

# Sustainable Investing Tracker Study

Advisers climb upon the slope of enlightenment as assets show resilience to market headwinds

October 2022





# Executive Summary

## Demand for sustainable investing is on the rise despite market headwinds

22% of advised client assets were invested in sustainable funds and portfolios in August 2022. This is up from 18% in April. Advisers report that 26% of new client money goes into sustainable funds and solutions.

Client demand is on the rise, the percentage of clients raising sustainable investing with their adviser has risen above 20% for the first time.

After a sharp fall in adviser confidence on sustainable processes, the most recent wave of the survey has seen confidence grow slightly from a low point six months ago.

Multi asset funds, in-house built portfolios and DFMs for model portfolio service are the leading investment strategies used by advisers for sustainable investing.

## Advisers enter the slope of enlightenment

## Sustainability reporting is a progressing area for advisers

The proportion of advisers who stated that they report the sustainability of investments to clients has increased by 9% up to 59% in Q3 2022, still more than one third of advisers say they don't report sustainability to their clients.

Reporting the sustainability of investments to clients remains the area advisers are least confident about. Only 45% of advisers said they feel confident or very confident reporting sustainability of investments against sustainable objectives.

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# Introduction

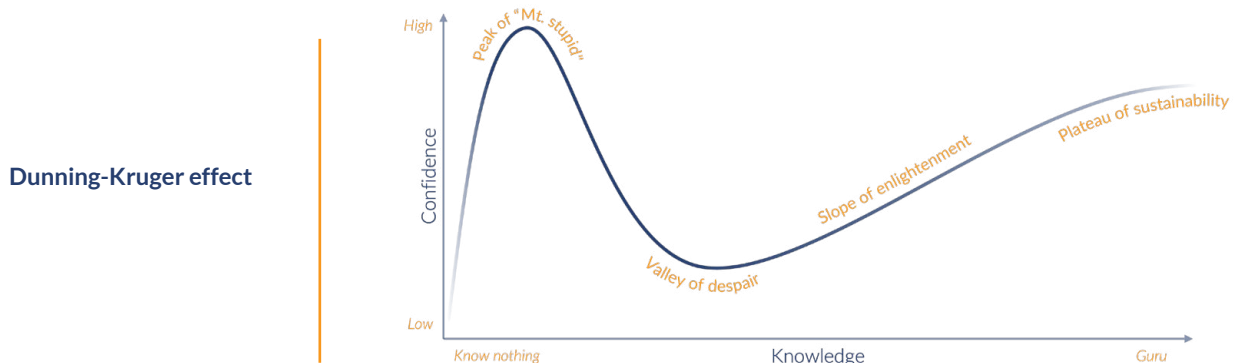
This report marks four years since NextWealth started tracking adoption of sustainable investing among financial advisers and their clients. Adoption continues to rise along with awareness of the complexities and shortcomings of sustainable investing and the challenges of matching client preferences to solutions.

Confusion in terminology continues to hinder adoption. Many use the terms ESG and sustainable investing interchangeably. In our [April report](#), we said they are as different as American and British football. ESG refers to investment inputs, an assessment of investment risk. Sustainable investing refers to outputs. When clients talk about sustainable investing, they are usually talking about the latter. The mismatch in language between product providers and end clients has put advisers in the awkward middle.

Our interviews with clients of financial advisers suggests that whilst advisers are bringing up ESG and sustainable investing, they are too often approaching it as a 'tick box exercise' as part of the fact find. Clients told us that they want to have a conversation about their investing preferences. Financial advisers told us that this is due to a lack of a consistent framework to understand customer preferences without risk of leading them down a particular path.

Since we began researching this topic, we have seen adviser confidence drop off significantly in many aspects of sustainable investing, including researching solutions, matching client preferences to solutions and reporting. The most recent wave of the survey has seen confidence grow slightly from a low six months ago. We think this might be a case of the Dunning-Kruger effect.

