

# Fundamentals of Sustainable Investment

## *A Guide for Financial Advisors*

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# Today's discussion

- About The Investment Integration Project (TIIP)
- TIIP and Money Management Institute's (MMI) new guide for financial advisors (FAs)
  - **Why** should FAs care about sustainable investment?
  - **What** exactly is sustainable investment?
  - **How** should FAs discuss sustainable investment with clients?
- “Real world” scenarios of FA/client interactions about sustainable investment
- Questions & answers



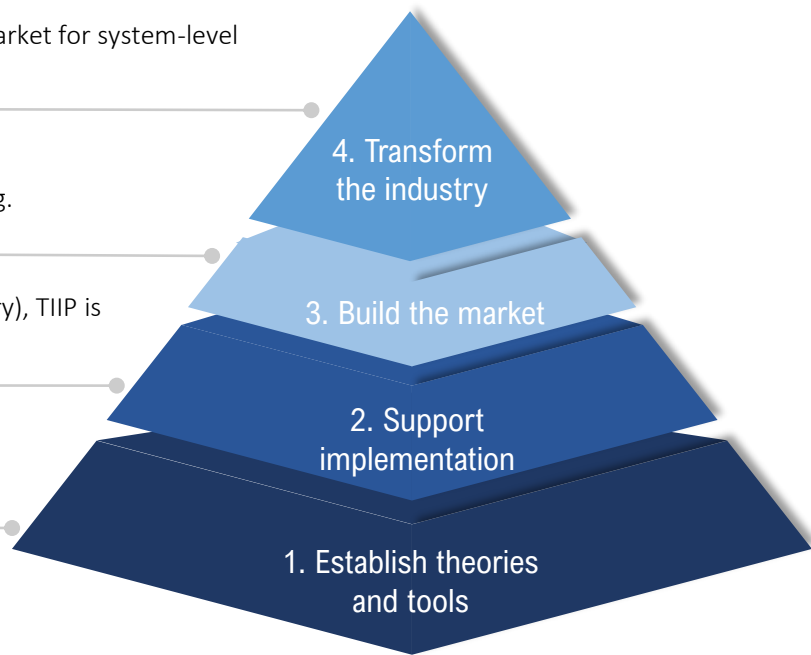
# The Investment Integration Project (TIIP)

TIIP's goal: Three-year initiative to continue to build the market for system-level investing and to catalyze industry transformation

TIIP's next phase of work: build the market for system-level investing.

Having made the case for the what and why of system-level investing (theory), TIIP is now addressing the challenge of implementation (practice).

Established in 2015, TIIP is an applied research firm providing thought leadership, resource development, and consulting on system-level investing to investors.



# TIIP's sustainable investment guide for FAs

- **Released in April 2019**

- Instructional guide that assists FAs in effectively integrating sustainable investment into their practices, developed by TIIP **in close partnership with MMI**
- Provides practical information and guidance for FAs of all types and who work with individual and institutional clients of all wealth levels
- Informed by 30+ interviews with FAs and other sustainable investment thought leaders and influencers

- **Answers three core questions**

- **Why** should FAs care about sustainable investment?
- **What** exactly is sustainable investment?
- **How** should FAs discuss sustainable investment with their clients?

- **Includes** hypothetical “real world” scenarios outlining the guidance and recommendations in action



# Impact & Momentum

- **Industry Awards**

- *Fundamentals* was nominated for a 2019 Barron's Industry Award for excellence in sustainable investing

- **Used for industry trainings & continuing education sessions**

- Serves as the foundation for education and training by MMI, CFAI and others, some which provide credits for I&WI CIMA®, CPWA®, CIMC®, RMA®, and CFP® professionals

- **Adapted and customized for client education**

- Tailored material specific to LPL Financial, Envestnet, Fidelity Labs and others



# Key current developments

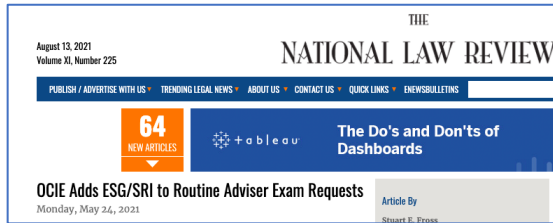
## CFA Institute recommends system-level thinking in latest report

- “Systems theory is more than just an extra discipline to be studied.... The key principle is that there are multiple interconnected factors that drive the investment ecosystem that need to be recognized.”



