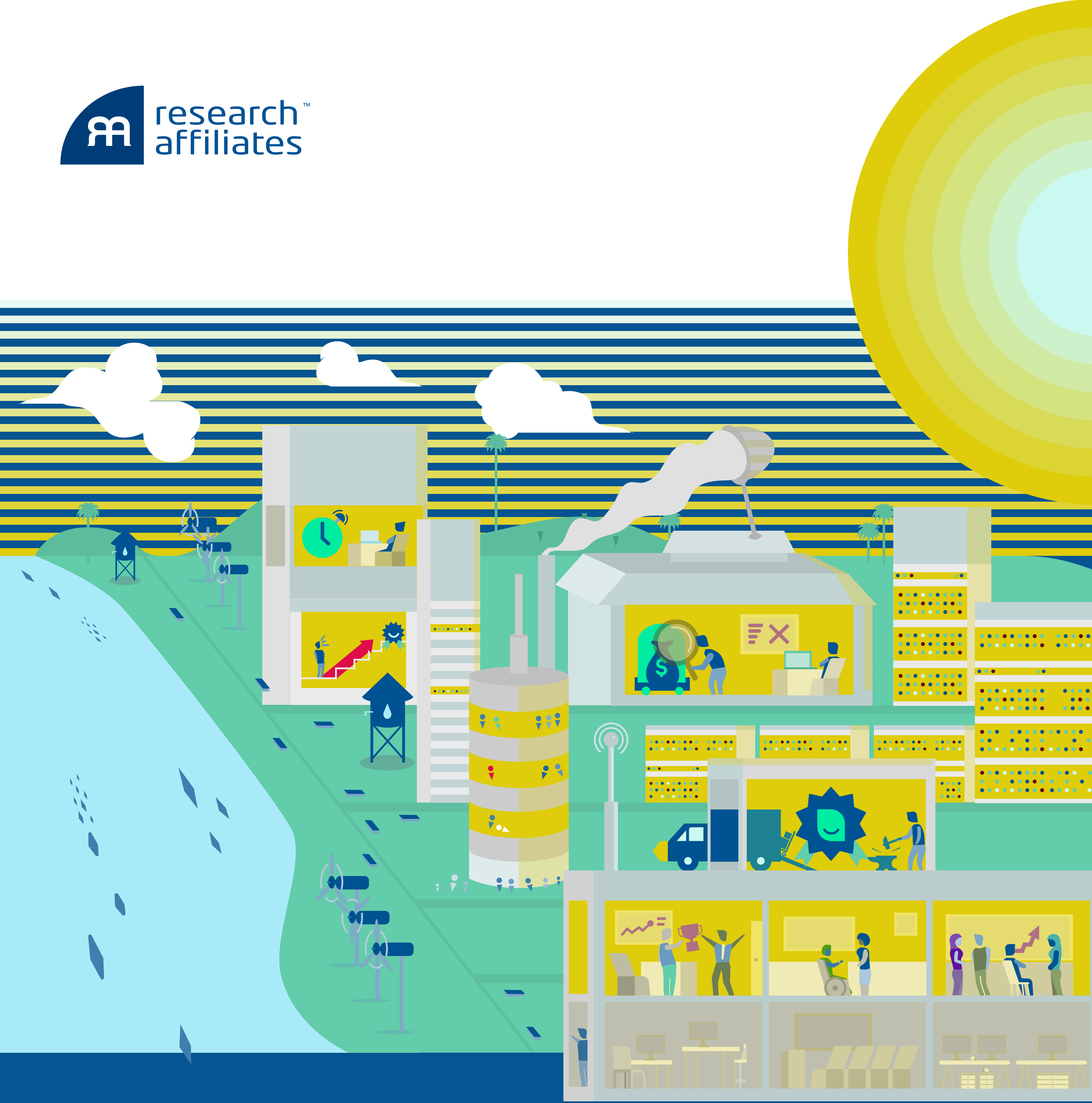
research affiliates



Learning to invest responsibly.

ESG

2021 Research Affiliates ESG Survey Report

Financial Advisors and Wealth Managers

Foreword

As our name implies, Research Affiliates is a research-centric firm dedicated to ongoing research activities that extend our understanding—and the investment industry's—of the benefits and challenges associated with smart beta, asset allocation, and systematic active equity strategies. We seek to offer investment strategies that meet a diverse set of investor preferences, while delivering superior expected returns over a full investment cycle. Included in our strategy portfolio are environmental, social, and governance (ESG) investing strategies, which we offer in collaboration with our industry partners, who include data providers, index calculators, and asset managers.

