Asset owners are buying into sustainable investment: How risk management enables widespread adoption

2021 global survey findings from asset owners

FTSE Russell

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Contents

Introduction

Welcome to the fifth edition of the FTSE Russell survey of asset owners that this year focuses on the fast-evolving global theme of sustainable investment.

The continued growth and mainstreaming of sustainable investment have become a core consideration for asset owners of various sizes, underpinned by widespread adoption that has created a baseline of global acceptance. We can conclude that sustainable investment for asset owners today is indeed a maturing story – with a positive outlook.

Our research shows an established commitment to sustainable investment across the globe, including a narrowing of the gap between evaluation and adoption levels reported by asset owners in traditionally first-moving Europe and slower-adopting North America. Beneath the global trend, the regional stories continue to evolve, however.

Variations in macroeconomic and societal factors across regions are resulting in specific approaches by asset owners that are implementing sustainable investment strategies. Among the key drivers and motivations that are fueling sustainable investment are risk management considerations, which the survey shows playing out with varying emphasis in different regions. Our report discusses how risk management factors are behind the widespread adoption of sustainable investment. We also observe that although asset owners are moving toward a greater level of adoption, their methods and approaches differ, reflecting their size, investment strategy and geography.

Our research highlights that asset owners face data-related barriers to implementing sustainable investment into their investment strategies. As there are considerable variations in how companies disclose data about their own performance, asset owners are prioritizing standardization of data and materiality as they look for a clearer investment view on their potential investee companies.

I hope you enjoy reading the compelling findings in the following pages – and that this important study helps you and your colleagues benchmark your approaches against the wider industry's evolving experiences.

At FTSE Russell we look forward to hearing your thoughts about this study and welcome the opportunity to explore how we can help you and your organization to advance your own sustainable investment strategy.

Best wishes

Sylvain Chateau

Global Head of SI Product Management, LSEG

About the research

This report is based on the results of the FTSE Russell survey of asset owners that we conducted between February and early April 2021, in partnership with Radius Global Market Research. This research marks the fifth year we have covered sustainability/environmental, social and governance (ESG) considerations. This year is the first time that we have focused on sustainable investment in general.

Our sincere thanks go to the investment professionals at 179 global asset owners who participated. The majority of participating institutions are located in North America (40%), EMEA (36%) and Asia Pacific (19%). Among those who participated from the Asia Pacific region, 32% of respondents are located in Australia or New Zealand and the remaining 68% are located in Asia. The regional distribution chart (next page) shows the four-year trend from 2018-2021.

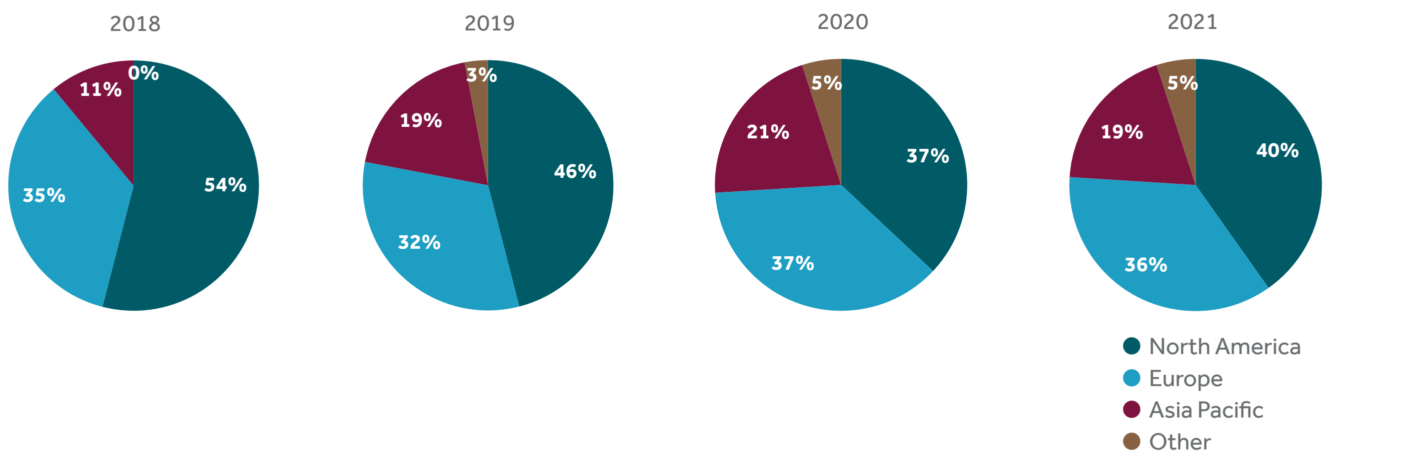
Pension funds/plan sponsors account for 42% of all respondents, insurance companies make up 18%, government organizations represent 12% and endowments/foundations 10%. The remaining respondents represent sovereign wealth funds, family offices, non-profits, banks, healthcare organizations or hospitals, and unions.

The majority (59%) of respondents are asset owners that manage defined benefit plan assets, 31% manage defined contribution plan assets, 21% manage endowment or foundation assets and 21% manage insurance company general accounts. Some respondents manage multiple asset types.

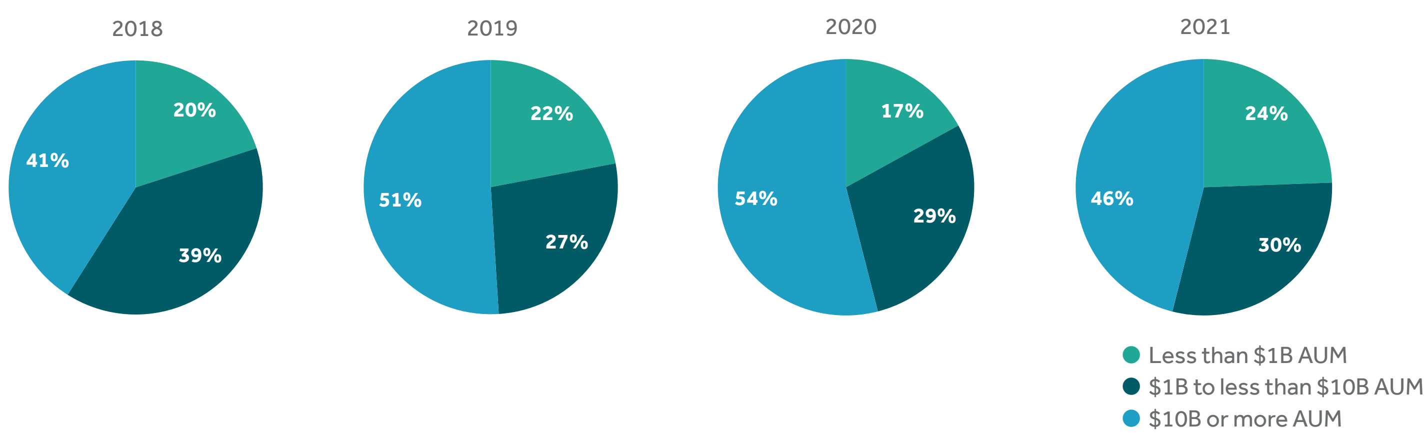
Our sincere thanks go to the investment professionals at 179 global asset owners who participated.

Sample distribution by year for 2018 – 2021

Region distribution



AUM tier distribution



Nearly half (46%) of the participating asset owners have an AUM total of $10 billion or more, those with AUM between $1 billion and $10 billion account for 30% and those with under $1 billion in total AUM make up the remaining 24%. The AUM tier distribution chart (above) shows the four-year trend from 2018 – 2021.

For a sample size of 179, the margin of error is +/-7% 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 options in each exhibit footer).

Executive summary

Sustainable investment has clearly matured to become one of the most high-profile, high-priority investment considerations for institutional asset owners across the world. More than eight in every ten (84%) of the institutional asset owners that took part in our research are either implementing or evaluating sustainability into their portfolios. It's notable though that just over a third (36%) of asset owners are motivated to capture associated investment returns from sustainable investing.

Our research shows that asset owners that are implementing and evaluating sustainable investment are motivated by risk management.

Almost two-thirds (64%) of all asset owners are motivated to adopt sustainable investing to mitigate long-term investment risk.

Managing risk considerations

Almost two-thirds (64%) of all asset owners say mitigating long-term investment risk is a key factor. There is a correlation between an investment institution's AUM and a heightened focus on risk: asset owners with assets greater than US$1 billion are more concerned about managing long-term risks than smaller institutions.

Nearly half (49%) of asset owners in North America and 60% in EMEA implement sustainable investment strategies to avoid harming their institution's reputation.

Climate and carbon are the leading priority focus area for over two-thirds (67%) of asset owners. The Covid-19 pandemic has shone a light on social issues globally: 60% of all asset owners say that social themes are a sustainability priority focus.

Though asset owners in EMEA and Asia Pacific view climate/carbon as the number-one priority focus area, asset owners in North America cite social themes as their top priority, with climate/carbon coming in third.

Regulation headwinds and tailwinds

Asset owners worldwide have mixed views about how supportive regulation is in the financial services industry. However, in the context of sustainable investment, asset owners tend to view regulation as enabling greater adoption of sustainable investment. Overall, 82% of those we surveyed view sustainable investment regulation as enabling or potentially enabling depending on the specifics of the regulation, while only 15% view this regulation as exclusively constraining.

For those asset owners that agree with the potentially enabling benefits of regulation, over three-quarters (78%) say that regulations might improve the quality and consistency of corporate reporting and disclosures.

With the rise of corporate ESG and climate-reporting requirements, asset owners say that there are notable benefits to investors of improved reporting and standardization. More than six in ten (61%) say that the development of corporate ESG and climate-reporting requirements are beneficial to their institutions' investment approaches.

61% say that the development of corporate ESG and climate-reporting requirements are beneficial.

The International Financial Reporting Standards (IFRS) Foundation, the Sustainability Accounting Standards Board (SASB) and the International Organization of Securities Commissions (IOSCO) have worked hard to create standardized reporting approaches.

Implementing sustainable investment

Of the asset owners we surveyed, over eight in ten (84%) of them globally are implementing or evaluating sustainable investment considerations in 2021, up from a little over half (53%) in 2018. In North America, 39% were doing so in 2018 compared with 68% in 2021. And in EMEA, the total in 2018 was 72% and 97% in 2021.

