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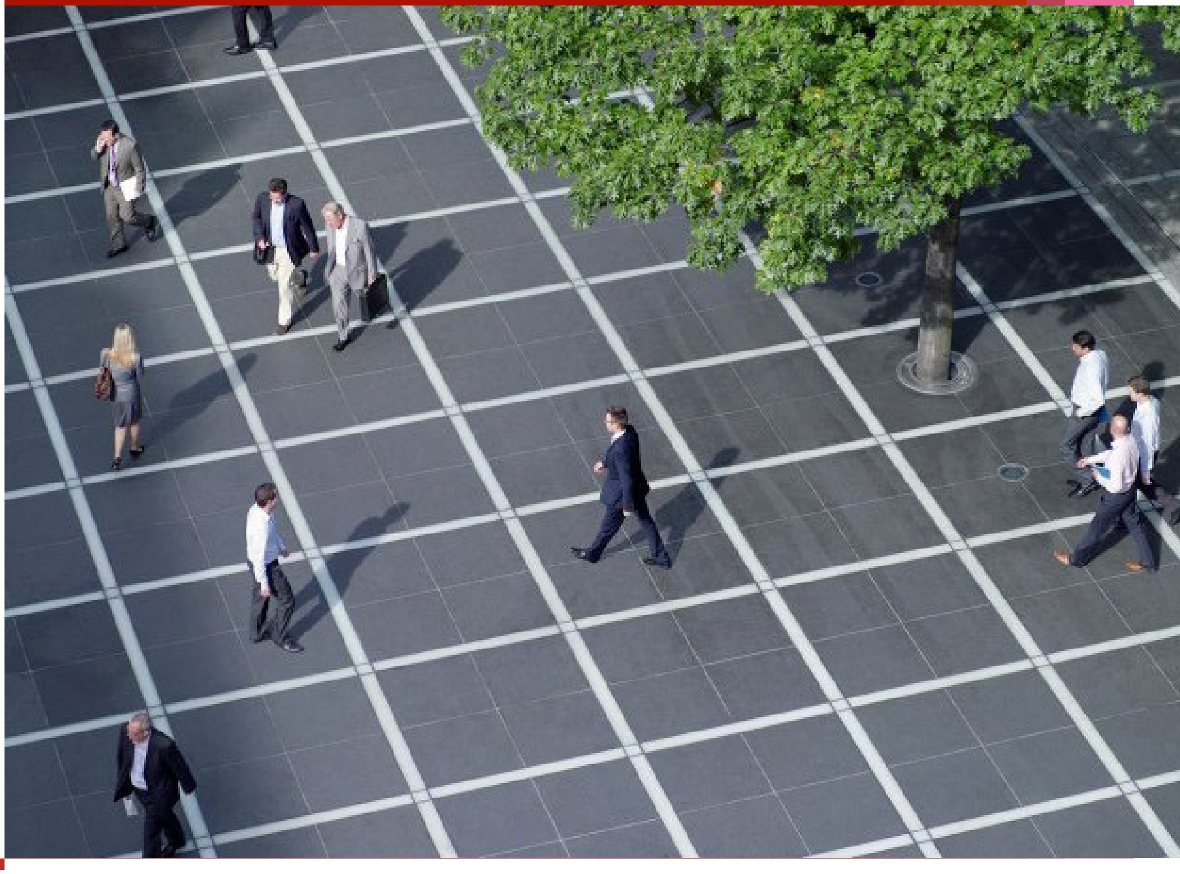
Sustainability goes mainstream: Insights into investor views

Investor Survey, winter/spring series

May 2014



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Introduction

In 2009, the United Nations-supported Principles for Responsible Investment (PRI) Initiative[1] counted approximately 560 global investment institutions with more than $18 trillion in assets under management as signatories.[2] This initiative seeks to integrate environmental, social, and governance (ESG) issues into investment practices. In the last five years, the number of PRI signatories has grown to 1,200, and these investors manage assets valued at approximately $34 trillion.[3] But, as PRI has recognized with its new reporting requirements, signing on to voluntary and aspirational goals is one thing—actually considering the issues included in the broad concept of ESG in investment decision making is quite another.

In our survey, we asked investors about the environmental and social components of ESG.[4] Our goal was to identify the types and sizes of institutional investors that are incorporating these issues into their investment strategies or practices and to learn specifically how they are doing so—do these issues influence asset allocation, strategy, product offerings, proxy voting, and/or shareholder engagement? We also asked investors to project whether consideration of these issues is likely to change in the next three years. For those who have already incorporated environmental or social considerations into their decision making, we asked them to explain why.

We approached this survey with no pre-disposed concept of what we would learn. We structured the survey questions to be as neutral and non-judgmental as possible—we consciously limited our use of words and phrases such as "sustainability" and "ESG," as they may have different meaning to different investors. Instead, we asked investors about "climate change" and/or "resource scarcity" and "corporate social responsibility" and/or "good citizenship." We specifically defined this latter phrase as follows:

"Corporate social responsibility" and "good citizenship" refer to both a company's compliance with laws (e.g., product quality and labelling, Foreign Corrupt Practices Act), as well as activities/practices that are intended to promote particular social goals. This may include labor practices that are above applicable minimum standards; operational policies that avoid suppliers, markets, or products based on ethical judgments; and other corporate activities that are intended to advance health, safety, education or other similar objectives.

We appreciate the input of those investors—representing over $7.6 trillion in assets under management—who participated in our survey. PwC's Investor Resource Institute will be surveying investors about the governance component of ESG during the summer of 2014. As the work of PwC's Investor Resource Institute advances, we will continue to seek this input and to share results. Please watch our progress at *www.pwc.com/us/InvestorResourceInstitute*.

