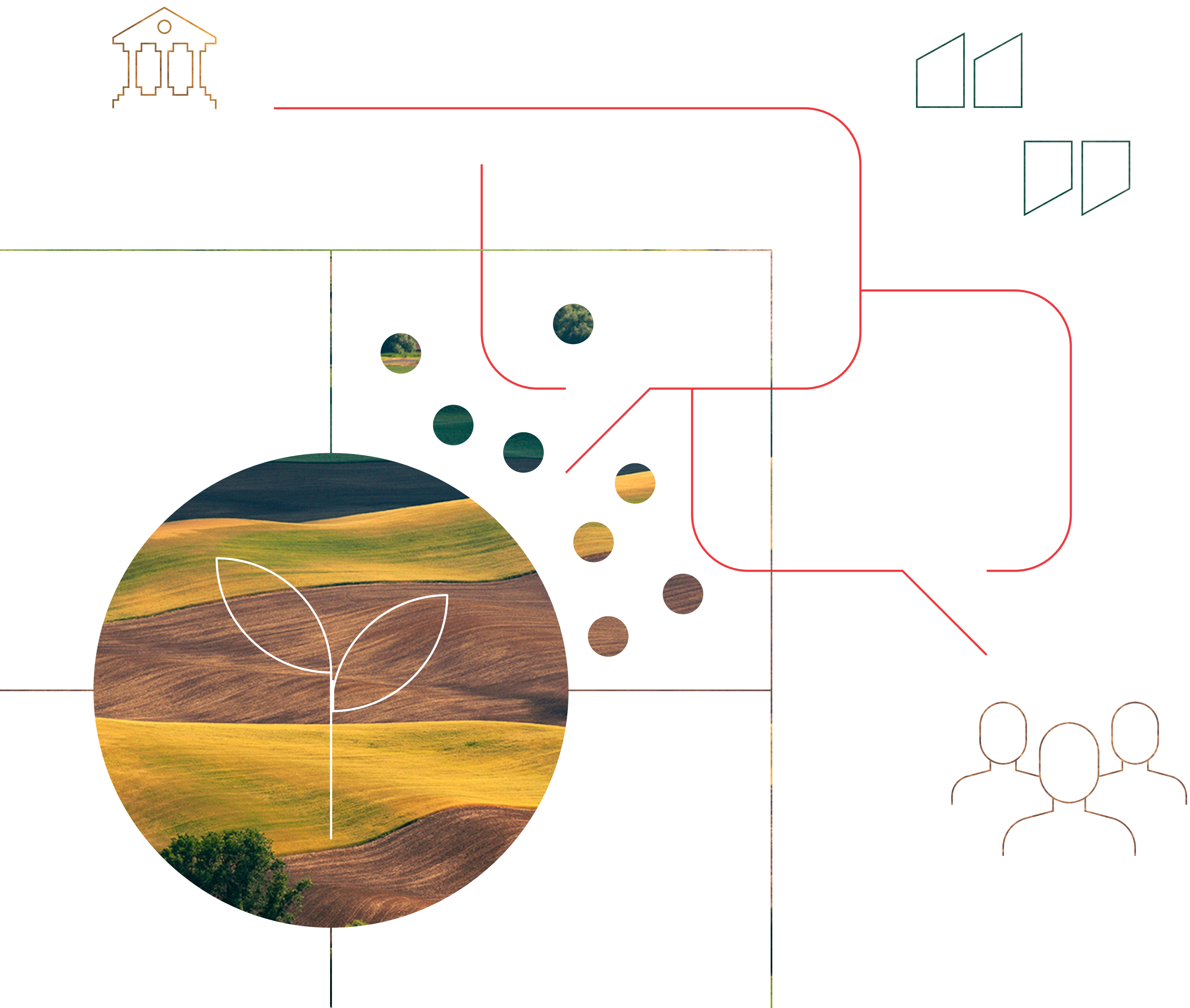
Voice of the Asset Owner Survey 2023

Qualitative Insights

Conducted by Morningstar Indexes and Morningstar Sustainalytics



Thomas Kuh
Head of ESG Strategy, Morningstar Indexes

July 2023

A global survey of institutional investor priorities and perspectives

Introduction

Institutional asset owners (AOs) play an important role in the global capital markets. Acting as fiduciaries, they oversee some of the world's largest pools of capital, steering investment policy on behalf of pension plans, foundations, endowments and sovereign wealth funds.

