RBC Global Asset Management
PH&N Institutional

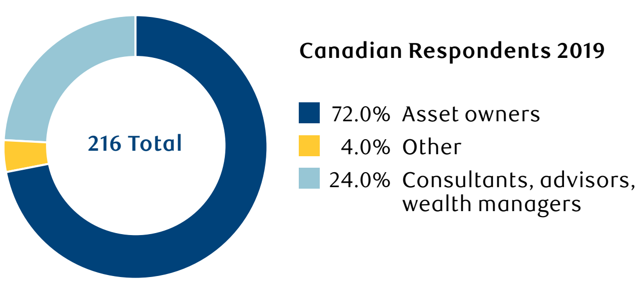
2019 Responsible Investment Survey

Canadian institutional views

Recently, RBC Global Asset Management (RBC GAM) surveyed 799 institutional investors in Canada, the United States, Europe and Asia about trends, attitudes, and opinions regarding responsible investing. As the Canadian institutional asset manager within RBC GAM, PH&N Institutional was instrumental in engaging the 216 Canadian respondents.

An Evolving Landscape is revealed in RBC GAM's fourth annual survey of institutional investors' views on responsible investing. The results signal that institutional investors who apply environmental, social and governance (ESG) principles are committing more of their assets to this approach than ever before because they view it as a way to enhance returns and mitigate risk.

ESG has been mainstream for a number of years and continues to gain enthusiasts. Eighty percent of Canadian institutional investors reported using ESG factors in investment decision-making, up from 74% in prior years. Among this group, those who use ESG factors "significantly" was almost 6% higher than in 2018, and 10% higher than in 2017.



The group of adopters is also more convinced of the tangible value that an ESG-based approach brings to their portfolios. Mitigating risk and enhancing returns is now the number one reason institutional investors incorporate this approach, according to 61% of Canadian respondents (versus 53% in 2018), overtaking fiduciary duty as the top driver.

More positive about the impact on performance. When asked how ESG-integrated portfolios are likely to perform when compared to non-ESG-integrated investments, 90% of Canadian institutional investors said as well or better, consistent with last year. What is interesting is the 9% jump year-over-year among those who believe performance will be better. It seems institutional investors increasingly view ESG integration as a help rather than a hindrance for returns. Over 70% believe that ESG integration helps mitigate risk. Moreover, this year we witnessed a jump of 10% among those who believe ESG integration can also help generate alpha (40% in 2019 versus 30% in 2018 – almost double the 2017 result of 21%), although a significant proportion are still unsure (43%).

ESG integration is widely adopted within equities and fixed income investing, and is a focus in real asset investing as well, especially in Canada. Equities continue to experience the highest adoption among the asset classes, with nearly 90% of Canadian respondents affirming that ESG factors are considered in decision-making about equity investments; while adoption in fixed income management is lower but still above 65%. When it comes to other asset classes, Canadian investors are ahead of their global peers in adopting ESG considerations for real assets like real estate (53% consider ESG, versus 38% among global peers who responded) and infrastructure (45% of Canadian consider ESG in infrastructure investing, versus 31% globally). The long-term, illiquid nature of real assets amplifies the importance of ESG considerations in this context.

Institutional investors are more likely to choose active management for ESG portfolios. For the first time, we asked survey respondents what percentage of their "responsible investing" portfolio is actively managed. Despite the rise of passive management as a trend globally, the overall average level of institutional ESG-based portfolios that is actively managed is 61%, and 68% in Canada specifically, according to the survey data. Only 13% of Canadian respondents and 10% of global respondents are investing their entire ESG portfolio passively. Canadian institutions, more so than their global peers, favour active management for ESG portfolios. 42% of Canadian respondents said their entire ESG-based portfolio is actively managed, while only 28% of global respondents made this claim. Among Canadian respondents, 70% actively manage more than half of their ESG-integrated portfolio, compared with 62% of global respondents.

Shifts in negative screening. Similar to the 2018 results, almost three quarters of 2019's global respondents – 80% of Canadians -- said they do not apply negative socially responsible investment (SRI) screens, which is in line with their preference for engagement over divestment. That said, among those institutional investors who do apply negative screens, there were some interesting shifts. As in 2018, the cluster munitions and landmines category remained the most widely used screen globally, but it dropped in popularity this year by 11%. In Canada, tobacco has been the top screen (67% in 2019, albeit down from 73% the year before). The application of fossil fuel-related screens grew modestly overall in 2019 (by 2%), but with marked regional differences: in Canada the use of a fossil fuel-related screen grew by more than 10% (now used by a third of those who apply screens) whereas it declined by 17% in the US to 45% of those who apply screens.

The level and quality of ESG disclosure continues to concern investors. The disclosure of ESG-related issues has been an important area of discussion in each of our annual surveys. Investors continue to demand more and better disclosure from issuers, with only 10% of Canadian institutional investors satisfied with the amount of current disclosure and only 8% satisfied with the quality. 43% of Canadian respondents believe shareholders should take the lead in influencing issuers to do better; and 33% believe governments regulators should lead (for context, in the US, 55% of our respondents put the onus on shareholders, while only 13% assign it to government regulators).