Dunning-Kruger is a cognitive bias where people with limited knowledge or competence overestimate their knowledge or competence. They describe it as starting at the peak of 'Mt Stupid', fall to the 'valley of despair' and slowly climb back up as we gain knowledge and competence up the 'slope of enlightenment' toward the 'plateau of sustainability'. Could financial advisers be entering the slope of enlightenment? Our future studies may confirm this trend.



Some in the financial advice world/industry have referred to sustainable investing as a fad. Our research with advisers and their clients confirms this is not the case. Momentum continues to build – measured by assets, client interest and adviser understanding. While we are in a period of underperformance for sustainable funds and challenging markets, we believe this trend to sustainable investing will continue. We look forward to charting the course ahead.

We hope employees of financial advice firms find this report useful to benchmark their own approach and process. Thank you to our sponsors for continuing to support this research. We couldn't publish this work without them. If you are considering your sustainable investing solutions, we hope you'll give them a look.

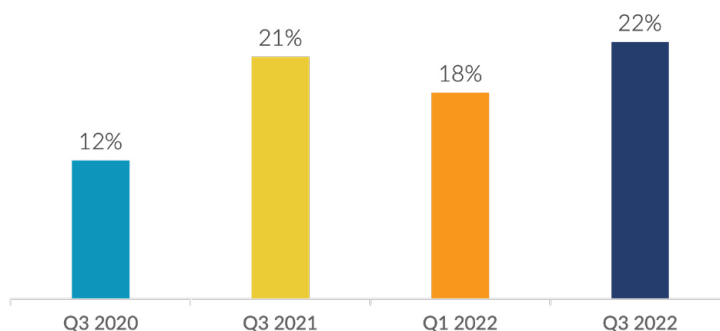


# Adoption: Measuring the uptake in sustainable investing

## Current and future demand for sustainable investing

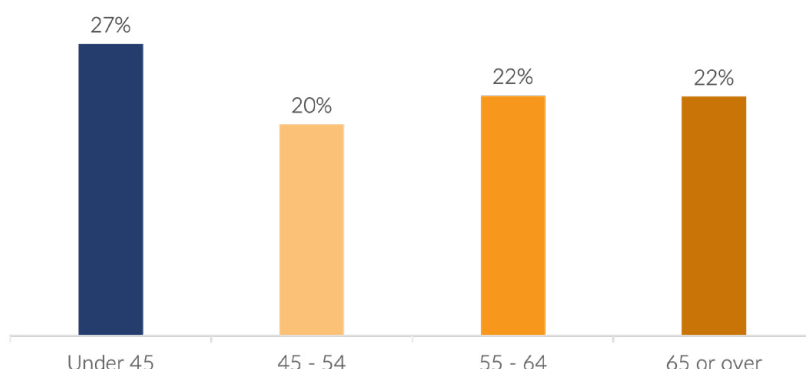
While some expected customer interest in sustainable investing to fall in face of faltering markets and a cost of living crisis, it continues to rise. There remains strong appetite among advised clients to invest sustainably. Both the proportion of advised client assets and the percent of clients bringing up sustainable investing in conversations with advisers are up over the past six months, year and two years. The outlook is strong for demand for sustainable funds and portfolios from advised clients.

**Figure 1:**  
Percentage  
of advised  
client assets in  
sustainable funds  
or portfolios



Nearly a quarter (22%) of advised client assets were invested in sustainable funds and portfolios in August 2022. The increase comes against a back-drop of tough market conditions and a year of under-performance for sustainable funds and portfolios.

**Figure 2:**  
Percentage  
of advised  
client assets in  
sustainable funds  
or portfolios - by  
age of adviser



Younger advisers (under 45) on average have a larger share of client assets in sustainable funds or portfolios. This difference by age tells us that there is an element of revealed preferences to client demand. Where advisers ask clients about their views clients are more forthcoming and willing to invest sustainably. In our consumer focus groups we heard a similar message.

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“For me, not only is it down to performance, but also the behaviour of the things that's related to. And I can see the way he conveys it across. If he[the adviser], is passionate and energetic about it, then I know I'm kind of onto a winner there. So I'll be like, right, okay, you seem keen for those. Let's go with that.”

