

Sustainable investing

RBC iShares ETFs



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iShares®

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Summary

In recent years, we have seen sustainable investment assets grow at a rapid pace. The asset inflows underscore evolving investor preferences and a growing conviction in companies that can better manage environmental, social and governance (ESG) risks. We believe the growth of sustainable investing is only getting started. Demand continues to be driven by trends such as evolving government policy, evolving views on ESG-related investment risks and opportunities, as well as demographic shifts.

This paper provides a guide to sustainable investing for investors. Its components cover the following topics: the growing demand for sustainable investing, why sustainability risk matters to a portfolio's return, and an outline of different sustainable investing approaches in the market. Among the three sustainable investing approaches, we find ESG integration to be the most popular. We discuss a framework for evaluating which ESG integration strategy is appropriate for you, using RBC iShares's two ESG integrated product suites: ESG Aware and ESG Advanced.

With more sustainable investment solutions available, it can be difficult for investors to determine the appropriate ESG strategy for their portfolios. One should consider one's own risk and return objectives and sustainability preferences when choosing a strategy. In addition to suggesting a framework on how to navigate between the ESG Aware and Advanced suites, this paper also provides a portfolio application, illustrating the ESG portfolio characteristics for each suite compared with a traditional core portfolio.

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The growth of sustainable investing

Sustainable investing is about investing in progress and recognizing that companies adapting to the world’s biggest challenges may be best positioned to grow.

It is about pioneering better ways of doing business and creating the momentum to encourage more and more people to opt into a more sustainable future. Through the combination of traditional investment approaches with ESG factors, investors ranging from global institutions to individuals are taking a sustainable approach to pursuing their investment goals.

The appetite for sustainable investing is growing across a wide range of investors. The demand is being driven by a number of trends:



Government policies

Evolving government policy is prompting large institutions around the world to put capital towards sustainable investments.



Evolving views on risk

The improving quality and availability of ESG data can help investors assess previously unidentified risks and opportunities.

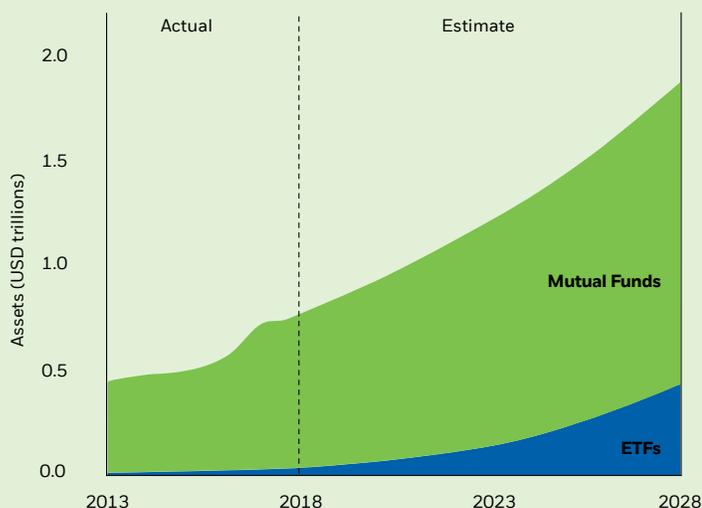


Demographic shifts

A new generation of investors are seeking sustainable solutions for the core of their investment portfolios.

Assets in dedicated sustainable investing strategies have grown at a rapid pace in recent years, and this trend is showing no signs of slowing.

Figure 1: Assets of sustainable mutual funds and ETFs, 2013-2028



There's no guarantee that forward-looking estimates will come to pass.

Sources: BlackRock, with data from Broadridge/Simfund, June 2018. Notes: The chart shows the total assets under management in ESG mutual funds (MFs) and ETFs globally. The 2019 to 2028 figures are based on BlackRock estimates, assuming a 5% annual growth rate in the underlying markets. Other assumptions: MF asset growth starts at 5% in 2019 and declines by 0.5% annually through 2022, then declines at a zero-to-0.5% rate annually thereafter. ETF asset growth starts at 45% and decreases by 5% annually through 2022, with a zero-to-3% pace thereafter.

Impact on investment returns

“ We believe a transformative shift is taking place in financial markets as investors grow increasingly wary about allocating capital to companies that fail to demonstrate a commitment to sustainability. Our investment conviction is that sustainability-integrated portfolios can provide better risk-adjusted returns to investors. And with the impact of sustainability on investment returns increasing, we believe that sustainable investment will be a critical foundation for client portfolios going forward.”

