FROM UPSTREAM TO MAINSTREAM: ESG AT A TIPPING POINT

Calvert

IN RESEARCH

FOREWORD

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Calvert believes that we are at a pivotal moment for Responsible Investing. A combination of client interest, product availability and global events have placed investments that adhere to environmental, social and governance (ESG) principles squarely in the spotlight.

The data included here is compelling. It indicates that investors across age ranges and income levels are showing greater interest in ESG investing.

Not surprisingly, financial advisors appear to have noticed this trend and are paying more attention. Results from the Q3 2018 Eaton Vance Advisor Top-of-Mind Index (ATOMIX)* survey, which generated responses from more than 600 advisors, found that 79% reported that they incorporate Responsible Investing into their practice. Of those, 44% identified it is an important part of their practices, up from 31% in Q2 2018. In addition, 35% reported increased interest from clients and 60% said Responsible Investing is an ongoing topic of discussion.

Where client and advisor interests go, assets follow. The net flow of assets into sustainable funds rose in 2017, as the growing Responsible Investing trend continued into the new presidential administration. This increased interest has been accompanied by an increase in supply as well. Responsible Investing has grown from a niche product to become progressively more mainstream, and the comprehensive and sophisticated approaches to integrating ESG data with traditional financial metrics allow advisors to take a more holistic approach to wealth management with their clients.

While both client and advisor interest has increased, some advisors acknowledge the need to learn more about this area. More than half (56%) of advisors who responded to the ATOMIX survey said Responsible Investing is driving new business to their practice. However, only 35% classified themselves as "very well-informed" about Responsible Investing. As this mainstreaming of ESG continues, it will become more difficult for advisors to serve clients unless they can close the knowledge gap. The insights contained here should help in that regard.

The next phase

As we enter a new phase in Responsible Investing, Calvert believes that an increasingly sophisticated and savvy client base is demanding more from its portfolios, seeking investments that offer positive impact alongside competitive returns.

While ESG investing traditionally has emphasized negative externalities, "ESG 2.0" adds an emphasis on the positive impact an investment can achieve. Instead of simply avoiding companies with poor ESG behaviors or engaging with them to stop negative behavior, we are recognizing opportunities that arise when companies seize the imperative and use ESG analysis to enhance their strategic position.

When integrated with business and financial analysis, ESG analysis allows investors to examine both risk and opportunity in a more comprehensive way. As the market – and appetite – for Responsible Investing continues to grow, the possibilities for advisors to advance their businesses should rise as well.

*The Advisor Top-of-Mind Index was calculated based on the findings of a survey of 618 financial advisors from a diverse group of companies. Eaton Vance contracted with a third party to conduct the online survey from August 20, 2018 – September 7, 2018.

Introduction: ESG Investing Has Reached Critical Mass

Over the past two decades, ESG interest steadily gained traction among investors. In 2018, that interest has reached a tipping point. Socially responsible investment values went mainstream this year, gaining broader acceptance among generations and wealth groups.

The numbers speak to the groundswell of interest. In a year's time, the percentage of Millennials expressing a high level of interest in ESG investing jumped from 26% to 35%, advisers say, while the percentage of Gen Xers embracing ESG spiked from 16% to 25%.

This is more than a generational story, however. Interest has also grown up the wealth spectrum. Twenty-six percent of ultra-high-net-worth investors now show a high level of interest in ESG investing, advisers say, up from only 10% in 2017. Similarly, interest among very-high net worth investors shot from 13% to 19% in a year's time.

Advisers are taking note. As more clients demand that ESG factors get utilized in their portfolios, the adviser community has reached its own responsible investing turning point. A growing number of advisers are ramping up their understanding of ESG investing and using that knowledge to attract new clients.

This paper explores the critical issues concerning both investors and advisers as ESG investing reaches critical mass. Among other issues, it identifies the key drivers of ESG investing among investors and the barriers they see to incorporating socially responsible investing principles in their portfolios. The paper also shares adviser expectations for ESG investing, the areas clients lean on advisers for help, and, importantly, how advisers may use ESG expertise to sustain and grow their practice in the years ahead.

To learn about these and other issues, *InvestmentNews* Research surveyed more than 300 financial advisory professionals and compared their answers to our ESG adviser survey last year. This year, *InvestmentNews* Research also surveyed more than 800 investors to gauge their own attitudes toward ESG investing. The following report details our findings, and their implications for advisers.

