

HUB²⁴

Platforms and responsible investing

A new look

HUB24

This paper brings together the perspectives gathered by HUB24 of financial advisers, investment managers and research houses who have provided their thoughts on the state of the market, how they are approaching responsible investing, the challenges and the opportunities that lie ahead.

Responsible investing interest has grown from boutique to mainstream and the range of investments increase from not many to an ever-increasing amount to consider. Of course, appealing to many clients, is the opportunity to align their values with investment choices. Recent events, including the bushfires in Australia over summer and COVID-19, have brought into sharp focus what matters to them and how they interact with the world.

Yet despite the growth in responsible investments, the performance and the renewed vigor in which clients, financial advisers and investment managers are approaching this space, there remains an opportunity for all to facilitate more informed and insightful conversations around issues which can be complex and multi-layered.

Technology is playing a role in providing financial advisers and investment managers with new tools to demonstrate and communicate value to their clients. The key is also the ability to better tailor portfolios to the need and values of their individual clients.

Platforms and now managed portfolios are playing an increasingly important role in this space, offering investors greater control and transparency over how they invest, through stock substitution capabilities.

The performance of responsible investments is removing barriers to investment. Long-term track records are showing that investing in line with your values does not come at the cost of meeting investment outcomes. Indeed, responsible investments have demonstrated some resilience in the current volatile market conditions, with the defensive sectors in which these funds generally invest— including health and medical services, technology, and infrastructure—providing some diversification in these market conditions.

It is clear from the findings presented in this paper that responsible investing is an enduring trend with clients and one that is set to become the new normal as more clients seek education and in time, investment in this space.

Background

Interest in responsible investing has increased in Australia, as shareholders and investors mobilise to take a more active part in how and where their money is invested. Yet despite this increased interest and motivation, there remain challenges in delivering diverse and communicable responsible investing solutions to clients.

Responsible investors demand transparency. They want to not only ethically align with the core business of the companies in which they invest, but often also with the suppliers and companies it partners with to produce goods and services.

Choice is a key feature of the responsible investing market, and investment managers attribute choice as critical to the historical growth of responsible investing in Australia. However, choice has actually been a necessity. In the absence of clear definitions on 'ethics' as well as differences in individual preferences, choice has provided the range of options needed for investors to find their match.

Traditionally, responsible investing has been accessed through direct investing or dedicated managed fund providers. Today, many investment managers offer responsible investment products across a range of both product types and asset classes.

Another change is the impact technology is now having on helping financial advisers and clients manage their responsible investments. Innovation in the platform and managed portfolios space means investment managers and financial advisers now have new tools to help them meet client expectations and to further tailor portfolios.

Technology is also playing a significant role in making it easier for advisers to meet and address their clients' investment values. What we are now seeing is platform technology coupled with good-quality advice and a broad range of product solutions, all helping advisers to efficiently deliver a consistent and valued customer experience to their clients.

The purpose of this paper is to provide financial advisers with a current perspective on the evolution of responsible investing products in Australia and how advisers are using them in portfolios.

Acknowledging that a number of industry participants have pioneered this space, we have reached out to the community to delve into responsible investing and gather insights and commentary from research houses, investment managers and financial advisers who are offering their clients a responsible investing approach.

In response to the rise in interest, financial advisers are well placed to have deeper conversations with their clients on their values and how they want to invest.

The responsible investing landscape

There are a number of common terms (often used interchangeably) across the industry when discussing responsible investing: sustainable, responsible, ethical, future leaders, impact, and the list goes on. The following list

is not exhaustive, but provides a good starting point for navigating this sector. These terms or definitions are often used when an investment product is being discussed.

Negative screening

Negative screening is the decision not to invest in investments that are inconsistent with the values of the investor. These values can vary from investment manager, to adviser, to individual investor. A common negative screen applied is screening out investments in industries that have a negative impact on society and/or the environment. Some examples of how a negative screen can be applied include, assessing a company's core business activity, supporting activities or by analysing its revenue drivers.

Positive screening

Positive screening is the decision to actively seek out investments that are consistent with the values of the investor. Again, these values can vary from investment manager, to adviser, to individual investor. Common positive screening applications include proactively searching for investments that contribute positively to society and/or investments that contribute positively to the environment. Some examples of how positive screening may be applied include assessing a company's activities against its peers, or actively seeking sectors that will have a positive impact on the environment or society.

