Coalition Greenwich
A division of CRISIL

Q3 2023

Emerging Trends in Sustainable Investing

Best Practices and Wildcards for Institutions

20230915-3113076

CONTENTS

Todd Glickson advises on investment management globally.

Executive Summary

This report presents the complete results of a special Coalition Greenwich study on sustainable investing. In Q1 and Q2 2023, Coalition Greenwich interviewed 143 pension funds and endowments and foundations (E&Fs) in North America and Europe about sustainable investing. From the results of that research, we identified a series of factors that are influencing the evolution of sustainable investing around the world.

These factors, which we examine in detail, include emerging best practices such as the full integration of sustainability into institutional investment processes and portfolios, the growing expectation for investment returns on sustainable investments to meet or beat asset-class benchmarks, an increasing awareness and commitment to screen out greenwashing, and the broad use of thematic strategies to enhance both investment performance and impact.

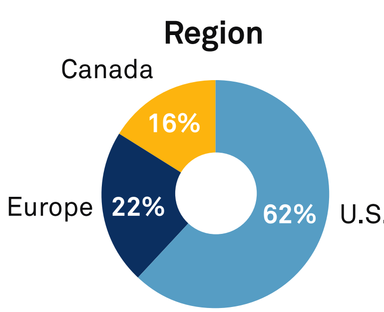
The research results also identify two key variables that could slow the future growth of sustainable investing: a lack of consensus on how to measure impact and increasing regulatory uncertainty.

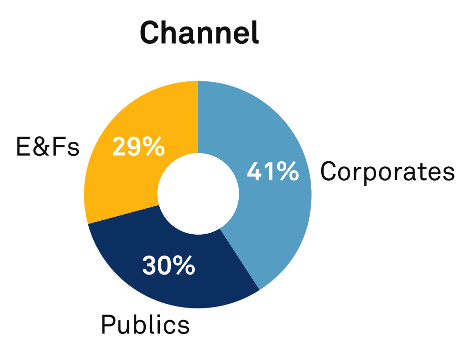
METHODOLOGY

From March through April 2023, Coalition Greenwich conducted 143 telephone and online interviews targeting corporate pensions, public pensions and endowments and foundations based in North America and Europe to examine overall trends of investor attitudes on key aspects of sustainable investing and identify differing perspectives and approaches within it.

The study that this report is based on was commissioned by AGF Investments and conducted by Coalition Greenwich, a division of CRISIL.

Respondents





Source: Coalition Greenwich 2023 Sustainable Investing Study

20230915-3113076

Introduction

Our recent research on sustainable investing demonstrates the remarkable speed with which sustainability has evolved from a tool employed by a handful of activist institutions into something close to standard operating procedure across the entire universe of asset owners. Today, sustainability holdouts are outliers who will become increasingly rare in the years to come.

Within the next five years, 9 out of 10 asset owners expect to be investing sustainably or working toward the goal of introducing sustainable investment practices into their portfolios. In Europe, not a single study participant envisions any scenario in which sustainability is not playing a role in their portfolios in 2028. Even in North America, where skepticism about climate change and environmental, social and governance (ESG) practices is much more prevalent, only about 1 in 10 asset owners expect to be abstaining from sustainable investing in that five-year time frame.

As sustainable investing gains widespread acceptance, it is moving into a new and more mature stage. Now that institutional investors have at least some experience with sustainable investing, certain common trends and best practices are beginning to emerge, including:

- **Heightened Expectations for Investment Performance:** While some of the earliest adopters of sustainable investing were prepared to make a trade-off between impact and returns, investors today expect sustainable investments to match or outperform investment benchmarks—while also delivering positive impact.
- **A Journey toward Full Integration:** Although investors today are using a variety of approaches, the long-term trend appears to be a clear movement toward full integration of sustainable investment practices into investment processes across portfolios, asset classes and strategies.
- **Guarding against Greenwashing:** Greenwashing is acknowledged as a real concern, and investors are taking proactive steps to guard against it.
- **Enhancing Potential for Impact and Returns with Thematic Strategies:** Even as investors move to fully integrate sustainability into their portfolios, they continue to employ thematic strategies that allow them to concentrate assets in order to enhance environmental and social impact, as well as investment returns.

Even as the industry begins to coalesce around these and other emerging standards and practices, there remain some wildcards in the form of key unanswered questions and variables that will affect the future evolution of sustainable investing:

- **No Consensus on Impact Measurement:** As yet, the investment industry has not reached any universal agreement on how best to measure the non-financial performance and impact of sustainable investments.
- **Regulatory Headwinds and Uncertainty:** Political pushback in the United States against ESG investing and lingering regulatory uncertainty around the world remain headwinds to the continued growth of sustainable investing.

In this report, we will assess the current state of play in sustainable investing and examine in detail these emerging trends, best practices and wildcards.

20230915-3113076

Sustainable Investing in 2023

Just two decades ago, sustainable investing was restricted for the most part to a small group of mission-focused endowments and foundations dedicated to supporting specific environmental or social causes. Today, the vast majority of asset owners have adopted sustainability into their investment processes to at least some extent. Roughly half (47%) of the institutions participating in our study have codified goals and standards into firmwide ESG or sustainable investing policies, and more than 40% now make it standard practice to report sustainability/ESG performance alongside financial performance. “We are a believer that addressing systemic risks in the environment is of utmost importance, so investing in sustainable strategies is important to us,” explains the representative of a North American institution.

Anticipated Changes in Sustainable Investing
By Region and Channel Type

	North America	Europe	Corporates	Publics	E&F
	(111)	(32)	(58)	(43)	(42)
Sustainability will be a factor similar to growth or value	49%	63%	59%	56%	38%
Sustainability will be incorporated into all portfolios	41%	63%	55%	40%	40%
Sustainability will be incorporated selectively into portfolios	38%	25%	29%	35%	43%
Other	11%	6%	7%	7%	17%

Note: Based on 143 respondents.
Source: Coalition Greenwich 2023 Sustainable Investing Study

Although adoption is growing rapidly on both sides of the Atlantic, asset owners in Europe and North America say they are integrating sustainability into their investment processes for different reasons. In Europe, the adoption of sustainable investing practices is being driven by a sincere commitment to fighting climate change. In North America, many asset owners say they are embracing sustainable investing because they believe it will improve risk-adjusted returns.

