

Schroders

Schroders Institutional Investor Study 2018

**Institutional perspectives on
sustainable investing**



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About this survey

This global study was commissioned for a second year by Schroders to analyse institutional investors and their attitudes towards sustainable investments, investment objectives and risk.

Respondents represent a variety of institutions, including pension funds, foundations, endowments and sovereign wealth funds and manage approximately \$24 trillion in assets¹.

The research was carried out via an extensive global survey during June 2018. The 650 institutional respondents were split as follows: 175 in North America, 250 in Europe, 175 in Asia and 50 in Latin America.

Respondents were sourced from 15 different countries.



	Overall	North America	Europe	Latin America	Asia
Corporate pension plan	26%	29%	22%	44%	26%
Public or government pension plan	28%	25%	30%	8%	35%
Sovereign wealth fund	4%	4%	2%	10%	5%
Insurance Company	24%	28%	24%	26%	19%
Endowment	9%	7%	10%	8%	8%
Foundation	8%	5%	11%	4%	7%
Other	1%	2%	1%	0%	0%

Which of the following best describes the type of institutional assets your organisation oversees/manages?

	Overall	North America	Europe	Latin America	Asia
Less than \$1bn	13%	10%	20%	12%	9%
\$1bn to less than \$5bn	20%	20%	14%	30%	24%
\$5bn to less than \$10bn	17%	6%	23%	32%	14%
\$10bn to less than \$50bn	25%	26%	30%	24%	21%
\$50bn to less than \$100bn	11%	13%	7%	2%	13%
\$100bn and above	15%	25%	6%	0%	19%

What is the cumulative size of assets (in USD) your organisation is responsible for?

¹ The total assets were calculated using the midpoint value of asset bands.

Executive summary

- While the outlook for incorporating sustainability in institutional portfolios is strong, sustainability currently plays a muted role in investment decision-making. Only a quarter of investors say sustainability has a significant influence with a third of investors saying it has little to no influence.
- Larger institutional investors are more focused on improving the sustainability of their portfolios' investments and say sustainability is of greater influence on their investment decisions.
- Investors focused on sustainability (defined as Sustainability Advocates) have greater levels of confidence in their ability to reach their performance objectives. Sustainability Advocates are more focused on generating high risk adjusted returns and assign greater value to diversification, when compared to their counterparts.

The Schroders Institutional Investor Study 2018 reveals the majority of institutional investors globally believe sustainability is set to play a more important role within their portfolios over the next five years.

Sustainable investing has been a growing trend in the global institutional market with almost half of respondents telling us their allocations have increased over the past five years – yet for this to continue, performance, transparency, risk and cost concerns need to be addressed if future investment forecasts are to become a reality.

Although several academic studies have shown a connection between sustainability factors and improved performance, institutional investors remain unconvinced. They continue to exhibit concerns around this issue and performance tops the list of the greatest challenges in this area. Strong data showing sustainable investments deliver superior returns could therefore spur higher levels of investment in the space.

This year's study also reveals a link between sustainability and investor confidence. Institutional investors who value sustainability as an investment objective are considerably more confident in their ability to achieve their goals. The 'Sustainability Advocates'² show distinct characteristics which differentiate their investment behaviour from those investors who do not prioritise sustainability as an investment objective. These investors also tend to be more diversified and are more interested in using alternatives. According to this study, investors rank corporate strategy and climate change highest when it comes to areas for investors to engage on.

Institutional investors also outline their desire for data and evidence that shows investing sustainably delivers better returns. They question the transparency of this information and say that if this improves it could support increasing allocations to sustainable investments.

² Sustainability Advocates are identified as the institutional investors who responded "4" or "5" on a scale of zero to five to the following question: How important are the following investment objectives for your organisation over the next 12 months? [Improve the sustainability of my portfolio's investments].