Kayla J. Gillan

Kayla J. Gillan
Leader, PwC's Investor Resource Institute

1 The PRI Initiative "is an international network of investors working together to put the six Principles for Responsible Investment into practice." (*About the PRI Initiative*, retrieved on April 8, 2014 from www.unpri.org/about-pri/.) These six principles are: (1) We will incorporate [Environmental, Social and Governance (ESG)] issues into investment analysis and decision-making processes, (2) We will be active owners and incorporate ESG issues into our ownership policies and practices, (3) We will seek appropriate disclosure on ESG issues by the entities in which we invest, (4) We will promote acceptance and implementation of the Principles within the investment industry, (5) We will work together to enhance our effectiveness in implementing the Principles, and (6) We will each report on our activities and progress towards implementing the Principles. (*The Six Principles*, retrieved on April 8, 2014 from www.unpri.org/about-pri/the-six-principles/.)

2 Petition for Rulemaking submitted to the Securities and Exchange Commission by the Social Investment Forum (July 21, 2009).

3 *About the PRI Initiative* retrieved on April 8, 2014 from www.unpri.org/about-pri/.

4 PwC, *Investor Survey, winter/spring series, Sustainability goes mainstream: Insight into investor views,* May 2014.

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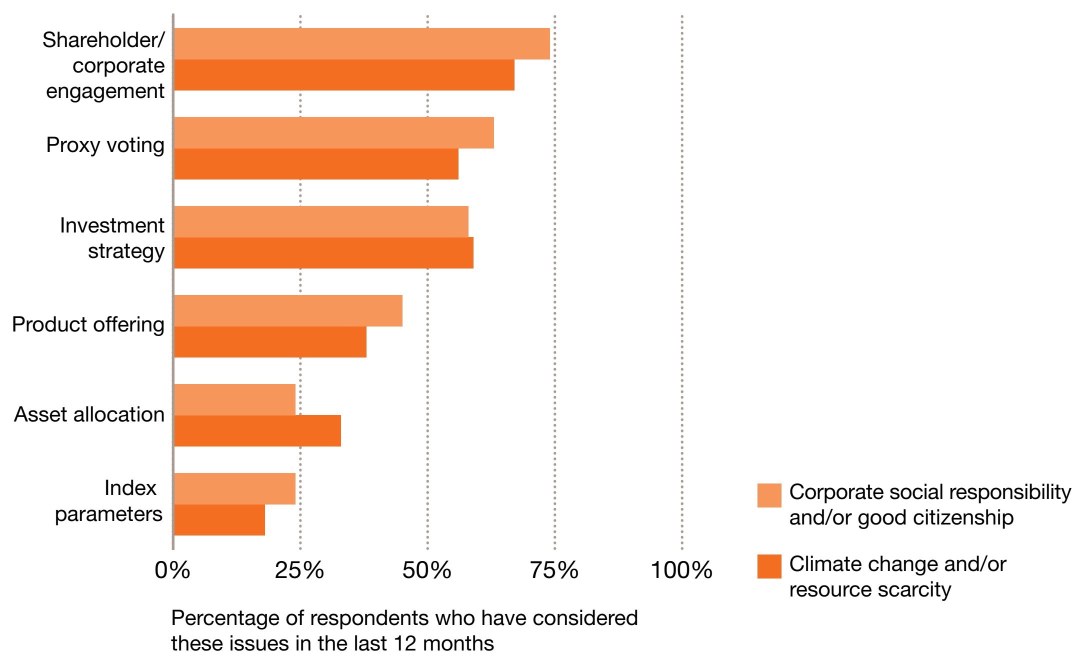
When do investors care about sustainability issues?

Do investors care about sustainability? If so, when do they consider those issues in investment decisions? It turns out that about 80% of responding investors said they considered these concepts in one or more contexts in the past year.

Sustainability issues are most relevant in proxy voting, shareholder-corporate engagement, and investment strategy

During the last 12 months, the majority of responding investors considered sustainability issues when they were voting proxies and deciding whether to engage directly with a portfolio company about an area of concern.[5] This is particularly true when investors were considering matters involving corporate social responsibility or good citizenship. Most investors have also incorporated sustainability issues into their investment strategy.

When are sustainability issues most relevant?

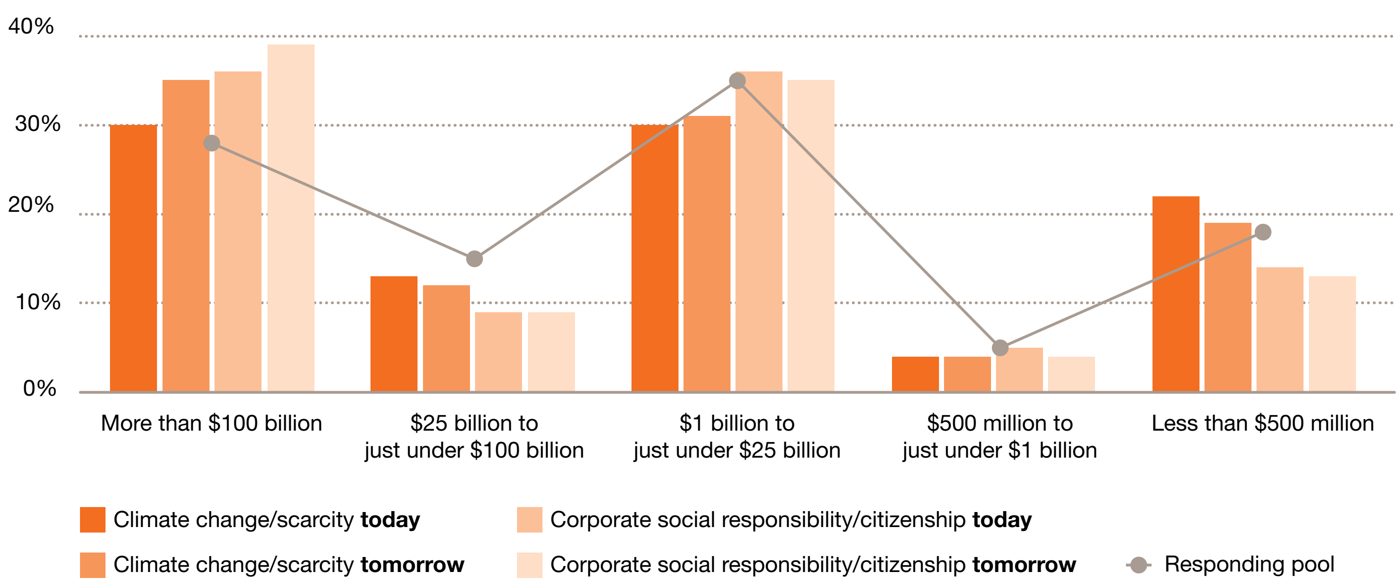


Q: In each of the following contexts, please specify whether corporate social responsibility and/or good citizenship issues were considered when making investment decisions in the last 12 months.
Base: 38
Q: In each of the following contexts, please specify whether climate change and/or resource scarcity issues were considered when making investment decisions in the last 12 months.
Base: 39

