Schroders

North America

Sustainability

Institutional Investor Study 2022

SCROLL TO EXPLORE

A message from Schroders' Head of Sustainability, North America

Marina Severinovsky
Head of Sustainability,
North America

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2022 promises to be a pivotal year in the lifecycle of ESG investing. As we have tracked in our prior studies, ESG has gathered interest globally, and in a lagged fashion, in North America as well. Much of that interest was driven by strong performance, especially in passive ESG strategies that tend to be large cap growth biased, and the underperformance of value areas, including energy. These trends have made it easy for investors to jump on the ESG bandwagon without much real due diligence. Today, that part of the ESG investing cycle appears to be over, as interest rates, inflation, the energy markets haven risen, and expensive growth has sold off. As a result, investors are being forced to re-assess and frankly re-define ESG investment for themselves. This shift in demand could be an indication that the next leg of the ESG investing cycle is likely to be less performance chasing, but more of a maturing and mainstreaming of ESG as an investment discipline.

The fact that this is coinciding with a renewed regulatory focus, as we see new proposals from the SEC and DOJ around climate and human capital risk disclosures, ESG fund reporting, and definitions and naming conventions to support more clarity and deter greenwashing, makes this trend all the more powerful.

North American respondents continue to find it challenging to invest in ESG, with well over 60% expressing this view; this means that it is incumbent on the asset management industry to continue to provide education, transparency and support to investors.

Investors were also very clear in the Study about what is important to them when investing sustainably, and here again consistent and comparable data, and transparency and enhanced reporting, were the top stated needs. Evidence of improved financial performance as a result of integrating ESG was also important, especially in the US where, as has been noted, the potential for enhanced performance is a primary motivator for ESG investing.

We are seeing in this year's Institutional Investor Study many indications that investors are ready to participate in this new stage in a more thoughtful and committed fashion.

About the Study

Schroders commissioned CoreData to conduct the sixth Institutional Investor Study to analyze the world's largest investors' key areas of focus and concern including the macroeconomic and geopolitical climate, return expectations, asset allocation and attitudes to private assets and sustainable investing.

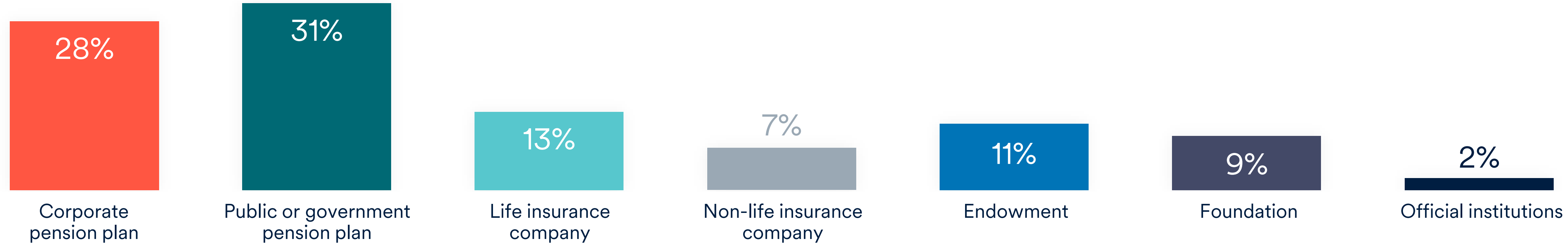
The respondents (770 globally and 205 in the North American region) represent a spectrum of institutions including corporate and public pension plans, insurance companies, official institutions, endowments and foundations, collectively responsible for US$27.5 trillion in assets. The research was carried out via an extensive global survey during March 2022.

Any opinions expressed reflect our Study and interview results as at the end of March 2022. They are not intended to be a forecast or guarantee of future results. Throughout the report, we complement our findings with commentary and insights from Schroders experts.

Source: Schroders Institutional Investor Study 2022.

About the Study – North America respondents

Breakdown by institutional type



Assets under management ($US)

Source: Schroders Institutional Investor Study 2022.

Key findings for North American institutional investors

ESG integration becoming mainstream...

63% of US and 88% of Canadian institutional investors identified ESG integration into the investment process as their preferred method of investing sustainably

...but need for financial returns alongside

64% of North American investors want to invest sustainably by investing in a fund/solution that focuses primarily on delivering financial returns while broadly integrating ESG factors

Lack of transparency and reported data a challenge

Greater than 50% of both US and Canadian Institutional investors cited this as a key challenge when investing sustainably

Growing importance of active ownership

Governance, human rights and climate action are the key areas for asset managers to be engaging on. But notably with some significant disparity between US and Canadian investors

Source: Schroders Institutional Investor Study 2022.

