

HUB²⁴

Investing for the future, with clients of the future

HUB24

As the demand for responsible investing grows, many financial advisers are seeking ways to incorporate it into their practice and meet their clients' needs more holistically. This paper brings together industry experts in environmental, sustainable and governance (ESG) investing to discuss how it is spanning generations and influencing how advisers engage with their clients.

ESG trends, challenges and misconceptions

Demand for responsible investments is growing as financial advice clients search for ways to invest for impact and leave a positive legacy for future generations.

Australian trends

Responsible investing is no longer a niche investment concept sought out by a select group of financial advice clients. The pandemic, natural disasters, climate change and a growing awareness of our world and environment have prompted clients to pay more attention to how and where their money is invested. According to research from the Responsible Investment Association Australasia (RIAA), 83% of Australians expect their super to be invested responsibly and ethically, and 80% expect their savings to have a positive impact on the world. In addition, 64% of Australians ex-

pect their financial adviser to be knowledgeable about responsible investment options. This has increased from 54% in 2020 and is now the number one expectation that Australians place on financial advisers—even prioritised over investment returns.¹

As a result of this growing demand, companies and investment managers are responding to bottom-up pressure to report on their sustainability metrics, and top-down pressure from regulatory bodies such as The Australian Securities Exchange (ASX), The Australian Securities and Investments Commission (ASIC) and The Australian Prudential Regulation Authority (APRA) to ensure products are labelling themselves truthfully as the pool of responsible investments continues to grow.

The increased focus on sustainability is having a positive impact on corporations, prompting them to improve their business operations to compare favourably to their peers and attract capital from institutional and retail investors. Leah Willis, head of client relationships at Australian Ethical, explains that many Australians are no longer willing to invest just for returns without any consideration of potential risks for the environment, animals, human rights and the supply chain. Leah says:

There's a rising social consciousness around what we do every day that has tipped over into investments. Responsible investing, as benchmarked by RIAA, now makes up over 40% of all professionally managed assets in Australia. It's rapidly becoming mainstream, and it's growing every year.²

Environmental issues are the primary concern for clients who currently hold ESG investments—rating above corporate governance, ethical, social and Indigenous issues. Over the past year, 54% have bought or sold ESG investments based on environmental considerations.³ Leah says:

Climate is the number one issue we’re contending with globally, and also where the investment demand lies. Clients are seeking forward-looking approaches to climate, rather than settling for investment managers excluding certain stocks from portfolios.

Table 1 shows the top 5 environmental and social themes that Australians care about when investing, as reported by RIAA.

Table 1. What Australians care about when investing

Environmental themes	Social themes
1 Renewable energy and energy efficiency	1 Healthcare and public health
2 Sustainable water management	2 Employment and local business
3 Healthy rivers and oceans	3 Green, social and community infrastructure
4 Zero waste and circular economy	4 Education and vocational training
5 Sustainable land and agriculture	5 Inclusion (financial, social, accessibility etc.)

Source: RIAA, *From Values to Riches 2022: Charting consumer demand for responsible investing in Australia, 2022.*

Today, nearly one in two Australian advisers provides advice on ESG investments. This is up from one in five in 2016. More than half (57%) of these advisers have seen an increase in client demand for responsible investments over the last 12 months.

Global trends

Globally, similar trends are emerging. According to the [United Nations] *Principles for Responsible Investment Annual Report, 2021*, climate change is the highest priority ESG issue facing consumers and organisations around the world.

As ESG investing becomes mainstream globally, regulators are focusing on sustainability ratings and standards to ensure credibility and improve transparency. Global developments such as the Paris Agreement, the Sustainable Development Goals, the Task Force on Climate-Related Financial Disclosures and the United Nations Environment Program Finance Initiative (UNEP FI), are providing a framework for companies to follow, which is making it easier for clients and advisers to rate their sustainability.

