THE ESG JOURNEY ACCELERATES

2022 ANNUAL ESG MANAGER SURVEY

NOVEMBER 2022

EMBRACE THE POSSIBLE™

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Executive summary: The ESG journey accelerates

Our 2022 ESG manager survey reveals that the widespread integration of environmental, social and governance (ESG) factors by the asset management community continues to enhance investment processes, providing a more comprehensive, forward-looking picture of investment opportunities. At the same time, regulators across the globe are stepping in to establish standards for sustainability frameworks - to provide for increased portfolio transparency as the data used to assess whether a product is ESG-managed or sustainable continues to attract heavy scrutiny.

These efforts are being undertaken in large part to tackle the practice of *greenwashing* - the overstating of the ESG profiles of financial securities and products - although our survey shows that the asset management community believes there is still much more work to be done in this regard. The survey results also indicate that investors are continuing to demand standardised disclosures of key ESG metrics - and that asset managers are increasingly responding to this request.

In addition, this year’s survey shows that net zero commitments from asset managers are gaining momentum across the globe, while climate-related disclosures are also expanding. Just as significant, the 2022 survey highlights the vital role that engagement activities continue to play in confronting climate risk and expanding diversity, equity and inclusion (DEI) disclosures.

Key findings:

- Biggest ESG issue: Climate risk dominates the client concerns
- Top growing ESG product sector: ESG integration
- Greatest challenge of incorporating ESG for asset managers: Varying client needs
- Data concerns: ESG data and reporting continue to be a challenge
- DEI: Roughly half of the asset managers have gender or ethnic-minority representation of <20% on their investment staffs

About the survey

Russell Investments conducted its 2022 annual ESG manager survey across equity, fixed income, real assets and private markets asset managers from around the globe. The survey aims to assess their attitudes toward responsible investing and shed light on how managers integrate ESG considerations into their investment processes. This year's survey covered a wide range of topics, including the following:

- Sustainability initiatives
- ESG resourcing
- Climate data coverage
- Product offerings
- Reporting and data
- Climate risk management
- Engagement activities
- Diversity, equity and inclusion

This year marks our eighth annual ESG manager survey. The survey has evolved over the years, enabling deeper insights into trends and how attitudes toward responsible investing have shifted since it was first launched in 2015.

Russell Investments incorporates ESG considerations into the investment process. As a component of the manager research process, our analysts assign an ESG rank to individual strategies, based on a rigorous analysis of a number of key determinants of expertise and effectiveness in the area. The ESG manager survey results provide a rich source of information about how each asset manager approaches ESG. As such, the survey results may serve as significant reference points for our analysts when evaluating investment strategies.

In order to provide the most accurate representation, we tried to consolidate assets under management (AUM) for single firms which provided more than one regional response. The survey participants have a broad representation by asset size, region and investment strategy offerings.

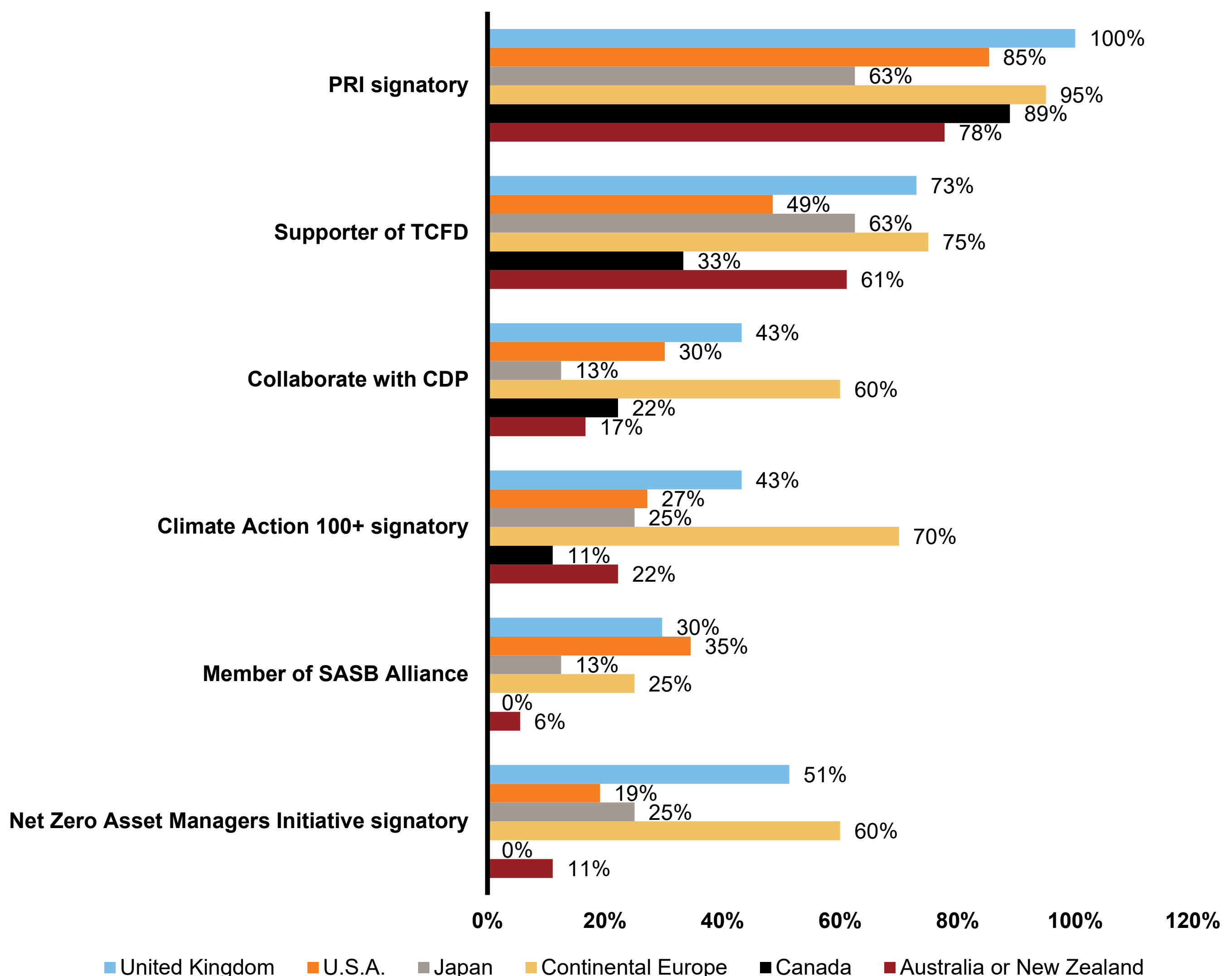
- There were 236 total survey participants
- 184 offer equity strategies
- 147 offer fixed income strategies
- 77 offer private markets strategies
- 66 offer real assets strategies
- 58% of the respondents are headquartered in the U.S
- 16% are based in the United Kingdom and 9% are based in continental Europe
- The remainder are located in other regions
- 28% of the respondents have AUM less than US$10 billion
- 33% of the participants have over US$100 billion in AUM

We observed that the level of ESG efforts have a high correlation to a firm's assets under management, as the larger firms can afford greater resourcing - resulting in seemingly better ESG-related infrastructure. When comparing the survey results, we were mindful of the underlying composition difference, such as region and asset base.

Sustainability initiatives

We continue to observe expanded commitments to sustainability-related initiatives across the asset management industry. This is driven by an increase in regulatory standards, an accelerated focus on climate change (which is leading to multiple initiatives) and a shift in perspective, particularly in social considerations to further advance diversity agendas. The industry standards used to assess sustainability frameworks, such as the United Nations-supported Principles for Responsible Investment (PRI), have ramped up their methodologies to better reflect the state of responsible investment practices. In order to provide deeper analysis into this trend, we asked survey participants to identify sustainability-related organisations and initiatives that they are engaged with (Exhibit 1).

Exhibit 1: Commitment to sustainability initiatives



The results show that of the 236 survey participants, 87% of are signatories to the UN-backed PRI, compared to 80% in 2021 and 75% in 2020. For PRI signatories, the biggest change we saw was among U.S.-based firms, where the share of U.S.-based signatories increased to 85%, versus 73% in the previous year.

A majority of managers surveyed are also supporters of the Task Force on Climate-related Financial Disclosures (TCFD), at 56%. We also noted an uptick in the number of managers collaborating with the CDP (formerly the Carbon Disclosure Project), as well as those who are Climate Action 100+ signatories. In particular, the number of signatories to the Net Zero Asset Managers initiative, launched in December 2020, continues to expand, although still at low overall percentages outside of Europe. This is significant, as these firms are committing to support the goal of net zero greenhouse gas (GHG) emissions by 2050 or sooner.

Staff ESG resources continue to expand

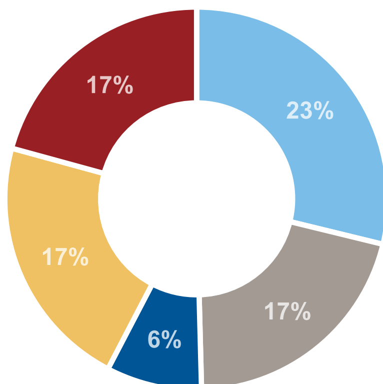
Our survey also revealed an uptick in the number of asset managers who have ESG professionals on their staff. Of the 236 respondents, 63% of the respondents have dedicated ESG professionals who spend more than 90% of their time on ESG matters, compared to 55% in 2021 and 43% in 2020. Continental Europe remains the highest region to have these types of ESG professionals, with 90% of European-based firms employing dedicated ESG professionals - up slightly from 88% in 2021. Among UK-based firms, 76% have dedicated ESG professionals, versus 63% in 2021.

The high level of dedicated ESG professionals in Europe likely stems from the combination of a stricter regulatory environment and heighted interest among clients. Notably, among U.S.-based firms, this number is much lower, at 59%. However, it marks a notable increase from the prior year, when less than half (47%) of the firms surveyed reported having dedicated ESG professionals on staff.

When asked to identify the specific roles of the respective ESG professionals they employ, corporate governance and/or engagement-focused professionals were among the highest listed, followed by ESG research. 12% of firms responded that they had in-house climate specialists, with some indicating they've brought these specialists on board to further assist with climate-risk management efforts. When asked to identify which team the dedicated ESG resources mostly belonged to, the proxy and engagement team was the highest, followed by the dedicated sustainability/ESG team and the equity team.

