RBC Dominion Securities Inc.

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Responsible investing

Aligning personal values and investments

Prepared by the Canadian Investment Committee

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Wealth Management
Dominion Securities

Responsible investing

Aligning personal values and investments

Responsible investing is an umbrella term that encompasses a broad range of investing approaches, including socially responsible investing (SRI); environmental, social, and governance investing (ESG); and impact investing.

Amid mounting awareness and concern about environmental degradation and socioeconomic inequalities, the different responsible investing approaches provide investors with an efficient means to align their values with their investments.

Many individuals are choosing responsible investing because of its unique ability to combine the goals of financial success and social impact. Recognizing that investors have a diverse set of values and goals, responsible investing also allows for personalization to tailor portfolios that better reflect the unique objectives of each investor.

Choose an approach that is right for each investor

Responsible investing is any investment strategy that considers financial and non-financial factors. Asset classes and individual securities are selected for their ability to achieve an investor's specific investment goals as well as for their ability to align with and support an investor's personal values.

The application and objectives may vary, but the common element in responsible investing is the consideration of factors beyond traditional fundamental and valuation metrics (see table on page 2).

It is here to stay

A popular misconception about responsible investing is that it is a niche investment style or a trend. We believe there is a broader story at play.

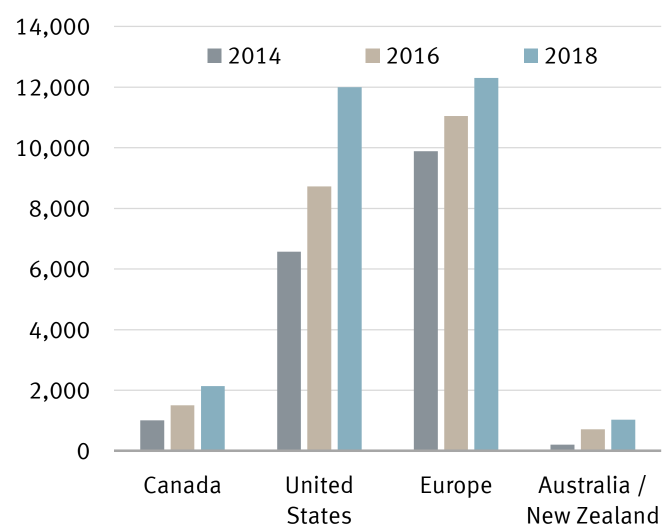
Responsible investing, once viewed as a specialist approach confined to a relatively small group of investors, has swiftly become part of the global investment mainstream. As of 2019, more than 2,000 asset managers had signed on to the Principles for Responsible Investment (PRI), a leading global network established by the United Nations in 2006 for investors committed to integrating ESG considerations into their investment decision making. These signatories collectively oversee over US$80 trillion in assets under management.

In Canada, too, investors are putting money behind their personal-value convictions. Demonstrating the rapid adoption rate, assets in Canada managed using at least one responsible investing strategy reached roughly $2.1 trillion at the start of 2018, more than doubling from approximately $1 trillion in 2014, according to data compiled by the Global Sustainable Investment Alliance (see chart).[1]

Evolving investor attitudes and preferences explain—and will continue to reinforce—the building momentum of responsible investing strategies in the years ahead, in our view. A recent survey conducted by Canada's Responsible Investment Association revealed that 72% of respondents expressed interest in responsible investing strategies, up from 60% in 2018.[2] This was particularly evident amongst women and younger investors, including a resounding 81% of investors aged

Responsible investing assets by region in local currency

(In billions)



Source - Global Sustainable Investment Alliance; data through 12/31/18

[1] See "2018 Global Sustainable Investment Review", Global Sustainable Investment Alliance.

