Framing an ESG conversation with your clients Transcript

Kristi Mitchem: When you have a truly integrated ESG strategy, it should feel a bit like a layered cake. You start with the things that you absolutely won't hold. You understand where ESG factors are creating new opportunities for companies. And then lastly, what you want to see is that a manager is constantly on top of stewardship, that they are dialoguing and in conversations with the company managements that they own to really bring these ESG issues to the forefront and ensure that they are understood and either opportunistically sought after or mitigated against if they represent challenges.

Ben Jones: Welcome to Better Conversations, Better Outcomes, presented by BMO Global Asset Management. I'm Ben Jones.

Emily Larsen: And I'm Emily Larsen. On this show we explore the world of wealth advising from every angle, providing actionable ideas designed to improve outcomes for advisors and their clients.

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Emily Larsen: At BMO Global Asset Management, responsible investing isn't just a recent trend. We've been managing sustainable portfolios for over 35 years, and we've provided third-party responsible engagement and stewardship for two decades.

Emily Larsen: Our guest today is BMO Global Asset Management's CEO, Kristi Mitchem. She's joining us to share new research and insights about responsible investing, also known as ESG.

Ben Jones: The BMO Financial Group is driven by our purpose to boldly grow the good in business and in life. And our commitment to responsible investment over the years is one of many examples where BMO's delivering on this purpose. BMO's practices of active ownership and ESG integration enrich the good in both business and life for professional investors like you and your clients.

Before we get ahead of ourselves though, I asked Kristi to set the stage by explaining what responsible investment entails. I'd love to just start with kind of level setting the definition of what is responsible investing.

Kristi Mitchem: Yeah. So the way that I typically talk about responsible investing is sort of using the lexicon E S and G. So that's environmental, social and governance. And essentially I think what responsible investing really is, is it's an investment process or approach, which incorporates not only traditional factors, in terms of how investments are managed and risk is thought about, but also these sort of nontraditional factors that fall into the ESG bucket.

Kristi Mitchem: So here I'm talking about things like climate change, water management, pollution, labor standards, human rights. Factors that I think really have an impact on overall long-term performance.

Ben Jones: And you and I probably can relate to 10 or 15 years ago in the US, they talked a lot about SRI approaches or socially responsible approaches. How does that differ from ESG?

Kristi Mitchem: I would say SSI was just sort of an early version or a beta version, in my view, of what we know today as ESG. A lot of the really early SRI strategies were more exclusionary in terms of the way that they were run. And it was really about values alignment, and sort of using a values-based screen to determine what the investible universe would look like.

And to be Frank, I think we've come a long way from there. I think SRI remains a very viable approach, but there's now more that we can do to proactively incorporate ESG and also help clients really benefit financially from the transition of the world to a more sustainable planet.

Ben Jones: I love that because that's a nice transition into beyond just the traditional investment strategy, one of the things that's emerging, and it has been around for many years globally, but it's really emerging in the US, is this idea of active ownership or active engagement. Could you maybe describe what that is?

Kristi Mitchem: Yeah. So the way I think about active ownership is that it's really a discussion or a dialogue that an asset owner can actually have with a corporation, with the board, with its management. And it's about essentially focusing the board on those really important aspects of ESG that are going to drive and impact long-term returns.

It's about sharing best practices. It's about understanding, not where the world is today, but where the world is going from a sustainability perspective, and ensuring that that is factored into the way a company is run and the way that they think about their future strategically.

Ben Jones: What are some of the things that, advisors who aren't familiar with engagement, what are some of the things you want to look for when you're thinking about how to engage and if you should outsource it or try to take it on yourself?

Kristi Mitchem: Yeah. So I would say one of the very interesting things that we're increasingly finding is that investors really want to understand how their ownership interest is being used for good in the world. And one of the ways that that can happen irrespective of which securities you own is to ensure that you're engaging in the right way with companies, and again, that you're sort of sharing and pushing these best practices from an ESG perspective.

I think whether you want to do this alone or whether you want to engage in a third party, probably depends mostly on the level of resourcing that you can actually put against it. I think it would be important to say that active ownership is very resource intensive and it requires a high level of expertise to do it really well. And I think that's what we do at BMO GAM really, really well. We have a dedicated group of experts that actually focus on this specifically, and we have a 20 year heritage of actively engaging on important topics, really across the spectrum of ESG factors.