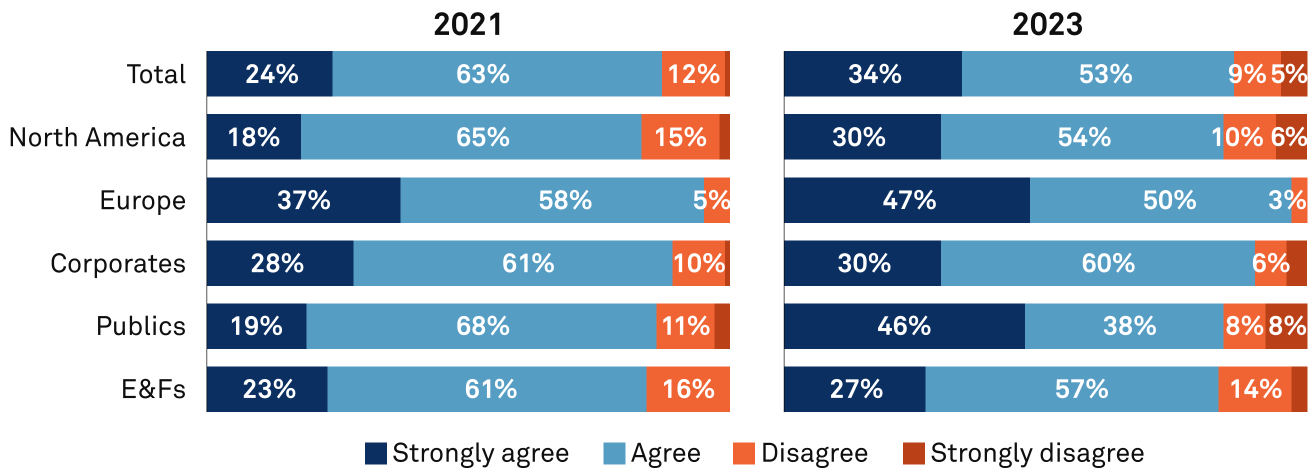
Key Motivation by Region

North America
Improving risk-adjusted returns

Europe
Fighting climate change

Source: Coalition Greenwich 2023 Sustainable Investing Study

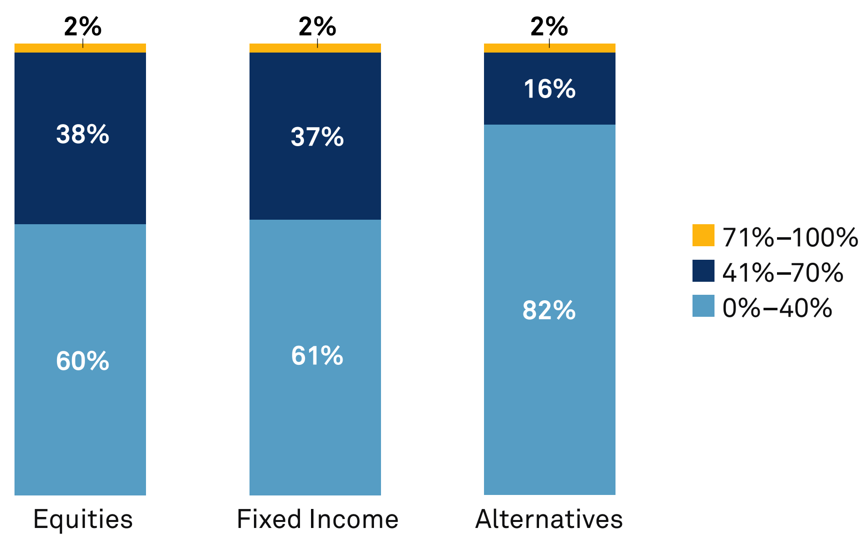
Impact of Climate Change on Portfolio



Note: Based on 137 respondents in 2021 and 143 in 2023. May not total 100% due to rounding.
Source: Coalition Greenwich 2023 Sustainable Investing Study

It's possible that changing interpretations by U.S. regulators of the relationship between fiduciary responsibility and investing for impact could be coloring the responses of North American institutions. Despite differences in stated motivations, a majority of asset owners in both North America and Europe agree that climate change will have a meaningful impact on their portfolios. Going forward, the extent to which these two goals converge or diverge will go a long way in determining the future of sustainable investing. So too will the perspectives of important constituencies such as shareholders, consumers, donors, the media, activists, and regulators. As one European institution candidly admitted, "We're being moved to these positions [on increasing sustainability] because of societal pressure."

Allocation to Sustainable Strategies by Asset Class
(% of portfolio)



Note: Based on 45 respondents.
Source: Coalition Greenwich 2023 Sustainable Investing Study

Regardless of what motivations are driving the trend, the rapid embrace of sustainable investing by asset owners around the world has already had a dramatic impact on institutional portfolios. Among study participants with specific sustainability allocations by asset class, 4 in 10 say they dedicate at least 40% of equity and fixed-income assets to sustainable strategies.

Within those allocations, asset owners are prioritizing investments aimed at generating impact in the key areas of energy transition, climate adaptation and water services. Diversity, equity and inclusion (DEI) is also playing a prominent role. In fact, among endowments and foundations, commitment to social issues like DEI is by far the No. 1 reason study participants plan to increase their use of sustainable strategies.

"We have a 100% impact portfolio allocated across every asset class to investments we consider to have a positive impact on the planet or lead to avoiding detrimental impacts to the planet," says one asset owner.

Endowments and Foundations Leading Push into Sustainable Alternatives

Endowments and foundations have traditionally been at the vanguard of alternative investing. Now, they are taking the lead in integrating sustainable investing practices into alternative asset classes.

Sustainable investing has already established a presence in alternatives. Roughly 60% of European institutions and 45% of North American asset owners say they allocate at least a portion of their alternatives portfolios to sustainable strategies. A relatively small minority of institutional investors in alternatives have adopted sustainability in a big way. Across all types of institutions, about 1 in 5 asset owners allocate more than 40% of their alternative assets to sustainable strategies.

Those adoption rates and allocation numbers could increase rapidly if endowments, foundations and other asset owners follow through on current plans. Nearly half (48%) of the endowments and foundations participating in the study who plan to expand their use of sustainable investing cite alternatives as an area for future growth, as do about a third of North American institutions overall.