Exhibit 2: The roles of dedicated ESG professionals

Q: What is the nature of the roles for the dedicated ESG individuals in your organisation?

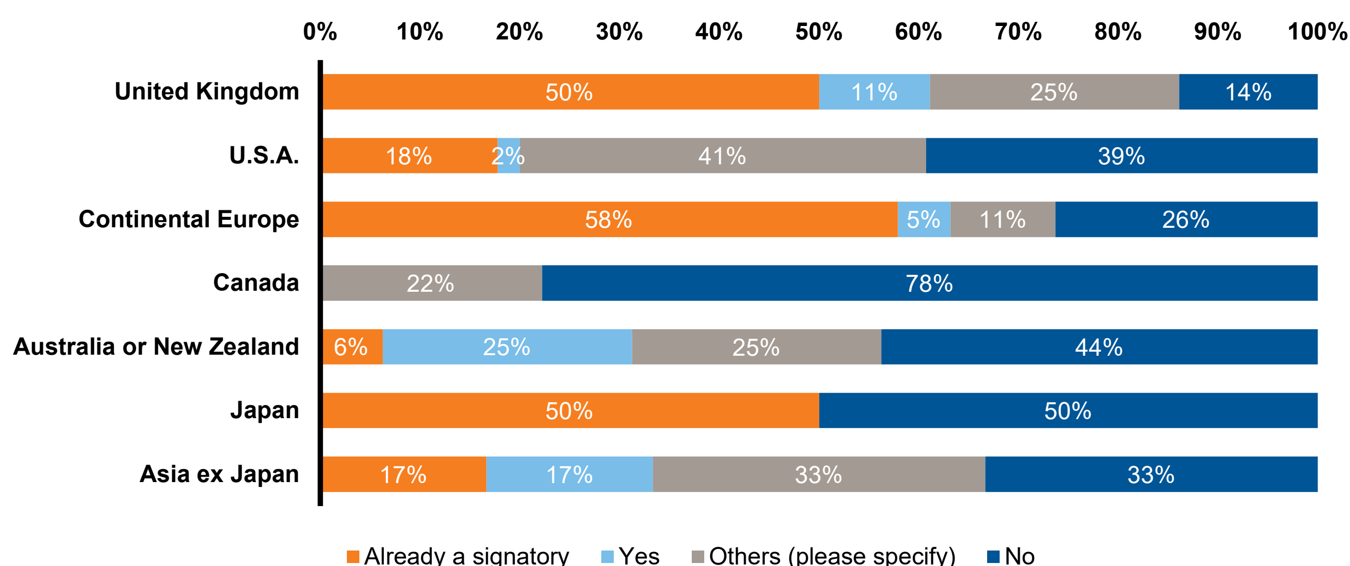


Net Zero Asset Managers initiative - Europe, UK and Japan lead the way

There has been much attention paid to net zero climate initiatives and how, specifically, companies could turn climate goals into actual emission reductions. This November, Egypt is hosting the United Nations Climate Change Conference (COP27). The summit is bringing almost every country together to accelerate actions toward the goals of the UN Framework Convention on Climate Change amid the urgency of the deepening climate emergency. In our survey, this urgency is reflected in the spike of Net Zero Asset Managers initiative signatories. Our survey indicates that the signatory status of the Net Zero Asset Managers initiative is proportionally the highest among continental-Europe-based firms, followed by UK-based firms, with more firms committed compared to the previous year. Notably, among the participants who selected “other” when asked if they plan to become a signatory over the next 12 months, many stated that they’re still evaluating the initiative.

Net Zero Asset Managers initiative signatories have to disclose their plans to reach net zero emissions by 2050 and update their targets regularly, ensuring transparency and accountability. There are multiple net zero target frameworks, with the popular ones being the Paris Aligned Investment Initiative’s Net Zero Investment Framework (NZIF), the Science Based Targets initiative (SBTi) and the Net Zero Asset Owner Alliance Target Setting Protocol. Among those which are signatories to the Net Zero Asset Managers initiative already, we asked which target-setting framework they’re applying. While many are still in the process of evaluating or hadn’t disclosed their plans at the time the survey was submitted, the results indicated that the most popular framework was the NZIF, followed by the SBTi.

Exhibit 3: Net Zero Asset Managers initiative plans

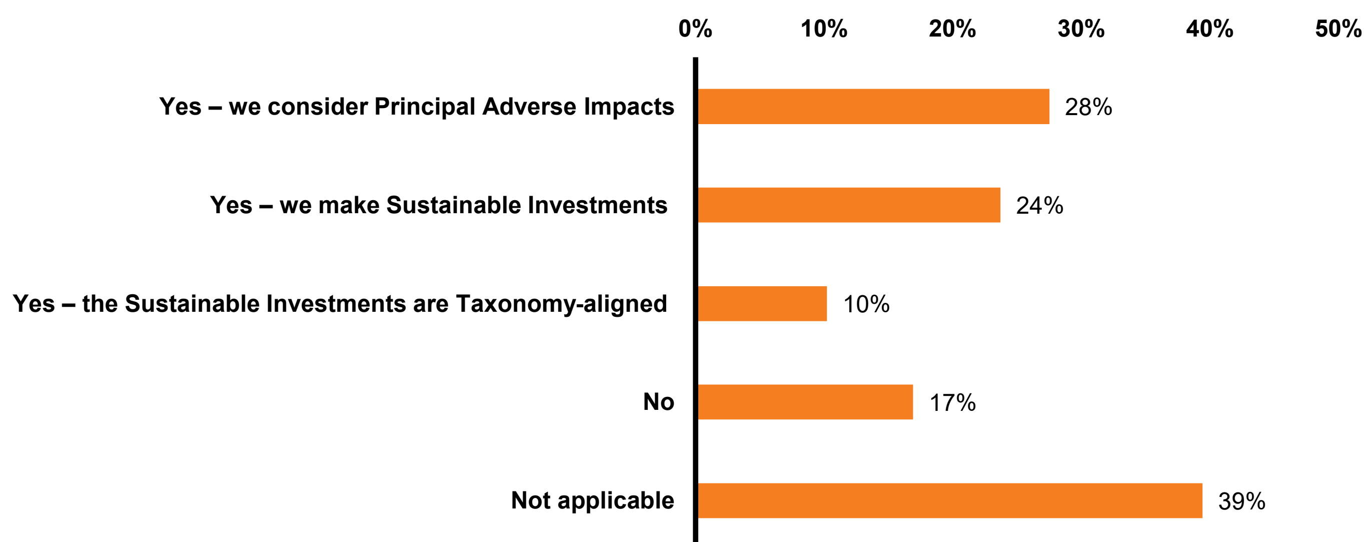


Regulations and sustainability - ESG data continues to be a challenge

Regulators, particularly in the European Union (EU), are stepping in to provide guidance for what qualifies as sustainable investments. Under the EU Sustainable Finance Disclosure Regulation (SFDR), a sustainable investment is defined as (under section 2(17) of SFDR) "an investment in an economic activity that contributes to an environmental or social objective, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee, relations and remuneration of staff and tax compliance."

When asked about how they see the increasing complexity of regulations - such as the MiFID requirement to (i) take into account a client's sustainability preferences as part of the suitability assessment (which must be performed prior to performing individual portfolio management/offering investment advice) and (ii) to integrate sustainability preferences into the product governance fund distribution chain - impacting client demand for ESG strategies/solutions in the next 12 months, the results were mixed.

Exhibit 4: Products under updated MiFID rules



The variability in responses could be because the reporting requirements under the SFDR will become more stringent starting early next year, and asset managers are trying to prepare for the change. That said, at the time when the survey was conducted, only a handful of firms were able to meet clients' sustainability preferences under the EU MiFID rules for the Principal Adverse Impacts (PAI) and sustainable investments, and less so for the EU taxonomy - suggesting there's still a long way to go. Based on our conversations with asset managers, another issue may be around the complexity and existing uncertainty in interpreting these regulations.

The PAI refers to an extensive list of impacts which the EU regulator has determined are the most significant forms of adverse impacts on sustainability factors which, at least in principle, allow investors to monitor the adverse impacts of the securities they invest in. The PAIs are measured by 14 mandatory corporate indicators, with two additional indicators for both sovereigns and real-estate, and an additional list of optional indicators. One of the big challenges in measuring any portfolio through a sustainability lens is data availability in general, as well as the specific frameworks, such as the PAI and the EU taxonomy. Further adding to the data availability challenges is the lack of industry-standard framework references in sustainability measures outside of corporations, such as sovereigns and securitised credit markets.

The regulatory disclosure requirements bring greater transparency to sustainable investing. However, where to go from here remains unclear. In addition to the challenge of ESG data quality and how it actually contributes to the financial impacts of corporations, different regulators appear to be heading in different directions. The EU, for instance, is expanding further regulations to encourage incorporation of non-financial aspects with Article 8 and Article 9 products - both popular demands in the region. On the other hand, the U.S. Securities and Exchange Commission (SEC) has shown a cautious tone around incorporating ESG factors, likely to divest from a fiduciary-duty standpoint. At the same time, regulators across the globe appear to be united in acknowledging the many issues around the practice of greenwashing. Ultimately, we believe that acknowledging both the data disclosure challenges and establishing industry-disclosure frameworks are important steps for building greater transparency in sustainable investing.