Ben Jones: Excellent. Now we hear a lot about, there's a lot of assets that have reclassified as ESG strategies over the last several years, and this is kind of commonly referred to as greenwashing. But what is greenwashing and how does someone decipher the noise from the signal?

Kristi Mitchem: Yeah, I guess my definition of greenwashing is when the attention around ESG is more focused on the marketing and the storytelling than it is on the investment process and the investment philosophy.

When you see a strategy which is truly integrated in terms of ESG, you should be able to sort of pull on the string. You should see ESG factors incorporated into the investment process in a very visible way. You should see the incorporation of ESG factors done systematically and consistently over time. And again, you should be able to push on numerous different threads and sort of get a consistently green response, if you will.

And so I do think we have seen a lot of greenwashing in the industry overall, but I think it's fairly easy, honestly, if you really think about it, to distill greenwashing from true ESG investing with a couple of simple questions. First, you definitely want to understand specifically how ESG factors are measured and understood.

Secondly, you want to understand how those factors are actually incorporated into the investment process.

And third, you want to see demonstrable evidence of where security selection has been guided by ESG criteria, either because it's factored into the risk model or because it's factored into the return trajectory of a potential security in the portfolio.

So I think those three questions, if you just ask them and look at the answers, will give you a big indication of whether it's greenwashing or whether it's true integration.

Ben Jones: That's wonderful. And I was wondering, now that we're on integration, can you maybe explain the different levels of integration, because I think those questions of determining once strategy's got substance or style, then it comes to how do those layers of integration work. In other words, how do we move from the old avoidance you mentioned to kind of this invested and engaged strategy.

Kristi Mitchem: I'm glad you actually started with the old avoid strategies, because I think they really created an important foundation for the way that we think about ESG integration. So negative screening, understanding those things that you won't hold from an ESG perspective is a very important process to go through as you think about really constructing a portfolio that is ESG centric. But again, I think where we're building on that foundation today is not just to avoid, but also to invest.

So again, this is another layer of integration, and it requires really understanding, again, how this transition to a more sustainable planet can create opportunities for certain companies, and where you see companies that are leading on ESG issues, being able to invest in those companies specifically.

Lastly, I would just point out that a third layer of integration is engagement. And again, this is sort of circling back to the beginning of our conversation where we were talking a little bit about the importance of stewardship overall.

So when you have a truly integrated ESG strategy, it should feel a bit like a layered cake. You know, you start with the things that you absolutely won't hold. You understand where ESG factors are creating new opportunities for companies or maybe risks that aren't fully appreciated, but can be appreciated and owned by some of the leaders in the ESG space.

And then lastly, what you want to see is that a manager is constantly on top of stewardship, that they are dialoguing and in conversations with the company managements that they own to really bring these ESG issues to the forefront and ensure that they're understood and either opportunistically sought after or mitigated against if they represent challenges.

Emily Larsen: We love the analogy of the layered cake. It's such an easy way to visualize ESG integration. And if you didn't get them all jotted down, the due diligence questions are, how are ESG factors used? How are they incorporated into the investment process? And how has security selection been guided by ESG criteria?

Emily Larsen: Kristi has recently spearheaded some very interesting research that also has taken a layered approach. It all began when she started thinking about existing research into responsible investing and decided to take it a bit deeper.

Kristi Mitchem: I think my original idea was that a lot of the research to date had been very focused on what I would call sort of high-level statistics, almost like marketing talking points, indicating things like 70 to 80% of investors care about ESG, or things like 50 to 60% of investors want to have a conversation with their advisor around ESG strategies.

And I felt that what these high-level statistics did was they provided a lot of confidence for advisors that these were themes that individuals wanted to talk about, but they didn't describe how to talk about them. They didn't describe the different levels of receptivity that you might see in your client base. And I had a strong view that again, kind of popping the hood, getting under the high-level statistics could really unearth some insights that would help advisors approach this conversation in an optimal and very personalized way.

Ben Jones: And so what were the findings?

