What investors want

Our research on client perceptions of ESG investing and what we can do to improve their engagement

June 2021

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Introduction

2020 was the year environmental, social and governance (ESG) investment demonstrated it was as much about delivering outperformance as meeting personal values. Returns from some ESG funds exceeded those of their traditional counterparts by as much as 20 percentage points during the first nine months of that year[1].

It is no wonder then that $45.6bn of new money poured into ESG funds during the first quarter of 2020 at a time when $384.7bn of investment was pulled out from the overall fund universe[2]. This trend looks set to continue.

Invesco recently surveyed 161 financial advisers and 201 advised investors[3] to get their views on ESG and found a considerable and widespread appetite for these strategies.

The key conclusion from the survey is that though knowledge remains the biggest barrier to sustainable investing, demand is not limited to a niche group of clients. The new reality is that every client is an ESG client, with nearly four out of five (79%) investors declaring that sustainability is important to how they invest. More than half (52%) of those not already investing sustainably plan to start doing so over the next 12 months.

It is clear that interest in sustainable investing is strong among all generations of investors, but it is also clear that the next generation exhibits the highest levels of interest; 90% of respondents aged under 45 say it matters that their money is invested responsibly, versus three-quarters of the over 60s. Undoubtedly then, the role of the financial services industry must be to support investors in meeting their responsible investment goals today, and also in the future.

The survey confirmed that knowledge levels are nascent, with inconsistent terminology making it harder for investors to get on board. More than two-fifths of investors say a lack of knowledge is the biggest barrier to sustainable investing and that there is too much jargon or confusing language.

Both advisers and their clients admit to struggling with the multitude of terms employed to classify the general landscape of ESG. Those surveyed were comfortable using adjectives, not acronyms. Responsible, sustainable, ethical and green were well used but perhaps less understood. While these terms are distinct, they are often used interchangeably. Interestingly, only 14% understood the term ESG.

In addition, terms used to describe the investment approach of sustainable funds were not well understood. Negative screening was the only ESG approach well understood by advisers and surprisingly this was the least understood phrase by investors. Conversely, sustainability focus was the only investment approach that the majority of investors understood.

It is apparent that investors could benefit from more guidance on sustainable investing, but the survey reveals that while advisers are enthusiastic about advising on ESG, that message may not be getting through, given that nearly 60% of investors say their adviser has not mentioned sustainable investing despite two-thirds (62%) of advisers having a framework in place for discussing the topic.

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>
> **Clive Emery**

“ESG” is just letters. I want to do something that might mean something to a client. “Sustainable” and “Responsible” mean something.

Advisor

Don’t reinvent the wheel, just add another spoke

Our research suggests there is an opportunity for the investment industry to enhance their sustainability offering and differentiate themselves from the competition by giving investors the advice they want on ESG investing.

The research shows investors want clear, consistent terms to help them develop a firm foundation on which to develop their knowledge. They also need reassurance about the relative risk and return profiles of sustainable strategies, and to be made aware that a range of products to suite different objectives exists.

It need not be complicated or a dramatic change of approach for investors. Our report suggests how advisers can incorporate ESG issues into their existing framework. This starts by introducing responsible investment at initial fact-finding mission stage, moving to the relevance of ESG issues, through the client’s risk profile to the final product analysis and recommendation. However, a key conclusion is the need to be pragmatic and to offer what is actually deliverable to clients. The marketplace of possible solutions needs to be better defined, like a risk spectrum, and then this spectrum should be matched to a client’s needs.

Sustainable investment can no longer be considered a passing ‘fad’ and the investment industry needs to assist investors in finding the right ESG strategies and products for them.

Invesco recognises the importance of joining advisers on the sustainable investment journey and we hope that this report – and our other learning materials – provide valuable support.

Sustainable Investing is mainstream/core

Overwhelmingly, people believe that environmental, social and governance (ESG) factors matter.

Nine out of ten of investors responding to the Invesco Research in Finance study say sustainability is important in everyday life, advisers show similar appetite for sustainable investment. Eighty-five percent say they are already advising on ESG or are interested in doing so. More than three-quarters (77%) are recommending sustainable portfolios.

Yet there is a clear disparity between interest and allocation. Just 10% of investors’ assets are allocated to responsible investment strategies, suggesting there are barriers to overcome if advisers and their clients are to get the most from the ESG opportunities available and to align the over 80% interest in sustainable investing

The research reveals that a lack of knowledge is the biggest obstacle to responsible investment (42% of respondents), and this is perhaps borne out by a belief that ESG strategies are riskier or more likely to underperform their traditional counterparts.