The largest AOs are universal owners, meaning they own broadly diversified global portfolios and have a long-term investment horizon. Since they "own" the market, they cannot diversify away from negative external costs—such as environmental degradation, biodiversity loss and human rights violations—resulting from corporate activity. These conditions encourage AOs to align with sustainable investment strategies that aim to address externalities through investment decisions, engagement and public policy.

To better understand the motivations, attitudes and challenges of institutional AOs in the current environment, Morningstar Indexes and Morningstar Sustainalytics piloted an annual global survey of asset owners in 2022, and we are conducting our second annual asset owner survey this year.

The annual survey explores topics such as:

- Investment objectives and policies
- Views on current and future investment trends
- The impact of regulatory change
- Key stakeholders and influencers
- The role of ESG in investment decisions and opinions on service providers

Survey findings, gathered through separate qualitative and quantitative outreach to asset owners in North America, Europe and Asia with the help of Opinium Research and Bob Collie of Collie ESG, are used by Morningstar for a variety of purposes. They are useful input for the development of products and services, as a reference tool for the industry, for marketing communications and promotions, and for client education.

Phase one – Qualitative analysis

The first phase of our 2023 study consisted of direct qualitative conversations with ten hand-selected asset owners from a range of institutional types and sizes across North America, Europe and Asia, including one investment consultant. Our intent with these in-depth discussions is to probe for perspectives and issues to help inform our broader quantitative study, to be fielded later this year. Here's what they told us.

THE MACRO ENVIRONMENT

Instability & uncertainty have become the "new normal"

We asked asset owners about their current investment strategy and what influenced their outlook over the last year. Major destabilizing influences on the global economy that were viewed as major threats a year ago—specifically the war in Ukraine and its impact on energy markets—have now become normalized in their eyes.

While recent events that have diminished confidence in the US banking sector have asset owners concerned, the war in Ukraine has faded into the background. Investors are learning to live with higher inflation levels and its impact on investing and are closely monitoring monetary policy. Interestingly, inflation has become a concern with some pension plan managers to the extent it is putting pressure on beneficiaries' ability to meet their financial needs. China is also an area of concern, particularly given geopolitical developments over the last year and the fact that it is such a large part of the global economy. Yet despite all these factors, asset owners are finding places to constructively deploy their capital this year.

> "We have been seeing the impact of the rising cost of living across the UK manifest in an increased number of members taking their retirement benefits compared to years prior to 2022. Younger members have made fewer changes to their savings rates despite rising energy and housing costs. We are mindful of these strains and have recently spoken with members about balancing competing short-term strains and long-term pension savings."

Head of Investments for $3.5 billion EMEA-based DC Master Trust

Regulation as a two-sided coin

Asset owners acknowledge they need regulators to set ESG disclosure standards for companies to improve data comparability and for asset managers to protect investors against greenwashing. They simultaneously recognize the burdens regulation can place on them and the firms they work with across the investment value chain.

> "A lot of my work, whether I like it or not, in the past two years has been focused on regulation. One of the key challenges that I see is that the asset owners have to rely to a large degree on what the asset managers are doing for them to meet their regulatory requirements. However, the implementation speeds are not always aligned and the level of transparency is not always aligned to what the asset owners need."

EMEA-based Independent Investment Consultant

> "There is a mismatch between the regulatory requirements and the standardization of data that becomes available. A lot of different parties report in a lot of different ways, which makes it a lot of comparison between apples and pears."

Senior Controller & Asset Management Lead, $1.6 billion (Euro) EMEA-based Insurer

SUSTAINABLE AND ESG INVESTING

ESG materiality largely overrides ESG politics

Asset owners feel investment uncertainty and unrest to be particularly acute in the US, where political polarization has reached levels beyond economic concerns to affecting societal stability in general, particularly around ESG. One respondent referred to the current political environment in the US as the "weaponization of investment sectors."

> "Because unfortunately (ESG) has become so politicized, we are focused on ensuring that investment managers as well as ourselves as plan sponsors are able to take into consideration any material factor that may affect financial performance of an investment over the longer term."

Chief Investment Officer, $64 billion State Treasury Fund

> "When talking about the 'noise' coming out of some states recently that are quick to criticize ESG, the fundamental flaw is that they don't see ESG issues as investment issues. There are plenty of environmental, social and governance issues that are investment issues, and if they are they should be considered."