Approximately nine in ten asset owners in Asia Pacific (88%), UK (90%) and Europe (97%) have strong appetite for sustainable investment, but less than half (45%) of US-based asset owners are currently implementing sustainable investment.

Nearly half (46%) have implemented sustainability considerations within their public equity portfolios and 35% have implemented sustainability considerations within fixed income.

In active public equity strategies, a large majority (74%) of asset owners that have implemented sustainable investment are following a broad integration approach. For active fixed income allocations, 57% are broadly integrating sustainable investment.

In passive strategies, the most popular approach when allocating to public equity is through shareholder engagement and voting (40%) followed by negative screens (37%).

Lack of standardization in ESG data, scores and ratings is the most commonly cited barrier to increased sustainable investment adoption (59%). Almost half (45%) of respondents express concern about the quality or consistency of corporate reporting and disclosures while 42% are concerned about availability of ESG data and the use of estimated data.

In EMEA, sustainable investment evaluation and adoption by asset owners is nearly universal.

1

Risk management considerations fuel appetite for sustainable investment

While asset owners state there are various reasons why they are implementing sustainable investment strategies, risk management makes up the top two reasons that institutions cite in our research.

Reflecting how sustainable investment will be integral to their institutional investment strategies going forward, nearly two-thirds (64%) of all asset owners say that mitigating long-term investment risk is a key factor (see Exhibit 1.1).

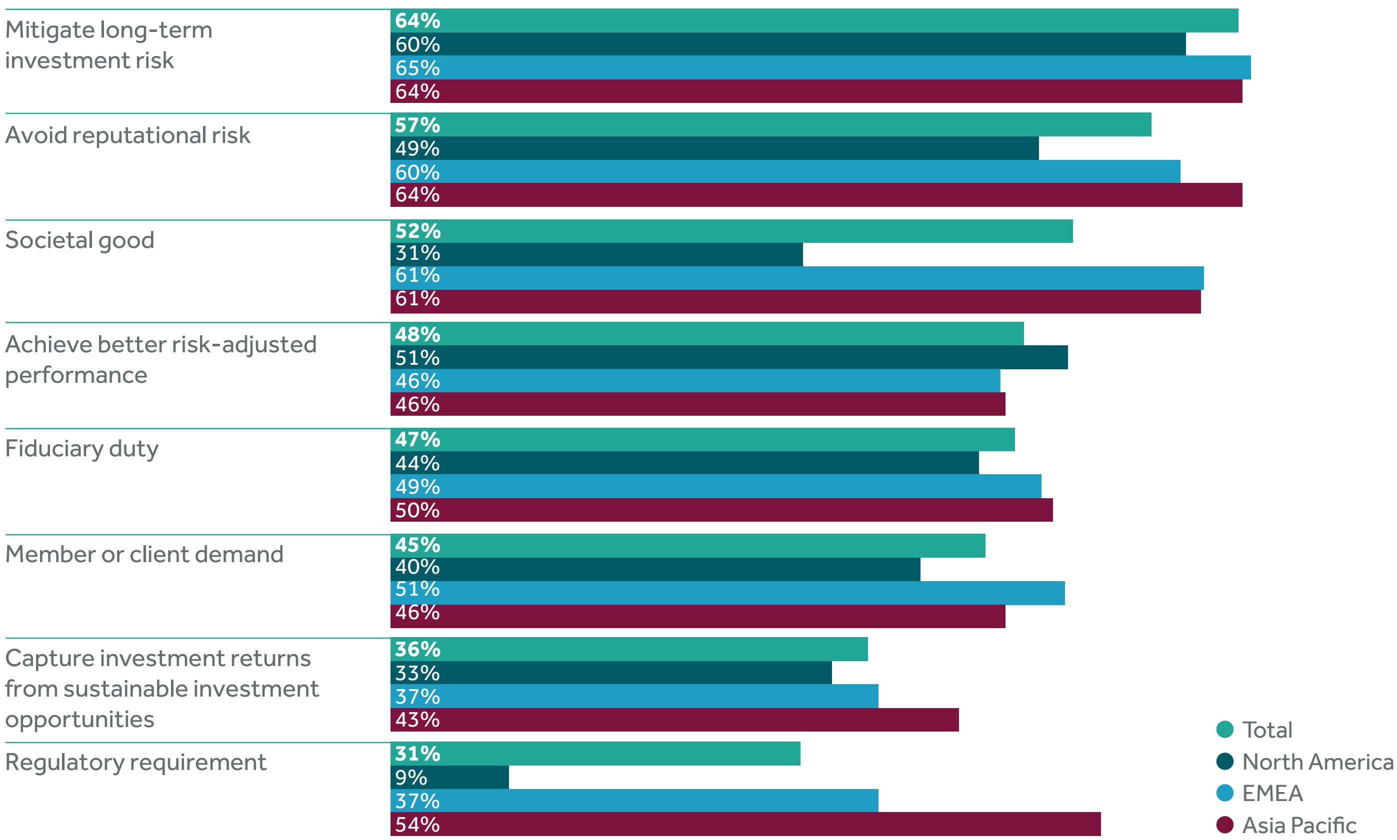
Larger asset owners are more concerned about managing long-term investment risk than smaller institutions: seven in ten (70%) respondents with AUM of US$1 billion or more cite this reason compared with just 42% of asset owners with AUM of less than US$1 billion, Exhibit 1.2 shows.

Not allocating to sustainability-focused investments is perceived to come with a risk to institutional reputation. Nearly half (49%) of asset owners in North America implement sustainable investment strategies to avoid harming their institution's reputation while 60% in EMEA and 64% in Asia Pacific choose this reason.

Over half of asset owners with AUM greater than US$1 billion are motivated to implement sustainable investment to achieve better risk-adjusted performance, but only 30% of asset owners with smaller AUM share the same motivation.

Exhibit 1.1

Rationale for implementing or considering sustainable investment in investment strategy – by region



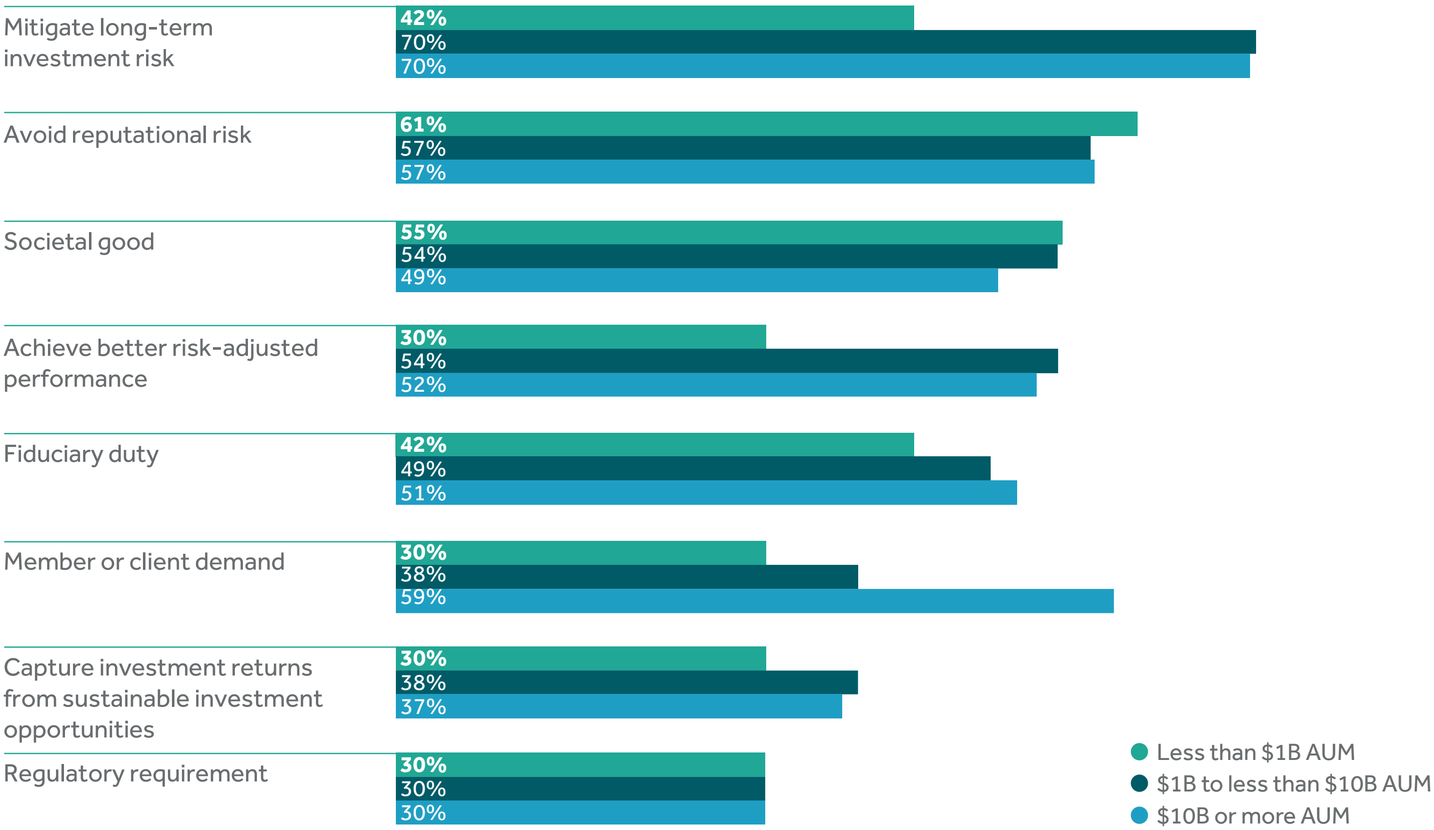
Multi-pick. What is your rationale or motivation for implementing or considering implementing sustainable investment considerations in your investment strategy?

Segment = Currently implementing, evaluating, or plan to evaluate sustainable investment

Sample size for Asia Pacific is 28, below the preferred threshold of 30.

Exhibit 1.2

Rationale for implementing or considering sustainable investment in investment strategy – by AUM tier



Multi-pick. What is your rationale or motivation for implementing or considering implementing sustainable investment considerations in your investment strategy?