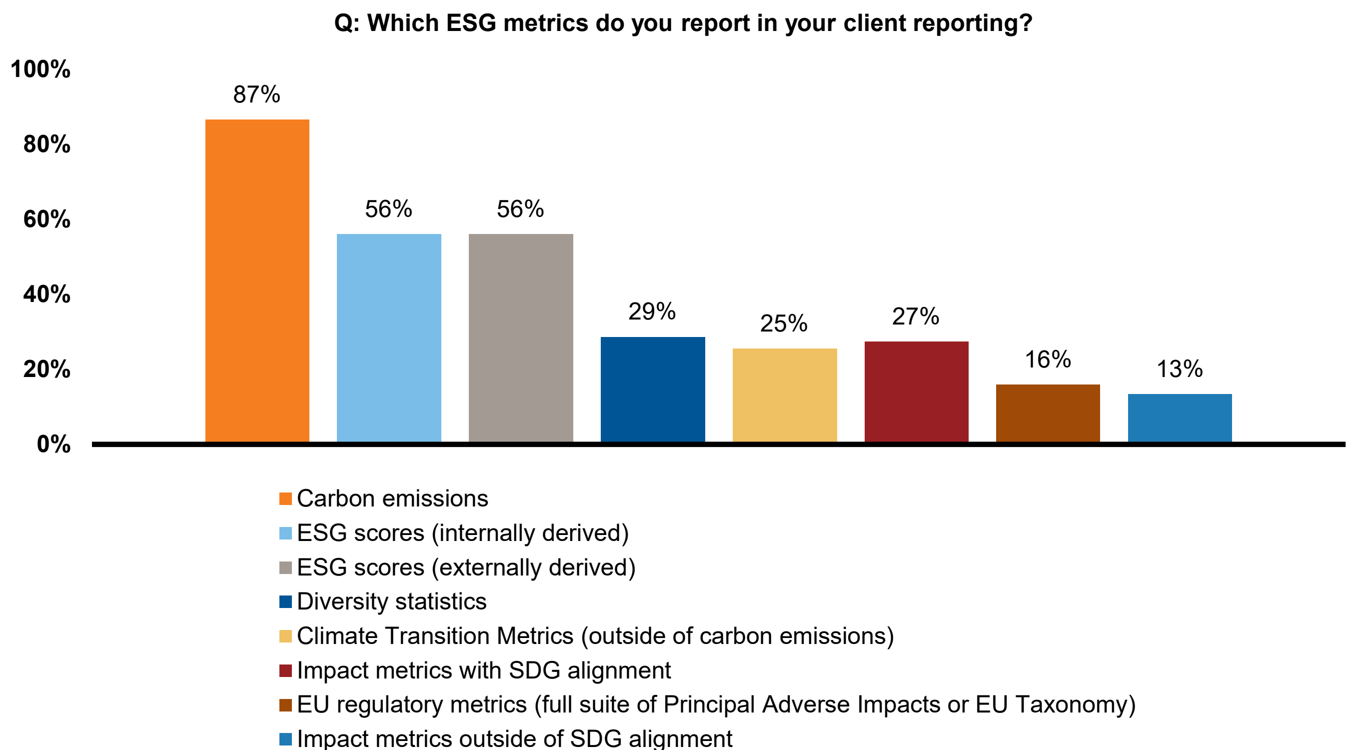
ESG reporting - standardisation begins to increase

While ESG-related reporting guidance continues to grow in prominence - one chief example being the TCFD framework - the reporting contents still vary widely. Our survey indicates that carbon emissions data is currently the most popular of the reporting items.

For ESG profile reporting, the results showed an equal level of respondents who disclose their internally-derived ESG metrics versus those who rely on and report to third-party ESG data vendors' outputs. ESG factors involve non-financial metric-driven considerations, which are often harder to quantify and can be highly subjective. That's why ESG data providers' outputs can vary for the same company, unlike credit rating agencies, where outputs have less dispersions. The results seem to indicate a slight shift in the reporting content source for ESG profiles. Last year's survey results suggested that an increasing number of asset managers were utilising their internally-derived ESG characteristics or metrics, as opposed to third-party ESG data providers' metrics. This year, however, asset managers were evenly split when it came to using third-party ESG data or their own metrics. This result aligns with our market observations. During our discussions with asset managers, we often hear about the challenges of third-party ESG data providers' outputs and how they try to augment it with their in-house ESG analysis. However, we are hearing more market participants reporting both internally derived and externally derived ESG data in their reporting. This suggests that investors want a standardisation of disclosures in key ESG metrics, and that asset managers are increasingly responding to this request.

In addition to carbon emissions and ESG-profile metrics, managers identified diversity statistics, climate-transition metrics and UN SDG (sustainable development goal) alignment as other popular ESG metrics included in reports.

Exhibit 5: ESG metrics included in reports



Climate data coverage - still focused on listed equities and corporate bonds

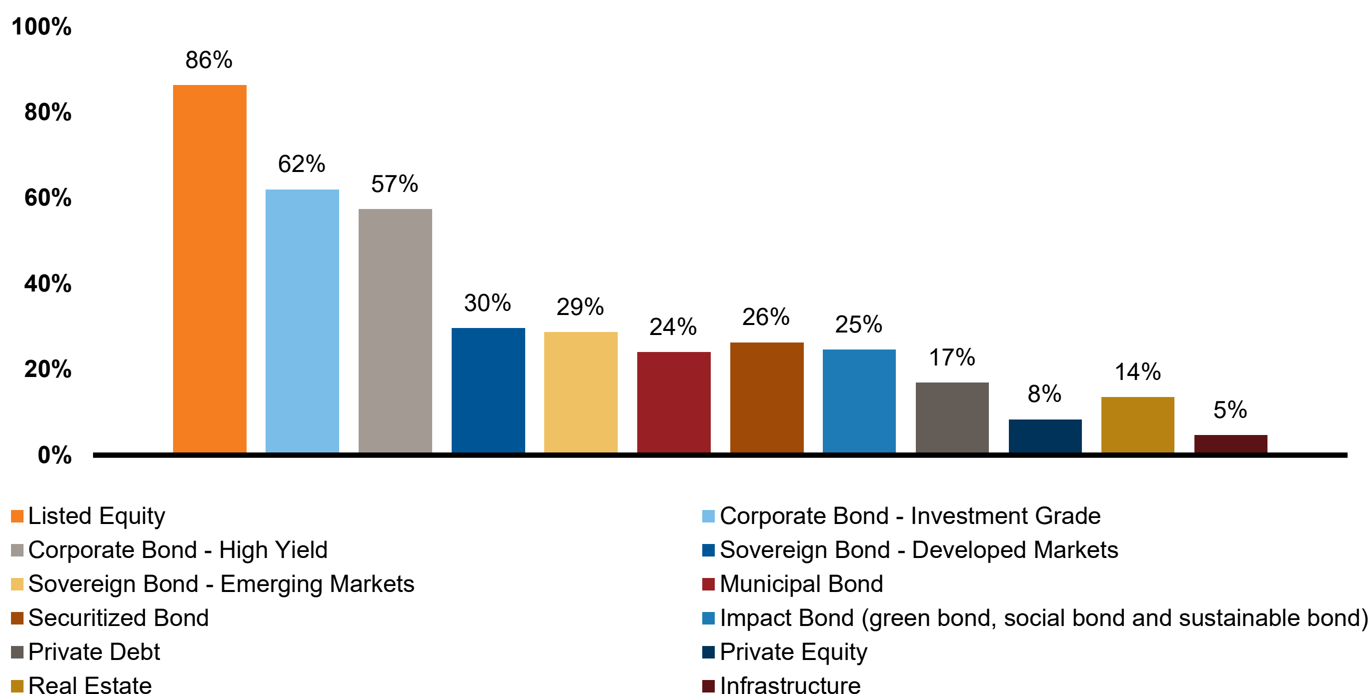
The spotlight continues to shine on the demand for climate metrics. The increased urgency has resulted in third-party data providers expanding the types of climate-related metrics offered. It is also reflected in increased subscriptions among asset managers to third-party data providers.

Currently, many asset managers focus on scope 1 (which covers direct emissions from owned or controlled sources) and scope 2 (which covers indirect emissions from the energy generation of the reporting company) of the entities they invest in. There is a growing desire to capture scope 3 data as well, which would include all other indirect emissions that occur in a company's value chain, which involves a wide range of assumptions. This data is still considered unreliable. However, the availability of climate metrics in the market varies greatly depending on strategy type. The scope 1, 2 and 3 emissions were initially developed for corporate emissions. For sovereign emissions, there are some framework recommendations being developed, such as territorial production emissions (emissions produced domestically, which include domestic consumption and exports), yet there is no clear industry-standard framework to tackle sovereign climate data. In order to gauge the current status of climate data availability, we asked asset managers which investment strategy types currently provide carbon-intensity data.

When comparing climate data across different asset classes, it is important to be mindful of differing measurements. For example, a popular carbon intensity measure used in the corporate bond market is the weighted average carbon intensity (WACI) – which calculates the carbon intensity as metrics tons of GHG emissions per million sales for corporate bond issuers. On the other hand, a common carbon emission measure for sovereign bond issuers is the use of GHG emissions divided by GDP (gross domestic product) or GDP per capita. The climate measures of these two segments are very different, making it a challenge to consolidate both.

Exhibit 6: Portfolio carbon-intensity measures

Q: If you report carbon intensity measures of portfolios, for which asset class(es) is the calculation provided? (select all that apply)



The results from our survey respondents indicate that carbon-emission data availability in the capital market is the highest in the listed equity space, followed by the corporate bond market. This is understandable as the corporate credit market is the closest to equities, allowing equity coverage to be expanded there. Within the fixed income market, sovereign data availability is the highest after corporate credit.

Carbon-intensity measures are challenging for securitised and municipal bonds because of poor data availability, given these markets involve various segments, such as asset-backed securities, mortgage-backed to commercial-mortgaged-backed securities for the securitised, and revenue bonds to general obligation bonds for municipal bonds. Additionally, climate data linking to security level output is hard for the securitised and municipal market due to the many layers of projects associated with these bonds, as opposed to corporate bonds linking to specific corporations. The securitised market especially is a fast-evolving segment, and many market participants like Fannie Mae are planning to come up with security level social scores to provide further transparency.

While carbon emissions data captures a snapshot of an entity, our survey does reveal a growing trend toward evaluating the energy transition with forward-looking views. For instance, the number of asset managers who collaborate with the Transition Pathway Initiative and the Science Based Targets initiative expanded in this year's survey, when compared to previous years.

Which ESG considerations drive decision-making? Governance still dominates but environmental awareness increased.