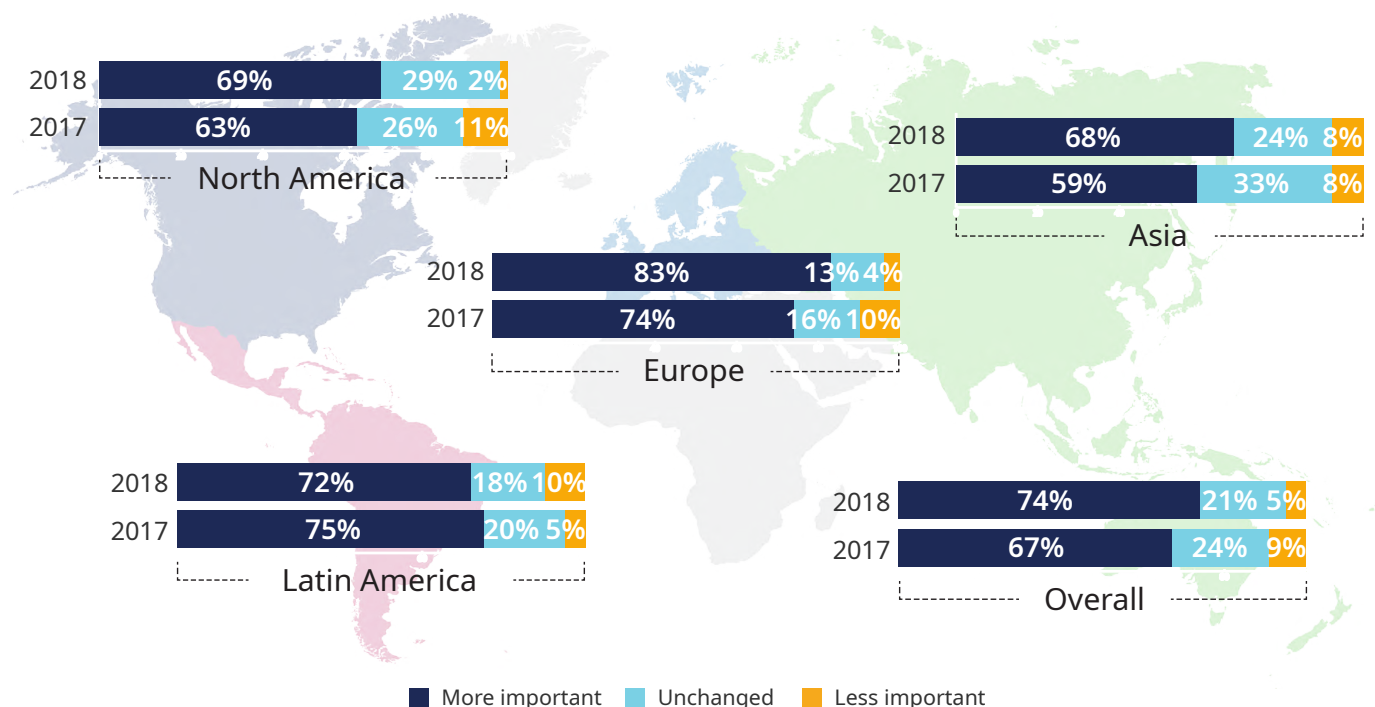
Strong outlook for sustainability



Sustainable investing is growing in prominence among institutional investors as they understand the valuable role it has and how this is due to grow in the future - three quarters of respondents to this study believe this way of investing

is due to become more important over the next five years. This represents a greater number of institutional investors when compared to last year when 67% thought sustainable investing was due to become more important.

Sustainability to become increasingly important



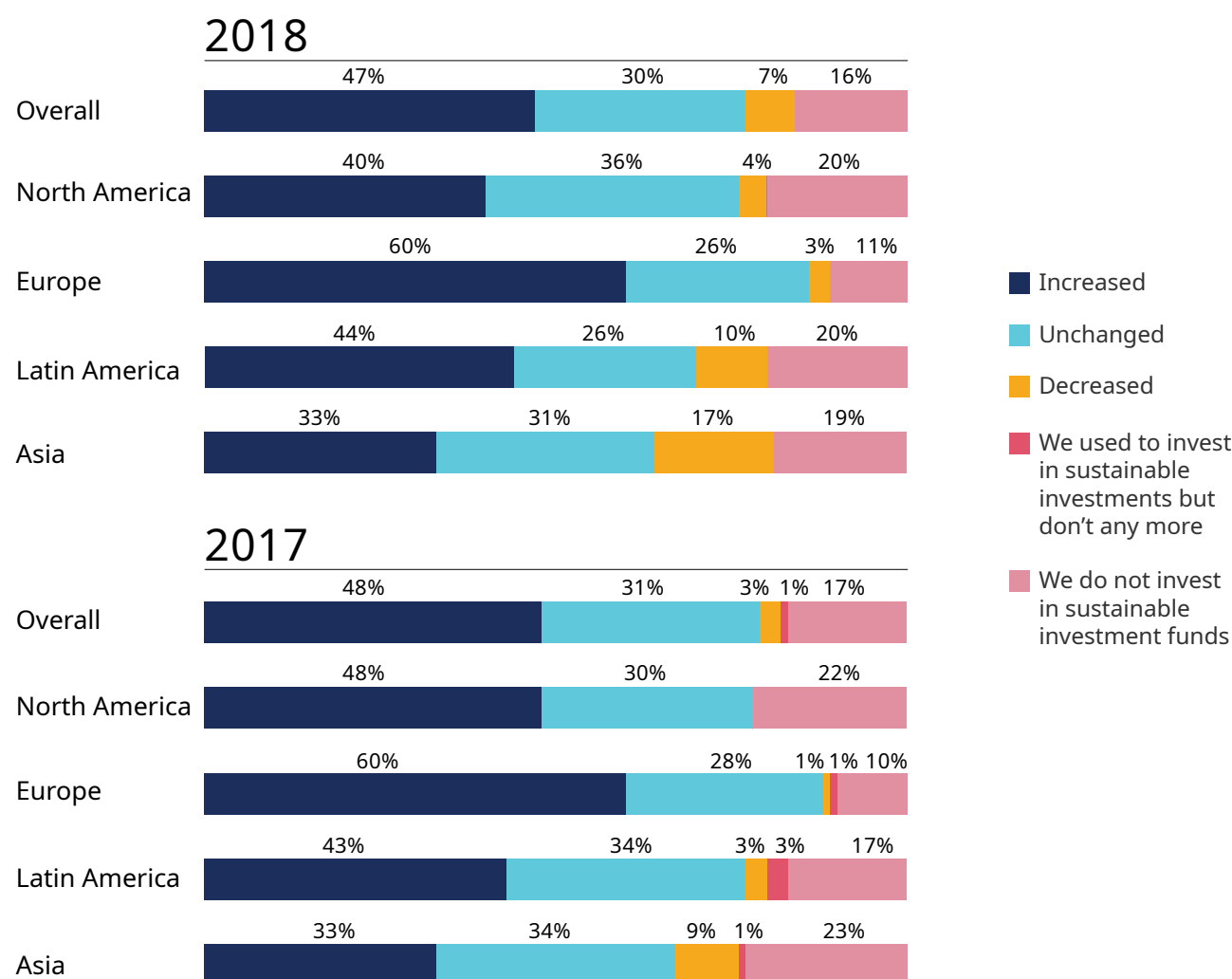
How do you expect the role of sustainable investing to change in the next five years?

We see increasing evidence of this among large institutional investors. For example, in October 2017, Japan's Government Pension Investment Fund (GPIF), the world's largest pension fund with \$1.3 trillion under management, formalised a partnership with the World Bank Group to promote sustainable investments. In its stewardship activities report, GPIF announced it had selected three ESG indices for Japanese equities – further showing its commitment to this area. Also, CalPERS injected \$1bn into an internally managed ESG global equity strategy in February 2018 and Swiss

Re, which was one of the first in the reinsurance industry to switch to ESG benchmarks, now applies ESG criteria to almost 100% of the company's portfolio.

Across the whole institutional market, the increase in sustainable investment has remained consistent. Just under a half of investors say they increased their sustainable holdings over the past five years. This was the same level registered last year.