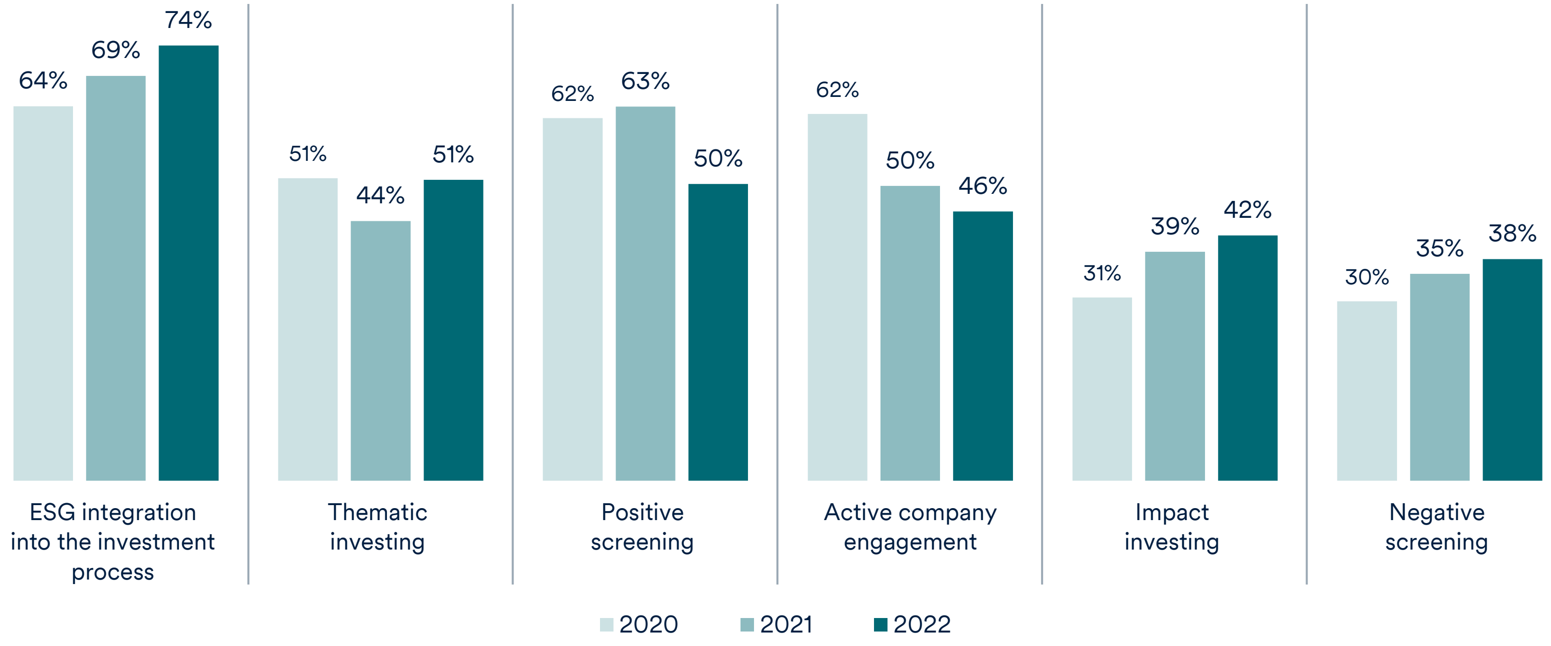
Focus on ESG Integration becoming mainstream

ESG Integration has laid down roots in North America as almost three quarters of investors (74%) now take this approach when investing sustainably. This figure represents an increase over the 69% of investors employing an integrated approach last year. Active ownership/engagement also garners some attention and is a trending topic in markets this year. This suggest that investors continue to be focused on mitigating risk and seeking out opportunity and are looking at ESG investing in the context of maintaining durable financial returns in the long run.

88% Canadian institutional investors have highlighted their preference is ESG integration into the investment process

63% US institutional investors have highlighted their preference is ESG integration into the investment process

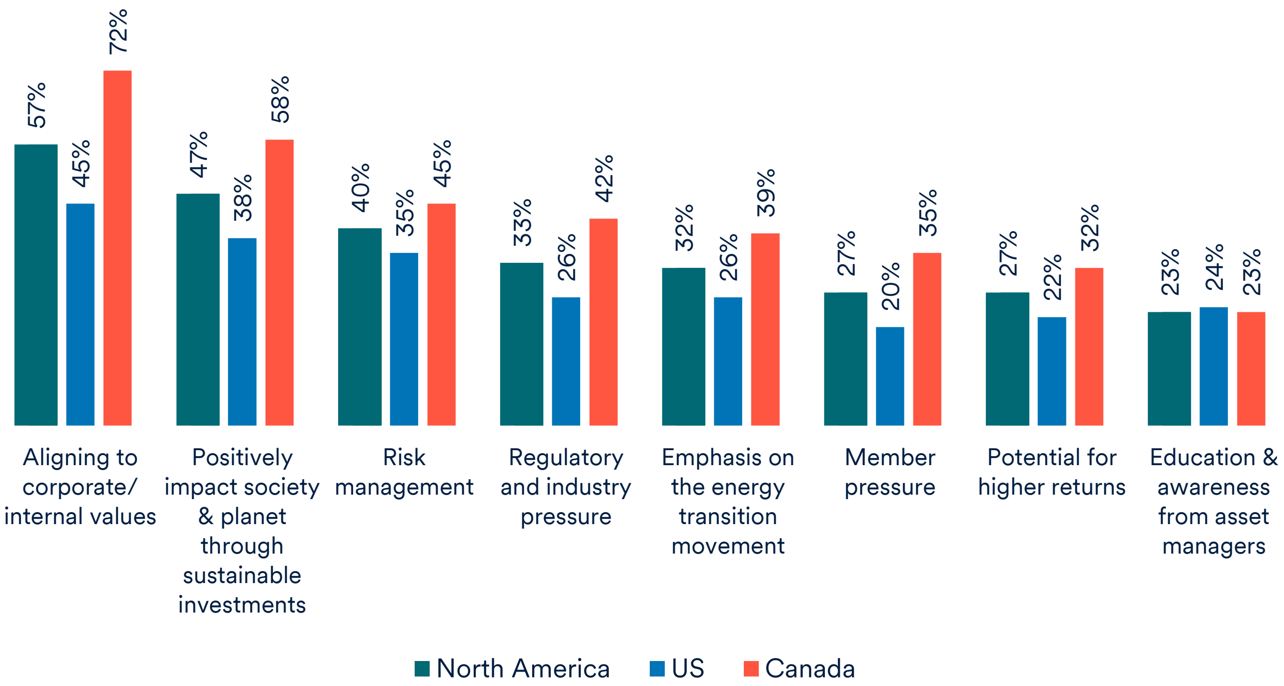
Q. What is your preferred approach to implementing sustainable investments?



