A guide to **sustainable investing**

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Sustainable investing **for a brighter future**

Social and environmental change is happening faster than ever. Global warming, shifting demographics and the technology revolution are reshaping our planet. In this fast changing world, there are a growing number of investors who want to understand how social and environmental change is affecting their investments, and how the way they invest affects the environment and society.

Research indicates that the majority of investors believe they can contribute to a more sustainable world through their investment choices and that additional information from financial advisers would encourage them to allocate more of their investment portfolio to sustainable investments[1].

To help you meet your clients' needs, this guide covers the key things you should know about sustainable investing, including how to identify your clients' preferences.

Sustainability factors are a key consideration for people in the UK when selecting investments[1]

52%

of people consider sustainable investment factors when selecting an investment solution

61%

of people who believe that individual investors can significantly contribute to a more sustainable world by choosing sustainable investment solutions

Factors that people think would be highly likely to encourage them to allocate

56%

If my financial adviser provided me with more, easy-to-understand information on sustainable investments

53%

If my financial adviser prompted me to put more money into sustainable investment

[1]Schroders Global Investor Study 2019.

What is **sustainable investing?**

Sustainable investing is about understanding how investments contribute to society and their impact on the environment, people and our planet.

It involves considering more than just traditional financial analysis though. It's about also paying attention to how non-financial factors such as Environmental, Social and Governance (ESG) considerations may impact an investment's ability to generate long-term returns. The idea is that those actively preparing themselves for future risks and opportunities by recognising their social and environmental impact will have better long-term prospects than those that don't. Their ability to generate sustainable financial returns should therefore be superior to those that take a shorter term view.

Why has it become **so important?**

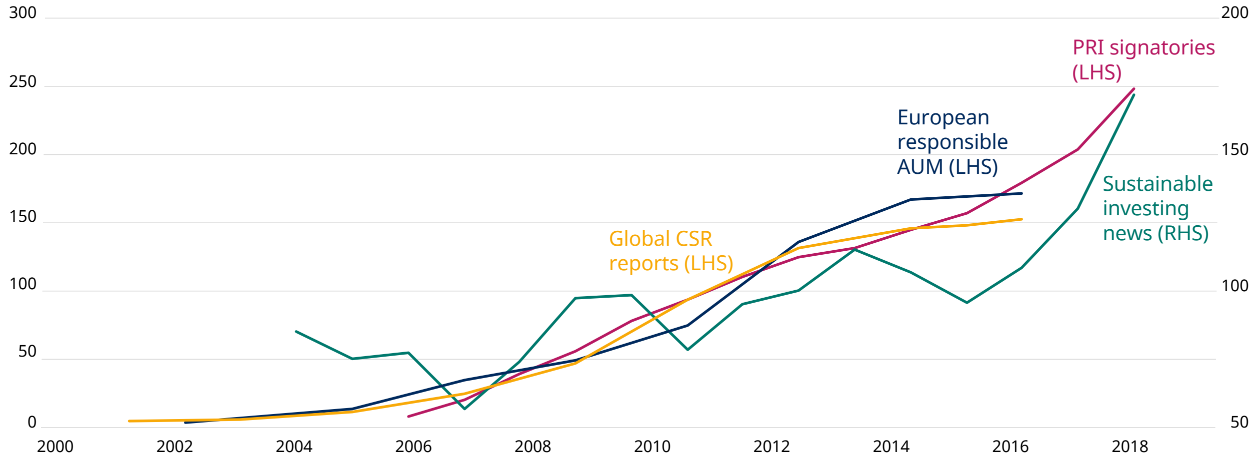
Social and environmental trends pose increasingly significant risks to investments, to a point now where they can no longer be ignored. Moreover, it is increasingly being considered a normal part of fiduciary duty to clients to consider ESG factors.

People all over the world are becoming increasingly conscious of acting in the best interests of the environment and society at large. As a result, investors are increasingly looking to invest in a way that reflects these personal values.

It's no longer about profits above all else. How a company makes its money is just as important as how much it makes. As a result, investors are demanding more from their investments; more transparent reporting, greater commitment to tackling social and environmental issues, and more concrete evidence of them having done so.

Sustainable investing has moved from niche to mainstream

Interest, demand and sophistication are on the rise
Indexed, 2008 to 2018 average = 100



Source: Hightail (news search for articles containing 'sustainable investing' relative to all articles referring to 'investing', principles for sustainable investment (number of signatories) and EuroSIF (combined AUM invested in different ESG strategies, adjusted for double-counting). Latest available data as at 7 May 2020.