Importantly, nearly a quarter (22%) say lack of advice is hindering their involvement with responsible investment, which may – in part – explain the 20% of respondents who feel there are too many options and they do not know where to start.

There is widespread confusion both among advisers and their clients over the terminology; the products available; and the associated risks and returns.

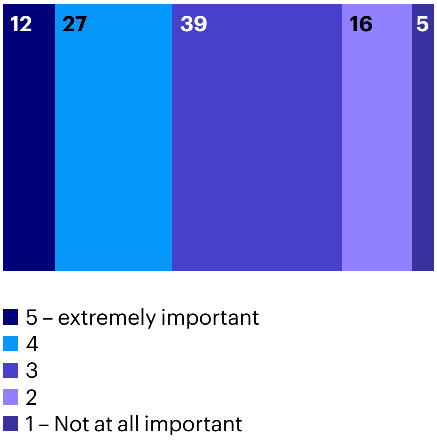
Additionally, there appears to be potential to improve the way in which advisers gather information from their clients, which may open discussions to ESG more effectively.

More than a third (38%) of advisers say they do not have a framework for discussing clients’ sustainably preferences. Further, just over half (51%) of advisers say they ask investors the single binary question, ‘would you prefer to invest sustainably or not?’.

Given investors’ low levels of knowledge and confidence in ESG strategies, taking this approach could potentially close the door to exploring sustainable investment before it has been properly explored.

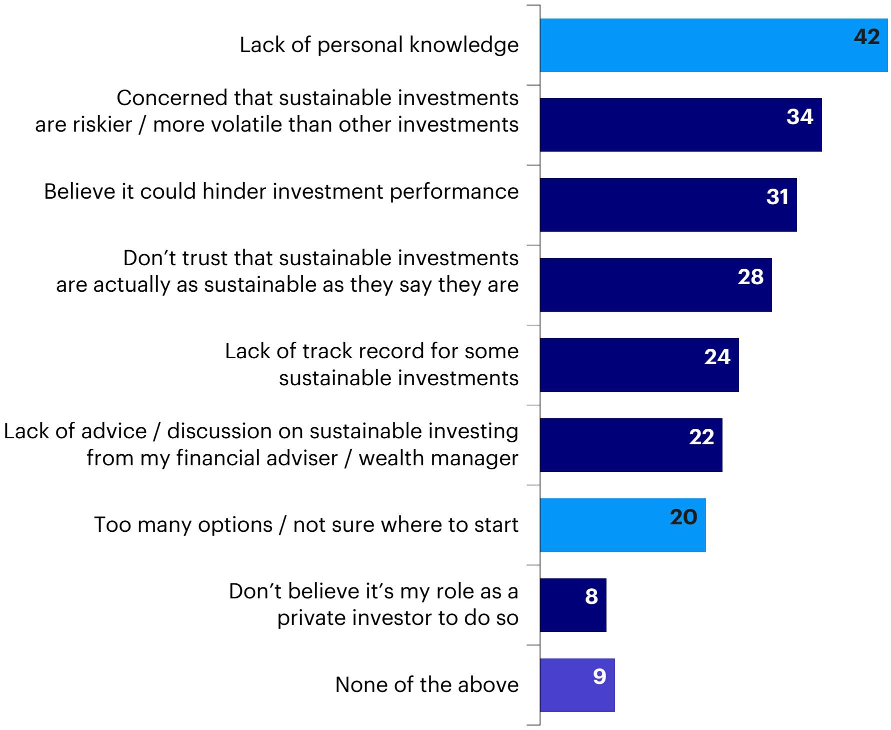
Yet as we discover in this report, these barriers can be overcome. The positive combination of investor and adviser appetite for ESG mean we can build on existing frameworks to improve education and make sustainable strategies accessible for all those who want them.

Figure 1
Importance of sustainability to how your money is invested (%)



Source: Invesco research, January 2021.

Figure 2
Barriers to sustainable investment



Source: Invesco research, January 2021.

Knowledge levels

Improving investors' knowledge of sustainable investment lies at the heart of meeting their growing interest in accessing appropriate ESG strategies. More than two-fifths of respondents admit that their lack of knowledge is a barrier to allocating to sustainable strategies.

However, there is a clear age divide when it comes to understanding responsible investment. A quarter of those aged 55 and under said they lack the knowledge to invest sustainably compared with 56% of those aged over 55.