Segment = Currently implementing, evaluating, or plan to evaluate sustainable investment

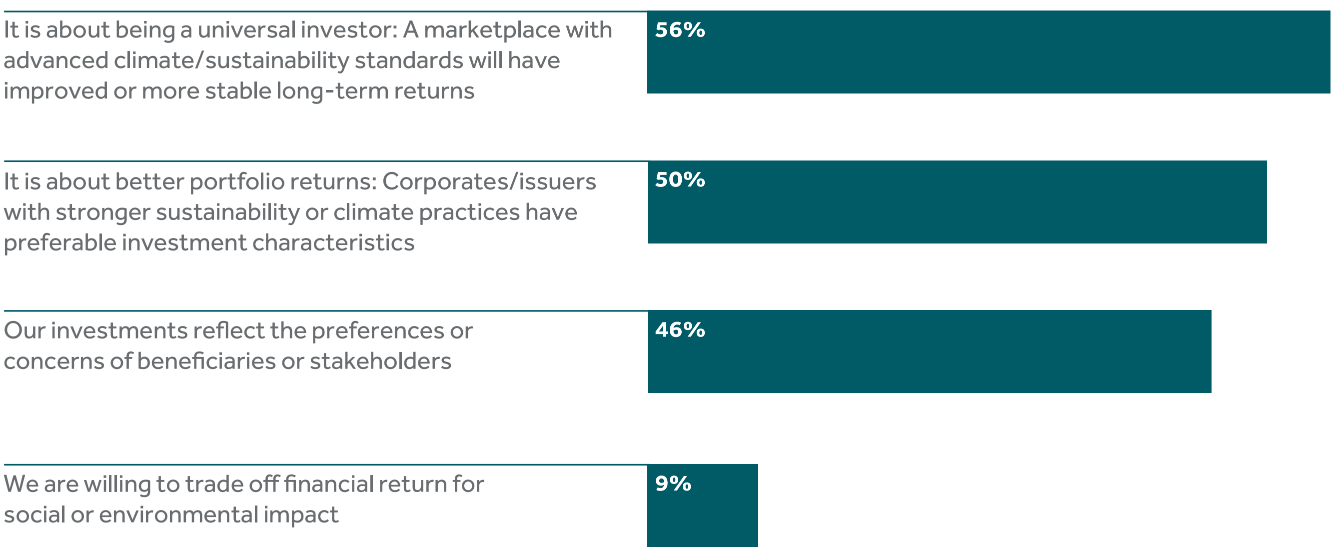
Achieving better portfolio returns

Less than 10% of the asset owners we surveyed are willing to trade off financial return for social or environmental impact. However, half (50%) say that sustainable investment correlates with better portfolio returns because corporates and issuers with stronger sustainability or climate practices have preferable investment practices.

A similar number (56%) of asset owners say that implementing sustainable investment strategies reflects their universal investor approach. A marketplace with advanced climate and sustainability practices will, they say, have improved long-term returns (see Exhibit 1.3).

Exhibit 1.3

Organizations' views on sustainable investment



Multi-pick. Which statements best reflect your organizations' views on sustainable investment?

Segment = Currently implementing, evaluating, or plan to evaluate sustainable investment

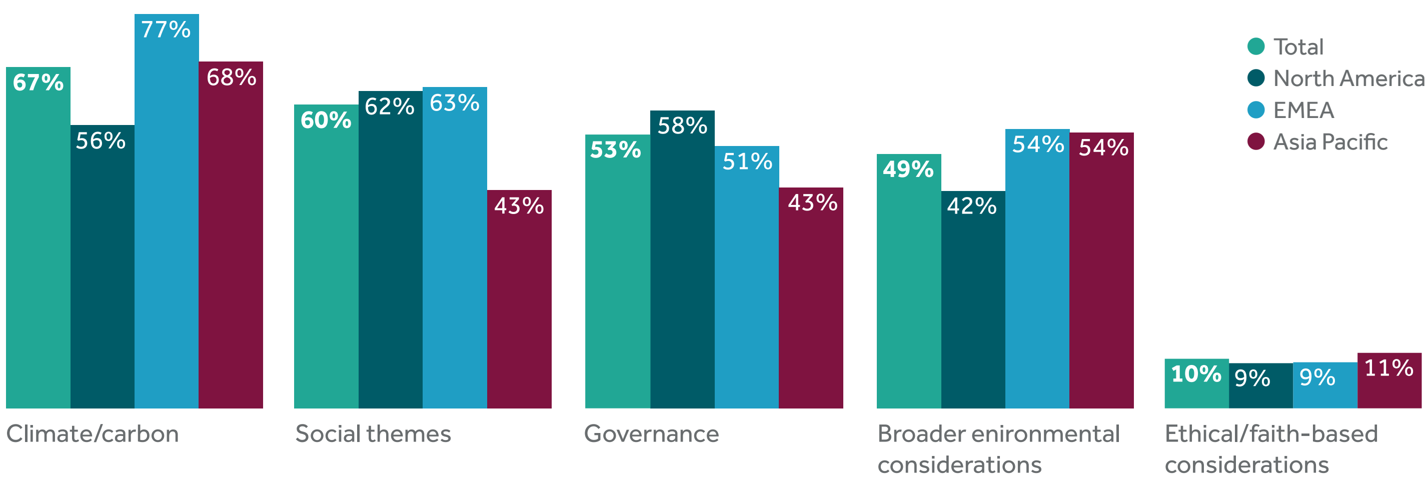
Priority focus: climate and carbon issues

Before the Covid-19 pandemic, business leaders and governments around the world had started to address the climate crisis. Despite the possibility that the pandemic would interrupt the momentum of the global climate campaign, over two-thirds (67%) of asset owners that took part in our research say that climate and carbon are their leading sustainability priority focus area (see Exhibit 1.4).

Examining the regional data, differences of opinion exist. In EMEA and Asia Pacific, the priority focus area is climate and carbon, with over two-thirds of asset owners focused on this area (77% and 68%, respectively). In North America, the focus is strongest on social themes (62%), followed by governance (58%) and climate/carbon (56%).

Exhibit 1.4

Sustainability issues that are priority focus areas



Multi-pick. Which sustainability issues does your organization consider as a priority focus?

Segment = Currently implementing, evaluating, or plan to evaluate sustainable investment

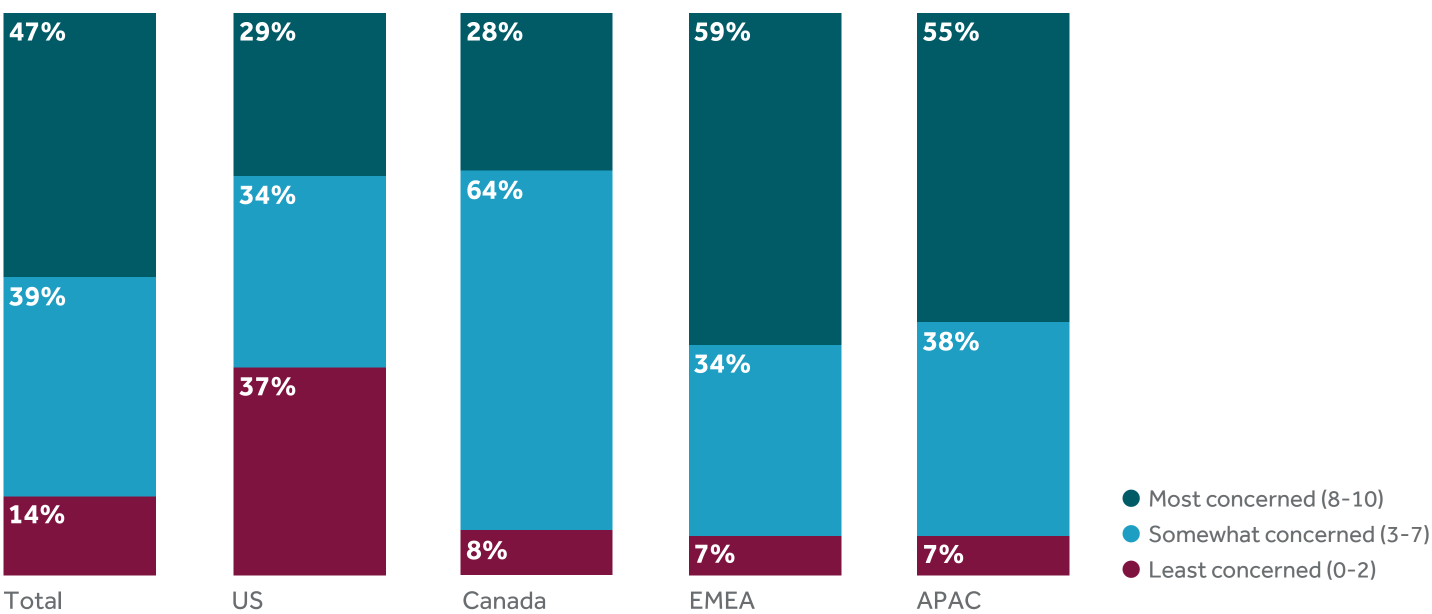
Sample size for Asia Pacific is 28, below the preferred threshold of 30.

Although asset owners worldwide are concerned about climate-related risk, they express varying levels of concern. Asked to rate their level of concern with the investment impact of climate risk on a zero-to-ten scale, over half of asset owners in EMEA and APAC are very concerned (8, 9 or 10 rating).

In contrast, less than 30% of North American asset owners rate their level of concern this way. Notably, over one-third of US asset owners say that they are not or not very concerned about the investment impact of climate risk (0, 1, or 2 rating), perhaps highlighting how much climate and carbon are considered as part of a political debate in the country.

Exhibit 1.5

Level of concern with investment impact of climate risk



What level of concern do you have with the investment impact of climate risk? (asked on an 11-point scale; responses grouped into three buckets)

Sample size for Canada is 25 and Asia Pacific is 29, below the preferred threshold of 30.