The trends in overseas investment markets are also similar to the Australian market. Global ESG assets surpassed \$35 trillion in 2020 (in US Dollars), up from \$30.6 trillion in 2018 and \$22.8 trillion in 2016, according to the Global Sustainable Investment Alliance, *Global Sustainable Investment Review, 2020*.

From 2018 to 2020, Canada experienced the largest growth in ESG assets (48%), followed by the United

States (42%), Japan (34%) and Australasia (25%). Europe continues to lead the way for the rest of the world with ESG investing. In 2022, ETFs aligned with ESG outcomes accounted for 65% of all net inflows into European ETFs.^{5,6}

ESG terminology

The words ‘ethical’, ‘responsible’ and ‘sustainable’ can mean different things to different clients. Understanding your clients’ priorities and motivations can help you ascertain what approach to take when developing their portfolio.

For example, Morningstar’s ESG framework describes ESG investing in the context of a client’s motivations for people, the planet and profits. At one end of the scale, a client might consider ESG risks and wish to exclude certain investments from their portfolio. At the other end of the scale, they might actively seek investments that will make a positive impact to the world.

So, what does the jargon mean?

ESG investing approaches

Excluding investments (or negative screening)	Reducing or excluding exposure to certain companies, sectors or countries that do not align with your client’s values or are considered unethical, harmful or controversial according to global standards. For example, tobacco, firearms, gambling, alcohol, palm oil, adult entertainment or fossil fuels.
Assessing ESG risk	Using ESG information and ratings to assess an investment’s material ESG risk alongside traditional financial analysis.
Including investments (or positive screening)	Identifying companies that are sustainability leaders or are solving specific ESG challenges such as climate change or human rights.
Shareholder advocacy	Engaging with a company as a shareholder to influence a company’s strategy and actions to generate positive ESG outcomes.
Investing for impact	Choosing investments that are likely to benefit from long-term environmental and social trends. This might include renewable energy, innovative technology and gender equity. Sustainability is a major component of security selection and portfolio construction. For example, selecting bonds that finance projects which will benefit people and the planet.

Busting the top 5 ESG myths

Despite the growth and widespread popularity of ESG investing, there are still many misconceptions held by clients and financial advisers. Erica Hall, ESG analyst at Morningstar, describes some misconceptions she frequently comes across.



The quote

Responsible investing, as benchmarked by RIAA, now makes up over 40% of all professionally managed assets in Australia. It’s rapidly becoming mainstream, and it’s growing every year

Here are her top five:

ESG is a fad

The ESG market is evolving and maturing and is no longer a niche strategy that appeals to a certain type of client. Instead, it is fast becoming a mainstream strategy that enables all types of clients to align their portfolios to their values and invest for impact. Erica said:

ESG investing is a way to make a positive difference and enact change. While each country has its own sustainability priorities, ESG is a growing global trend. Now that the Climate Change Bill 2022 has passed in the Senate, Australia has a path to net zero by 2050. We're already seeing in Australia, strategies relating to mitigating climate change.

Only younger generations are interested in ESG investing

Millennials and Gen X may be the ones leading the charge towards sustainable and impact investing, but Baby Boomers also care about how their money is invested. Erica said:

This generation is being influenced by the younger generations. They're concerned about the future too. They're thinking about handing over their assets and what that will look like. They're keen to make a positive difference so their children and grandchildren have a good world to live in.

ESG investments have poor performance

While some ESG investments will not always perform in line with the broader market, this does not mean that clients need to accept poor performance to invest responsibly. Nor does it mean that clients need to place their values above their desire for strong investment returns. Erica said:

Sustainable investors still seek to generate positive returns from their investments, however the difference compared to a non-sustainable investor is they care how those returns are derived. The composition of ESG portfolios means there may be short-term periods where they perform better or worse than the broader market. But the data has shown this evens out over the long term. Even with the energy crisis and price correction for tech stocks that we've seen recently, ESG portfolios have kept up with the broader market over a five-year period.