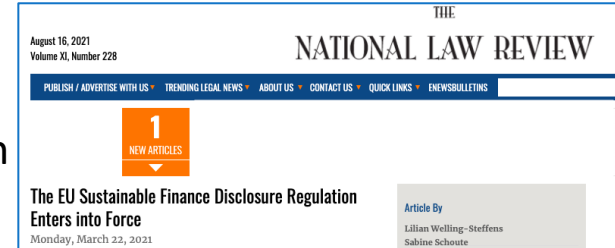
## Securities and Exchange Commissions' office requests ESG documents

- Advisors must submit all documentation and due diligence for their recommendations around a broad set of ESG-related investments



## E.U. requires disclosure on ESG-related information

- Advisors & investors are required to disclosure certain ESG information using mandatory templates



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# Why should FAs care?

# Why should FAs care about sustainable investment?



Sustainable investment is growing, and it's good for business.



Sustainable investment can enhance financial performance.



Environmental and social phenomena affect investors and vice versa.

## What's in it for me?: What experienced FAs and industry leaders are saying...

“We were nudged into [sustainable investment] by client demand over a decade ago. We started as reluctant disbelievers... We’ve since become wholehearted advocates and have built our practice around it. Eighty percent of our new business is in this space – the trajectory of new growth for us is in this space.”

“You’re going to run into [sustainable investment] during your career. If you ignore it, you’re going to lose the edge to another guy.”





# Sustainable investment is growing and it's good for business

Sustainably invested assets grew an estimated 15% worldwide (from 30.6 trillion to 35.3 trillion) and 42% in the U.S. (from 11.9 trillion to 17.0 trillion) between 2018 and 2020.

Large institutional investors drove much of the growth, but individual investors are increasingly interested too:

- At least 84%—and as much as 90%—of Millennial investors and nearly three-fourths of women are interested in sustainable investing.

*Given that 2/3 of adult children and 70% of women leave their family FA after receiving an inheritance or after a spouse's death, could considering their sustainable investing preferences might help curb such asset attrition?*

- But! Men and older investors are interested too. In fact, **nearly 3/4 of all investors are interested in sustainable investment.**

## Experienced FAs assert that incorporating sustainable investment into advisory offerings can help FAs to:

- ✓ Attract new clients
- ✓ Retain existing clients
- ✓ Competitively position themselves relative to peers
- ✓ Provide clients with a more satisfying investment experience.

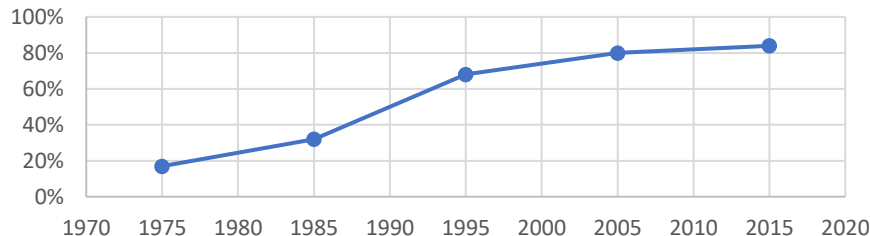


# Sustainable investment can enhance financial performance

- Sustainable companies can be better at managing risk and have less systemic volatility than their conventional peers, making them **better overall investments**.
- Sustainable investments large and small that are focused in private equity, private debt, and real assets **can achieve market-rate returns**.
- Sustainable investment indexes can **perform as well or better than their conventional counterparts**.

- Sustainability factors impact value, which encourages growth and **enhances shareholder returns and can ultimately lead to higher valuations**. Intangible assets have accounted for an increasing percentage of company market value over time.

Intangible assets as a percentage of S&P 500 market value over time



Adapted from Ocean Tomo. *Intangible Asset Market Value Study*. Cate M. Elsten and Nick Hill. Journal of the Licensing Executives Society, Volume LII No. 4, September 2017.



# Environmental and social phenomena affect investors and vice versa

- **Environmental and social phenomena affect investors, e.g.:**
  - Investors could experience losses of up to 45% if policymakers and the private sector do not partner to mitigate climate change and limit global warming.
  - Social unrest caused by global youth unemployment could produce significant volatility in financial markets.
- **Investors affect the environment and society, e.g.:** divestment from companies doing business in South Africa prompted legislation ending apartheid.

