INVESTOR INSIGHTS SERIES

Looking for the Best of Both Worlds

Investors turn to ESG to fulfill personal values and performance expectations

Professional investors across the globe say their top reason for implementing environmental, social, and governance (ESG) investment strategies is to align organizational values with their investment assets. In line with this, the ability to invest according to personal values and ethical requirements is important to individuals. But in the process of pursuing important sustainability goals, many are realizing that ESG has the potential to provide investment benefits as well.

In fact, professional investors believe ESG has the potential to support both sides of the risk/return equation. Six in ten professionals also believe there is alpha to be found in ESG. But in an age of heightened regulation and increased public scrutiny, the professionals also believe these strategies can mitigate exposure to governance and social risks not captured in traditional analysis.

Individual investors share a similar perspective: More than half (56%) of those surveyed believe that all things being equal, companies that demonstrate a higher level of integrity will outperform similar companies that do not. This is an important consideration, since half of investors say they are not willing to give up investment performance in order to align their assets with their values.

6 in 10 professionals agree there is alpha to be found in ESG investing.

Nearly two-thirds of institutional investors believe ESG will become an industry standard within the next five years.

7 in 10 individual investors believe it is important to make a positive social impact through their investments.

ABOUT THE SURVEYS

The Natixis Investment Managers ESG Cross-Survey Report leverages data from four global surveys:

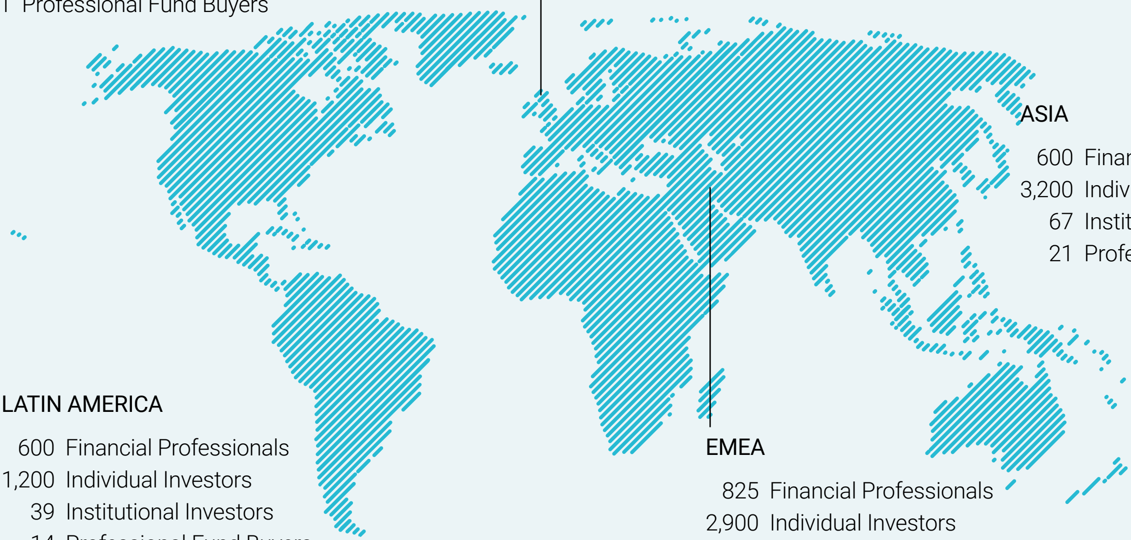
2018 Global Surveys of Financial Professionals, Individual Investors, Institutional Investors and Professional Fund Buyers.

UNITED KINGDOM

300 Financial Professionals
750 Individual Investors
67 Institutional Investors
30 Professional Fund Buyers

NORTH AMERICA

450 Financial Professionals
1,050 Individual Investors
112 Institutional Investors
51 Professional Fund Buyers



ASIA

600 Financial Professionals
3,200 Individual Investors
67 Institutional Investors
21 Professional Fund Buyers

LATIN AMERICA

600 Financial Professionals
1,200 Individual Investors
39 Institutional Investors
14 Professional Fund Buyers

EMEA

825 Financial Professionals
2,900 Individual Investors
215 Institutional Investors
84 Professional Fund Buyers

GLOBAL

9,100 Individual Investors
2,775 Financial Professionals
500 Institutional Investors
200 Professional Fund Buyers

Survey methodologies

Natixis Investment Managers, Global Survey of Financial Professionals conducted by CoreData Research in March 2018. Survey included 2,775 financial professionals in 16 countries.