Sustainability issues may be more likely to be incorporated into investment strategy with very large investors

Our survey suggests that the largest institutions are most likely to consider sustainability issues as part of their investment strategies—both today and tomorrow.

Which investors are using information about sustainability in their investment strategy?



Q: Please specify whether climate change and/or resource scarcity issues or corporate social responsibility and/or good citizenship were considered in the context of investment strategy in the last 12 months or are expected to be considered in the next three years. Please provide your organization's current assets under management.

Base: Those that have incorporated sustainability into investment strategy: 22–23; total responding pool: 40

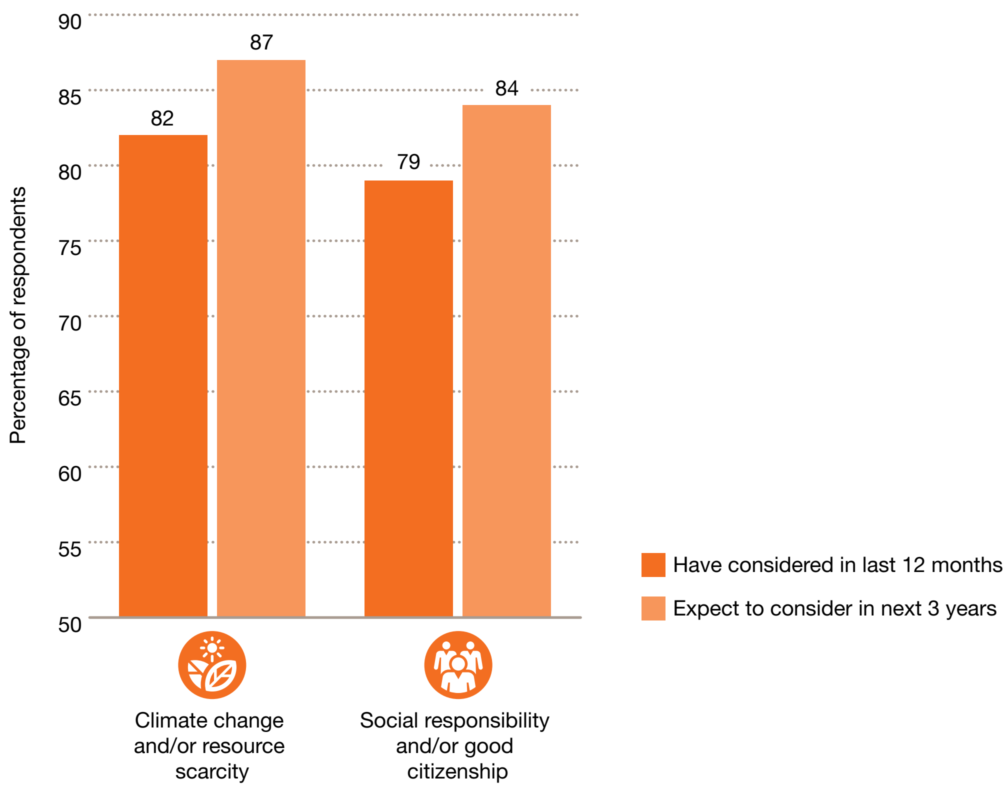
5 For more about corporate-shareholder engagement, see Guidelines for Engagement (Research Report 1541-14-RR), by the Conference Board Governance Center Advisory Board on Corporate/Investor Engagement. See also Director Dialogue with Shareholders—*What You Need to Consider* (PwC and Weil Gotshal & Manges), available at http://www.pwc.com/en_US/us/corporate-governance/publications/assets/pwc-regulations-fair-disclosure-directors-communicate.pdf.

What's on the horizon?

Investors expect sustainability issues to become increasingly relevant

So what will sustainability issues mean to investors in the next three years? Most anticipate considering these concepts in some aspect of investment decision making.

More consideration of sustainability in future investment decisions



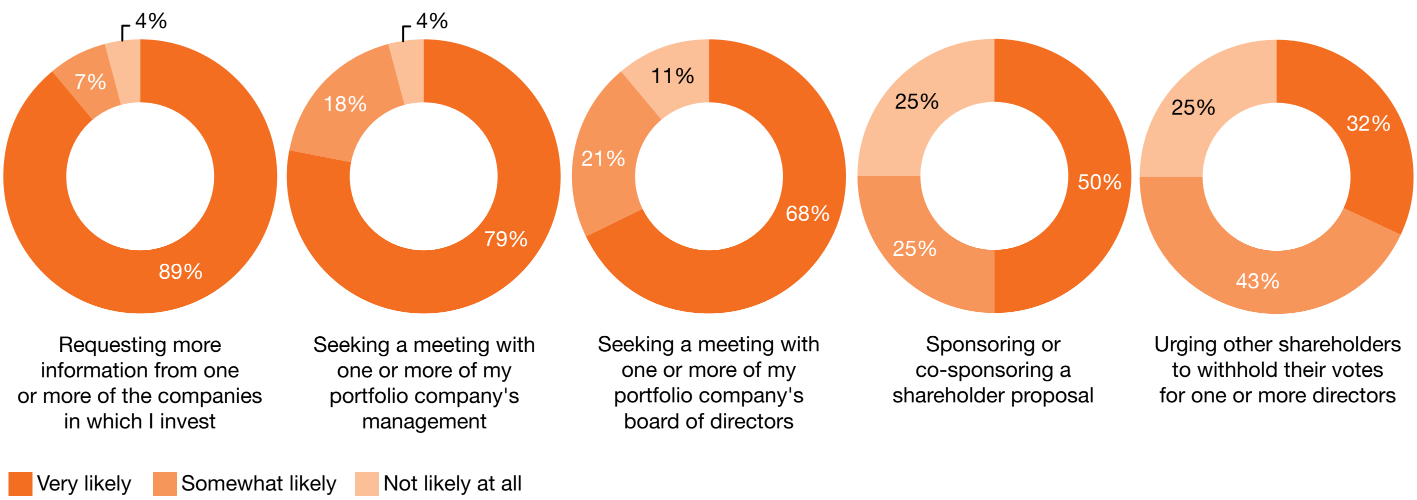
Q: Please specify whether climate change, resource scarcity issues, corporate social responsibility, or good citizenship were considered in the context of any of the illustrated types of investment decisions in the last 12 months or are expected to be so considered in the next three years.

