

Sustainable Investing Tracker Study

April 2023



Introduction



Welcome to the 6th instalment of our Sustainable Investing Tracker Study. We are delighted to partner with the sponsors listed at the bottom of this page to track advised client appetite for sustainable funds and solutions and to chart the adviser processes supporting this. This report is meant for financial advice professionals looking to understand this important trend and to benchmark their process and approach to the wider market.

Highlights

- Client interest in sustainable investing has collapsed, with the share of clients raising the topic with advisers falling from 22% in Q3 2022 to 12% in this report. Advised clients with assets already invested in sustainable funds and solutions are largely staying the course, with the share of advised assets in sustainable funds and solutions remaining steady.
- Advisers overwhelmingly consider it a requirement of COBS to ask about sustainable investing preferences. Few are aware of SDR labelling proposals and our research confirms that advisers draw little distinction between the proposed labels.
- Our study shows that advisers are coalescing around the terms 'sustainable' and 'responsible' when referring to a client's investing preferences in the KYC process.
- There remain gaps in the ability to report to clients against sustainable preferences on an on-going basis.

Research Methodology

- Quantitative survey of 181 financial advisers in March/April 2023
- Interviews with eight financial advice professionals





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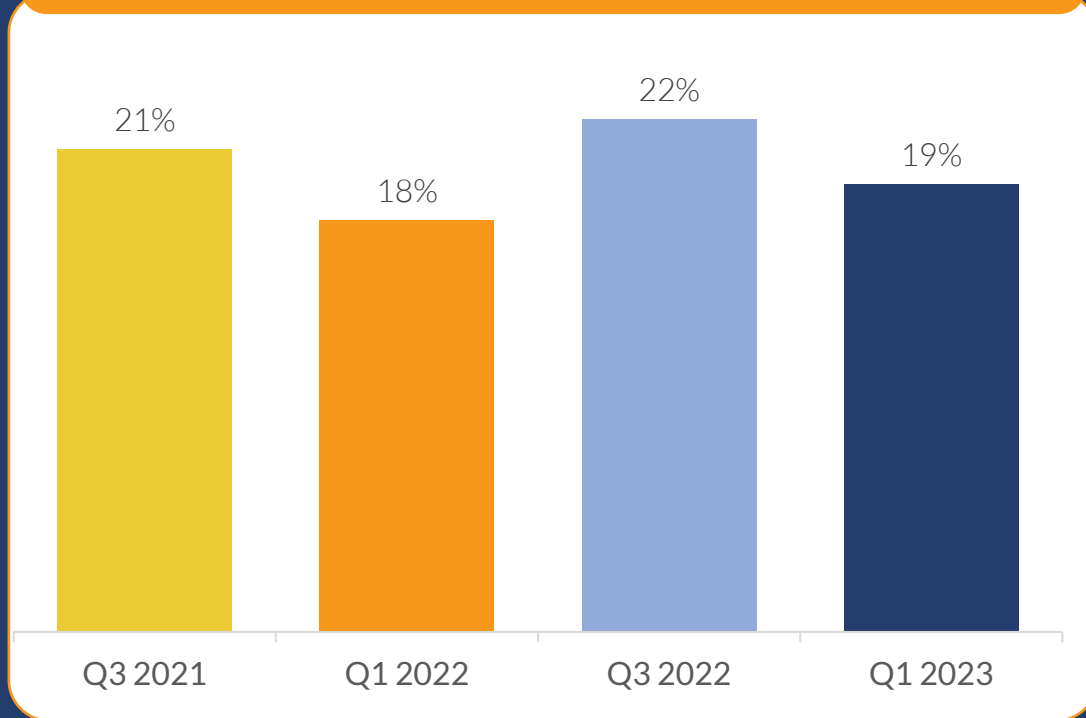
1/ Asset flows and client interest slows



