IMPACTONOMICS

GLOBAL INSTITUTIONAL CONSULTING

Institutions and ESG: On the Rise

Chief Investment Office

DECEMBER 2018

If your board is considering adding environmental, social or governance factors to your institution's portfolio or policy, give members more information and more opportunities for discussion.

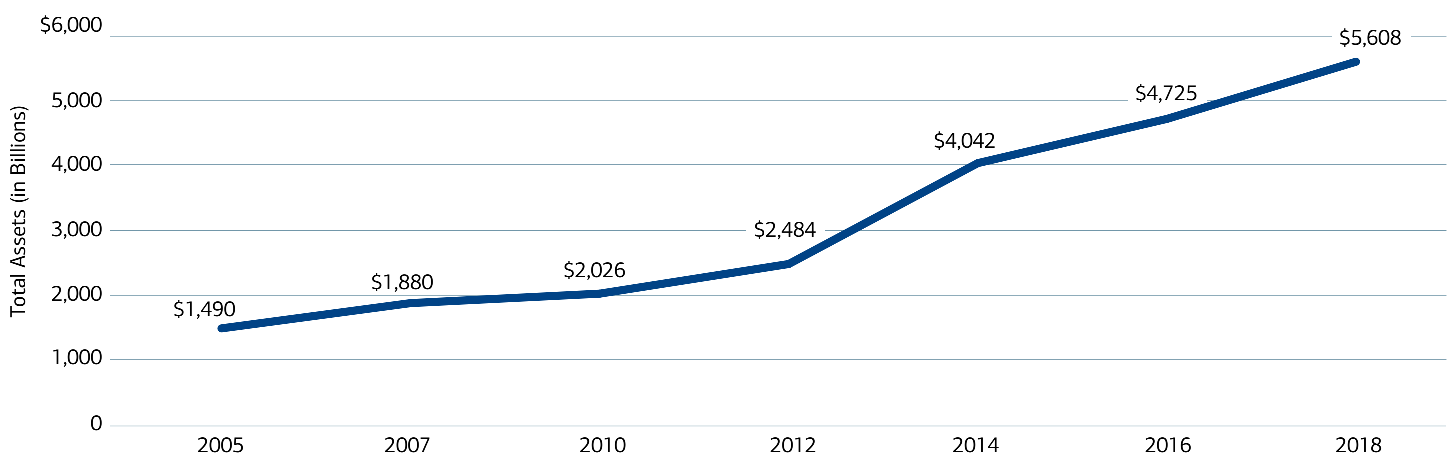
For some institutional board members, incorporating environmental, social and governance (ESG) factors into an investment policy statement (IPS) or investment portfolio may seem like an obvious choice to make, especially if they are well informed or passionate about the strategy. Or, if others are less familiar with ESG, or are concerned about its effectiveness as an investment strategy, having access to information and engaging in discussions are essential steps. This primer should provide some of the answers you're looking for as well as raise topics for further discussion.

Rise in Adoption Rates

It may be helpful to know that you are part of a growing community: A broad cross-section of U.S. institutions, from philanthropic foundations to public funds, have added ESG strategy, with many doing so only recently, and a growing number are considering it. Take a look at adoption rates, according to a recent study by the Callan Institute, a research organization:[1]

- Institutional incorporation of ESG climbed from 22% in 2013 to 43% in 2018.
- Boards considering ESG rose from 7% in 2017 to 15% in 2018.
- Among organizations that already incorporated ESG, 39% said in 2018 that they planned to broaden their commitment going forward.

Growth of ESG Incorporation Reported by Institutional Investors 2005-2018



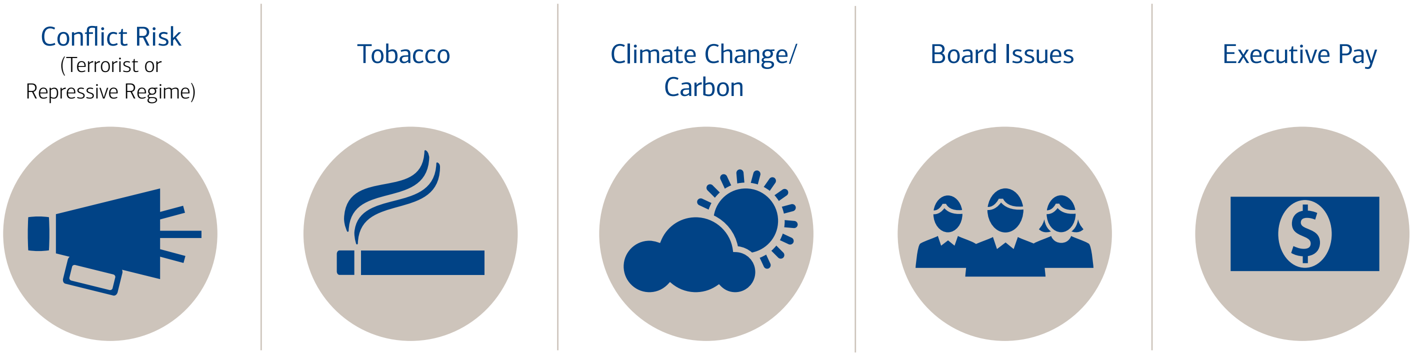
Source: "2018 Report on U.S. Sustainable, Responsible and Impact Investing Trends," US SIF, 2018.

