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Sustainable investing and the advice process



Adviser Solutions



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Sustainable or responsible investing – once regarded as a relatively niche area – is now very much a mainstream investment strategy. This move towards a more responsible approach has predominantly been driven by institutional investors, such as pension funds and investment foundations. This is due, in part, to a changing legislative and regulatory backdrop that requires investors to consider environmental and societal issues, such as tackling climate change.

Increasing demand for responsibly-managed investments – those that consider Environmental, Social and Governance (ESG) factors as part of the investment process – can now be seen in the UK retail arena too. This has undoubtedly been led by an increasing awareness of environmental issues amongst the population as a whole.

Our adviser research indicates the interest in sustainable investing will, in all likelihood, accelerate further in the years ahead. Indeed, within our [IFA DNA 'Sustainable investing and the advice sector'](#) report¹, advisers stated that 56% of clients are now expressing an interest in this area of investing. What's more, advisers predicted that sustainable investments will account for 30% of client portfolios in five years' time – up from around 12% today. Women appear to be at the vanguard of this movement – more than half of advisers in our [Financial Power of Women survey](#)² said that women tend to be more interested in investing responsibly than men. Finally, regulatory pressure may also be a factor as we move forward – this could raise sustainable investing even further up the agenda.

1. Fidelity: IFA DNA 'Sustainable investing and the advice sector', April 2021.

2. Fidelity: [Unlocking the power of advice](#), February 2020.



ESG considerations and suitability

Over the last few years, there has been a wave of legislation and regulatory changes aimed at promoting more sustainable investing. To date, this has predominantly impacted asset managers and other institutional investors but this could change. As we show below, the FCA certainly has an eye on environmental issues. The EU is also making moves in this area:

Within the **FCA's Climate Change and Green Finance Feedback Statement** (FS19/6), the regulator specifically commented on investment advice:

'Investment advice is also an important area where climate change and other sustainability risks should be appropriately considered. In assessing the suitability of investment decisions for clients, advisers are required to gather sufficient information so that they can make recommendations to or decisions on behalf of clients that meet their investment objectives. This can include the understanding of clients' sustainability preferences. However, it is not mandatory for ESG issues to be considered under the current suitability regime.'

It is worth noting that the FCA's PROD rules (3.3.1) already state that advisers must assess the compatibility of the product with the needs of the client.

The **European Commission** has expressed that it wants to make ESG investing easier across Europe. As a result, the European Securities & Markets Authority (ESMA) will be introducing new regulations which will bring ESG investing even further into the mainstream. A proposed change to MiFID II legislation relates to investment suitability whereby firms will need to take account of clients' ESG preferences when assessing their investment objectives.

Further to this, the EU is proposing some supplemental wording within Regulation (EU) 2019/2088. This states that:

'Financial advisers should disclose how they take sustainability risks into account in the selection process of the financial product that is presented to the end investors before providing the advice, regardless of the sustainability preferences of the end investors'.

These EU rules are expected to come into force in the second half of 2022. While there is no certainty that these regulations will find their way to the UK, the FCA has acknowledged this work and has said that they will continue to monitor and engage with it. The UK regulator is widely expected to stay close to the EU in this area, given the global shift to more responsible investing.

Incorporating ESG considerations into the fact finding process

Whether or not it becomes mandatory for advisers to take account of a client's ESG preferences when assessing suitability, it is certainly good practice to address this within the fact find and annual review process. Of course, many firms will have done this for years but if you do want to add some questions on sustainable investing into your fact find process, the following suggestions may be a good starting point:



How important is it to you to invest in companies that take a more responsible or sustainable approach to producing or delivering the products and services they offer?

Or, if you want to ask more specific questions on the three pillars of ESG investing:



How strongly do you feel about environmental factors when investing your money – factors such as climate change, resource depletion, waste and pollution?



How strongly do you feel about social issues when investing your money – factors such as employee relations, working conditions and human rights more generally?



How strongly do you feel about how a company is run when investing your money – factors such as executive pay and board diversity, political lobbying, bribery and corruption, and the company's tax strategy?



Are there any particular companies, industry sectors or countries that you wish to avoid when investing your money because of ethical concerns, religious beliefs or other values that are important to you?



Identifying appropriate sustainable investment options

Once you have established that a client has sustainable investment preferences, the next step is to identify investment options that can meet their needs and requirements. This may not be as straightforward as it initially seems, particularly if the client has specified exclusions based on ethical, religious or other values-based grounds.