While most investors (81%) are willing to talk about ESG issues, both they and their advisers responding to the survey concede there needs to be more of a formal structure to ensure responsible investment is made part of the conversation.

Investors in all age groups noted there had been some reluctance on the part of advisers to discuss sustainable investment. One respondent in the 35-44 years age group says, "I don't recall ever having a conversation around sustainable investing." An investor in the age 65 plus group says: "I don't think my adviser is altogether on board with some of these sustainable things."

An adviser admits: "I think we are chickening out at the moment because we wait until they [clients] bring it up."

Yet there is plenty that advisers are already doing upon which they can build to improve knowledge levels.

Clearly, initial fact-finding missions should be designed to ascertain appetite for sustainable investing, which can then lead to more in-depth and educational conversations.

More than a third of investors responding to the survey would like to know the benefits and drawbacks of sustainable investing. A similar number said they would benefit from receiving case studies, along with more articles and guides to sustainable investment.

Importantly, just under a third of investors would like more information on the range of sustainable investments strategies available to them to help inform and shape their views.

All these materials should be made readily available by the asset managers in clear and consistent formats to support advisers and investors.

Overwhelming terminology

Advisers and investors find the terms associated with sustainable investing confusing – and it is proving a real obstacle for allocating to these strategies.

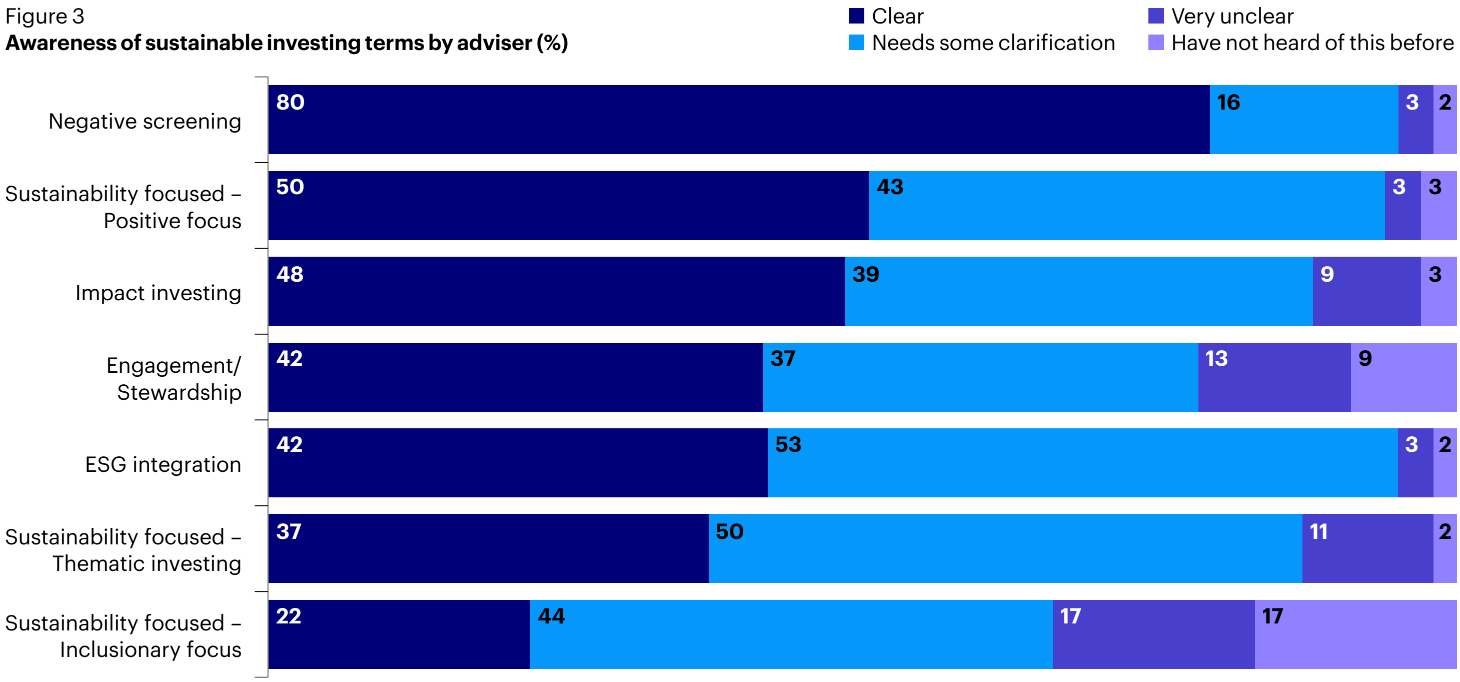
Nearly half (43%) of investors say there is too much jargon and the terminology is confusing. Nearly 40 % also say there is not enough accessible literature available on sustainable investment, while the language used by the investment industry in general acts as a barrier.

