WealthManagement.com

ESG & Socially Responsible Investing Expected to Grow Within 5 Years

Environmental impact is driving client interest and firm screening for SRIs

The survey's key findings include:

- **Expect SRI and ESG strategies to increase in popularity:** Most advisors expect SRI and ESG investing to increase. These investments currently make up only a small proportion of the average client's portfolio.
- **A lack of information may be holding investors back:** Almost half of financial firms offer SRI solutions, but customers may not be aware of them and rarely inquire about them.
- **Environmental impact is the #1 driver:** Concerns over the environment dominate how analysts and clients think about ESG investing.
- **Customization is key as current offerings evolve:** Analysts believe clients want the opportunity to customize their holdings based upon their unique ESG preferences.
- **Error tracking is important for investor comfort:** Tracking errors and fund performance are important for mitigating investor worries about the potential for performance drag related to ESG screens.

Most advisors expect investor interest in socially responsible investing (SRI) and environmental, sustainability and governance (ESG) investment strategies to expand substantially over the next five years. But before this expected growth can take place, both advisors and investors have to become more comfortable with the concept of SRI and ESG investing.

Currently, customers rarely inquire about SRI solutions during introductory conversations. And despite growing interest in value-oriented investing, a relatively small proportion of client assets currently goes toward ESG strategies. Reducing tracking errors and providing customization options for clients could offer opportunities to raise investors' awareness of and comfort in SRI and ESG investments. Advisors who take advantage of these opportunities may find themselves with a head start over the competition.

Recently, WealthManagement.com and Informa Engage surveyed financial analysts on behalf of Parametric to gain a better understanding of the role they expect ESG and socially responsible investing will have on their client portfolios and how they and their clients approach these investment opportunities.

Expect SRI and ESG Strategies to Increase in Popularity

Advisors anticipate a substantial increase in their clients' interest in SRI and ESG strategies in the near term. Over the next five years, most financial advisors (69%) expect SRI to play a larger role in their practices. By contrast, very few advisors see SRI as a passing fad: Only 4% expect it to play a less significant role in their practices in the next half-decade.

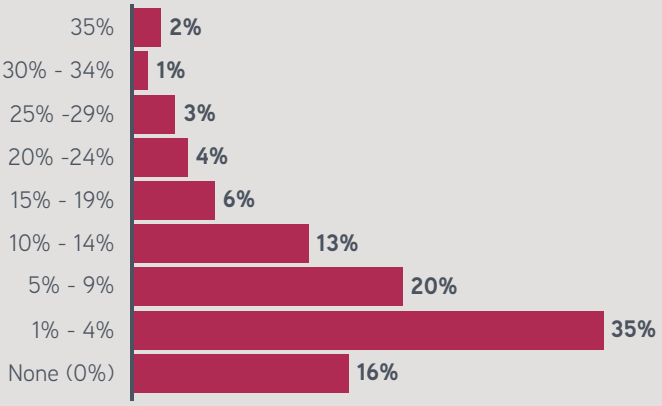
However, that increasing interest has yet to make itself broadly evident. On average, advisors report that only 8% of client assets are currently allocated to ESG strategies. In fact, most firms (51%) report that they allocate less than 5% of client assets to ESG strategies.

Nevertheless, advisors anticipate rapid growth off of that relatively small base. Survey respondents expect the percentage of client assets allocated to ESG to almost double within the next two years (from 8% to 15%).

A changing demographic mix of investors partly explains advisors' bullish outlook on ESG strategies. Millennials, women, and Gen X clients, in particular, are inclined to consider social responsibility alongside their other investment preferences. More than one in three (34%) advisors say their millennial clients consider ESG strategies to be very important, followed by 24% of female clients and 22% of Gen X clients. While advisors say that boomer and male clients place less importance on ESG strategies, the rising numbers of younger, more diverse investors have clearly created some momentum in the industry. Two-thirds of the advisors surveyed (66%) say ESG has become at least somewhat important to their overall business.

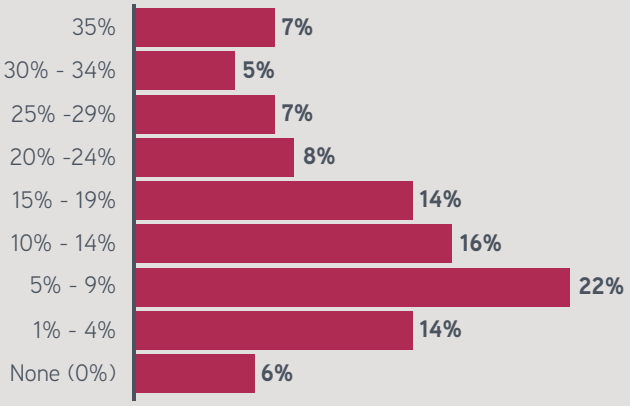
Percentage of Client Assets Allocated to ESG Strategies

Client Assets Allocated to ESG Strategies Currently



Question: On average, what percentage of your client assets is allocated to ESG strategies today?