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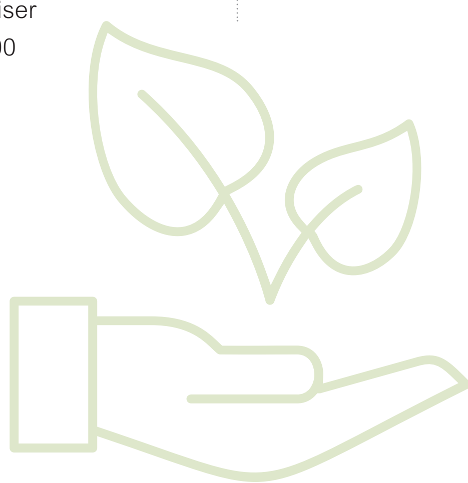
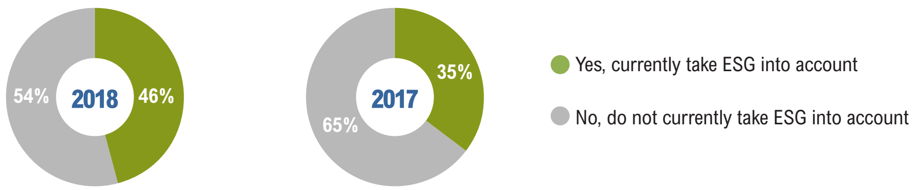


Survey Results: ESG Becoming Increasingly Relevant to Adviser Toolkit

Many advisers readily acknowledge socially responsible investing is becoming a staple to their practice, with two-thirds of those surveyed saying that social and environmental issues are important to the success of their business. For a third of advisers, the importance of such issues grew in the past year.

ESG's growing relevance is reflected in the spike in advisers using it: Forty-six percent of advisers say they take ESG factors into account when constructing client portfolios, an 11-percentage point jump from 2017.

FIGURE 1: Advisers useage of environmental, social, and corporate governance (ESG) factors when constructing client portfolios



Advisers' ESG usage is expected to grow from here. Twenty-two percent of advisers' clients held ESG allocations in 2018. In three years, advisers expect that portion to jump to 34%. The size of the ESG sleeve within the client portfolio is also expected to expand, up from 27% today to 36% in three years.

FIGURE 2: Average percent of clients and portfolio allocations to ESG

	2017	2018	2021 (Projected)
% of Clients with ESG allocations	**17.6%**	**21.9%**	**33.6%**
Average allocation to ESG investments amongst those clients	**17.8%**	**26.6%**	**36.4%**

While many advisers believe socially responsible investment issues are becoming more important to their success, a wide gap remains in how strategically advisers are using ESG to grow their business. Roughly half (51%) of advisers believe acquiring greater ESG expertise investing will help them attract new clients. Belief and utilization are different, however. Only 29% of advisers are currently using ESG investments to attract new clients. On the other end of the spectrum, nearly a fifth (19%) of advisers say there are still no benefits to learning about ESG.

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ESG Interest Climbs Among Gen X, Millennials and Wealthier Clients

Our adviser survey shows ESG interest is moving up the generational ladder and up the wealth spectrum. Millennials were quicker than other generations to embrace socially responsible investing, and their interest rose sharply this year. More than a third of advisers characterize millennial client interest as "very" or "extremely" high, up from 26% last year. ESG principles also gained considerable traction among Gen Xers, where a quarter of the generation expresses a high level of interest to advisers, up from 16% in the prior year. Notably, ESG investing now commands attention from a meaningful portion of baby boomers (15%).

Advisers may be underestimating the interest from non-millennial generations. Our survey revealed a higher portion of Gen X, baby boomer and silent generation investors expressing a "very" or "extremely" high level of ESG interest than advisers indicated.

