Are You SRIous?

IS SUSTAINABLE, RESPONSIBLE, AND IMPACT INVESTING GOOD BUSINESS FOR ADVISERS?

By Ed McCarthy

Investor interest in sustainable, responsible, and impact investing (SRI) continues to grow. According to a 2014 report by Washington, DC–based US SIF (the Forum for Sustainable and Responsible Investment), SRI investing in the US "has grown substantially over the past two years. The total US-domiciled assets under management using SRI strategies expanded from $3.74 trillion at the start of 2012 to $6.57 trillion at the start of 2014, an increase of 76%. These assets now account for more than one out of every six dollars under professional management in the United States." It's not possible to identify how much of that money can be attributed to private clients, but the report states that "$4.80 trillion were identified within specific investment vehicles managed by money managers or community investing institutions."

KEY POINTS

Some surveys find strong interest in and adoption of ESG/SRI strategies. Other surveys find less enthusiasm.

Advisers' interest in SRI and willingness to invest in research resources appear to be important factors influencing clients.

Advisers citing low levels of client interest in ESG/SRI believe that interest will increase.

A February 2015 survey from the Morgan Stanley Institute for Sustainable Investing ("Sustainable Signals: The Individual Investor Perspective") also found strong interest in sustainable investing, reporting that "71% of individual investors are interested in sustainable investing" and "Millennial investors are not only the most interested in sustainable investing (84% are interested); they are also more likely to factor sustainability into their daily lives."

Other studies into SRI adoption point to a different conclusion, however. Lake Forest, Illinois–based Spectrem Group's report "Asset Allocation, Portfolios, and Primary Providers—2014 Mass Affluent Quarter 4" states: "The fact is that social responsibility does not matter when most investors make their financial decisions regarding investments." In the ultra-high-net-worth investor segment—defined as having a net worth between $5 million and $25 million excluding primary residence—only 20% of investors said the SRI factor mattered in their investment selections.

A June 2015 CFA Institute environmental, social, and governance (ESG) survey found that one-third (33%) of advisers responding in the private client category did not consider ESG factors in their investment analysis or decisions. The main reason, cited by 47% of the respondents, was lack of demand from clients and investors.

One reason advisers have given for the low level of interest in SRI is the widely held belief that SRI imposes an opportunity cost on potential returns. SRI supporters argue that recent research disproves that notion, however, and cite studies like the March 2015 Morgan Stanley report "Sustainable Reality: Understanding the Performance of Sustainable Investment Strategies." The study examined performance data from 2007 through 2014 for 10,228 open-end mutual funds and 2,874 separately managed accounts based in the United States and denominated in US dollars. The report's conclusion: "[I]nvesting in sustainability has usually met, and often exceeded, the performance of comparable traditional investments. This is on both an absolute and a risk-adjusted basis, across asset classes and over time."

THE ADVISER'S INFLUENCE

The ESG survey performed by CFA Institute addressed another factor that could help explain the gap between public and adviser surveys. When asked whether employees at firms received training on how to consider ESG issues in investment analysis, only 21% of the private client respondents said yes. But some advisers experience significantly greater SRI interest and participation from clients than their peers. In those cases, the advisers' interest in SRI and willingness to expend resources on research appear to be key factors.

Linda Pietroburgo, a principal with the Moneta Group in Clayton, Missouri, has been a "champion of SRI" for about 10 years. She suspects that the low reported level of advisory clients' interest is at least partly attributable to advisers' failure to pick up clients' cues. For example, if the client expresses interest in an ESG-related cause during a meeting and the adviser simply notes that interest for the file, that is a missed opportunity. In contrast, when Pietroburgo responds to clients' cues and explains they can align their values and investments, she says "their eyes get big" and they become eager to learn more. Advisers can also help clients express their SRI values more clearly, she says: "I think a lot of people would be a lot more interested in this if they knew the language, if they knew what they wanted."

Chitra Staley, CFA, managing director and partner with Beacon Pointe Wealth Advisors (BPWA) in Boston, Massachusetts, has been active with SRI since 1991. She estimates that about 30% of clients in her office have SRI positions. Because clients bring their own definitions of SRI, a broad SRI definition can simplify matching clients' interests with suitable investments. "We don't have a one-size-fits-all policy on SRI within the firm, but rather we tailor the SRI investments to each client," she says. "Having said that, there are, of course, many areas of congruence, so generally the themes are social, economic, environment justice. Within those broad themes, clients can either just adopt the overall themes or specify if there are particular areas of interest that they would like to focus on, and then we follow that mandate."