Corporate engagement

Along with screening, corporate engagement can be used by investors to seek more ethical investment outcomes. Companies may be invested in, or divested from, certain assets to initiate engagement or communication between investors or potential investors and the company. This approach can raise environmental, social and governance (ESG) issues of concern and/or be used to advocate for changes to company practices.

Socially responsible investing

Socially responsible investing (SRI), also known as sustainable, socially conscious, green or ethical investing, means any investment that seeks to consider financial returns and social and environmental change. Applying this method sees companies and sectors negatively screened out and not included in portfolios if they make or sell certain products or engage in certain activities.

Positive screening can also be part of the SRI investment process to make sure the investments not only avoid having a negative impact but also seek a positive impact. For deep-green investors, corporate engagement may be used in conjunction with the positive and negative screening processes.

ESG investing

This method referring to the three central factors of environmental, social and governance in measuring sustainability and societal impact can be incorporated across both



The quote

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The quote

Being informed and confident to offer the education that clients may need is an important aspect of offering responsible investing.

mainstream and ethical portfolios. In a mainstream portfolio, the ESG rating on a portfolio will often help the investment manager determine the valuation of an investment.

In an ethical portfolio, ESG factors again might be used as part of the investment valuation process, however, in addition, investments may be included or excluded based on how well an investment manages its environmental, social and corporate governance processes. This process tends to reduce the focus on screening a sector or product, but instead tends to assess the policies and procedures implemented and applied by a company to address their ESG positions.

Best of sector

With this method, the investment will still invest across every sector but will try to find the most sustainable or responsible companies in each sector. Generally, this method is considered to have less impact than SRI investing because it does not screen out whole investment sectors.

A surge led by motivated consumers

Over the past five years, ESG factors have shaped political views, geopolitical relationships, news cycles and consumer investment appetites.

Major events such as COVID-19 and the recent bushfires in Australia, together with broader themes around climate change, have propelled communities and consumers to speak out in large numbers.

The rise of the 'conscious consumer' has seen the emergence of a new framework of consumer decision-making, where every decision made is guided by a much broader set of considerations, which include ESG factors.

The investment world has not been excluded from this. Investors have come to expect that companies, investment managers and superannuation funds with which they invest, do so in a responsible fashion or at least offer them choice of investments, but this is not always the case.

Key findings from the 2020 Responsible Investment Association Australasia's (RIAA) report titled *From values to riches 2020: charting consumer expectations and demand for responsible investing in Australia* are shown in Figure 1.

State of the market

Responsible investing in the Australian market is at a watershed moment. With considerable momentum on its side, technology and tools are now being developed to facilitate its use and to ensure investors and clients can access what they are looking for.

According to the RIAA's 2020 report, assets managed in accordance with responsible investment principles account for 44% of Australia's total \$2.25 trillion in professionally managed assets. Five years ago, this figure was 17% of the total assets under management.

Lonsec's head of sustainable research, Tony Adams, said responsible investing presents a great opportunity for the Australian financial services industry and all stakeholders can play a part.

A provider of ethical and sustainable investments since 1986, Australian Ethical Investment's head of client relationships, Leah Willis, said despite good traction, there is still a long way to go with responsible investing.

This is because ethical investors characteristically look more deeply at underlying investments, so not all products suit all ethical investors. While range and choice are important solutions to this, they can create confusion in the market between product options and investment styles.

This is where financial advisers can close the gap between client values and product options, and with the rise of ESG issues, there is often a perception that these factors are already being considered.