Investment products:

Are Not FDIC Insured	Are Not Bank Guaranteed	May Lose Value

Please see important disclosure information on the last page.

Top ESG Considerations for Institutional Investors



Source: “2018 Report on U.S. Sustainable, Responsible and Impact Investing Trends,” US SIF, 2018.

“Institutions are inherently careful as they have to satisfy investment committees, adapt and comply with investment policy statements and ensure best practices,” says Jackie VanderBrug, head of Sustainable and Impact Investment Strategy for the Chief Investment Office. “Yet even with this typical institutional restraint, we are seeing a significant shift from interest to implementation, and receiving many more requests on how to ‘get it done.’”

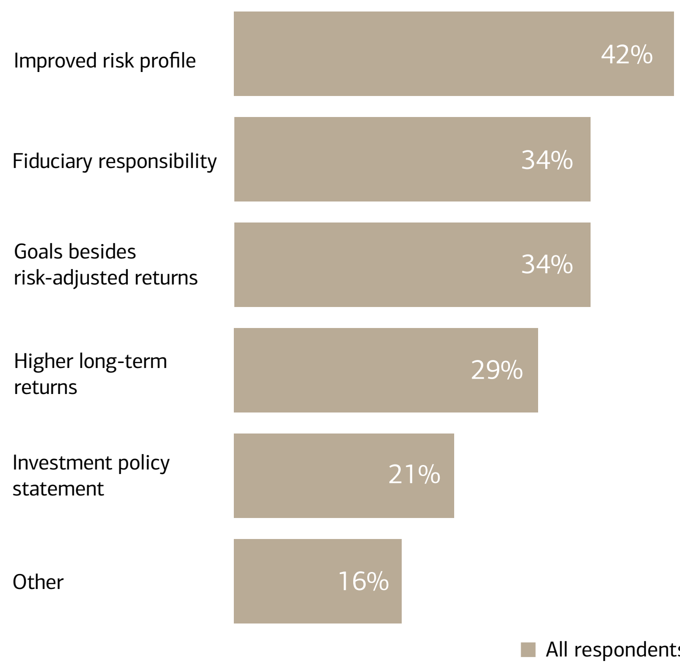
We believe this shift will continue for the foreseeable future, as the world undergoes a host of long-term transformations. For starters, we think the U.S. economy will become more closely tied to ESG factors as corporations seek to attract employees, investors and consumers, and avoid negative publicity, by focusing more on sustainability, cleaner production processes and better labor practices.

What’s more, a generational shift is under way that could increase the institutional focus on ESG. “We know from the 2018 *U.S. Trust Insights on Wealth & Worth®* survey that ESG is appealing to millennials, and they may seek to influence boards more as their wealth or giving grows, or as they join boards themselves,” says William Jarvis, Philanthropic Market Strategy and Delivery Executive at U.S. Trust.

Differing Motivations

Board members may have different reasons to incorporate ESG. Some may wish to promote a goal they feel passionate about, such as gender equality, while others may seek to correct an apparent misalignment of an organization’s mission and its investments (e.g., a clean-air foundation with investments in companies that score poorly on carbon emissions). In addition to making decisions based on internal discussions, boards may also be petitioned by outside sources such as student bodies or foundation donors. Then again, a board may recommend a shift based solely on the portfolio risk reduction that ESG factors can potentially bring. “Here, the concern is solely about risk-reward, with no reference to organizational values,” VanderBrug says.

Reasons for Incorporating ESG Factors into the Investment Decision-making Process



Source: “2018 ESG Survey,” Callan Institute, 2018.

$12 Trillion

U.S. institutional assets engaged in social, responsible and impact investing grew from $8.7 trillion at the start of 2016 to $12 trillion at the start of 2018, according to a recent study from US SIF, and now represent about one quarter of all U.S. assets under professional management.[2]

ESG and Growth in...

Asset Types. An important factor influencing many institutions on ESG is a broadening of available investment types. Until a few years ago, equities were essentially the only choice. Today, investment types or strategies that incorporate ESG also include real estate investment trusts (REITs), mutual funds (MFs), exchange-traded funds (ETFs), fixed income and more. Of particular interest are a relatively new type of investment, dubbed "green bonds," which may be offered by companies and municipalities seeking to fund initiatives focused on climate benefits, clean water or renewable energy. "I think we are going to continue to see an increase in new offerings sparked by client demand and also where asset managers are seeing investable opportunities," VanderBrug says.

