

IFA DNA Report

April 2021

Sustainable investing and the advice sector

FundsNetwork



Fidelity
INTERNATIONAL

Introduction

The origins of sustainable investing in the UK retail market can probably be traced back to the launch of the first ethical funds around forty years ago. At that time – and until relatively recently – it was generally considered a somewhat special interest area only appealing to a comparatively small group of clients who had strong views on not investing in certain ‘sin’ sectors. Times have changed and today society is much more conscious of environmental and social issues. Clients are now taking an active interest in how their money is invested. For some, it’s not just about avoiding companies involved in certain lines of business – they want their money to make a positive impact.

The retail investment industry has reacted to this growing trend and there are now over 155 sustainable or ESG funds available in the UK today. This represents a rise of 95% in the last five years alone¹. ESG funds under management have grown strongly too – up 150% over the same period. The climate emergency and other environmental issues mean it is highly likely that the focus on living life in a more sustainable way is here to stay. But does this mean it’s inevitable that sustainable investing will grow further or will it prove to be a short-lived fad?

1. Source: Morningstar, UK domiciled funds, figures to 31 December 2020.

In this IFA DNA special edition, we examine advisers’ views on one of the most talked about subjects in investment today. Are clients really that keen to match their money with their morals? If so, what does sustainable investing really mean to them? How are firms incorporating clients’ ESG concerns into the advice process and how do advisers feel about the support on offer from providers?

Our survey reveals all and complements a broader IFA DNA study on how advice firms have coped with the effects of the Covid crisis. This report is available now and uncovers how advisers are looking to the future with real optimism.



[Read the full report](#)

Methodology

Fidelity commissioned NextWealth to produce this report based on a representative sample of financial advisers from research conducted in January and February 2021:

- A digital survey of 200 UK financial advisers.
- In-depth qualitative interviews with ten financial advisers.

The interviewees were chosen to represent a range of experience levels, firm size and operating models, from large independent IFA firms, appointed representatives and a small start-up practice.



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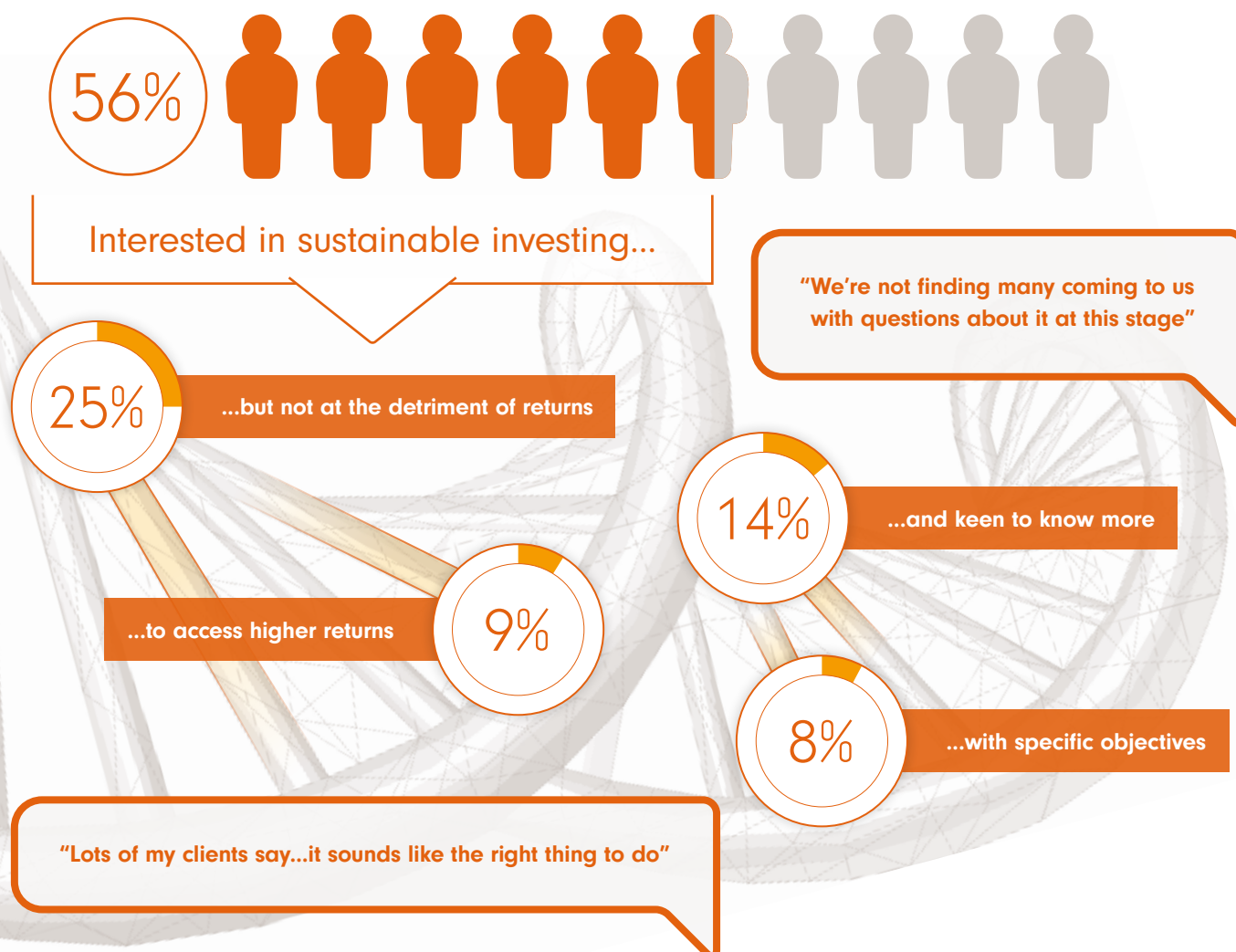
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Client demand for more sustainable investing