Source: Schroders Institutional Investor Study 2022.
North American respondents only. Respondents ranked approaches from 1-6. This graph showcases %Rank 1+2+3.

Alignment to internal values and understanding impact are key drivers to invest sustainably

Q. What is driving your sustainable investment focus?



Source: Schroders Institutional Investor Study 2022.
% Multiple answers allowed. Option None of the above not included.

This year's results have highlighted that North American investors do want to feel that their investments are aligned to their own corporate / internal values (57%) and are therefore prepared to scrutinize how their investments impact society (47%). While this may not yet mean impact investing in the traditional sense of having an additional impact objective alongside a return objective, it does mean that investors understand that investments can cause externalities to people and planet, and they want to quantify and account for those impacts. Risk management (40%) and regulatory and industry pressures (33%) are also driving investor focus on sustainability but are much less important than in other regions.

We can observe stark differences between the strength of motivation among investors in Canada and the US. For 72% of Canadian institutions, their sustainability focus is driven by aligning to corporate values – 45% of US investors feel this way. The desire to make a positive impact is also stronger in Canada (58% vs 38%), as is the regulatory push (42% vs 26%).

Need for financial returns key when selecting a sustainable investment

In particular, the predominance of North American survey respondents, when considering making an investment in a sustainable fund/solution, wanted to invest in one that delivers financial returns while broadly integrating ESG factors. This option was chosen nearly 2-to-1 versus options focused on specific sustainability characteristics, impact objectives, or ESG themes or issues. Specifically, 64% of North American investors say they are likely to invest in a fund that primarily focuses on delivering return, while broadly integrating ESG factors. This fund solution is preferred in both Canada and the US.

For Canadian investors, 52% are keen for funds/solutions that have an explicit objective to have a positive impact on people, aligned to SDGs.

Q. When considering making an investment in a sustainable fund / solution, where would you like to invest?

	North America	US	Canada
A fund/solution that focuses primarily on delivering financial returns while broadly integrating ESG factors	64%	66%	62%
A fund/solution which has an explicit objective to have a positive impact on people and/or the planet, aligned to SDGs	41%	34%	52%
A fund/solution that contributes to solutions to a specific ESG theme or issue e.g., circular economy, energy transition, diversity	36%	30%	44%
A fund/solution that has specific sustainability characteristics e.g. a lower carbon footprint than the benchmark or a higher social benefit	35%	33%	39%

Source: Schroders Institutional Investor Study 2022.
Select all that apply.

Need for financial returns key when selecting a sustainable investment

"As a pension fund, we are moving at the pace of the sponsor, a large Canadian corporate. They care [about sustainability and ESG issues] and we care as well. We might always be a little ahead of them, but we don't go too far ahead of them. The employees and the members are a second force, but honestly, they care more about getting their payments. If we make better returns, they get a little better escalation. And we deal with them less than we deal with the sponsor, who has to make up the gap if returns are lower, because members are entitled to a fixed payment.

Canada - portfolio manager, corporate pension plan, AUM US$10bn to less than 50bn

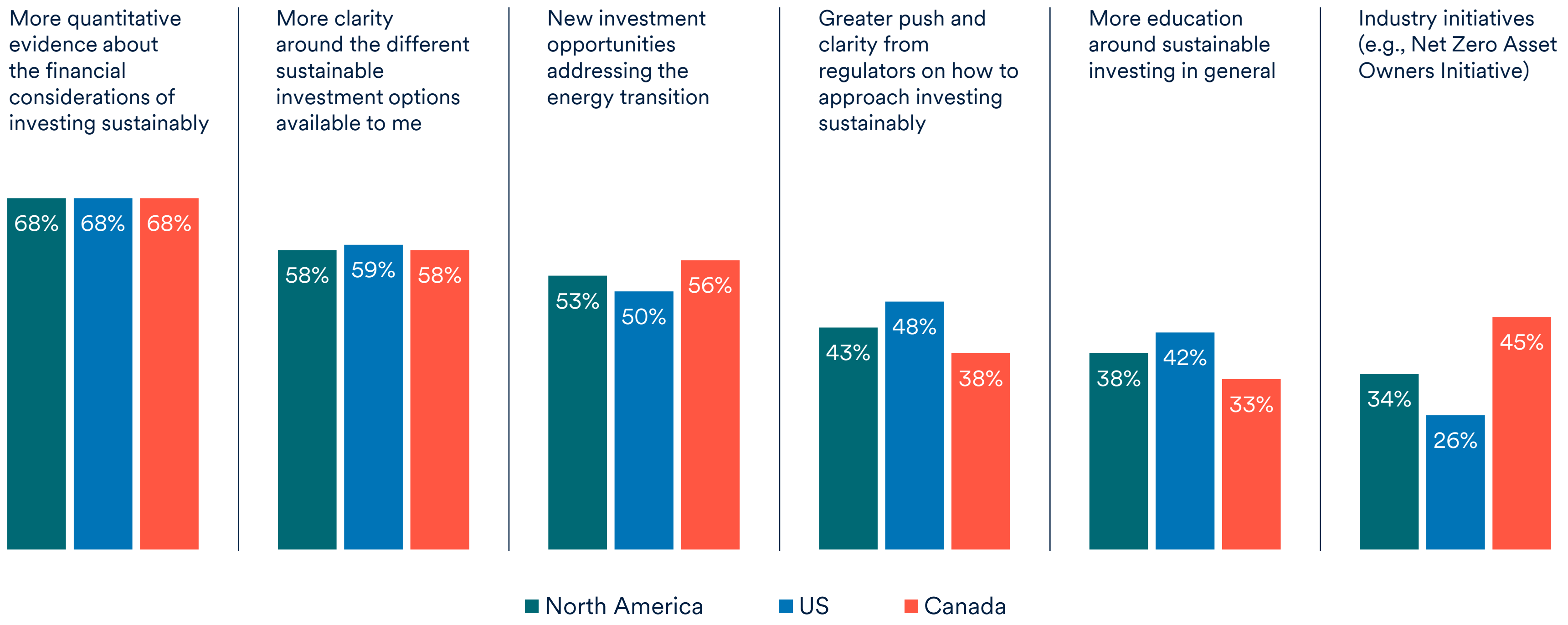
"As an institution, we don't have the luxury of saying, 'this investment will only break-even, but it is going to do something good for the world'. In the past, we thought ESG products would not meet the return expectations we have, although I now understand that you can make money on it, but, like any investments, you have to be choosy. I don't think we've seen the data on it for a full market cycle and the majority of these sustainable investing funds have come out in the past few years. But there is a lot more information on it now, so we are slowly moving towards the idea of sustainable investing.