Natixis Investment Managers, Global Survey of Individual Investors conducted by CoreData Research, September 2018. Survey included 9,100 investors from 25 countries.

Natixis Investment Managers, Global Survey of Institutional Investors conducted by CoreData Research in September and October 2018. Survey included 500 institutional investors in 28 countries.

The Natixis Investment Managers Global Survey of Professional Fund Buyers was conducted by CoreData Research in October and November 2018. The survey included 200 respondents in 22 countries throughout North America, Latin America, the United Kingdom, Continental Europe and the Middle East.

Growing demand for ESG

But as it moves out of the narrow scope of negative screening once associated with socially responsible investing and expands into a broad set of strategies, investors will need greater clarity and definition on how ESG is implemented – and why. With asset managers offering strategies built on negative screening, positive screening, thematic investing, impact investing, and full-on ESG integration, the industry needs to adopt a standard taxonomy that allows investors to match their motivations for implementing ESG with the strategies asset managers deliver.

Looking across results from the most recent Natixis Global Survey of Individual Investors, Global Survey of Financial Professionals, and Global Survey of Institutional Investors, we find three significant issues that will drive decisions on ESG investing:

- **Positive performance perceptions:** Investor sentiment is positive on the potential for ESG to drive investment performance. The industry will need to harness this tailwind and clearly communicate ESG's role in investment strategy, rather than what some might incorrectly assume is a "feel-good filter."
- **Demonstrating the asset to values connection:** Investors want investment performance, but they also want to see that investment selection actually helps achieve positive results on the values side of the scale. This will require the adoption of standards for measuring and reporting results. For many, the key toward achieving this goal has been made with large global companies adopting the Sustainable Development Goals as outlined by the United Nations. But broader adherence and more convincing narratives about how they are in fact contributing to the SDGs, are needed.
- **Closing the information gap:** Despite positive performance perceptions and growing demand for investments that reflect their values, investors and institutions still hunger for more information to support their ESG investment decisions.

Nearly two-thirds of institutional investors believe ESG will become an industry standard within the next five years, and an important part of that argument comes down to how well these strategies can perform on all three fronts.

Investors see potential performance advantages

At a time when they are seeking more opportunities to diversify returns and manage risk, professional investors believe ESG can play a role. A majority of professional investors believe there is alpha to be found in ESG (including 59% of financial professionals and 56% of institutional investors).

What many may find is that fulfilling performance assumptions is not as simple as choosing and following an ESG index. Generating this alpha requires significant levels of expertise, deep company and industry analysis, and a highly active approach to portfolio management. The same is true for mitigating risk.

Now, as lapses in corporate governance, powerful social movements, and environmental issues make headlines, professionals see that ESG analysis also offers potential benefits on the risk side of the investment equation. In fact, 56% of institutional investors believe ESG mitigates governance and social risks, such as loss of assets due to lawsuits, social discord, or environmental harm.

To understand investors, think of them as consumers

The wallet has long been a powerful tool for consumers to express their values through their money. The same holds true for the power of the portfolio.

As Consumers	As Investors
63% seek to **buy products** from companies aligned with their personal values	60% actively **seek out investments** aligned to their values
59% actively **avoid buying products** from companies that conflict with their personal values	56% actively seek to **avoid investing** in companies that conflict with their values

Going forward, it will be important to have this values-based discussion with investors in order to understand which companies or industries get a thumbs up with their assets and which get a thumbs down.

Source: Natixis Investment Managers 2018 Global Survey of Individual Investors.