– Financial adviser

Some advisers remain cautious when bringing up the topic so as not to lead clients into answers that are not their own:

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“But also, you don't want to lead them down the path of making them feel bad. So I think it's difficult that it's quite a fine line. Yeah. Because you can quite easily guilt trip someone into doing something they don't really want to do.”

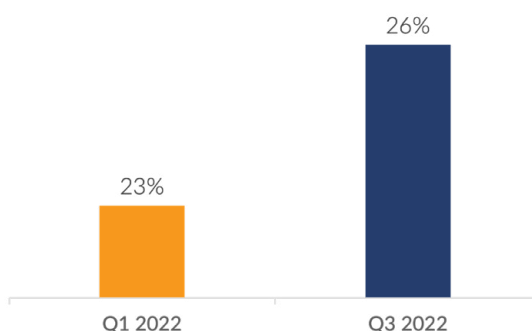
– Financial adviser

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"One is a stated preference, the client comes in with an explicit view that actually they want to invest sustainably. That's quite small part of the demand. And then the slightly larger part of the demand is under revealed preference whereby on education as part of the interaction with adviser, the adviser makes them aware of the sort of investment styles and potential options. And then what we normally get is a client who has a view that, yes, they'd prefer to do that (invest sustainably), but not necessarily the whole way."

– Financial adviser

**Figure 3:**  
Percentage  
of new client  
assets allocated  
to sustainable  
investments in the  
past 12 months



Advised clients say they want to be asked by their adviser about sustainable investing.

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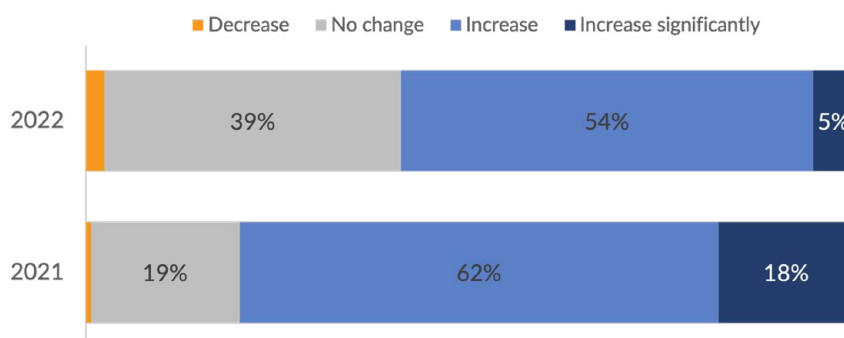
"We wait to be advised... yes, it's about getting a reasonable return, not taking too many risks, [but] it will be interesting, with a meeting coming up, whether the tone of the discussion has changed in relation to ESG...But I wouldn't say no [to considering ESG investments]."

"I just leave things up to my adviser because I trust him...he brought up the topic of ESG [very briefly] but he seemed to suggest that it was too risky... so we just left it...I've heard more about ESG recently, so I'd be intrigued to know more"

– Advised client

We also asked about new client assets to get a comparison of stock versus flow, assets versus sales. Advisers report that 26% of new client money is going into sustainable funds and solutions, suggesting more new money is being invested in this way. Once again this shows strong resilience for sustainable investments and suggests we'll see assets in sustainable funds and portfolios continue to grow over time.

**Figure 4:**  
Anticipated  
change in assets  
held in sustainable  
investments in the  
next 12 months



With flows higher than stocks it is likely that the final level of sustainable investments among a wider portfolio will be higher than the 20% range we have seen so far.

When asked if they expect allocation to sustainable investments to increase in the next 12-months, most said they expect to increase. While the overall picture remains one of expected positive growth in assets in sustainable investments, fewer advisers than last year expect assets in sustainable investments to increase. This could indicate a slowing of the growth of sustainable investing or could suggest that there are other issues further up investors' agendas.