US - Chief Investment Officer, endowment, AUM US$ Less than 1bn

Source: Schroders Institutional Investor Study 2022.

Strong need for quantitative evidence and data

Q. What would encourage you to invest more in sustainable investments?



Source: Schroders Institutional Investor Study 2022.
Respondents ranked approaches from 1-6. This graph showcases %Rank 1+2+3. Option Other not included.

This year's Study identifies a strong need for quantitative evidence and data to support North American investors' comfort with committing to ESG investing. They note that they would be encouraged to put more capital into sustainable investments if they had more quantitative evidence supporting the financial considerations of investing sustainably (68%). This is the highest percentage registered across all regions and higher than the global average of 59%. More clarity around different sustainable options available (58%) is the second most important. This percentage is also higher than the global average of 51%. The latter point is something new SEC regulation is particularly focused on.

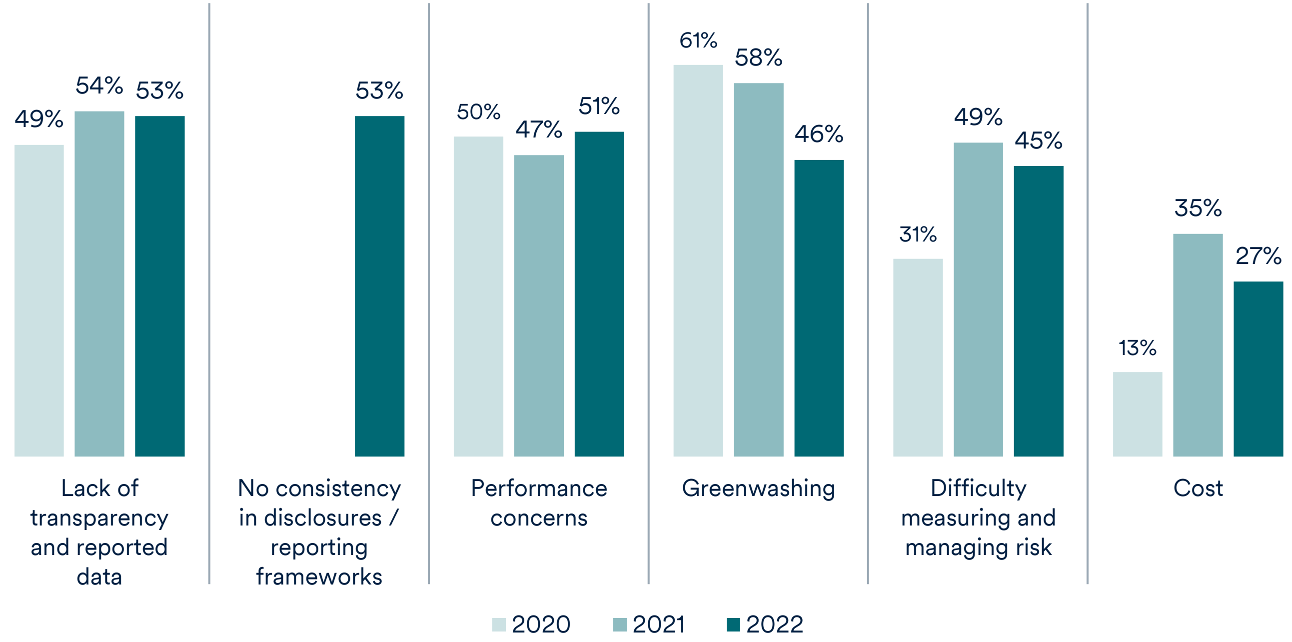
Lack of transparency and reported data cited as key challenges to investing sustainably

This strong need for quantitative evidence is also seen in the challenges to sustainable investing. A lack of transparency and reported data (53%) and lack of consistency in disclosures and reporting frameworks (53%) are the primary challenges noted in this year's Study. Consequently, these two points point to "greenwashing" as the result of the absence of this data and disclosure, which breeds a lack of clear agreed definitions on what ESG is and how it can be judged and measured.

Potentially fueling investors' suspicions further, a report published on the Harvard Law School Forum on Corporate Governance states: "Despite ongoing initiatives from the U.S. Securities & Exchange Commission and the International Financial Reporting Standards Foundation, a uniform global sustainability reporting framework seems unlikely to emerge in the near-term."

Performance concerns were also cited as important for over half of North America investors (51%). This is particularly true in the US (58%), which suggests that it is even more critical for investors to understand clearly the nature of these investments to have realistic performance expectations of them in different market environments and over different time horizons. On the other hand, a greater percentage of investors from Canada highlight the lack of consistency in disclosures and reporting frameworks as a challenge (62%).

