

Smart Sustainability: 2020 global survey findings from asset owners



**FTSE
Russell**

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Introduction

This is the fourth year FTSE Russell has conducted and published the findings from our Smart Sustainability survey of global asset owners. With each passing year we learn more details about asset owners' awareness, attitudes and behaviors related to the combination of Sustainable Investment (SI) and smart beta, and we continue to adapt the questionnaire to accommodate emerging trends and areas of investment interest for our clients and the global asset owner community.

Back in 2017, when we first asked questions to ascertain if asset owners were thinking of applying sustainability considerations to smart beta, we were surprised to find out the degree to which ESG factors were being considered an option to accompany smart beta indexation—in 2017 over 40% of asset owners using or evaluating smart beta globally said they were looking to apply ESG considerations to a smart beta strategy. Now, nearly 60% of asset owners using or evaluating smart beta are using or evaluating the two approaches together.

This trend is reflected in our engagement with clients where we work with a growing number of asset owners who wish to integrate sustainability parameters—especially climate risk—into smart beta indexes. We call this Smart Sustainability and apply a consistent factor methodology across both risk premia factors and sustainable investment parameters.

Covid-19 has certainly focused investors on sustainability factors and, in addition, the recent social unrest has sharpened our clients' focus on factors

around social and diversity policies and their impact on markets and company performance. It is important to note that the annual survey was fielded in the run-up to the global Covid-19 pandemic. Depending on an asset owner's geography the questionnaire reflects the associated uncertainty and volatility differently, and should be interpreted as a pre-cursor to those changing markets and asset allocation decisions.

In these turbulent times, this year's survey results are a striking reminder that sustainable investment is becoming an ever more important consideration for asset owners, and that while regional differences persist, the gaps are narrowing with particularly rapid growth in North America.

- In Europe, sustainable investment is now firmly part of the mainstream, with 81% of EMEA asset owners expressing interest in applying SI/ESG considerations to smart beta (up from 73% last year).
- In North America, the share of asset owners that indicated similar interest jumped to 42%, from just 17% last year.

- Large asset owners are leading the charge; globally 80% of asset owners with an AUM of \$10 billion or higher are either evaluating or already implementing sustainability factors in their investment strategy.
- With COP26 and new EU regulations looming, climate risk tops the list of sustainability themes that asset owners focus on at 64%.
- Sustainable investment strategies continue to broaden, with a greater emphasis on more sophisticated approaches such as re-weighting based on SI and ESG factors (from 36% in 2019 to 55% in 2020) compared to more basic negative screening (64% in 2019 to 48% in 2020).

We hope you enjoy reading through this year's findings and welcome any feedback or questions you may have.

Jaakko Kooroshy
*Head of SI Data & Methodologies,
FTSE Russell*

Survey background

The results included in this report are sourced from the FTSE Russell survey of asset owners, conducted in partnership with radius | illumination. This year marks the fourth year we have covered the topic of sustainability/ ESG considerations within the context of smart beta. We have expanded our coverage of sustainable investment in each of the past four years as interest in the topic has continued to grow.

The 2020 survey was conducted in January and February, with 139 global asset owners participating. The majority of participants were located in North America (37%), EMEA (37%), and Asia Pacific (21%).

A wide mix of organization types are represented, including government organizations (28%), corporations or private businesses (18%), unions or industry-wide pension schemes (12%), and non-profit organizations or universities (12%). The rest is a mix of insurance companies, sovereign wealth funds, health-care organizations and family offices.

Fifty-four percent of the asset owners who responded manage defined benefit plan assets, 26% manage defined contribution plan assets and 13% manage endowment or foundation assets. In some cases, respondents indicated management of multiple asset types. Participants also include asset owners with insurance general accounts, sovereign wealth funds and other types of institutional entities.

Asset owners with \$10 billion or more in total AUM account for 54% of responses, those with AUM between \$1 billion and \$10 billion account for 29%, and those with under \$1 billion in total AUM make up the remaining 17%.

The distribution of our asset owner sample has shifted from year-to-year across regions and AUM tiers. This can contribute to year-over-year changes in the results.