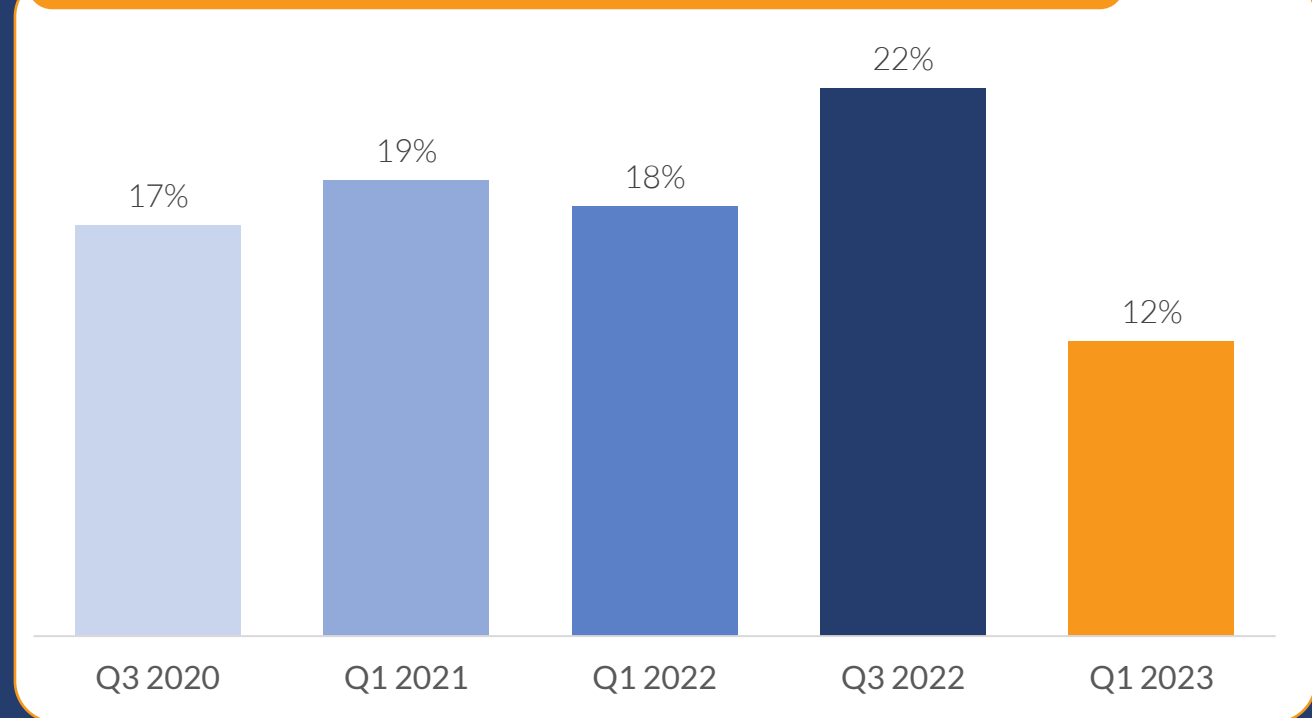
Client interest falls sharply as assets remain sticky



% of client assets invested in sustainable funds/portfolios



% of client conversations where the client raises sustainable investing



We have seen a sharp fall in the percentage of clients raising the topic of sustainable investing with their financial adviser. Financial advisers report that 12% of clients raise the topic, down 10 percentage points from 6 months ago. Our interviews with financial advisers suggest performance chasing has contributed to shrinking interest. Others point out that interest tends to rise and fall along with the prominence of sustainability in the news cycle. The share of assets invested in sustainable funds and solutions hasn't significantly changed. Advisers and their clients are invested for the long term.

Collapse in client interest



We asked advisers about their clients' interest in sustainable investing...

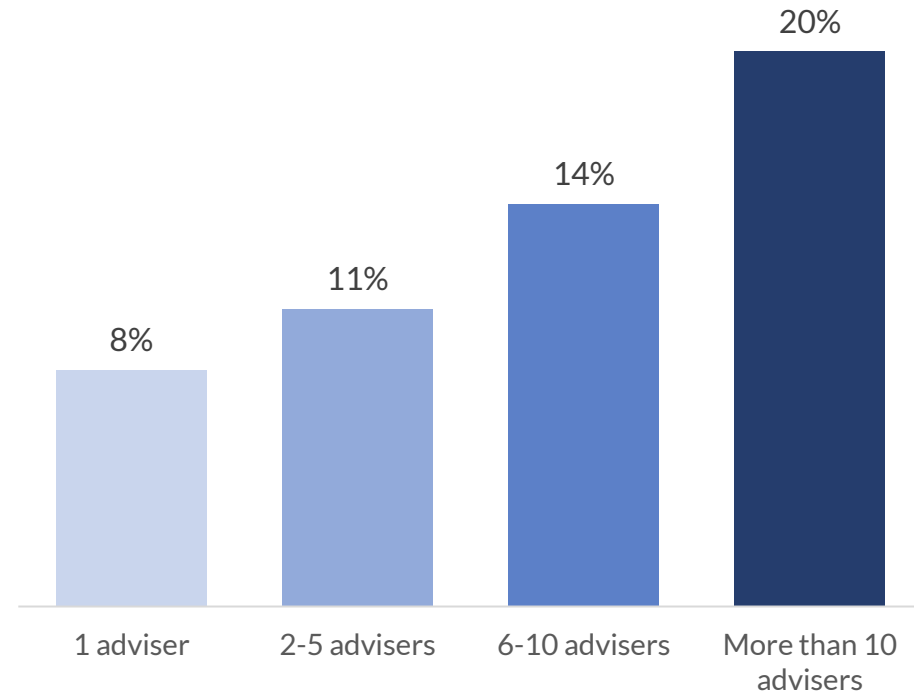
"I think it's massively tailed off. In 2021 it felt like it was everywhere."