An overview of responsible investing approaches

	Socially responsible investing (SRI)	Environmental, social, and governance (ESG)	Impact investing
How it works	Create or withdraw support for companies/sectors in a portfolio that do/don't meet personal values. Also known as values-based or ethical investing, SRI strategies involve **negative** and **positive** screening of companies, industries, or sectors to make a financial influence that match their values.	Support companies that perform well on environmental, social, and governance metrics. ESG strategies apply a **positive** screen to search for companies with leading ESG metrics, such as what is shown below.	Support social or environmental issues with the expectation of measurable results. Impact strategies seek to generate a **measurable, positive social, or environmental impact**, and financial returns are often secondary to the mission, though not irrelevant.
	• Portfolios may **remove sectors and companies** with characteristics that do not meet an individual's values or responsibility standards. Common examples include companies that produce **alcohol, tobacco,** and **weapons**. • Portfolios may **increase exposure to sectors and companies** having characteristics aligning with an individual's values or responsibility standards. Common examples include companies involved in **social housing** and **renewable energy**.	• **Environmental concerns** including climate change, natural resources conservation, pollution and waste management, and water scarcity. • **Social issues** such as corporate philanthropy, community and government relations, workplace health and safety, human rights, and diversity. • **Governance topics** including accounting practices, board accountability and structure, disclosure practices, executive compensation, corporate ethics, regulatory compliance, and transparency.	• **Impact investing is not charity**. It is an investment where an investor is hoping, first and foremost, to generate social or environmental impact by funding specific initiatives. • An impact investor also wants to **earn a return on his or her investment**. However, the investor may be willing to accept lower-than-market return rates as long as the investment delivers tangible results. In that way, it is essential to be able to measure the impact of this investment.
Examples	• Religious organizations may choose to remove investments that produce contraceptives, and Sharia (Islamic law)-compliant investments may remove investments that collect interest. • A popular modern application of negative screening is a Fossil Fuel Free portfolio.	• Portfolios focus on non-financial factors the managers believe play a material role in determining the risk and return of the company being evaluated. • Common examples include entities involved with sustainable energy or that have strong records in promoting diversity or human rights.	• Common examples include investments in low-income housing loan assistance, clean energy, and water access in emerging countries; or micro-loan initiatives to women-owned small businesses. • In the examples, a tangible impact can be measured (i.e., number of households able to afford housing, electricity, and water access, or number of businesses started).

Source - RBC Wealth Management

18–34. Most importantly, interest was up across all demographics, regardless of age and gender.

Within a generation, RBC Wealth Management estimates that US$4 trillion will be passed down to inheritors in Canada, the U.S., and the UK, marking one of the largest inter-generational transfers of wealth in history as Baby Boomers age.[3] As younger investors accumulate wealth, their collective investing preferences will increasingly reshape how investment decisions are evaluated and bolster demand for responsible investing strategies.

Responsible investing has taken root. We believe factors ranging from evolving investor mindsets and preferences to regulatory reforms and risk management are set to remain powerful long-term drivers of broadening and deepening investor engagement across an expanding spectrum of responsible investing strategies.

Numbers speak louder than words

Another common misconception is that responsible investing typically has a negative impact on performance. We believe this claim is an overly simplistic generalization in light of the considerable improvement in ESG research and the growing sophistication of responsible investing approaches in recent years.

As investor conviction in responsible investing has grown, so too has the breadth and depth of the accessible strategies. Painting all responsible investing approaches with the same brush overlooks the fact that each investor has his or her own set of values and goals, as well as the growing diversity of strategies available to meet those unique objectives.

Admittedly, there are certain strategies that could have an impact on relative performance. An example would be fund products that employ extensive negative screening to systematically exclude specific sectors and industries, such as the oil & gas sector, which could serve as a source of performance deviation compared to the broad market in terms of return and risk characteristics.

If we take a step back to look at the robust amount of academic research on broader responsible investing approaches, such as ESG factors, for insight on potential performance impact, we see that the weight of the evidence suggests there is no material performance disadvantage associated with ESG portfolios over the long term.

In an article published in the Journal of Sustainable Finance & Investment, researchers aggregated evidence from more than 2,000 studies that evaluated the relationship between ESG factors and performance. This was by far the most comprehensive study on this topic and it found that 90% of these studies showed ESG had, at worst, no impact on performance. Within that 90%, the majority of the studies showed a positive impact on performance when ESG factors were considered.[4]

Closer to home, the historical performance of Canadian ESG indexes appears consistent with the findings of academic literature, underscored by long-term returns

Select Canadian ESG index performance

	Annualized returns				
	1 year	3 years	5 years	7 years	10 years
MSCI Canada ESG Universal Index	-9.9%	1.0%	2.9%	6.4%	5.3%
MSCI Canada ESG Leaders Index	-10.7%	0.9%	4.1%	7.6%	6.4%
S&P/TSX Composite	-7.9%	1.3%	2.5%	5.6%	5.0%

	Annualized volatility				
	1 year	3 years	5 years	7 years	10 years
MSCI Canada ESG Universal Index	31.4	19.6	17.3	15.6	15.2
MSCI Canada ESG Leaders Index	31.1	19.5	17.3	15.6	15.4
S&P/TSX Composite	31.4	19.6	17.3	15.6	15.3

Source - Bloomberg; data through 4/30/20

2 See "2019 RIA Investor Opinion Survey", Responsible Investment Association.

3 See "2017 Wealth Transfer Report", RBC Wealth Management.

4 See "ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies", Journal of Sustainable Finance & Investment, December 2015

and volatility outcomes that are largely in line with the broad market (see table).

Like any investment strategy, responsible investing approaches can experience periods of mediocre performance. To counter short-term performance fluctuations that can test investors' patience, we believe it is crucially important to approach responsible investing with a long-term ownership mindset.

Research shows that well-governed companies that manage ESG issues well can benefit in several ways, including: lower cost of capital, lower risk, better operational performance, and stronger shareholder value creation.[5] Maximizing the likelihood of reaping these potential benefits requires investors exercise discipline and adopt multi-year horizons.