Initial steps toward proving potential

Recent research by MSCI suggests that professionals may be on to something in their assumptions on the effect of positive ESG records on risk and return performance. In its 2017 paper, "Foundations of ESG Investing,"[1] MSCI examined the impact of ESG on valuations, risk, and performance of equities on 1,600 stocks globally. Examining how information within companies is transmitted to the equity markets, the authors found three potential advantages for those organizations with good ESG characteristics:

- **Cash flow:** Researchers suggest that companies with high ESG ratings may be more competitive and can generate abnormal returns, which leads to higher profitability and dividend payments.
- **Idiosyncratic risk:** The research indicates that high ESG-rated companies may be better at managing company-specific and operational risks, resulting in a lower probability of suffering incidents that can impact their share price. As a result, there is lower idiosyncratic tail risk to their share prices.
- **Valuation:** These companies generally have lower exposure to systemic risk factors, and as a result, their expected cost of capital is lower, which results in higher valuations in a discounted cash flow analysis framework.

Insights like these are a positive step forward on the road to broad-based adoption of ESG investment practices, but should be kept in perspective. Many times, there can be a correlation between ESG performance and financial performance, but some experts caution that correlation does not necessarily mean causation.

Comparative measures of ESG performance can sometimes be limited by the size and sophistication of the companies covered and even the regions where they are based. Larger companies with deeper resources are in a better position to report on sustainability initiatives, or how they are contributing to Sustainable Development Goals, than smaller organizations, giving them the advantage. Similarly, companies based in regions with more stringent regulations need to comply, increasing the likelihood that they will take action on ESG issues.

Key strategies for pursuing ESG objectives

- **Negative screening:** excludes countries, companies, industries based on poor ESG records and performance
- **Positive/Best-in-class screening:** invests in sectors, companies, or projects selected for positive ESG performance compared to peers
- **Thematic strategies:** invest in megatrends related to global sustainability
- **Impact strategies:** aim at solving social or environmental problems
- **Integration strategies:** make analysis of ESG risks and opportunities part of the fundamental analysis process
- **Engagement:** using the voice of the shareholder to influence change on sustainability issues such as climate change and reduction in carbon footprints, often through proxy voting policies

Tools of the trade

Despite any potential limitations, these tools present significant advantages. They provide a new, specific stream of data to consider in fundamental analysis. Understanding the potential value these tools provide may be especially important in the broader adoption of ESG. In the past, analysts may have failed to consider ESG, but now they are gaining access to tools to support a process that is designed to achieve their ultimate goal: better risk-adjusted returns.

It's not just institutional investors that benefit from the marriage of financial and ESG goals. Individual investors also want to ensure that they are delivering on sustainability goals, while also attaining the investment performance needed to meet their financial goals.

How are institutions implementing ESG?

46% of institutions who implement ESG say they believe this analysis is as important to their investment process as traditional fundamental analysis.

Top 5 Ways Institutions are Implementing ESG:

1. ESG integration
2. Negative screens
3. Active ownership
4. Best-in-class strategies
5. Impact investing

Source: Natixis Investment Managers 2018 Global Survey of Institutional Investors

1 Guido Giese, Linda-Eling Lee, Dimitris Melas, Zoltan Nagy, Laura Nishikawa. "Foundations of ESG Investing." MSCI ESG Research LLC. November 2017. Accessed April 4, 2019.

Investing with enlightened self-interest

Three-quarters of those included in our 2018 Global Survey of Individual Investors say that it is important to have the ability to invest in accordance with their personal values and ethical requirements; one-quarter deems it very important. This is in line with results from our 2017 survey, where 78% said it's important to invest in companies that reflect their personal values, and 2016's survey where 75% agreed.

But their desire to put their assets behind their values and causes that matter most in their lives does not include a tradeoff in performance expectations. In fact, half of those surveyed say that they want their investments aligned with their values, but not at the cost of investment performance.

While not willing to accept lower performance, a majority of investors may not think there has to be a tradeoff. Overall, 56% believe that all things being equal, a company that demonstrates higher integrity will outperform similar companies that do not. To confirm this conviction, nearly three-quarters of investors say that if a fund demonstrated a better carbon footprint, they would buy it.

The why, how, and what of ESG

Growing interest and demand for ESG has brought with it a more expansive tool box. Ranging from the negative screens associated with socially responsible investments, to the forward-looking thematic strategies, to the issues orientation of impact investing, investors have options for implementing ESG. In order to determine which of these strategies is best suited to investor and institutional portfolios, it's most critical to understand the motives and expectations behind the decision to deploy an ESG strategy.