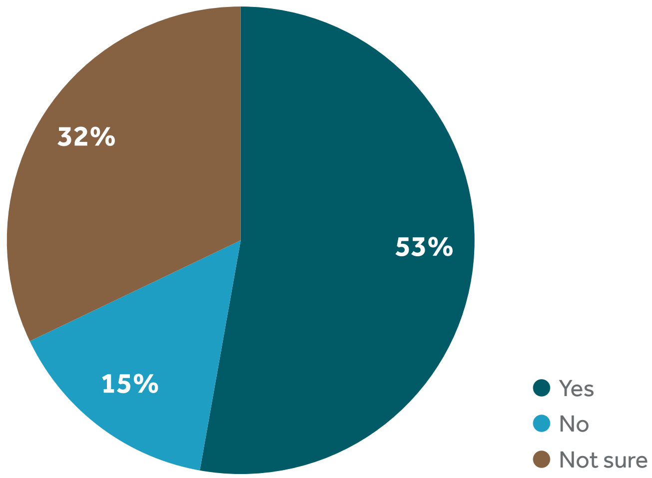
Emphasizing the social in ESG

As the Covid-19 pandemic spread and as infections soared in mid-2020, many social issues intensified in communities and in the media around the world. They included the social and healthcare inequities highlighted by the pandemic, race relations challenges that inspired civil rights movements including Black Lives Matter, and gender-related crimes that generated global support for the Me Too movement.

Although 60% of all asset owners say that social themes – including diversity and inclusion, human rights, customer responsibility and social impact – are a sustainability priority focus, that leaves 40% of respondents that do not agree. Our research investigated why this group of asset owners do not consider social themes to be a current priority focus for their institutions. Over half (53%) say that they would prioritize social themes if social data were reliable and widely available (see Exhibit 1.6). As the quality and availability of social data improves, we expect that asset owners will increasingly view social as an area of priority focus.

Exhibit 1.6

Whether sustainability issues related to social themes would be a priority if social data were reliable and widely available



If social data were reliable and widely available, would sustainability issues related to social themes be a priority for your organization?

Segment = Currently implementing, evaluating or plan to evaluate sustainable investment and social themes are not a priority focus

2

Regulation can enable sustainability-focused investing

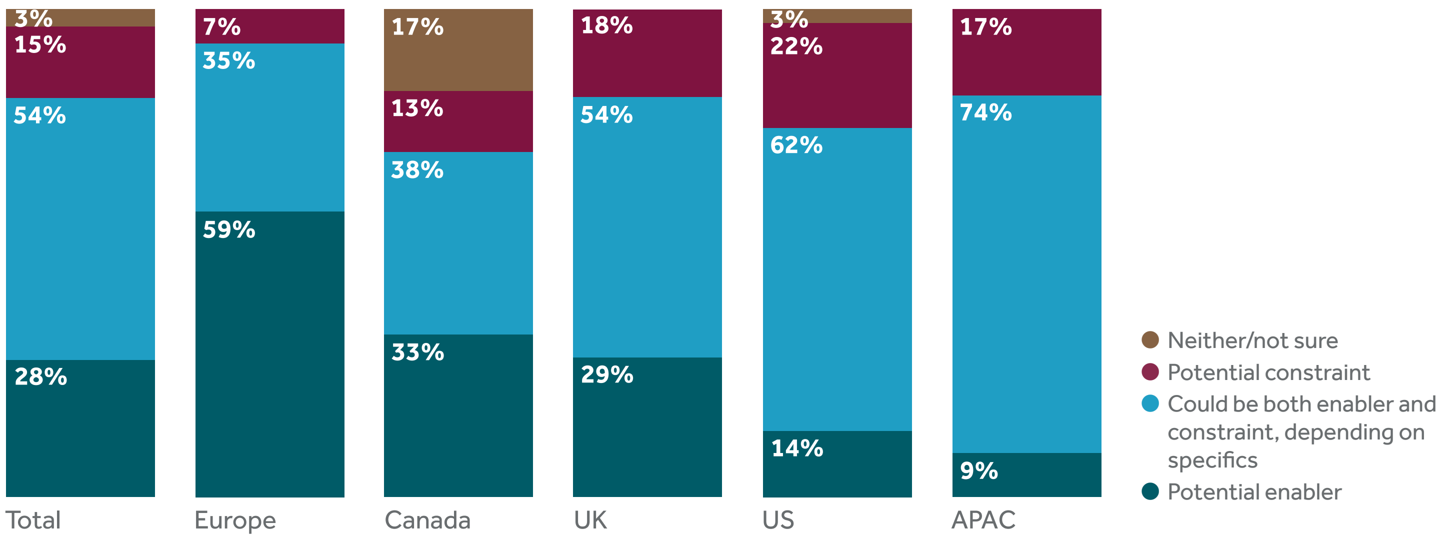
Regulation of sustainable and ESG-focused investment is viewed as more of an enabler than a constraint for asset owners, particularly in Europe.

More than a quarter (28%) of respondents worldwide say they view regulation as a potential enabler (see Exhibit 2.1). In Europe, where sustainable investment strategies have been most widely implemented, nearly six in ten (59%) asset owners see regulation as an enabling factor.

Overall, 82% of asset owners view sustainable investment regulation as enabling or potentially enabling depending on the specifics of the regulation, while only 15% view this regulation as exclusively constraining. However, the majority (60%) of asset owners say the regional inconsistencies across regulation of sustainable investment and ESG are a cause for concern (see Exhibit 2.2).

Exhibit 2.1

Is sustainable investment regulation perceived as a potential enabler, constraint or both?

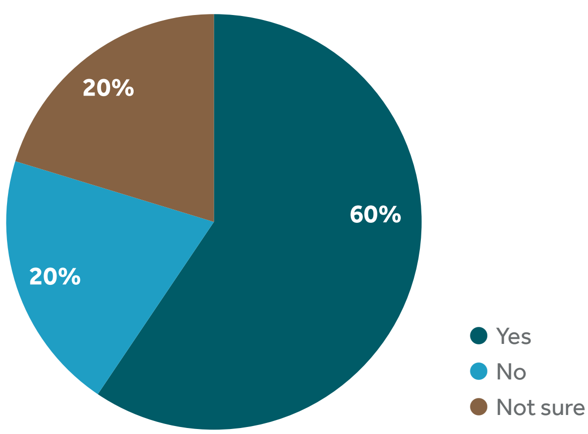


In your view, do you see sustainable investment or ESG regulation as a potential enabler, potential constraint, or both?

Sample size for Europe, UK, Canada and Asia Pacific are 29, 28, 24 and 23 respectively, below the preferred threshold of 30.

Exhibit 2.2

Are regional approaches to sustainable investment regulation a concern?



Do you think differences in regional approaches to sustainable investment regulation is a concern?

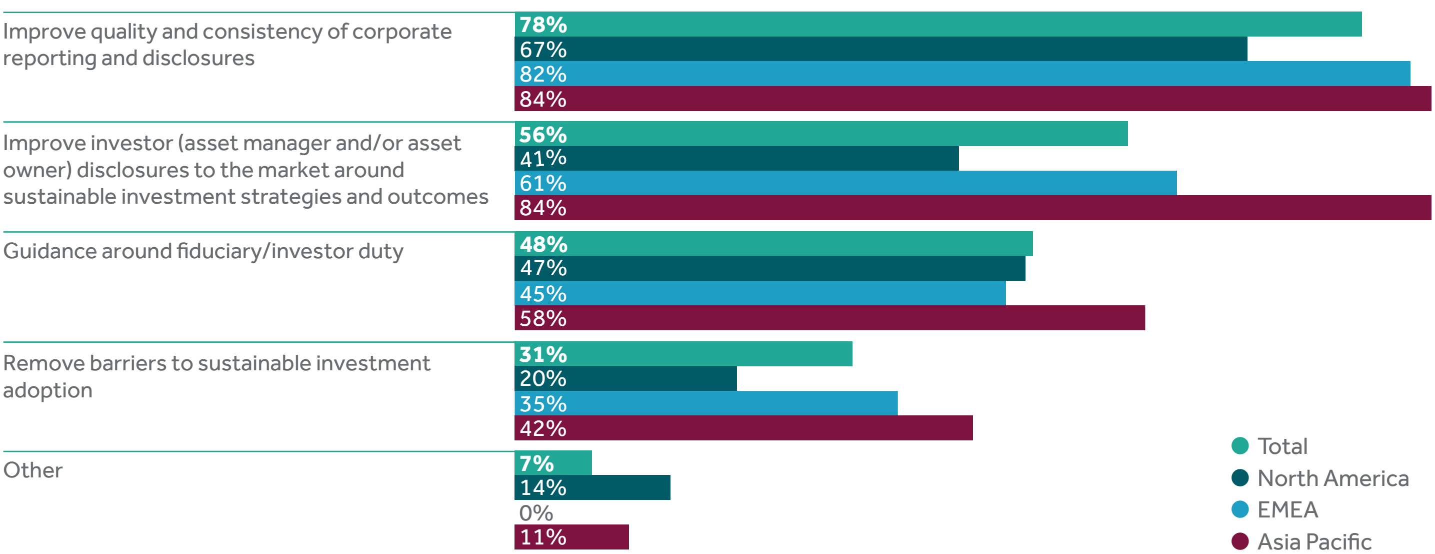
Improving corporate reporting and disclosures

Among the group of asset owners that do not see regulation of sustainable investment and ESG-focused investing as a constraint to their investment strategies, a resounding 78% say that regulations might improve the quality and consistency of corporate reporting and disclosures.

For this group, more than half (56%) say that regulation could help to improve investor disclosures around sustainable investment strategies and outcomes. And nearly half (48%) say that regulation might help improve guidance on their fiduciary or investor duty (see Exhibit 2.3).

Exhibit 2.3

Ways in which sustainable investment regulation might be helpful



Multi-pick. In what ways might sustainable investment regulation be helpful?

Segment = Do not see sustainable investment/ESG regulation as exclusively a constraint

Sample size for Asia Pacific is 19, below the preferred threshold of 30.

Benefiting from corporate ESG/climate reporting

As corporate ESG and climate reporting continues to evolve, investors across the asset management industry say that there are notable benefits in reporting and standardization.