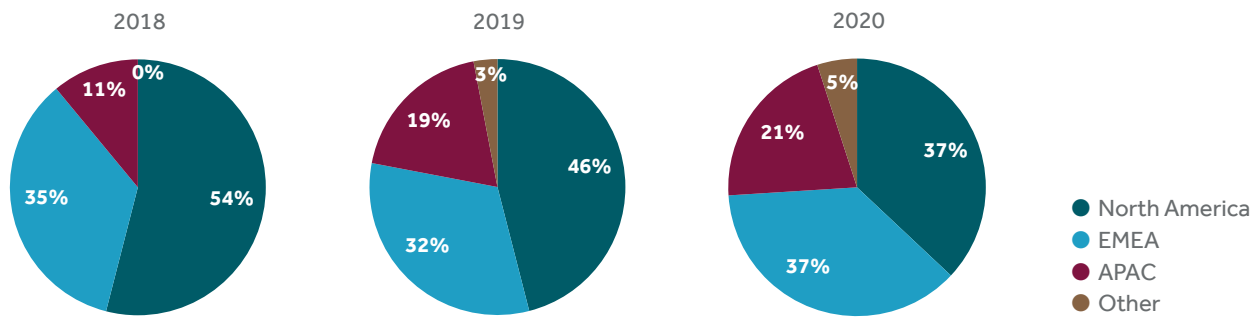
For the purposes of this survey, “smart beta” is defined as an investment strategy that applies an index-based investment strategy that is not traditionally market cap-weighted (i.e., fundamentally weighted, equal weighted, factor weighted, optimized, etc.).

For a sample size of 139, the margin of error is +/- 8% at a 95% confidence margin. Throughout the report, percentages may not total 100 due to rounding and/or because some questions allowed for multiple responses. (Allowance for multiple responses is noted as “multi-pick” in each exhibit footer).

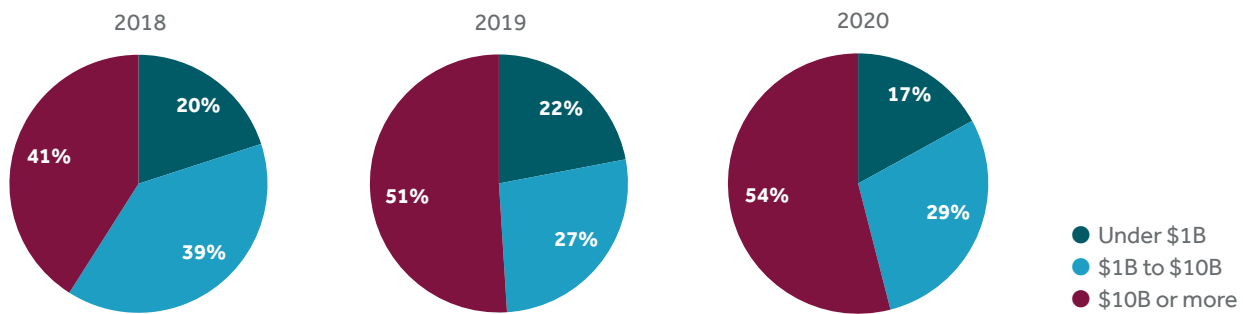
Sample distribution by year for 2018 – 2020

Exhibit 1

Region distribution



AUM tier distribution



1

Implementation and evaluation of ESG considerations

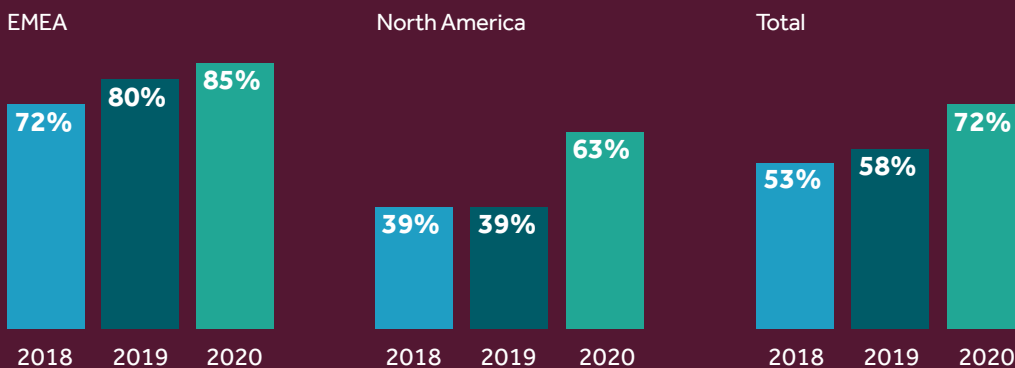
There has been a global rise in implementation and evaluation of sustainable investment considerations, with over seven in ten doing so globally in 2020. Regional differences between North America and EMEA are narrowing.

