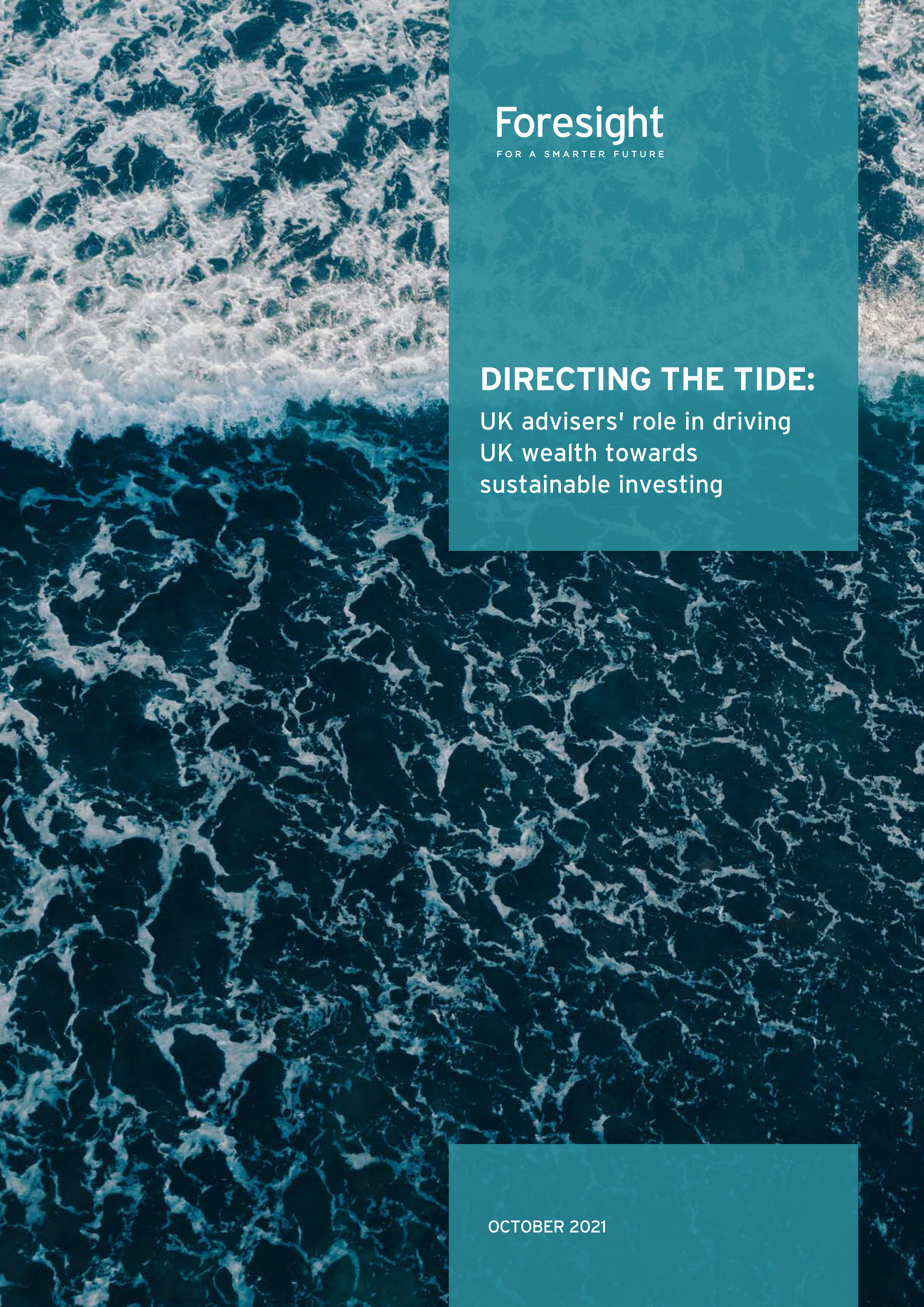

Foresight
FOR A SMARTER FUTURE

DIRECTING THE TIDE:

UK advisers' role in driving UK wealth towards sustainable investing

OCTOBER 2021

DIRECTING THE TIDE:

UK advisers can play a pivotal role in helping investors to understand, develop and fulfil ESG goals.