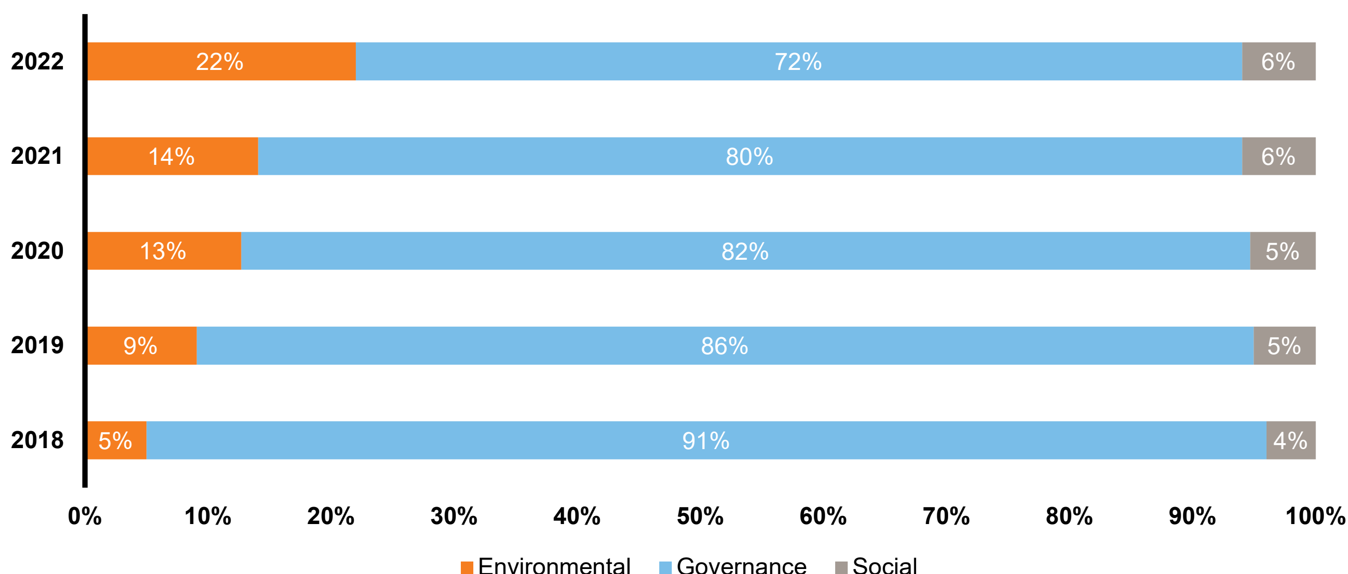
We believe that ESG considerations are an enhancement to the overall investment process - as they help to provide a more complete picture of material drivers of corporate profitability and risk - but that they are not a game changer. Why?

In most cases, ESG considerations are nuanced and only obvious in outsized circumstances. The broadening of ESG-related information available in the marketplace is helping highlight the material risks associated with ESG, enabling further adoption of the integration of ESG factors. However, despite this increase, the extent of the role that ESG assessments play in actual investment decisions remains unclear - especially around environmental and social considerations.

To gain further insight into this, we asked which ESG considerations impact investment decisions the most. Each year, governance has remained the dominant factor - and that was true this year as well (Exhibit 7). This is no surprise, given that company management is a critical component in generating long-term enterprise value. When asset managers are considering each of the ESG elements, they need to consider the materiality of each factor, and importantly, materiality differs by industry. For example, environmental aspects might be important for the energy or utility sectors but less important for the banking sector. However, overall corporate governance - how companies are managed - applies to all companies, regardless of industry.

That said, we noticed a reasonable increase in environmental considerations this year when compared to previous years' responses. This is likely due to the increased awareness and desire among market participants to tackle climate risk, as it could impact asset prices over time. This is particularly the case in continental Europe, where the highest share of survey respondents chose the environmental factor as the most important of the three (followed by Canada and the UK).

Exhibit 7: Which ESG factor impacts your investment decisions the most?



How ESG considerations play a role in investment decisions - Risks worth paying attention to

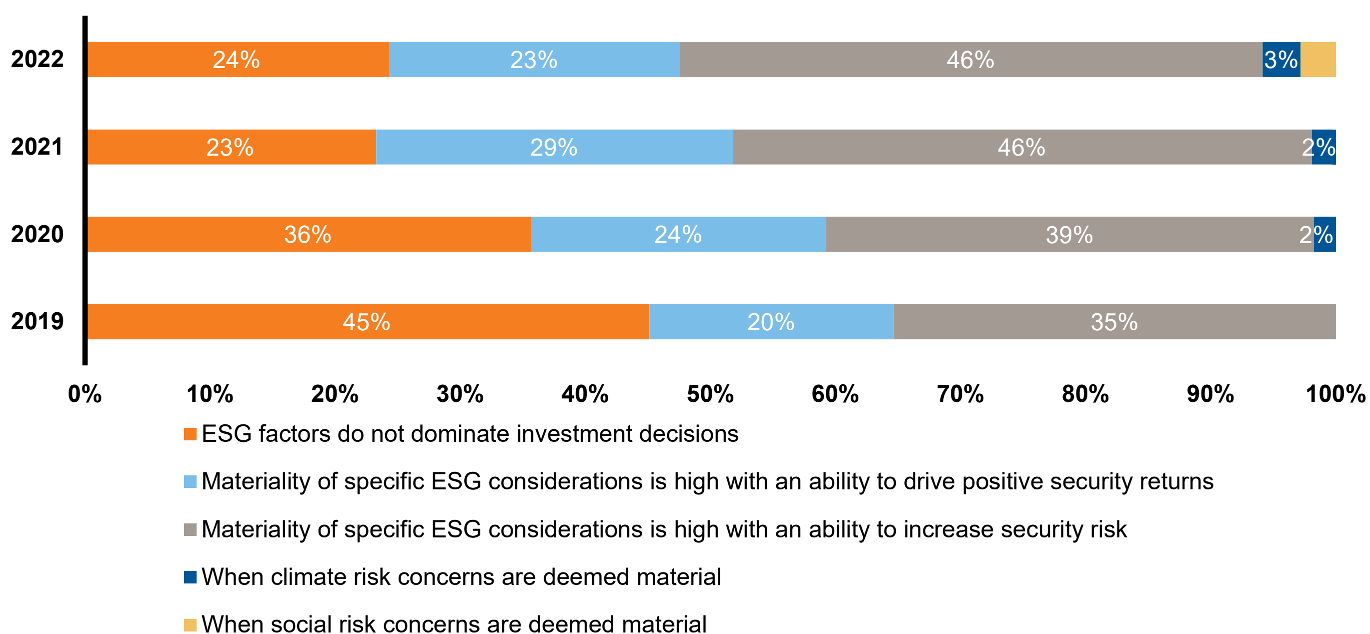
We asked managers when ESG considerations should dominate investment decisions (outside of investment guideline considerations). Notably, 92% of respondents indicated that they regularly incorporate explicit qualitative or quantitative ESG factor assessments at the issuer/entity level in their investment processes - a slight uptick from the 89% observed in 2021. Similarly, 79% of respondents said that they incorporate both qualitative and quantitative ESG factor assessments.

The results also show that financial materiality is a focal point for the decision-making process. 76% of respondents claim to incorporate specific ESG considerations when materiality is high, versus 77% from the previous year (Exhibit 8).

Notably, nearly half (46%) of respondents indicated that they incorporate ESG considerations into investment decisions when there is a potential impact to security risk generated from higher materiality considerations. Importantly, security risk consideration remains a higher concern than the ability to drive positive security returns. This response suggests that more asset managers are treating the evaluation of the impact of ESG considerations as a risk-management exercise. This points to a belief that whether it's governance, environmental or social matters, ESG risks are worth paying attention to.

Our survey also showed that climate risk concerns, in isolation, have little influence on the majority of managers' overall investment decisions. We believe this is because asset managers are mostly evaluating the materiality of ESG considerations - of which climate risk is a part - instead of having climate risk be the sole driving factor. However, it is worth noting that this year's survey saw a slight uptick in materiality concerns for climate or social risk aspects from previous years, perhaps reflecting heightened attention toward climate and social risks.

Exhibit 8: When ESG considerations should dominate investment decisions



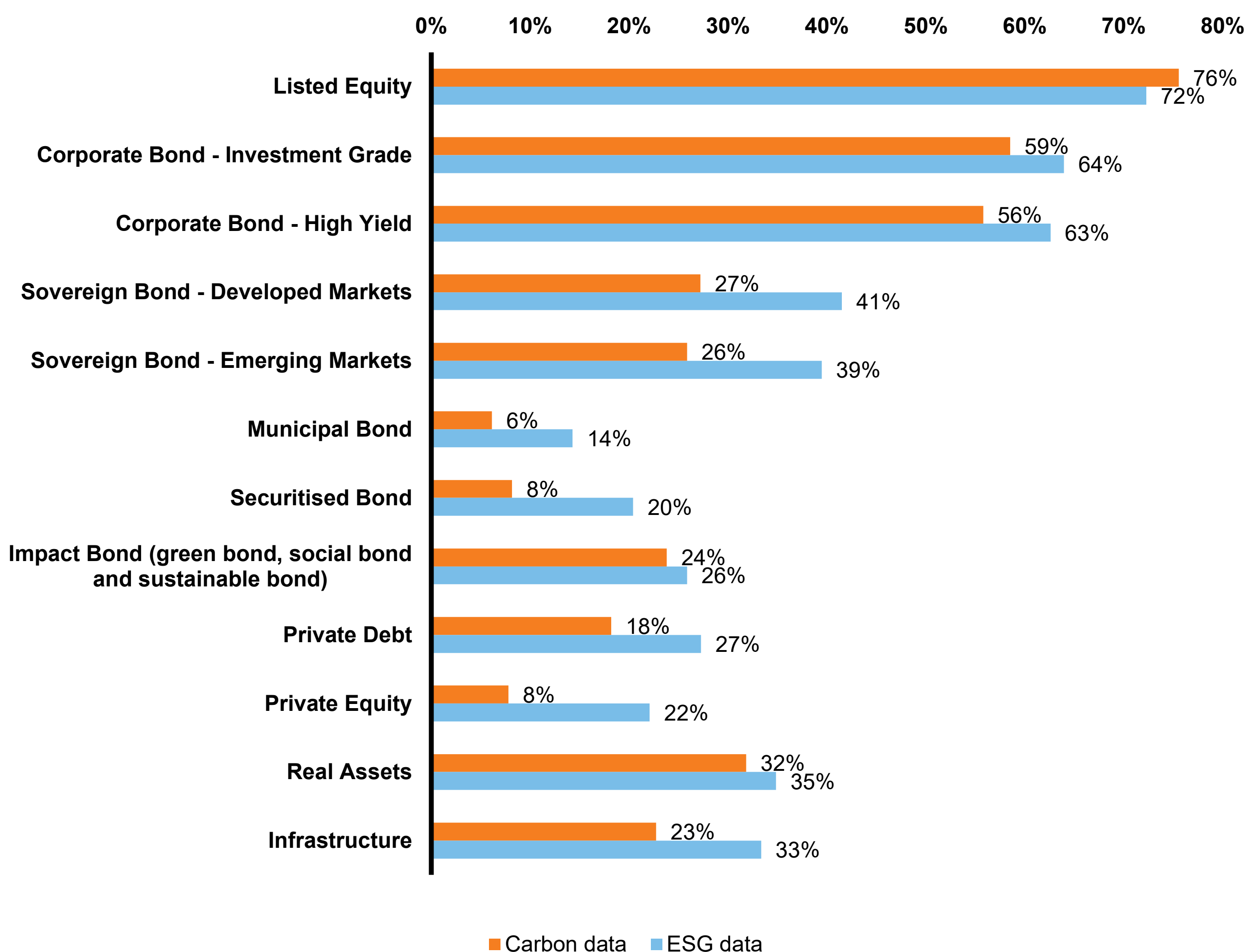
ESG data sources continue to broaden

ESG data providers continue to broaden their in-depth coverage and quality across asset classes. Notably, both ESG profile and climate-related metrics' availability is greatest in listed equities.