The 2020 rate of sustainable investment adoption and evaluation in EMEA (85%) remains higher than that of North America (63%). Notably, in North America the rate of implementation and evaluation increased from 39% in 2018 and 2019 to 63% in 2020.

Adoption and evaluation of sustainable investment/ESG considerations grew for asset owners across the AUM spectrum. Eighty percent of asset owners with AUM of \$10 billion or higher have adopted or evaluated SI/ESG considerations, compared to 65% of asset owners in the sample with AUM under \$10 billion.

Exhibit 2.1

Sustainable Investment / ESG Implementation or Evaluation by Region

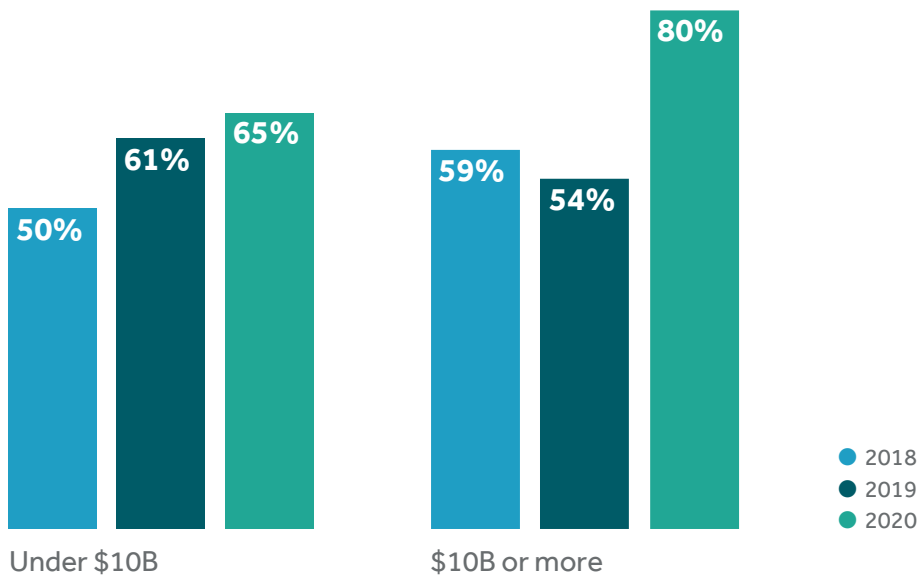


Is your organization currently implementing or evaluating ESG/sustainability considerations in your investment strategy?

Sample size for Other regions not large enough to break out; respondents from these regions are included in total.

Exhibit 2.2

Sustainable Investment / ESG Implementation or Evaluation by AUM



Is your organization currently implementing or evaluating ESG/sustainability considerations in your investment strategy?

Sample size for <\$1 billion and \$1-10 billion not large enough to break out; responses from these segments are grouped as <\$10 billion.