Calls to protect the environment and tackle social injustices continue to grow louder globally. Climate change is climbing the international agenda and public demonstrations reflect growing sentiment towards promoting change and securing a 'sustainable' world.

A major element of this movement is the demand to direct investors' capital towards achieving Environmental, Social and Governance (ESG) aims.

This clamour has only grown since we published our last ESG research report in January 2020, when the implications of COVID-19 were not recognised. Since then, the world has changed dramatically. Public sentiment has focussed even more towards sustainability and the White House has a new president committed to environmental causes.

The UK's private wealth is substantial and can make a significant contribution towards a sustainable world. If the power of this wealth is to be leveraged, then key influencers in bringing this about will be financial advisers.

They engage with those who own the lion's share of this personal wealth and can play a pivotal role in helping investors to understand, develop and fulfil ESG goals.

To gain more insights into what influence wider trends are having on these advisers and their thoughts on ESG integration, the reasons for its growing popularity, the barriers to its advancement and how to offer clients solutions, we have conducted new research among UK financial advisers. Comparing our results with those of the survey we conducted last year also reveals some of the dynamics around how sentiments are changing on these issues.

Our findings are outlined in this report.

DIRECTING THE TIDE:

The growing popularity of ESG

The growing popularity of ESG integration in investments is undeniable on the global stage. But to what extent is it becoming standard practice among UK advisers?

Our research shows that ESG is indeed increasingly important to advisers: 80% now say it is important when building client portfolios, including 28% who say it is 'very important'. These figures represent a significant step change versus last year, when 65% described this as important (Q7).

UK retail investors seem to be understanding the importance too, albeit gradually. The proportion of advisers who say more than 50% of their clients now express a preference for ESG investing has risen from 9% in 2020 to 12% this year, while those who say none of their clients are expressing a preference for it has fallen slightly over the year from 12% to 8% now (Q5).

Advisers expect that most (over 50%) of their clients will be invested in portfolios in which ESG is a core component in an average of about 4.7 years. Only 6% of advisers now say this will never happen, versus 12% who said this last year (Q10).

> *"From an investment viewpoint, real estate offers reliable, inflation-adjusted returns, including steady rental income, which is highly sought by investors in a world dominated by lower for longer interest rates."*

Real estate offers sustainable option

One asset class with significant sustainability implications is real estate. Buildings can have a massive positive or negative impact on society and the environment in which we live and work. The materials and energy used to construct them has significant implications for the environment, while they also consume a significant majority of the energy produced in the developed world. Making them more efficient is key in the fight against climate change. As the environment in which we work and live, they are also fundamental to societal health and well-being.

From an investment viewpoint, real estate offers reliable, inflation-adjusted returns, including steady rental income, which is highly sought by investors in a world dominated by lower for longer interest rates.

A significant minority (33%) of the advisers in our research are seeing an increase in appetite for 'sustainable' real estate. The most popular reason for this is the wish to support companies that are speeding up the adoption of sustainable practices, which was cited by 78% of those advisers who are seeing such an increase. One third of this group (33%) also cite sustainable real estate's potential to deliver returns that are uncorrelated to global equity markets and 19% cite the resilient, consistent yields of the asset class (Q17).

80%

OF ADVISERS

see ESG considerations as important when building portfolios for their clients

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Barriers to mass adoption

The paradigm shift towards sustainable investing was never going to happen without challenges.

There is clearly growing momentum in the investment industry towards greater adoption of ESG principles but many people are naturally sceptical and quite rightly question what sustainability means in practice. There is a lack of consensus and standardisation around what ESG means and how it relates to investing.

Clients' unfamiliarity with ESG is biggest hurdle

UK advisers believe that the biggest barrier to recommending ESG investment options is their clients' lack of familiarity with the concept. This was cited by 43% of respondents. This is significantly higher than the 29% who said so in 2020.

While it may seem that awareness of ESG in the retail investor space has diminished, it may be that advisers' own understanding has improved to such an extent that they appreciate more fully the knowledge gaps among their clients. Nearly two in five (39%) this year also cite confusing terminology surrounding ESG investment as a barrier (Q6).