Only fifteen percent of investors say the language used by their advisers creates a pain point. This suggests that they are getting it right and that the investment industry as a whole needs to do more to simplify and be consistent to make life easier for clients.

One paraplanner says: "The advisers try to be relatively consistent, but they do tend to throw most of the terms into the same space. They might say sustainable, impact investing, ESG [...] and it is almost like see what sticks – what does the client register with any of those?"

Of all the terms, 'ESG' was singled out as a phrase with which investors had little affinity. When asked if the topic of 'sustainable investing' came up in conversation with their financial adviser/ wealth manager, only 14% say they are comfortable using ESG. This compares to 65% who are happy with the term 'sustainable investing' and 58% who will use 'ethical' or 'responsible investment'.

Figure 3
Awareness of sustainable investing terms by adviser (%)



Source: Invesco research, January 2021.

Investment approaches, too, suffer from lack of understanding and there is disparity between those most familiar to advisers and those familiar to clients. Negative screening was clear to 80% of advisers, yet only a quarter of investors were fully aware of the approach.

Even where advisers and clients have heard of a particular term or approach, it does not automatically equate to understanding. It is clear there is a need for universal definitions. Nearly a third (32%) of advisers say they would like more help in using the right language and terminology with clients.

Fortunately, in November 2020, the UK government said it planned to create a green taxonomy,[4] which would define terms to 'improve understanding of the impact of firms' activities and investments on the environment and support our transition to a sustainable economy'.

As we await this arrangement, advisers and asset managers can help by ensuring they are consistent with the terms they use in conversations and literature. By understanding and explaining the differences between responsible, sustainable and impact investing, and putting these on a spectrum upon which a client's objectives can be placed, investors will be better equipped to find the right solutions.

Clients desire greater engagement

Advised investors are keen to hear more about sustainable investing – more than 80% say they would like to discuss these strategies – but this enthusiasm is not always met by an equivalently robust response from advisers.

The survey found that just 17% of advisers had raised sustainable investing with clients on multiple occasions. Just under a quarter (24%) had mentioned the topic just once with the majority (46%) of respondents saying their advisers had failed to raise the topic at all.

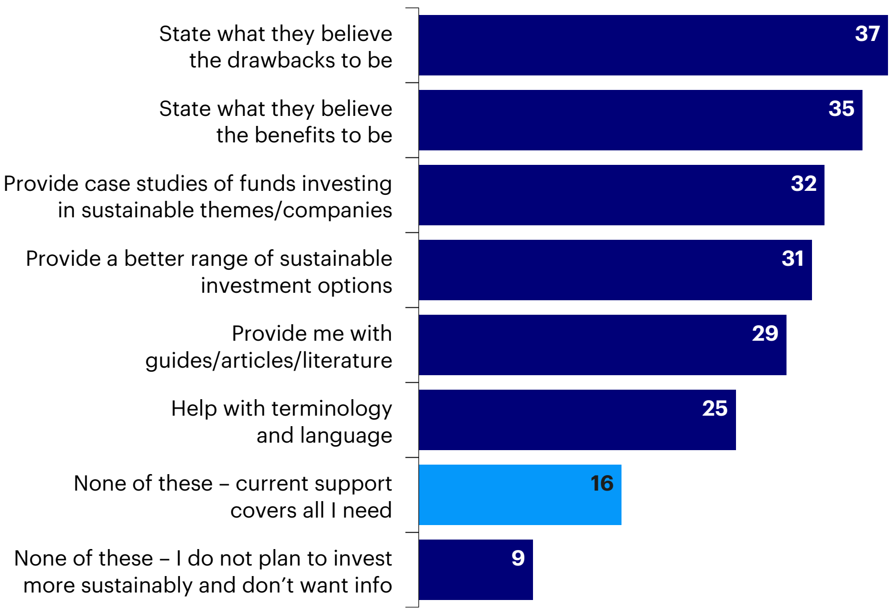
Where sustainable investing has been raised, more than half (51%) of advisers asked the simple question 'do you want to invest sustainably or not?'. This approach appears at odds with investors' interest in receiving more in-depth information. However, the topics and issues covered by ESG are so broad and universal that starting conversations with clients defining their interests can lead to the nearly impossible task of satisfying them.