Identifying clients' values

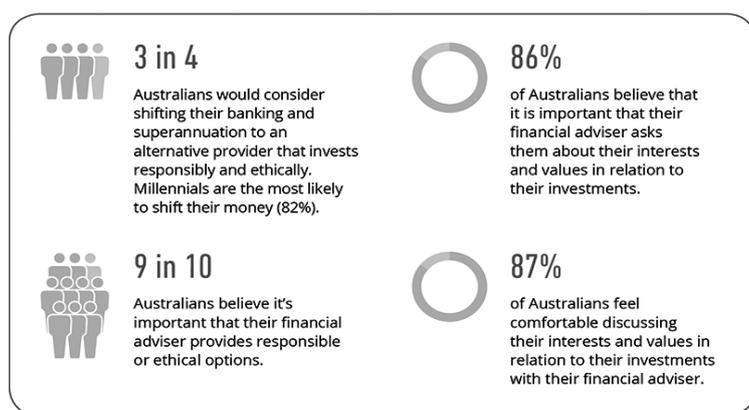
Financial advisers play an important role in facilitating the growth of responsible investing in Australia. Their understanding of their clients' financial goals and values puts them in a unique position to discuss responsible investing and the options it can provide.

Through the fact find process, advisers identify their clients' attitudes and values to create a more fulsome understanding of what is important to them. It acknowledges that no two clients are the same and each requires a tailored and individual approach to designing their financial plans and ultimately, portfolio construction.

Two years ago, Vanguard conducted research to uncover a common list of ESG factors that were important across a range of clients. While they found fossil fuels, human rights issues, nuclear power and vice products such as tobacco, guns, gambling, and adult entertainment were consistently areas in which investors did not want to invest, this was not uniform.

Australian Unity's head of intermediated markets, Adam Kirk, said most investors at a high level understand responsible investing to mean 'don't harm people,

Figure 1. Charting consumer expectations and demand for responsible investing in Australia



Source: HUB24 compiled from RIAA data.

animals or the environment,' but after this, it depends on personal values.

For Louise Edkins, joint director and financial adviser of Ethical Investment Advisers, personal values not only guided her to responsible investing, but it has also shaped her business.

"I wanted to reflect my personal values with my job. I worked in stockbroking in the 1980's in the era of 'greed is good' but I hoped there was more to it," Edkins said.

While a discussion of values with a client does usually raise ESG issues, Edkins thought clients have the perception that such considerations are already being addressed in the selection of investment products.

Choice is key

Platforms play a major role in offering choice in responsible investments to financial advisers and their clients. Reflecting the central role platforms now play in advisers' businesses, Australian Ethical Investment's Willis said the majority of its new inflows are via platforms.

"Choice has been critical to the growth of responsible investing in Australia because with no clear definition of ethics, and differences in individual preferences, advisers need to have a range of products," Willis said.

Investment managers predict the role platforms will play in this space will only increase as their product agnostic nature and independence gives them a unique role in the market place.

"Platforms can be a really important player in this space. Platforms are moving above and beyond their remit in terms of admin and are making themselves more valuable to advisers. They provide good contact with advisers," Rachel White, senior manager, product strategy, Vanguard Investments Australia, said.

"Platforms are a facility to access investment manager products whether they be managed funds, ETFs or managed portfolios. A higher value will be put on platforms as there is an increased intention for platforms to become part of an advisers' business," White said.

Managed portfolios also give advisers and their clients the opportunity to exclude or substitute investments, so tailored, personalised and potentially stronger screening can be applied to a portfolio.

Exclusion lists are an efficient way to exclude investments across one or more client accounts, whether it be a single stock, asset type or a subset of investments based on GICS sectors. Stock substitution works within and outside of managed portfolios.

Ethical Investment Advisers' Edkins said she uses this functionality to screen out banks and investments that are not fossil fuel free.

Getting started

Being informed and confident to offer the education that clients may need is an important aspect of offering responsible investing.

Australian Unity's Kirk said some of the questions from

clients can be quite sophisticated, however, advisers should not feel the pressure to know all the answers, rather just how to source them. Today, this can still be a challenge.

"Investors need their adviser to know where to source information, but I am not sure advisers know where to start or what they need to know. Advisers are often looking for a packaged solution," Kirk said.

Growth in product has certainly created more choice, with more vehicles such as ETFs and managed portfolios fuelling greater competition. However, to date, experts say this choice has only highlighted the lack of consistency in how responsible investing is described.

"Investment managers have done a great job of confusing everyone. Part of it is deliberate on the part of investment managers as they want to differentiate themselves," Lonsec's Adams said.