Institutions have a range of reasons for implementing ESG investment strategies: Six in ten (59%) say it is to align investment strategies with organizational values. Nearly four in ten (38%) say it is to help minimize headline risk (respondents were asked to choose their top two reasons). Three in ten (30%) also report that ESG is implemented to comply with the organization's investment policy statement. One-fifth also say their ESG is incorporated as a way of generating higher risk-adjusted returns.

Growing numbers incorporate ESG

Sustainable investing has gained a significant foothold within institutions, with six out of ten institutional investors reporting that they incorporate ESG. And even if they have not yet begun to implement these strategies, institutional investors sense they soon will, as 65% believe ESG will become a standard practice in the next five years – a number that is up from 62% in 2016, and 60% in 2017.

Among those who implement ESG today, there is a wide belief that consideration of these factors is a critical part of their investment process. In fact, 46% of those who implement ESG say they believe this analysis is as important to their investment process as traditional fundamental analysis. In the process of examining ESG factors, the respondents are focused across all three factors, though somewhat greater importance is given to environmental (76%) and governance (70%) factors than social factors (61%).

Investors are predisposed to ESG investing

76% say the ability to invest according to personal values and ethical requirements is important

56% believe that all else equal, a company that exhibits higher integrity in its practices will outperform its peers

73% would be more inclined to buy a fund if it demonstrated a better carbon footprint than others

Source: Natixis Investment Managers Global Survey of Individual Investors

As they look to follow through on these views with investments, institutions are integrating a wide range of strategies. Most frequently, they deploy ESG integration, which makes analysis of ESG factors part of their fundamental analysis process. Beyond this, 28% use negative screens to exclude investments based on poor ESG performance, while 13% implement best-in-class strategies that select companies based on positive ESG performance relative to peers. And 10% also deploy impact strategies aimed at solving key social or environmental problems, while 6% say they use thematic strategies to invest in trends related to global sustainability.

> 65% believe ESG will become a standard practice in the next five years.

In terms of how they manage portfolio implementation, most institutions (51%) rely on in-house teams. But few see the process as an either-or proposition. Many institutional investors combine internal and external capabilities to manage ESG, including third-party managers (33%), outsourced CIOs (24%), and institutional consultants (23%) for ESG expertise.

ESG is making inroads in wholesale markets as well, where 65% of fund buyers say it is part of their investment practices. In this field, slightly fewer rely on full integration (28%) and exclusionary screening (22%), but larger numbers employ both impact investing and best-in-class approaches (15% each).

ESG preferences among individual investors

A majority of investors worldwide agree that it is important to invest in companies that reflect their personal values, and when it comes down to it they share consistent views on what they see as most important. In the environmental realm, investors most frequently say they are concerned with pollution (52%). But given multiple choices, large numbers also identify climate change (45%), waste and recycling (40%), water use (33%), and renewable energy (32%) as the issues they care most about.

On the social side, investors were most concerned with human rights (54%), but large numbers also cited employee health and safety (45%), economic inequality (38%), labor practices (29%), and gender equality (27%). Surprisingly, there was a high level of consistency in the ranking of these issues across age groups and gender with two big exceptions: 1) women (31%) are more likely to care more about gender equality than men (24%); and 2) members of the Silent Generation (53%) care more about employee health and safety than the global population (45%).

In the area of governance, bribery and corruption (60%) ranked highest. Many investors are also concerned with transparency (48%) and business ethics (43%), while executive compensation (23%) and shareholder rights (22%) rank lower. One slight, surprising difference of opinion can be found in concerns about transparency, as Baby Boomers (52%) and the Silent Generation (56%) were more likely to care about the issue than Millennials (44%) or Generation X (48%).

Action and engagement

In terms of monitoring and managing ESG exposures within their portfolio, investors even show clear preferences in what actions they want to take when a violator is brought to light. Sin stocks (weapons, tobacco, gambling companies) garner the strongest reactions from investors. When asked how they would like to handle these stocks in their portfolio, 44% would want to sell, while 18% would want to engage with the company. Only 20% said they would continue to hold the companies, a number that corresponds directly to the number who say they do not consider their personal values when investing.