Increase in investment over the last 5 years



Bumps in the road

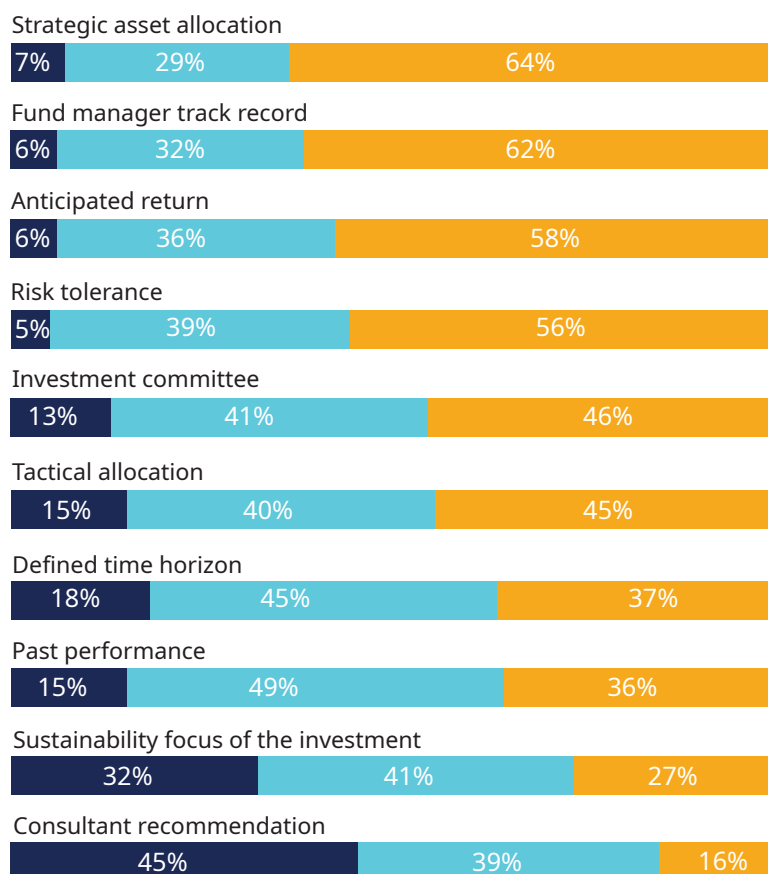
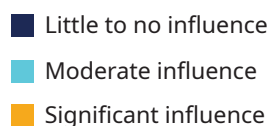


Although the implementation of sustainability within institutional portfolios has continued to steadily increase, this study has identified a mismatch between actual investment compared to the strong outlook and intentions relating to the sector. While three-quarters say the role of sustainability will be important over the next five years, only half have already increased their allocation to sustainable investments. This suggests that at present, anticipation of the role of sustainability outweighs real investment. The discrepancy between expected importance and investment

could be driven by a number of challenges institutional investors still face when considering sustainable investments.

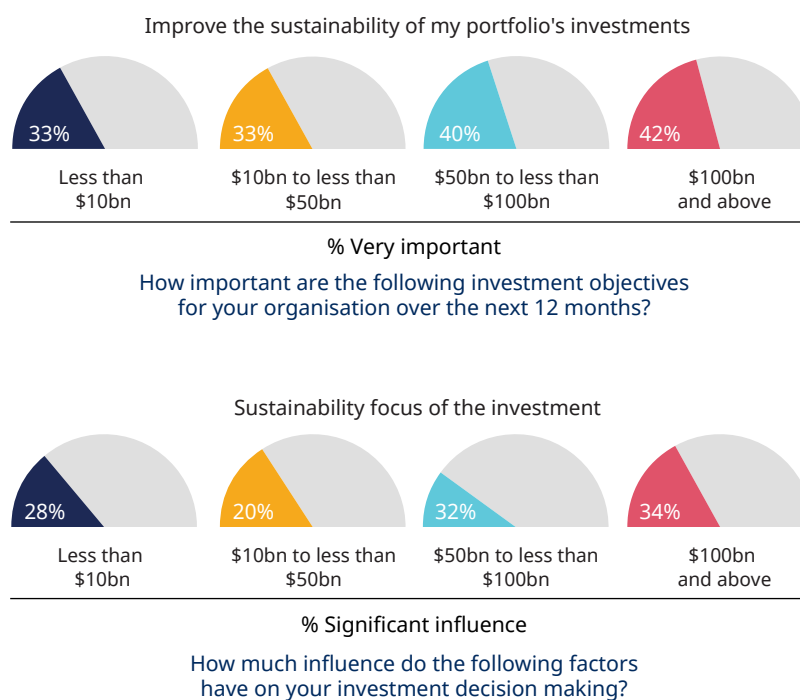
Only a quarter (27%) say sustainability has a significant influence on their investment decision-making with another 41% saying it has a moderate influence. A third of investors (32%) say it has little to no influence in their investment decision making currently.

Sustainability plays a minor role in investment decision-making



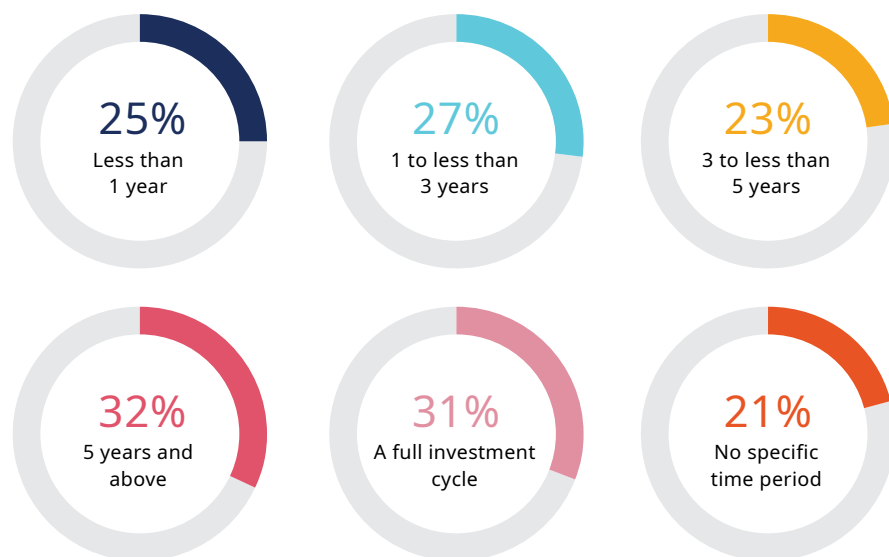
Sustainability a bigger focus for investors with larger AUMs

Investors with larger AUM (above \$50 billion) seem to have a greater sustainability focus than the rest.