Base: 38–39

Direct engagement likely to dominate the playbook

Most investors who identified sustainability issues as relevant say they're likely to have some form of direct communications with their portfolio companies about these issues in the next 12 months, and nearly 90% indicate that they will "very likely" simply request information from the company. More than two-thirds of these investors are "very likely" to seek a meeting with the companies' boards or management. Use of the proxy—through either shareholder proposals or "vote no" campaigns targeting company directors—is less likely.

Investors want to engage on the issues through direct communication



Q: Please describe the likelihood that the following forms of shareholder-corporate engagement will be used in the next 12 months.

Base: 28

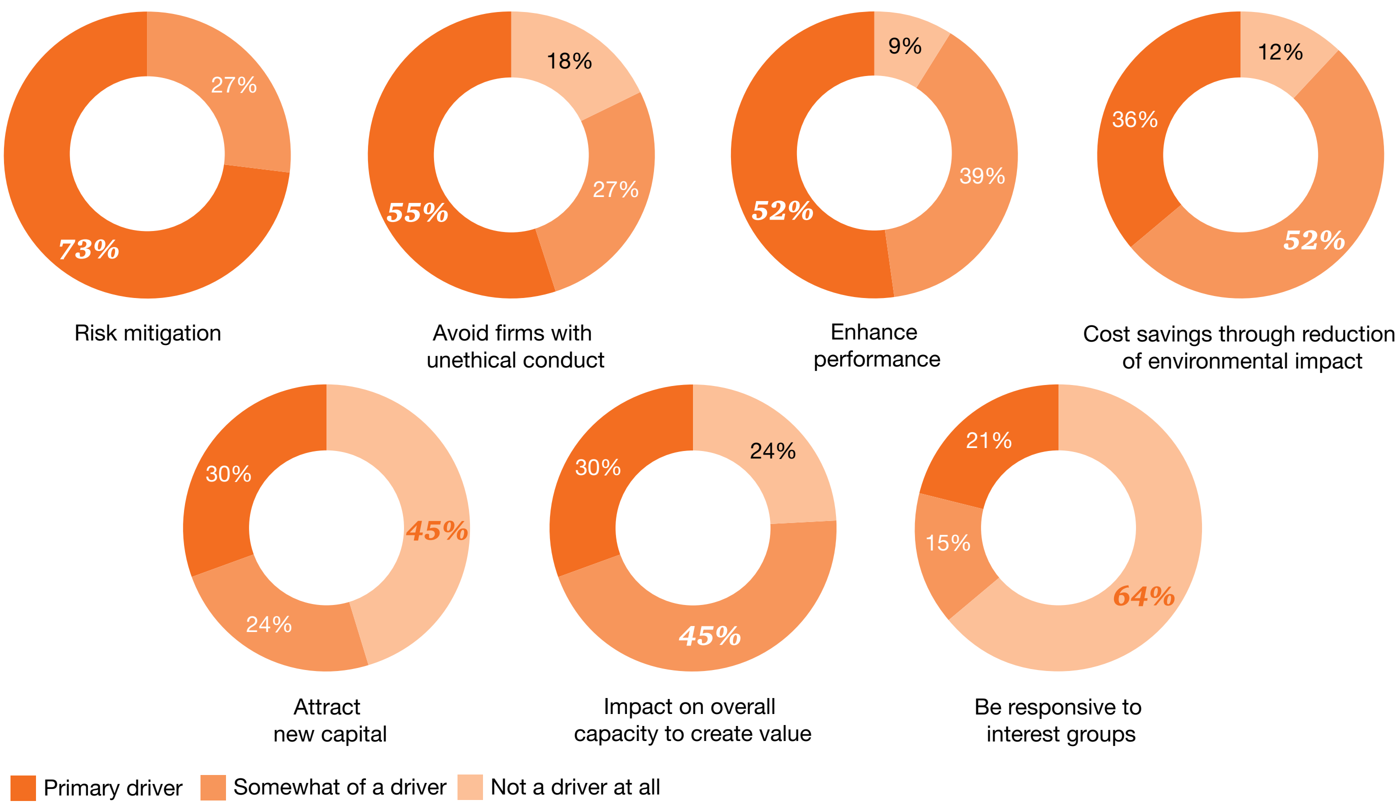
What's driving these investors?

We also asked those investors why.

Reducing risk is a driving force; interest group pressure has little effect

Investors' primary driver for considering sustainability issues is to mitigate risk. Nearly three-quarters of responding investors consider sustainability issues primarily because they believe doing so will reduce risk. Enhancing investment returns and generally avoiding firms with unethical conduct are other significant drivers. Since most responding investors operate under a fiduciary responsibility to consider the interests of their clients and beneficiaries above all other interests, it's not surprising that responsiveness to interest groups is not a driver for most.

Why are investors considering sustainability issues?



Q: Please specify whether the following objectives are drivers of why climate change, resource scarcity, corporate responsibility, and/or good citizenship are relevant to your investment program.