One adviser firm which also runs a DFM service put it like this:



*"We're still growing and investors are still coming to us. Both directly and through the IFAs because of the interest in climate change, or the greater cost of living and wanting to tackle social inequality. So these types of trends remain, these social and environmental challenges that they want to tackle. So I think in general, there is continued demand, but a little bit of a slowdown of growth."*

– Financial adviser

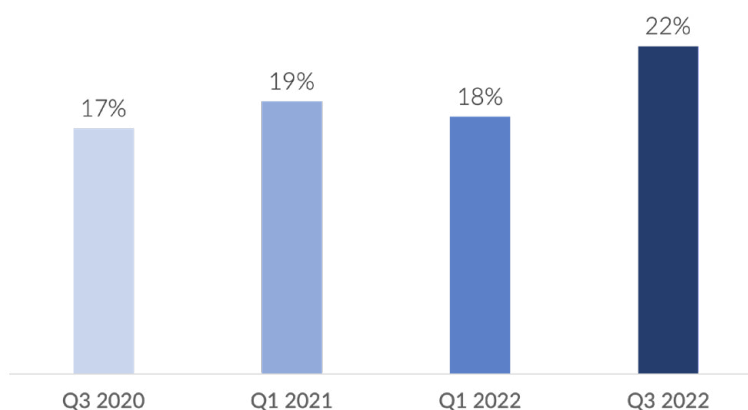
Whilst another adviser took the view that all asset growth is slow at the moment:



*"Growth has probably slowed slightly, but I'm not sure this is all to do with their perception of sustainable investing. I think people are just cautious about generally investing at the moment."*

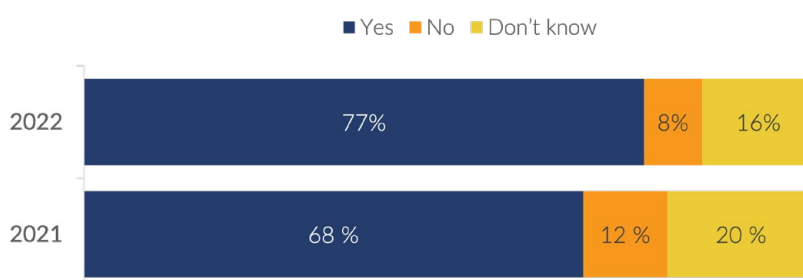
– Financial adviser

**Figure 5:**  
Percentage of client conversations where the CLIENT raises the question of sustainable investing



The share of client conversations in which sustainable investing comes up reached 22%, a 5% increase in the past two years. Whilst not a huge increase it suggests that more and more clients proactively raise the topic. Alongside this we have seen an increase in advisers asking their clients about their sustainable preferences, as shown below in Figure 6, over 3 quarters of advisers now consider it a regulatory requirement to understand clients' sustainable preferences.

**Figure 6:**  
Percentage of advisers who agree KYC rules under COBS require them to consider clients' sustainable preferences when recommending funds or portfolios



Our focus groups with advised clients suggest that advisers are too often treating gathering sustainable investing preferences as a tick box exercise. Clients told us that they are asked on a form about investing preferences but several said they'd rather have a conversation. Many financial advisers are not comfortable asking clients about sustainable investing preferences. They don't want to appear to be judging the values of their clients nor leading clients down a particular path.