Client Assets Expected to be Allocate to ESG Strategies 2 Years from Now



Question: On average, what percentage of your client assets do you anticipate will be allocated to ESG strategies in two years?

A Lack of Information May Be Holding Investors Back

In anticipation of increased investor interest, advisors have already begun to expand their offerings. Nearly half (43%) of respondents currently offer SRI investing options and another 25% have plans in place to offer them in the future.

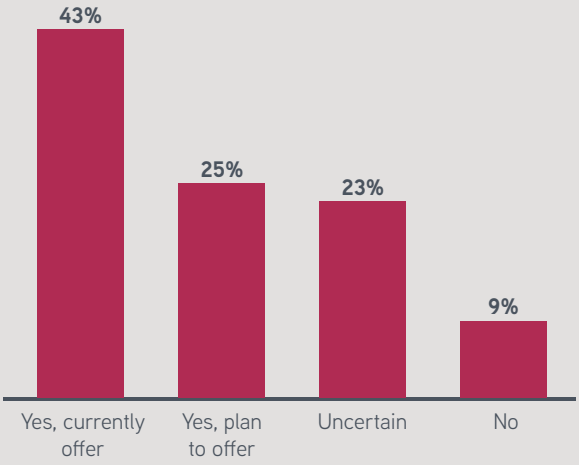
These solutions are not featuring prominently in investors' decision-making processes, however. Only 18% of advisors report that their customers frequently ask about SRI solutions in their introductory conversations. Roughly a third (36%) of advisors say they field at least some client questions about these investment types, but almost half (47%) say customers rarely or never ask about them. This dynamic creates a potential issue when it comes to getting investors to adopt these strategies, as 55% of firms say customer requests represent the primary reason they would offer or consider offering SRI solutions.

A lack of familiarity with the available options may be partly to blame for investors' reticence, according to Gwen Le Berre, director of responsible investing at Parametric. "Investors and customers want to pursue ESG investments, but the ambiguity about the terminology and the lack of standardization in the market can make people hesitant about pursing them," she says. "Advisors need to be more willing to start these conversations and educate clients about how ESG and SRI opportunities can impact their portfolios."

Le Berre says as ESG becomes more relevant and the younger populations gain more financial influence and interest in investing, she expects more clients to initiate ESG conversations with their advisors during introductions.

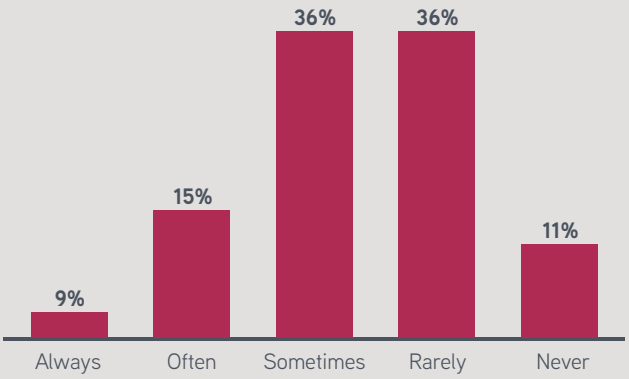
SRI Solutions: Firm Offerings & Customer Inquiries

Offering SRI Investing Options to Clients



Question: Do you offer, or plan to offer, SRI investing options to clients?

Frequency of Customer Inquiries about SRI Solutions in Introductory Conversations