"It's just not as talked about anymore. It's just because it hasn't performed as well. It just feels like it's gone a bit quiet."

"There was a majority of clients making value-based decisions. There was a period of time where sustainable portfolios were performing, because they're a little bit more skewed towards growth stocks. So, there's a few people that have shifted for performance reasons."

"I think it ebbs and flows with the news. I think it's collectively known as the availability bias, human beings making judgments based on the recent impact of information rather than more rationally."

% of clients raising the topic of sustainable investing by size of firm



Advisers told us that inconsistent performance is a factor that has slowed the growth in sustainable investing but also that client interest ebbs and flows in response to external factors. With constant reminders of the cost of living crisis and inflation, sustainable investing has fallen down the list of priorities.

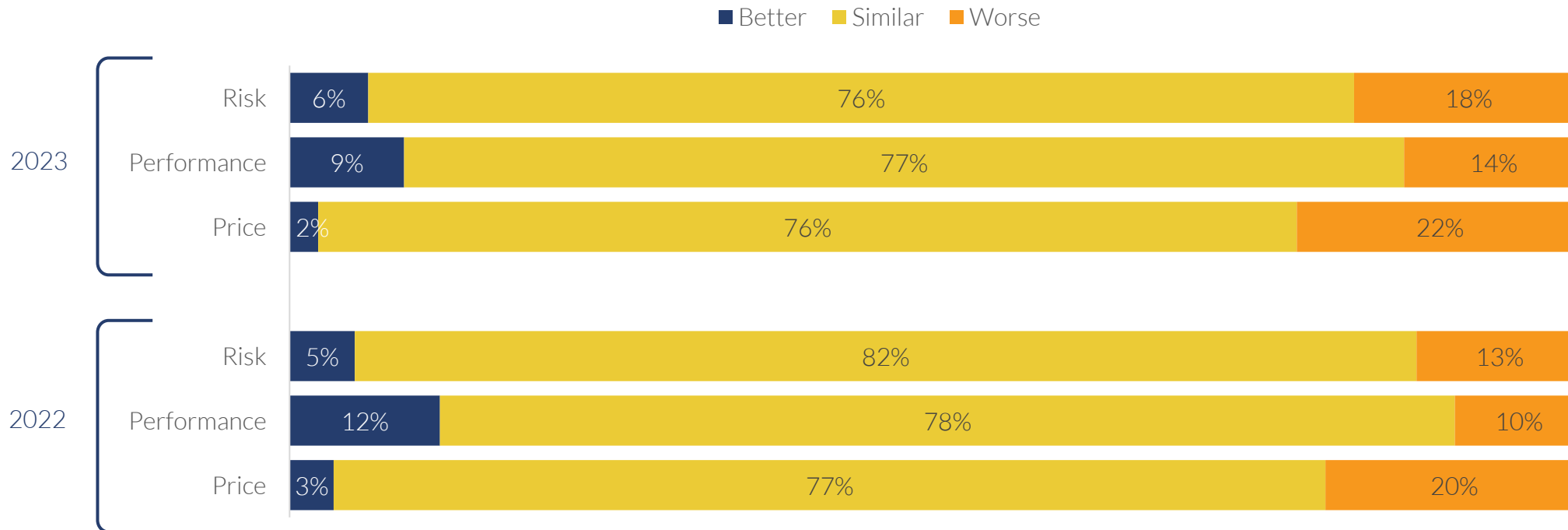
Adviser perception of sustainable products



Compared to one year ago, slightly more advisers have a negative view of sustainable investments compared to conventional investments. However, the vast majority view these products as similar on price, performance and risk. We have heard from some financial advisers that sustainable funds and portfolios in the long-run should perform in line with conventional products but with the caveat that they may not always perform in line with the market as has been seen in the last 5 years.

“We explained to them that it is a long-term consideration. We show to clients the performance over five years as well as one year to show that a year is not long enough. If you just look to sustainable funds this year, a lot of people wouldn't want to be invested in them. But if you looked over five years, they've done pretty well.”