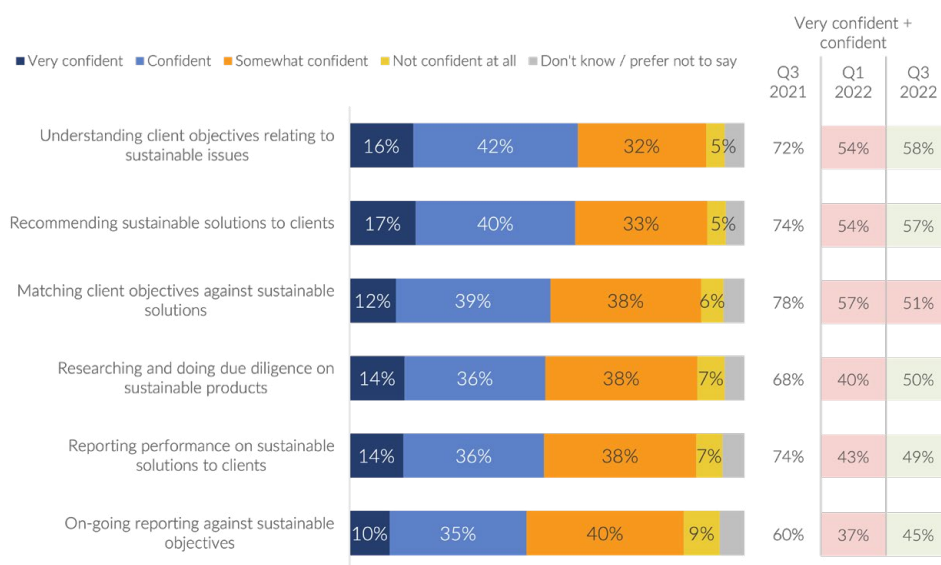
## Adviser processes

### Where do advisers feel confident and what investment strategies are used?

#### Adviser confidence

At the start of 2022 we saw a sharp drop in adviser confidence on all sustainable investing processes. The most recent results show a slight improvement in confidence, suggesting advisers are getting more comfortable with researching and recommending sustainable investing funds and solutions.

**Figure 7:**  
Adviser confidence  
on their processes  
to support  
sustainable  
solutions?



Advisers remain most confident in their ability to understand and match/ recommend solutions to their clients. They are less confident on reporting and researching solutions. There is a clear opportunity for businesses that are able to help advisers with their sustainable information gather and reporting. But such a solution relies on consistent data standards. As one of the advisers we interviewed said:



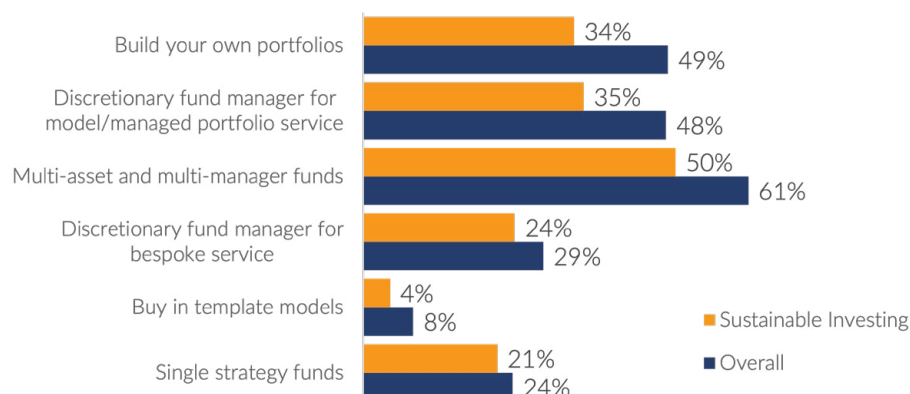
*"It's the bit that we think is getting the industry into a lot of challenge. We cannot see data providers align."*

– Financial adviser

#### Investment selection

We asked financial advisers what investment strategies they are using for their sustainable propositions. In our in-depth interviews we explored investment selection in some depth, uncovering frustration about depth and consistency of data and confirming the shift to further outsourcing suggested by our survey results.

**Figure 8:**  
Investment strategies used by advisers for sustainable solutions versus overall use of investment strategies



We note from the chart that first, every category is used less for sustainable investing than overall. This makes sense because sustainable investments make up one part of a firm's overall investment strategy. Advisers tend to choose fewer options for their sustainable investing propositions than for their standard CIP.

The most used strategies for sustainable investing are multi-asset funds, in-house built portfolios and DFM for model portfolios. Advisers who use bespoke DFM feel most confident when recommending sustainable products to clients. Two of the financial advisers we interviewed for this research said they are moving from in-house models to outsourced discretionary solutions. The reason is the workload for researching solutions and challenges reporting back to clients.

