Cases on Ethics in Sustainable Investments

PRIVATE WEALTH MANAGER / ADVISER ROLES

CFA Society
United Kingdom

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Whether wealth advisers have discretion over their private clients' investments or not, they need to be aware of, and document, their clients' sustainability related preferences as well as the relative importance of sustainability within the hierarchy of their investment goals. Only when this has been completed can a wealth adviser ensure that their advice, recommendations, and investment decisions comply with their clients' full wishes.

1) Sustainability Context:

Sustainability has added a new dimension to the roles of private wealth advisers and their relationships with clients. Advisers need to be aware of their clients' sustainability related preferences, to document them in their IPS and keep them updated.

Once documented, sustainability considerations then also need to be factored into investment advice, recommendations, and decisions. Advisers will have clients with a range of sustainability preferences, with those having none, those having some (perhaps governance and environmental but not social) through to those embracing all. Advisors will need to adapt their advice, recommendations, and investment decisions to the differing ESG goals of their clients.

The qualitative, disputed and sometimes inaccurate nature of sustainability data makes this new requirement particularly challenging. Private wealth advisors are typically not experts on all ESG matters, so they need to have specialist and expert opinion available that they can trust, either in-house or provided external to their firm. If done well, it can become an important way for an adviser to differentiate their firm favourably from competing firms.

2) Key CFA Institute standards relevant to private wealth managers/advisers:

CFA INSTITUTE STANDARD	RELEVANT ISSUE
I (C) MISREPRESENTATION	Wealth advisors should exercise great care in recommending investments to clients based on their sustainability credentials in cases where such credentials may be disputed or uncertain.
Iii (B) FAIR DEALING	Where aggregate client demand for a sustainable investment exceeds a firm's allocation, it may be acceptable to favour those clients that have expressed a sustainable preference over those who have not and allocate accordingly.
Iii (C) SUITABILITY	As Sustainability increasingly becomes a key consideration for clients in their investment decisions, private wealth managers should take time and care to discuss their clients' attitudes to

	ESG risks and issues and document them in their IPS. They should ensure that a client's investments mirror and balance each of the client's various investment goals. The pursuit of Sustainability goals should not put other financial goals at undue risk, particularly where clients' preferences or circumstances place greater importance on the latter.

APPLICATION OF THE CFA INSTITUTE STANDARDS (9 cases)

Issue 1: Misrepresenting past performance

Example

Garg, CFA is an investment advisor with Tukan Investment Managers. Her client is asking to recommend appropriate investment targets in the clean energy infrastructure fund sector. Garg identifies Solar Infrastructure Fund I, a first time fund raised by Helios Capital Partners. Having spoken with the firm's management, Garg learned that the PE firm was recently established by several partners, who have worked for over 20 years in renewable finance with major investment banks and developers. Garg recommends that her clients invest in Solar Infrastructure Fund I, omitting to mention it is the firm's first fund, but instead stating that the funds' general partners have over 20 years of investment experience in the renewables sector.

CFA UK Comment

We think that Garg, CFA has failed to give complete, full, and accurate information in her investment recommendation clients. The GP's experience comes from their time spent with prior employers. In their capacity as a newly established PE firm, they may lack the prior employer's infrastructure process and other research and human resources that is likely to have been the firm's and not the individual's. Hence, we think that Garg is probably in breach of CFA Institute's *Standard I(C) - Misrepresentation* as she has failed to make a full and proper disclosure of the general partners' previous employment.

Issue 2: Exaggeration of sustainability claims

Example

Blue, CFA is an Investment Counsellor at a UK Wealth manager. She is under pressure from her manager to promote a solution that consists of an ESG-orientated portfolio of publicly listed global equities. The equities in question have been chosen because they derive at least 25% of their revenue from economic activities widely considered to constitute an environmental or social good. Her division head says she should include in any marketing materials language like, "this solution will help solve many of the global issues we face and will generate lots of positive impact". Blue thinks this statement is incorrect, due to the difficulties of measuring and attributing any impact to the portfolio, and that clients could easily be misled by this.

CFA UK Comment

Blue, CFA should faithfully market the solution as she perceives it, otherwise we think that she will breach CFA Institute's Standard I(C) Misrepresentation. She should not promote sustainability claims which she does not believe to be genuine just because her divisional head has said she should or because it may result in her accounts increasing their investments. Focusing on client education and explaining the concept of impact and what can be achieved with an investment portfolio is key. Blue should also raise her concerns with her manager and local risk team.

Issue 3: Managing family accounts and staying true to the objectives in the IPS

Example

A family office contracted to run a family trust is mandated to manage a portfolio to provide a steady income to c.100 individual family members. The lead trustee, and family scion, wants to compensate 'Society' for the environmental damage caused by the original family chemicals business and so is determined for the family trust to pursue investments in R&D-led companies involved in "clean tech" and nature-based solutions. He constantly pressurises his managers to invest in new technologies and early-stage, high-growth companies with green solutions. This is at odds with the trust mandate that places primacy on generating a minimum level of income for the family diaspora. The trust's Investment Director, Bruce, CFA nevertheless steadily increases his investment in these pre-cash generating companies forcing him in turn to steadily sell more positions in mature, dividend-generating shares and bonds.