Investors with longer time horizons have a higher sustainable focus

Sustainability focus of the investment

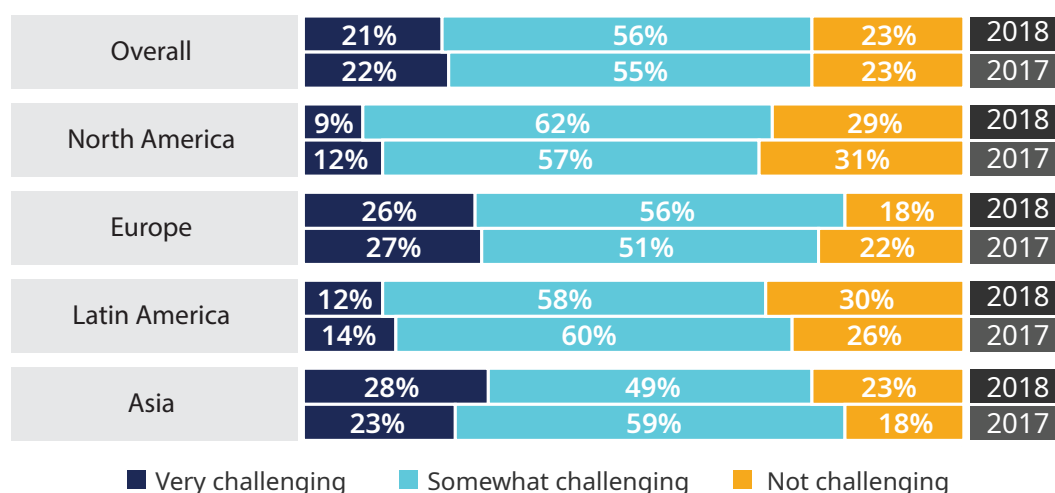


Investors with a longer holding period (5 years and above and full investment cycle) have a greater sustainability focus than the rest

% Sustainability a significant influence

How much influence do the following factors have on your investment decision making?

Continued challenges



How challenging do you find investing in sustainable investments?

One in five investors (21%) globally tell us they find investing in sustainable investments very challenging with another 56% saying it is somewhat challenging. The numbers are slightly higher in Europe and Asia.

citing performance concerns as the main challenge to investing in sustainable investments. Reflecting the issues identified by this study a year ago, they are also concerned by the lack of transparency and reported data.

More specifically, institutional investors are not convinced sustainable investments can generate satisfactory returns,

Concerns over performance have consistently been a hurdle sustainable investment has had to overcome and, according to this year's study results, it continues to be an obstacle to acceptance among institutional investors. A considerable number still express scepticism about the ability of

sustainable investments to perform well. These concerns seem to be lower for Latin America (48%) and Asia (45%) than for North America (56%) and Europe (53%).

Challenges of investing in sustainable investments

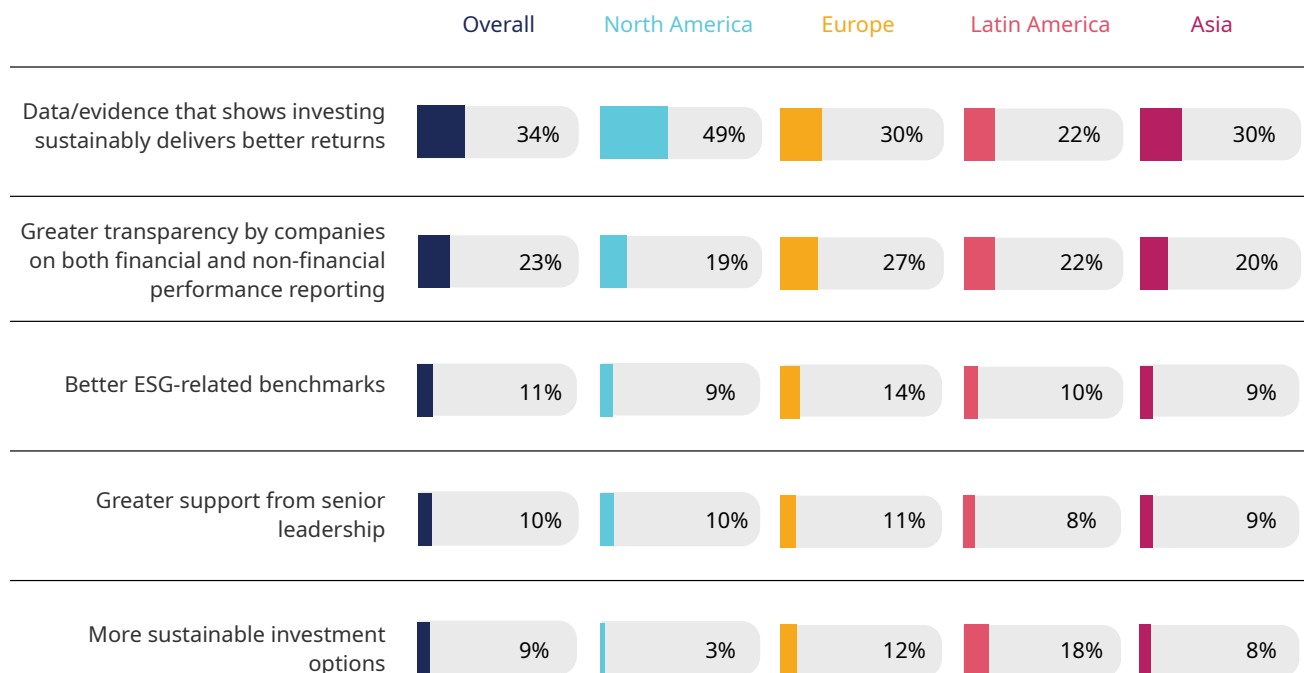
	Overall		North America		Europe		Latin America		Asia	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Performance concerns	51%	44%	56%	42%	53%	47%	48%	37%	45%	45%
Lack of transparency and reported data	48%	41%	44%	33%	50%	44%	34%	34%	54%	45%
Difficulty measuring and managing risk	33%	28%	36%	29%	33%	26%	22%	26%	33%	31%
Cost	29%	23%	26%	28%	28%	22%	22%	26%	36%	21%
Investment committee is not comfortable making sustainable investments	15%	14%	10%	6%	17%	14%	28%	23%	14%	18%
I do not believe in sustainable investments	18%	20%	19%	22%	16%	15%	20%	29%	17%	23%
I do not consider there to be any challenges to investing in sustainable investments	13%	0%	21%	0%	12%	0%	12%	0%	7%	0%
Other	2%	11%	1%	12%	3%	9%	4%	6%	2%	13%

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

Finding solutions to these challenges could be instrumental in making institutional investors' expectations of sustainability's importance become a reality in terms of allocations.