We are pleased to provide the inaugural Research Affiliates ESG Investing Survey Report as a means of offering greater insights into current ESG adoption by practitioners in the advisor community and their clients. We realize a number of ESG surveys are available to investors. Why add another? We designed our survey to drill down on what really matters to ESG investors by structuring many of the survey questions to have ranked responses. Our goal for the survey was to produce the most meaningful results possible for advisors and investors. Investing is about making choices based on beliefs and preferences. Ranking provides a better understanding of respondents' preferences when forced to make choices.

We hope the survey sheds light on advisors' preferences, motivations, and past and prospective decision making related to ESG strategies and that this heightened understanding can improve ESG practices both inside and outside the financial industry. In the context of the survey, ESG refers to a wide array of investment strategies variously referred to by investors as socially responsible investing, sustainable investing, climate investing, and ESG investing.

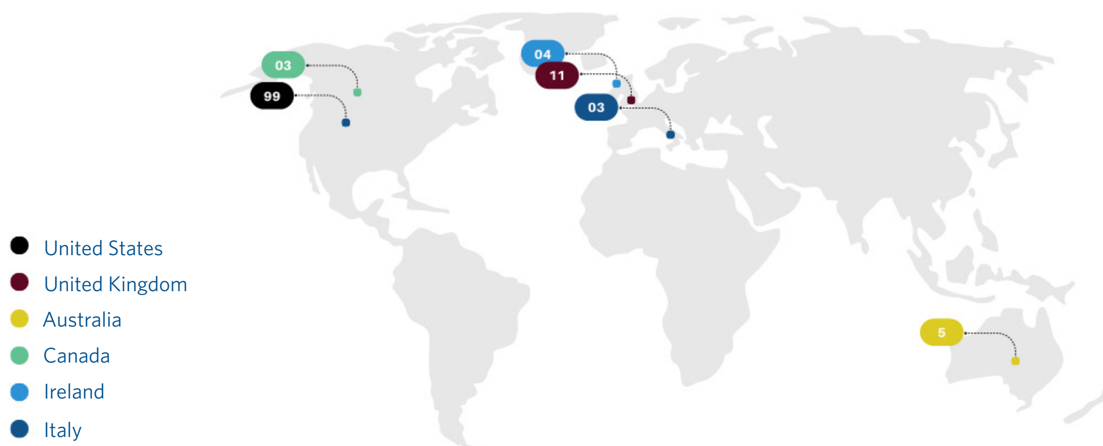
> Our use of ESG investment products is driven by client demand. If we can deliver what they want and it is a diversified, reasonably risk-managed solution, we will assist the client.
>
> – Survey Respondent

As a firm, Research Affiliates values feedback, which we consider a gift. We encourage you to contact us with feedback about the survey as well as to submit questions you would like answers to about advisor practices and client preferences related to ESG investing. Of course, we can only speculate about the important trends that will develop in ESG investing, but recurring surveys will allow us to capture those trends in adoption, investing themes, and product preferences. We look forward to communicating future survey results with you.

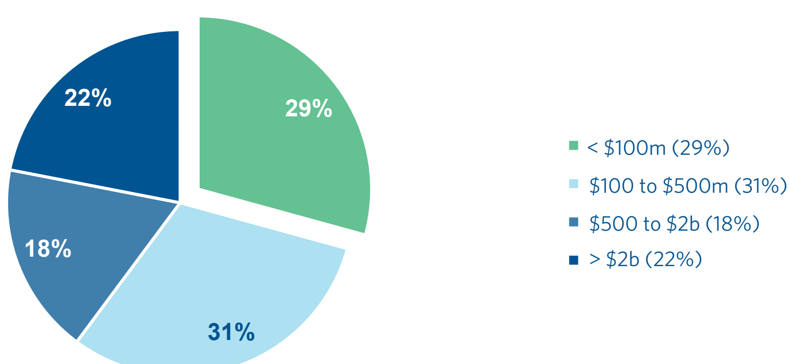
About the Survey

In June and July 2021, Research Affiliates surveyed 131 financial advisors and wealth managers from 13 countries to gather the industry sector's latest thinking about, and approaches to, ESG investing. Respondents answered 46 questions via an anonymous online questionnaire. Most survey participants practice in the United States and Europe, with representation of 76% and 16%, respectively. The majority, approximately 83%, of survey participants are 40 years old or older. The bulk of respondents' practices have over $100 million in assets under management (AUM), with 31% having AUM of $100–500 million and 40% having AUM of over $500 million.