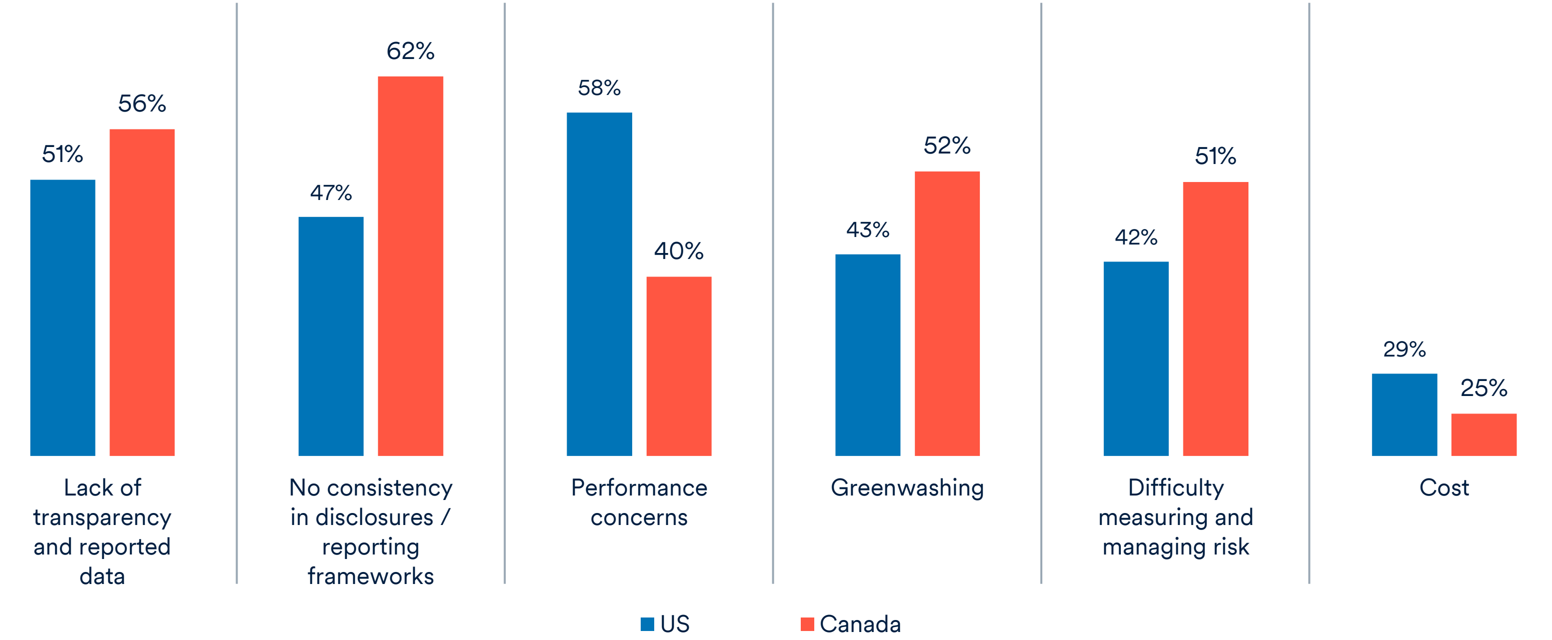
Q. Which, if any, of the following specific factors do you consider a challenge of investing in sustainable investments? North American respondents



Source: Schroders Institutional Investor Study 2022.
% Multiple answers allowed. Option None of the above not included.

Lack of transparency and reported data cited as key challenges to investing sustainably

Q. Which, if any, of the following specific factors do you consider a challenge of investing in sustainable investments?



Source: Schroders Institutional Investor Study 2022.
% Multiple answers allowed. Option None of the above not included.

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The biggest hurdle is whether we feel it can provide a competitive return compared to traditional, non-sustainable investing.

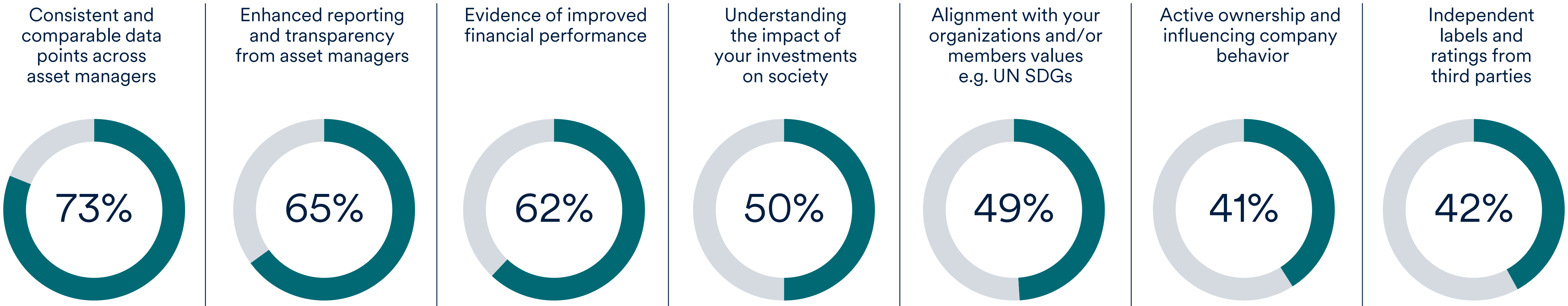
Another challenge is that definitions of ESG and sustainable investing vary; there are exclusionary screens, inclusionary screens, thematic funds, so it’s hard to rank ESG funds. Shouldn’t there be somebody saying, ‘these are the standards’, so we all follow the same thing?

US - Chief Investment Officer, Endowment, AUM US$ Less than 1bn

Lack of transparency and reported data cited as key challenges to investing sustainably

When investing sustainably, the three most important factors North American investors consider are: consistent and comparable data points across asset managers (73%), Enhanced reporting and transparency from asset managers (65%), and evidence of improved financial performance (62%).