Absence of ESG standards hampers advice

In terms of delivering advice and selecting suitable ESG strategies for clients, the greatest challenge is the lack of an industry-wide definition of ESG investing, according to 49% of advisers. The lack of an industry-wide gold standard for ESG criteria and a lack of transparency when reporting ESG activity were also each cited by 20% of advisers (Q12).

The investment industry is still some way from providing standard definitions, although new regulation being introduced by the European Union this year does take a major step forward in helping companies and investors to define what qualifies as a sustainable economic activity or investment. The new regulation is part of the EU's overall 'Green Deal' to make the economy sustainable. Whilst it is only applicable to EU funds at present, it does provide a useful framework to create financial products that have 'green' credibility. Most advisers (62%) are unconcerned about the impact of the new regulation on ESG fund portfolios, with 38% expressing some concerns.

Evidence counters concerns over performance

A substantial minority of investors also still question whether a focus on ESG harms investment performance. The proportion of advisers referring to clients having concerns about performance in relation to ESG has risen over the last year from 24% to 31% now (Q6).

A majority (72%) of advisers believe incorporating ESG considerations into investment strategies does not usually impact financial returns negatively though, with just 13% saying this is the case and 15% saying they do not know (Q8).

Advisers' thinking on this is in line with several academic studies that have shown there can be a positive relationship between corporate ESG scores and financial performance. Similarly, funds with a commitment to ESG are outperforming non-ESG funds on a risk-adjusted basis.

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Barriers to mass adoption

There are several reasons supporting this positive link.

Companies that are well-governed seem to be more likely to outperform those that are not. If a company is cognisant of modern ESG principles then it is more likely to be well-governed and therefore more profitable with a tighter control on risks. Equally, conforming with ESG principles reduces the risk of falling foul of ever-changing ESG-linked regulations. It is becoming more common for suppliers and customers to expect companies to adhere to strict sustainability principles to engage with them. Sustainable procurement has been a core practice in the public sector for some time. Bodies such as the UN and EU continue to develop and implement policies and strategies for sustainable procurement, for example. The private sector has been slower in adopting sustainable procurement practices but is increasingly forced to do so because of global trends. Some procurement consultancies such as Efficio are also offering sustainable procurement as an element of their expertise.

A 2017 MSCI[1] study showed that companies with stronger ESG profiles typically exhibited higher profitability, lower frequency of severe drawdowns and lower systematic risk. Morningstar Financial Research provided further evidence, reporting that 73% of the 56 Morningstar ESG indices outperformed their non-ESG equivalents from inception[2]. Companies that effectively manage ESG risks and can capitalise on sustainability opportunities may in fact be better long-term investments.

There are several examples of this, especially throughout the pandemic. Some observers have attributed this outperformance to the growing popularity of sustainable investing having attracted more positive interest and demand from investors driving up prices.

Clients' lagging knowledge holds back demand

Clients' appreciation of the positive link between ESG and performance lags their advisers'. The overwhelming majority (93%) of advisers in our survey say fewer than half of their clients are aware of this link, including 63% who say less than 10% of their client base is aware of this. Only 8% would say more than half of their clients are aware of this, and only one in 50 (2%) says more than three in four of their clients know this (Q9). On average, around 17% of clients are aware, which is marginally higher than the 14% advisers cited in 2020.

So there are still substantial challenges facing those advisers who do wish to integrate ESG into their clients' investments. Around half (49%) of advisers still note low investor demand as the main reason preventing them from investing a higher proportion of clients' assets in ESG funds and 11% cite fund performance. A significant minority (38%) cite a lack of available options, which highlights a key failure on the part of the UK investment industry. Other reasons cited individually by advisers include a fear of greenwashing and a lack of clarity about ESG investing, as well as getting time to speak to all clients about the issues. One adviser blames his firm having no available ESG portfolios and a limited range of funds that do not always match average true range measures of volatility (Q13).