The survey revealed that advisers would appreciate more support from asset managers in the form of training and support to improve engagement with client on sustainable investing – information is the key to confidence.

When asked, what sort of training and support on sustainable investing they would be interested in receiving now and in the future, more than two-thirds of advisers cite educational seminars that would contribute to continuing professional development (CPD).

Almost half (46%) would like client-facing educational materials, while 42% would like more online tools or support in the initial fact-finding missions.

Figure 4
What information would you like?



Source: Invesco research, January 2021.

What a responsible framework can deliver

- Structure to a difficult conversation
- Balance between financial & non-financial goals
- Co-ordinated financial & non-financial risk profile
- Responsible client segmentation/ product list
- Governance document to share with clients & regulator

Investors clearly want greater engagement and it important that the industry does not reinvent the advice wheel – merely add another spoke to what is an already strong framework.

Advisers' existing frameworks can be enhanced to create better outcomes for clients. For example, moving from a single, binary questions to a questionnaire that covers more topics and includes open questions, is likely to lead to more fruitful discussions with clients.

However, it is important that advisers review the efficacy of questionnaires; are they facilitating better outcomes? Many advisers raised concerns that questionnaires can be superficial or leading. In some cases, they may be emotive or lack context. Advisers need to carefully devise questionnaires to ensure they serve their purpose.

Ultimately the framework should give advisers the confidence to support clients in choosing a suitable sustainable investment strategy.

Distinction of product offerings needed

Given the confusion around the range of sustainable investment terminology, it is no surprise that the investment industry is struggling to ensure clients can differentiate between the products available.

When asked which challenges they face when thinking about sustainable investing with clients, nearly two-thirds (62%) of advisers point to an inability to distinguish between the different types of fund or strategy.

More than half (52%) say they struggle to match their client's preferences to a solution, while 45% say it is difficult to research sustainable funds. This figure rises to more than two thirds (68%) of advisers who are not yet talking to clients about sustainable investment.

At Invesco we think it is important to establish that a spectrum of sustainable solutions exists. It is no longer the fact that a client who wants to do good with their money is only offered SRI investments. A far wider range of options is available. Responsible and sustainable investment products are mainstream and are likely to replace traditional approaches that do not include responsibility into their approach.

The appreciation of the differences between responsible, sustainable and impact investing is crucial. It enables the key elements of a fund to be understood and within that category, the nuances between the funds can be established providing a greater chance of finding a match for a client. For example, funds do not need to be seen as 'green' or 'not green', rather they can be placed along the spectrum giving a greater appreciation of the differences in themes, styles and strategies.

The conversation that has evolved is about "what can I do with my money? How can I make a difference, and show me that?"

Advisor

Performance drag perception remains

Sustainable investment is often seen as synonymous with sacrificing return, yet as we have seen since 2020, ESG funds are more than capable of outperforming traditional funds.

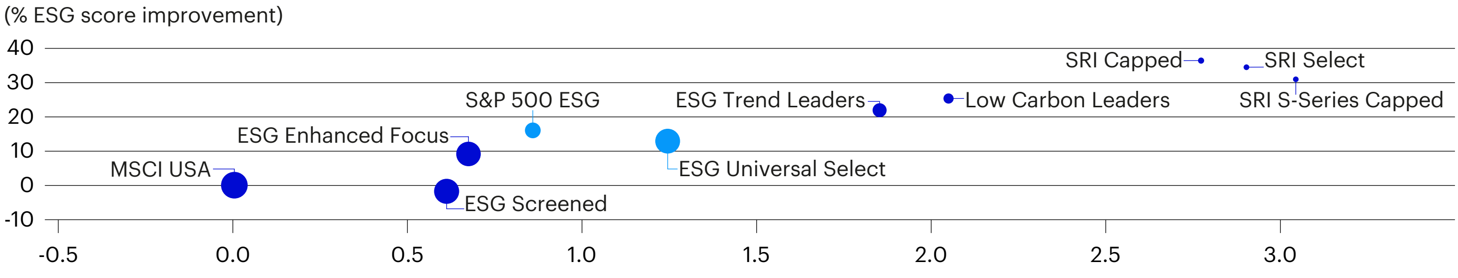
It is critical that advisers can communicate the long-term risk/return profiles of these funds and reassure investors who want to invest sustainably that they do not need to compromise on performance.