Base: 33

Corporate disclosures

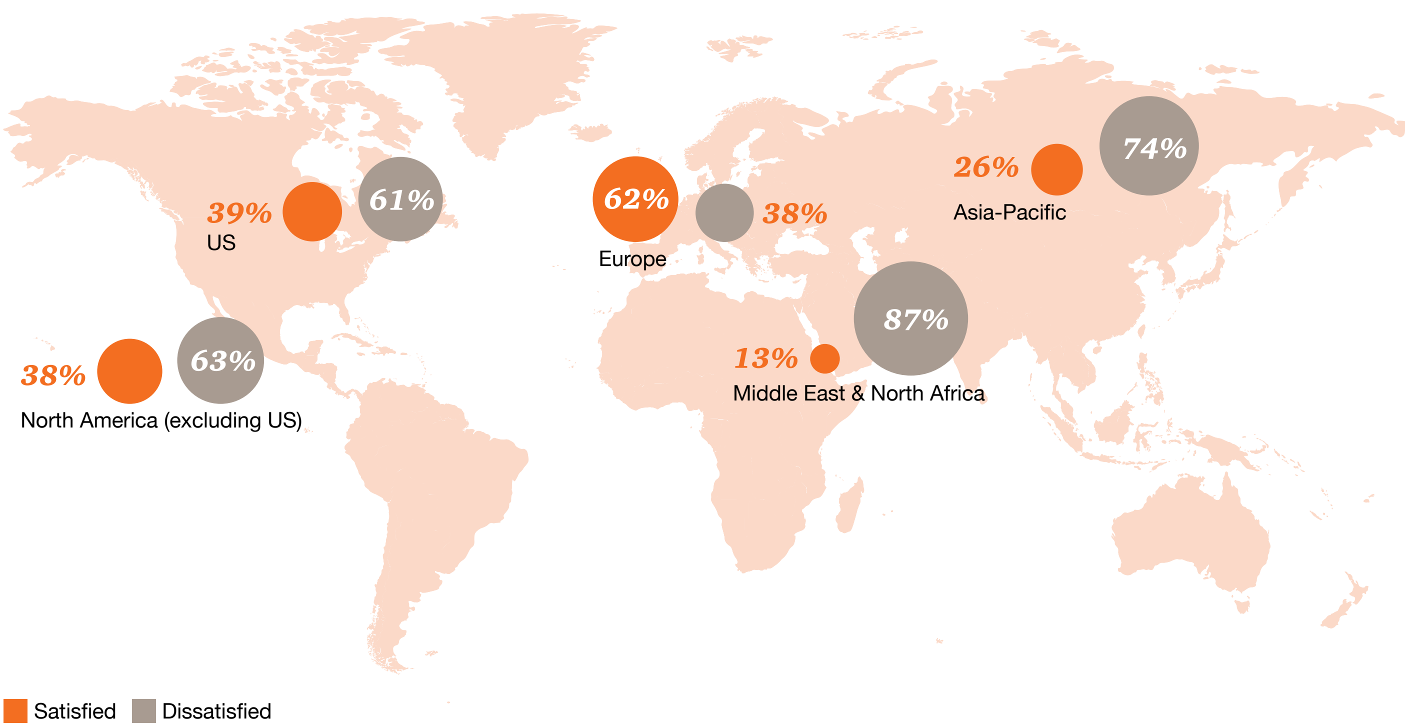
Common standards wanted!

The lack of common standards to assess the materiality of environmental or social issues may be affecting investors' ability to consider these issues as they want. Two-thirds of investors responding to our survey say that they would be more likely to consider this type of information when making investment decisions if common standards were used.

Most investors are dissatisfied with current reporting, both in the US and around the globe

Consistent with prior PwC surveys,[6] investors expressed a high level of dissatisfaction with the sustainability-related information being provided by companies. Europe represents the only region where investors are more satisfied than dissatisfied with the current level of disclosure.