# What exactly is sustainable investment?

# Disentangling the vocabulary

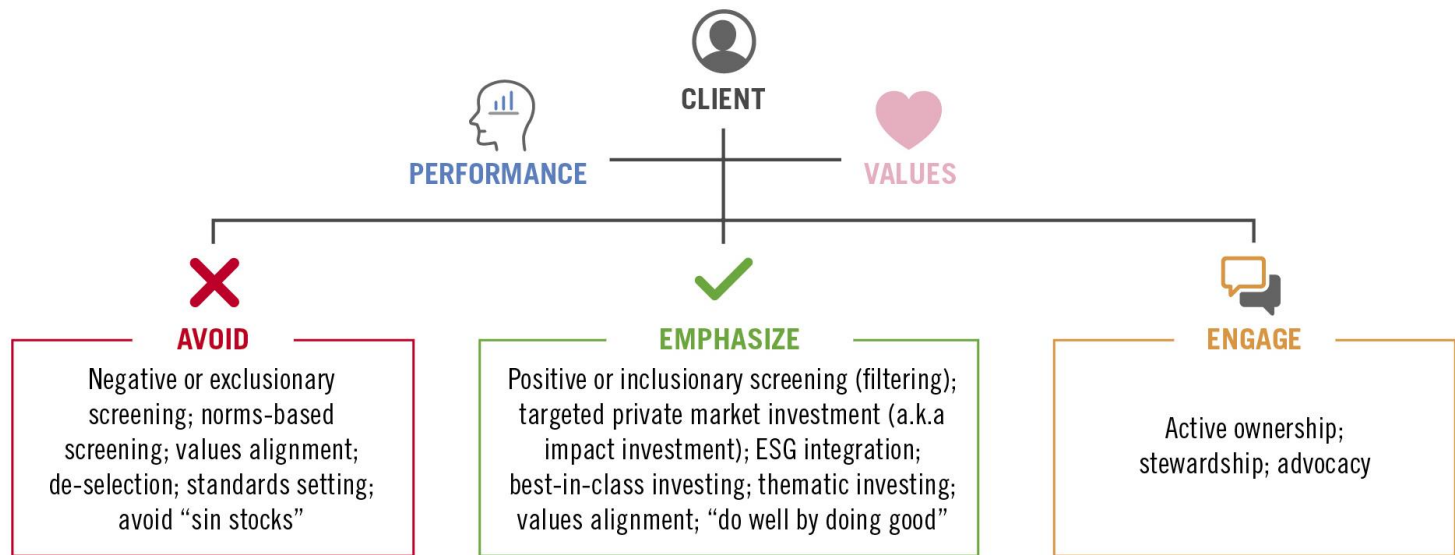
Each of term refers to specific financial industry actors, types of clients, investment strategies, or subsectors of activity, **they fundamentally describe the same thing**. They describe investment approaches that pursue:

- **Financial sustainability**. Protect and enhance long-term value through addressing environmental, social, or governance (ESG) risks or investing in solutions to environmental and social challenges.
- **Environmental or social sustainability**. Protect, enhance, or otherwise positively impact the long-term health of the environment or society through expressing ESG values.



# Fundamental concepts:

## *Motivations and strategies*



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# How should FAs discuss it with clients?

# How should FAs discuss sustainable investment with clients?







# 1. Prepare

## Objective:

Know about the sustainable investment options that are available to your clients

Philosophy	Process	People	Products	Performance
Know your home office's <b>philosophy</b> for selecting products and constructing portfolios in the way that it does, to know which products and portfolios address which issues.	Understand the <b>process</b> for evaluating products and portfolios, so that you understand its due diligence process and product standards and can convey this information to clients.	Know the <b>people</b> who select products and construct portfolios, so that you know who to contact for information and guidance.	Understand what sort of sustainable investment <b>products</b> and portfolios are available to your clients—number available by asset class and issues—to provide clients with examples that align with their goals.	Know whether and how the home office evaluates product and portfolio sustainability <b>performance</b> , so that you understand what sustainability performance information you can relay to clients and how often.



## 2. Discover

### Objectives:

- (a) Assess client sustainability goals as part of regular discovery processes
- (b) Determine whether and how clients want to pursue these goals in their investments

### → **When** to discuss sustainability goals with clients

- During life event
- Semi-regular client appreciation or informational events

### → **What** to say to start discussions with clients about sustainability goals

- Reference recent publications or events
- Mention things that you have observed about a client's behavior
- Talk about current events and issues Ask about institutional governance documents (*institutional clients only*)

### → **How** to collect and assess information about client sustainability goals

- Ask a series of sustainability-related questions and note responses on a formal checklist
- Have clients complete an assessment questionnaire or values activity (e.g. think2perform)



### 3. Recommend

**Be realistic with clients about:**

Portfolio diversification

Ability to “change the world”