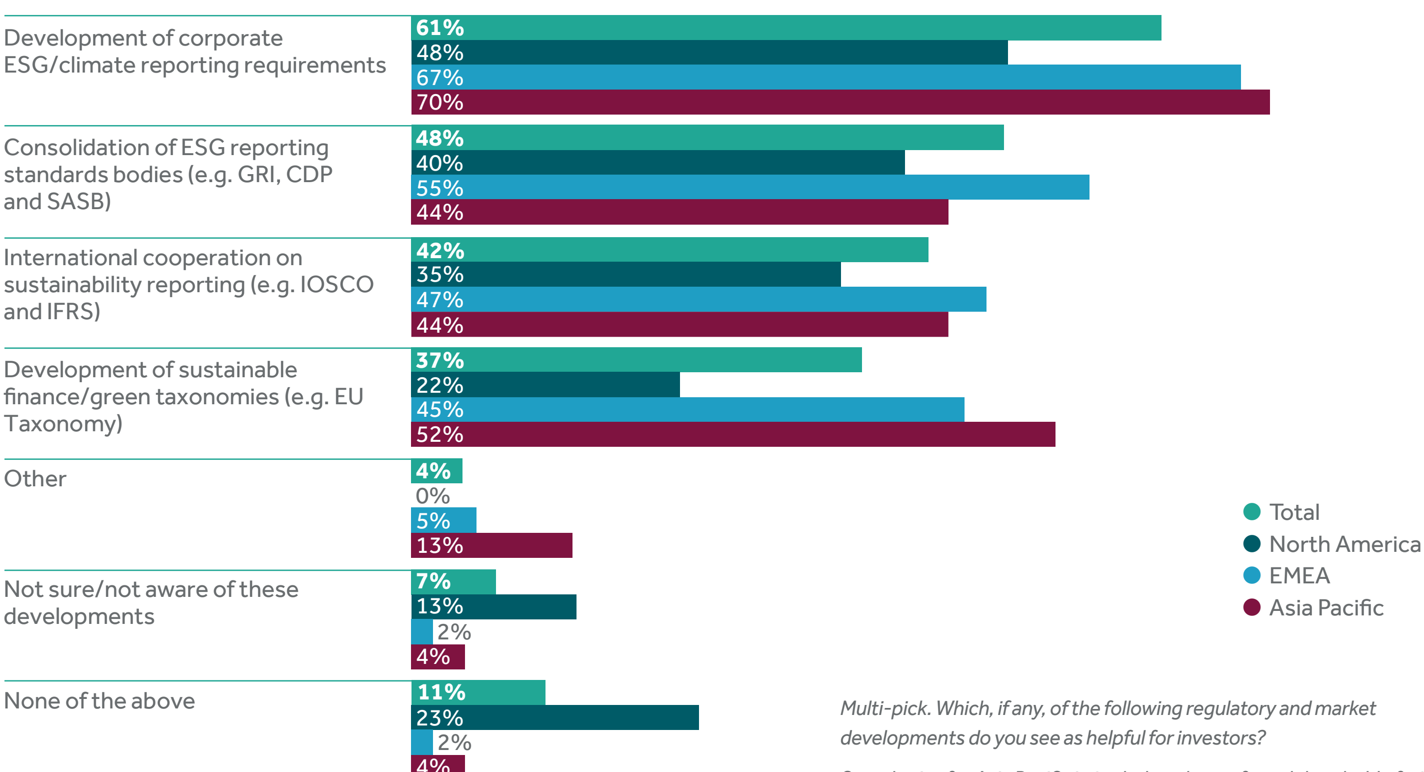
More than six in ten (61%) respondents in our research – rising to 67% for EMEA-based asset owners and 70% for Asia Pacific-based asset owners – say that the development of corporate ESG and climate-reporting requirements are beneficial to their institutions' investment approaches.

Exhibit 2.4 shows the other areas of regulation and market developments that asset owners say are helpful, including sustainable investment standards and reporting. As levels of reporting increase, institutions are paying considerable attention to standardization and materiality as they search for greater clarity and consistency in the large volume of data points to help make investment decisions.

As asset owners explore sustainable investment opportunities, an increasingly stronger global regulatory framework provides a supportive backdrop for them to allocate to various asset classes.

Exhibit 2.4

Regulatory/market developments considered to be helpful for investors



Multi-pick. Which, if any, of the following regulatory and market developments do you see as helpful for investors?

Sample size for Asia Pacific is 23, below the preferred threshold of 30.

3

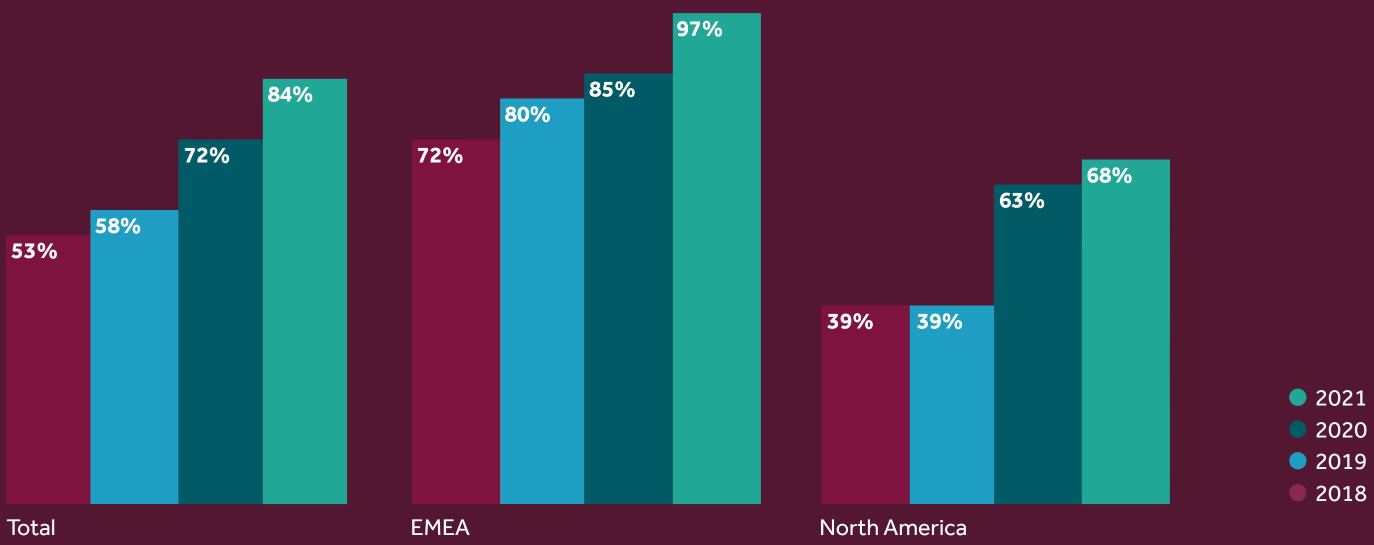
How asset owners are implementing and evaluating sustainable investment

Over eight in ten (84%) asset owners globally are implementing or evaluating sustainable investment considerations in 2021, up from a little over half (53%) in 2018.

In North America, 39% of respondents were implementing or evaluating sustainable investment in 2018 compared with 68% in 2021. In EMEA, sustainable investment evaluation and adoption by asset owners is nearly universal (97%), up from 85% in 2020 and 72% in 2018. While the figures for North America also show an increase from 2020 to 2021 (63% to 68%), the region's rate jumped most from 2019 to 2020 (39% to 63%) (see Exhibit 3.1).

Exhibit 3.1

Sustainable investment implementation or evaluation by region



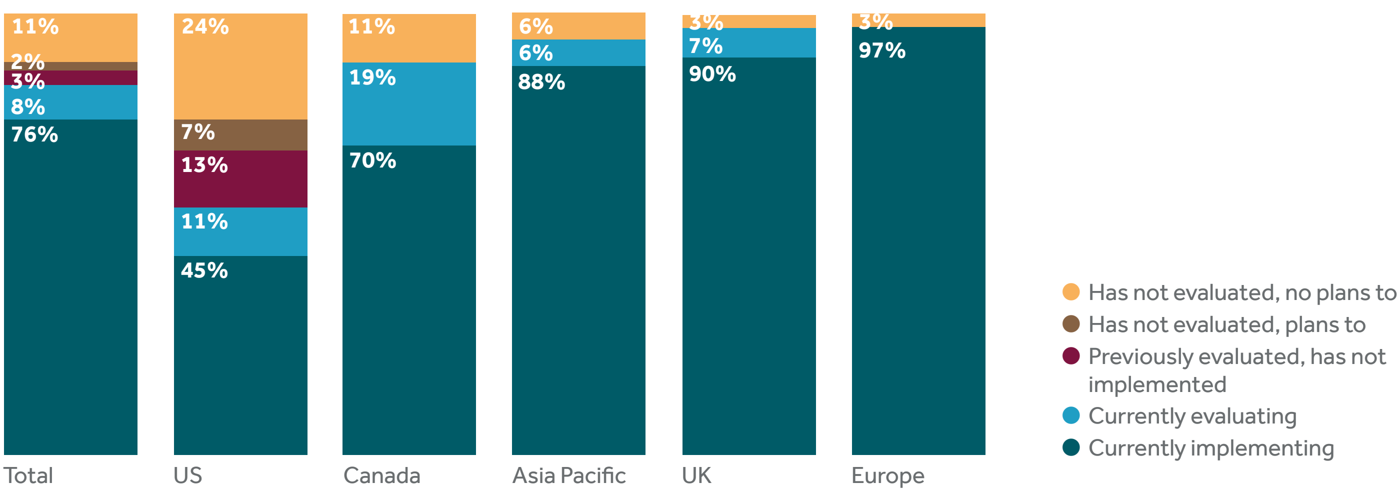
Is your organization currently implementing or evaluating ESG/sustainability considerations in your investment strategy?

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

Appetite for sustainable investment is particularly strong with approximately nine in ten asset owners reporting an allocation in Asia Pacific (88%), UK (90%) and Europe (97%). By comparison, less than half (45%) of US-based asset owners are currently implementing sustainable investment and a quarter (24%) say they have not evaluated it nor plan to (see Exhibit 3.2).

Exhibit 3.2

Sustainable investment adoption segments – 2021



Sample size for Canada is 27 and UK is 29, below the preferred threshold of 30.