Emerging Best Practices and Wildcards

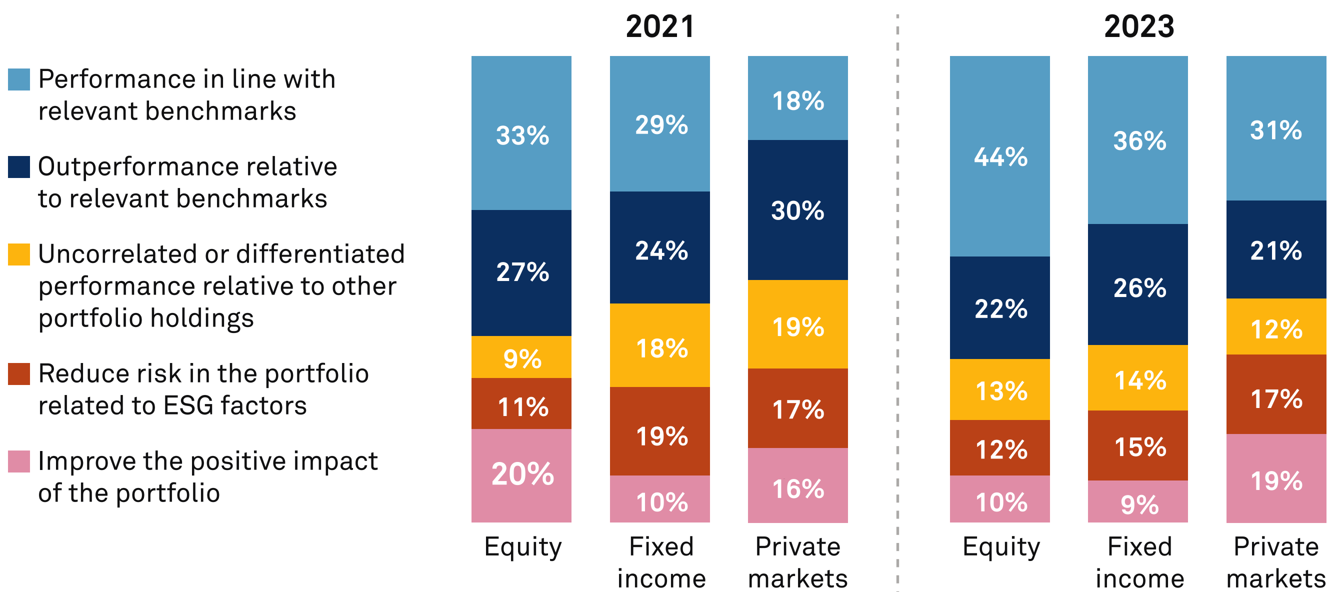
Heightened Expectations for Investment Performance

More than half of asset owners expect investment returns from sustainable investments to match or exceed relevant benchmarks. That finding represents a significant shift from the earliest days of sustainable investing, when investors were more likely to accept reduced investment performance in exchange for positive environmental or social impact. Over the past five years, studies have produced significant empirical evidence suggesting that integrating sustainability factors into an investment process can improve long-term risk-adjusted returns by identifying and helping to mitigate ESG-related risk factors. That research, combined with continued debate over fiduciary responsibility in the U.S., is pushing investors toward a more bottom-line approach to sustainability.

"We have a policy at the institute that any asset we put into the portfolio has to meet or exceed its relative benchmark," explains one asset owner. "I can bring something to the table that is mission-related as long as the benchmark criteria are met first, or if it has something to do with the kind of work we want to see done. I'm not allowed to bring in some sort of investment that is not expected to meet or exceed its expected benchmark."

Over just the past 12 months, the share of asset owners expecting the performance of their sustainable investments to match or beat benchmarks increased to two-thirds from less than 60% in equities, and jumped by nine percentage points in fixed income. The same trend is unfolding in private markets, where the share of asset owners expecting sustainable investments to match or beat investment benchmarks climbed above 50% this year for the first time.

Performance Expectations from Sustainable Investments



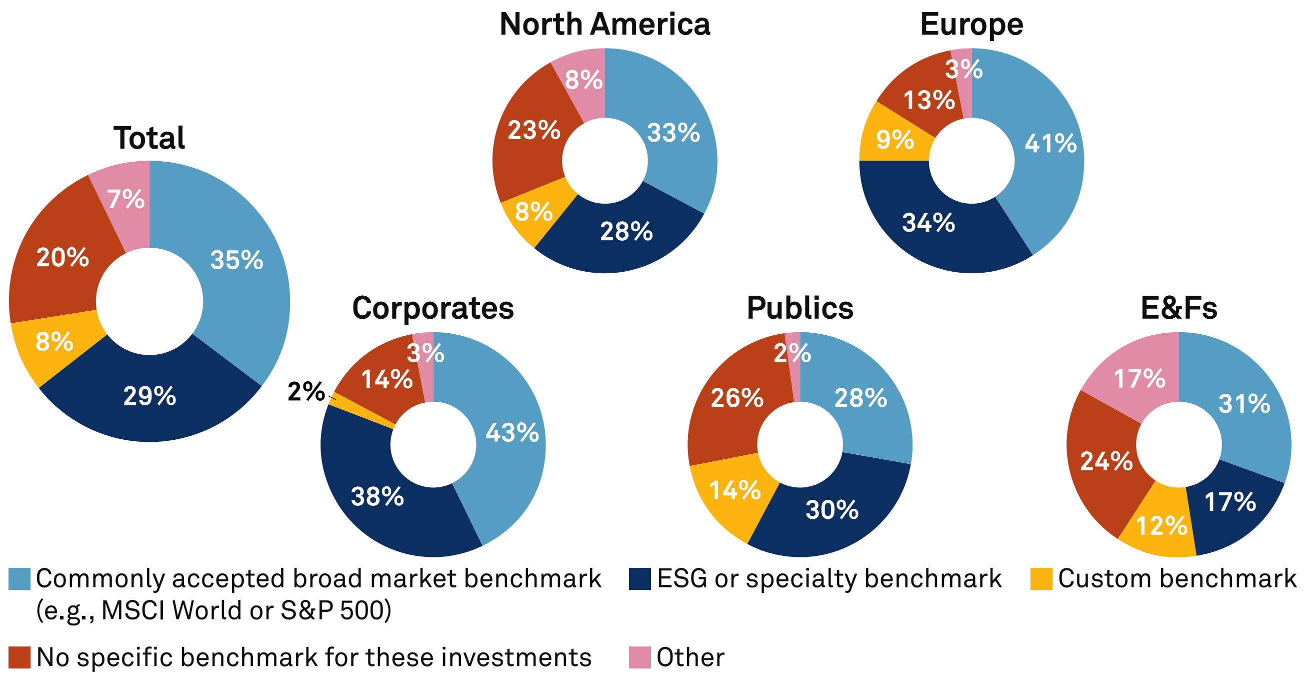
Note: Based on 141 respondents in 2021 and 143 in 2023.
Source: Coalition Greenwich 2023 Sustainable Investing Study

Those shares actually understate the new focus on investment performance among some investors. For example, 77% of public pension funds in North America and Europe expect sustainable investments in equities to meet or beat their benchmarks. In fixed income, about three-quarters of endowments and foundations expect that level of performance.