Product availability

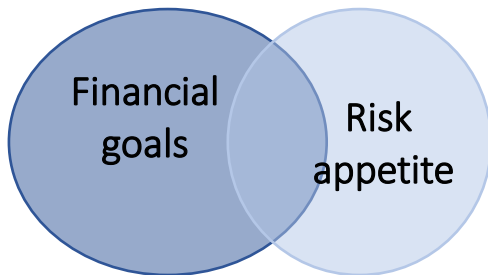
Strategy execution

speed

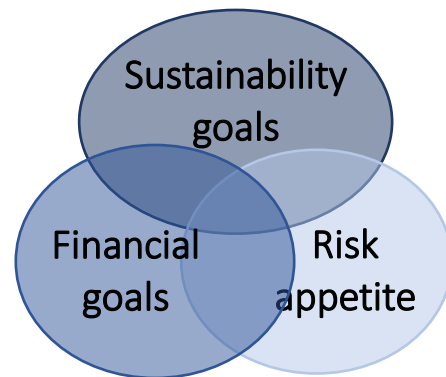
**Objectives:**

- (a) Manage client expectations about how and how much they can reflect these goals in their investments
- (b) Recommend a financial plan and investment strategy that considers risk appetite, financial goals, and sustainability goals

**Conventional financial advising**



**Sustainable investment financial advising**





## 4. Manage

### Objective:

Monitor and report on sustainability performance alongside financial performance.

→ **What** is my role in sustainability performance reporting?

- Asset managers typically do most of the work
- FAs should coordinate with their platforms to obtain data & analysis from managers

→ **What** sustainability information should reports include?

Depends on:

- Approach (avoid, emphasize engage)
- Asset classes
- Investment products
- Sustainability themes and goals

→ **Where** does the information come from?

Various data providers and ratings agencies

**Sustainability performance information is not standardized and data and analysis from different sources are not necessarily comparable**

FAs should understand the nuances of each data provider and ratings agency enough that you can explain why scores for an investment or fund might differ.

# Supplemental appendices:

## tools to help FAs Prepare - Discover - Recommend - Manage

### APPENDIX B.

#### Sustainable Investment Discussion Guide for Financial Advisors

This appendix contains a checklist for your first sustainable investment conversation with a client and notes specific prompts for various phases of the discussion. It provides ideas only; you will need to customize it to reflect your personal style and to accurately reflect the sustainable investment services and products available to your client.

Complementary tools to what we provide here include the Impact Management Project's forthcoming discovery guide—which similarly provides discussion prompts and includes a supplemental spreadsheet for matching client goals to strategies—and State Street Corporation's Values Discovery Tool—an online resource for assessing client sustainability values. Check these organizations' websites for more information.

#### □ Start the Conversation

##### Approach 1: Reference recent publications, conference presentations, firm newsletters, etc.

- "Did you happen to see the article in our [month] newsletter about our commitment to providing sustainable investment options to clients?"
- "I recently attended a conference/read an article that discussed growing interest among people like yourself in sustainable investment strategies. The conference/article discussed how more and more investors are interested in assessing risks associated with a company's environmental or social behaviors or operating procedures, or are interested in aligning investments with personal values."

##### Approach 2: Mention things that the client has said or that you have observed about the client's behavior

- "You've mentioned a number of times that you're interested in/like to [activity/hobby/etc.]."
- "You've mentioned in the past that you'd like to use your wealth to 'do some good' and to 'make the world a better place.'"
- "I know that you are very committed to [specify environmental or social issue(s)]."
- "Your philanthropic giving/volunteer activity in recent years has focused on [specify environmental or social issue(s)]."

##### Approach 3: Discuss current events

- "Did you see the [scandal (e.g. Facebook, Equifax, VW, Kobe Steel)] on the news?"
- "Have you been following the [scandal/movement (e.g. #metoo)]?"
- "I know you have kids in [X, Y, and Z] grades; have you had to talk with them about the recent school shootings?"

##### Approach 4: Ask about institutional governance documents (institutional clients-only)

- "Are there governing documents that outline how your organization wants to reflect its mission or values in its investments, such as an investment belief statement (IBS)?"

### APPENDIX C. Client FAQs

#### 1. Will integrating a sustainable investment strategy get in the way of my financial goals? Will it hurt the financial performance of my portfolio?

Not necessarily. Numerous recent studies have found that sustainable investors can realize at or above market-rate returns for their investments over the long-term.<sup>1</sup> Notable findings of this research, which has been conducted across asset classes and investment approaches (e.g. public and private markets, explicitly impact-focused strategies and those focused on risk mitigation), include: sustainable investment indexes can perform as well or better than their "non-sustainable" counterparts; companies with strong environmental, social, and governance practices achieve higher profits and dividends, lower business risks, and lower capital costs (encouraging growth and enhancing shareholder returns); and sustainable investments large and small that are focused in private equity, private debt, and real assets can achieve market-rate returns.