Investors say data around sustainable investing and evidence of better returns (34%) is the main factor which would help increase allocations to sustainable investments. This is true for almost half (49%) of investors in North America.

Data related to returns could boost sustainable allocations



In your opinion, what would help you invest in more sustainable investments?

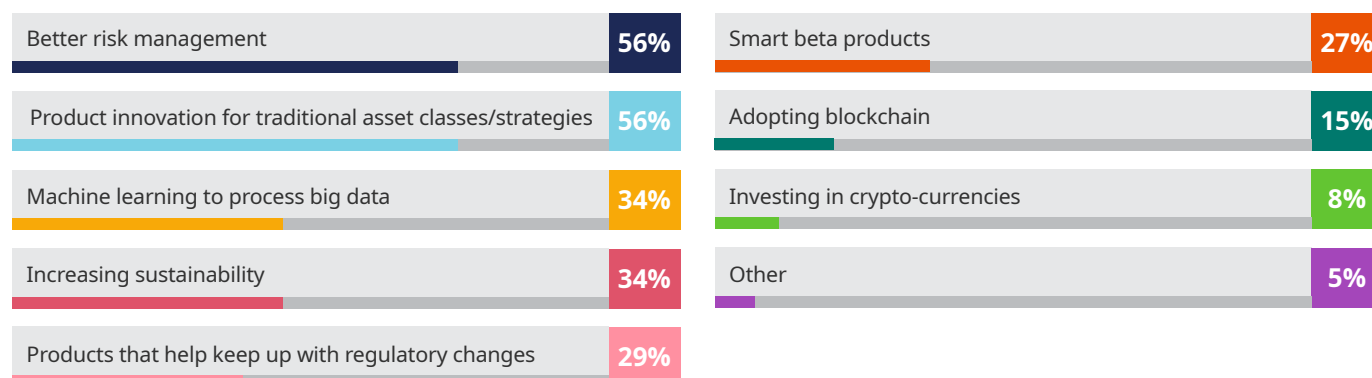
When asked specifically about ways to increase investment in sustainability, investors reiterate their call for greater transparency by companies on both financial and non-financial performance reporting (23%).

Institutional investors request better sustainability related benchmarks that would help investors properly measure the performance of their sustainable investments and

differentiate these strategies from traditional investment approaches.

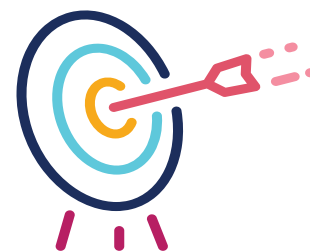
The chart below shows that just over a third of investors (34%) also say they are looking for innovative solutions to help them increase sustainability in their portfolios.

Investors looking for innovative solutions around sustainability



In terms of innovation in your industry, what solutions would be most helpful to you in the next 12 months?

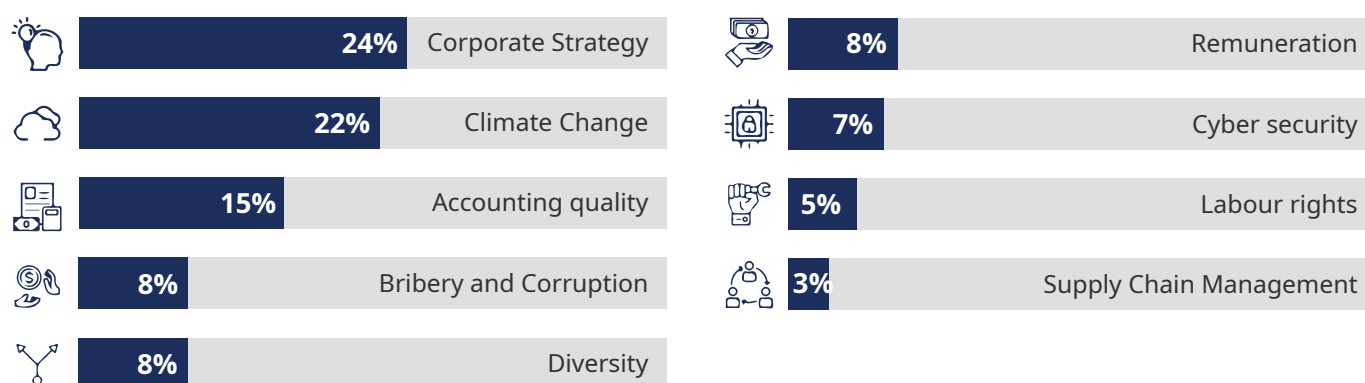
Focus areas and asset classes



In terms of areas of focus when it comes to sustainability, institutional investors rank corporate strategy (24%) and climate change (22%) as the most important.

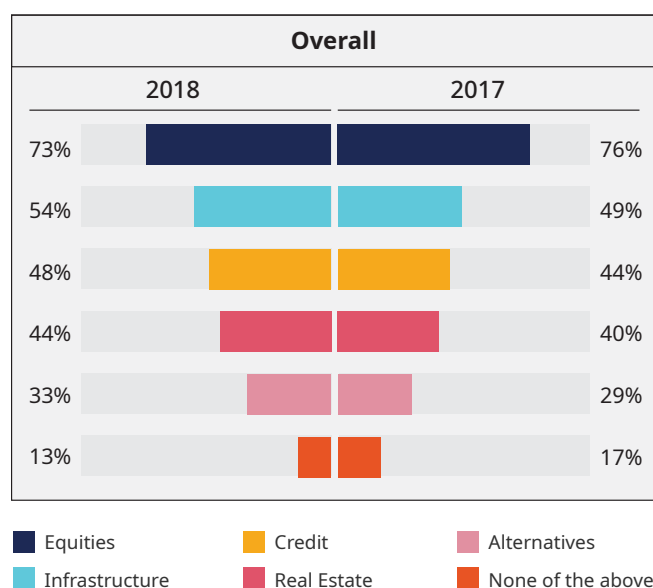
While governance has always been an area of focus for investors, environmental factors are rapidly growing in importance as the debate on climate change continues and the effects of environmental risks continue to come to the fore.