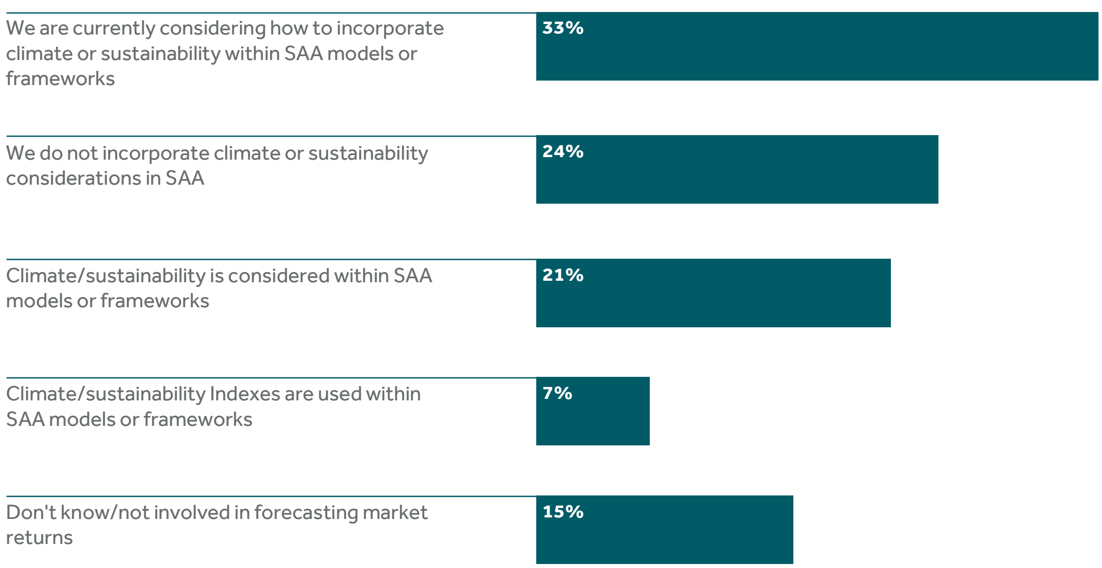
Asset owners: Incorporating or considering climate/sustainability within SAA models

Our research indicates that 21% of asset owners consider climate/sustainability within their strategic asset allocation (SAA) models or frameworks while a further 7% are using climate/sustainability indexes within SAA models (see Exhibit 3.3). The positive trend is backed up by a further 33% of asset owners that are in the process of considering how to incorporate climate/sustainability in their SAA.

Conversely, just under a quarter (24%) of asset owners say they are not incorporating sustainability or climate considerations into their SAA models or framework.

Exhibit 3.3

Incorporating or not incorporating sustainable investment/climate considerations into SAA models or framework



Are you incorporating sustainability or climate considerations into your strategic asset allocation (SAA) framework, including around long-term market returns forecasting and investment risk?

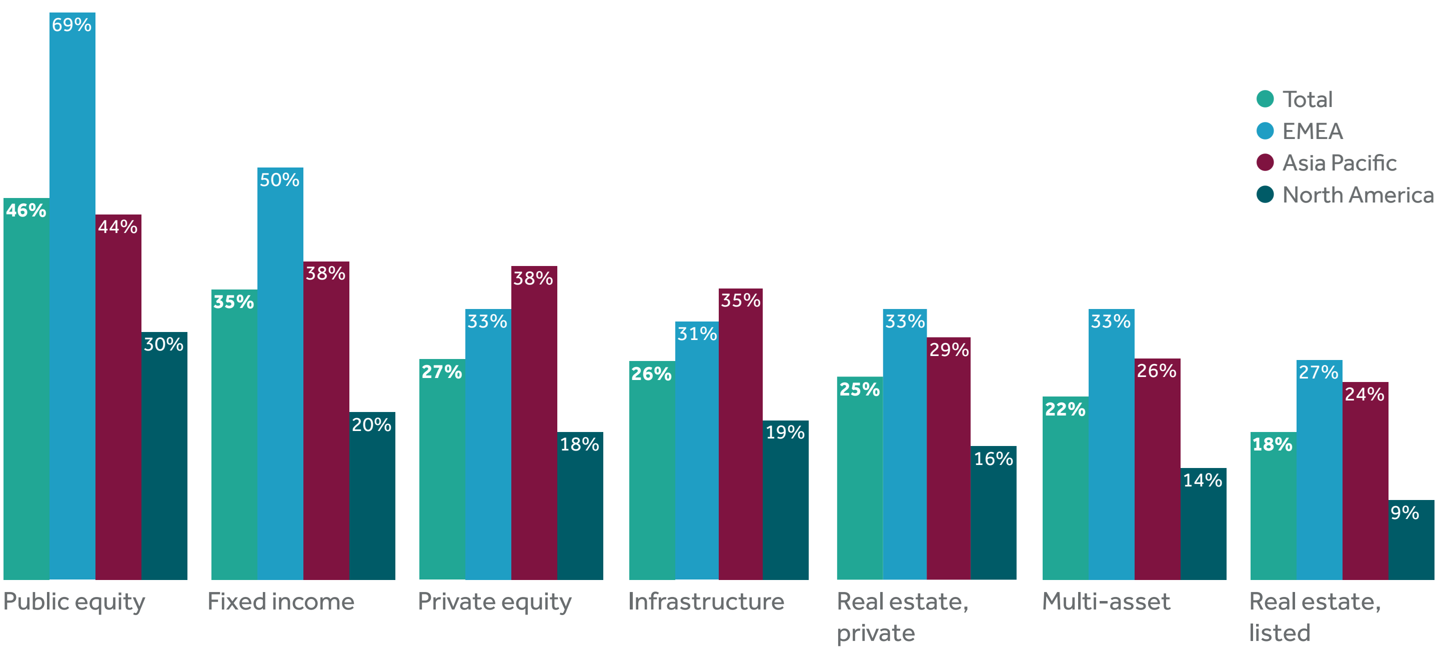
Segment = Currently implementing sustainable investment

Public equities dominate sustainable investment allocations

Sustainable investment allocations are more prevalent in public equity than other asset classes, reflecting the relative maturity of product and data infrastructure in this space. Nearly half (46%) of asset owners we surveyed have implemented sustainability considerations within their public equity portfolios, rising to 69% of asset owners in EMEA (see Exhibit 3.4).

Exhibit 3.4

Asset classes for which sustainability considerations have been implemented



Multi-pick. For which asset classes have you implemented or are you considering implementing sustainability considerations? (Summary of "implemented")

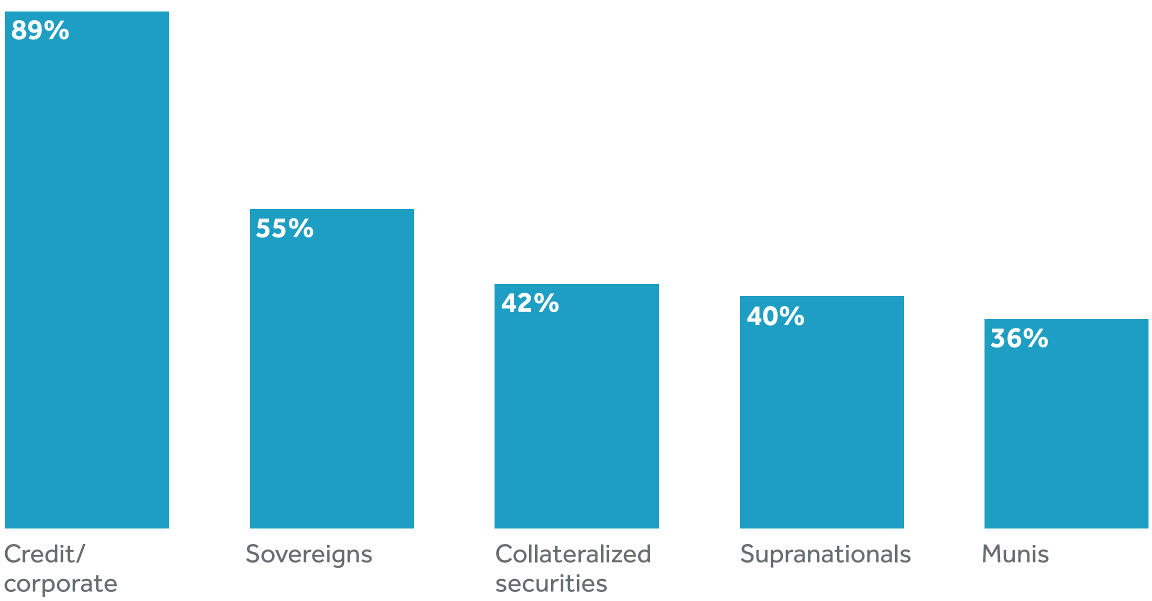
Over a third implemented fixed income sustainability allocations

Over a third (35%) of all respondents have implemented sustainability considerations within their fixed income portfolios, including 50% in EMEA, 38% in Asia Pacific and 20% in North America. Nearly nine in ten (89%) of those with a sustainable fixed income allocation are focusing on credit and corporate, while over half (55%) of the same group are allocating to sovereigns (see Exhibit 3.5).

Asset owners in Asia Pacific indicate an appetite for sustainable investment in alternative asset classes of private equity (38%) and infrastructure (35%) at a rate higher than European or North American peers, as Exhibit 3.4 shows.