20230915-3113076

The following graphic shows the benchmarks investors use most to evaluate the financial performance of their sustainable investments.

Benchmarks Used to Evaluate Sustainable Investments



Note: Based on 143 respondents. May not total 100% due to rounding.
Source: Coalition Greenwich 2023 Sustainable Investing Study

Institutions expect sustainable investments to help their portfolios in other ways as well. A growing share of asset owners expect sustainable investments to enhance diversification by delivering performance uncorrelated with or differentiated from other portfolio holdings. Others see the potential for sustainable investments to reduce overall portfolio risk by minimizing specific risks related to ESG factors. Institutions expect their sustainable investments to deliver all these benefits while also producing positive environmental and social impact.

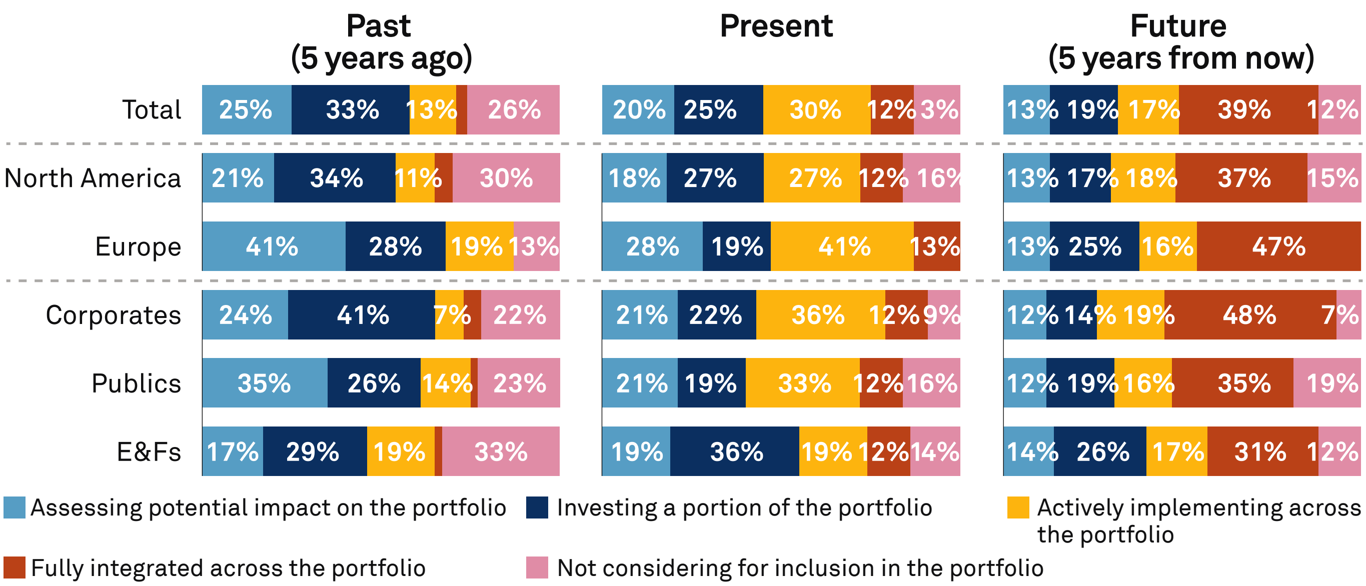
As the representative of one institution explains, “Historically, we approach all of our investments as an opportunity to employ risk mitigation and also a green approach. We go a step further because our clients are seeking to have all their assets align with their mission and values. Clients want to see the results of those investments drive better outcomes across all sustainability issues.”

20230915-3113076

A Journey toward Full Integration

Sustainable investing is still very much a work in progress. As shown below, institutional investors vary significantly in terms of their progress in implementing sustainability and the approach they are taking to integrating sustainability factors into their investment processes. Even in Europe, the traditional leader in ESG and sustainable investing, nearly 30% of asset owners are still in the assessment phase.

Sustainable Investment Positioning within Portfolio



Note: Based on 143 respondents. May not total 100% due to rounding
Source: Coalition Greenwich 2023 Sustainable Investing Study

In both Europe and North America, a sizable minority of asset owners invest a discrete portion of their assets in sustainable strategies. However, across both regions we see an emerging trend that we believe is rapidly evolving into a best practice for institutional investors: Rather than carving out separate allocations for sustainable investments, institutions are gravitating to the more holistic approach of integrating sustainability criteria into their overall investment processes. In this model, investors apply sustainability considerations to all asset classes, with a growing share of institutions treating sustainability as an investment "factor" akin to growth and value.

Almost 55% of European asset owners and approximately 40% of North American institutions have fully integrated sustainability across their entire investment process and portfolio. In Europe, half of asset owners now say they apply sustainability criteria to every asset class and investment, up from just 28% in 2021.

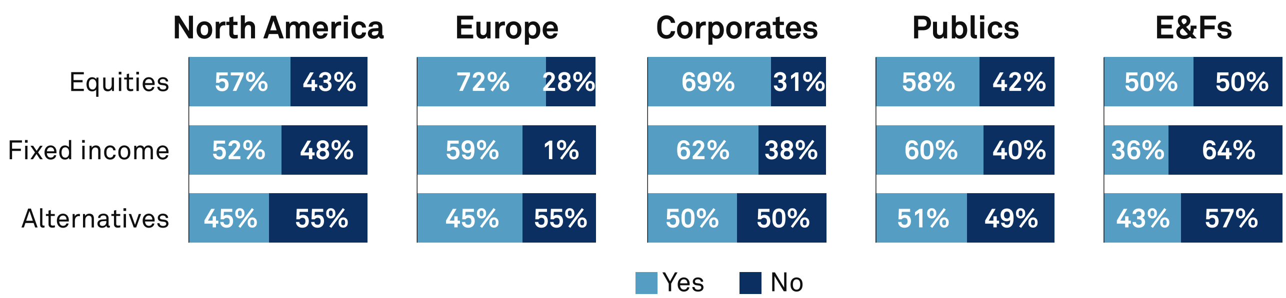
The trend toward full integration is picking up steam. Looking ahead five years, 63% of European institutions predict that sustainability will be integrated across their entire portfolio. That share is up sharply from 2021, when many institutions around the world were making discrete allocations to sustainable strategies, and only 14% in Europe predicted they would be fully integrated in five years' time. In North America, 55% of institutions expect sustainability to be fully integrated within five years, up from just 22% in 2021.