FIGURE 3: Investor and Advisers' client interest in ESG (Extremely/Very Interested)

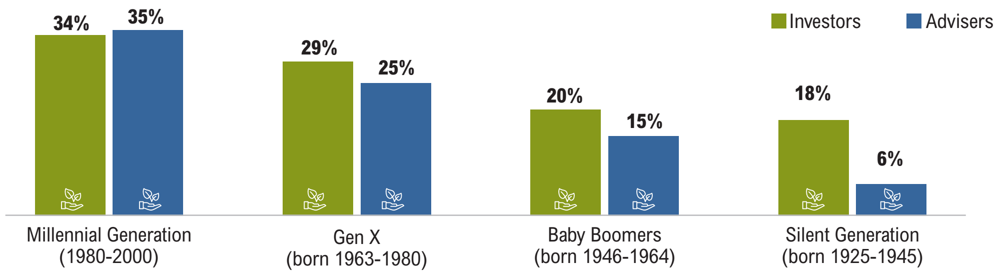
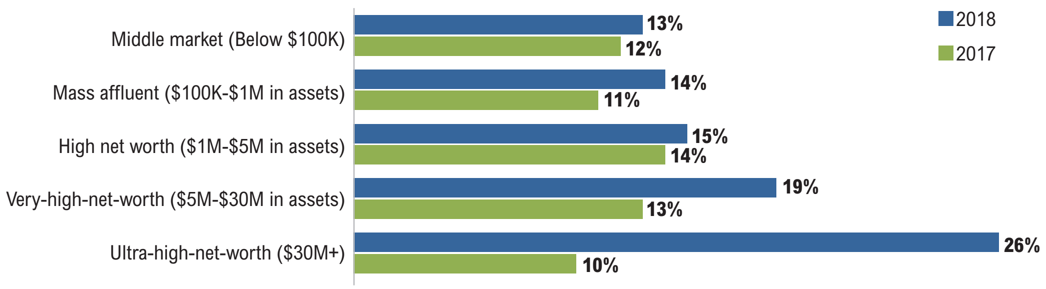


FIGURE 4: Advisers' client interest in ESG (Extremely/Very Interested)



This year, our survey also revealed a relationship between client wealth and ESG views, with higher wealth segments also showing a higher level of interest. The chart below shows the heightened enthusiasm among ultra-high-net-worth and very-high-net-worth investors.

A substantial portion of these wealthier investors want to employ ESG strategies through a financial adviser. Forty-three percent of high-net-worth investors and 39% of very-high-net-worth investors say they would go about ESG investing with an adviser, while 36% and 43%, respectively, would take a do-it-yourself approach. Only 21% of high-net-worth investors and 26% of very-high-net-worth investors would prefer an online platform to conduct ESG investing.

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While more clients are turning to socially responsible investing, a considerable gender gap still exists, with females (33%) embracing ESG at a higher rate than males (21%).

Both advisers and investors agreed on some of the main factors driving ESG interest this year. Those include greater media exposure, personally witnessing the effects of client change and wanting to improve it and a desire to respond to some of the environmental policies the new presidential administration has enacted.

Environmental Issues Draw Investors In, Lack of Expertise Holds Them Back

Environmental factors continue to dominate client conversations about ESG. In our survey, 43% of advisers say that climate change was one of the most commonly prioritized ESG criteria in client meetings, followed by emissions and waste (35%) and clean technology (32%). Those were the most oft-cited criteria in last year's survey as well. Emissions and waste and climate change criteria saw the biggest increase in interest from last year's survey, up from 26% and 35%, respectively. Interest in items such as clean technology demonstrate how investors are looking not only to avoid investing with companies that have poor environmental track records, but to fund companies solving environmental problems.

While clients may discuss environmental criteria with advisers most frequently, non-environmental issues are also top of mind. In addition to asking advisers what ESG criteria come up most in client meetings, this year's survey also asked end investors to list the three criteria that matter most to them personally. The most oft-cited criteria included Corporate structure/accounting (44%) and cybersecurity/data security (33%).