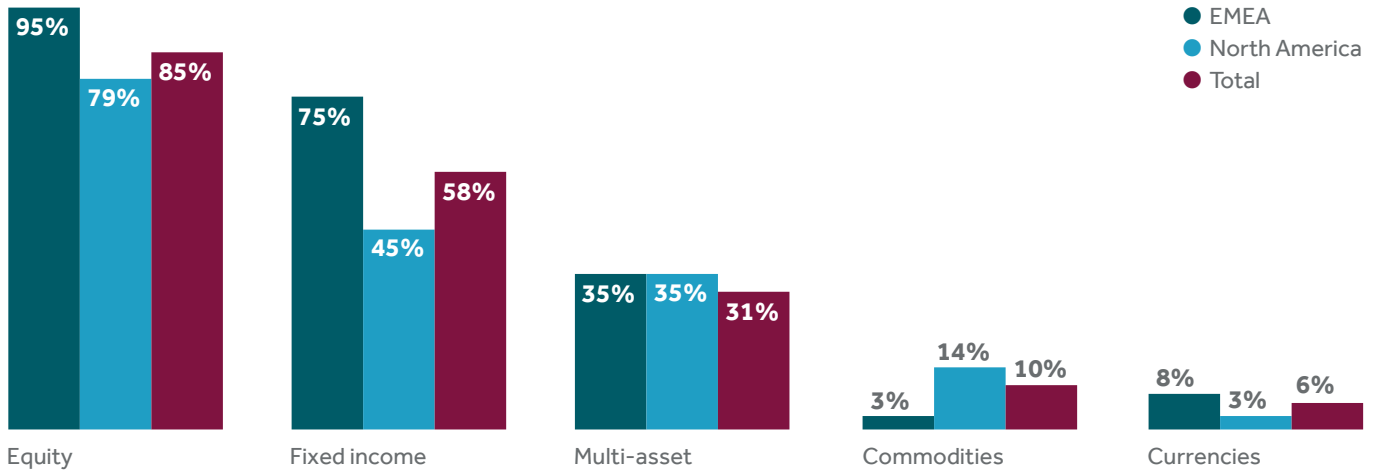
Among those who are implementing or evaluating ESG/sustainability considerations, there is significant interest in fixed income (58%) and multi-asset (31%) applications.

Fixed income applications, which have historically lagged equity market application of sustainable investment considerations, are particularly strong in EMEA where 75% of respondents are currently implementing or evaluating sustainability considerations for this asset class. In North America, 45% of respondents are implementing or evaluating ESG/sustainability considerations for fixed income investments.

About one-third of respondents globally are implementing or evaluating ESG/sustainability considerations for multi-asset investments. Interest in commodities application of sustainable investment considerations is stronger in North America than EMEA, with 14% of North American asset owners reporting evaluation or adoption. Less than 10% of respondents are evaluating ESG/sustainability consideration for currency investments.

Exhibit 3

For which asset classes are you currently implementing or evaluating ESG / sustainability considerations?



Multi-pick. Segment = Currently implementing or evaluating ESG/sustainability considerations.

Sample size for North America is 29, below the preferred threshold of 30.

2

Combining ESG and Smart Beta: "Smart Sustainability"

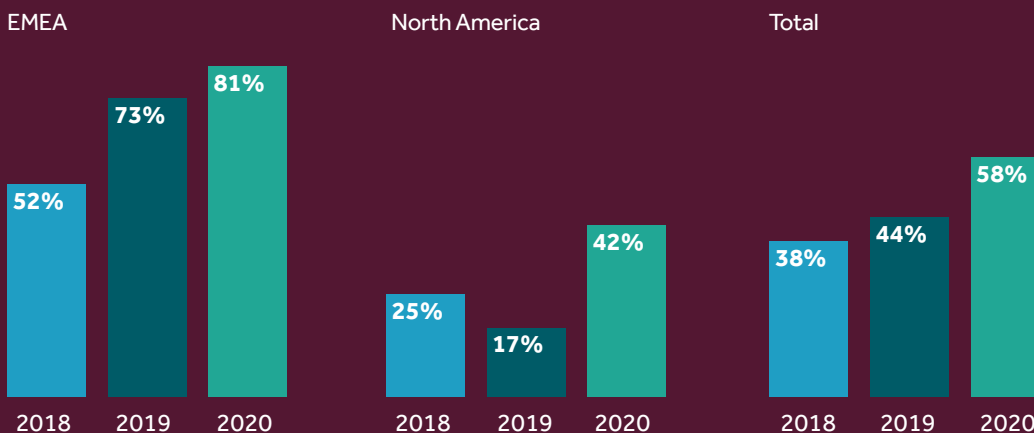
Among those who are using or evaluating smart beta strategies, an increasing share of global asset owners anticipate applying ESG considerations to their smart beta strategy of choice (58%, up from 44% in 2019).

Over 80% of EMEA asset owners using or evaluating smart beta expect to apply ESG considerations to smart beta, which is up from 73% last year.

In contrast, 42% of North American asset owners do, which has grown significantly from 17%.