Potential for behavioural resilience

There will likely always be some lingering qualms about whether investors will abandon responsible investing after periods of middling performance. Our sense is that such a view may be too superficial because it does not take into account how the behavioural motives behind the pursuit of sustainable investing may, in fact, improve investor behaviour.

Interestingly, a recent study on the "investor return gap"—which seeks to measure the difference between the average return for a fund and what the average investor actually received in returns within that fund—suggests sustainable investing can potentially enhance investor behaviour. This so-called return gap is typically negative and exists mainly because of behavioural inefficiencies, in particular investors' tendency to buy and sell at inopportune times.

The study, which looked at over 800 U.S. mutual funds of varying styles from 2008 and 2018, revealed that investors, on average, lost roughly 1.80% per annum due to the costs of mistimed buy and sell decisions, compared to roughly 0.95% for the average investor in funds with a sustainable, social, or impact focus.[6]

This is just one study, and more research is needed to corroborate the results. Nevertheless, the initial findings are encouraging. One possible explanation for the better return gap of ESG funds is that, by better understanding "what matters" to investors and incorporating those personal values into their portfolios in a transparent way, it can help reduce reactionary impulses when market volatility inevitably flares up, thus helping investors stay invested through periods of inevitable market turbulence.

A diverse array of ESG considerations

Many components of responsible investing are not new. Corporate governance, for example, has long been a critical element in the due-diligence process for evaluating companies in areas such as prudent accounting practices and diverse and independent board of directors, which are issues that play a role across all companies in all sectors.

Over the past decade, the advancement of ESG research has significantly enhanced the availability and quality of ESG data that can bring new insights to investments (see table). Understanding ESG exposures associated with companies can inform investors about risks and opportunities in a way that is complementary to

Some examples of ESG factors

Environmental (E)	Social (S)	Governance (G)
Climate change	Working conditions (incl. slavery and child labour)	Executive pay
Greenhouse gas (GHG) emissions	Local communities (incl. indigenous communities)	Bribery and corruption
Resource depletion (incl. water)	Health and safety	Board diversity and structure
Waste and pollution	Employee relations and diversity	Tax strategy

Source - UN Principles for Responsible Investment

[5] See "Sustainable Investing: Establishing Long-Term Value and Performance", Sustainable Investing, 2012 and "From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance", Journal of Sustainable Finance and Investment, 2015.

[6] Derek Horstmeyer, George Mason University. Study compared the return gap on 864 mutual funds with stated sustainable, social, or impact focus to the Morningstar data set on traditional funds.

traditional fundamental analysis focused primarily on business/industry metrics and financial statements.

Gradually, then suddenly

Skepticism about any investment strategy is normal, and responsible investing is no different. We believe healthy critique around responsible investing should be welcomed, as it can help fuel innovation around implementing common standards, sourcing better data, and developing more suitable investment solutions that fulfill different investor needs. This has been one of the key factors behind the increase in the number and growing sophistication of responsible investing solutions in recent years.

More and more investors are concerned about issues ranging from climate change and environmental degradation to inequality and human rights. And they want to do something about it. Thus, for many investors responsible investing can help meet an increasingly essential "want", with an investment approach that can simultaneously help them secure their financial objectives and contribute to changes they want to see in the world.

With rising support coming from different stakeholders—including governments, corporates, and investors—and as investors demand greater corporate accountability and step up their engagement efforts on various environmental, social, and governance issues, the rate of adoption of responsible investing and the integration of ESG factors into portfolios look set to accelerate in the years ahead.

Our responsible investing mission

At RBC, we are proud of our dedication to environmental and social values. RBC is committed to community involvement, diversity and inclusion, and environmental responsibility to help the world become a better place—for current and future generations.

Through the RBC Blue Water Project, RBC has committed to a 10-year, $50 million program to help protect fresh water across the globe. RBC is also dedicated to children through the RBC Children's Mental Health Project, which promotes children's mental health education and awareness, and the RBC After-School Grants Project, which funds organizations that provide safe after-school programs for children.

But it can't just be about us

The broadening range of responsible investing strategies equips investors with different tools to align their values with their investment portfolios, as well as engage companies in distinct ways to affect changes they want to see in the world.

To help make good on our commitment to have a positive social and environmental impact, we must look beyond our own actions and create pathways for people to invest capital in a more responsible manner and one that aligns with their values.

That's why we are pleased to offer responsible investment strategies that can help investors meet their return expectations while having positive social and environmental impact.

From education and information to a robust suite of responsible investing solutions, including those managed by an in-house team of experts as well as a variety of third-party solutions hand-selected by our own experts, investors now have access to the tools to help take the first steps toward integrating their values into their investment portfolios.

Balancing prudent investment strategies with a view toward the impact they have socially, environmentally, and economically has never been easier. RBC has a long history of helping clients thrive and communities prosper. And now we are pleased to enable investors to join us on this journey toward a more sustainable world.

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