43%

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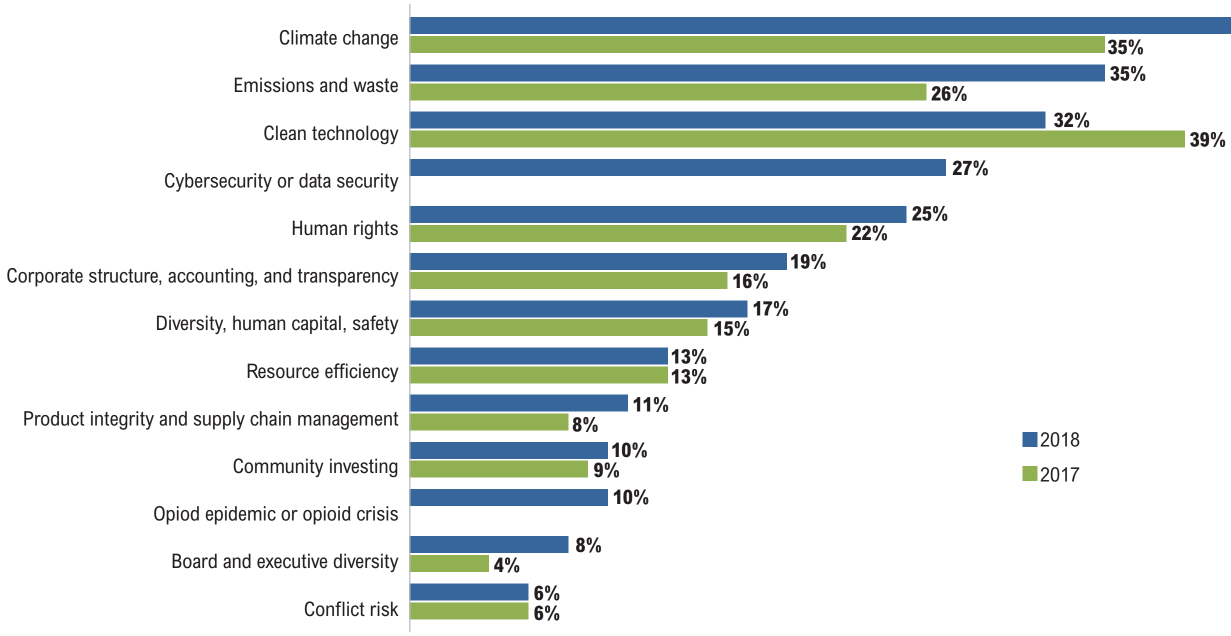
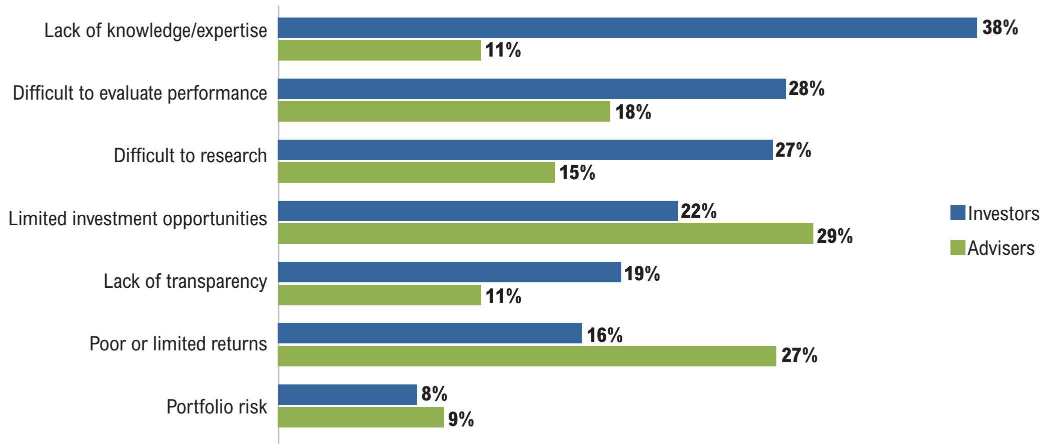
FIGURE 5: Most common ESG criteria brought up by Advisers' clients



Our survey also asked investors about perceived barriers to ESG implementation. The most common impediments included: lack of expertise (38%), difficulty in evaluating performance (28%) and the challenge of researching ESG investments (27%). As the chart below shows, those issues are not stumbling blocks for most advisers. This suggests an opportunity for advisers to add value in their relationship with clients who want to incorporate socially responsible investment principles but have remained on the sidelines.