Exhibit 4

Do you anticipate applying ESG, climate or exclusion considerations to a smart beta strategy?



Segment = Have a smart beta allocation OR are currently evaluating/re-evaluating smart beta strategies OR are planning to evaluate smart beta strategies in the next 18 months.

Sample size for North America in 2020 is 26, below the preferred threshold of 30.

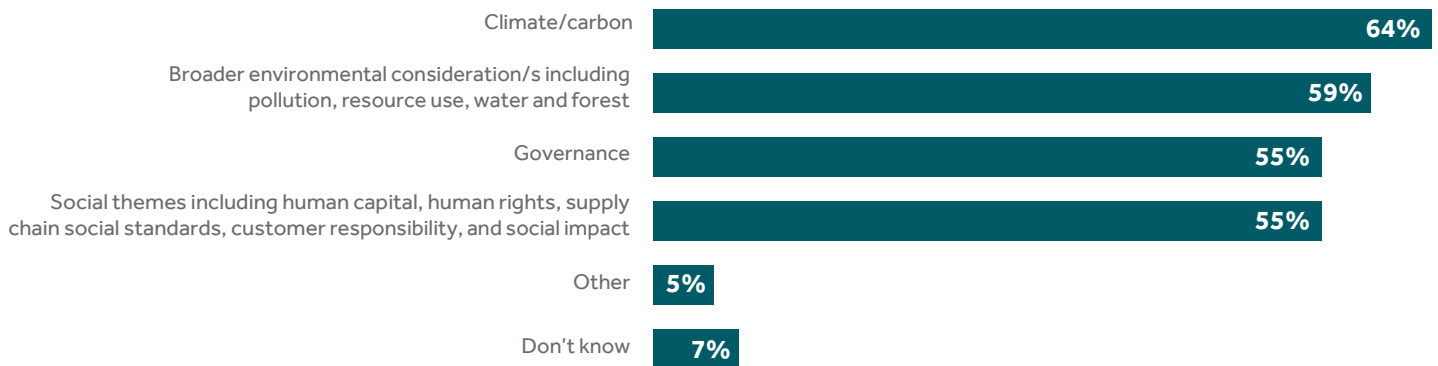
Sample size for Asia Pacific and Other regions not large enough to break out; respondents from these regions are included in total.

Among those who anticipate applying ESG/sustainability to their smart beta strategy, climate/carbon is the top issue under consideration.

Climate/carbon tops the list of sustainability themes that appear to be a focus at 64%, with environmental considerations close behind at 59%. Governance and social themes are also widely considered, with over half of respondents indicating such.

Exhibit 5

What ESG/sustainability issues are you considering using in a smart beta and ESG allocation?



Multi-pick. Segment = Anticipate applying ESG/sustainability considerations to a smart beta strategy.

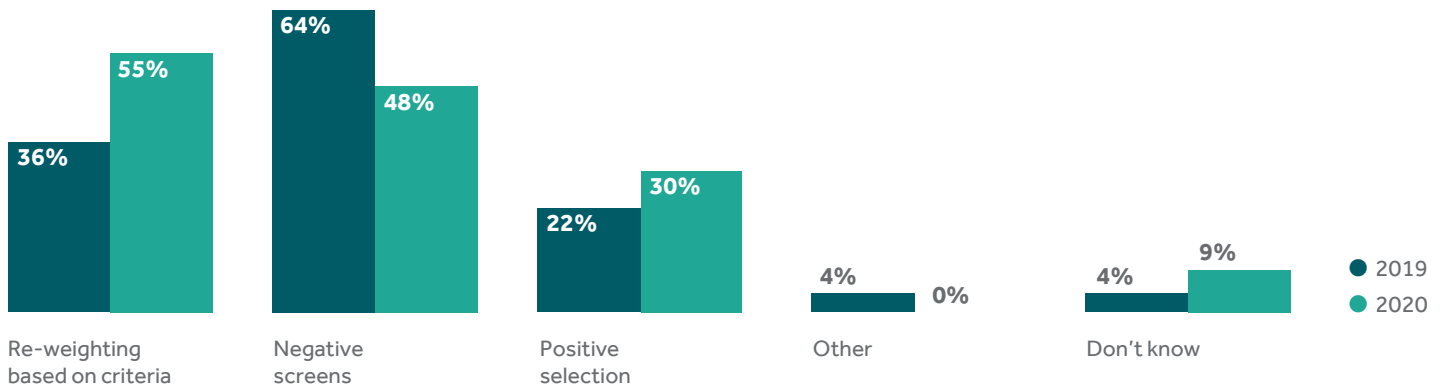
In 2020 there is a marked decline in interest in negative screens, coinciding with a growth in the more sophisticated approach of re-weighting based on ESG/sustainability criteria.