MD of the Pension Investment Team for an $17.2 billion North America-based Religious Organization Pension

Yet, despite political pressures, asset owners globally are adamant that ESG considerations are a financially relevant and material part of the investment process. Several AOs commented that ESG-oriented investment considerations are driven by fiduciary duty and, in the words of one AO, to "outlaw (such consideration) entails a breach of fiduciary duty."

Most AOs interviewed see ESG ultimately becoming integrated into mainstream investment practices due to its fundamental materiality.

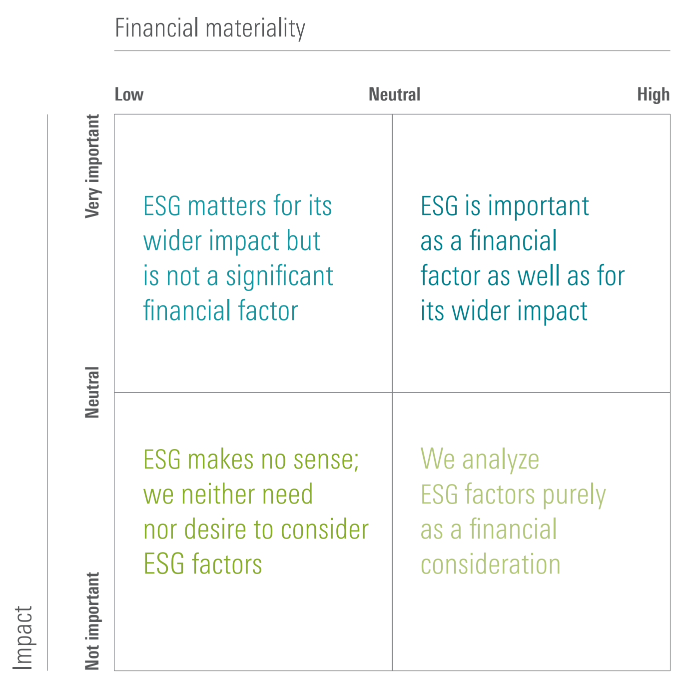
Impact as an investment consideration…as long as it's material

Delving further into the concept of materiality and ESG, we spent a lot of time in our discussions probing on how they view impact and materiality. To gain a better understanding of how AOs view ESG within their investment process and outlook, interviewees were asked to pinpoint their position on the grid below based on how financially material they believe ESG considerations to be in addition to how important they believe are the social and environmental impacts of their investments.

Institutional convictions about the materiality & impact of ESG considerations

Financial materiality
Do you believe that ESG considerations are financially material?

Impact
How important are the social and environmental impacts of your investments?



Not surprisingly, all asset owners saw ESG considerations as financially significant, but there were a range of views on the relevance of impact objectives as goals. Most asset owners give some nod to impact objectives as important, but most see their fiduciary duty as first financial, with impact as a secondary consideration if financial objectives are met. The relationship between financial materiality and impact of course varied by the type of plan.

"Environmental issues are financial issues in analysis, when you think about it, again, extreme weather events, water scarcity, resource scarcity, all those issues are environmental issues that investors who are just pure fiduciaries must consider. But they also happen to align with our call to care for the planet."

MD of the Pension Investment Team for an $17.2 billion North America-based Religious Organization Pension

"ESG and impact are two different things, and when we have them combined as one it leads to additional confusion because there is no set standard on what ESG particularly means."

Chief Investment Officer, $64 billion State Public Treasury Fund

"We wouldn't be applying an exclusion across our equities portfolio that we didn't think had a reputational or a positive financial benefit to the fund. Reputational meaning that it was addressing a risk that could cause severe reputational impact on the fund that we could be losing members. So, we can't just exclude things for moral reasons. We have to have a really clear purpose about why we are choosing to do that."

Portfolio Manager, $20 billion Australia-based Superfund

Broadening & deepening of climate considerations

While asset owners consistently cited climate-related themes and considerations as taking center stage, they are broadening their views beyond carbon to include a larger set of environmental issues, such as biodiversity, and a range of social and governance factors, such as human rights, living wage, diversity, inequality and tax fairness.

"I think much more than 5 years ago, 10 years ago for sure, there's the awareness of climate change as an existential threat, but considering biodiversity—if our natural systems collapse, there's nothing to do any more. That will actually ruin our economy and our society as well. So both climate change and biodiversity are important."