Dissatisfied with disclosure

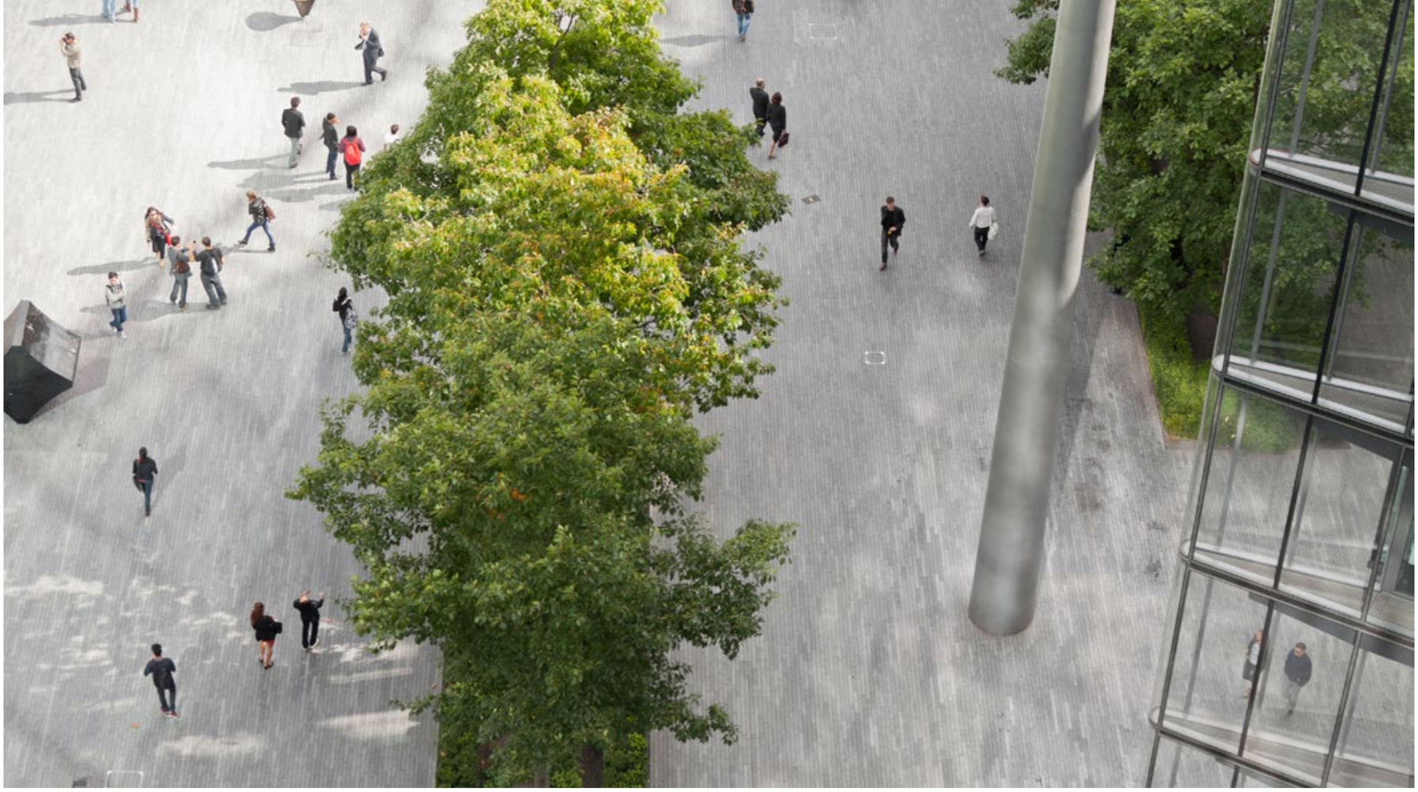


Q: How satisfied are you with the current level of corporate disclosure regarding matters relevant to climate change, resource scarcity, social corporate responsibility, and good citizenship in each of the following regions?

Base: 15–37

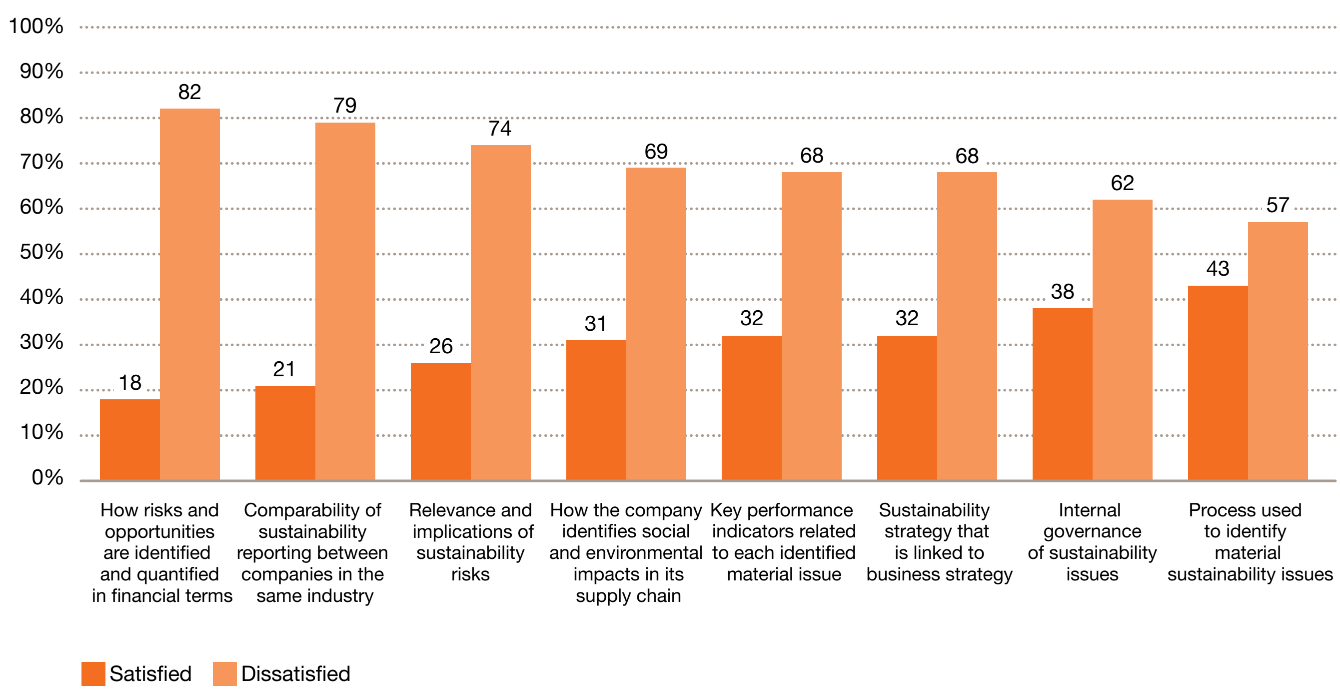
Note: Sample sizes for Asia-Pacific and Middle East and North Africa regions are smaller than other regions, as many investors within our survey do not invest in those regions.

6 See *Through the investor lens: perspectives on risk and governance*, available at http://www.pwc.com/us/en/pwc-investor-resource-institute/publications/assets/pwc-investor-survey.pdf.



Focusing specifically on information being provided by US-listed companies, investors are significantly more dissatisfied than satisfied with every topic included in our survey. This disparity is most pronounced in the context of risk and comparability.