Investors are split in how they would react to polluters in their portfolio. In this case, 35% would want to sell the holding, and another 29% would want to engage with the company in question. It is interesting to note that Millennials (35%) are more likely to want to engage with the polluter than other investors, which is in keeping with this generation's activist reputation.

What matters most to investors when it comes to the E, the S and the G?

Source: Natixis Investment Managers 2018 Global Survey of Individual Investors

Investors express similar sentiment toward companies that seek influence by making political contributions to gain preferential treatment: 32% would sell, and 25% would look to engage, while 23% would hold. Investors are somewhat more inclined (30%) to engage with companies that lack diversity or gender equality in top management than they are to sell (25%). As with other issues, Millennials are most clear in their preference with 37% seeking engagement here as well, indicating that they are looking to do more than just align investments to their values and instead want to take action.

Based on the positive perceptions held by both individual and professional investors, it would appear that ESG should be a central point in the investment discussions across the globe, but a deeper look at the challenges identifies an information gap that may be impeding more widespread adoption.

Closing the information gap

When asked what they consider to be a challenge with ESG investing, institutions most frequently cite what they perceive to be the lack of an established track record (43%) and that they find it difficult to measure performance (43%). These reservations may not be founded in fact. ESG investing is not a new practice at all. Even though growing interest in ESG has brought a number of new entrants to the field, there are managers with 20-plus years of experience with impact investing, thematic strategies, and even the negative screens many associate with old-school socially responsible investing.

In terms of performance reporting, professional investors have more tools at their disposal than ever before. For example, the MSCI ESG Index Family provides an integrated solution for examining environmental, social and governance factors, flagging outliers in institutional portfolios and providing company performance factors. The index does not exclude industries or sectors; instead, companies within a sector are ranked relative to each other.

For mutual funds, Morningstar has partnered with ESG specialist Sustainalytics for sustainability ratings that measure how well fund holdings manage ESG risks and opportunities as compared to their peer group.

Top 5 Reasons Institutions Implement ESG

1. Align investment strategies with organizational values (59%)
2. Minimize headline risk (38%)
3. Mandated by investment policy (30%)
4. Generate higher risk-adjusted returns (20%)
5. Benefit from new sources of diversification (14%)

Source: Natixis Investment Managers 2018 Global Survey of Institutional Investors

In addition, leading investment publishers including Barron's, Thomson Reuters, and Bloomberg have introduced ESG rankings and tools to support ESG analysis.

When it comes down to evaluating ESG performance, institutions deploy a wide range of these tools and other strategies in their ESG analysis. Most frequently they turn to sustainability ratings (70%) in this part of their analysis. But many also rely on company reports (57%), rankings and awards (37%), regulatory filings, news reports (24%), and non-governmental organizations (23%). What appears to be critical to continued growth is more broad-based availability and acceptance of third-party evaluation standards, the most ubiquitous of which are the Sustainable Development Goals.

Who do institutions rely on to manage ESG strategies?

	Global	Asia	Europe	Latin America	Middle East	No. America	UK
In-house team	51%	36%	57%	46%	39%	51%	52%
Outsourced CIO	24%	9%	21%	—	—	43%	20%
Third-party manager	33%	37%	40%	36%	23%	25%	36%
Institutional consultant	23%	24%	11%	—	67%	16%	40%

Source: Natixis Investment Managers 2018 Global Survey of Institutional Investors. Question sample size=486 respondents, 38.7% of whom indicated they do not invest in ESG strategies.

Information, individuals, and financial professionals

Information is also key for individual investors. One important factor to be addressed is the need to validate investors' decisions to align their values and their portfolio. We see that despite wanting the ability to make this alignment, about half of those surveyed (47%) think that their investments can actually have a positive impact on the world. But one number does not tell the whole story.

Looking at generational differences in the investor data shows a significant split between the attitudes of younger investors and older investors. When posed the same question, 56% of Millennial investors said they believe their investments can have a positive impact on the world, while 48% of Generation X, 41% of Baby Boomers, and just 30% of the Silent Generation share the same belief.