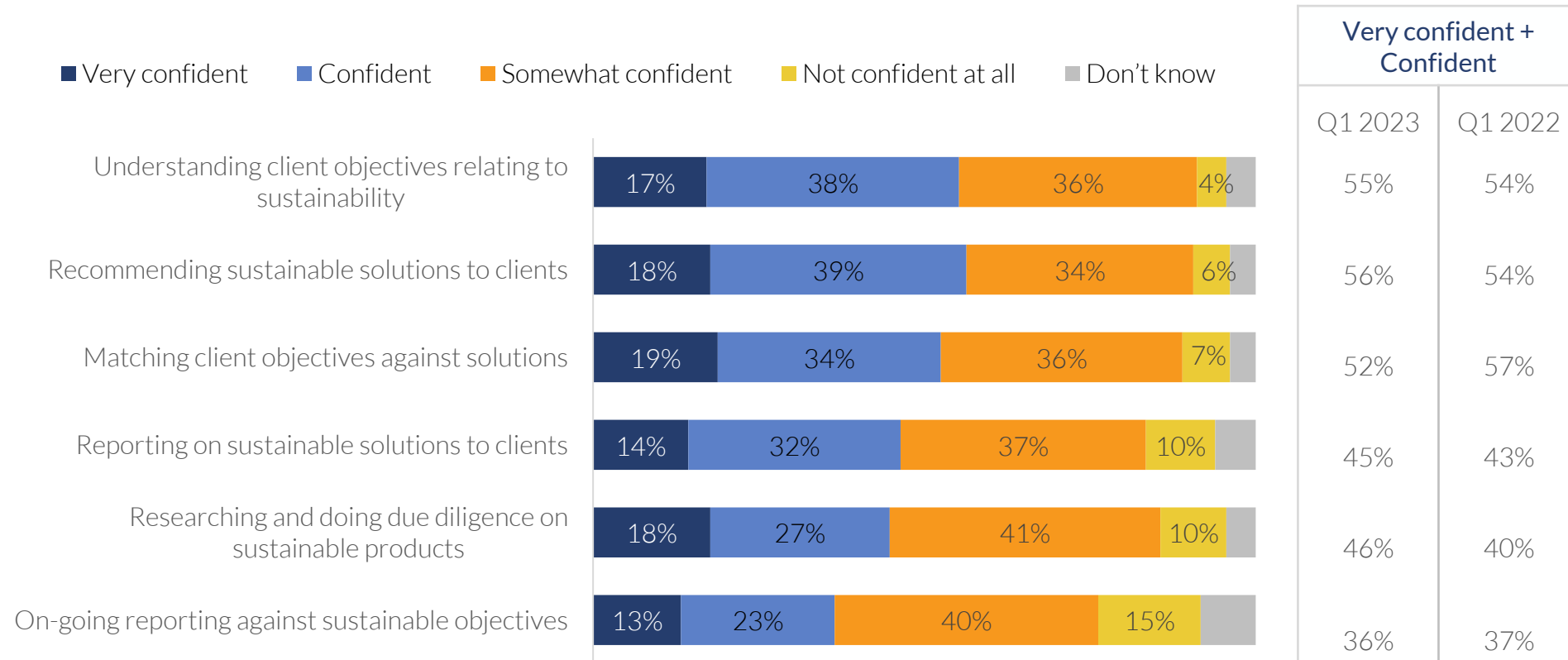
Advisers perception of sustainable products compared to conventional



Confidence among advisers



Adviser confidence on processes to support sustainable investing



Adviser confidence remains steady compared with a year ago in understanding client objectives and recommending solutions. Confidence remains weakest in on-going reporting against client sustainability objectives.



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2/ Regulation

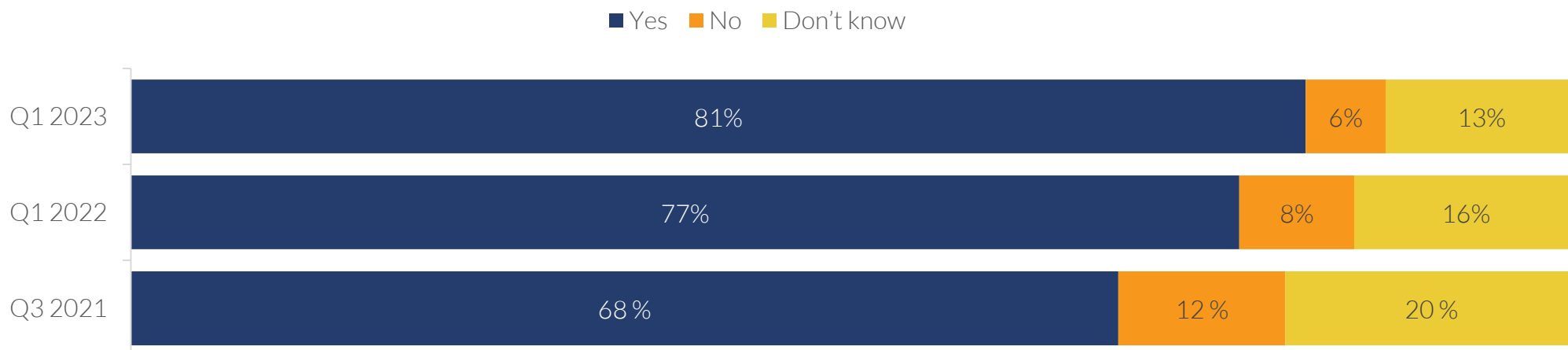


KYC Requirements



Increasingly advisers consider it their obligation to understand clients' sustainable preferences. A growing majority of advisers consider it a regulatory requirement to ask about clients' sustainable preferences as part of the KYC process. Whilst the industry awaits the finalised Sustainability Disclosure Requirements, advisers are already taking steps to integrate sustainable investing into their businesses. Part 3 of this report looks at how they are doing this.