Q. When investing sustainably, how important are the following to you? North American respondents



Source: Schroders Institutional Investor Study 2022.
% Important (4 + 5)

Regional nuances when seeking out information to inform sustainable investment decisions

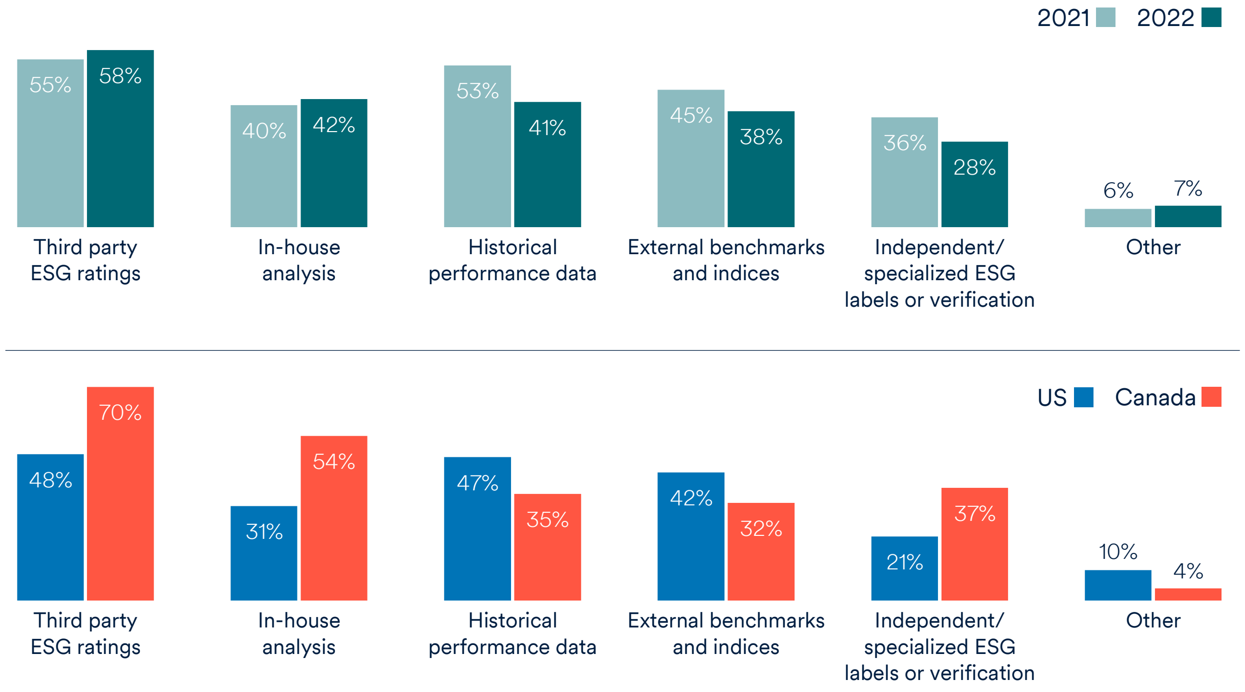
In terms of where investors are currently seeking out information to inform their sustainable investment decisions, it is telling that investors have primarily relied on 3rd party ESG ratings in the absence of more consistent information available from asset managers; this has no doubt fed the passive ESG investing bubble in large cap growth names that screen well on third party ESG ratings.

Investors across Canada and the US value third party ESG ratings as this is the preferred data source within both groups (though a much stronger inclination is expressed by Canadian investors at 70%).

However, in second place among Canadians is in-house analysis (54%) while investors in the US rate historical performance data as the second most used data source (47%). This presents further evidence of performance chasing, especially prior to 2022.

The need for more clarity around data is well-documented across this year's North American results. Investors are still struggling to manage this aspect of investing sustainably. American investors in particular are less likely to use independent or specialized ESG labels or verification (21% vs 40% globally).

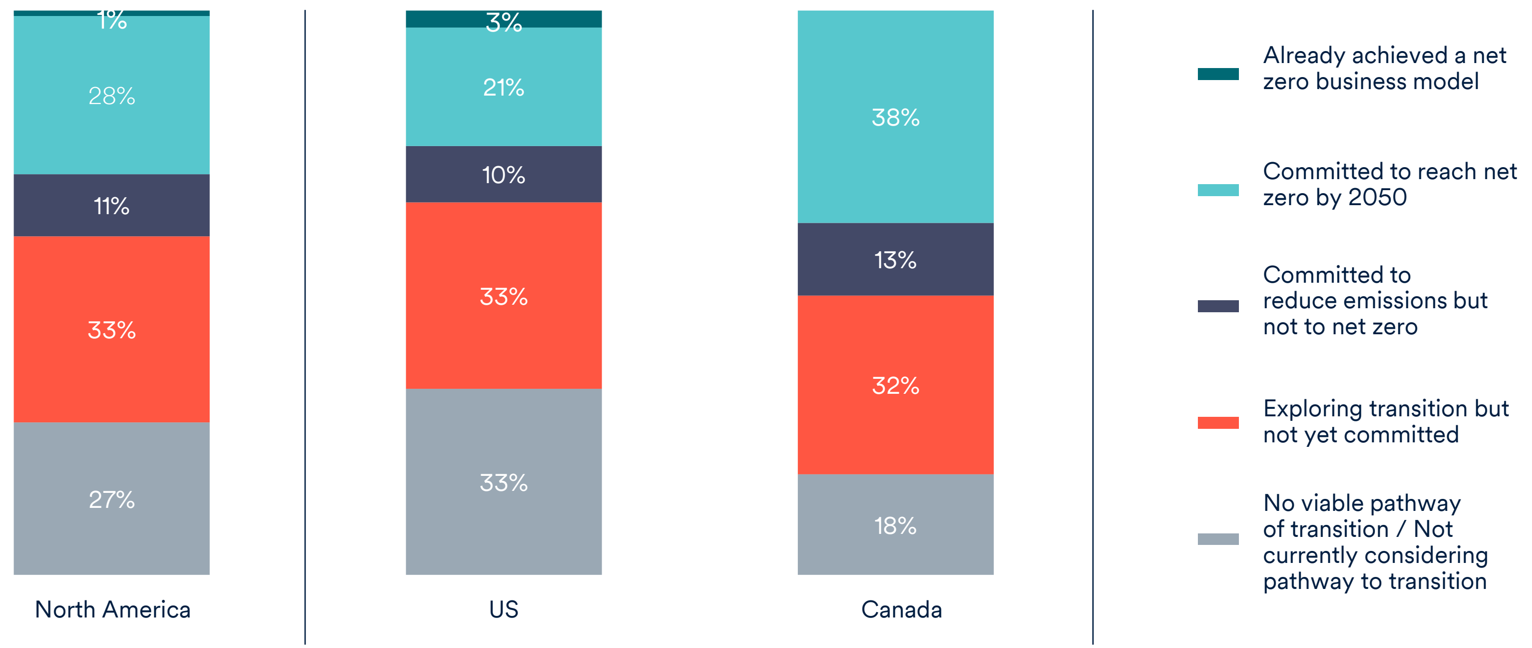
Q. What primary data sources do you use to inform your sustainable investment decisions?