Investors want better information from companies



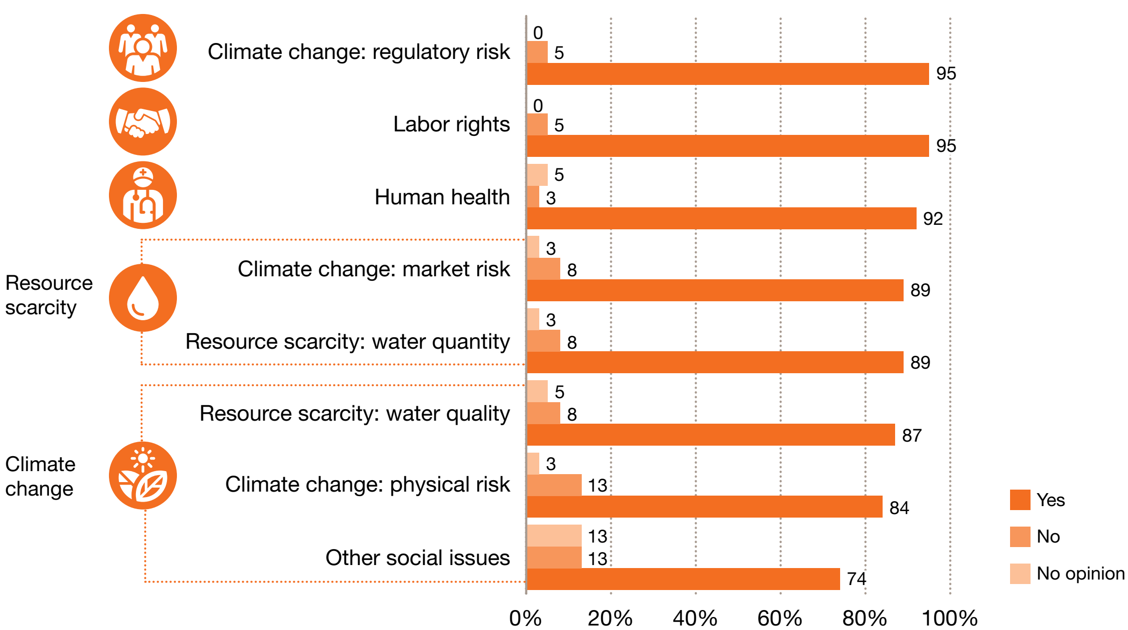
Q: Focusing specifically on US-listed companies, how satisfied are you with the information currently being provided by these companies on the following topics?

Base: 27–29

Investors strongly believe that companies should periodically assess multiple types of risks for materiality. For each type of risk, we provided examples:

- *Climate change: regulatory risk*—Risk of stranded assets due to carbon regulations
- *Climate change: market risk*—Risk of disruptions from lower greenhouse gas (GHG) emitting technologies
- *Climate change: physical risk*—Risks from heat waves, storm intensity, water shortages, other physical impacts of climate change
- *Resource scarcity: water quality*—Impacts of deteriorating source water on production costs
- *Resource scarcity: water quantity*—Impacts of water scarcity on production costs
- *Human health*—Demand for fewer toxic chemicals, reduced costs of pharmaceuticals
- *Labor rights*—Use of child labor, "sweat shops"
- *Other social issues*—Increasing income inequality, human rights practices

Yes to periodic assessments for materiality



Q: In your view, which of the following issues should be periodically assessed by companies for materiality?
Base: 38

Implications

The purpose of this survey was to gain a deeper understanding of whether sustainability issues are affecting the decisions being made by investors—primarily large institutions that provide the bulk of capital used by companies to finance growth. We found that such an effect is occurring today—and that it is likely to increase in coming years.

As companies consider how resource scarcity, extreme weather events, rising sea levels, and evolving societal expectations regarding corporate responsibility will affect their long-term business strategies, operations, and reporting, the perspectives of their owners and providers of future capital are critical. It's equally important for securities regulators to understand how, when, and with what weight investors consider these issues as they determine what disclosure requirements best serve the public markets. And as institutional investors strive to understand the impact of these issues on corporate strategy, investment returns, and portfolio risk, they can better exercise their responsibilities to those whose assets they manage.

We will continue to monitor evolving views and practices and share what we learn.

To learn more about PwC's Investor Resource Institute, please visit *www.pwc.com/us/InvestorResourceInstitute*.

To learn more about our Sustainable Business Solutions, please visit *http://www.pwc.com/us/sustainability*.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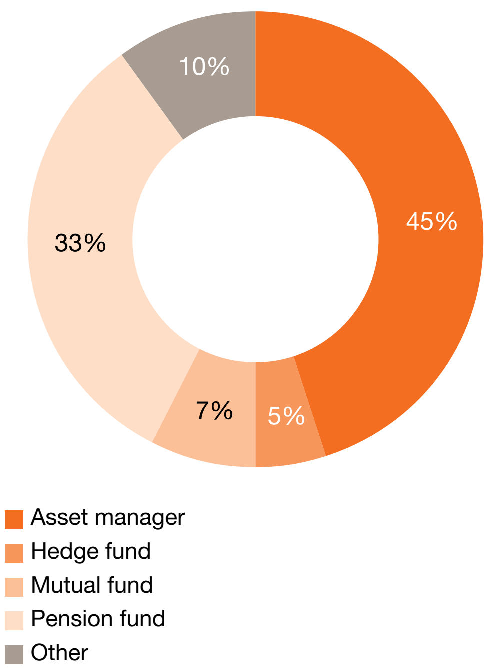
More London Riverside

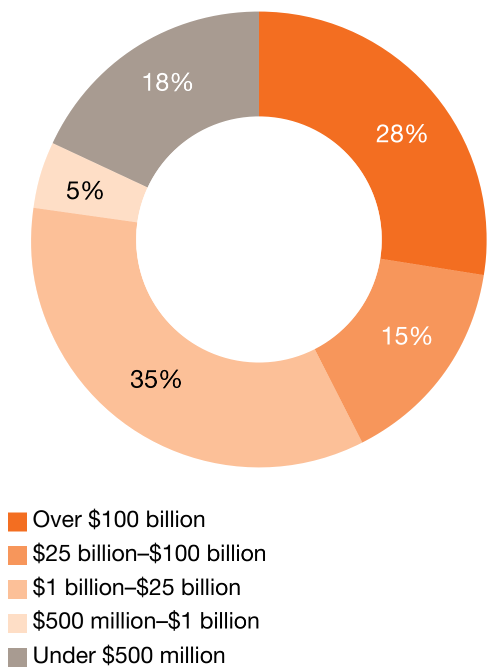
Methodology

Demographics of responding investors

A diverse mix of institutional investors responded to the survey: About 45% are asset managers, one-third are pension funds, and the remaining represents a variety of other types of organizations. Compared to the general population of US institutional investors, asset managers are over-represented in our survey, while pension fund representation is comparable.[7]