Across both regions, corporate pension plans are planning to lead the charge into full integration. Two-thirds of the corporate funds participating in the study expect to have sustainability integrated throughout their portfolios and investment processes by 2028.

Enhancing Potential for Impact and Returns with Thematic Strategies

As growing numbers of asset owners work to holistically integrate sustainability into their investment processes and portfolios, they continue to allocate assets to thematic investment funds focused on particular ESG-related issues or technologies. "Thematic funds are something we keep in the mix to increase our commitment," explains one asset owner.

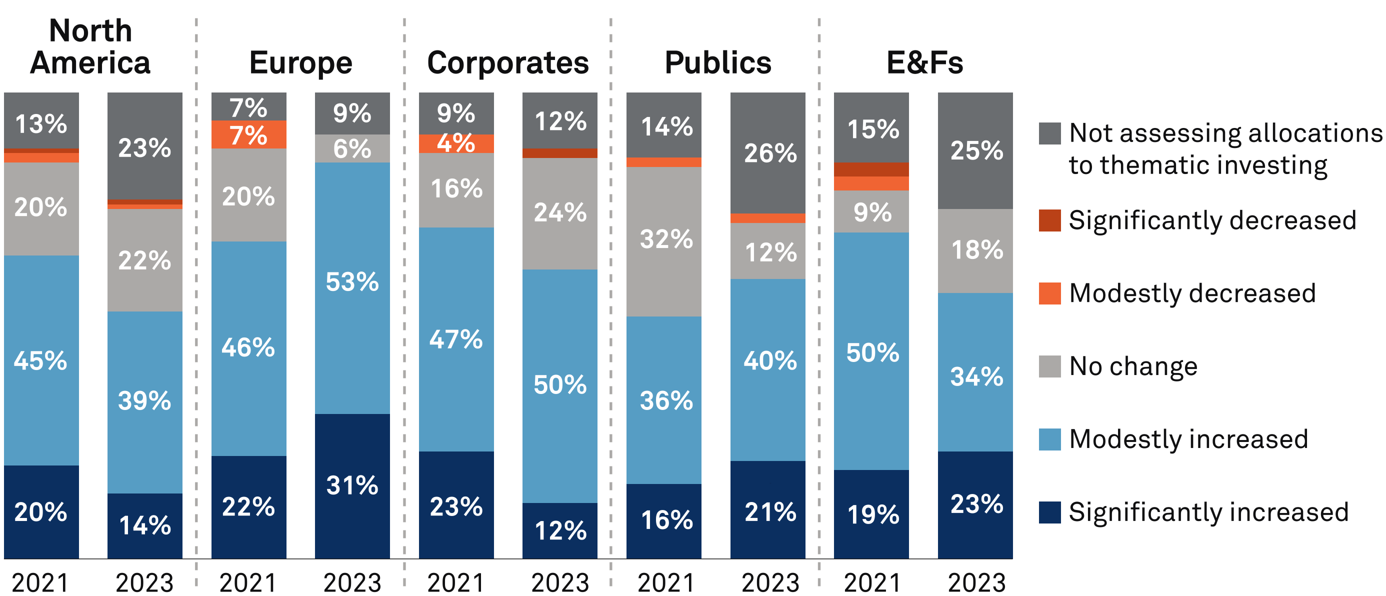
Thematic Strategy Allocation by Asset Class—2023



Note: Based on 143 respondents.
Source: Coalition Greenwich 2023 Sustainable Investing Study

As shown in the above graphic, a large majority of asset owners employ thematic funds. Usage is highest in Europe and among corporate pension funds on both sides of the Atlantic. Overall, usage rates are down slightly from 2021 (see graphic below). That reduction comes as no surprise, given the shift among institutions away from discrete allocations to sustainable strategies and toward full integration of sustainability criteria across all investments. What might be less expected is the fact that a majority of institutions that use these funds actually expanded their allocations to thematic funds over the past three years. In Europe, 84% of thematic fund users increased allocations in that time frame, as did more than half of users in North America.

Allocation Shifts in Thematic Sustainable Investing

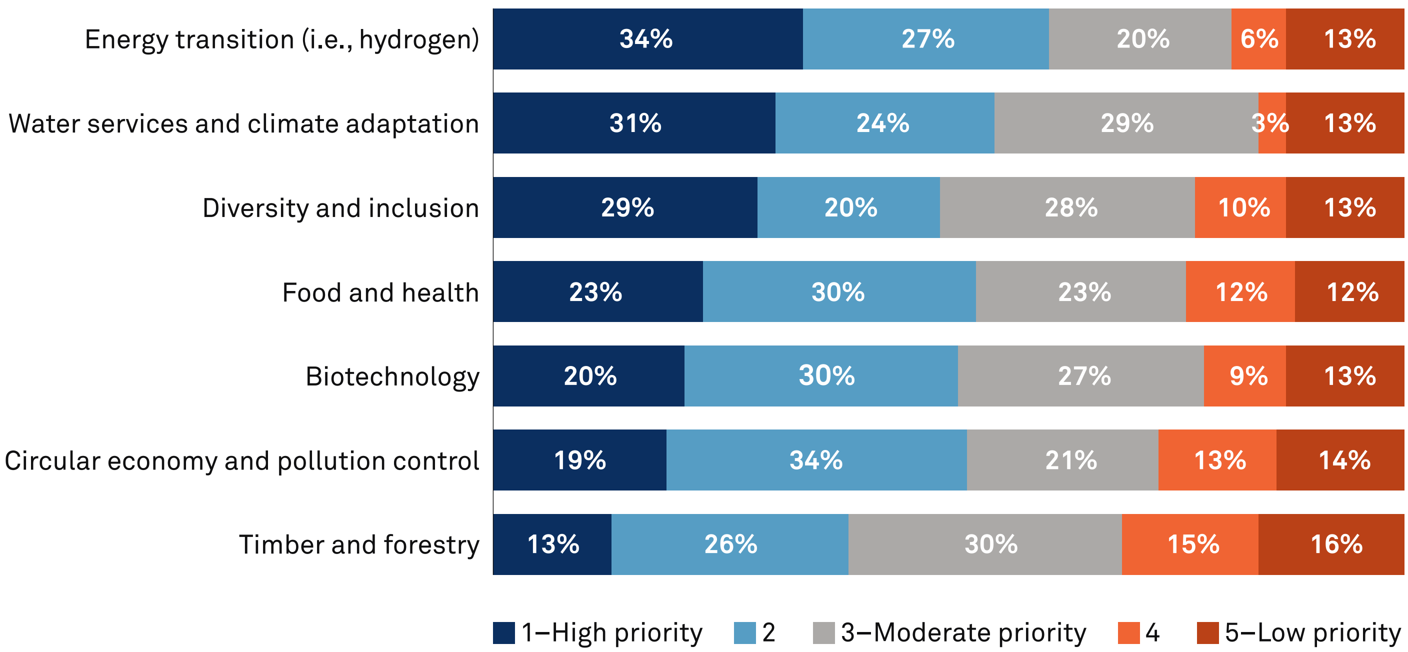


Note: Based on 151 respondents in 2021 and 143 in 2023.
Source: Coalition Greenwich 2023 Sustainable Investing Study