Among the fixed income firms, ESG data availability is the highest in the corporate credit market. This is understandable, given that corporate bonds are the closest to equities, allowing equity coverage in ESG considerations to be transferred over to the corporate credit market. The survey results also showed that within these firms, securitised and municipals markets have the least data availability.

One thing to consider for ESG integration in fixed income is the concept of entity mapping in corporate bonds. For instance, there are often multiple levels of entities - such as subsidiary organisations issuing debt as opposed to an ultimate parent entity - and each entity might have different business operations, therefore different ESG profiles or even different carbon emissions data. Outside of the corporate credit market, securitised, municipal and labeled bond markets are centred around certain projects. Such granular project base information also lacks data availability, let alone common frameworks. It's also worth pointing out that the private market also lacks data frameworks and reporting standards.

Exhibit 9: Quantitative data by market segment



Market price - ESG impact still unclear

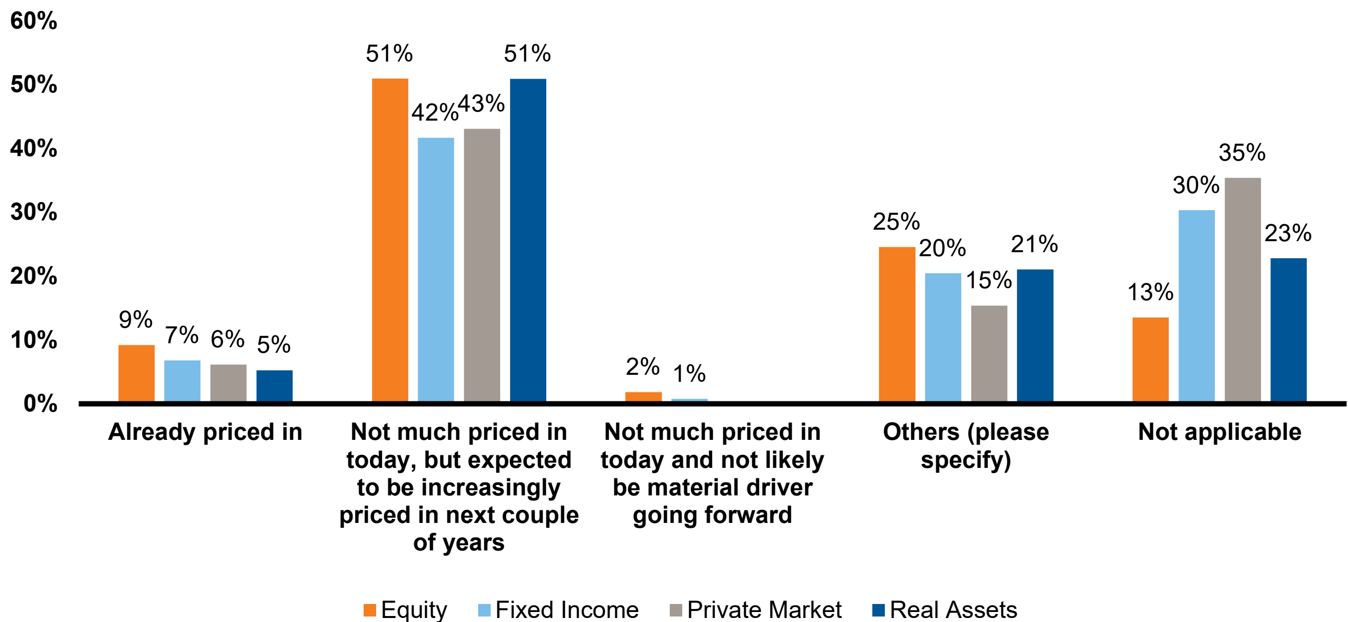
How much of ESG-related risks are reflected in the market price? At what point do ESG factors - which often involve non-financial-metrics not directly tied to cash flow or earnings analysis - impact the fundamentals of corporations? Many have asked these questions - and our survey reveals that the answers are still quite unclear.

Naturally, investors care about the potential impact of incorporating ESG-related information into portfolio outcomes. In this survey, we wanted to gauge the sentiment of how ESG considerations potentially impact asset prices, while recognising the complexity of ESG considerations and knowing that any blanket statement around ESG is too naïve. To do this, we asked survey participants to share how much of ESG-related risks they think are reflected in market prices in general. We separated the responses by asset class.

Among the ones that shared their views, roughly half think ESG-related risk is not priced in much today, but expect it to be increasingly priced in over the next couple of years. This response is fairly intuitive, in that it's fair to assume that the more market participants pay attention to ESG factors in their analysis, the poorer ESG performers would see their asset prices impacted.

Perhaps more importantly, how investors implement ESG factors plays a key role in asset pricing. For instance, if ESG implementation means exclusions or divesting, then those securities that are broadly excluded can result in a lack of capital providers, therefore increasing the cost of capital - a common belief we often hear from asset managers.

Exhibit 10: ESG-related risk in market price



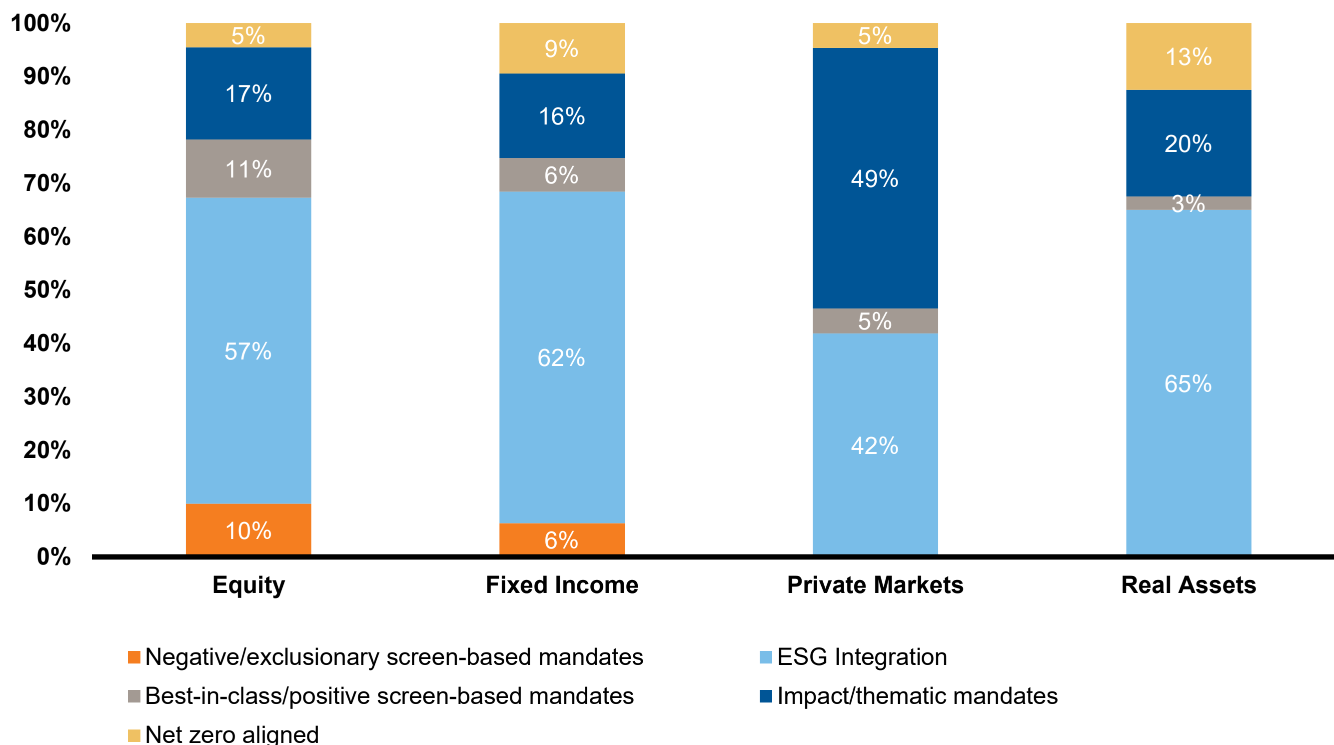
Growth in ESG product offerings - ESG integration leads the way

In order to gain a deeper understanding of ESG-related strategy offerings, we asked firms to classify the types of products they currently offer, including exclusionary screen-based mandates, ESG integration, best-in-class/positive tilt-based mandates and impact/thematic strategies. Across all asset classes, the strategies which provide ESG integration make up the largest proportion of strategies offered to date. Additionally, we asked asset managers which type of strategies saw the most interest and asset growth over the past 12 months. The results show proportionally more demand in ESG-integrated strategies, which are often mainstream strategies that are benchmarked against traditional public indices, such as the MSCI EAFE Index and the Bloomberg Barclays Global Aggregate Index.