Sustainable portfolios should not have any exposure to resource stocks

While reducing exposure to fossil fuels is a major component of many sustainable portfolios, the resources sector is going through a transition process in Australia. Resources can include both renewable and non-renewable forms and labelling sustainability-related portfolios clearly and accurately is important to provide transparency and avoid misleading investors. Instead of avoiding resource stocks completely, another strategy might be to examine which companies are on a clear transition pathway to net zero. Erica said:

A lot of fossil fuel companies are proactively transitioning and investing in more renewables. They're getting rid of their high polluting assets and actively reducing their carbon emissions. It's complicated. We're a resource-rich nation with a lot of exposure—directly or indirectly—to the fossil fuel sector. If you exclude a big component of the market, there will be unintended consequences you will have to deal with."

There are not enough ESG options to create a diversified portfolio

The first ESG investment options to appear in the Australian market were heavily focused on equities, which made it difficult to construct a multi-asset portfolio. However, now that the industry has

evolved, there are many more options and ESG-related data available to help advisers make an appropriate ESG assessment for their clients. Erica said:

It used to be much harder to find suitable over-the-counter instruments, like bonds, but that's come along in leaps and bounds. Over the past 12 months we've seen a lot more rated ESG bond strategies and that's allowing advisers to construct efficient multi-manager strategies.

What is greenwashing?

Companies are responding to the growing demand for sustainability by examining their business practices, aligning their business goals to benchmark sustainability goals, and disclosing their results to investors and shareholders.

While this is a positive development, it has led to an issue referred to as 'greenwashing' where some companies have been found to convey false or misleading information about the sustainability of their products, processes or investment strategies. This is a serious issue because it can influence clients' decisions and erode confidence in sustainability products.

In the Investment Trends 2022 ESG Adviser Report 34% of financial advisers said they find greenwashing their biggest challenge when recommending responsible investments.

In June 2022, ASIC issued Information Sheet 271 to provide responsible entities of managed funds and super fund trustees with guidance about how to avoid greenwashing when offering or promoting sustainability-related or ethical products and investments.

ASIC has stated that enforcement action against greenwashing is one of its current priorities and has issued several infringement notices to companies for making false or misleading sustainability-related statements.

Conclusion

Responsible investing is here to stay, and clients of the future will continue to seek ways to invest according to their ESG preferences and values. By starting the conversation with clients, advisers can not only broaden the scope of their practice and drive investment outcomes, but deepen client relationships through meaningful discussions. At HUB24, we believe in the value of advice and are committed to innovation that drives efficiencies for advisers and value for clients. **FS**

Notes

1. RIAA, From Values to Riches 2022: Charting consumer demand for responsible investing in Australia, 2022.
2. RIAA, Responsible Investment Benchmark Report Australia 2022.
3. Investments Trends, Investment Trends 2022 ESG Adviser Report, May 2022.
4. Investments Trends, Investment Trends 2022 ESG Adviser Report, May 2022.
5. Global Sustainable Investment Review, 2020.
6. Financial Times, ESG accounts for 65% of all flows into European ETFs in 2022, 13 January 2023.

Disclaimer – important information

This document has been issued by HUB24 Custodial Services Ltd (ABN 94 073 633 664, AFSL 239 122 (HUB24)). HUB24 is the operator of HUB24 Invest (an investor directed portfolio service), promoter and service provider of HUB24 Super which is a regulated superannuation fund. The trustee and issuer of interests in HUB24 Super is HTFS Nominees Pty Limited (ABN 78 000 880 553, AFSL 232500, RSE L0003216). The information in this document is intended to be general information only and not financial product advice. The views expressed in this document by persons who are not representatives of HUB24 are their own, and do not necessarily represent HUB24 views. HUB24 has not validated or verified the views expressed in this paper, make any representation as to the completeness or reliability of the material in this paper, accept any liability for loss attributable to use of this paper, including liability for any statements which are incorrect or misleading. Readers should not rely on the information in this paper and should undertake their own investigations and use their own commercial judgment. This document must not be copied or reproduced without the prior written consent of HUB24. © HUB24