These allocation increases suggest that asset owners see a continued role for thematic funds—even in an investment process that fully integrates sustainability into all asset classes and portfolios. From an impact perspective, thematic funds allow institutions to concentrate their assets and influence on the issues they see as most important, be that climate change, water or DEI. From an investment performance perspective, thematic funds provide institutions with a focused mechanism to take on exposure to what they see as powerful, ESG-related growth trends like renewable energy or electric vehicles, and to mitigate specific ESG-related risks.

The following graphic shows the issues and areas most often targeted by asset owners through thematic funds.

Priority Themes in Sustainable Investing



Note: Based on 143 respondents. May not total 100% due to rounding.
Source: Coalition Greenwich 2023 Sustainable Investing Study

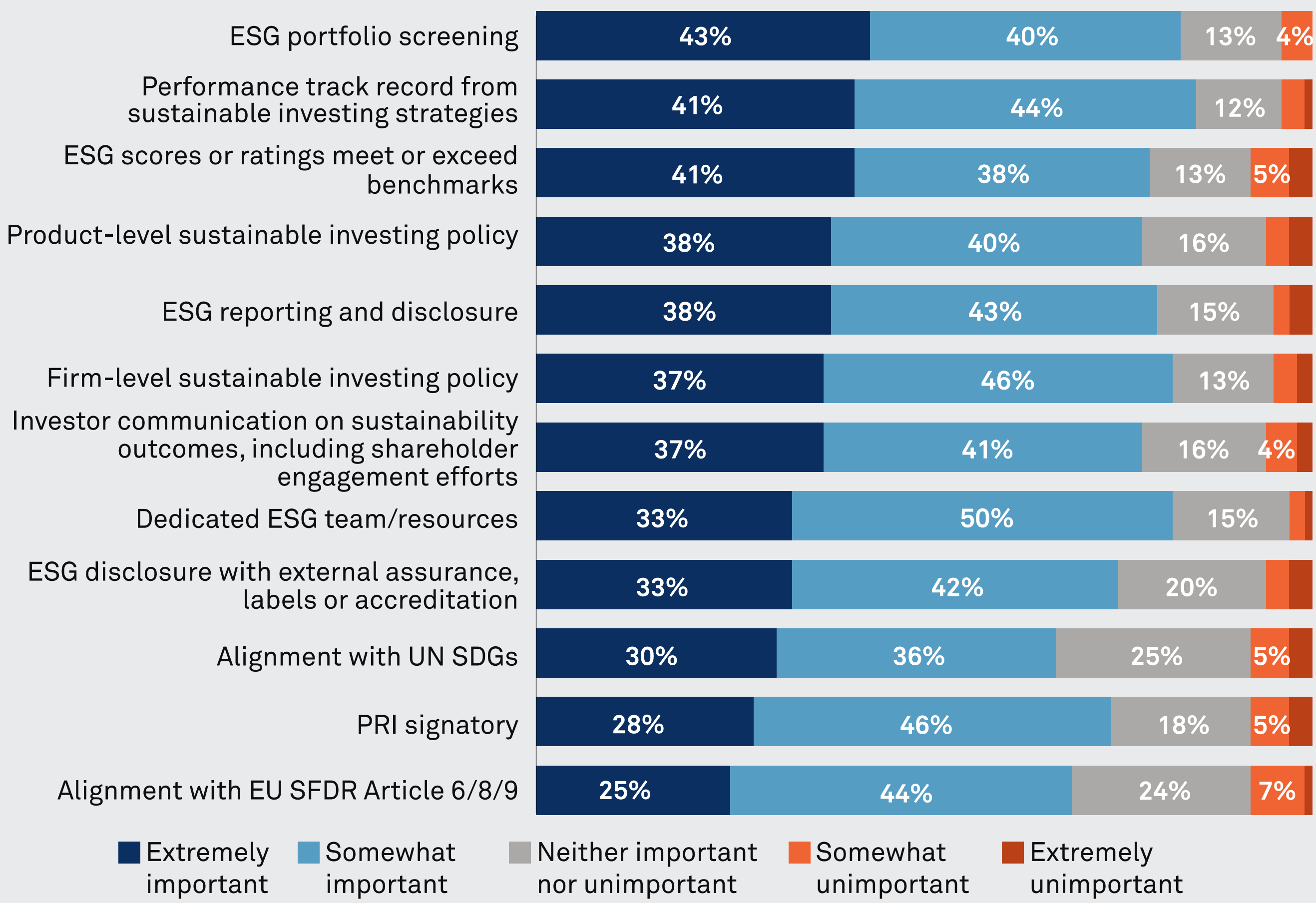
20230915-3113076

What Are Institutions Looking for from Asset Managers in Sustainable Strategies?

When seeking asset managers for sustainable strategies, institutions are looking for managers who demonstrate transparency, clarity, an established track record, and a shared understanding of environmental and social goals.

- "Before we engage with a manager, we evaluate them in terms of real sustainable investment experience. They must not only have experience, but their experience must be a minimum of 10 years. We look at the firm's commitment in terms of resources on staff."
- "We'd be looking at whether or not there are dedicated ESG resources. If not, then we would want to know what experience and/or training they have that makes them proficient at making decisions regarding ESG resources."
- "We look at the specific holdings in the portfolio and we do a bottom-up analysis to see that they are truly in sustainable positions."
- "It would be a red flag if they can't show me hard data in a fund that they've managed. I just want to see the numbers and how they compare to the world at large. When managers do say that they have something that is measurable, I need to see how they got to that data. I need to understand their process as well."