Corporate strategy and climate change cited as the most important areas to engage on



Please rank in order of importance the areas that you believe it is important for investment managers and asset owners to engage on.

Sustainability and asset classes



Sustainability is an important consideration in which of the following asset classes?

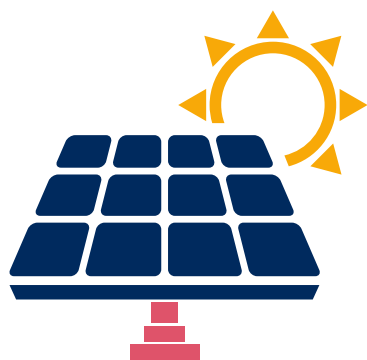
Sustainability considerations have typically been higher in equities than other asset classes.

There is a growing interest for sustainability considerations to be made in other asset classes like credit. The United Nations' Principles for Responsible Investment notes that the 'assessment of governance factors has traditionally featured in credit risk analysis'.³ On the environmental side, there has been a steady increase in the issuance of green bonds which according to some reports, is set to grow by around 60% to \$250 billion this year.⁴ Although, compared to some mainstream assets this may be considered small, it still goes a long way to signify growth in the space.

Given the long-term, often illiquid nature of infrastructure and real estate investing, social and environmental factors also carry considerable weight when it comes to investment decisions for these asset classes.

³ <https://www.unpri.org/credit-ratings/esg-credit-risk-and-ratings-part-2-exploring-the-disconnects/3250.article>

⁴ <https://www.bloomberg.com/professional/blog/gender-focused-strategy-beat-sp-500-141-percent/>



Sustainability Advocates

As with last year's study, we have identified the Sustainability Advocates⁵ – that is those institutional investors who say that improving the sustainability of their portfolio is an important investment objective for the next 12 months. The following section details the difference in investment behaviour and attitude these investors demonstrate.

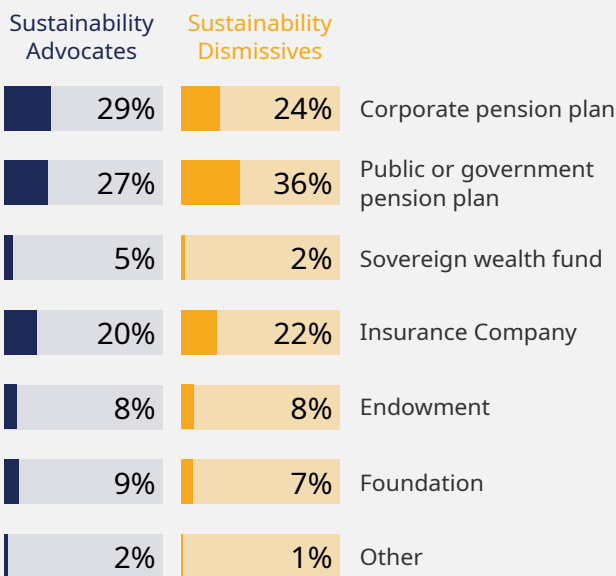
⁵ Sustainability Advocates are identified as the institutional investors who responded “4” or “5” on a scale of zero to five to the following question: How important are the following investment objectives for your organisation over the next 12 months? [Improve the sustainability of my portfolio's investments].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

Who are the Sustainability Advocates?



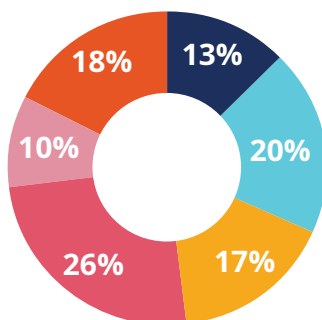
We surveyed 650 institutional investors....
and identified 228 Sustainability Advocates

Sustainability Advocates represent over a third of our sample of institutional investors

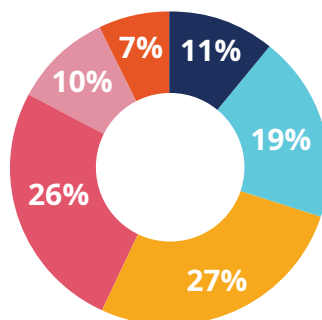


65% others

Sustainability Advocates



Sustainability Dismissives



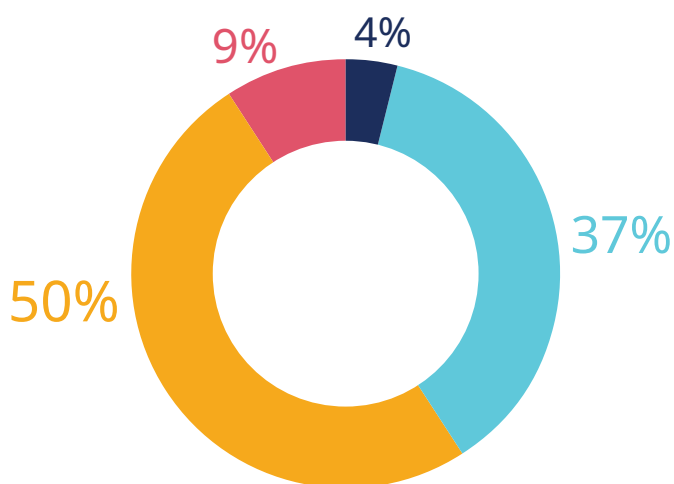


Confidence and investment outlook

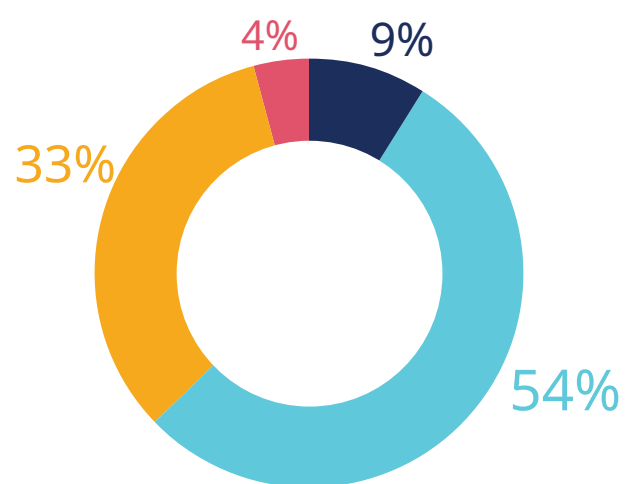
Having sustainability as a primary investment objective has a distinct influence on institutional investors' behaviour and traits. We have identified these Sustainability Advocates and can reveal that institutional investors who prioritise sustainability are considerably more confident (59% vs 37%)

about the prospects of meeting their return expectations. What's more, almost one in ten Sustainability Dismissives are not confident at all in terms of meeting their return expectations, compared to just 4% of Sustainability Advocates.