Ratings houses and data providers are bridging this gap by providing more detailed reporting and ratings specifically targeted at responsible investing. The RIAA is also working hard to build the responsible investing community, to open up discussions and create resource networks for participants in this sector.

Financial advisers who have pioneered responsible investing in Australia say the information provided on the Ethical Advice Co-op (www.ethicaladviserscoop.org) website is a good place to start. It also offers ethical ratings of ethical investment funds and superannuation.

"It's a good resource for all advisers and investors to consider the varying ethical screening in products," Ethical Investment Advisers' Edkins said.

Case study: building a practice with a difference

Louise Edkins has been advising on responsible investments since 1994. Joint director and financial adviser of Ethical Investment Advisers in Brisbane, Edkins specialises in responsible/ethical investments that are also in line with her personal as well as professional values.

She uses the usual financial planning questioning on risk profile, financial situation and objectives, but also asks her clients about their values and to fill in an ethics questionnaire.

Edkins explained that while ESG screening in the market place is common, particularly by big investment managers and superannuation funds looking at ESG risks and engaging with companies, her clients want to be more specific in their exposure.

"For example, a client who wishes to avoid investment in fossil fuel companies will not wish to invest in an ESG fund/ETF offering that has an ESG screening which could be investing in fossil fuel companies and engaging with them on their ESG risks. They want more than this as they don't want fossil fuels at all," Edkins said.

Further, Edkins believes the rise in responsible investing is driven by consumers, with investors and clients often disappointed by what they have been offered in the past.

Edkin's 100% responsible investing approach has hit the mark—currently she is not open to new clients and is



The quote

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urging other financial advisers to work more in this space.

While the FASEA Code of Ethics recommends a deeper and broader understanding of the client with questioning of their needs and the application of advice, Edkins said responsible investing advice “sits well with that because you are having questions with clients on value”.

However, Edkins added that unfortunately, most clients have a perception that these issues are already addressed in the advice.

Figure 2. What does responsible investing add to a financial advice business?

WHAT DOES RESPONSIBLE INVESTING ADD TO A FINANCIAL ADVICE BUSINESS?

1.

The conversation is highly personal, focusing on a client's beliefs and providing an opportunity for financial advisers to connect with their clients on a different level.

2.

Clients tend to be clients for a longer time as they feel the financial adviser understands their personal investment beliefs.

3.

Client conversations tend not to be return focused as in most cases, clients are much more interested in the environmental and social impact their investments are making.

4.

In volatile times, clients continue to value what is being done, despite performance impact that is usually not just exclusive to responsible investing options.

Source: Louise Edkins, Joint Director and Financial Adviser of Ethical Investment Advisers.

Source: Ethical Investment Advisers.

What does the future look like?

Investment managers are looking to enhance their responsible investing capabilities, further facilitating the growth and momentum of responsible investments in the Australian market.

Vanguard's White said advisers are looking for more transparency, more ESG data, examples and proof points of how companies are making a difference. While whole portfolios can be invested this way, this is currently only done by a minority of investors.

“Some investors are not prepared to give up performance, others are not prepared to pay higher fees. In the end, if a fund meets their criteria, they are prepared to look at an ESG option,” White said.

Pendal Group's head of Regnan and responsible investment distribution, Jeremy Dean, said that while financial advisers are on board with responsible investing in Australia, it is the investment managers who need to get better at helping them have informed, insightful discussions with clients.

“We are dealing with often complex and multi-layered issues and in many cases, there is no clear ‘right answer’. We must be true to label and explain issues at the margin. Importantly, we cannot stuff this up. There is a structural change in the needs and expectations of investors, and we must continue to deliver quality investment returns through an ESG lens,” Dean said.

Australian Unity has a long-term, and continuing commitment to responsible investing. It offers a range of options that deliver strong long-term performance, and continues to expand its footprint in sustainable investments to complement its broader and well-established social and sustainable expertise addressing matters around ageing population, healthcare and social infrastructure.

“Most investment managers are going down this track because clients and margins are there. Also, once someone does it, everyone else moves in,” Australian Unity's Kirk said.

Lonsec covers ESG factors in all its investment ratings and has recently added a new sustainability measure that looks at the goods and services within a company and how they are being used.