Key Criteria in Manager Evaluation

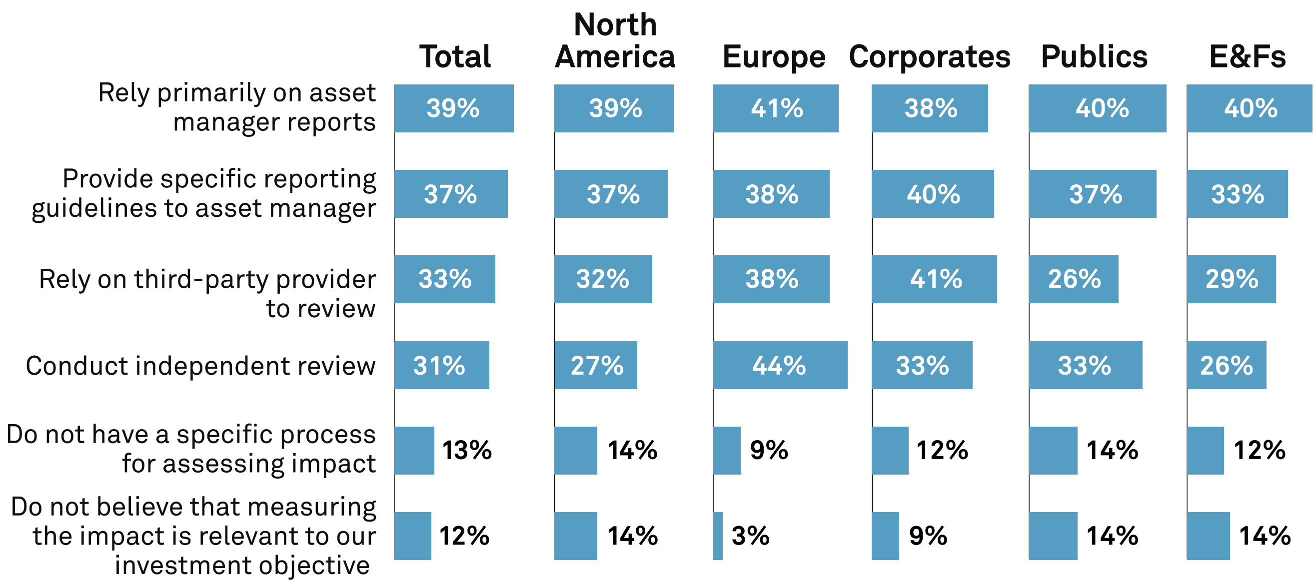


Note: Based on 143 respondents. May not total 100% due to rounding.
Source: Coalition Greenwich 2023 Sustainable Investing Study

No Consensus on Impact Measurement

One of the great ironies of sustainable investing is that, even as institutions and other investors position their portfolios to make a positive environmental and social impact, the industry has yet to agree on an effective method for measuring that impact.

Impact of Sustainable Investments

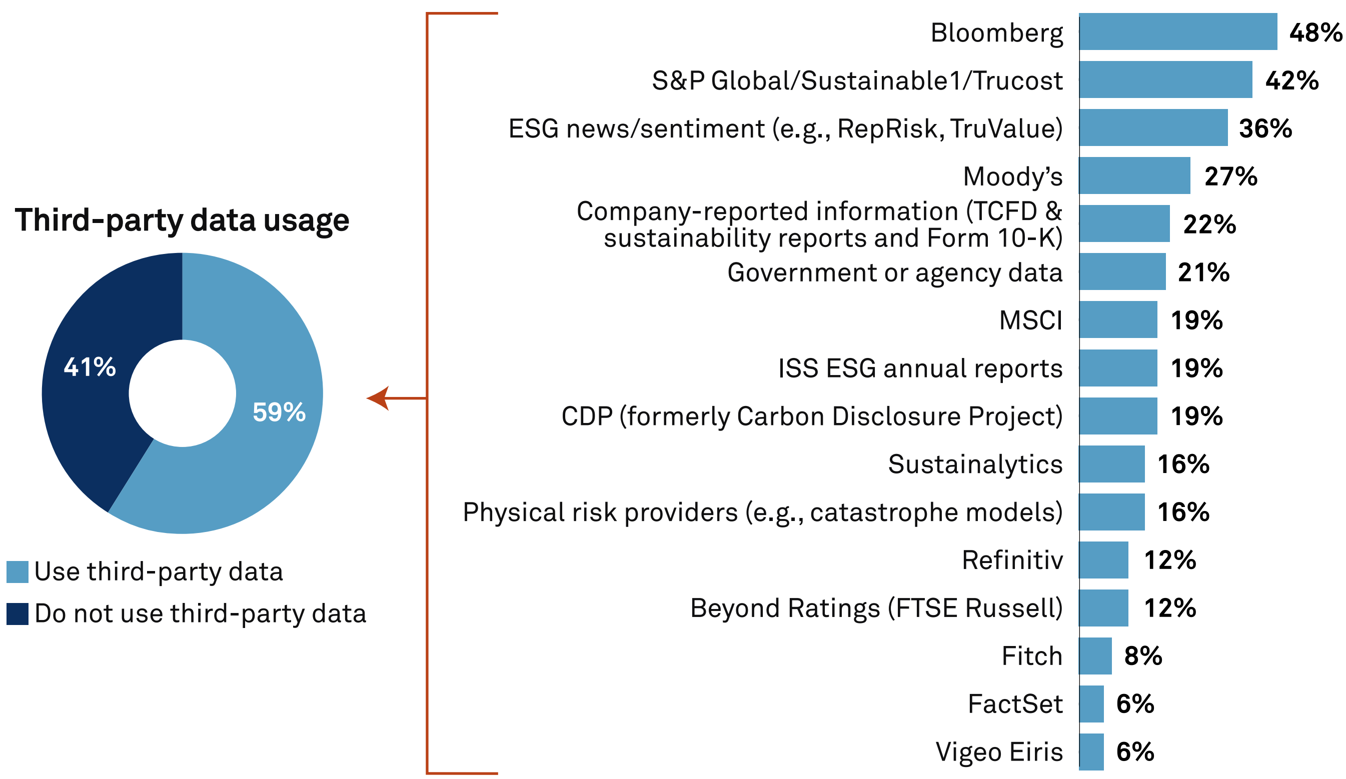


Note: Based on 143 respondents.
Source: Coalition Greenwich 2023 Sustainable Investing Study

As the chart above illustrates, asset owners are experimenting with a variety of methods to quantify and track impact. Most institutions rely primarily on information provided by the asset manager, either as part of standard reports from the manager or from specific reporting guidelines the institutions provide. Institutions in Europe are more likely to supplement manager data with assessments from third parties or their own independent review. More than a quarter of public pension funds and endowments and foundations are not measuring impact at all—either because they have yet to create a process or because they don't think impact measurement is relevant to their investment objectives.