– BlackRock Global Executive Committee,
January 2020



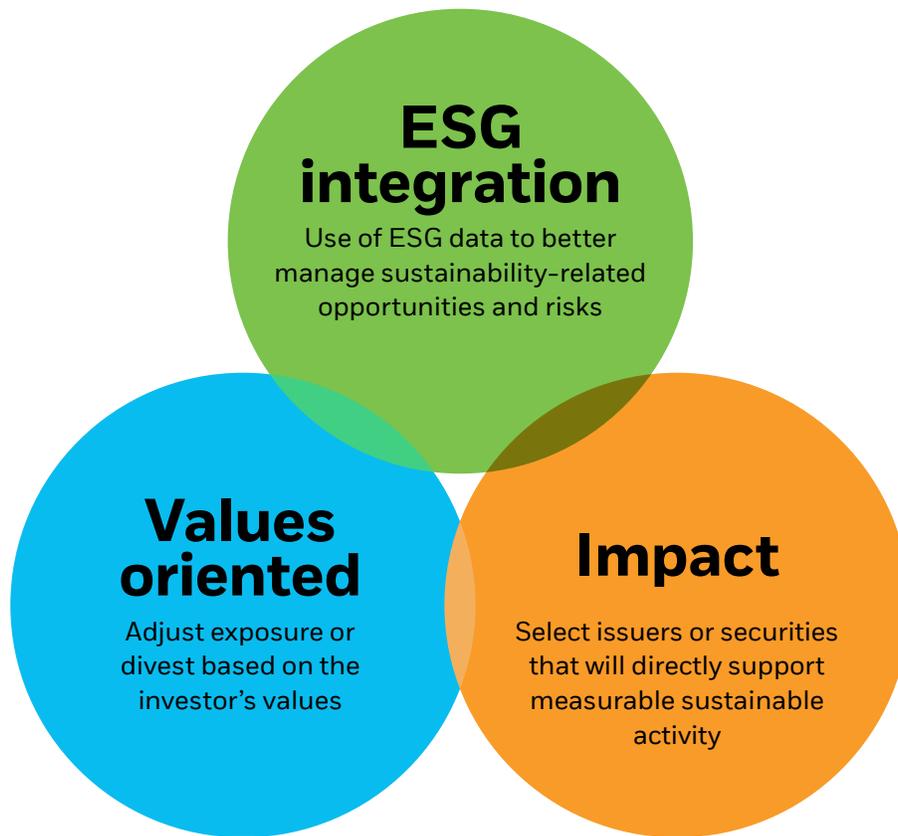
Sustainability risk is an investment risk

Over time, we believe that sustainability effects will become embedded in market prices and become visible within investment flows. Since these flows are in their early stages, the full consequences of a shift to sustainable investing are not currently reflected in market prices.

We expect assets backed by companies with stronger sustainability practices will appreciate in value through this reallocation of capital, while others will decline in value. By integrating ESG considerations into the investment process, investors are better able to assess a company's long-term risk and return prospects and enhance their portfolios' risk-adjusted returns.

Ways to invest sustainably

Sustainable investing refers to the different ways people can support certain positive business practices when they invest. With a multitude of terms being used in practice to describe the numerous ways to invest sustainably, for clarity's sake, we outline below the three major categories that capture the various approaches available in the market. The focus of this paper, and the one category of the three that has seen the strongest adoption from the investment community, is ESG Integration.



The ABCs of ESG

A company's ESG characteristics represent non-traditional financial metrics that can help investors evaluate whether that company runs itself responsibly. ESG stands for Environmental, Social, and Governance.

Here we provide a list of common ESG considerations:

Environmental	Social	Governance
<ul style="list-style-type: none">• Climate change• Resource depletion• Pollution and waste• Environmental opportunities	<ul style="list-style-type: none">• Employee relations and diversity• Health and safety• Product liability• Impact on local communities	<ul style="list-style-type: none">• Board diversity and structure• Executive pay• Ethics• Corruption, bribery and instability

Being able to analyze ESG issues helps investors assess the resilience of companies and construct portfolios with...