Advisers say the majority of clients (56%) are now open to ESG and sustainable investing, with 44% of clients having no interest in this approach. Although we have no previous data to compare this to, it is perhaps surprising so many clients are open to a more sustainable approach given the apparent indifference to the concept just a few years ago.

When pressed further on attitudes to ESG and sustainable investing, advisers state that a quarter of clients are interested in this approach but not at the detriment of returns. A small percentage of clients (8%) express a real interest in investing with specific objectives, such as requesting certain exclusions, for example, or investing to make a particular impact.



Typical profile of clients positive towards sustainable investing

In terms of the profile of clients interested in an ESG approach, advisers identify younger clients (37%) as those driving demand. This compares to just 9% who either fit an older age profile or are retired. Female clients (20%) are also more likely to be open to sustainable investing.

Younger clients

37%

"It's the under-35 female who seems to be driving the ESG bandwagon"

20%

Female clients

Sustainable investing philosophies

Advisers state that an exclusionary approach – avoiding companies in certain 'sin' sectors – resonates the most with clients (64%). This compares to 36% who state funds that seek to influence companies to act more sustainably tend to appeal more to clients.

Excluding companies in favour of those aligned with sustainable investing objectives

64%

36%

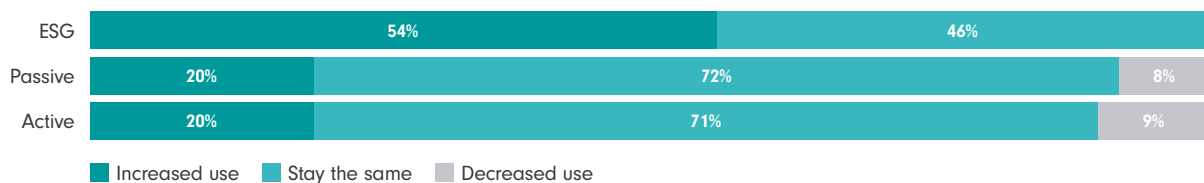
Investing in traditional companies in order to influence change for the future

"Most ESG clients want to have some pre-determined and defined exclusions"

ESG: a look to the future

Future use of investment strategies as a result of the pandemic

As we emerge from the coronavirus pandemic, advisers believe their use of ESG investments will increase substantially. Indeed, 54% state they will recommend more of these strategies as a direct result of the crisis. This builds on the findings of our earlier IFA DNA survey¹ conducted in the first lockdown period in 2020, where 47% anticipated that their usage of ESG funds will increase going forwards. The use of other types of investment strategies – such as passives – is also expected to increase, although much less so than ESG.