Interest grew to 55% in re-weighting/tilting approaches based on ESG/sustainability criteria alongside more traditional smart beta/risk premia factors.

Negative screening/divestment e.g. excluding fossil fuel industries or tobacco from investment portfolios, has declined to 48%, from 64% in 2019.

Exhibit 6

What ESG/sustainability investment approaches are you using or considering using in a smart beta and ESG allocation?



Multi-pick. Segment = Anticipate applying ESG/sustainability considerations to a smart beta strategy.

3

Outlook

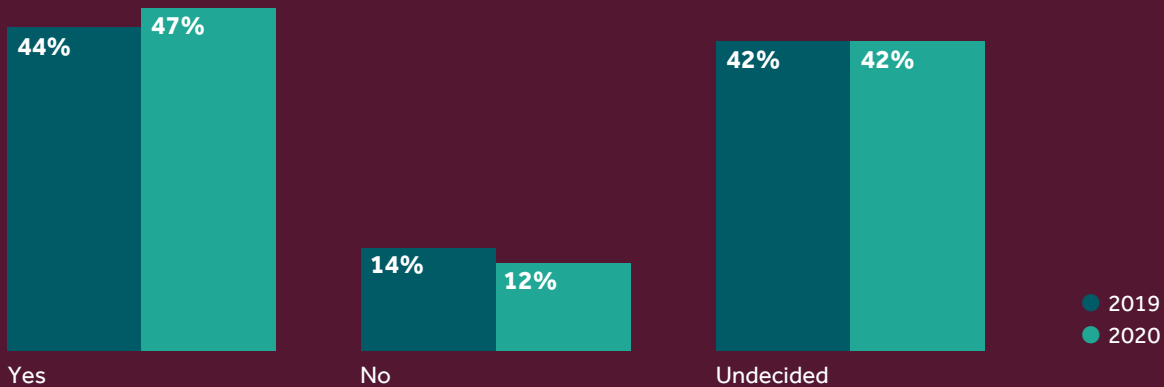
The outlook for “smart sustainability” remains strong.

Consistent with last year, nearly half of those who anticipate applying ESG/sustainability considerations to a smart beta strategy expect to increase their allocation to smart beta ESG

over the next year or two. Only 12% do not expect to increase their allocation, while 42% are undecided.

Exhibit 7

Do you expect to increase your allocation to smart beta ESG over the next one to two years?



Segment = Anticipate applying ESG/sustainability considerations to a smart beta strategy.

Conclusion

One of the key themes that emerged from our 2020 survey of asset owners was the continued growth in sustainable investment and ESG. With nearly three quarters of asset owners either implementing or evaluating ESG considerations in their investment strategies, the incorporation of data on an issuer's ESG performance into investment analysis has become mainstream.

Regional differences in ESG usage that were so pronounced in 2019 are also levelling off: EMEA continues to lead the way with its enthusiasm for applying ESG considerations to smart beta, though North America is catching up. This year 81% of EMEA asset owners evaluating or using smart beta expect to apply ESG considerations to smart beta (up from 73%), while 42% of North American asset owners do (up from 17%).

In terms of ESG smart beta implementation, asset owners increasingly embrace the use of ESG re-weighting over negative screens, positive selection or other approaches.

We will continue to include sustainability topics in future surveys to monitor how this confluence of trends takes shape and matures over time.

Appendix

Organization type

	2018	2019	2020
Corporation or private business	20%	16%	18%
Government	36%	31%	28%
Non-profit, university	15%	14%	12%
Union or industry-wide pension scheme	10%	15%	12%
Other	20%	24%	30%

Plan type

	2018	2019	2020
DB	67%	53%	54%
DC	36%	36%	26%
E/F	15%	14%	13%

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