81% agree KYC rules under COBS require them to take into consideration client views on climate change, sustainability and ethical investments when making product recommendations



Advised client demand by SDR label

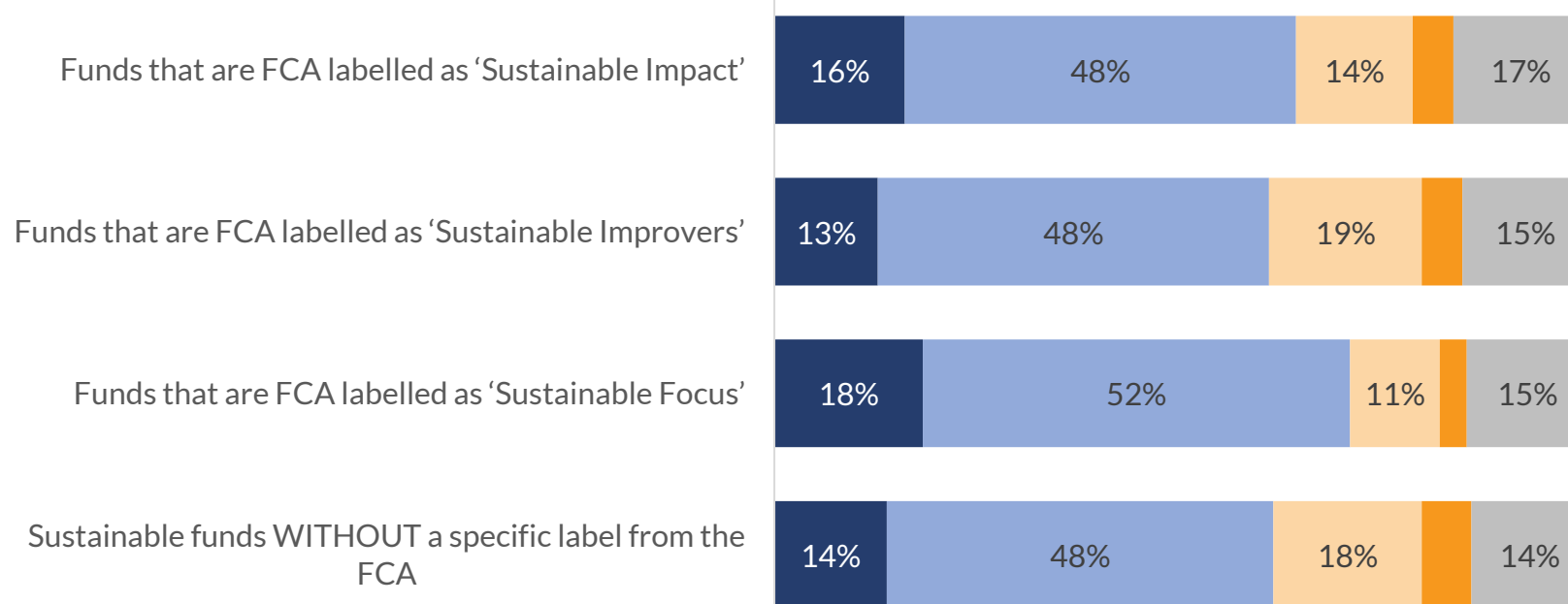


Advisers make little distinction between proposed FCA labels for sustainable funds/portfolios. The Sustainability Disclosure Requirements are yet to be finalised and as such advisers remain focussed on more pressing regulatory change. One adviser put it this way:

“I think the reality is we've got three big pieces of regulation coming at us this year. We've got bandwidth for the Consumer Duty. Then we're just going to have to be very reactive on the rest of it. I think we're also going to have to rely on the providers to help deal with some of this.”

Likelihood to recommend funds by FCA proposed SDR labels for clients with a sustainable investing preference

■ Very Likely ■ Likely ■ Unlikely ■ Very Unlikely ■ Don't know



“
We used to get new regulation once every three years.
Now we get three in one year.”