Source: Schroders Institutional Investor Study 2022.

North America lags behind on net zero journey

Q. Where are you on path to net zero?



Source: Schroders Institutional Investor Study 2022.
% Important (4+5). Data may not sum to 100% due to rounding

North American investors lag behind their global counterparts in their commitment to reaching net zero emissions. The majority (60%) are either exploring a transition but have not yet committed or can see no viable pathway to transition. This compares to a global average of 40% of investors who are in the same position.

The North American average is largely driven by the 66% in the US who are either exploring transition or are not considering it. In Canada on the other hand, 38% have committed to reaching net zero. This compares to 21% in the US.

Consistent frameworks and methodology needed to help investors on their net zero journey

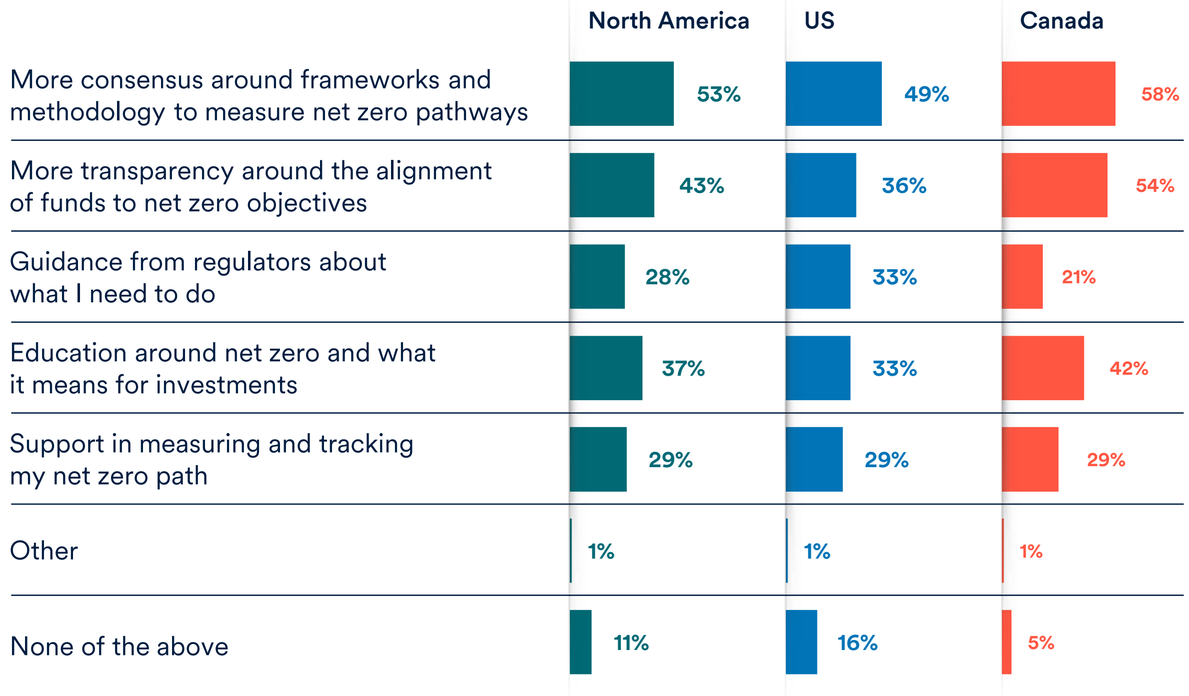
Harkening back to the earlier reference to concerns about disclosures and frameworks, investors say the primary impetus to supporting their journey to net zero would be more consensus around frameworks and methodologies used to measure net zero pathways (53%). This is slightly higher than the global average of 51% who say this would help them, but in both North America and globally, this emerges as the most significant way to encourage investors to reach net zero.

Regulatory changes in the US could therefore help stimulate greater commitment to reaching net zero. In March 2022, the Securities and Exchange Commission proposed rule changes that would require registrants to file climate-related disclosures.

“The required information about climate-related risks also would include disclosure of a registrant’s greenhouse gas emissions, which have become a commonly used metric to assess a registrant’s exposure to such risks,” the commission said in a statement. The data therefore suggests investors will welcome this change as they seek greater clarity.