ESG Data. A lack of reliable ESG-related data provided by corporations was once reason enough for many investors to shy away from the strategy. But times have changed, and there has been rapid growth in the number of organizations that collect and provide ESG research and ratings, including MSCI ESG Research, Bloomberg ESG Data Service and Sustainalytics.

Signatories. More corporations are becoming signatories of organizations such as the United Nations-supported Principles for Responsible Investment (PRI). PRI, which encourages reporting transparency and incorporation of ESG issues into decision-making processes, reports that its signatory base grew from 100 in 2006 to about 2,000 in 2018.[3] Even some states, such as California and Illinois, are calling for ESG integration in government pensions and funds.[4]

Implementation

In our experience, institutions rarely, if ever, go all-in on ESG at the get-go — nor do they have to. Most take a staged approach, dipping their toes in at first, says Danielle Ward, Institutional Market Investment Director at U.S. Trust. "That way they can evaluate performance while continuing to educate themselves and clarify priorities, before figuring out if they should incorporate ESG more deeply."

It's important to recognize that one size rarely fits all, VanderBrug believes. "Institutions are implementing differently based on their current investment portfolio as well as their motivations." And eventually, as Jarvis notes, "ESG may disappear as a separate discipline because it will be integrated into mainstream security and manager selection." Until that time, our view is that for essentially all institutions, education, discussion and a staged approach are essential to ESG integration.

ESG and Risk/Reward

Where ESG integration was once considered a likely contributor to portfolio underperformance, investors may now find that it offers the potential to actually lower portfolio risk, improve performance or both. Investors may, for example, look at ESG factors to help pinpoint corporations that are demonstrating more responsibility, in their work places, head offices, supply chains and communities. Companies that score well on ESG factors may be able to lower their financial or reputational risk from government fines, gender discrimination lawsuits, lower consumer or investor interest and so forth. By incorporating ESG strategies, companies demonstrate good management, and may be in the long term positioned to outperform industry peers.

For more information on incorporating ESG into your investment strategy, contact your advisor or asset manager.

1 "2018 ESG Survey," Callan Institute, 2018.

2 "2018 Report on U.S. Sustainable, Responsible and Impact Investing Trends," US SIF, 2018.

3 "About the PRI," Principles for Responsible Investment, 2018. Available on unpri.org.

4 "Governments push ESG investment forward," Bloomberg.com, 2018.

IMPORTANT DISCLOSURES

This material was prepared by the Chief Investment Office (CIO) and is not a publication of BofA Merrill Lynch Global Research. The views expressed are those of the CIO only and are subject to change. This information should not be construed as investment advice. It is presented for information purposes only and is not intended to be either a specific offer by any Merrill Lynch or U.S. Trust entity to sell or provide, or a specific invitation for a consumer to apply for, any particular retail financial product or service that may be available.

Global Wealth & Investment Management (GWIM) is a division of Bank of America Corporation. Merrill Lynch Wealth Management, Merrill Edge®, U.S. Trust, and Bank of America Merrill Lynch are affiliated sub-divisions within GWIM. The Chief Investment Office, which provides investment strategies, due diligence, portfolio construction guidance and wealth management solutions for GWIM clients, is part of the Investment Solutions Group (ISG) of GWIM.

Neither Bank of America Merrill Lynch, Merrill Lynch, U.S. Trust nor any of their affiliates or advisors provide legal, tax or accounting advice. Clients should consult their legal and/or tax advisors before making any financial decisions.

Investing involves risk, including the possible loss of principal.

Impact investing and/or Environmental, Social and Governance (ESG) managers may take into consideration factors beyond traditional financial information to select securities, which could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. Further, ESG strategies may rely on certain values based criteria to eliminate exposures found in similar strategies or broad market benchmarks, which could also result in relative investment performance deviating.

Bank of America Merrill Lynch is a brand name used by several Bank of America Corporation ("BofA Corp.") businesses, including, but not limited to, Global Institutional Consulting ("GIC"), which offers products and services for the benefit of institutional and ultra high net worth clients. GIC is part of the Global Wealth and Retirement Services business of BofA Corp. Institutional Investments & Philanthropic Solutions ("II&PS") is part of U.S. Trust, Bank of America Corporation ("U.S. Trust"). U.S. Trust operates through Bank of America, N.A., Member FDIC, and other subsidiaries of BofA Corp. For both GIC and II&PS, trust and fiduciary services and other banking products are provided by wholly owned banking affiliates of BofA Corp., including Bank of America, N.A. Both brokerage and investment advisory services are provided by wholly owned brokerage affiliates of BofA Corp., including Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("MLPF&S"), a registered broker-dealer, Member SIPC and registered investment adviser; the nature and degree of advice and assistance provided, the fees charged, and clients' rights and MLPF&S's obligations will differ depending upon the products and services actually provided. Global Institutional Consultants are registered representatives with MLPF&S.

Bank of America, N.A. and MLPF&S make available investment products sponsored, managed, distributed or provided by companies that are affiliates of BofA Corp.

Bank of America Merrill Lynch