Less exposure to companies with environmental risk	Higher exposure to companies with stronger employee engagement and customer retention	Higher exposure to companies with more robust risk controls
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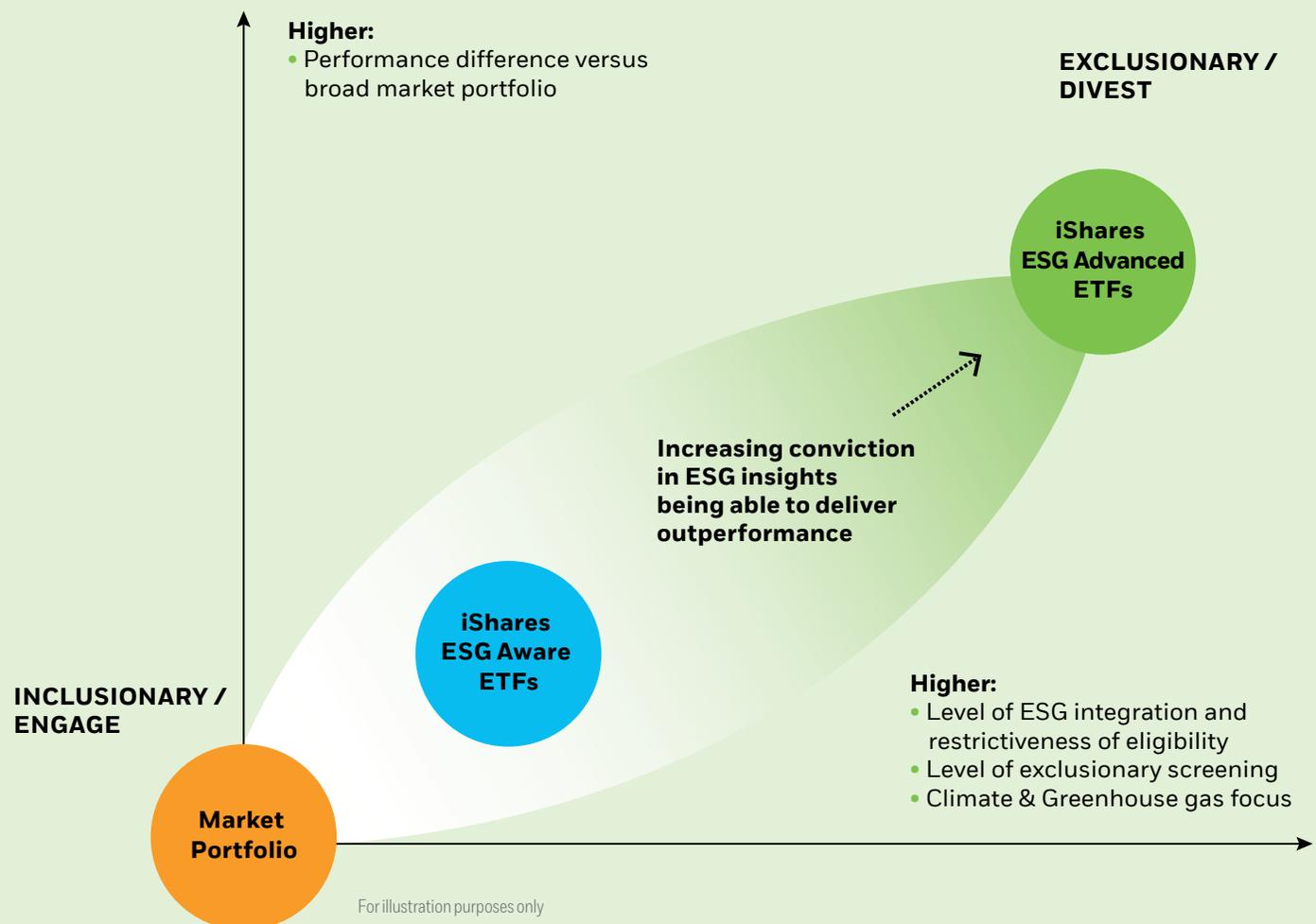
ESG integration with RBC iShares

For investors who seek ESG Integration solutions, RBC iShares offers two ESG suites that apply a broad range of ESG considerations. While both provide exposure to companies with high ESG ratings (see ESG characteristics on the next page), they are designed for investors with different investment objectives.

- **iShares ESG Aware ETFs:** focus on providing exposure to companies with high ESG ratings while maintaining market-like risk and return characteristics. They are designed for investors seeking ESG integration without deviating too far from the broad market benchmark.
- **iShares ESG Advanced ETFs:** seek to provide exposure to companies with high ESG ratings while extensively screening out controversial industries that may pose elevated headline and ESG risks. They are designed for investors with very high conviction on ESG risks and opportunities, and/or a strong focus on climate-related risks.