Kristi Mitchem: Yeah, so I guess I would say our intuitions were correct, although there's always so many surprising things that come out of these surveys when you do this level of work. But yes, I would say our hypothesis was proved out. We do find that there are many different types of ESG personalities and we've sort of grouped these into four buckets. And then again, these different ESG personas or personalities want to talk about ESG in a different way. And certain of these groups, I think actually represent more significant opportunities for advisors than others, at least as it relates to ESG strategies and topics.

Ben Jones: So I think this is a really important concept because even prior to this research, I kind of often heard people referred to as ESG investors or non-ESG investors. And we kind of used broad brushes to paint certain demographics and populations as either ESG or not. But I think the real important thing that came out of this research is it's really shades of gray and there's different clients that are at different points in that journey along their understanding and motivation around ESG. So maybe we could start at a high level and you could just share what are kind of the four common groupings of ESG personalities?

Kristi Mitchem: Yeah. So Ben, I think you're absolutely right there. It's definitely a spectrum. And again, we created these four personalities to really capture, as you rightly mentioned, where people are on their journey of understanding ESG factors, determining how much they care about them. And then also determining how much they want to see them reflected in their own financial portfolio.

So the four personalities that we have are ESG motivated, which represented about 22% of our survey respondents, ESG ready, which was about 30%, ESG pragmatic, which was 27%. And then lastly, ESG skeptical that represented about 21% of our overall respondent base.

And I think the easiest way to think about it is that the ESG motivated and ESG ready segments want to be talking about ESG with their advisors as a lead topic, not a secondary topic. When you talk to these individuals or these clients about their investment portfolio, risk, return and values, and ultimately the overall impact of what they own on the world really needs to be sort of pari passu in the conversation.

For the ESG pragmatic and skeptical investors, they want to hear about ESG, but more as investment factors. They don't want to hear about values alignment separately. What they want to understand is how certain aspects of ESG can actually impact overall portfolio returns. So they're open to a conversation, but it needs to be led by risk, return and overall portfolio construction and how ESG fits into optimizing that calculus.

Ben Jones: I love the way that you broke these down. Now BMO's created a quiz where people can go and actually determine what their own personality is, and I'd highly encourage any advisors listening to figure out your own so you understand where your biases might lie as well. I had a chance to take the quiz. I'm curious, Kristi, did you?

Kristi Mitchem: I did. I took it very early on, in fact. So I won't say what I am. Maybe I should ask you to disclose first.

Ben Jones: Yeah. Well, Hey, I'm happy to share. I came out as an ESG pragmatic, which I think kind of describes my view to life in general, is fairly pragmatic. So I felt like it was about right.

Kristi Mitchem: Yeah. So I guess I should say it was about right for me, too. I came out as ESG motivated, and I think it's because I'm a true believer here. I have long thought that really creating long-term value demanded an understanding of where the world was going from a sustainability perspective, and incorporating ESG factors into the portfolio is not only something that I think maximizes return, but I also think it's just very consistent with who I am. And I like to see who I am as a person actually reflected in the portfolios that I own.

Ben Jones: I love it. And before we get into what an advisor can do with this information, I want to ask two more questions about the research. One, just from your perspective, what was the biggest surprise? And then, just maybe as an add-on to that, from the research, how did demographics play a role or not play a role in the survey results?

Kristi Mitchem: Yeah, so I would say probably the biggest surprise for me was just how many individuals wanted to have conversations with their advisors about active ownership and stewardship. Going into it, I thought maybe proxy voting and engagement is like a little too in the weeds for a typical retail investor, even if they skew towards high net worth and ultra high net worth. And the truth is we absolutely found the opposite.

There was a very small percentage of people that didn't want to have a conversation about it, that didn't believe that it mattered, but that was only about 7%. And in fact, over 50%, 51% to be exact, wanted to have a real dialogue with their advisor. They wanted their advisor to understand their preferences with regard to ESG factors. And they absolutely wanted to see a connection between that understanding and how their proxy votes were cast.

Emily Larsen: This information provides a lot of opportunities for advisors to have better conversations with their clients and really align the client's intentions with their portfolios and planning strategies. And remember that even though most clients will benefit from having these conversations, there is also no one size fits all conversation that will work for everyone.

Keep in mind women, high net worth individuals and younger people between 30 and 50 might be more likely to have stronger ESG beliefs.