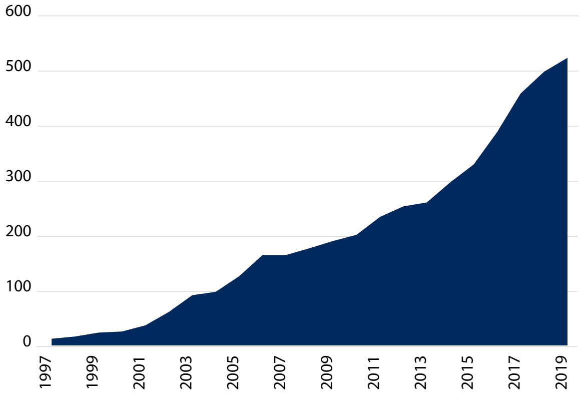
How does this affect **me as an adviser?**

With this rise in popularity has come an exponential rise in regulatory scrutiny. Regulations relating to sustainable investing have increased significantly as the chart opposite shows.

Arguably one of the most important regulations for you as an adviser is the proposed amendment to MiFID II. These planned changes will obligate you to incorporate a client's sustainable investing preferences into their suitability assessment. It will not be enough to simply tick a box confirming you've asked a client about their needs; taking sustainable investment considerations into the advice process will become a formal requirement that you will need to evidence to the regulator.

You need to first determine and record your client's preferences and take this into account, along with the other factors in your suitability assessment, when you make your recommendation. This will involve helping your client identify whether and how they would like to incorporate environmentally sustainable investments, social investments or good governance investments into their investment strategy. To be clear, sustainable investment considerations don't take priority over other suitability criteria, they are simply meant to be an additional way to provide insights into your client's needs. Based on this information, you can then start to recommend suitable solutions. You will also need to disclose all the ESG-related features of the solutions you propose and be able to show regulators that you have done so.

ESG regulations and amendments in the top 50 largest economies



Source: PRI and Schroders as at June 2020.

Asking the **right questions**

Ascertaining your client's sustainable investing preference is an increasingly important part of the advice process.

Investors don't just invest to make money; they also invest for expressive and emotional reasons. Understanding these aspects will help you establish a more realistic and meaningful view of what your clients want to achieve with their investments.

The below chart will help you start to have those conversations and understand where on the sustainable investing spectrum your client lies based on their priorities and preferences.

Financial benefits → **Social impact**

Integrated	Sustainable	Screened	Impact	Philanthropy
Does your client want to maximise their investment opportunity set but ensure financially material risks relating to E, S or G issues are taken into account in the investment decision-making process? Does your client have a preference for engagement and encouraging better ESG performance over divestment?	Does your client only want to invest in those companies at the forefront of sustainability practices and stakeholder management? Are there specific sustainability themes they would like to gain exposure to/their investments to prioritise? Are there specific investments or areas of the market they wish to avoid?	Does your client have religious, ethical or personal values that they wish to be reflected in their investments? Are there specific investments or areas of the market they wish to avoid? Do they wish to exclude companies directly involved in those areas or also those that are indirectly involved?	Does the client want their investment to deliver a specific, positive, measurable social and/or environmental benefit alongside a financial return? Is there appetite to potentially invest in private markets to achieve this?	Is your client most focused on maximising their social impact? Are they willing to donate their money to good causes?
Environmental, Social and Governance factors are considered as an integral part of the investment selection process. Environmental factors include resource and energy use, pollution and climate change; social factors relate to social trends such as demographic changes and societal attitudes; and governance factors relate to the quality and robustness of a company's internal structure and practices.	Specific sustainability themes such as environmental solutions, education and diversity. Or targeted outcomes, for example delivering a lower carbon intensity. Or a thematic focus such as climate change, pollution or healthcare.	Exclusions based on company exposure to a controversial activity, for example armaments, tobacco, or gambling. Or 'positive screening', focused on companies with the potential to provide positive benefits to society. In the energy sector, this could involve investing in companies generating power from clean sources such as solar and wind rather than from fossil fuels, for example.	Delivers a specific, positive, measurable social and/or environmental benefit alongside a financial return. And demonstrates a clear link between the capital provided and the positive social or environmental impact, often aligned to the United Nations Sustainable Development Goals.	Deploying capital, typically to not-for-profit organisations, for social impact and support.

Answering your **client's questions**

There are a number of myths surrounding sustainable investing. We expect your clients will want to know whether these are true or not, so here are some common questions and possible answers to support you with any 'difficult conversations'.

Is there a trade-off between performance and sustainable investing?

Sustainable investing is not about sacrificing financial returns. The goal is still to meet the investment objectives but in a more sustainable, long-term way. While there are other influences (some of which may be outside a company's control) that will affect how well a company does over time, several academic studies have shown a connection between responsibility factors and improved performance. One study (Friede & Busch 2015) found that companies focused on ESG enjoyed, on average, enhanced financial performance, while analysis by Arabesque Asset Managers and Oxford University show that good responsibility practices positively impact share prices. Morgan Stanley has also done research that shows sustainable funds can help protect investors against downside risk.

