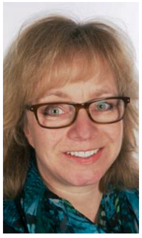
Trust and a cleaner, greener future



Julia Dreblow considers how offering SRI options and adopting an SRI advice process could bring the financial advisory world into line with other industries where consumer choice is key

Financial advisers provide a much valued service by helping their clients to plan for the future. Yet the current debate around the trustworthiness of financial professionals indicates that work remains to be done.

To imply that there is a simple solution to the trust issue would be unhelpful - however, suggesting that it may be useful to bring people's broader interests into the advice process more effectively should not be too controversial. In most areas of business, acting - and being seen to act - responsibly and fairly is integral to risk management and therefore shareholder value. Indeed, our industry has 'TCF'.

An ethical niche

Yet to date, our industry has given little consideration to whether or not investors may like to make a connection between their investments and the way in which money shapes the world. Indeed, rather than seeing this as a core responsibility, or opportunity, our industry tends to view consideration of the effects of where we invest as the preserve of an ethical 'niche'.

This is deeply flawed in my view as well as being out of line with other consumer facing industries. Considering where investments are held and their likely impacts should be firmly 'mass market' and integral to the investment selection process. After all, most people will have opinions on the kind of world they hope to retire into or leave to their offspring.

Ethical investment, with its origins in the early 80s, is clearly not the only solution. Indeed it is perhaps better viewed as the tip of the iceberg. The iceberg itself is now more likely to be seen as the newer breed of fund managers who have reflected on the relevance of environmental, social or corporate governance (ESG) issues and found different ways to invest in line with their deliberations.

Approaches therefore vary. Some have gone down the route of reviewing their investment management strategies across the board, while others have launched fund options to attract specific investors. Options now range from funds which either implicitly (as the result of a theme) or explicitly (as the result of screening criteria) favour different companies, to approaches which are only a slight variation on 'conventional' fund management.

Yet commonality exists. All such strategies are responses to the growing importance of ESG issues, including factors such as legislative pressures, resource constraints, environmental and social concerns and changes in public opinion. These fund managers, collectively referred to as the 'SRI' (sustainable and responsible investment) market, now offer advisers a broad spectrum of investment options to cater for different client interests.

Establishing an SRI advice process

For most advisers the first step in the direction of integrating clients' views on such issues into the advice process is for advisers

to recognise that the only way to find out whether or not someone is interested in such issues is to ask them. The second - and perhaps least palatable step - is to reflect on their own points of view and recognise that their opinions may differ from their client's, and that, in most cases, neither is strictly 'right' or 'wrong'. The third and most straightforward step is to work out how to integrate clients' personal views into the advice process.

For some advisers having a checklist of common areas of interest works well, for others 'keeping it simple' - by grouping related areas into segments and fact finding accordingly - can work rather better. **Figure 1** is an example SRI advice process.

Offering SRI options and adopting an approach of this kind can help bring the financial advisory world more into line with other industries where consumer choice is key. The food industry, for example, offers 'fair trade', 'organic', 'free range', 'sustainable' and 'locally-sourced' options. These labels help reflect what goes on behind the scenes as well as serving the needs of clients with different interests and opinions.

SRI segments

Grouping SRI funds into segments, rather than thinking of investments as 'ethical' or 'unethical' - or going to the other extreme and discussing every consideration in detail - is a variation on this approach. Offering segmented options is also a pragmatic way to help make investments clearer and better aligned to clients' lifestyle choices and longer term goals.

The segmentation model sriServices has developed cluster funds according to their core SRI attributes. The model currently offers eight 'styles', although more will no doubt emerge over time. Seven of the styles are highly accessible, regulated retail fund options. The eighth is a 'specialist' option, listing funds which may be harder for advisers to recommend.

While these segments focus on core attributes, there is in practice much crossover between the groupings. So in the same way that a shopper may be interested in both organic and fairtrade products (and a product may indeed be both) advisers may like to consider all the options that may be of interest. The list below groups these segments together to illustrate where similarities are greatest:

Funds where explicit ethical screening criteria are a core SRI attribute are...

- '**Negative**' **Ethical** investment options primarily focus on 'avoidance based' ethical screening criteria, making clear 'in/out' decisions. They tend to avoid areas that are traditionally viewed as 'unethical', such as armaments, tobacco, nuclear and alcohol, but are likely to consider environmental, social and governance issues, too. Good examples of such funds are those run by Kames Capital and Standard Life.

Figure 1: An example SRI Advice Process

SRI Advice Process

STEP 1
- **Ask everyone an initial SRI fact-find question**
- 'Are you interested in taking ethical, social, environmental or governance issues into account when you invest...?'

STEP 2
- **Identify SRI related aims, opinions & /or goals**
- Opinions vary so be flexible. Identify relevant SRI styles or segments

STEP 3
- **Combine SRI and regular fact-find information**
- List product, risk & SRI relevant options

STEP 4
- **Identify preferred options**
- Shortlist appropriate options that meet clients' full range of aims

STEP 5
- **Recommendations**
- Agree investment choices

STEP 6
- **Review**
- Agree & implement review strategy as aims, opinions and fund options can change

- '**Balanced**' **Ethical** investment options employ both positive and negative screening criteria and take a balanced view of the 'pros and cons' of what companies do. They may use 'best in sector' criteria in order to select industry leaders. These funds tend to have sophisticated and well-researched 'buy lists' but their nuanced approach can be harder to explain. The Ecclesiastical, F&C and Rathbones ethical options are good examples of this style.

- **Faith-based** funds are a small cohort of options which typically employ negative screening criteria to identify investments that suit a specific set of religious values, e.g. Shariah funds.

Styles of SRI which employ thematic approaches include...

- **Sustainability Themed** investments are funds which focus on a single or multiple 'sustainability' related issues - such as resource efficiency, labour standard, health and/or clean energy - to help identify future winners. These funds may also list ethical screens to make it clear where they can invest. Good examples of funds in this area include those from Alliance Trust Investments, Quilter Cheviot and WHEB.

- **Environmental Themed** investments focus on one or more environmental issues or areas of opportunity - such as climate change, resource usage, energy or water - sometimes in combination with ethical, social or governance related screening criteria. Good examples of funds in this area include options from Jupiter and F&C.

- **Clean Technology** investments tend to focus on newer, cleaner and often more specialist environmental solutions and technology companies. These funds tend to be more appropriate for experienced and wealthier investors, hence their separation from other funds with an environmental bias. The Allianz Global Eco-Trends fund is an example of such a fund.

Other useful options that have 'sustainable and responsible' investment strategies include...

- **Responsible Engagement** and increasingly **'ESG integration'** are the largest (in terms of assets), fasted growing and also the least well-known area of retail SRI. These are mainstream funds (or assets), which have across-the-board strategies that help fund managers to manage environmental, social and governance (ESG) risks and opportunities through additional research or dialogue with companies. Active players include Aviva, F&C, First State and Standard Life.

- **Specialist options** are investments that are likely to appeal to many of the same investors as the above groups. This includes the exciting and relatively new area of 'impact investment', where investments explicitly set out to achieve both financial and social returns. They are, however, often more difficult to advise clients on and are perhaps best viewed as appropriate for wealthier clients or as a 'toe in the water' - if unregulated or illiquid.

Offering to discuss this area with clients, both new and old, may just help make the investment world come across as being a little more forward-looking and trustworthy. It will also help to direct money towards the kinds of companies that investors may be interested in holding - if given the choice.

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