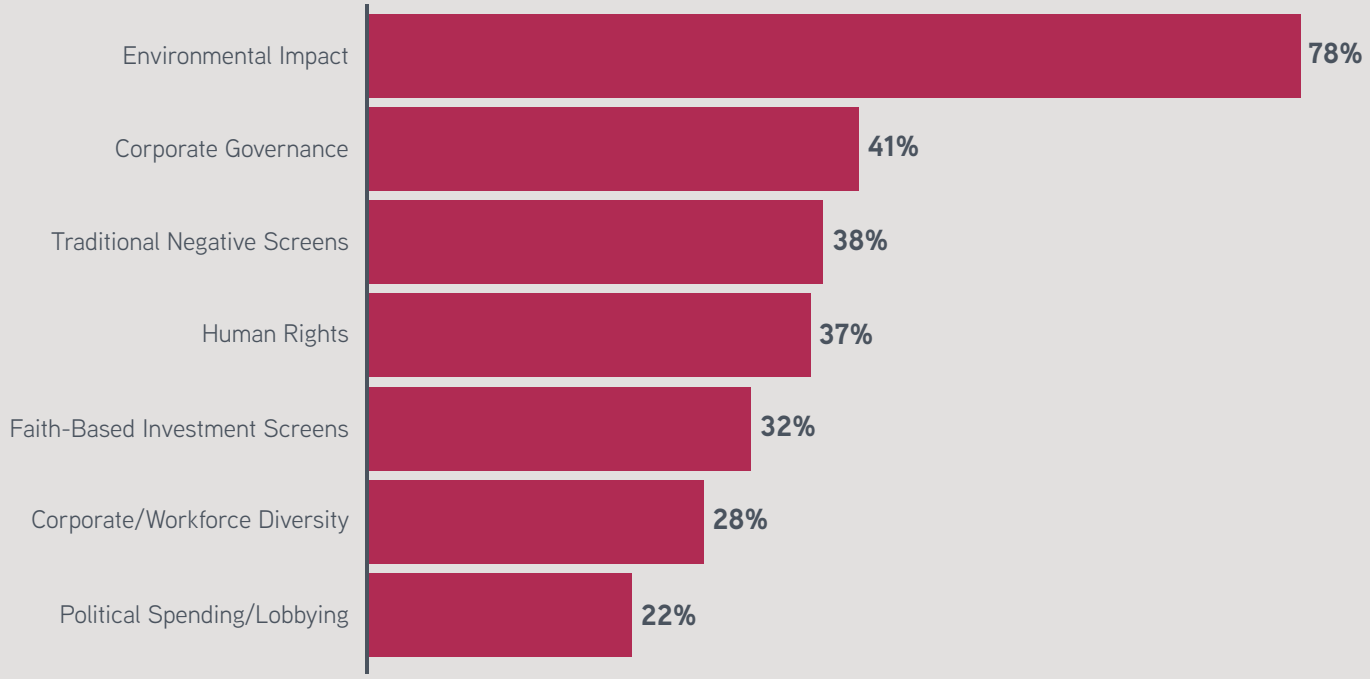
Question: How often do your clients ask about SRI solutions in your introductory conversations?

Environmental Impact is the #1 Driver

Concerns about the environment have been the primary driver of client interest in SRI funds to date. The 78% of clients interested in investment strategies that accommodate their environmental concerns is nearly double the 41% of clients focused on corporate governance. Traditional negative screens for organizations that deal in guns, tobacco, and gambling remain a concern for 38% of clients.

Unsurprisingly, the vast majority of financial advisors (81%) prioritize environmental impact above other SRI screening criteria. More than half also incorporate transparent corporate governance (55%) and labor conditions/employee workplace policies (51%) into their firms' SRI screening criteria.

Client Concerns Driving Interest in SRI Funds



Question: What areas of concern are driving clients to SRI funds? (Select all that apply)

Customization is Key as Current Offerings Evolve

Most of the time, advisors say they offer or would consider offering SRI solutions for two reasons: client requests (55%) and their personal view that investors should have access to this type of approach (53%).

No single consideration emerged as "very important" to most firms when selecting an ESG strategy, but 37% said it is "very important" to make sure the ESG process is deeply embedded as part of the strategy.

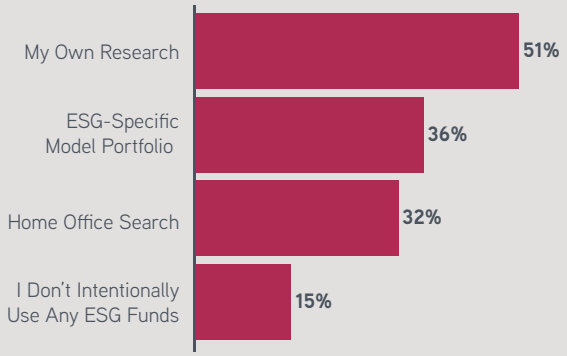
For clients and advisors alike, the appeal of ESG strategies is personal. More than half (53%) of advisors cite their personal values-based view that this type of investment approach should be made available to investors as a primary reason for offering SRI and ESG products. This may explain why so many advisors are paying particular attention to the strategies they offer for their clients. A little more than half (51%) say they choose ESG funds based on their own research. By contrast, only a little more than a third (36%) use ESG-specific model portfolios provided either through their home office or asset manager.

Being intentional about these choices can be important because client priorities are not universal. "Giving clients choices and flexibility to determine their own ESG values and principles as part of their investment decisions and processes can only create better outcomes for clients and financial advisors," Le Berre says.

A substantial number of advisors believe it's important to give investors an opportunity to customize their investments further. The vast majority (78%) say customization is at least somewhat important to clients. In fact, more than a third (37%) consider client customization either very important or critical. Since clients may not even be aware that customization is possible, Le Berre says conveying that information to investors can make them more comfortable about joining the ESG investment trend.