These findings align with our discussions with asset managers, which suggest that investors may be looking to substitute existing core allocations for sustainable strategies with ESG outcomes. Ultimately, investors' desire to align investments that are contributing toward positive environmental or social objectives with impact/thematic strategies has resulted in an uptick in momentum for this category across all asset classes.

We believe it's important to distinguish between ESG integration and impact investing. ESG integration is about incorporating ESG factors into an investment process in order to enhance the portfolio analysis. Impact investing is about seeking measurable positive environmental and/or social outcomes within a portfolio. If an investor were to limit their investment universe based on certain exclusion criteria, then their portfolio outcome would also likely change. This is because if an investor constrains their investment universe materially, performance outcome will naturally be impacted, especially in a shorter time period. Therefore, we believe it's important for clients to understand the potential performance implications of sustainable investing.

Exhibit 11: ESG/responsible investing product demands

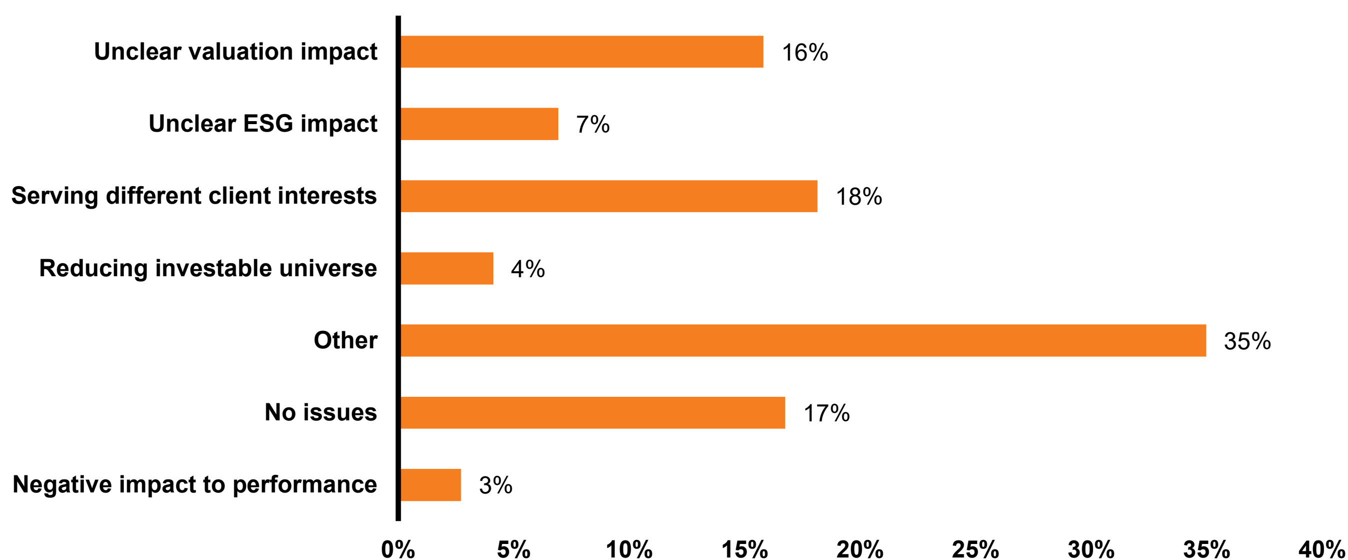


Biggest challenge of incorporating ESG for asset managers - Varying client needs

While ESG integration has reached universal recognition among the asset management community, there is still a wide range of views around how asset managers treat ESG considerations. To better understand the various views, we asked participants to identify the single biggest challenge of incorporating ESG-related information into a portfolio's construction.

18% of respondents cited the challenge of serving different client needs as the largest issue - and that is understandable since specific ESG preferences vary depending on the client. For instance, some clients may prefer to focus on portfolios that are centred around tackling climate risk, while others might prefer to focus on social issues. Also of significance, 16% of respondents cited the challenge of unclear ESG pricing impact. It's also worth highlighting that 35% of respondents selected the "other" category, with the majority stating that data transparency and consistency were the key issues. This algins with the data challenges highlighted earlier.

Exhibit 12: Single biggest challenge of incorporating ESG-related information into portfolio construction



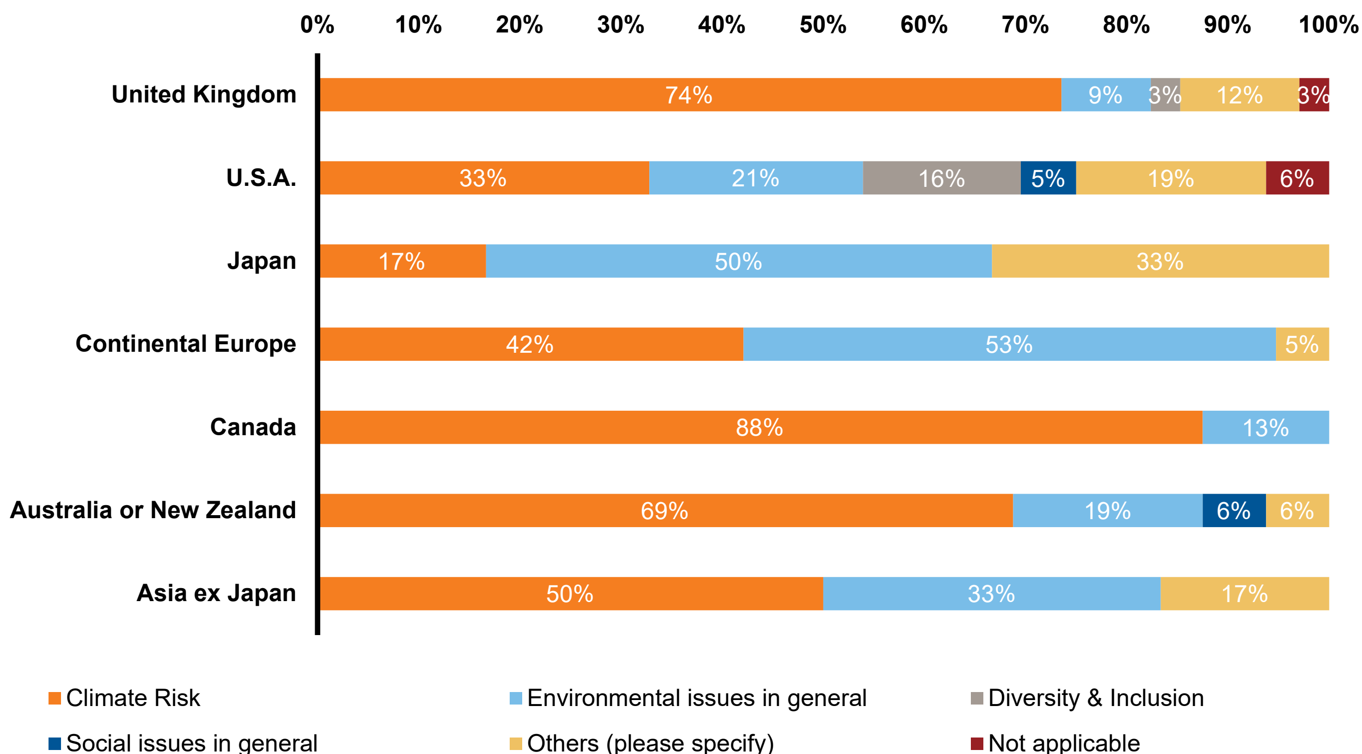
Biggest ESG issues among clients - Climate risk dominates

Given that ESG considerations cover a wide range of topics, we asked survey participants to select the single largest ESG issue they tend to hear from their client base. In a sign of increasing awareness of the climate crisis, 45% of respondents selected climate risk, versus 39% from the previous year. In addition, 23% of respondents chose environmental issues in general, versus 21% in 2021. Climate risk was identified as the biggest issue among managers' client bases in Canada, the United Kingdom and Australia and New Zealand. When combining climate risk and environmental issues, the client base in continental Europe, Australia and Canada had the largest weight in environmental-related topics.

Interestingly, 10% of respondents selected diversity, equity and inclusion (DEI), compared to 15% from the previous year, while 15% of respondents chose "others" versus. 11% from 2021. Of particular note, many in this category cited both climate risk and DEI as equally large issues. In fact, the number of firms that cited DEI in the comments under "others" was larger than the previous year.

DEI concerns were most prominent in the U.S. versus other regions, where 16% of U.S.-based firms cited it as the biggest ESG issue they hear from their client base. While the number declined from 31% last year to 23% this year, factoring in the respondents that flagged DEI as a big issue in the "others" section leads to an overall level of concern that is similar to last year's.

Exhibit 13: Single biggest ESG issue that clients report



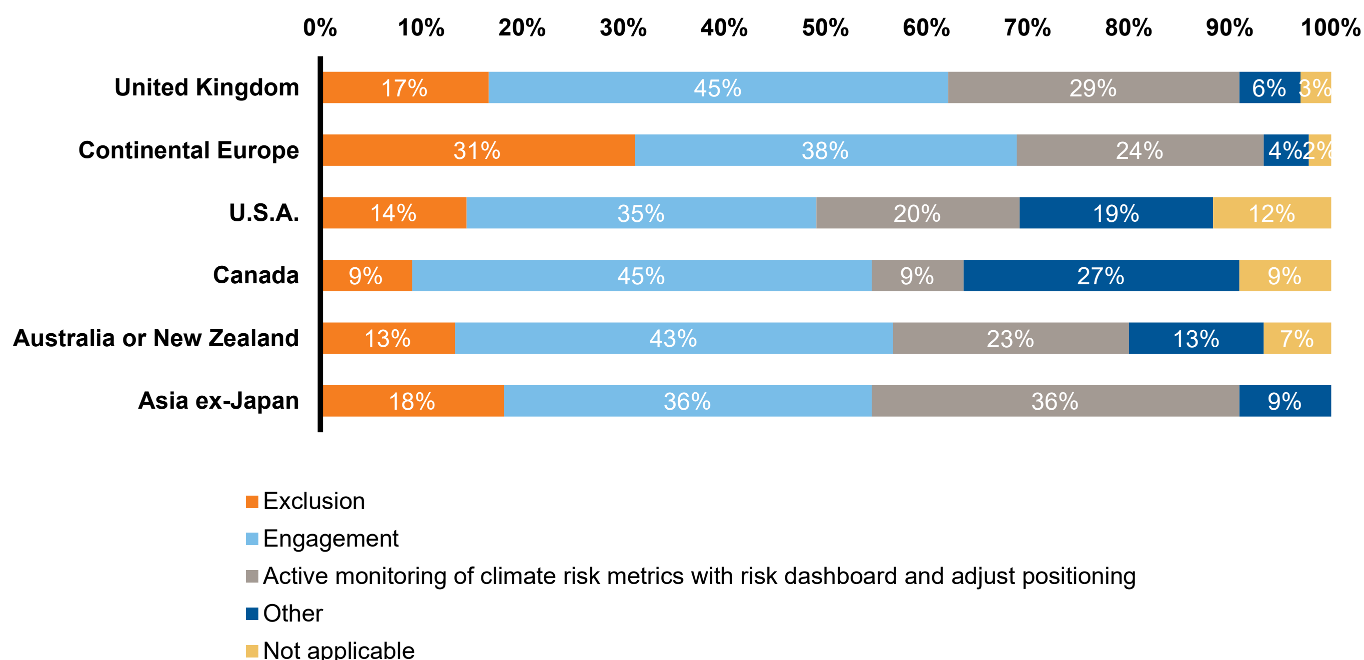
Climate risk management - Engagement reported as top strategy

Across the globe, efforts to combat climate change have sparked a heightened interest in the topic for investors. Amid this backdrop, we asked survey participants to identify how they manage climate risk across their portfolios in general.