FIGURE 6: Why Investors and Advisers don't utilize ESG investments

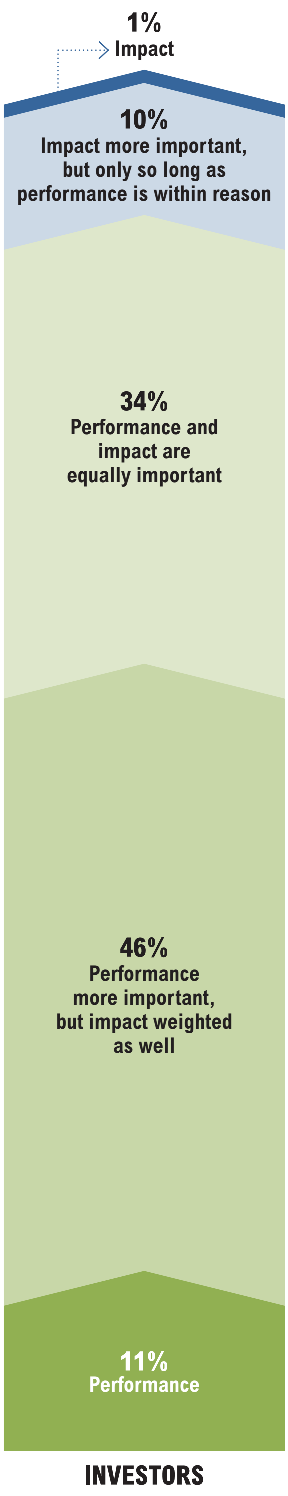


The Investors' ESG Framework: Affecting Change, not Avoiding the Bad

Most clients who incorporate ESG principles into their investments judge success by two factors: performance and impact. Fifty-seven percent of investors say performance is more important than impact when determining ESG investment success. Yet 89% of investors say impact also plays a role when evaluating ESG investment success. Specifically, 88% of investors say it is at least "moderately" important to see the non-financial impact of their investments. Nearly half (48%) say seeing that impact is "very" or "extremely" important.

The desire to see a non-financial impact demonstrates the framework through which investors now view ESG. Most view socially responsible investing not simply as a way to avoid companies with poor environmental, social or governance policies, but as an avenue to funnel resources toward those companies that are actively improving the environment or working to solve societal inequities.

FIGURE 7: How investors determine the success of an ESG investment



Conclusion: Actionable Insights for Advisers

Socially responsible investing has reached an inflection point. As a growing cohort of clients seek positive societal change from their investments, advisers will need to embrace ESG principles for the survival and growth of their business. The following insights can help advisers stay relevant and improve their practices as socially responsible investing becomes mainstream:

- **Interest is growing … everywhere.** Advisers can expect ESG to come up in conversations with any client. While millennial interest is rising fastest, a quarter of Gen Xers also express a high level of ESG interest to advisers and 15% of baby boomers also express high interest. Further, our survey finds a link between wealth and ESG interest, with wealthier clients embracing socially responsible investing at a higher rate.
- **Advisers may be underestimating the ESG opportunity with older generations and females.** Our survey shows that advisers underestimate the percentage of Gen X, baby boomer and silent generation clients who are interested in ESG. They also underestimate female investor interest, which remains substantially larger than male interest.
- **Wealthy clients look to advisers for personal help with ESG.** A far greater percentage of high-net-worth and ultra-high-net worth investors would prefer to build an ESG portfolio through a financial adviser than through an online platform.
- **Clients need advisers to bridge the gap when it comes to ESG education, performance evaluation and research.** These were the three greatest impediments investors see toward implementation. None of those areas presented a barrier for most advisers.
- **Socially responsible investing expertise can be a competitive advantage for savvy advisers.** Half of advisers believe acquiring greater expertise in ESG investing will help them attract new clients, but only 29% of them say they are actively using ESG to win business. Those who take the lead in learning, discussing and helping clients with ESG investing may put themselves in pole position to win clients as socially responsible investing trends push forward.
- **Clients want to see both performance and impact from ESG investing.** For the vast majority of investors, performance remains the key determinant of ESG investment success, but most clients believe it is also important to see the non-financial impact of their investments.
- **The client conversation should pivot toward how investments are affecting positive change, not just "avoiding the bad."** Most investors don't perceive ESG solely in terms of avoiding companies with poor environmental, social or governance track records. Instead, they view ESG as a way to allocate resources toward companies solving environmental and social issues. Advisers who fail to frame the ESG conversation this way may be out of touch with their clients' mission and values.

INResearch

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About Calvert

Calvert Research and Management is a recognized leader in Responsible Investing. Our mission is to deliver superior long-term performance to our clients and to enable them to achieve positive impact.

Calvert Research and Management traces its roots to Calvert Investments, which was founded in 1976 and was the first to launch a socially responsible mutual fund that avoided investment in companies that did business in apartheid-era South Africa. Today, the Calvert Funds are one of the largest and most diversified families of responsibly invested mutual funds, encompassing actively and passively managed strategies, U.S. and international equity strategies, fixed-income strategies, and asset allocation funds.

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