CFA UK Comment

We think that Bruce CFA is likely in contravention of CFA Institute's *Standard III(A): Loyalty, Prudence & Care.* Bruce is treating the family scion as the sole client and ignoring firstly that the family trust is his true client and secondly the trust's mandate and purpose. His loyalty should be to the trust beneficiaries as a group and not to one individual beneficiary; his duty of prudence and care means that he needs to observe the requirements of the mandate i.e. ensuring the reliability of the portfolio income. Bruce should suggest that all beneficiaries are consulted, and the trust mandate is updated formally and to provide clear guidance on the importance of ESG factors.

Issue 4: Fair allocation between ESG clients and non-ESG clients

Example

Purple, CFA works as an investment advisor for a national wealth manager. He manages discretionary, single line multi-asset portfolios for several clients. Some of these clients have expressed no interest in ESG/Sustainability and are invested in his "standard" portfolio, whereas others who have expressed interest in owning ESG funds are invested in his "dedicated sustainable" portfolio. Both portfolios have the objective of maximising returns, while the "dedicated sustainable" has additional constraints around only investing in companies deemed sustainable by a firm wide policy. Purple becomes aware of a new bond issue from a fast-growing renewable energy company, which he wants to allocate to all portfolios, as he believes it is a risk/return maximising trade and meets all the sustainability requirements as well. The new issue is oversubscribed, however, and the block he has been allocated is insufficient to initiate a position size above the minimum lot size for all portfolios, as stipulated by the firm's policy. He believes that the clients in his "dedicated sustainable" would gain more utility from this trade, given their expressed interest in sustainability, so he only allocates to these portfolios, thereby also allowing him to initiate these portfolios with a meaningful position in the new issue.

CFA UK Comment

We think that Purple is in compliance with CFA Institute's *Standard III(B) Fair Dealing.* An allocation to all clients cannot be done because the firm's total allocation is insufficient to give everyone the minimum lot size. Therefore, it is reasonable to allocate the investment to clients to whom it is more suitable given their sustainability goals rather than forego the investment opportunity for all the firm's clients. However, Purple should also escalate the need for the firm to have a formal policy for allocation at which details allowable discretion.

Issue 5: ESG driven investment contradicting client's Investment Policy Statement

Example

Janith, CFA is a private wealth manager for Windmill Investments, a UK private wealth fund manager building a reputation for expertise in green investment. Its fund range is dominated by ESG, best-in-class and impact funds but includes a handful of traditional, non-sustainable funds as well. Like Windmill's other wealth advisors, Janith receives commissions based on AuM sold and the commissions are higher, the greener the product. The impact funds pay the highest commission. Brown, 72, is one of Janith's clients and they have an agreed Investment Policy Statement (IPS) in place which records that Brown's prime investment goal is income given his age, capital sufficiency and low risk appetite. Despite this Janith seeks to include an impact fund in Brown's portfolio. This fund produces no income and contains equity investments in early-stage clean-tech and green-tech companies. It is scored as 'high risk' but has a very strong track record with compound growth averaging over 20% over the last 5 years. Janith argues that the fund offers diversification from Brown's other investments, that his other investments already produce sufficient income for Brown's needs and that this 5% allocation is acceptable.

CFA UK Comment

We think that Janith has most likely not breached CFA Institute's *Standard III(C) Suitability* as the impact fund does not materially compromise the sufficiency of income that Brown's overall portfolio produces given the low percentage allocation, and Janith believes it may offer diversification benefits. However, Janith will need to explain to Brown her rationale for including the impact fund investment within his overall portfolio and keep it under periodic review in case

Brown's income needs change or the income from the remainder of the portfolio drops for any reason. Failure to do so would likely be a breach of *Standard III(A) loyalty, prudence, and care.* Also, to comply with Standard VI(A) Janith should also disclose her firm's commission scales for the different products.

Issue 6: Addressing Unsolicited Trading Requests & Sustainability in the IPS

Example

Sanders, CFA is a private wealth manager managing ESG and impact portfolios for clients. One of her clients, Jersey, is currently invested in an active investment strategy targeting 'Sustainable Stocks" and has a dedicated Investment Policy Statement ("IPS") in place. The definition of what constitutes a "Sustainable Stock" is in line with Sanders' firm's policy. Jersey asked Sanders to include a new stock in the portfolio, a fast-growing producer of battery components for EVs that was recently listed on the stock exchange and is currently a very popular share. Even though the stock meets most of the parameters of Jersey's IPS, Sanders is concerned that the stock does not qualify as "Sustainable" as per the strict IPS' definition. Press reports have cited concerns around environmental damage from the battery components produced, which, in turn has been denied by the company. If the concerns are confirmed, the company would not meet the conditions around Sustainability set out in the IPS.