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3/ Advisers develop their processes

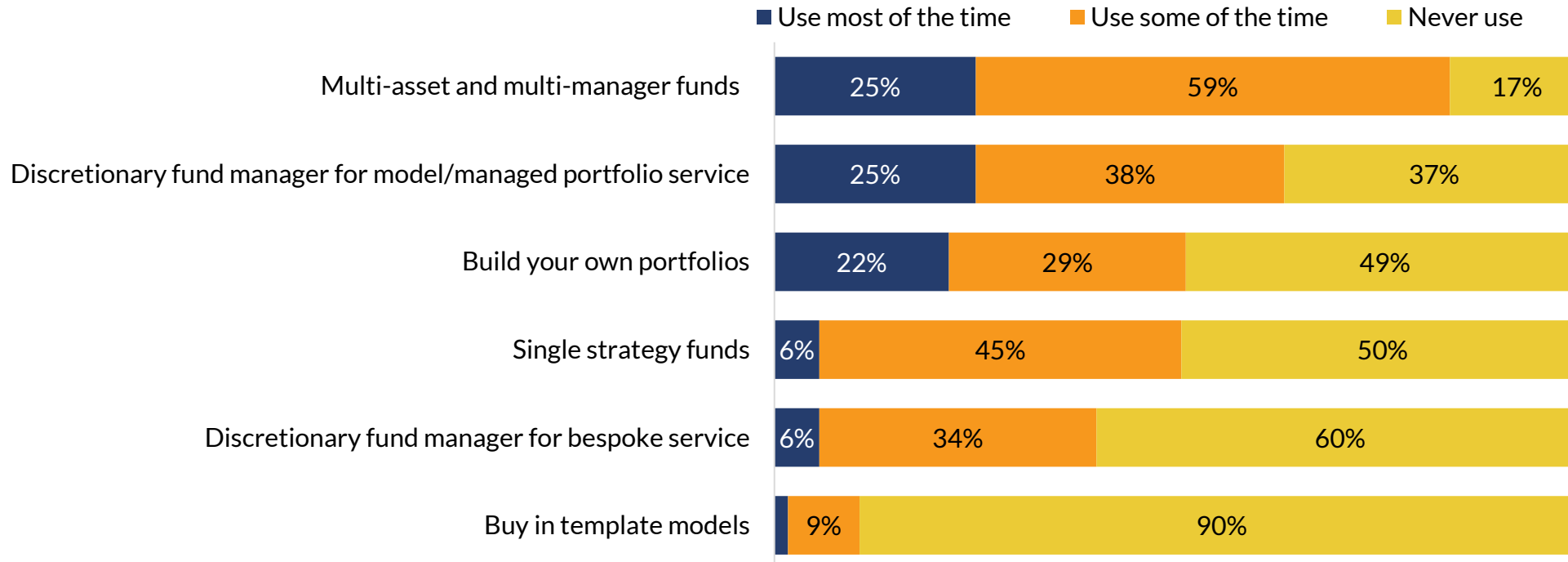


Investment strategies used



In NextWealth's Financial Advice Business Benchmarks report we see that advice businesses predominantly use multi-asset funds and model portfolios. The same is true for clients with sustainable investing preferences. Multi-asset funds are particularly appealing, used 'most of the time' or 'some of the time' by 84% of financial advisers.