This is because there are different approaches to managing sustainable investments. A fund that takes an ESG weighted approach, for example, does not necessarily prohibit any investments. Such sustainable strategies could invest in any business, sector or geography as long as the ESG risks of such investments are identified and taken into account.

Comparing different fund options

In order to make comparisons of sustainably-managed funds easier, SRI Services, an independent and specialist business with over three decades of experience in sustainable investment, has classified every fund as one of seven 'SRI Styles'. Definitions of these styles are shown below:

- **Sustainability focused:** an investment approach that focuses on identifying companies that offer products and services that encourage greener lifestyles or show sustainability leadership. Funds adopting this approach typically avoid sectors that don't help raise environmental or social sustainability standards, as well as arms and tobacco companies.
- **Environmentally focused:** an investment approach that focuses on environmental opportunities
 - from single issues like water, resource management or waste, to broader issues such as biodiversity and climate change.
- **Socially focused:** an investment approach focused on people issues – from employment and education, to diversity, equality and human rights. Funds adopting this approach invest in companies with positive social practices.
- **Ethically focused:** an investment approach that focuses on issues relating to personal values or opinions. Funds adopting this approach typically invest in companies with more positive environmental and social practices and avoid areas that are widely regarded as more negative
 - like arms, tobacco and gambling.
- **ESG weighted:** an investment approach that considers environmental, social and governance (ESG) or sustainability issues, but isn't wholly directed by them. Funds adopting this approach tend to favour companies with higher ESG or sustainability standards. They will typically invest more heavily in those that have higher ESG ratings, standards or scores and less heavily in companies with lower ESG ratings.
- **Limited exclusions:** an investment approach that will only limit investment in, or exclude a small number of, companies such as tobacco companies or companies that breach commonly adopted ESG standards. They may aim to encourage companies to improve their standards.
- **Faith based:** an investment approach that focuses on faith-based issues (e.g., Sharia Law). Funds adopting this approach tend to use negative ethical screening to invest in assets that align with a recognised religion or faith. Other funds may also be suitable for investors of faith, although their core focus is not religious beliefs.

Source: SRI Services.

There are tools available that can help you identify funds that meet certain sustainability criteria, including our [Sustainable Investment Finder](#). This tool allows you to search for funds using filters that draw upon the SRI Styles shown above.

Ten tips for discussing sustainable investing with clients



The following tips may aid your client discussions. They are based on a list compiled by SRI Services, an independent company devoted entirely to advancing retail sustainable investment funds in the UK.

- 1 Very few sustainable investing issues are straightforward – there are almost always ambiguous areas to explore and decipher. Clients should be advised that different funds will interpret issues differently.
- 2 There is no ideal size of company. Smaller companies often have interesting stories to tell and may lead change, but for our lifestyles to become more sustainable larger companies need to be encouraged to change too and many of them are already doing so.
- 3 Larger companies tend to be more diverse than smaller companies – and are more likely to do things that some clients don't like – try to manage client expectations.
- 4 No one's perfect – most companies have positive and negative attributes – no company is entirely ethical or unethical. Remember to consider what companies actually do as well as how they do it. Expect companies to make mistakes sometimes and be aware that some people will disagree with this view!
- 5 Funds are not a homogeneous mass. Different fund managers have different policies and investment aims, even within similar looking groups or styles. Expect diversity.
- 6 There are many different ways to influence a company. A company may respond best if they know they are excluded from some sustainable funds. Conversely, others may respond more favourably if they are included. Companies can also be encouraged to change through shareholder pressure. For some companies, excluding them from sustainable funds reduces the pressure put on them to improve. No single approach works all the time.
- 7 Don't forget 'engagement only' as an option (funds which encourage better management of ESG issues through stewardship) if other sustainable funds are not suitable or what the client is looking for.
- 8 Always ask questions of product providers, fund managers and others in order to gain the information you need.
- 9 Try to keep your personal views out of the investment recommendation process. An adviser's role is to represent their client's view not their own.
- 10 Keep up to date by reading up on sustainable investing issues. Think through how current news items relate to the agenda. What is in the news this week that you might use to 'bridge' a discussion with clients about sustainable investing?

Fidelity: your home for sustainable investing

As interest and assets in responsibly-managed investments continue to grow, we are committed to providing advisers with all the information they need on this area of investing. This ranges from helping advisers identify appropriate solutions for their clients through the provision of research and tools as well as educational guides, client-facing materials and fund partner insights.



For tools, news and insights on sustainable investing visit
fidelityadvisersolutions.co.uk/sustainableinvesting

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