*"We're moving to Rathbones – it has become too much for us to do with the team we have."*

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*"The data is a mess. Too few firms have ratings meaning we have to exclude funds just based on data that's available."*

*"We were using Liontrust for a bit and Royal London. We're planning to use EQ Investors now because they have a wider range and better reports."*

– Financial adviser

Advisers feel least confident when recommending multi-asset funds, in our interviews with financial advice professionals we heard that transparency of holdings is a key issue.

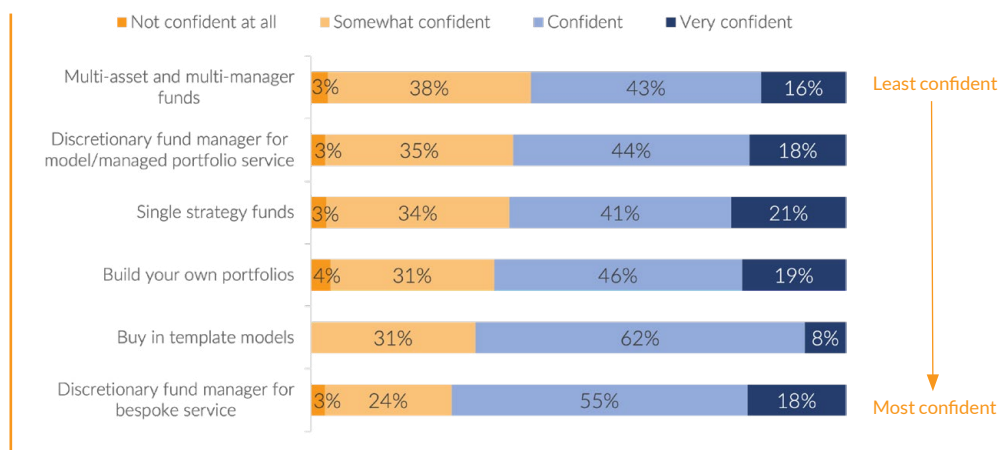
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*"It's very difficult to research what's right without putting our integrity on the line, because not everyone publishes their holdings. So the recommendations we make are for solutions where they do publish everything. Otherwise how are we going to tell our clients if they want to know exactly what they're investing in? That's much more important for some people in this space, then I think fund managers appreciate."*

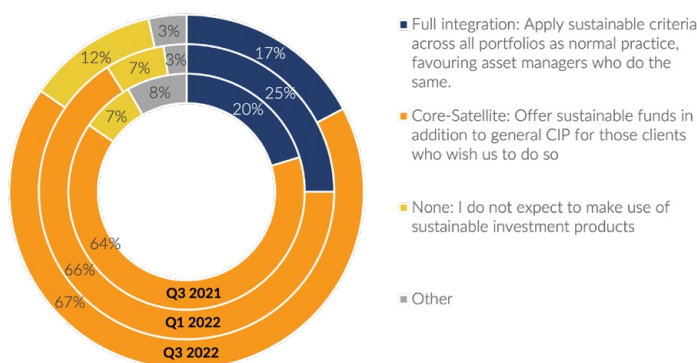
– Financial adviser



**Figure 9:**  
Advisers confidence in recommending sustainable products by solution used



**Figure 10:**  
Integration of sustainable investing into overall investment products offered to clients



The core-satellite approach remains the dominant strategy used by two thirds of advisers. Full integration of sustainable investing criteria is the approach taken by one fifth of advisers. The core-satellite approach is when sustainable funds and portfolios are offered in addition to a standard CIP with no ESG or sustainability screens. Full integration is when all investments are chosen with sustainability in mind. An adviser in a firm that has a fully ESG integrated investment proposition explained the decision this way:

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*“We put ESG at the core of our investment proposition. Why wouldn't we? Why would an investor want to invest in companies that would not be run properly.”*

– Financial adviser

Another, whose firm takes the more common core-satellite approach described the proposition like this:

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*“We have a main offering, in which most of the funds integrate ESG, but we are not specifically targeting with ESG metrics. And then we have a responsible investing offering, which is fully ESG integrated. This allows us to give clients who wish to invest with ethical consideration a product to do so and excludes certain sectors that clients wouldn't want to have exposure to.”*

– Financial adviser

## Use of exclusions

Another challenge faced by advisers is the desire among clients who want to invest sustainably to use exclusions. All of our interviewees have portfolios for clients with exclusions. Several would rather not use exclusions but for various reasons use them to support specific client needs.