Impact reporting is one way to help address investors' beliefs and motivations. This may not only be needed to enhance adoption of ESG, but it may also be needed to improve clarity about investing overall. For example, only 52% of those surveyed say they are aware of the companies and products their assets go to when investing in a mutual fund. Fewer (47%) say they have all the information they need to make socially responsible investment decisions.

For professionals, closing the information gap could be a significant step to enhancing long-term client relationships.

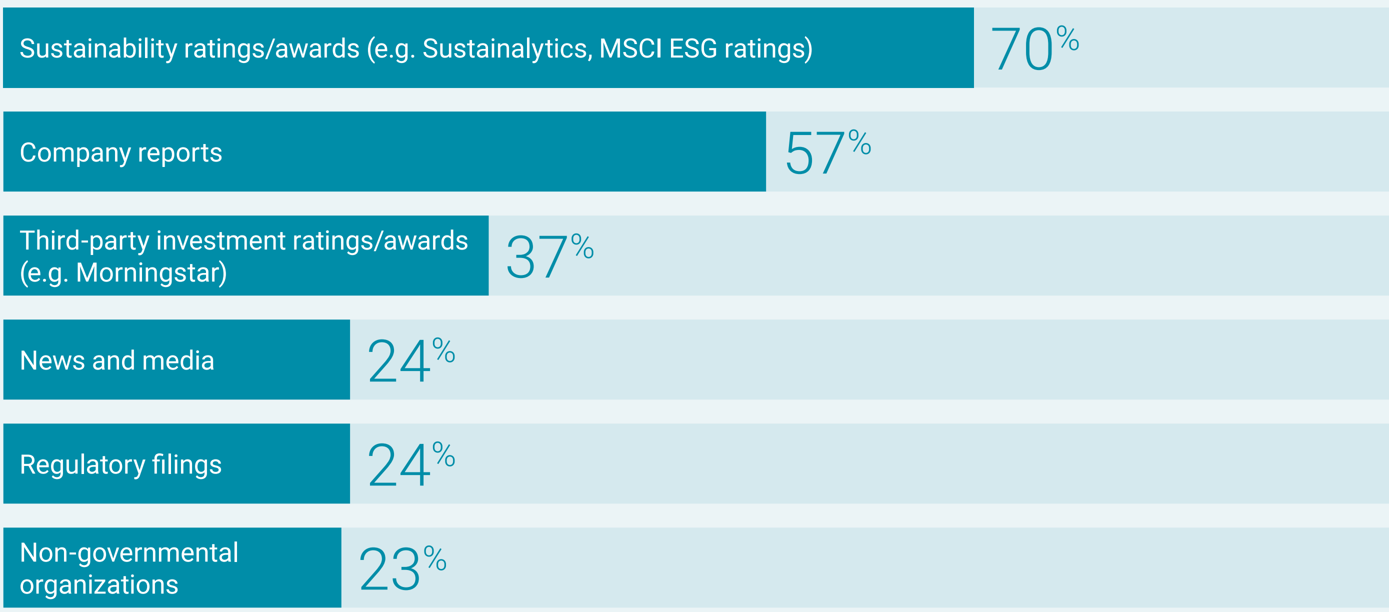
Considering that 88% of financial professionals globally say the key to their success is their ability to demonstrate value above and beyond asset allocation, being more attuned to client values could be a clear point of differentiation. But in the analysis of individual and professional perception, the conversation that's happening today could be clearer.

> Professionals see that ESG analysis offers potential benefits on the risk side of the investment equation.

Despite the large number of investors who think it is important to align their investments with their value, only one-third of advisors believe clients are asking more for ESG. Advisors may be slow to recognize an important investment trend: With investor interest increasing, only 15% of financial professionals think they need to get better at explaining ESG.

Beyond better investor conversations, there are many steps the financial industry can take to ensure that individuals, institutions, and other professional investors are in the position to realize their desire to align their investments with their personal and organizational values.

Where do institutions turn when evaluating ESG?