These issues are being increasingly addressed by the industry, however, with many new funds being launched and marketing campaigns that are promoting a growing awareness of ESG principles and the favourable risk-adjusted returns they can secure.

73%

OF THE 56 MORNINGSTAR ESG INDICES

outperformed their non-ESG equivalents from inception[2]

Past performance is not an indicator of future performance.

Solutions

If the world is to see more assets invested responsibly then financial advisers will clearly play a pivotal role by directing more clients towards ESG strategies. The next section will explore what factors play a part in driving this change forward and what solutions may exist to overcome the barriers expressed by advisers.

SOLUTIONS:

What can be done

Investing responsibly as a concept goes back several decades – but mostly as a niche pursuit. As it increasingly becomes part of the mainstream there is still much to do in terms of raising awareness and drafting regulations that define standards and govern appropriate behaviour in companies.

More sophisticated measures are needed to assess companies and rate funds. These need to be sufficiently robust to avoid 'greenwashing', or the spinning of environmentally friendly credentials.

All of this must also be implemented within the context of realistic goals. The United Nations went some way towards defining these with the Sustainable Development Goals (SDGs) it published in 2015, although the actual investment levels being made are woefully short of what is needed to fulfil them by the target date of 2030.

TOOLS ARE NEEDED TO INFORM INVESTORS

This need for more information to help promote sustainable investing to clients is highlighted in our research. Nearly half (45%) of advisers say education sessions would encourage them to suggest ESG funds more frequently, followed by learning tools (40%), available case studies (32%) and testimonials (11%). Only 11% said none of the above would help (Q14).

The provision of accurate ratings is also a clear priority among advisers. When selecting products for their clients that integrate ESG, the most common approach among advisers is to select those that invest in companies with high ESG scores or that have a demonstrable commitment to improving their ESG scores. This was cited by 65% of advisers.

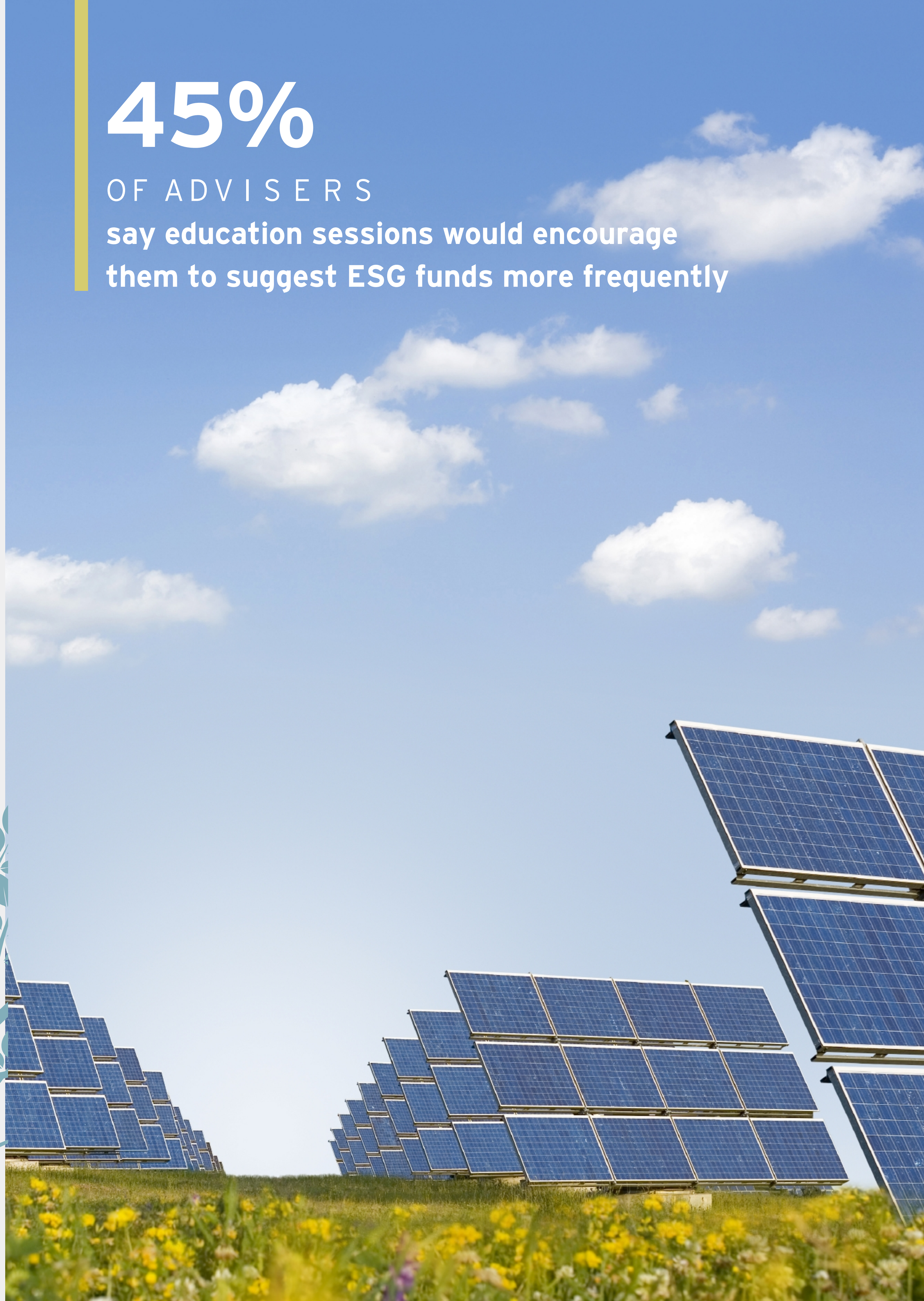
Just over half (55%) of advisers also look for products investing in companies with a demonstrable commitment to environmental issues i.e. renewable energy/climate change, or which seek to make a positive societal or environmental impact, such as by building social housing or renewable energy generation (50%).