Are sustainable investments expensive?

Historically, sustainable investment solutions have been more expensive than their traditional counterparts because it used to be something of a niche area that required specialist skills. But now, these options have become more widespread and the skillset more prevalent.

Sustainable choices have become more competitively priced compared to traditional funds, and in many cases cost the same as a traditional fund.

The important **role of advisers**

Sustainable investing is becoming increasingly popular as investors look for ways in which to align their investments with their personal beliefs.

As an adviser, you have an important role to fulfil; you can help your clients meet both their financial and sustainable investment objectives, and feel more engaged and emotionally connected with their investments.

This guide should help you navigate this growing field, understand your client preferences and recommend investment options that best suit their needs and circumstances.

Adviser checklist – Top 5 tips

1. **Start** a conversation with your clients on sustainable investing
2. **Ask** your clients the right questions – understand their sustainable investing preferences
3. **Record** your client's preferences in your fact find
4. **Search** for a sustainable investment solution within your usual investment selection process
5. **Present** your client with a sustainable investment strategy

Helping your clients make **the right choices**

Just because you've walked your client through these options, doesn't guarantee that they will make the right choices according to their overall outcomes.

You could consider this simple four step approach:

1. Make it **Easy.** Presenting your clients with default options helps.
2. Make it **Attractive.** For example, encouraging a sense of civic duty in a client's plan can be very powerful.
3. Make it **Social.** Within the constraints of client confidentiality, clients are more likely to support a plan if they have socialised it with the people most important to them. This is especially powerful in next generation family wealth transition planning, but it is rarely used.
4. Make it **Timely.** Immediate benefits encourage action. Just the feeling of having contributed to supporting our planet can help clients feel happy about their choices very quickly.

Demystifying sustainable **investments jargon**

The field of sustainable investing has become a sea of acronyms and technical terms, which can leave investors confused. We've put together a glossary of some of the key terms to know.

2°C limit or '2 degrees'

It is widely agreed that limiting the average rise in global temperatures to less than 2°C above pre-industrial levels by the end of this century may help stave off the worst of the natural disasters associated with global warming.

Active ownership

Actively exercising your shareholder rights and engaging with investee companies to encourage sustainable corporate behaviour and improve long-term shareholder value.

Carbon footprint

A measure of a group, individual or a company's total greenhouse gas emissions.

Carbon pricing

The cost of emitting CO2 into the atmosphere, either in the form of a fee per tonne of CO2 emitted, or an incentive that's offered for emitting less. Putting an economic cost on emissions is widely considered the most efficient way to encourage polluters to reduce what they release into the atmosphere.

Divestment

The sale of any investment related to controversial activities for social or political goals. For example, investors divested from South African assets during the apartheid era in protest against the regime.

ESG

Environmental, Social and Governance.

ESG criteria

A set of standards that investors use to screen potential investments. Environmental criteria consider how a company performs as a steward of nature. Social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates. Governance deals with a company's leadership, executive pay and shareholder rights.

ESG integration

An investment approach that takes into consideration a range of environmental, social and governance-related risks and opportunities, in addition to traditional financial analysis.

Greenwashing

Falsely communicating the environmental benefits of a product, service or organisation in order to make a company seem more environmentally-friendly than it really is.

Impact investing

Investments that are made with the intention of achieving specific, positive, measurable social and/or environmental benefits alongside a financial return.

Impact measurement

This is not the same as impact investing. It is the measurement of how companies' activities affect the world both positively and negatively. Measurements try to quantify the effect on companies' profitability if their negative social or environmental impacts or benefits were recognised financially.

Screening

An investment approach used to filter companies based on pre-defined criteria before investment. As an investor, you can use a negative screen (in which you deliberately exclude certain companies because of their involvement in undesirable activities or sectors) or a positive screen (in which you select companies based on their sustainability practices). In the jargon, this can also be a 'best-in-class investment' – where you only invest in companies that lead their peer groups in terms of sustainability practices and performance.

Sin stocks

Stocks of companies associated with activities considered to be unethical or immoral, such as tobacco, alcohol, gambling and adult entertainment.

Stewardship

An ongoing dialogue between shareholders and boards that aims to ensure a company's long-term strategy and day-to-day management is effective and aligned with shareholders' interests.

Transition risk

The financial risks that could result from significant policy, legal, technology and market changes as we transition to a lower-carbon global economy and climate resilient future.

UN Sustainable Development Goals (SDG)

A collection of 17 goals reflecting the biggest challenges facing global societies, environments and economies today.

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