This tool provides advisers and their clients with more meaningful information on what is in a portfolio. It also uncovers funds that may not rank themselves as practicing responsible investing, but have a portfolio that might even be better than those that do.

“We have partnered with a tech company focused on sustainability mapping to develop a tool for the scoring system. It will cut through some of the confusion in labels so advisers can know for themselves,” explained Lonsec's Adams.

In this vein, Dean said Pendal was asked by AMP to help develop an ESG framework for its adviser network, recognition that advisers were looking for a framework to be able to rationalise and respond to the shifting expectations of clients.

“A framework helps advisers and investors make some sense of the often complex and shifting issues in markets and across the community. There is no such thing as a perfect company, and there are trade-offs that we all must make. Guiding principles provide context to the investment decision.”

Investment managers see the value of distributing via platforms. They allow advisers to use their preferred investment managers and gain access to their IP but also to then tailor clients' accounts to meet their needs by substituting securities or sectors. In this way, investment managers can broaden the appeal of their products.

With platforms laying the foundations for growth, managed portfolios are the next step in tailoring, enabling a customising of portfolios which truly aligns with the individual nature of responsible investing. It is for this reason managed portfolios are regarded as both needed and necessary in the future growth plans of responsible investing in Australia.

To date, managed portfolios have played an instrumental part in the re-engineering of the financial services industry, powering the ability of financial advice businesses to service their clients in an efficient and effective manner while providing a great customer experience.

Given this, many experts are looking to managed portfolios as the next step in responsible investing as they allow advisers to build responsible investment portfolios in an efficient and scalable way.

Advisers have the ability to choose a specific responsible-investment-focused portfolio or use any portfolio that the adviser prefers as an investment manager and use our technology to tailor it for each client's needs.

Case study: keenness to do more in responsible investing

Tim Scott is a director of Ford + Scott Financial Planning, based in Hobart. The practice has three other financial advisers, with approximately 500 active clients.

Scott estimated around 10% of the client base invests with an ethical overlay and said there is greater demand for this investment approach. Over the past 12 to 18 months, Ford + Scott has undergone a significant investment committee overhaul with regard to meeting this demand and the ability for the business to source a multi-sector product to make responsible investing more efficient. He believed if that solution is found, between 50 to 70% of clients would invest this way.

Scott said it is important to have clients believe in the investment approach and to have peace of mind, and it is in a discussion on client values that responsible investing comes to the fore. Further, Scott noted that multi-sector solutions are currently a gap in the market.

Yet despite responsible investing being a seemingly natural part of the values and goals discussion between a client and an adviser, Scott thought it has not always been easy to source the appropriate investments.

"A stumbling block has been cost and there is still a lack of depth in the market. If you are trying to build a portfolio, you are limited to sector-specific investments," Scott said.

Ford + Scott use a core and satellite approach to investing, using multi-sector funds and supplementing this with sector-specific opportunities to provide diversification and to meet the client's needs and match their values.

According to Scott, said this approach does present challenges from a business efficiency perspective.

Research houses such as Lonsec rate approximately 1,300 funds in the managed fund space and approximately 600 of these funds have a 'recommended' or 'highly recommended' status. Only about 10 responsible investing funds hold such status.

Conclusion

Responsible investing is establishing a strong base in the Australian investment market with good support from research houses, investment managers, financial advisers and platforms.

In the future, a greater level of activity in the managed portfolio space will help overcome some of the challenges highlighted by financial advisers, including tailoring portfolios specifically to the values of their clients.

Managed portfolios will also assist advisers to offer responsible investing across their client bases in a time- and tax-efficient manner, as advisers continue to remain busy evolving and shaping their businesses for the future.

Technology tools which provide financial advisers with the ability to 'look through' and differentiate responsible investment offerings will facilitate a better understanding of what is on offer in the market and provide greater confidence to advisers that they are matching client values with investment products.

Further, tools such as stock substitution and setting investment preferences provides financial advisers and their clients with greater tailoring and management capability.

Finally, platforms will continue to offer financial advisers and their clients great choice in the market with value adds such as stock substitution, in-depth investment reporting and tax optimisation: highlighting that no two platforms are the same. **FS**

Figure 3. HUB24's responsible investing framework