A practice that was formerly the main rationale for responsible investing, namely investing in products that excluded companies deemed to cause harm because of their involvement in controversial products, is still practised by 37% of advisers (Q11).

45%

OF ADVISERS

say education sessions would encourage them to suggest ESG funds more frequently



DIRECTING THE TIDE:

Conclusion

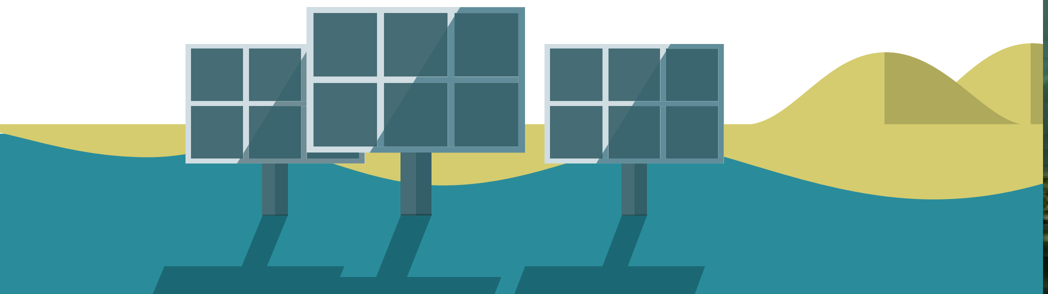
There can be no doubt that UK advisers are increasingly open to joining the global movement towards sustainable investing.

Public opinion is moving towards that but our research shows that advisers are already ahead of their clients in understanding the issues and are well-placed to help direct UK retail wealth towards ESG goals.

There are still many challenges for the investment industry to overcome, which are recognised by advisers, and significant changes are needed before ESG factors are integrated into most, if not all, investors' portfolios.

Such a scenario is entirely feasible – but to get there the investment industry must provide the investment vehicles to achieve it, together with a high degree of transparency and accountability to show investors what positive impacts their investments are having.

Advisers will need sustainability-led investment managers with excellent ESG credentials such as Foresight. We align our investment strategies with the same trends shaping society's concerns around ESG issues. We are committed to sustainability and are prepared to lead the way in helping to educate the investment community and shape future approaches to sustainable investing.