Top Countries by Number of Respondents



Assets under Management (USD) in Respondents' Practices



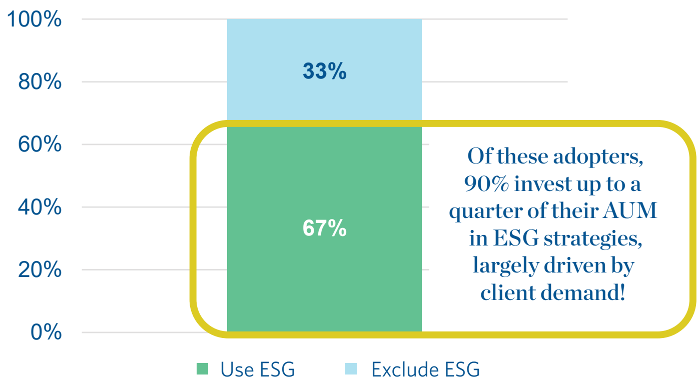
The survey results are organized in five sections. Section One highlights the key findings of the survey. Section Two provides an overview of the rationale and motivations behind respondents' decisions to use or exclude ESG strategies in their financial advisor practices. Section Three explores the preferences and beliefs surrounding advisors' decisions in implementing and applying ESG considerations in their practices. Section Four focuses on provider attributes and important ESG investment themes. Finally, Section Five discusses advisors' management practices and client communications and their ESG investing education preferences.

Section One: Key Findings

- The primary driver of advisors' decisions to employ ESG investment strategies is client demand.
- By far the most commonly used investment vehicles to gain ESG exposure are mutual funds and ETFs, and the preferred asset classes are global and US stocks and bonds.
- Over the next three years, only 16% of advisors expect to have zero ESG exposure in their clients' portfolios compared to 33% having zero exposure today.
- CO_2 emissions is the environmental issue of most concern to clients. Reducing allocations to fossil fuel and large-emitting companies is the most common approach to address this concern.

Section Two: ESG Adoption Driven by Client Demand

Two-Thirds of Respondents Currently Use ESG Strategies



More than two-thirds of the survey's advisor and wealth manager respondents use ESG investment products in their practices. The majority of adopters (90%) invest up to a quarter of assets under management in ESG strategies; choosing to invest more than half of AUM in ESG strategies was rare. When asked how long they have been using ESG investment strategies in their practice, only 13% of respondents stated a duration less than one year, and more than half have been investing in this arena for three years or longer.

Client demand is the primary motivation for using ESG strategies in their practices, as cited by 63% of respondents. The least important motivation behind the decision to use ESG products is the desire to influence corporate ESG behavior.

The direct investment-related reasons for allocating to an ESG strategy—reducing risks and increasing returns—found moderate support, with reducing risks and increasing returns ranked 1 or 2 by 36% and 25%, respectively, of respondents, and ranked 4 or 5 by 35% and 51%, respectively. At the current time, enthusiasm for ESG investing among financial advisors is driven primarily by non-investment-related rationales.

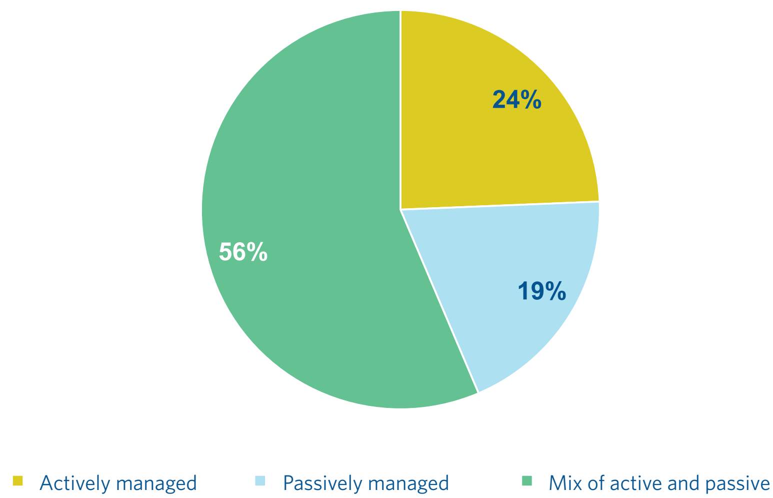
> ESG strategies offer an attractive business opportunity as we have the resources to develop this kind of portfolio/process when others do not.
>
> – Survey Respondent

On the flip side, among the respondents who exclude ESG strategies in their practices, again the main rationale was client demand—in this case, a lack of demand—followed by the belief that ESG investing does not add value to client portfolios as well as the challenge presented by the absence of a commonly accepted definition of ESG investing.

Section Three: ESG Implementation Preferences

So, how do adopters of ESG investing in the advisor community implement and apply these strategies in their practices? At the present time, the lion's share of respondents use a mix of active and passive strategies (56%). Among those who use purely active or passive strategies, only 5% more use active versus passive (24% vs. 19%). When asked whether active or passive strategies most effectively capture the material ESG risks and opportunities, 54% of respondents selected actively managed compared to 37% who chose passively managed.

ESG Investing Adopters Use a Mix of Active & Passive Strategies



The two primary ways advisors apply ESG considerations in client portfolios are exclusions (i.e., excluding a company from the portfolio based on one or more ESG criteria) and integration (i.e., changing a company's portfolio weight based on its ESG score).