When we asked the consulting and advising community globally what ESG reporting they seek from external managers, the vast majority, 73%, require reporting on ESG practices and integration, but less than half ask for anything beyond that. Reporting on proxy voting is required by 48% and on engagement activities by 36% of responding consultants. Canadian consultants' responses were consistent with those of their global counterparts in this regard.

Investors still prefer engagement over divestment. In the context of the "fossil fuel free" movement, Canadian institutional investors came down squarely on the side of engaging with corporate management, rather than selling their holdings, as a way to influence company behaviour: 47% favoured engagement, consistent with 2018; versus the 8% each year who viewed divestment as more effective.

Institutional investors believe corporations are too focused on short-term results. Short-termism is the focus on short-term profits, while ignoring long-term costs and interests. Given the long time horizons of pension plans, endowments and other institutional funds, a curtailed focus can be problematic. An overwhelming majority of global respondents, 85%, felt that corporations are too focused on short-term results. We then asked why:

	Canadians 2019 (%)	Global 2019 (%)
Short-term earnings pressures from investors	79.8	76.1
Structure of executive compensation plans	70.5	60.8
Quarterly reporting	63.6	57.5
Short-term earnings pressure from executives and board	56.6	52.7
Quarterly forecasts	37.2	36.3
Short strategic planning horizons	36.4	31.5
Other	1.6	3.9

This year, Canadian institutional investors were more adamant about the top two drivers than last year: short-term earnings pressures from investors scored 14% higher than in 2018, and the structure of executive compensation scored 8% higher.

What keeps institutional investors up at night? This year, the survey asked respondents to rank which ESG issues they are concerned about when investing. Our Canadian respondents claim to be "very concerned" about cyber security (36%), climate change (34%) and anti-corruption (31%), which is consistent with their global peers (cyber security 40%, climate change 36%, anti-corruption 34%). When we delve a little deeper, however, and combine the "very concerned" scores with the "concerned" scores, regional differences arose with the broader Canadian concerns tending toward governance and social issues, while the Europeans are clearly more concerned about environmental issues. The table below shows the top 10 issues by this broader measure in Canada, the US and Europe.

	Canadian		US		Europe (incl. UK)
1	Anti-corruption	1	Cyber security	1	Climate change
2	Shareholder rights / voting	2	Anti-corruption	2	Water
3	Executive compensation	3	Water	3	Renewable energy
4	Water	4	Health & safety	4	Anti-corruption
5	Cyber security	5	Renewable energy	5	Biodiversity
6	Health & safety	6	Executive compensation	6	Resource use & management
7	Climate change	7	Climate change	7	Cyber security
8	Renewable energy	8	Shareholder rights / voting	8	Executive compensation
9	Resource use & management	9	Resource use & management	9	Income inequality
10	Community impact	10	Land use	10	Land use

Canadian institutional investors are relatively evenly split as to how to address gender diversity on corporate boards: In the 2018 survey, three-quarters of respondents said gender diversity on corporate boards was important to them. This year, board diversity was ranked 15th among 20 issues of concern to Canadian institutional investors (16th globally), the top 10 of which are cited above. In this year's survey, we asked if corporations should adopt targets to address board diversity, and Canadian respondents were split evenly between yes and no. While shareholder proposals continued to be the favoured means, the gap did narrow between market forces and government regulations as secondary approaches to encourage gender diversity on corporate boards.

Canada	2019 (%)	2018 (%)	Change
Shareholder proposals	41.3	41.7	-0.4
Market forces	26.7	34.0	-7.3
Government regulations	21.3	10.7	10.6
Other	10.7	13.6	-2.9

Conclusions

The picture of responsible investing among Canadian institutional investors is, indeed, an evolving landscape. More are integrating ESG factors into their decision-making, across asset classes, and with a larger portion in actively managed portfolios. Quality and quantity of ESG disclosure by issuers continues to be a concern among these investors, who also feel that shareholders and regulators should use their influence to encourage the availability of better ESG-related information.

Canadian institutional investors are active participants in responsible investing and take their involvement seriously. They favour engaging with the management of companies they own in order to effect or influence change; they prefer to manage their ESG-integrated portfolios actively; and they are concerned that the focus on short-term results not eclipse longer term corporate interests. When investing, they and their global peers are very concerned about cyber security, climate change and anti-corruption, but Canadians are more broadly focused on governance and social issues than are their American and European counterparts. Meanwhile, board diversity ranks markedly lower than these concerns, and Canadians are less definitive in terms of how best to address it.

For survey results or questions, please visit rbcgam.com/esg, rbcgam.com/cgri or institutional.phn.com, or email institutions@phn.com.

The survey took place from June 4 to 24, 2019. The findings of this survey may be accepted as accurate, at a 95% confidence level, with a sampling tolerance of approximately +/-3.5%. Survey invites were distributed by email by PH&N Institutional, RBC Global Asset Management, and Signet Research.

Publication date: October 18, 2019. IC1910863.

018GAM095_RI_SURVEY_2019_CANADIANINSTITUTIONALVIEWS_EN_V1_411/18/2019