Greater confidence among Advocates



Sustainability Advocates



Sustainability Dismissives



How confident are you in achieving these return expectations?

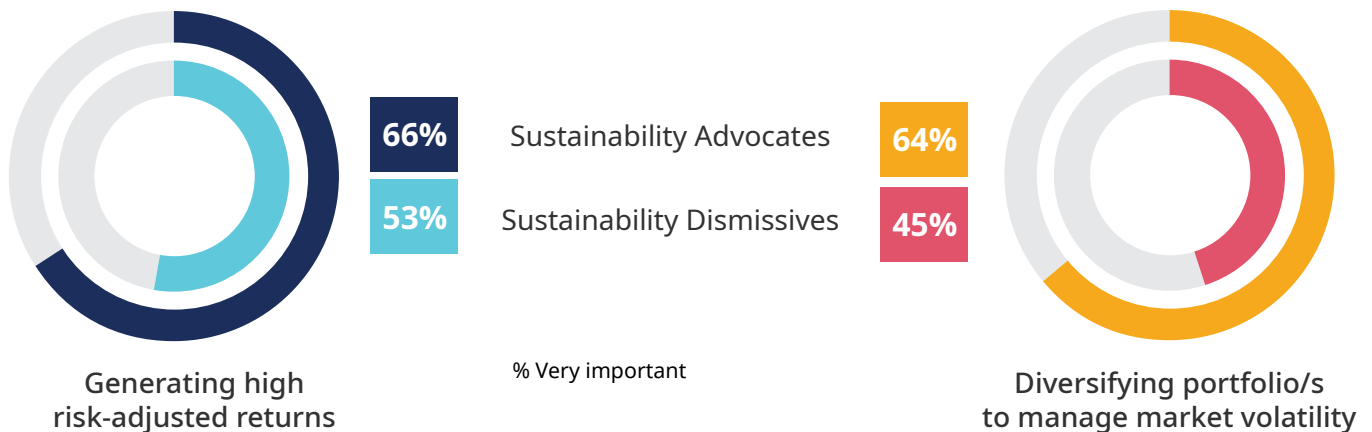


Diversification and greater use of alternatives

Generating high risk adjusted returns is more of a priority for Sustainability Advocates (66% vs 53%).

Sustainability Advocates also more highly value diversification as 64% say this is an important objective over the next 12 months. This compares to 45% of Sustainability Dismissives.

Generating high risk-adjusted and diversification important

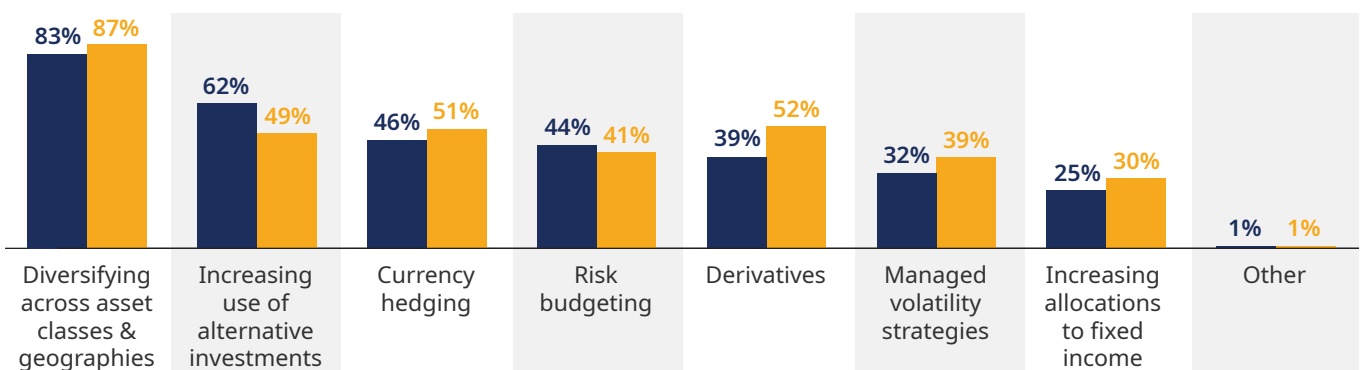


How important are the following investment objectives for your organisation over the next 12 months?

Greater use of alternatives

Sustainability Advocates also say they use alternative investments to manage risk in their portfolio (62% vs 49%).