EMEA-based Independent Investment Consultant

"There is going to be significant capital going to solve climate change and climate issues over the next 10 years, and as investors shouldn't we be getting our portfolios in the way of those asset flows, capitalizing on those flows and avoiding those risks. Those are the kind of conversations that are happening today and need to be happening today."

MD of the Pension Investment Team for an $18.5 billion North America-based Religious Organization Pension

In addition to their own work on climate within their plans, AOs are also actively engaged with climate advocacy groups globally. They cited multiple groups, including Climate Action 100+, PRI and the Council for Institutional Investors.

More–& better–tools needed!

Asset owners acknowledge that ESG data and analysis continue to improve, but they are still looking for better data and tools for use in decision making—a desire they voiced in last year's survey as well. They recognize that "ESG" does not mean the same thing to everyone, and the data currently available doesn't make it easy to consistently measure it. AOs interviewed agree that better internal portfolio tools and external metrics would help them more effectively deal with rapidly increasing regulatory reporting demands. While they continue to invest resources to develop in-house ESG expertise, they appreciate the contributions of, and challenges facing, ESG research providers.

> "I'm probably less concerned than I was about 5 years ago about the volume of products. I'm probably more concerned about the quality of those products… Most of the ESG tools are very equity-heavy; it is really hard to have a portfolio-wide view, or to have even an asset class view of any kind of ESG risks, opportunities or broader themes beyond equity."

Portfolio Manager, $20 billion Australia-based Superfund

> "I think what the entire industry struggles with is standardization of data but then also access to complete data or decision useful data itself. That is certainly something that needs to improve and will continue to be a focus as it relates to evaluating each company. It certainly needs to improve and evolve but we are making progress as we go."

Chief Investment Officer, $64 billion State Treasury Fund

Conclusion & next steps

So, what have we learned? After our conversations with a relatively small, select group of asset owners, we recognize that we have barely scratched the surface in terms of capturing the concerns of the global asset owner community as a whole. But these qualitative conversations help us adapt our broader quantitative survey to reflect the ever-evolving global landscape in which AOs operate.

Based on our qualitative results, some of the key questions and tension points we plan to test in our upcoming global quantitative survey include:

- Has the global investment landscape become more favorable for asset owners in 2023, or are there still major concerns – such as geopolitical instability and inflation - lurking below the surface?
- How are asset owners viewing impact relative to financial materiality when implementing ESG-oriented investment approaches? Is impact just a "nice to have" or is it beginning to have more weight in investment decisions?
- Climate is clearly "king" when it comes to ESG, but how is the dialogue, scope and investment approach around climate broadening and deepening as asset owners become more sophisticated and nuanced?
- Are service providers like asset managers, data and index providers keeping up with the needs of asset owners, or is the gap between need and product availability still too wide?

About Morningstar Indexes

As the fastest growing global index provider for the last two years according to Burton-Taylor, Morningstar Indexes was built to keep up with the evolving needs of investors—and to be a leading-edge advocate for them. Our rich heritage as a transparent, investor-focused leader in data and research uniquely equips us to support individuals, institutions, wealth managers and advisors in navigating investment opportunities across all major asset classes, styles and strategies. From assessing risk and return with traditional benchmarks to helping investors effectively incorporate ESG objectives into their investment process, our range of index solutions spans an investment landscape as diverse as investors themselves. We help investors answer today's increasingly complex questions so that they can more easily reach tomorrow's goals. For more information, visit indexes.morningstar.com.

MORNINGSTAR Indexes

About Morningstar Sustainalytics

Morningstar Sustainalytics is a leading ESG data, research, and ratings firm that supports investors around the world with the development and implementation of responsible investment strategies. For more than 30 years, the firm has been at the forefront of developing high-quality, innovative solutions to meet the evolving needs of global investors. Today, Morningstar Sustainalytics works with hundreds of the world's leading asset managers and pension funds who incorporate ESG information and assessments into their investment processes. The firm also works with hundreds of companies and their financial intermediaries to help them consider material sustainability factors in policies, practices, and capital projects. With 17 offices globally, Morningstar Sustainalytics has more than 1,800 staff members, including more than 850 analysts with varied multidisciplinary expertise across more than 40 industry groups. For more information, visit www.sustainalytics.com.

MORNINGSTAR | SUSTAINALYTICS