#### 2. Why should I care about a company's environmental and social impact?

For numerous reasons. Strong sustainability practices can positively influence company stock price (i.e. lead to higher valuations).<sup>2</sup> Companies with poor sustainability practices, on the other hand, might be "vulnerable to increased regulation or be required to pay punitive fines." Firms with strong ESG records are also better at managing risk and have less systematic volatility than their comparable "non-sustainable" peers, and indeed there is a causal link showing that an "improvement in ESG characteristics has led to increasing valuations over time."<sup>3</sup> Finally, there is growing evidence that relates the materiality of intangible ESG factors to long-term, financial performance (e.g. reputation, customer welfare and labor relations, business ethics, and transparency of payments). Today, such factors as these, along with other intangibles such as brand value and intellectual property, account for as much as 84% of a company's market value, an increase of 18 percentage points since 1995.<sup>4</sup>

### APPENDIX D.

#### Example Sustainable Investment Performance Reports

##### Example 1: Integrated ESG Fund with Exclusionary ESG Screening

This report summarizes the performance of the Sustainability Equity Fund relative to a benchmark. The portfolio contains only public equities. The Fund's manager retrieves the data from Bloomberg terminals, then provides it to you.

Notes for File on each report section

##### SUSTAINABLE EQUITY FUND

###### About

The Fund assesses environmental stewardship and labor and human rights policies of holdings companies to determine contributions to the company's competitive advantage in the market. Does not invest in companies that:

- Have <30% women on their board
- Derive more than 2% of revenue from the production of tobacco, weapons, anti-personnel mines, cluster bombs, or munitions
- Derive 30%+ of their revenue from fossil fuel production or extraction
- Have a track record of egregious human rights violations

High-level summary of the fund. Identifies strategy implemented and thematic issues of focus.

##### Asset allocation

FUND ASSET ALLOCATION	SECTOR EXPOSURES	FUND	BENCHMARK
Domestic Stock	Financials	28.2%	26.5%
Foreign Stock	Infrastructure	4.6%	2.6%
Cash and Cash Equivalents	Retail	17.4%	5.0%
Other	Energy	10.4%	32.6%
	Healthcare	12.9%	8.4%
	Technology & Communications	26.5%	24.9%

Indicates asset allocation across types of equities to provide context for what markets the client is invested in and can be sourced from fund managers.

##### Performance

SUMMARY	FUND		BENCHMARK		ESG SCORE TREND
	ESG SCORE	WEIGHT	ESG SCORE	WEIGHT	
% Covered by ESG Analysis (stress)	—	100.0%	—	97.6%	↑
Overall ESG Score	68.7	100.0%	50.9	100.0%	↑
ABSOLUTE PILLAR SCORES					
Environmental	69.4	43.2%	53.3	41.9%	↑
Social	66.6	29.2%	50.1	28.9%	↑
Governance	70.0	27.6%	48.3	29.2%	→

Demonstrates ESG scores of the fund vs. the benchmark. The benchmark score reflects the aggregate ESG scores of the underlying companies relative to their weighting. Overall ESG scores can be used to compare ESG performance to the benchmark.

# Scenarios

# “Real world” hypothetical scenarios



Married couple with young daughters inherits \$1 million and is seeking a financial advisor to help them to use the inheritance to realize various long-term



\$50 million foundation's new CEO wants to deepen its community and economic development impact in Cleveland, OH



Teacher does not want to invest in gun manufacturers given recent school shootings



Wealthy elderly couple is considering their legacy and wants to ensure that they use their wealth to “do well and do good”



# Wealthy elderly couple

*Wants to use their wealth to "do well and do good"*

## About

- Confronting their mortality
- Want to ensure that their wealth (~\$5 million) helps: (1) secure family's financial future, and (2) "make the world a better place"
- Have heard about sustainable investment
- Entrepreneurial spirit



- Prepare to educate them on the fundamental ways they might act on sustainability goals
- Identify platform's issue-agnostic approaches and how it examines potential sustainable investment strategies



- Why are they interested in sustainable investment?
- Does avoid / emphasize / engage resonate with them? What is their desired alignment of wealth with values?
- How does entrepreneurship fit into their world view and investment preferences?



- Invest in stocks in public companies that are emphasizing solutions to global issues; other investment in impact-focused fixed income and private equity, a donor-advised fund, and in microfinance
- Assess tax and capital gains implications



- Inquire about client reporting preferences
- Coordinate with platform to obtain relevant data
- Include examples of how individual investments bring the clients closer to alignment goals



# Questions & answers

# Contact information

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