■ Sustainability Advocates ■ Sustainability Dismissives



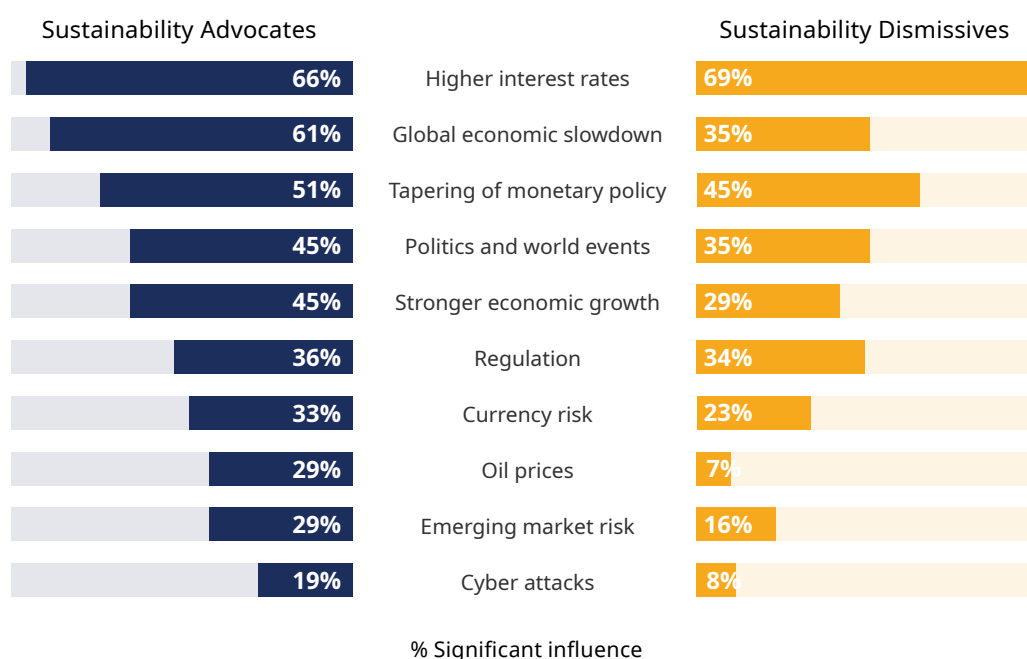
Across all your investments, which of the following strategies do you use to manage risk within the portfolio?

Portfolio influences



In this year's study, Sustainability Advocates show distinct differences in the factors they expect will affect their investment performance over the next 12 months.

Advocates are more mindful of a greater range of factors



What influence do you expect the following to have on your portfolio's investment performance in the next 12 months?

Within the top five influences, Sustainability Advocates say a global economic slowdown and stronger economic growth, as well as politics and world events are expected to have a significant influence on their portfolios' investment performance.

The greatest difference between the two groups can be observed in their expectations around a global economic slowdown with 61% (vs 35%) of Sustainability Advocates saying this will be a significant influence. Sustainability Advocates are also more wary of the influence other factors such as oil prices, emerging market risk and cyber-attacks will ultimately have on their portfolios.

Sustainability Advocates

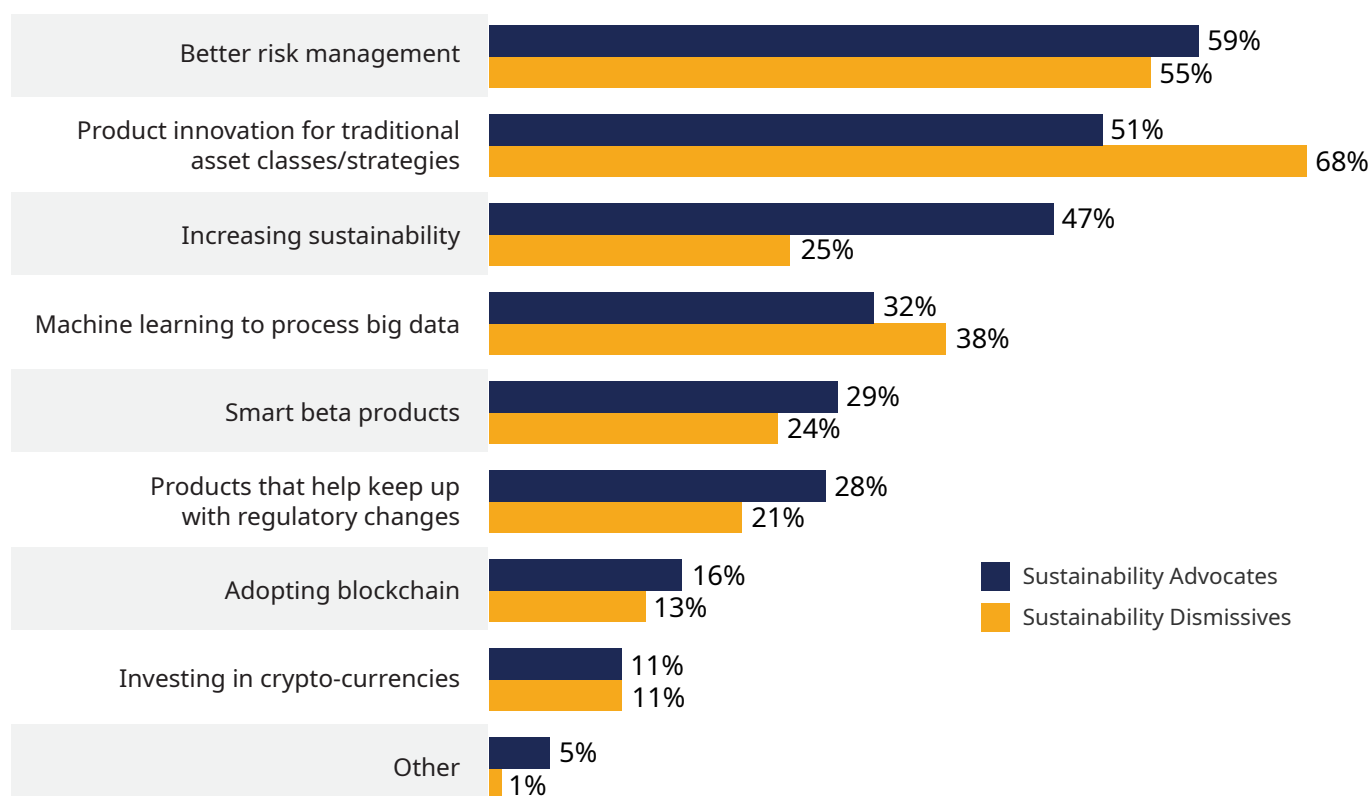


Sustainability Dismissives



% Significant influence - Sustainability focus of the investment

Greater need of increasing sustainability among Sustainability Advocates



Conclusion

The consensus on the importance of sustainable investments continues to build, and despite the challenges that remain, the outlook for growth in this area is strong.

This study shows how a focus on sustainability impacts institutions' broader attitude to investment decisions. The increased confidence levels, greater diversification and demand for high risk-adjusted returns all look to be traits of institutional investors placing sustainability at the forefront of their investment objectives.

For sustainability to gain more traction, investors are calling for better data around the link between these types of investments and improved returns. Because, in spite of their stated intentions, sustainability still plays a minor role in the investment decision-making of many institutional investors globally.

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