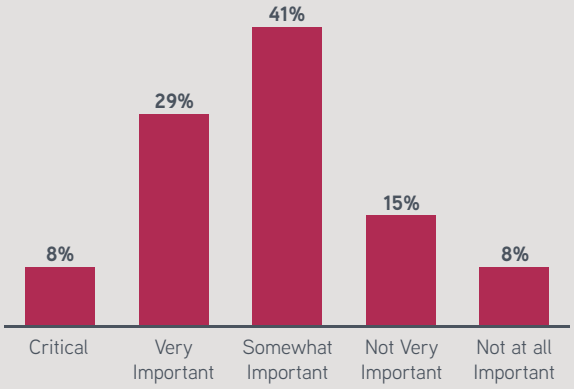
Choosing ESG Funds & Importance of Customizable Solutions

Choosing ESG Funds For Clients



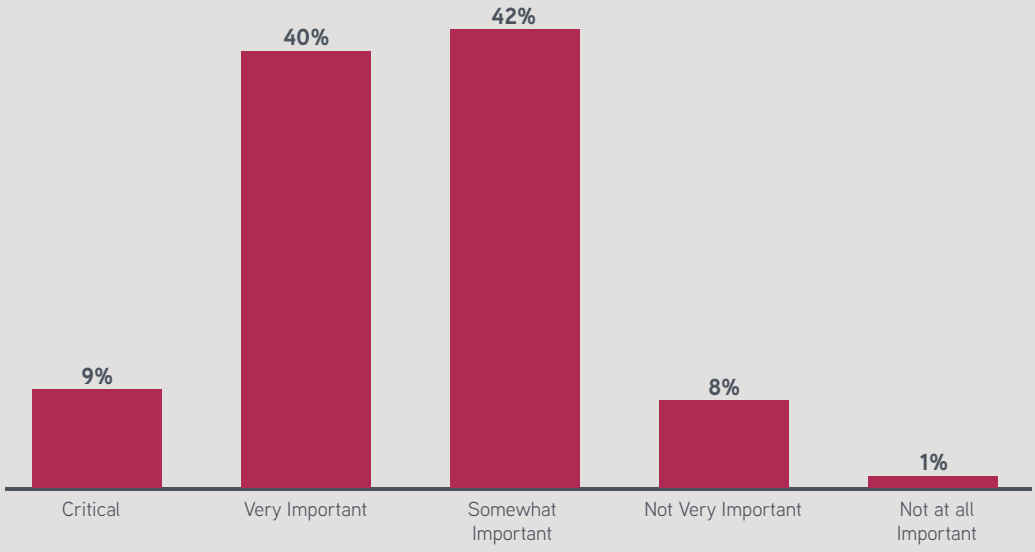
Question: How do you choose ESG funds for your clients? (Please select all that apply.)

Important of Customizing Solutions for ESG Preferences



Question: How important is it for your clients to be able to customize solutions to their unique ESG preferences?

Importance of Tracking Errors in Determining SRI Solutions



Question: How important is tracking error in determining appropriate SRI solutions?

Error Tracking is Important for Investor Comfort

Another reason for hesitancy among investors may be the lack of connection between ESG strategies and strong investment performance. Only 10% of advisors say they offer these strategies because they believe socially responsible companies will outperform their peers.

Unsurprisingly, fund performance remains a top priority for both investors and advisors. When it comes to forming an asset manager brand, advisors overwhelmingly say fund performance is their single most critical consideration, far outpacing third-party ratings or firmwide approaches to ESG investing.

Although ESG strategies are becoming more popular, they seem unlikely to become a higher priority for investors than returns. But even if advisors don't necessarily expect ESG considerations to help returns, they see the importance of making sure they don't hurt them—and of conveying that information to clients. Most firms (82%) say that the ability to monitor tracking errors is at least somewhat important for determining appropriate SRI solutions.

Introducing error tracking can allow investors to see how potential investments perform against standard benchmarks, which can make ESG investing less intimidating, according to Le Berre. "This is an attractive proposition that allows clients to invest with values without necessarily making a performance bet in either direction," she says.

Conclusion

Although interest in ESG investing is rising, advisors still have an important role to play in educating investors about what options are available. By anticipating common investor concerns and building flexibility into their solutions, advisors have an opportunity to position themselves ahead of their competitors in an area that is increasingly important to their clients.

OVERVIEW: Methodology, data collection and analysis by WealthManagement.com, FUSE Research and Informa Engage, underwritten by Parametric. Data collected October 23, through November 5, 2021. Methodology conforms to accepted marketing research methods, practices and procedures.

METHODOLOGY: Beginning on October 23, 2021, WealthManagement.com began emailing invitations to participate in an online survey to active users. By November 5, 2021, Informa Engage had received 476 completed surveys.

Move Beyond Talk to Action

Whether you call it ESG, SRI, impact investing, or responsible investing, Parametric offers uncomplicated portfolios your clients can tailor to align to their values.

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