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*“I'm personally a believer of positive involvement rather than negative. But I have got some clients that are members of the clergy, and they have a requirement as an employee of the church to invest in a certain way. Otherwise, I'm not sure the divestment argument has really borne out”*

*“We have a negative screening and we exclude certain sectors that clients wouldn't want to have exposure to.”*

– Financial adviser

An adviser at a firm that has a satellite range of ‘ethical models’ said the firm excludes a number of sectors in order to meet the range of client concerns:

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*“We exclude the usual list of sectors alcohol, tobacco, arms, coal, oil and gas, gambling, adult entertainment and uranium and nuclear energy.”*

– Financial adviser

However some advisers highlighted the negative bias that exclusions have, and the limitations this approach imbues on the options given to the client to consider. Advisers felt this can impact the potential uptake of sustainable investing options.

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*“If you only talk about what's been selected to offer the client, you miss the opportunity what is really important to them. Even if you can't offer something really bespoke, it's important to know what they value to make the most informed selection possible.”*

– Financial adviser

Consumers were more muddled in their views on exclusions but seemed more open to industries in transition, such as oil and gas and tobacco. Their exclusions were in some cases quite niche, which can be a challenge when putting together a well-priced investment solution.

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*“Obviously, I'm not investing in companies in Brazil that chop down rainforests. But I would invest in oil companies, because at the end of the day, they're not just drilling for oil, they're also looking at alternative and renewable energies. It's not solely about digging holes in the ground or going to the North Sea.”*

–Advised Client

Consumers also expressed that if investments in traditionally excluded entities can be justified on a performance and risk basis (by holding a more diverse range of investments) then they would also be interested in understanding the value of including them in the portfolio.

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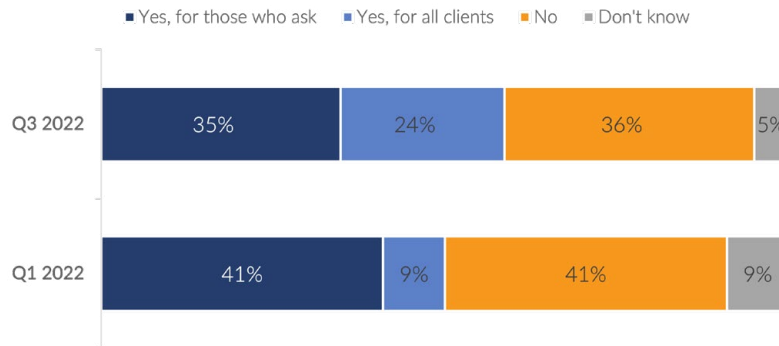
*“I was asked when resetting the portfolio, if I had an aversion to investing in companies that were making tobacco and firearms. So I said, that's fine, if that's in there for growth related reasons. So, we talked about risk and reward and medium term outputs and capital and wealth versus income, diversification and my view on equities versus bonds versus, smaller companies versus, investing in Japan and Europe and Asia – it was a quite a wide ranging conversation which I appreciated.”*

–Advised Client

## Reporting of sustainability

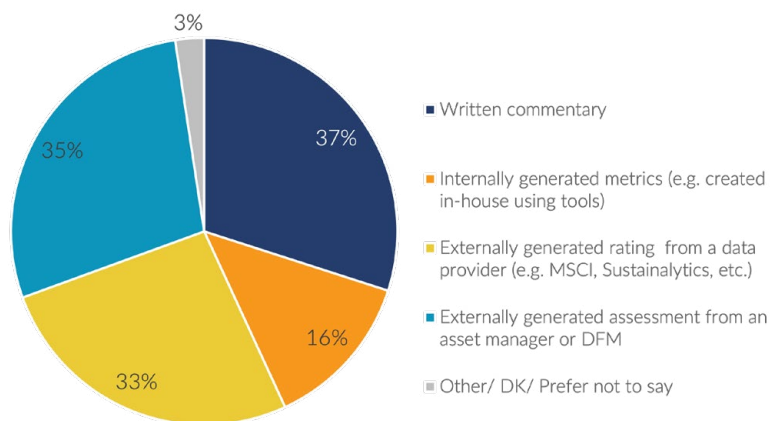
### How do advisers report the sustainability of investments to clients?