Engagement was cited as the most popular way to manage portfolios around climate risk. When we looked at the responses by asset class, the result was also the same, in that each asset-class response showed engagement being the most popular method. From our vantage point, this finding speaks to how engagement practices have expanded beyond equities, where the concept is most embedded.

Interestingly, exclusion is less popular than both engagement and the active monitoring of climate risk metrics with risk dashboards and adjustments to positioning. A look at the participants who selected exclusion, however, reveals that the practice is most common among firms based in continental Europe. This result aligns with manager observations made during our due diligence process, in that European-based firms seem to field more client interest in exclusionary practices. It's also worth noting that the active monitoring of climate risk metrics with risk dashboards and adjustments to positioning is also more popular in European-based firms.

Exhibit 14: Managing climate risk across portfolios

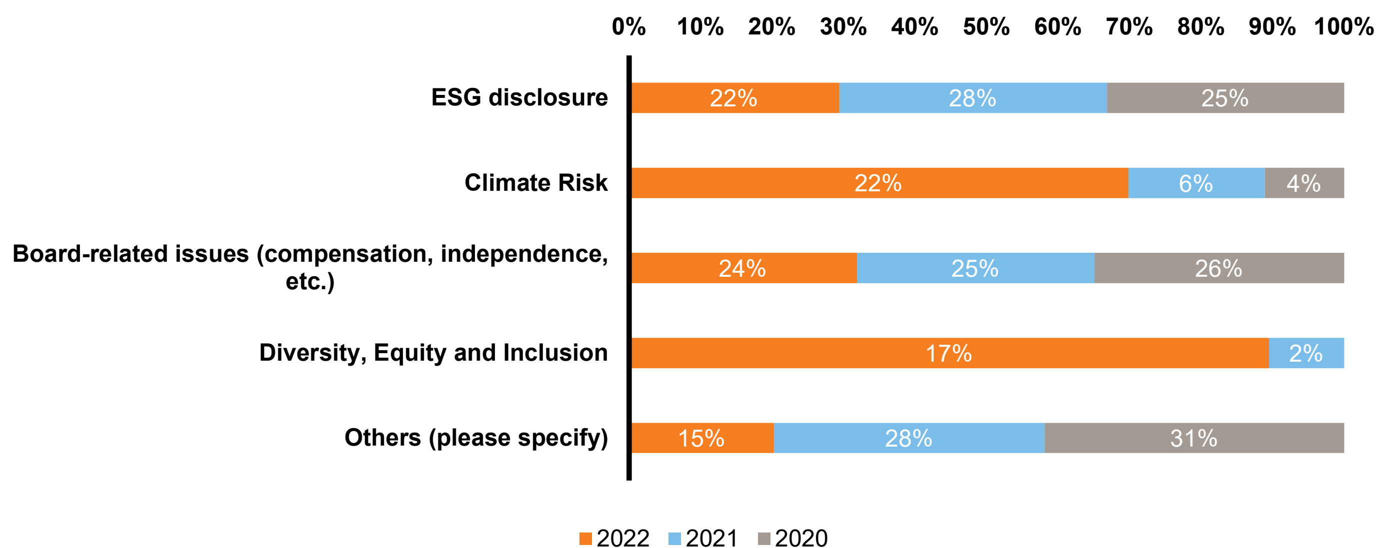


Engagement - ESG not always on the agenda

While our research and observations note rising efforts around active ownership generally and engagement specifically, ESG topics are not always covered. Only 34% of the respondents stated that they "always" cover ESG topics in their regular meetings with management, and roughly half stated that they "occasionally" cover ESG topics. These results are similar to those from the previous year. One of the main findings in this year's survey is the emergence of climate engagement as a key engagement topic, especially when compared to previous years. Looking deeper into the responses from 2021 and 2020, the firms that selected "others" had cited multiple different engagement topics as being key themes. This subtle shift in respondents moving away from selecting this general category suggests that asset managers have become more deliberate in setting specific engagement objectives.

This idea is backed up by our own manager observations, where we've noticed a shift in the general objectives of engagement activities - expanding from board-related issues and disclosures to a heightened focus around climate risk and human capital issues such as diversity, equity and inclusion.

Exhibit 15: Engagement themes

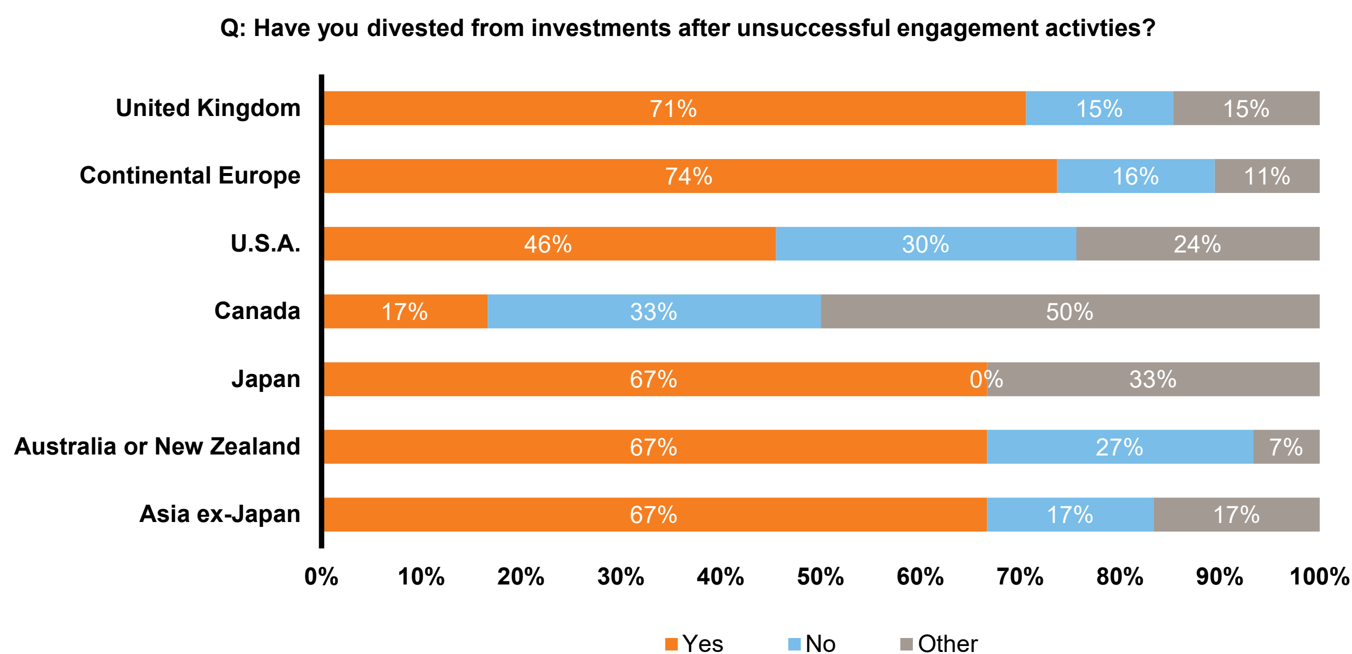


Divesting - Firms tend to divest when engagement fails

Many asset managers utilise engagement activities to make positive contributions to sustainable outcomes, rather than divesting. This is because when you divest from specific entities, your ability to influence is diminished.

At the same time, we wanted to gauge what happens to unsuccessful engagement activities. Overall, 54% of our survey respondents indicated that they've divested from investments after unsuccessful engagement activities. Looking at the responses by asset class, equity managers led the pack, with 60% indicating that they'd done so. Fixed income managers were a close second, at 58%. When comparing responses by region, firms based in continental Europe and the UK had higher divesting practices than firms based in the U.S. and Canada.

