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An adviser's guide to sustainable investing

Adviser Solutions

Fidelity INTERNATIONAL

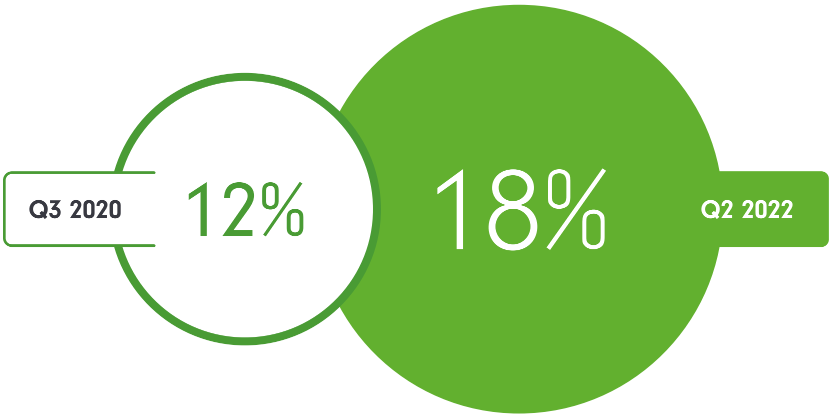
Matching money to morals

Sustainable investing has been around for many years. It first emerged in the UK around the 1980s with the launch of a number of what were then known as ethical funds. While there have always been investors keen to match their money with their morals, it is fair to say that up until a few years ago, sustainable investing remained a somewhat niche area. However, this is no longer the case – sustainable investing has now moved into the mainstream and many more clients are taking an active interest in just how their money is invested.

> 'Lots of my clients say...it sounds like the right thing to do'
>
> **Respondent to 'IFA DNA: Sustainable investing and the advice sector'[3]**

The trend towards a more sustainable approach has been led by institutional investors such as pension funds and investment foundations. The legislative and regulatory backdrop has facilitated this move with, for example, the introduction of legislation to tackle climate change. As wider society has become much more conscious of environmental and social issues, retail investors have come on board too.

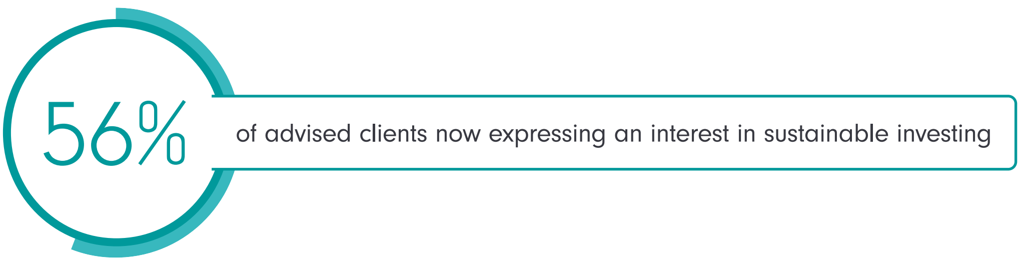
Percentage of advised client assets in sustainable funds or solutions



Rising retail interest in sustainable investing is reflected in increasing assets under management and fund options. Indeed, research from NextWealth[1] shows that 18% of advised client assets were invested in sustainable funds and solutions in April 2022 – up from just 12% in the third quarter of 2020. In terms of choice, there were nearly 500 sustainable fund options available in the UK in April 2022, more than double the number on offer just 18 months before[2].

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' report[3], 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. This asset allocation shift is probably already underway as over half of advisers said they are more likely to recommend sustainable investments to clients as a result of the Covid-19 pandemic.

A remaining issue in the retail market is confusion over what exactly constitutes an Environmental, Social and Governance (ESG), sustainable or responsible investment. The absence of clear definitions has made it difficult for advisers to compare products and providers and to feel confident a fund will adhere to the client's definition of a sustainable investment. However, this is changing as sustainable investing moves into the mainstream. As we cover on pages 5-7, specialist organisations such as SRI Services have been at the forefront of classifying the different styles adopted by sustainable investment managers. Indeed, our own Sustainable Investment Finder, which allows advisers to search for funds using filters, draws upon the definitions laid down by SRI Services.



1. Source: NextWealth Sustainable Investing Tracking Study May 2022.
2. Source: Morningstar as at September 2020 and April 2022, includes onshore and offshore funds identified as sustainable within all IA sectors.
3. Fidelity Adviser Solutions: IFA DNA 'Sustainable investing and the advice sector', April 2021.

What is meant by sustainable investment?