Use of different investment strategies by advisers for sustainable investing

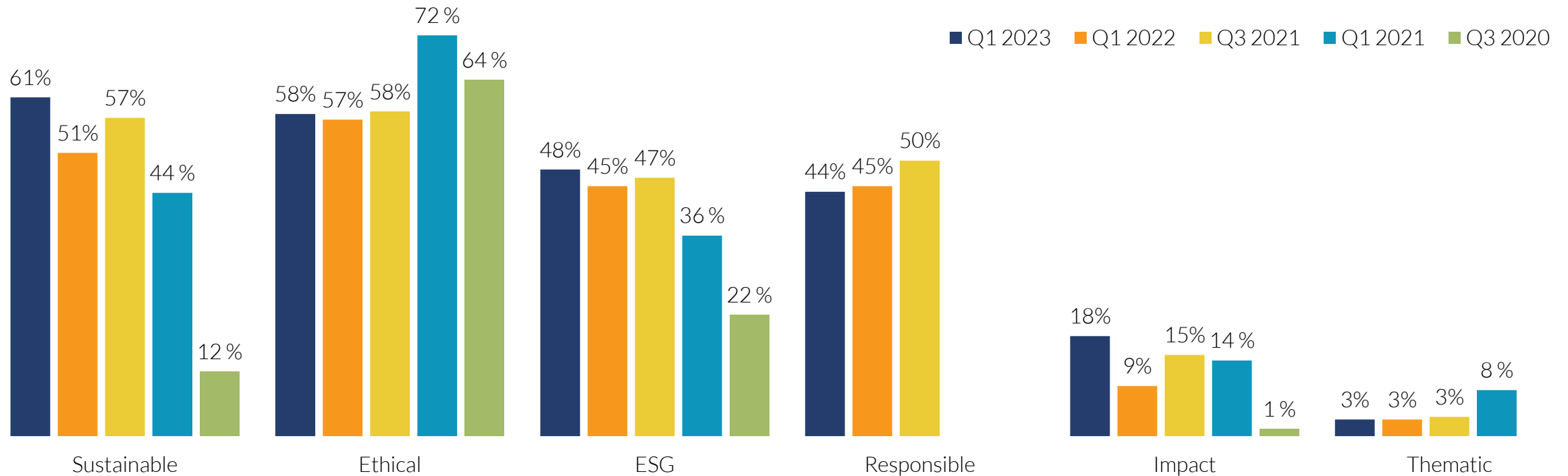


Adviser terminology



We have seen a big change in the terminology used by advisers in their KYC processes since we launched this study in 2020. The most significant change is the emergence of 'sustainable' (followed closely by 'ethical') as the most used term in the 'Know Your Customer' process to identify specific client requirements and preferences. The term 'impact' has not been adopted widely by advisers.

Terminology used by advisers in the 'Know Your Customer' process

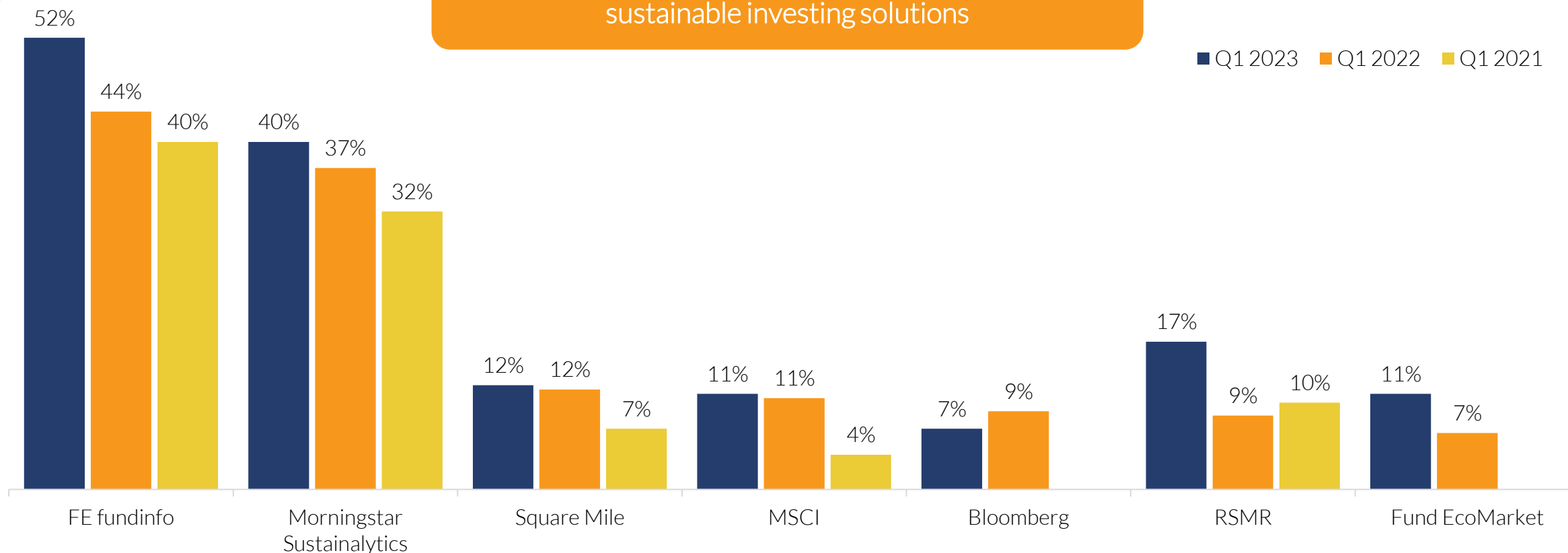


Ratings and information



FE fundinfo and Morningstar are the most widely used providers of sustainable investing ratings and information. We have seen growth across the board in the last two years in use of data providers. In NextWealth's on-going research we have recently interviewed advised customers about badges and ratings, these advised customers overwhelmingly said they don't trust ratings and badges on their own and want context from financial advisers on their credibility and meaning.

Ratings providers used by advisers for researching sustainable investing solutions