Source: Natixis Investment Managers 2018 Global Survey of Institutional Investors

Three steps to ensure greater acceptance across the investment value chain

There are some who look at ESG investing, see the increased due diligence and analysis, the potential for new sources of alpha, and the potential risk management benefits, and say that it should just be called investing. But the road to such broad-based acceptance is not without its challenges. As a result, the investment industry – including institutional investors, investment distributors, financial professionals and asset managers – will need a concentrated effort to address three key goals:

1. Enable investors to align their assets with their personal values.

   This will require better investor education to help them understand the strategies that will let them state these values in investment terms. Not only will financial professionals need to actively listen for how investors express this preference and what they want to accomplish with their money, but also engage in better education and training on the ESG strategies that help clients realize this goal – be it values alignment, better risk management or influencing corporate behavior.

2. Make ESG part of the investment performance discussion.

   One of the key questions for investors is whether the investments they choose to support their values are actually delivering on that objective. Asset managers who promote ESG investments have a responsibility to report not only on their investment performance but on how well their funds have delivered on ESG goals. For example, can they demonstrate that their integration strategy has enhanced risk-adjusted returns? Or can they demonstrate that their screening process has either helped them avoid bad risks or helped them capitalize on top performers?

   Investors clearly outline their interest in ESG strategies; the industry should do its utmost to prove they can deliver.

3. Put everyone on the same page with clearer definitions of what is meant by ESG.

   It starts by establishing consistent terminology on ESG, such as the taxonomy to be proposed by the EU Technical Expert Group on Sustainable Finance, which is slated to deliver its recommendations in June 2019. But it also means establishing clear standards for identifying which strategies will help investors achieve which motives and standardized reporting on which investments help investors achieve which goals.

Investing involves risk, including the risk of loss. Sustainable investing focuses on investments in companies that relate to certain sustainable development themes and demonstrate adherence to environmental, social and governance (ESG) practices; therefore the universe of investments may be limited and investors may not be able to take advantage of the same opportunities or market trends as investors that do not use such criteria. This could have a negative impact on an investor's overall performance depending on whether such investments are in or out of favor.

Surveys cited: Natixis Investment Managers, Global Survey of Financial Professionals conducted by CoreData Research in March 2018. Survey included 2,775 financial professionals in 16 countries.

Natixis Investment Managers, Global Survey of Individual Investors conducted by CoreData Research, September 2018. Survey included 9,100 investors from 25 countries.

Natixis Investment Managers, Global Survey of Individual Investors conducted by CoreData Research, February-March 2016. Survey included 7,100 investors from 22 countries.

Natixis Investment Managers, Global Survey of Individual Investors conducted by CoreData Research, February-March 2017. Survey included 8,300 investors from 26 countries.

Natixis Investment Managers, Global Survey of Institutional Investors conducted by CoreData Research in September and October 2018. Survey included 500 institutional investors in 28 countries.

The Natixis Investment Managers Global Survey of Professional Fund Buyers was conducted by CoreData Research in October and November 2018. The survey included 200 respondents in 22 countries throughout North America, Latin America, the United Kingdom, Continental Europe, Asia and the Middle East.

Alpha: A measure of the difference between a portfolio's actual returns and its expected performance, given its level of systematic market risk. A positive alpha indicates outperformance and negative alpha indicates underperformance relative to the portfolio's level of systematic risk.

The MSCI ESG Universal Index Family is the latest in a suite of MSCI Indexes and tools designed to help institutional investors globally integrate ESG into their investment decision-making processes.

Barron's Top 100 Most Sustainable U.S. Companies was compiled by Calvert Research and Management, based on hundreds of metrics that address environmental, social, and corporate governance, or ESG, factors.

Bloomberg makes ESG data relevant and actionable for financial market participants by collecting, verifying and sharing this data from more than 11,500 companies in 83 countries. Investors can incorporate ESG data into their financial analysis, generating critical insights into risks and opportunities in the evolving global economy.

Sustainalytics is the leading independent global provider of ESG and corporate governance research and ratings to investors.

Thomson Reuters ESG Scores are designed to transparently and objectively measure a company's relative ESG performance, commitment and effectiveness across 10 main themes (emissions, environmental product innovation, human rights, shareholders, etc.) based on company-reported information. An overall ESG Combined Score is further calculated which discounts the ESG Score for news controversies which materially impact the corporations.