The size of responding investors was more evenly dispersed. In total, responding investors represent assets under management (AUM) of more than $7.6 trillion.[8]

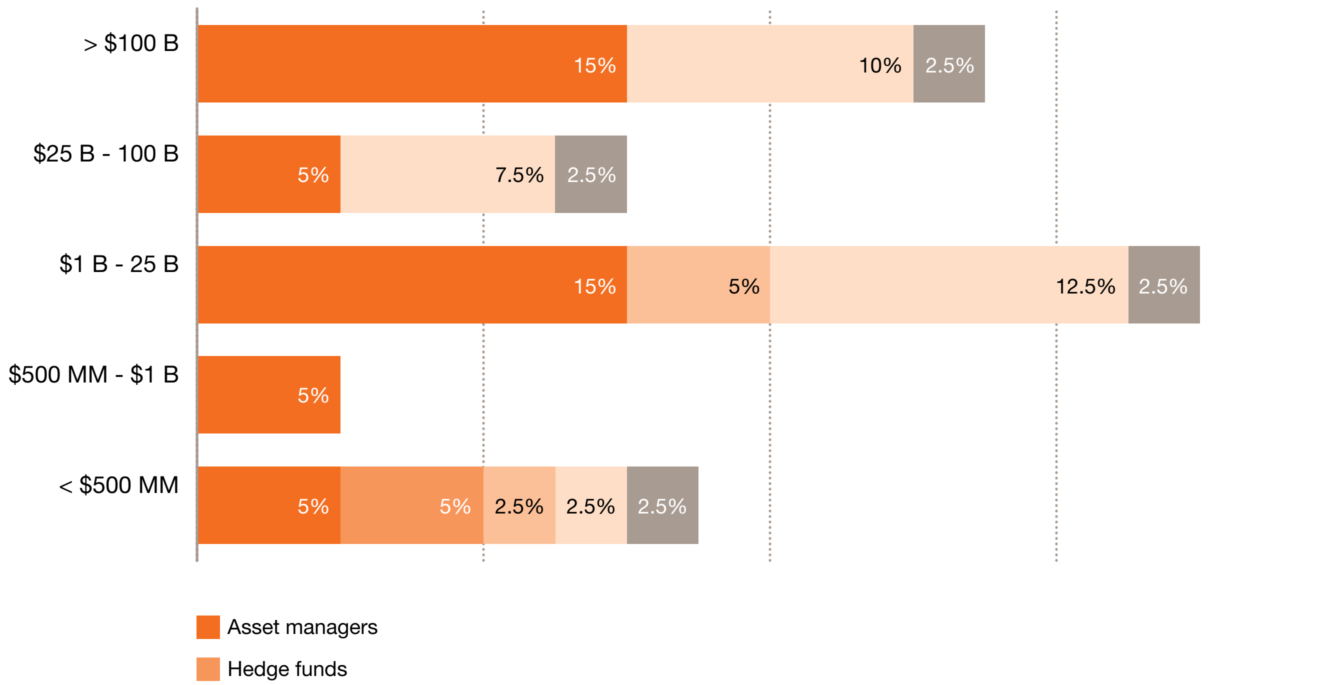




7 See *The 2010 Institutional Investment Report* (Conference Board), Chart 3 at p.10: as of the end of 2009, pension funds managed 39.9% of the total institutional assets, with the remaining managed by investment companies (28.4%), insurance companies (24.4%), savings institutions (4.9%), and foundations (2.3%).

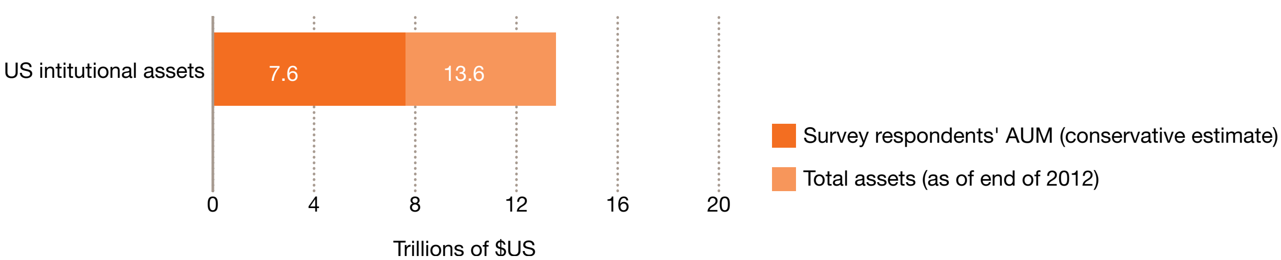
8 To calculate AUM, we used the low number within the range provided in survey results (i.e., for those responding that they manage assets valued at "between $25 billion and just under $100 billion," we used $25 billion in our AUM calculation). For those who reported that they manage assets under $500 million, we used the number $1 million. For those who responded that they manage assets valued at over $100 billion, we used the actual AUM as reported in each institution's public website. All of these values were retrieved on March 20, 2014, and if reported in other than US dollars were converted based on currency rates as of that same date.

AUM v. type of organization



Most of our survey respondents have primary operations in the US and invest in markets across the globe. Conservatively estimated, our respondents' AUM represents more than 50% of total US institutional assets.

Size of respondents' AUM v. US institutional assets



Source: Institutional investors' assets http://stats.oecd.org/Index.aspx?DataSetCode=7IA from OECD.StatExtracts http://stats.oecd.org, accessed May 7, 2014.

Unless otherwise indicated, 40 institutions completed the survey. When broken down by demographic information, some numbers are very small (e.g., number of hedge funds, number of mutual funds), and thus the margin of potential error can be quite significant. All demographic information should be considered when evaluating these results.

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Contact us

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About PwC's Investor Resource Institute

Our Investor Resource Institute seeks to add value to investors' decision-making processes by sharing PwC's insights and educational materials regarding markets, industries, and corporate governance.