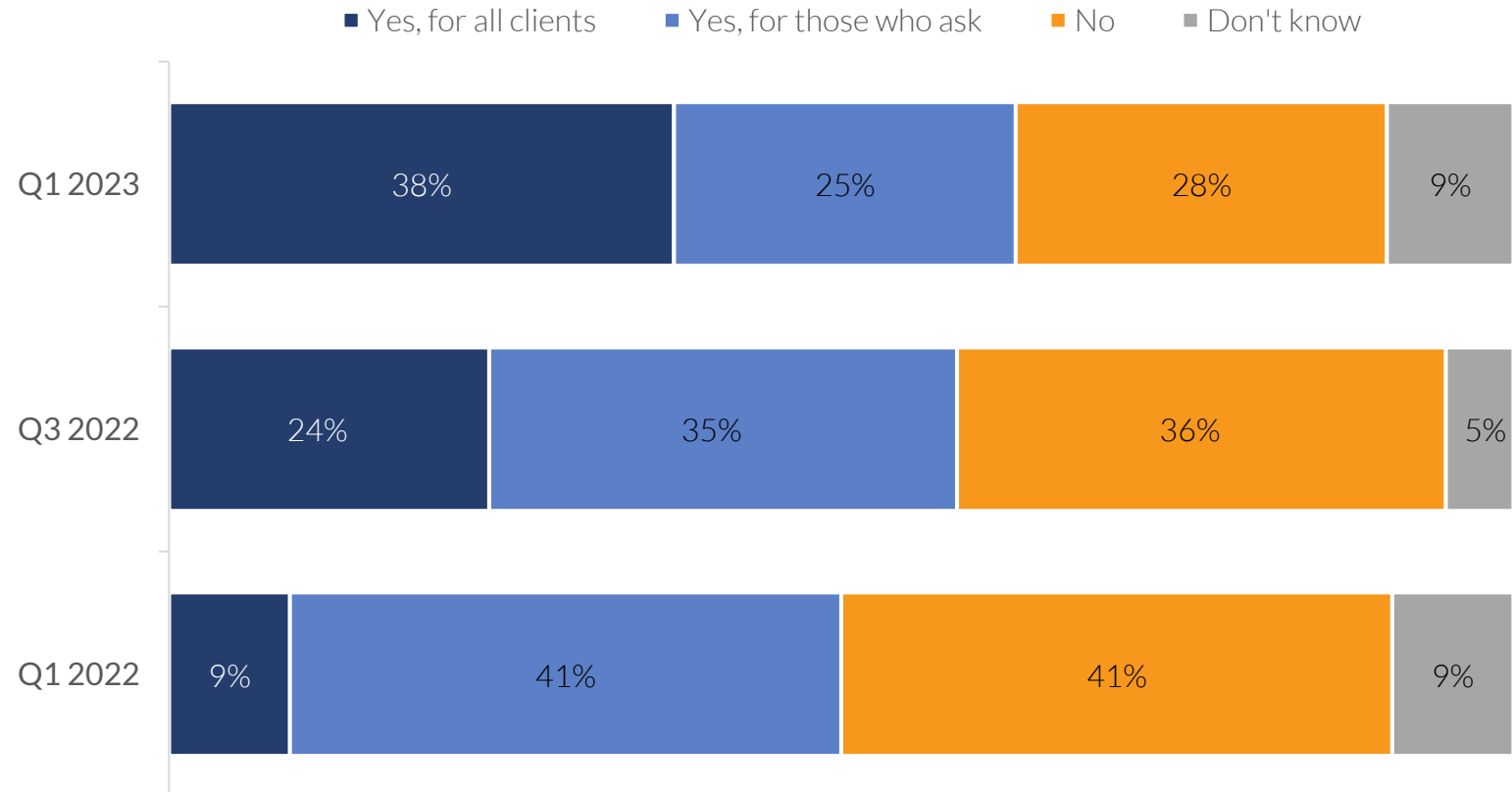


Prevalence of sustainability reporting



Sustainability reporting had been a nascent area for financial advisers until recently with many firms continuing to develop their ability to report the sustainability of investments back to clients. Over one third (38%) of financial advisers report to ALL clients on sustainability of investments. That is up 29% (from 9%) a year ago. The share that are NOT able to report on sustainability to clients fell from 41% to 28% year on year. We expect to see this trend continue as advisers and advice businesses enhance their processes around sustainable investing.

Percentage of advisers who report the sustainability of investments to clients



50% of advisers use externally generated assessments/ratings to report the sustainability of investments to clients





- 1. Client interest falls but assets remain** - clients may not be raising the topic of sustainability of their investments as much as they have in the past but those that have chosen to invest sustainably are staying the course. Concerns about the cost of living coupled with sustainable investing being out of the news have contributed to shrinking demand. We do not expect to see a significant decline in the share of assets invested in sustainable investments. Advisers appear to be explaining the risks and rewards effectively.
- 2. Advisers are building their processes for sustainable investing** - adviser confidence has stayed flat in the last year as they get to grips with the processes they need to support sustainable investing. The terminology they use continues to develop along with the ratings agencies and information sources used.
- 3. Sustainability reporting to clients is a developing area for advisers** - The percentage of advisers who are able to report sustainability of investments to clients is growing. However, many advisers lack confidence in their sustainability reporting process. There is an opportunity for product providers to support advisers with their reporting - half of advisers use externally generated assessments and/or ratings to report the sustainability of investments to clients.