There are many terms used to describe sustainable investing, such as green, responsible, socially responsible and impact investing. These are often used interchangeably even though they can signify different investment approaches. Traditional ethical investing, for example, typically involves excluding companies from specific 'sin' (exclusion) sectors such as alcohol and tobacco. Impact investing, on the other hand, goes further and involves investing to make a positive social and environmental impact.

Today, the common theme amongst sustainable investments is that they tend to focus to some degree on Environmental, Social and Governance (ESG) considerations, although some funds may concentrate on specific factors such as climate change. The following can be regarded as examples of issues within the three pillars of ESG investing:

Environmental issues

Climate change, resource depletion, waste, pollution and deforestation.

Social issues

Human rights, modern slavery, child labour, working conditions and employee relations.

Governance issues

Bribery and corruption, executive pay, board diversity and structure, political lobbying or donations and tax strategy.

Sustainable investing isn't restricted to just equity investing. It extends across asset classes – there are, for instance, responsibly-managed bond and multi-asset portfolios available to retail investors. Passive and smart beta strategies are also offered by some providers.

Selecting sustainable funds for your clients

Checking a fund is appropriate for a client is, of course, an important part of portfolio construction. Arguably, this is even more so if a client has expressed certain views on how their money should be invested from a sustainability perspective. A client, for example, may have moral or religious objections to investing in certain industry sectors. While some sustainable managers implement strict sector exclusion policies which may cover these objections, other sustainable managers may invest in these sectors if a company is perceived to be increasingly focused on sustainability as a business.

The key is to check the particulars of each fund's approach; but this is not always easy, particularly given there has been a lack of common language used to describe the various approaches to sustainable investment. This is now changing with fund classifications becoming more widely available.

SRI Services, an independent and specialist business with over three decades of experience in sustainable investment, has, for example, developed a set of 'SRI Styles' to make comparisons easier. SRI Services' classification system is based on the key issues a fund considers (such as sustainability, environmental, and ethical factors), as well as the approach taken by the fund (whether its focused, tilted, weighted or with only limited exclusions). Every sustainable fund available through our service has been classified as one of these seven styles.

SRI Styles

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 and/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.

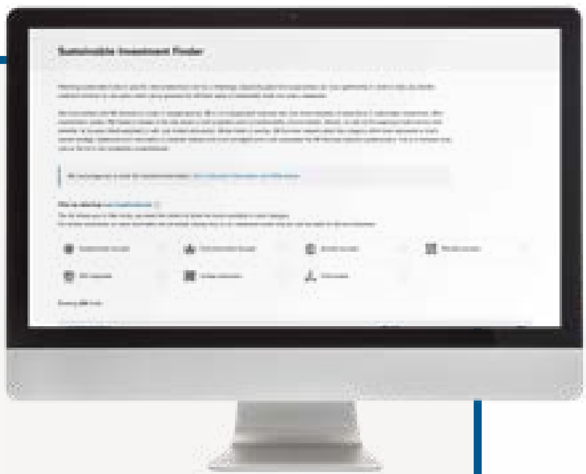
Limited exclusions
An investment approach that will only limit investment in, or exclude a small number of, companies involved in areas such as tobacco or businesses that breach commonly adopted ESG standards. They may aim to encourage companies to improve their standards.

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.

Match funds to client needs with our Sustainable Investment Finder

Our user-friendly Sustainable Investment Finder helps you identify potential solutions for any given client by allowing you to search for funds based on the seven SRI Styles listed above. You can refine your search by selecting additional preferences that reflect a client's aims more closely, such as limiting the results to funds that have adopted an animal welfare policy or exclude manufacturers of armaments.



SRI Styles and client aims

The following table is designed to help advisers match the seven SRI Styles to a client's sustainable investment aims (these seven SRI Styles are consistent with the primary filter within our Sustainable Investment Finder tool). This table has been produced by SRI Services and is only intended as a guide and should not replace your own due diligence research.

	Sustainability themes			Values led		Tilted	Limited
SRI Style name	Sustainability focused	Environmentally focused	Socially focused	Ethically focused	Faith based	ESG weighted	Limited exclusions
Client aim							
General interest in sustainability	✓	✓	✓	✓	?	✓	?
Keen interest in sustainability and positive outcomes	✓	✓	✓	?	✗	?	✗
Wants to avoid coal, oil and gas majors	✓	✓	?	?	?	?	✗
Focused on people and social issues	✓	?	✓	✓	?	?	✗
Wants to avoid arms, tabacco and other damaging industries	✓	?	?	✓	?	?	?
Wants to encourage companies to improve	✓	✓	✓	?	✗	?	?
Animal welfare focus	?	?	?	?	?	?	✗

Fund strategies vary within these SRI Styles and there is crossover between many of them.