Exhibit 3.5

Fixed income asset classes for which sustainability considerations have been implemented



Multi-pick. For which fixed income asset classes have you implemented or are you considering implementing sustainability considerations? (Summary of "implemented")

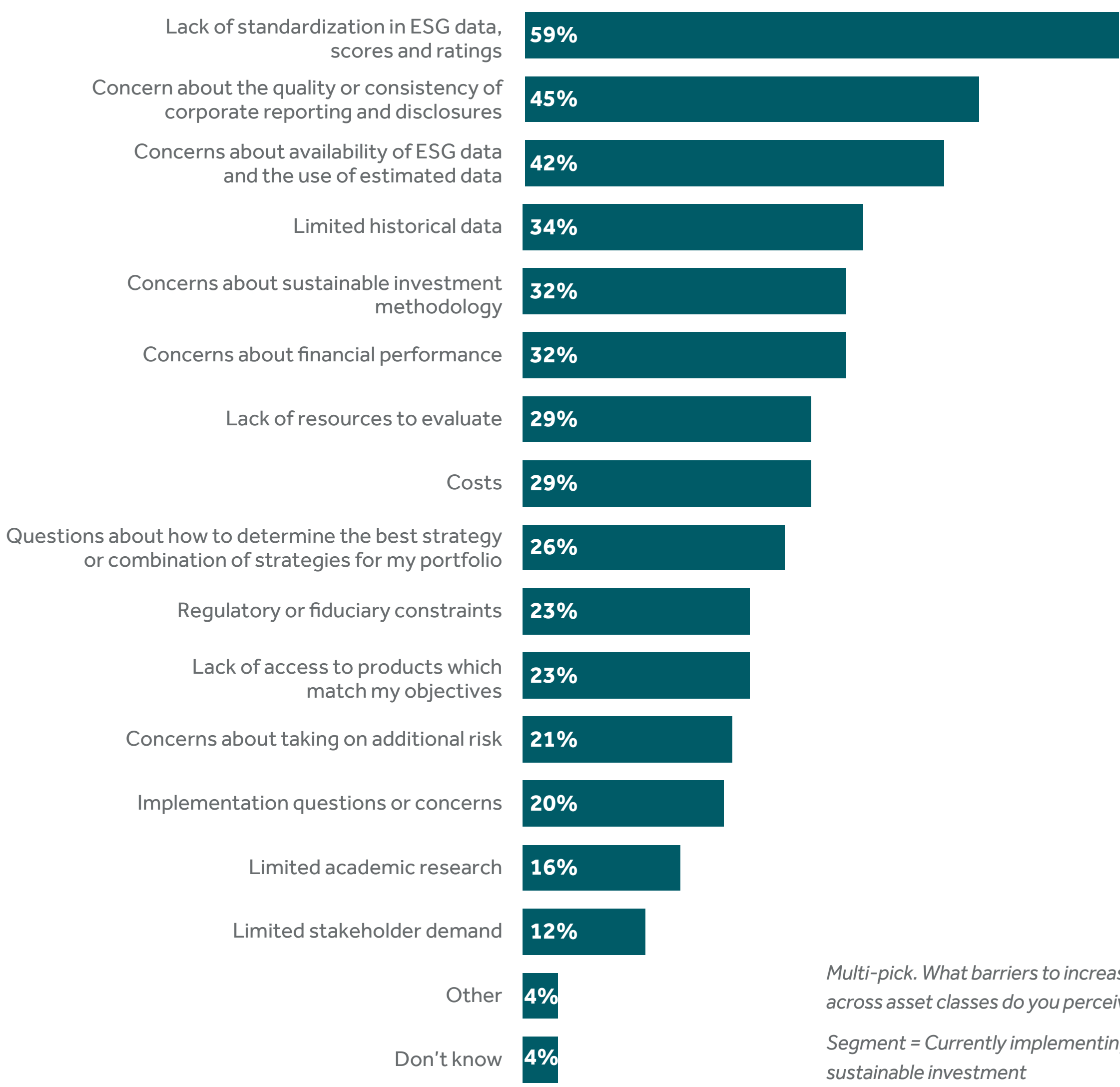
Segment = Currently implementing sustainable investment considerations for fixed income

Barriers to sustainable investment adoption

Our research highlights that asset owners face hurdles when it comes to implementing sustainable investment into their investment strategies. Lack of standardization in ESG data, scores, and ratings; concern about the quality or consistency or corporate reporting and disclosures; and concerns about availability of ESG data and the use of estimated data are the top three barriers listed (see Exhibit 3.6 for a list of barriers).

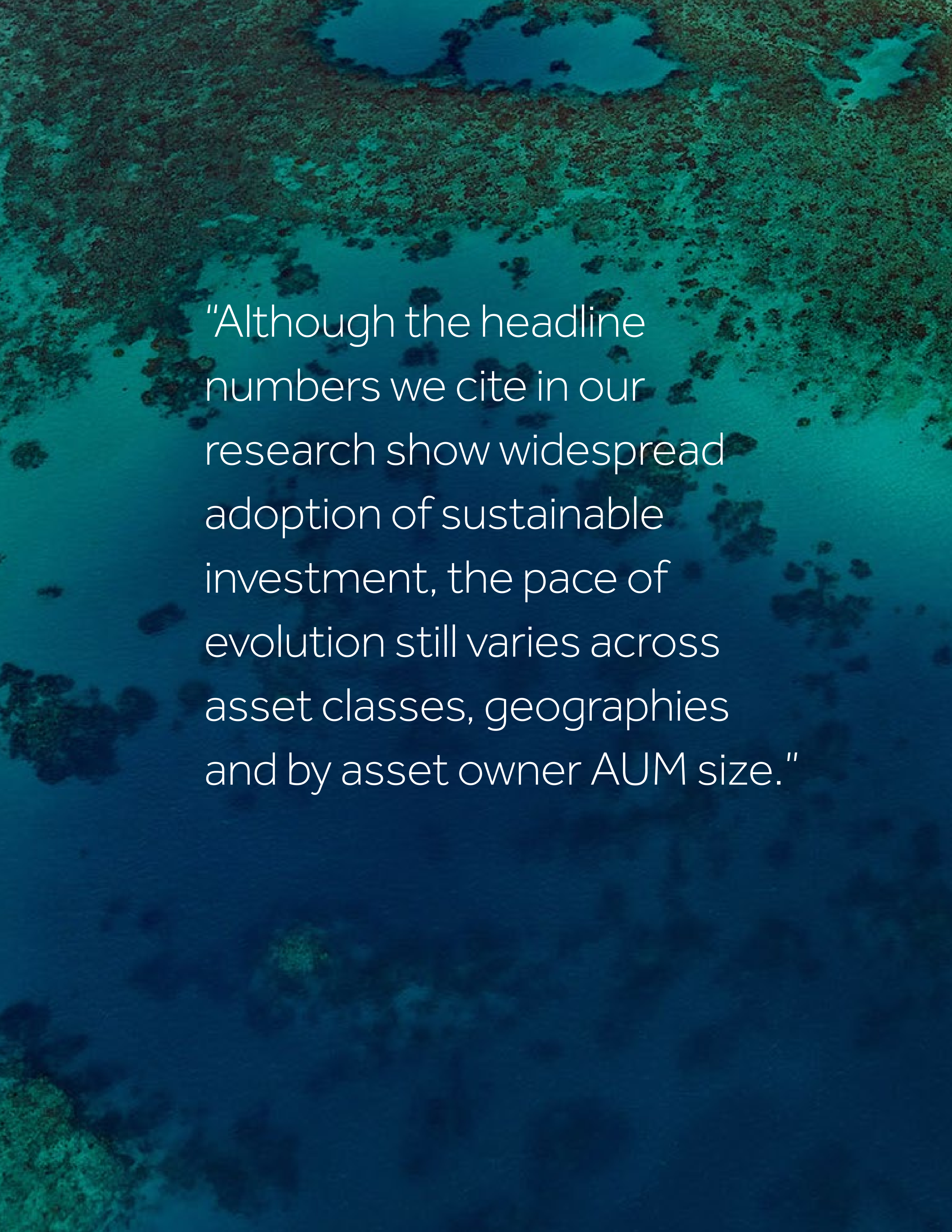
Exhibit 3.6

Perceived barriers to increased sustainable investment adoption across asset classes



Multi-pick. What barriers to increased sustainable investment adoption across asset classes do you perceive?

Segment = Currently implementing, evaluating, or plan to evaluate sustainable investment



"Although the headline numbers we cite in our research show widespread adoption of sustainable investment, the pace of evolution still varies across asset classes, geographies and by asset owner AUM size."

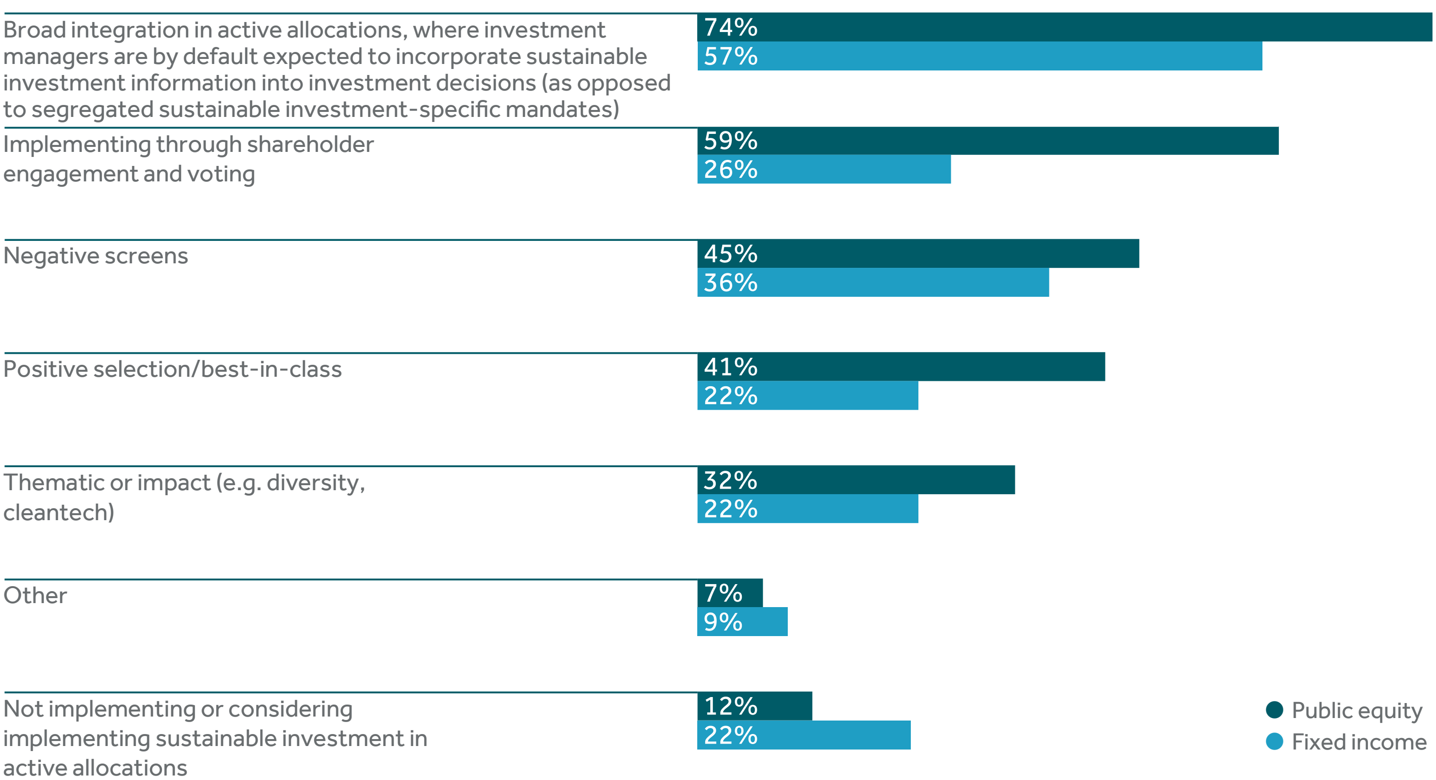
Strategic differences: Active versus passive

Asset owners take different approaches to sustainable investment implementation depending on the type of allocation, active or passive.