RESEARCH INFRASTRUCTURE

Advisers can draw on relatively inexpensive, readily available data and analytic measures for most asset classes, but that's not the case with ESG/SRI analyses. Research firms assign scores to companies and investment funds and sell access to ratings databases, but the services' cost can be hard to justify for a low level of SRI research.

As interest in SRI grows, however, research vendors are responding with new services. Morningstar has announced a new sustainability rating for about 20,000 mutual funds and exchange-traded funds. According to the company's press release, the company will use data from research firm Sustainalytics to calculate ratings. Morningstar provided the results to users of its adviser platforms first and rolled out to other platforms throughout the spring.

Some advisers recommend additional due diligence before accepting a third party's stamp of SRI approval. Rick Konrad, CFA, with Value Architects Asset Management in Hoboken, New Jersey, says he has seen companies about which he has serious doubts qualify for socially responsible lists. Konrad has an extensive history with responsible investing and estimates that about 20–25% of his clients have SRI positions. His firm conducts its company evaluations internally by reviewing financial reports and contacting companies' investor relations staff and chief financial officers.

Getting that information requires additional effort, he admits. "It really requires decent understanding of the company," he says. "There are third-party databases that do this, but because so much of it is not quantitative, it's not something that's easily screened. It requires discussion, it requires an understanding of the business, and it's something that most Wall Street analysts are not really looking for."

Incorporating SRI factors into portfolio decisions likely will require additional staff time. Pietroburgo says the Moneta Group has a centralized research department but that for years SRI remained a peripheral project for them; consequently, she was doing much of her own research. In 2015, she hired an investment specialist in her office to focus on SRI and help her develop an SRI platform that she can implement more readily with interested clients. Beacon Pointe Wealth Advisors is also expanding its SRI research capabilities, says Staley, who merged her prior firm with BPWA in August 2015. One benefit of the merger is that it gives Staley access to additional resources, and the firm now has a research analyst who is spending much of his time on SRI, as is the director of research.

Another option that several sources mentioned is to work with organizations that offer SRI-based investment products, such as Breckinridge Capital Advisors, Parametric Portfolio Associates, and Trillium Asset Management. Working with these organizations can allow smaller and mid-sized advisory firms to effectively outsource the SRI research role.

Jennifer Sireklove, CFA, senior investment strategist for responsible investing with Parametric in Seattle, Washington, says the firm decided to ramp up its ESG efforts last year and cites growing adviser interest in the SRI products. She reports that in 2015 Parametric funded approximately 200 new private client accounts incorporating ESG criteria, associated with an estimated $300 million in assets under management (AUM). As of year-end 2015, responsible-investing-related AUM was at roughly $10.5 billion, all in separately managed accounts, out of about $150 billion total AUM at the firm. About $3.2 billion is in private client accounts for individual investors, with 90% of that amount in tax-managed, index-based strategies.

IMPACT INVESTING

Assisting clients with impact investments poses more of a challenge. Staley draws on SRI contacts to identify opportunities. "There are a lot of, I wouldn't say wealth managers, but certainly people who are doing research in the field of impact investing who are trying to find these types of investments and then spreading the word," she says. "So, there's a lot of collaboration within the community to pinpoint these investments so that it is available to as many people as are interested."

Adrian Cronje, CFA, chief investment officer at Balentine in Atlanta, Georgia, says that his firm works with numerous entrepreneurs who express interest in making impact investments. The firm offers a private capital advisory service, which allows Balentine's advisers to identify possible impact investments using internal resources. "We've made a deliberate effort in investing in a systematic approach to making investments in direct private companies," says Cronje. "And so, our research in this area really just leverages the investments and resources we've made."

CLIENT RELATIONSHIPS

Developing SRI advisory expertise requires a commitment of time and resources, but Konrad believes it's worth the effort for several reasons. ESG/SRI knowledge can differentiate an advisory firm's services from its competitors, he says, allowing it to "offer something more than tracking quarterly results." It can also improve a firm's position with millennial investors, thus increasing the likelihood of the advisory firm's survival as those investors inherit their parents' portfolios. Moreover, Konrad points out that using such expertise to engage clients can promote a long-term relationship in which clients "are not just renting their money" with an adviser.

Ed McCarthy is a freelance finance writer in Pascoag, Rhode Island.

KEEP GOING

Environmental, Social, and Governance (ESG) Survey [www.cfainstitute.org/Survey/esg_survey_report.pdf]

"Expanding ESG Coverage," *CFA Institute Magazine* [www.cfapubs.org]

Find ESG educational content provided by CFA Institute at cfa.is/1FGXakq