The industry also remains divided in terms of data. Over the past decade, scores of third-party providers have come to market with data products designed to measure the performance and impact of sustainable investments. The following graphic shows the most commonly used sources of sustainability data.

Sustainable Investing Data Sources



Note: Based on 143 respondents.
Source: Coalition Greenwich 2023 Sustainable Investing Study

Because these products all measure different things and use various methodologies, they are largely incompatible. This sets sustainable investing apart from other, more mature parts of global financial markets. For example, in the bond market, there is a high degree of correlation among the ratings from major ratings agencies. That's not the case with sustainable investments, where investors will find a high degree of dispersion in the ratings and data from various providers.

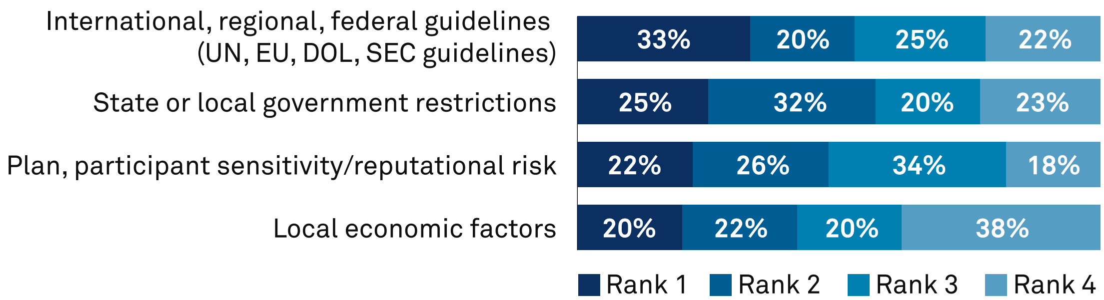
Regulatory Headwinds and Uncertainty

Sustainable investing has been on an upward trajectory for at least a decade. With the exception of some temporary slowdowns during COVID-19 and other major market events, investors have been steadily adopting sustainability standards and expanding their holdings of sustainable assets with no major headwinds to slow growth.

That could be changing. In the U.S., Florida and other states have passed laws barring state officials from investing money to promote ESG causes. For the past several years, U.S. companies and investors have closely followed a string of conflicting rulings from the Department of Labor about the permissibility of ESG investments in retirement funds. Meanwhile, the Securities and Exchange Commission (SEC) and other regulatory agencies are still in the process of issuing and developing new rules on disclosure and other ESG topics, resulting in lingering uncertainty about how exactly investors can and should proceed.

“Regulations are in limbo right now,” says one North American institution.

Importance of Regulatory Considerations



Note: Based on 88 respondents. May not total 100% due to rounding.
Source: Coalition Greenwich 2023 Sustainable Investing Study

Concerns about ESG and sustainability regulations are not limited to the U.S. Around the world, 60% of institutions see emerging international, regional and federal regulations as one of the primary variables affecting both their own sustainable investing programs and the development of the industry as a whole. In Europe, where regulators have taken the lead with rules on ESG reporting and the sweeping 2022 EU Taxonomy Regulation, 35% of institutions cite these still-emerging rules as one of the biggest issues facing their sustainability programs. Nearly half of corporate pension funds globally agree.

Together, all this regulatory activity represents one of the biggest wildcards in the future evolution of sustainable investing. There is no doubt that, at the moment, uncertainty about regulation is slowing growth and adoption. On the other hand, the passage of clear and comprehensive rules at the national level, combined with the continued development of international norms and best practices by investors and other actors, could unlock additional, massive asset flows into sustainable strategies.

Conclusion

Sustainable investing is moving into a new and more mature phase. In Europe and North America, many institutions now have more than a decade's experience with sustainable investments. Because of this experience, a set of trends and best practices is beginning to emerge. Among the most important of these developments is the steady move by institutions to holistically integrate sustainability into their investment processes, across portfolios and asset classes.

That process of full integration is taking place amid a critical shift in expectations. A growing majority of institutions are rejecting the notion of any inherent tradeoff between investment performance and impact. These asset owners expect returns from their sustainable investments to match or exceed asset class benchmarks. To enhance both investment performance and positive impact, institutions are taking proactive steps to screen out greenwashing and allocating assets to thematic strategies. The growing adoption of these and other practices is helping fuel the expansion of sustainable investing around the world.

However, that growth faces headwinds from a lack of consensus on how to measure the impact of sustainable investments and from uncertainty about regulation. As institutions continue to hone best practices for investors, the industry and global regulators must come together to create a solid and reliable framework to support the continued growth and evolution of sustainable investing.

AGF Disclaimer

The study that this report is based on was commissioned by AGF Investments and conducted by Coalition Greenwich, a division of CRISIL. As the author of this report, Coalition Greenwich owns, maintains, and is solely responsible for the content, and AGF or its affiliates assume no responsibility for the accuracy of the information within. This report is provided for informational purposes only and is not intended to provide specific individual advice including, without limitation, investment, financial, legal, accounting or tax. The comments should not be construed as recommendations to invest in any products or services but rather an illustration of broader concepts.

AGF Investments is a group of wholly owned subsidiaries of AGF Management Limited, a Canadian reporting issuer. The subsidiaries included in AGF Investments are AGF Investments Inc. (AGFI), AGF Investments America Inc. (AGFA), AGF Investments LLC (AGFUS) and AGF International Advisors Company Limited (AGFIA).

AGFA and AGFUS are registered advisors in the U.S. AGFI is a registered as a portfolio manager across Canadian securities commissions. AGFIA is regulated by the Central Bank of Ireland and registered with the Australian Securities & Investments Commission. The subsidiaries that form AGF Investments manage a variety of mandates comprised of equity, fixed income and balanced assets.

20230915-3113076

Coalition Greenwich, a division of CRISIL, an S&P Global Company, is a leading global provider of strategic benchmarking, analytics and insights to the financial services industry.

We specialize in providing unique, high-value and actionable information to help our clients improve their business performance. Our suite of analytics and insights encompass all key performance metrics and drivers: market share, revenue performance, client relationship share and quality, operational excellence, return on equity, behavioral drivers, and industry evolution.

Cover Illustration: © iStockphoto/baona

About CRISIL

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better. It is majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics, and data to the capital and commodity markets worldwide.

CRISIL is India's foremost provider of ratings, data, research, analytics, and solutions with a strong record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights and efficient solutions to over 100,000 customers through businesses that operate from India, the U.S., the U.K., Argentina, Poland, China, Hong Kong, and Singapore.

For more information, visit www.crisil.com

Disclaimer and Copyright

23-2034

CRISIL
An S&P Global Company

20230915-3113076