Exhibit 16: Divesting after unsuccessful engagement activities

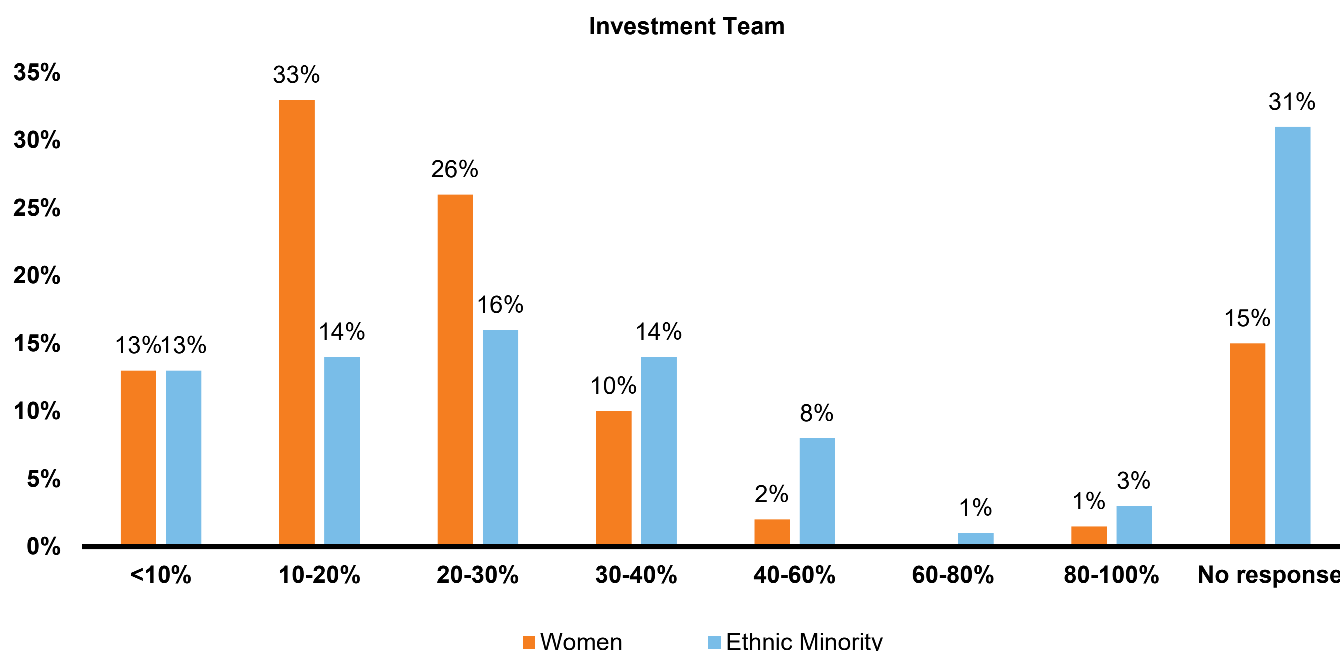


Diversity, equity and inclusion - Disclosures greater for gender than for ethnicity

There continues to be a growing effort to promote DEI practices in the asset management community, in order to recruit and retain a more diverse talent pool, increase employee engagement through diverse representation and empower broader perspectives and thinking. We have observed that many asset managers are taking DEI issues seriously, with a key focus on tackling the societal challenges of inequality in the workplace, as well as recognising the importance of having diverse talent and investment ideas. The application of supportive DEI efforts is necessarily multi-faceted, as diversity issues pertain to gender, ethnicity, sexual orientation, disabilities and social backgrounds.

The investment industry has a lack of diversity. We asked participants what the female representation is at the following levels: total firm, investment team, senior investment team and board membership. We also asked the same set of questions about ethnic minority representation. Generally speaking, we have observed that disclosures are greater for gender than for ethnicity - likely due to the fact that some firms only have data on the gender of their employees (often due to legal prohibitions or other difficulties in gathering information about ethnicity). For instance, 85% of respondents disclosed the percentage of their total female employees, while only 69% did so for ethnic minorities.

Exhibit 17: DEI profile of investment team

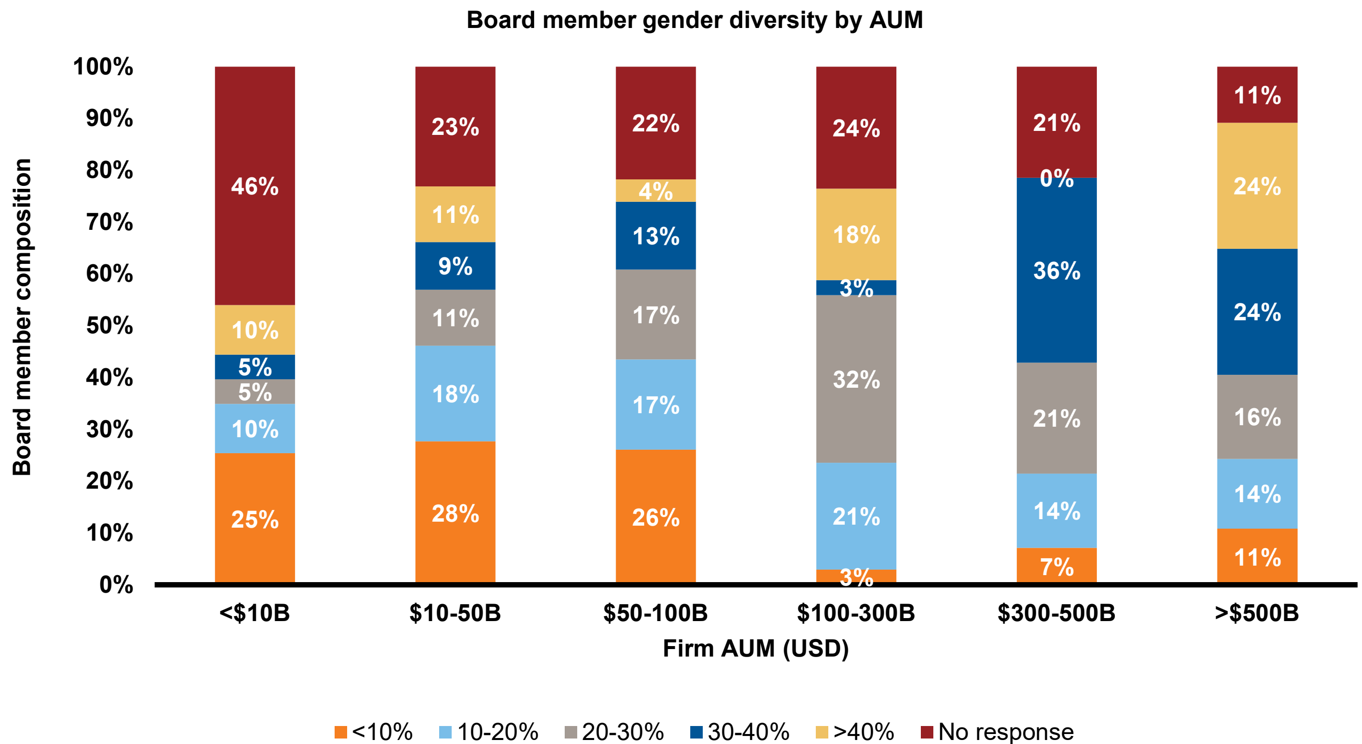


For the ethnic minority disclosure, disclosure was greatest in the U.S., where 85% of U.S.-based respondents disclosed their DEI statistics around ethnic minorities, and 90% disclosed their gender demographics. The ethnic minority disclosure was lowest among firms based in continental Europe, which is understandable, given the regulatory differences. In particular, it’s illegal for companies to collect and/or disseminate diversity-related information in some European countries.

Of the firms that disclosed their DEI statistics, most (54%) have investment teams comprised of less than 20% women, and 40% have investment teams where less than 20% of the members are ethnic minorities. In other words, roughly half of the asset managers we surveyed have gender or ethnic-minority representation of less than 20% on their investment staff. Perhaps this provides a reference point of the general demographics of the industry.

Minority ownership structure is one measure of DEI considerations, but has its own challenges. Firstly, it tends to centred around certain companies and often excludes firms like publicly traded entities (who are responsible to underlying shareholders) or subsidiaries (who don’t have direct ownership of the company). Perhaps unsurprisingly, then, only 53% of respondents disclosed their ownership structure. Of these, 82% disclosed that women comprise less than 20% of their overall ownership structure. In addition, 89% of respondents disclosed that ethnic minorities comprise less than 20% of their ownership structure. These results point to the lack of ownership by underrepresented groups.

Exhibit 18: Board member diversity



Another interesting finding is that gender diversity in board membership is greater than ethnic minority diversity. Our survey shows that just 48% of respondents have less than 20% of board members who are female, whereas 89% of respondents who disclosed this data have less than 20% of board members who belong to an ethnic minority group. In other words, not many firms have ethnic minority representation in their board membership. It's also worth pointing out that while gender diversity is indeed greater than ethnic minority diversity, of all the respondents who disclosed this data, only 17% of firms have boards where greater than 40% of members are women.

One final note is that when comparing the gender and racial diversity by firm AUM, boardroom gender diversity is greater for larger firms. This is understandable, given that large firms have more resources to apply to recruiting. They are also more likely to be public, which results in greater scrutiny and pressure to demonstrate DEI commitment.

Summary

Ultimately, the 2022 Russell Investments ESG Manager Survey shows that the ESG journey is continuing, and at a markedly escalated pace, with regulators across the globe aggressively stepping in as the investment community tries to digest and accommodate new ideas and practices at an incredible rate of speed.

The results indicate that client demand and risk mitigation are among the key reasons that asset managers are integrating ESG factors into investment processes. The survey also shows that investors increasingly are desiring a standardisation of disclosures in key ESG metrics, and that asset managers are responding to these types of requests. In regard to carbon emissions data, while it captures a snapshot of an entity, our survey reveals that there is a growing trend to evaluate the energy transition with forward-looking views.

The survey also shows that efforts around climate risk management continue to rapidly expand, and that this is reflected in resourcing, reporting and engagement activities. While roughly half of asset managers think that ESG-related risks aren’t priced in much today, a majority expect that to change within the next few years.

From a governmental and regulatory standpoint, regulators across the globe appear to be acknowledging the myriad of issues surrounding greenwashing. We view this as a positive development, because acknowledging the disclosure challenges with data limitations and establishing industry-disclosure frameworks are important steps to providing greater transparency in sustainable investing. However, it’s worth noting that the practicality of improving transparency and standardisation in sustainability goals faces some real challenges.

We also believe it’s important to distinguish between ESG integration and impact investing. ESG integration is about expanding the investment considerations to incorporate material ESG factors in order to limit risk and maximise opportunity. Impact investing is about seeking measurable positive environmental and/or social outcomes, which can have some performance implications, especially for shorter investment horizons. We should also acknowledge that many ESG measures are subjective, which makes them harder to quantify, compared to purely financial metrics.

At Russell Investments, we continue to take a holistic approach to portfolio construction and management. Our goal is to achieve best-practice ESG integration to effectively capture ESG materiality. We believe that ESG topics, including DEI and climate change, can have material impacts on capital flows, which can influence asset prices. An integrated ESG process allows ESG issues to be understood and managed holistically. We believe that this approach not only allows for the best outcomes for our clients, but for our society and planet as well.

QUESTIONS?

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