Below we illustrate the range of ways, from Aware to Advanced, to integrate broad ESG considerations into a portfolio using RBC iShares ETFs, mapped against an investor’s risk and return objectives and sustainability preferences.

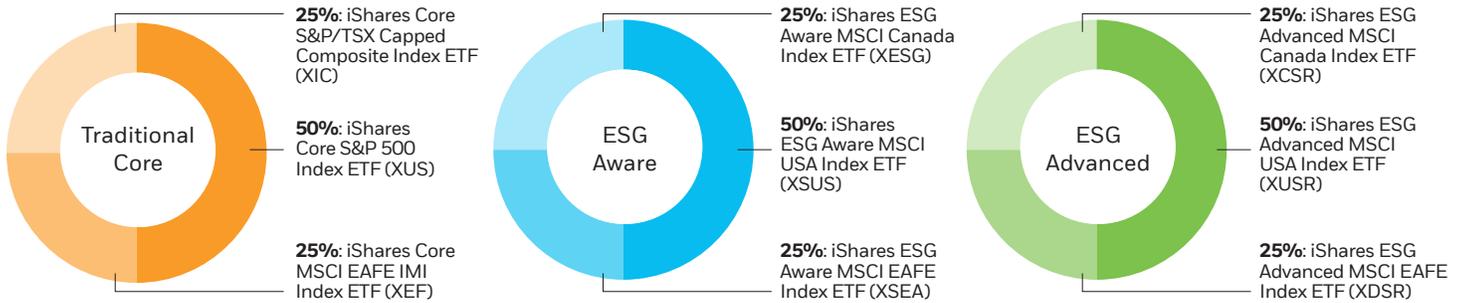
How to think about integrating ESG using RBC iShares ETFs



ESG portfolio characteristics

We illustrate three sample portfolios and highlight that the ESG portfolios have improved ESG characteristics over the traditional portfolio.

Balanced portfolios using sustainable and traditional core ETFs



Portfolio characteristics

Product Suite	ESG Quality Score	Carbon intensity	Very Severe Controversy in portfolio (%)	ESG leaders in portfolio (%)	Number of aggregated holdings
Traditional Core	High	221.2	2.1	28.0	3,362
ESG Aware	Very High	184.9	0.0	45.7	925
ESG Advanced	Very High	96.0	0.0	44.6	960

ESG Quality Score, Carbon Intensity, Very Severe Controversy in portfolio, and ESG Leaders in portfolio metrics are based on MSCI definition. See Appendix for more details. Source: BlackRock, MSCI ESG Manager; Based on holdings data as of Jan 31, 2020.

Appendix

Product details

Product Suite	Fund Name	Ticker	Index Name	Management Fee*	Asset Class	Inception
ESG Aware	iShares ESG Aware MSCI Canada Index ETF	XESG	MSCI Canada IMI Extended ESG Focus Index	0.15%	Equity	Mar 18, 2019
	iShares ESG Aware MSCI USA Index ETF	XSUS	MSCI USA Extended ESG Focus Index	0.20%	Equity	Mar 18, 2019
	iShares ESG Aware MSCI EAFE Index ETF	XSEA	MSCI EAFE Extended ESG Focus Index	0.25%	Equity	Mar 18, 2019
	iShares ESG Aware MSCI Emerging Markets Index ETF	XSEM	MSCI Emerging Markets Extended ESG Focus Index	0.30%	Equity	Mar 18, 2019
	iShares ESG Canadian Aggregate Bond Index ETF	XSAB	Bloomberg Barclays MSCI Canadian Aggregate ESG Focus Index	0.15%	Fixed Income	Mar 18, 2019
	iShares ESG Canadian Short Term Bond Index ETF	XSTB	Bloomberg Barclays MSCI 1-5 Year Canadian Aggregate ESG Focus Index	0.15%	Fixed Income	Mar 18, 2019
ESG Advanced	iShares ESG Advanced MSCI Canada Index ETF	XCSR	MSCI Canada IMI Choice ESG Screened 10% Issuer Capped Index	0.15%	Equity	Apr 15, 2020
	iShares ESG Advanced MSCI USA Index ETF	XUSR	MSCI USA Choice ESG Screened Index	0.20%	Equity	Apr 15, 2020
	iShares ESG Advanced MSCI EAFE Index ETF	XDSR	MSCI EAFE Choice ESG Screened Index	0.25%	Equity	Apr 15, 2020

*The management fee does not include all of the fees and expenses of the ETF. The management expense ratio ("MER") of the ETF is available in its most recent Annual Report of Fund Performance. The MER is based on total fees and expenses (including the management fee but excluding commissions and other portfolio transaction costs) for the stated period, including the ETF's proportionate share of the MER, if any, of any underlying fund in which the ETF has invested.