As discussed elsewhere in this report, advisers can understand responsible investment as a spectrum along which different strategies lie. The chart below (figure 5) illustrates three main investment approaches – Responsible (light blue), Sustainable (Leaders) and Impact (SRI). These approaches give an uplift in the ESG score of a portfolio but lead to different outcomes in terms of tracking error. Appreciating this spectrum and being able to explain the benefits and drawbacks of these approaches is a key step to enable clients to match their needs to products that exist.

For example, Responsible (ESG Universal) – which index provider defines as companies which demonstrate a robust MSCI ESG Rating and a positive ESG Trend, while maintaining a broad universe of securities. These have a tracking error of just under 1% and outperformed the MSCI All Word Index by an annual average of 0.20 percentage points over a seven-year simulated period.

However, advisers will also need to be sure that their clients have realistic expectations about the performance responsible investment funds can deliver. It is only since the turn of the decade that responsible investment funds have demonstrated they can outpace traditional strategies. There needs to be some pragmatism about consistent outperformance in the immediate future.

Figure 5



Source: Invesco research, January 2021. (Tracking error vs non-ESG benchmark).

“

I could be putting my money to good use, but I need to be convinced that it is what it says on the tin. I suppose the barrier is trust, that what we are being presented with is actually going to do what it says it is hoping to do.

Investor aged 55-64

“

I would be amazed if many firms could get away with dismissing sustainable investment in the way that they probably did four or five years ago. We attract dozens of clients every year because their advisers have dismissed it. That is the reality.

Adviser

Comparability and confirmation required

Importantly, advisers will need to identify ‘greenwashing’ (where funds are marketed as having greater ESG credentials than they possess). Forty-five per cent of advisers say a difficulty in spotting ‘greenwashers’ is an obstacle to helping clients with sustainable investment. More than a quarter (28%) of investors are concerned that products ar not as green as they promise to be.

To better manage providers that may be overpromising, advisers can focus on giving clients the three Rs: Return, Risk and Responsibility. The advisers should be able to clearly articulate the expected return, the risk exposure and the level of responsibility.

If advisers are to confidently recommend sustainable investment strategies and funds, it needs to be easier for them to compare what is available.

More transparency from providers will help as will an improved advice framework.

We think as the market develops all funds will need to report the 3 Rs. Clients will want to know the return, risk and responsible profile of their investments and importantly want to see the actual return, risk and responsible outcome. By delivering the 3Rs the asset management industry can provide a clearer picture of the products and solutions available and enable advisors to better match these to their clients’ objectives and demonstrate how the funds deliver against those expectations

R^3	Return	• What is the return going to be?
	Risk	• What are the risks I’ll be exposed to?
	Responsibility	• How responsible is the investment?

Conclusion

Sustainable investment can no longer be considered a niche strategy for a niche audience. Appetite among investors is not only growing, it is already widespread and, given the next generation’s clear enthusiasm for putting their money to good use, sustainable investment is here to stay.

The investment industry should see sustainability as central to their propositions if they are to build successful, profitable businesses that continue to grow into the future. Key to this is the recognition that an ESG client of today is potentially every client and not just the ‘deep green’ SRI investor of old.

This survey shows that many advisers already have processes in place that can be enhanced to better cater to those clients demanding support with responsible investment.

However, it is also clear that challenges remain in delivering effective advice in this area. Confusing terminology, low levels of knowledge and fear about potential performance drag are all issues that need addressing to aid the take up of sustainable solutions.

More can – and should – be done to provide advisers and their clients with accessible and transparent information to help them make optimum investment decisions. There needs to be a move towards universal terms and an agreed spectrum on which responsible investment can sit.

At present the complexity of ESG can be a hinderance in itself. The investment industry should focus on providing clear and simple explanations of the benefits and drawbacks of Responsible, Sustainable and Impact solutions.

In synopsis, we need to be pragmatic. The marketplace of possible sustainable investment solutions should be better defined, like a risk spectrum, and then this can be better matched to clients’ needs.

A concerted and common effort from the investment industry will ensure that investors have access to the best sustainable investment options that meet their objectives today and in the future.

1 Source: www.trustnet.com/news/7466122/esg-funds-beating-their-conventional-rivals-in-most-sectors-this-year
2 Source: www.morningstar.co.uk/uk/news/202274/investors-back-esg-in-the-crisis.aspx
3 Survey conducted January 2021. The quoted number of participants all responded/participated in the research.
4 Source: www.gov.uk/government/news/chancellor-sets-out-ambition-for-future-of-uk-financial-services

Risk warnings

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Important information

Data as at 31 January 2021, unless otherwise stated.

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