In active public equity strategies, a large majority (74%) of asset owners that have implemented sustainable investment are following a broad integration approach. For active fixed income allocations, 57% are broadly integrating sustainable investment (see Exhibit 3.7). Broad integration strategies defined here require managers by default to incorporate sustainable investment information into their investment decisions.

Exhibit 3.7

Methods for implementing/considering sustainable investment in active public equity and fixed income allocations



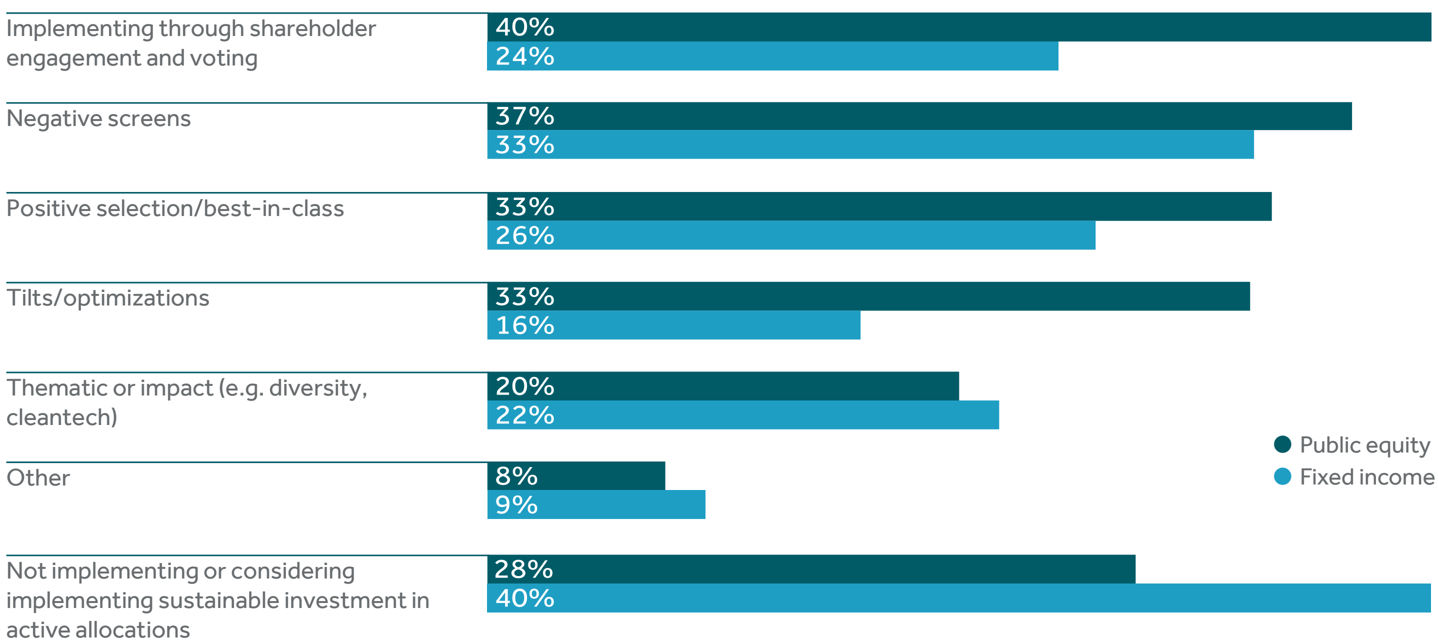
Multi-pick. How are you implementing or considering implementing sustainable investment in active public equity and fixed income allocations?

Segment = Currently implementing, evaluating, or plan to evaluate sustainable investment

Less cohesion exists around passive equity implementation approaches. The most popular approach when allocating to public equity is through shareholder engagement and voting (40%) followed by negative screens (37%). Positive selection/best-in-class and tilt/optimization approaches are considered by 33% (see Exhibit 3.8).

Exhibit 3.8

Methods for implementing/considering sustainable investment in passive public equity and fixed income allocations



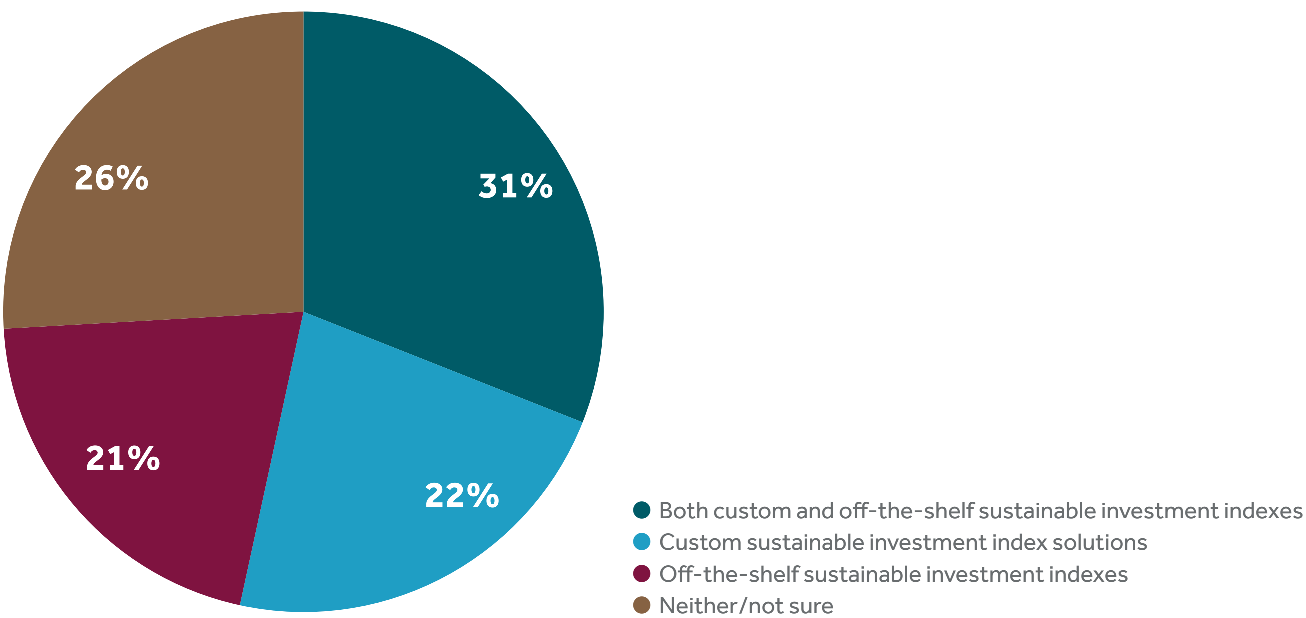
Multi-pick. How are you implementing or considering implementing sustainable investment in passive public equity and fixed income allocations?

Segment = Currently implementing, evaluating, or plan to evaluate sustainable investment

For those asset owners that are at least partly implementing sustainable investment into their passive investment strategies, 31% have used both custom and off-the-shelf solutions, while just under a quarter (22%) have used only custom or only off-the-shelf (see Exhibit 3.9).

Exhibit 3.9

Type of index solution(s) being used for passive portfolios



With respect to passive allocations where you have implemented sustainable investment considerations, are you using custom sustainable investment index solution(s) developed for your firm, off-the-shelf sustainable investment index solution(s), or both?

Segment = At least some of passive portfolio is currently implementing sustainable investment

Conclusion

Our survey of asset owners shows that sustainable investment is a well-established and maturing market across all regions, but despite widespread headline adoption, this investment approach continues to be a rapidly evolving, dynamic space.

Although the headline numbers we cite in our research show widespread adoption of sustainable investment, the pace of evolution still varies across asset classes, geographies and by asset owner AUM size. Indeed, many asset owners are at an early stage in their sustainable investment journey which is reflected in the asset allocations, for example.

As the barriers that we've highlighted continue to be addressed – including the standardization of corporate disclosures – this progress will in turn fuel further improvements in tools such as ratings and indexes, which will enable even greater adoption of sustainable investment.

For more information about our indexes, please visit ftserussell.com.

About FTSE Russell

FTSE Russell is a leading global index provider creating and managing a wide range of indexes, data and analytic solutions to meet client needs across asset classes, style and strategies. Covering 98% of the investable market, FTSE Russell indexes offer a true picture of global markets, combined with the specialist knowledge gained from developing local benchmarks around the world.

FTSE Russell index expertise and products are used extensively by institutional and retail investors globally. For over 30 years, leading asset owners, asset managers, ETF providers and investment banks have chosen FTSE Russell indexes to benchmark their investment performance and create investment funds, ETFs, structured products and index-based derivatives. FTSE Russell indexes also provide clients with tools for asset allocation, investment strategy analysis and risk management.

A core set of universal principles guides FTSE Russell index design and management: a transparent rules-based methodology is informed by independent committees of leading market participants. FTSE Russell is focused on index innovation and customer partnership applying the highest industry standards and embracing the IOSCO Principles. FTSE Russell is wholly owned by London Stock Exchange Group.

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