Source: BlackRock; Data as of Apr 21, 2020

Portfolio construction methodology of the two iShares ESG ETF suites

	ESG Aware (XESG, XSUS, XSEA, XSEM)	ESG Advanced (XCSR, XUSR, XDSR)
Key highlight	<ul style="list-style-type: none"> Benchmarked to broad markets with explicit tracking error constraints Optimized for higher portfolio ESG quality score Exclusionary screening for severe controversies and a number of business involvements with higher ESG risks 	<ul style="list-style-type: none"> Includes only companies with relatively high ESG quality scores Extensive screening on a wide range of business involvements with potentially higher ESG-related risks Significant focus on climate related investment risk through the exclusion of fossil fuel related ties
1. Starting universe	XESG: MSCI Canada IMI Index XSUS: MSCI USA Index XSEA: MSCI EAFE Index XSEM: MSCI EM Index	XCSR: MSCI Canada IMI Index XUSR: MSCI USA Index XDSR: MSCI EAFE Index
2. Screens		
ESG ratings	No minimum, but ESG ratings are central to the optimization	ESG Rating >= BBB
Controversies	Exclude companies with a Controversy Score of 0 (i.e. Very Severe Controversy)	Canada: Exclude a Controversy Score of 0; USA and EAFE: Exclude a Controversy Score less than 3
Fossil fuels	Canada: none USA/EAFE/EM: Exclude thermal coal and oil sands	Exclude all businesses with an industry tie to fossil fuels (thermal coal, oil and gas). An exception is provided to companies with over 50% revenue from renewable energy and alternative fuels.
Other screens	Exclude: Tobacco, Controversial Weapons, Civilian Firearms	Exclude: Adult Entertainment, Alcohol, Gambling, Tobacco, Genetic Engineering, Controversial Weapons, Nuclear Weapons, Civilian Firearms, Conventional Weapons, For Profit Prisons, Predatory Lending, Palm Oil, Nuclear Power (Canada: also exclude Cannabis)
3. Weighting	Optimized for higher portfolio ESG rating, and lower tracking risk. (0.5% tracking risk target for USA and EAFE, 1.0% tracking risk target for Canada and EM)	Market Cap Weighted (Unconstrained for USA and EAFE, 10% issuer cap for Canada)
4. Rebalancing	Quarterly	Quarterly

Source: BlackRock, RBC GAM; Data as of Apr 21, 2020

Definitions

- **ESG Leaders:** Companies leading their industry in managing the most material ESG risks and opportunities. i.e. companies with an 'AAA' & 'AA' MSCI ESG Rating. Leading companies may be more resilient to disruptions arising from ESG events.
- **MSCI ESG Controversy Score:** The score signals whether a company has a notable controversy related to the company's operations and/or products, and signals the severity of the social or environmental impact of the controversy. The score is on a 0-10 scale, with 0 meaning having the most severe controversy and 10 meaning having no notable controversy.
- **MSCI ESG Quality Score:** The score is calculated as the weighted average of the underlying holdings' ESG Scores. It is provided on a 0-10 scale, with 0 and 10 being the respective lowest and highest possible fund scores. MSCI rates underlying holdings according to their exposure to 37 industry specific ESG risks and their ability to manage those risks relative to peers. These issuer-level ESG ratings correspond to an issuer-level ESG Score.

MSCI ESG Quality Score Range			Description
Min.	Max		
7.0	10.0	→	Very High
6.0	6.9	→	High
5.0	5.9	→	Average
4.0	4.9	→	Low
0.0	3.9	→	Very Low

- **Very Severe Controversy (%):** represents the percentage of a portfolio's market value coming from holdings involved in very severe controversial events (i.e. an MSCI ESG Controversy Score of 0). An ESG controversy is an event reported by verifiable sources detailing a negative environmental, social, or governance-related impact linked to a company or multiple companies.
- **Weighted Average Carbon Intensity (tCO₂e / \$M sales)** which is a measure of the fund's exposure to carbon intensive companies. The figure is the sum of security weight (normalized for corporate positions only) multiplied by the security Carbon Intensity.

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