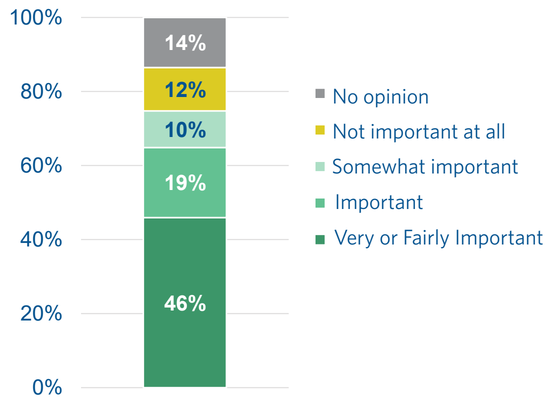
Not surprisingly, mutual funds and exchange-traded funds (ETFs) are the primary vehicles through which survey respondents are currently implementing ESG strategies; the majority of respondents expect this preference will continue over the next three years.

Most investment is in mainstream asset classes, namely, global and US stocks and bonds. Only 20% of respondents indicate they presently use alternatives and commodities to fulfil ESG-oriented mandates. Interestingly, the third most popular regional strategy after global (73%) and US (69%) is emerging markets (44%).

Section Four: Provider Attributes and ESG Investment Themes

When selecting providers of ESG investment products, only 12% of respondents view the provider's stated values and ESG policies as being unimportant to their decision-making process; almost half of respondents stated this criterion is either fairly important or very important when choosing an ESG product.

A Provider's Values & ESG Policies Matter to Majority of Respondents



Having access to ESG characteristics, analytics, and reports from their ESG investment product provider is viewed as highly valuable by respondents: 69% answered this question as either very important or fairly important.

Survey respondents selected climate change, good governance, and social equality/equity as the three most important ESG themes to their clients. Climate change was ranked as the most important theme by 43% of respondents and as the second-most important theme by 21%. Good governance was ranked the most important by 26% and as second-most important by 19%. Gender diversity was the lowest ranked theme of the six themes respondents ranked.

CO2 emissions was identified as the environmental issue of most concern to clients. The most popular approach to address carbon impact is to reduce allocations to fossil fuel companies and the largest emitting companies, which was ranked first by 34% and ranked second by 40% of respondents. The choice to *entirely* exclude fossil fuel companies and the biggest emitters was ranked first by 22% and ranked second by 22% of respondents. The option to allocate to fossil fuel companies and biggest emitters with the intent of advocating for their adoption of more sustainable practices was the lowest-ranked approach included in the survey as a means to address carbon impact.

> A theme important to our clients is ethical data use and privacy concerns.
>
> – Survey Respondent

Section Five: Management Practice, Client Communications, and ESG Investing Education

In assessing ESG investing to the firm's value proposition to prospective clients, 44% affirmed it was very important, fairly important, or important, whereas 28% stated it was not important at all. By far the primary means (89%) of communicating how value-based and ESG investing preferences are implemented is for the advisor to explain during client meetings. The second-most common communication tool was the firm's brochure and other print marketing materials (30%) and on the firm's website (26%).

The majority of respondents do not have a written policy on ESG (76%) or on diversity and inclusion (69%), choosing to communicate their firm's values to clients in person.

We view educational outreach as an important part of the Research Affiliates mission. When asked their preferences for delivery of ESG investing education, three methods stood out: articles, research white papers, and webinars/presentations.

About Us

Research Affiliates, LLC, is a global leader in smart beta and asset allocation. The firm is dedicated to creating value for investors over a long-term horizon through replicable sources of excess return. We seek to have a profound impact on the global investment community through our insights and products, building our investment strategies on a deep and empirically robust research base. We deliver solutions in partnership with some of the world's leading financial institutions through their offerings of mutual funds, exchange-traded funds, separately managed accounts, and/or commingled funds.

As a signatory to the United Nations–supported Principles for Responsible Investment, Research Affiliates embraces the importance of ESG investing and contributes to this space through research, development of investment strategies that incorporate ESG factors in our investment processes, and engaging with our partners and clients to learn more about their investment needs relevant to ESG investing. For more information about ESG research and investing strategies at Research Affiliates, visit researchaffiliates.com/en_us/insights/esg.html.

Our Research on ESG Investing

The Time Is Now: Climate Transition Investing for US Investors
Brightman, Kalesnik, Polychronopoulos
April 2021

Is ESG a Factor?
Polychronopoulos, West
July 2020

What a Difference an ESG Ratings Provider Makes!
Li, Polychronopoulos
January 2020

Unlocking the Performance Potential in ESG Investing
Li, Sherrerd
March 2018

Research Affiliates was founded by Rob Arnott in 2002 and is based in Newport Beach, California. As of June 30, 2021, $171 billion in assets are managed worldwide using investment strategies developed by Research Affiliates.

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