RESEARCH METHODOLOGY

The survey was conducted by PollRight among 112 financial advisers between 15th February 2021 and 12th April 2021.

The advisers had an average of 131 investment clients and managed an average of £51 million.

More than half (56%) had a prescribed asset allocation policy.

(1) Source: MSCI ESG Research, LLC, **"Foundations of ESG Investing Part 1: How ESG Affects Equity Valuation, Risk and Performance."** Contributors: Guido Giese, Linda-Eling Lee, Dimitris Melas, Zoltan Nagy, Laura Nishikawa. November 2017

(2) Source: ESG Funds Beat Non-Sustainable Sister Funds, Morningstar, 24 September 2019

Appendices

Clients expressing a preference for ESG (Q5)

Proportion of client base	Responses in 2021	Responses in 2020
Less than 50%	78%	75%
More than 50%	12%	9%
None	8%	12%
Don't know	2%	4%

The biggest barriers to recommending ESG investment options to clients (Q6)

Type of barrier	Responses in 2021	Responses in 2020
Client's lack of familiarity with ESG investment	43%	29%
Confusing terminology surrounding ESG investment	39%	-
Client's low understanding of ESG investment	38%	18%
Client's concerns about underperformance	31%	24%

Importance of ESG to advisers when building portfolios (Q7)

Degrees of Importance	Responses in 2021	Responses in 2020
Very important	28%	15%
Fairly important	52%	50%
Not important	20%	35%
All important	80%	65%

Impact of ESG integration on financial returns (Q8)

Answers	Responses in 2021	Responses in 2020
Yes	13%	15%
No	72%	68%
Don't know	15%	16%

Proportion of client base aware of positive relationship between ESG and performance (Q9)

Proportion	Responses in 2021	Responses in 2020
Fewer than 10%	63%	58%
11-25%	17%	15%
26-50%	13%	6%
51-75%	6%	4%
More than 75%	2%	4%
Average	17%	14%

How long before advisers expect the majority (over half) of their client bases will be invested in portfolios in which ESG is a core component (Q10)

Length of time	Responses in 2021	Responses in 2020
Within two years	26%	13%
In between three and five years	46%	31%
In between six and 10 years	14%	22%
In between 11 and 15 years	8%	8%
Never	6%	12%
Average years	4.7 years	5.7 years

Appendices

Advisers' approaches to selecting ESG products for clients (Q11)

Approach	Responses in 2021	Responses in 2020
Invest in companies with high ESG score or a demonstrable commitment to improving it	65%	54%
Invest in companies with a demonstrable commitment to environmental issues	55%	59%
Impact investing	50%	55%
Exclusions through a negative screening process	46%	39%
Companies with a demonstrable commitment to governance issues	37%	40%
None of the above	12%	13%

The greatest challenges to advising clients on selecting suitable ESG strategies (Q12)

Challenge	Responses in 2021	Responses in 2020
Lack of an industry-wide definition of ESG investing	38%	45%
Lack of an industry-wide 'gold standard' for ESG criteria	11%	21%
Lack of transparency when reporting ESG activity	49%	20%

Barriers to investing a higher proportion of assets in ESG-focused funds (Q13)

Barrier	Responses in 2021	Responses in 2020
Lack of available options	38%	33%
Fund performance	11%	8%
Low investor demand	49%	34%

Tools that could encourage advisers to suggest ESG funds more frequently (Q14)

Tool	Responses in 2021	Responses in 2020
Education sessions	45%	57%
Learning tools	40%	43%
Case studies	32%	45%
Testimonials	11%	26%
None of the above	29%	19%

Degree of concern about the European Union Taxonomy's impact on ESG fund portfolios (Q15)

Advisers' concern level	Responses in 2021
Very concerned	1%
Fairly concerned	37%
Not concerned	62%
All concerned	38%

Reasons for an increasing demand for sustainable real estate (Q17)

Reason	Responses in 2021
The opportunity to support companies that are speeding up the adoption of sustainable practices	26%
Returns that are uncorrelated with global equity markets	11%
Resilient, consistent yields	6%
Proportion seeing an increase in demand	33%
Advisers not seeing an increase in demand	67%

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