CFA UK Comment

Before accepting the trade, we think that Sanders must have a conversation with Jersey about the Sustainability criteria in the IPS. Although the client may consider the new stock sustainable, the client's view on what constitutes a sustainable stock may differ from what is currently in the IPS. In this instance, the IPS can be revised to reflect this new understanding, or the client can direct Sanders to purchase the stock outside of the IPS mandates. If she traded on the stock without doing this, she runs the risk of violating CFA Institute's *Standard III(C): Suitability.*

Issue 7: Identifying suitable investments to satisfy a client's sustainability investment objectives

Example

Orange, CFA is a private wealth manager for high net worth clients at a private bank. He meets with a prospective client who is particularly interested in sustainability issues and wants his investment portfolio to reflect this. The prospective client does not have a very good knowledge or understanding of investments and is mostly focused on his personal views around issues like climate change rather than what can be achieved with an investment portfolio. In the jurisdictions in which Orange operates, there are no regulations around sustainable investing. Orange therefore constructs a portfolio of global equities that he claims is sustainable and meets the client's needs because he has only chosen equities with top quartile "ESG Ratings" provided by a leading third-party provider of ESG ratings whose services his bank subscribes to.

CFA UK Comment

Orange should ensure that the prospect fully understands the sustainability characteristics of the investment solution in question. If he does not do this, we think that he will likely breach CFA Institute's *Standard III(C): Suitability* as it is evident that the sustainability characteristics of any investments are important to the client prospect. Using the CFA Institute's definition of sustainable investing as a guide, "a course of action 'which minimizes natural and social resource depletion", he should describe the investment selection process and explain how the solution he is proposing reflects the prospects' views on sustainability. If Orange's firm has a more developed or codified view of what constitutes a sustainable investment, then rather than relying just on external ratings, he should follow this instead.

Issue 8: Failure to thoroughly research and understand emerging technologies

Example

Godwin, CFA is preparing a research note for his HNW advisory clients covering the subject of ESG and sustainable investment options. He wants to produce a single newsletter and show his clients the fund options he can offer them. He is, however, struggling with the diversity of material that the funds have supplied him and what seem at times to be conflicting recommendations from the different fund managers. Godwin feels that to include all their information might result simply in confusion and much lower product interest. Godwin therefore decides to simply list the funds along with the fund self-ratings and labels provided by the fund managers. He is pleased with how it looks although he knows that each fund's underlying definition of ESG is very often different from others. He does not want to complicate the report, so leaves it to the reader to dig deeper if it occurs to them to do so.

CFA UK Comment

We think that Godwin is likely in breach of CFA Institute's *Standard V(A) Diligence & Reasonable Basis*. He has himself not dug deeper to allow his advice to be based on an adequate understanding of the issues and the processes underlying the products he is selling. He needs to properly advise his clients so they can understand the different products and how, despite seemingly similar labelling, the outcomes of the products may differ significantly both in reality and in intent, rather than just list the fund ratings that the funds have provided him with. Consequently, we think that Godwin is also likely in breach of CFA Institute's *Standard V(B) Communications* with clients and potential clients.

Issue 9: Disclosure to clients of variable commissions

Example

Joyce is a Director at Brice Willis Wealth Managers ("BWWM") where she has worked for several years managing the discretionary portfolios for HNW clients. Her client portfolio has seen a reasonable amount of turnover - there have been a few high-profile departures over the years to rival firms - but she picks up a lot of new clients through central referral because of her successful track record of new product sales which often earn her higher commissions than traditional products. BWWM have launched a new range of sustainability portfolios and the firm's top management have put a lot of emphasis on the strategic importance of this initiative succeeding. To support this, they have put in place commission arrangements which pay their wealth managers, such as Joyce, a higher commission on sales of investments into the new sustainable fund range than on the firm's traditional fund investments even though the fees paid by the clients are the same. Joyce decides to capitalise on this, so at the start of each annual client review meeting she systematically talks about the impact of climate change on her daily life and then switches to high profile ESG situations where companies have got into difficulties. When reviewing the clients' IPS she expresses strong personal views about the risks to the world from climate change and about how it is everyone's responsibility to promote green technologies and withdraw support from polluting activities. By doing this she subtly seeks to persuade clients to add sustainability goals to their investment strategies which then enables her to make the portfolio switches. She makes no disclosure of the higher commissions that she will earn from the sustainability fund range products.

CFA UK Comment

BWWM's internal commission structures seem to have created a conflict of interest for their employees. However, by not properly disclosing the fee arrangements Joyce is encouraging her clients to make a change to their IPS without knowing the full implications of it - i.e. the commission increases to Joyce. Through her failure to disclose the conflict of interest to her clients, we think that Joyce will have breached CFA Institute's *Standard VI(A) Conflicts of Interest.*