1. IFA DNA: How the advice sector is responding to the coronavirus crisis, June 2020.

12%

Current ESG allocation

Current vs. future ESG allocation

When asked about the percentage of client assets invested in ESG strategies, advisers expect this to increase noticeably too. Currently, only 12% of clients' assets are invested in these vehicles. However, this is expected to increase to 30% in just five years' time.

"We're expecting a real shift towards green within the next year"

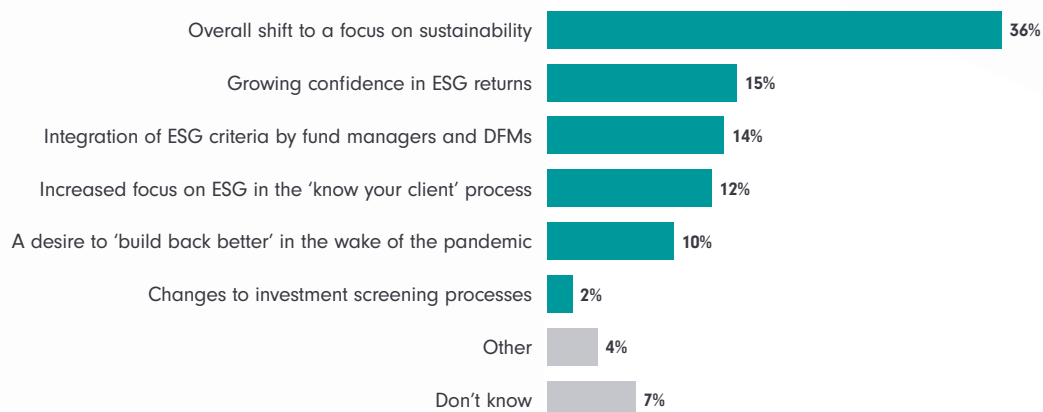
30%

ESG allocation in five years

Drivers of change

Respondents state this asset allocation shift will primarily be due to a greater focus on sustainability in both the consumer and political landscape. A growing confidence in the returns produced by ESG funds will also have an impact.

"I'd be surprised if the ESG badge is still around in five years. Every fund will be screening, it'll be part of the process"



Sustainable investing and the advice process

Assessing clients' ESG objectives

With more than half of clients open to sustainable and ESG investing, advisers are increasingly having conversations on this area. However, feedback from qualitative interviews suggests that most clients do not raise this directly themselves and the subject generally arises out of the fact-find and review process. While it is not mandatory for sustainability issues to be considered under the current suitability regime, most advisers appear to consider this good practice. Our research shows most (58%) are either completely or somewhat satisfied with their approach for assessing client objectives in relation to ESG. Only 11% of respondents state they are unsatisfied.

Satisfied with their approach

58%

11%

Unsatisfied with their approach

The terminology used

In terms of the vocabulary used when discussing this subject with clients, advisers use a range of different terms such as ethical investing, ESG and socially responsible investing. In contrast, when clients raise the topic, nearly half talk specifically about ethical investing. This highlights a big bugbear with advisers – 55% feel the industry does not have a clear vocabulary for ESG investing. As highlighted in our June 2020 IFA DNA survey, advisers think the absence of clear definitions makes it difficult for them to compare ESG products and providers and to feel confident the solutions will adhere to their clients' definition of an ESG investment.



Satisfied with the tools and research available

35%

Unsatisfied with the tools and research available

31%

ESG tools, research and fund options

When it comes to the quality of support available to advisers in helping them research and select ESG funds on behalf of clients, there is currently no clear consensus. While 35% state they are satisfied with the tools and research available, 31% state they are unsatisfied. There is a slightly more positive feeling about the range of ESG funds and solutions on offer.

"It's really difficult to match specific client ethics to funds"

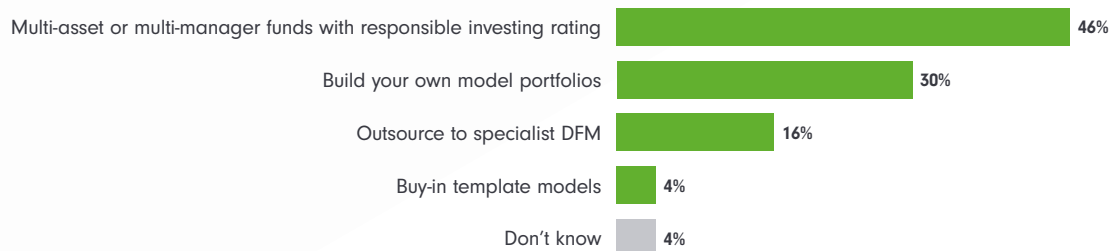
Satisfied with the range of funds and solutions available