The primary call by corporate plan investors on the other hand is more transparency around the alignment of funds to net zero objectives. Greater education about net zero and what it means for investments would be welcomed by smaller investors in North America as 37% say this would be helpful – a higher percentage than any of the other groups when considered by size.

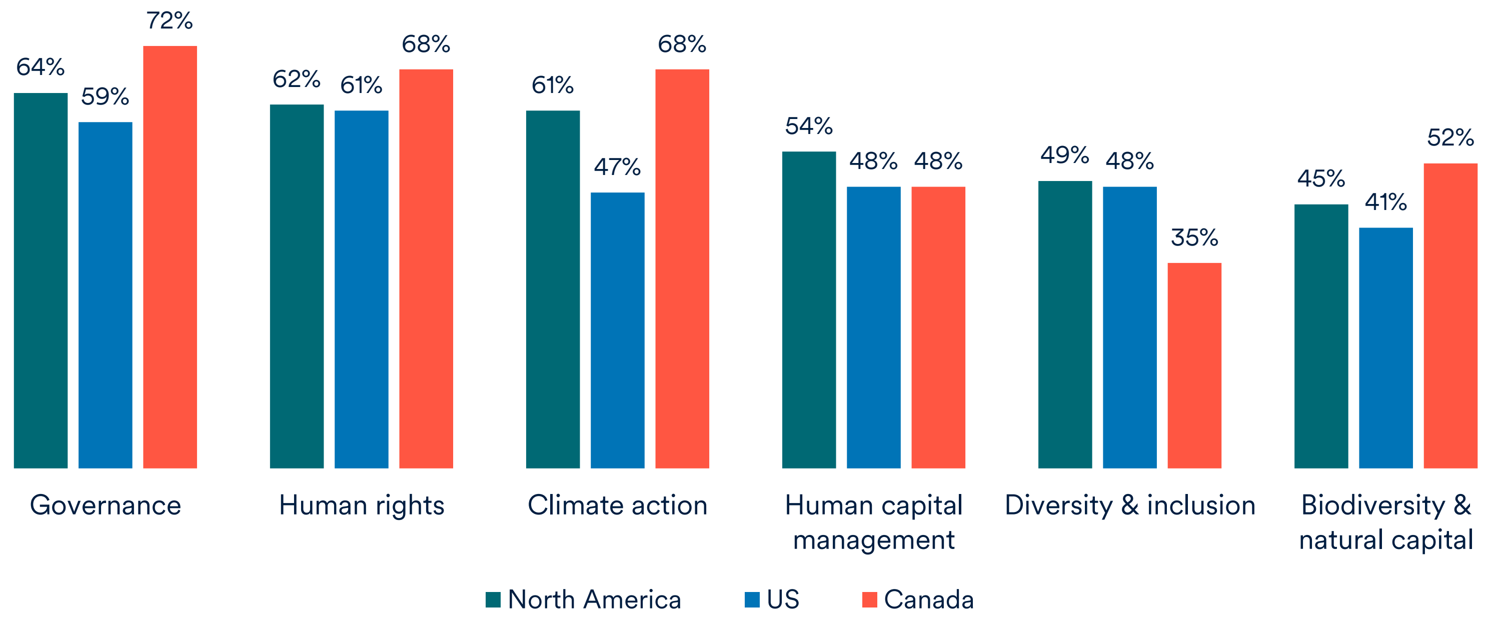
Q. What would help you on your journey to net zero?



Source: Schroders Institutional Investor Study 2022.
% Multiple answers allowed.

Active ownership rose in importance

Q. Investment managers and asset owners are often able to engage with and influence the behaviors of the companies that they invest in. How important are the following to you?



Investment managers and asset owners are often able to engage with and influence the behaviors of the companies that they invest in. Active ownership has been of greater discussion in markets this year as investors focus on how to approach net zero commitments and address human capital challenges. As we looked at various ESG themes in our Study, investors consistently cited Governance as a top concern, as well as human rights; climate was also an important consideration, especially in Canada.

When it comes to engagement, North American investors highlight these as the most important areas for efforts to focus. Interestingly, the larger investors in the sample are more likely to consider the topics under review to be important. Higher percentages almost across all the issues mentioned say these are important to them.

Active ownership rose in importance

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Active ownership to me would mean, you are not a passive investor, but you are part of the decision-making, you vote proxies.

We, as an institution, don't have the knowledge and time to do that, so part of our agreement with investment managers, is what they are doing to vote proxies on our behalf.

US - Chief Investment Officer, endowment, AUM Less than 1bn (US$)

"

Governance has always been important to us, and it is an example of where we will divest. It is a variable bar in that we don't have the same expectations in some countries as in others. The number one engagement issue is climate change, and we would divest there too, if a company has been negligent or doing something we would not want to be associated with. If there are repeated offences in emerging countries, for example people suffering from leaks, we would not be interested in that. The number one topic that we are pushing companies on is climate change and I would think it is the most important issue for most investors.

Canada - Portfolio manager, corporate pension plan, AUM 10bn to less than 50bn (US$)

Source: Schroders Institutional Investor Study 2022.

Final comments

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As the performance of naïve, passive ESG strategies falters, and the regulators circle the wagons, sustainable investing is at a critical juncture. Investors are clear that they need more quantifiable evidence of the value and impact of ESG, and more clarity and transparency into how this investing is practiced and measured.

At Schroders, we have always set a high bar with our internal definitions, and with ensuring that we can evidence and robustly report on our efforts, via our proprietary tools like SustainEx for impact measurement. We welcome the next stage of the ESG investing lifecycle where more industry consistency leads to deeper investor understanding.

Marina Severinovsky
Head of Sustainability, North America

Source: Schroders Institutional Investor Study 2022.

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