✓ **Yes – most funds in this style will meet this aim**

? **Maybe – many of the funds in this style will meet this aim**

✗ **No – most funds in this style will not meet this aim**

Source: SRI Services.

ESG standards and practices

A number of principles and standards act as a common reference point for investment managers adopting a responsible approach. A selection of these are shown below. Ensuring an asset manager has signed up to some of these codes or standards could form part of the due diligence process when selecting a responsible fund manager on behalf of a client.

The UN-supported Principles for Responsible Investment (PRI) is regarded as the world's leading proponent of sustainable investment. It encourages investors to use sustainable investment to enhance returns and better manage risks. It has issued a set of voluntary and aspirational investment principles that all signatories must commit to (shown opposite). Around the world, there are now over 3,800 signatories to the PRI, including over 600 asset owners[4]. Signatories are regularly assessed on their progress against targets and peers with ratings allocated to certain indicators.

The UN's Sustainable Development Goals (SDGs)

Launched in September 2015, these 17 high-level goals form a blueprint to achieve a better and more sustainable future for all. The aim is to achieve them all by 2030. A short description of each SDG appears in our glossary of sustainable investment terms. These goals are influencing asset managers in many ways. Firms may take these into account when analysing companies as part of the stock selection process, for instance, and when engaging with the companies as shareholders. Some asset managers have also launched SDG impact funds.

4. Source: Principles for Responsible Investment, as at 31 March 2021.

What are the Principles for Responsible Investment?

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice.

Signatories commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes
2. We will be active owners and incorporate ESG issues into our ownership policies and practices
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest
4. We will promote acceptance and implementation of the Principles within the investment industry
5. We will work together to enhance our effectiveness in implementing the Principles
6. We will each report on our activities and progress towards implementing the Principles.

Source: PRI.

The UK Stewardship Code

The UK Stewardship Code sets high expectations of those investing money on behalf of UK savers. It consists of 12 principles for asset managers and asset owners. It establishes a clear benchmark for stewardship as the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Climate Action 100+

Climate Action 100+ is an initiative taken by the investment industry to ensure the world's largest corporate greenhouse gas emitters take the necessary action on climate change. To date, 700 investors with more than $68 trillion USD in assets under management have signed on to the initiative[5]. Signatories engage with companies to curb emissions, improve governance and strengthen climate-related financial disclosures.

Task Force on Climate-related Financial Disclosures

The Task Force on Climate-related Financial Disclosures (TCFD) develops voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders.

5. Source: climateaction100.org, April 2022.

Four things to consider when selecting a sustainably-managed fund

1 Is the fund's management consistent with the client's aims?

Many clients may be satisfied that a fund is managed on a broadly responsible basis, whereby ESG factors are considered as part of the investment process. Stocks from certain 'sin' sectors may be included, for example, if the company has demonstrated that their ESG credentials are moving in the right direction. However, some clients may state that investment in certain stocks or industry sectors should be completely avoided due to ethical, moral or religious considerations. It is therefore important to check whether the investment manager or fund has an appropriate exclusion policy in place that covers a client's concerns.

2 How committed is a fund manager to sustainable investment?

One way to establish whether an asset manager is committed to sustainable investment is to check whether they are a signatory to certain standards or make specific pledges on areas such as climate change or the UN's Sustainable Development Goals. A manager may be a signatory to the Principles for Responsible Investment (PRI), for example. As part of this commitment, signatories are assessed on their progress towards certain targets and against peers. Asset managers frequently make PRI Assessment Reports available to investors in order to demonstrate how they are performing in this area.

In addition, asset managers may publish their engagement and voting policies as well as disclosing their voting records and other relevant stewardship and sustainability reports or commitments. These can be analysed to help establish a firm's ESG credentials.

3 The fund manager's investment process and resources

Sustainable funds, like all other funds, will be managed in a certain way. As such, researching an asset manager's investment process may be an important factor in your due diligence process. Some may claim that their ESG research process goes further and deeper than others, for example. Some asset managers may have dedicated ESG teams or have groups focused on specific activities, such as stewardship. If the fund takes a passive approach, consideration could be given to how the index is constructed and how the constituents are weighted within that index.

4 Sustainable fund ratings

In the same way as a fund can be assigned a rating based on its performance or the perceived robustness of its investment process, it can also be rated in terms of its ESG credentials. Square Mile Investment Consulting & Research, for example, issue 3D responsible ratings for sustainably-managed funds. SRI Services have also announced that they plan to launch a badge that will be awarded to funds based on certain ESG criteria. It is important to note ratings services may analyse different factors or score certain criteria in different ways when arriving at their ratings.

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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