41%

"DFMs need to up their game to provide model ESG portfolios"

Most favoured strategies for ESG clients

Finally, once the fact-finding and research process is complete, 47% of advisers state they are most likely to recommend multi-asset and multi-manager funds that have a sustainable investing rating. Many choose to build their own model portfolios (30%) while 16% opt to outsource to a specialist discretionary fund manager (DFM).



Beyond the pandemic: the advice industry looking forward

Building on two waves of research conducted last year, a separate complementary IFA DNA report considers how advice businesses are preparing for the future. The study explores whether working practices will revert back to how they were before the pandemic and assesses how the demand for advice will change over the next few years. A key insight is that firms are very bullish on their growth prospects as they plan ahead for the post-pandemic world. In fact, nearly two thirds (60%) of advisers say their firms are looking to grow their assets under advice organically over the next three to five years.

60%

Looking to grow organically

55%

Anticipating an increase in the demand for advice over the next five years



[Read the full report](#)

Conclusion

The results of this IFA DNA survey are quite clear – sustainable and ESG investing is here to stay and will likely become ingrained within most client portfolios within the next five years. Two key statistics from our research support this conclusion.

Firstly, advisers state that 56% of clients are now expressing interest in this area of investing – ESG is clearly no longer a niche interest. The biggest barrier to further growth appears to be client concerns about sacrificing returns. However, the performance numbers suggest that these worries are unfounded. Analysis of returns from both the UK All Companies and Global sectors show that ESG-themed funds have outperformed non-ESG funds over three and five years¹, although past performance is no guide to the future.

Secondly, advisers are predicting that ESG investments will account for 30% of client portfolios in five years' time – up from around 12% today. This is a substantial uplift. The asset allocation shift is probably already underway with over half of advisers saying they are more likely to recommend sustainable or ESG investments to clients as a result of the coronavirus pandemic.

Looking at the current market, we are already seeing supply increasing to meet demand – there have been a plethora of new ESG fund launches (or the re-badging of existing portfolios) over the last few months and years. There is now genuine choice available along with numerous different approaches. In addition to 'traditional' ethical funds that focus on exclusions there are, for instance, a wide variety of portfolios that fully integrate ESG analysis into the investment process and funds which aim to make a measurable social and environmental impact. Passive options are also becoming more common. Inevitably, expanding choice will only encourage even further interest in this growing area of investment.

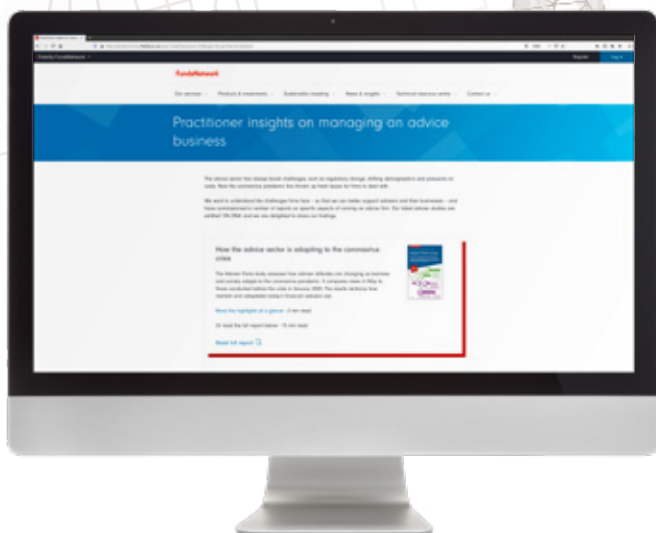


FundsNetwork: your home for sustainable investing

As interest and assets in responsibly-managed investments continue to grow, FundsNetwork is 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.

fundsnetwork.co.uk/sustainable-investing

1. Source: Morningstar Direct. bid-bid returns reinvested in GBP as of 28 February 2021, net of annual fees.



Read more research on how advice firms are
adapting to change and other business challenges

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