**Figure 11:**  
Percentage of advisers who provide an assessment/rating of the sustainability of investments to clients



The proportion of advisers who report the sustainability of investments to clients has increased by 9% to 59% in Q3 2022. Most advisers only report on sustainability for those that request it. We sought to understand more how advisers are reporting to clients.

**Figure 12:**  
Forms of reporting the sustainability of investments to clients used by advisers



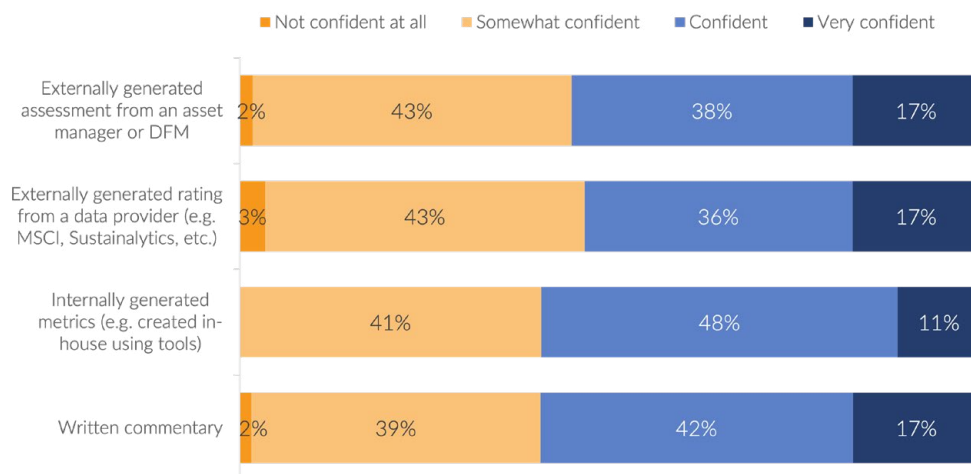
The most common method of reporting sustainability is for an adviser to pass on an externally generated metric to the client. Whilst 37% of advisers who report sustainability of investments provide a written commentary, the use of 3rd party reporting and metrics come up in our interviews with advisers.



*"We like to use Liontrust and use literature that they've created. We include it in our review meeting or even in the implementation report, where we do recommend funds. Before we would go into a bit more detail, because people want to know that they're investing in something that matches their feelings."*

*-Financial Adviser*

**Figure 13:**  
Adviser confidence  
in reporting  
sustainability  
against client  
objectives- by  
method of  
reporting



Advisers who provide clients a written commentary or internally generated metrics have the most confidence in their reports. This confidence is not necessarily a guarantee of quality but maybe more to do with their level of understanding of the contents.

One of the issues advisers have with external metrics is that whilst they are very data-rich, they are harder to explain to clients. Advisers told us that some DFMs offer excellent reporting but this makes it more difficult to offer a similar service across the client-base.

“

*“We use Morningstar Sustainalytics for that, so we take their numbers...it's nice to have but it's hard because the scales they include don't really tell much to the client in my view.”*

*-Financial Adviser*

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*“We like EQ investors because of their performance and their fees and their general attitude and the way that they present this in reports...but it's tricky because there isn't consistency across DFMs or platforms... for example carbon calculators vary so it would be good if when you report you could compare apples for apples. That's why we haven't chosen to go down that route yet.”*

*-Financial Adviser*

## Research Methodology

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This report is written based on both quantitative and qualitative research:

- Online survey of 327 financial advice professionals conducted between 12 July and 11 August 2022.
- 10 Interviews with financial advice professionals conducted in August and September 2022.
- Focus group with consumers receiving ongoing financial advice

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