Ben Jones: So when I first took the quiz, I was labeled an ESG pragmatic, and that makes sense because I'm a fairly pragmatic person in general. Speaking of being pragmatic, I had to ask Kristi for some practical tips and actionable advice to apply this research to your practice. Based on the research and these personalities, what do you think an advisor should do with this?

Kristi Mitchem: Yeah. So first of all, I would say it's going to be really, I think, impactful if advisors, as you mentioned, can sort of take the quiz themselves, so understand where they sit on the spectrum, and then use that as a way to really begin to understand how to have an optimal conversation with their clients around ESG.

So there's a lot of information that an advisor can glean just by having, again, one of their clients take the quiz, and it also just opens, I think, a really neat and differentiated conversation. In terms of just practical advice, there are a couple of things that I would say.

First, as I've already mentioned, I think it's going to be really important for advisors to lead with ESG when they're talking to an ESG motivated or an ESG ready persona type. If it's ESG pragmatic or it's ESG skeptical, it should be part of the conversation, but it should be very much interwoven in terms of a conversation about overall risk and return.

The other thing that I would just notice, I think the ESG ready population generally, and again, remember, Ben, that was about 30% of the overall respondent base. This is a really important population for advisors to have this conversation with. The way that I kind of think about the ESG ready group is they're excited to take action. They believe that ESG factors are important. They believe that companies should be held responsible for their actions. They believe that companies can actually have financial success while helping the world transition to a more sustainable place.

The one thing that they're missing is a way to connect their beliefs and their intent to the investments that they make in the portfolio. So if we looked at them as a group and we compared them to the ESG motivated persona, about half as much of this population has actually made an investment in an ESG strategy. So about 43% of the ESG ready personas have actively invested in an ESG strategy and that compares to about 83% in ESG motivated.

So I think there's just a tremendous opportunity to help them make that connection and actually realize this ambition that they very much have for seeing ESG factors take a more prominent place in their portfolio.

Ben Jones: The ESG ready in particular seems like a real ripe opportunity for advisors to make sure that they're asking those questions of their clients so that someone else isn't stealing those clients, if you will. Now, I am curious, for advisors as they're doing the re-fact or their initial discovery with a client, how do they better understand which one of these personalities their client might be? Are there some questions that you would recommend?

Kristi Mitchem: Yeah, so what's interesting is all of the questions are actually embedded in the little app that we've created. And so I think the easiest way for an advisor to understand where their client sits is to actually sit down and walk them through the app and sort of have a conversation around it. Because really just the process of bringing it up, of sort of pulling ESG into the dialogue, is a very important one.

And I do want to go back to maybe hear some of those high level statistics. So again, the purpose of this survey was to sort of get under the hood. But I do think it's important to highlight that across the population that we surveyed ,28% of all the individuals that responded indicated that they had had a conversation around ESG in the context of their portfolio in the last two years, and over 50% indicated that they wanted to have that conversation this year, if they had not.

So again, this is going to be a conversation that's welcomed by your clients, regardless of where they sit on the spectrum. And I think just getting them to engage with you, again, in our little quiz in the app, would be a strong step for advisors.

Ben Jones: I like that.

Kristi Mitchem: Yeah. The other thing I might just mention here, Ben, is that I do think that this quiz also represents a great way for an advisor to really think about wealth and transition and intergenerational transfer. It's a great conversation that you can have that really evens the playing field across family members, because everyone is going to have a view on this, and they're all going to sit somewhere on the spectrum. So I think it's great to engage with your clients individually, but I think there's also tremendous opportunity to use this tool as a way to engage with your client as a family or group of investors from an intergenerational perspective.

Ben Jones: Excellent. And we'll make sure that we put a link to all of this in the show notes and the webpage so people can access the quiz. For ESG motivated or ESG ready, then pragmatic and skeptical as you work your way down, do you see different levels of enthusiasm or excitement? So for example, like with ESG motivated, do those clients tend to care more about specific themes than maybe ESG ready, which is looking for more broad application of ESG?

Kristi Mitchem: No, in fact, I would probably say a bit of the opposite, Ben. I think as we look at ESG ready and ESG motivated individuals, they tend to care about sustainability and ESG factors across the spectrum. So they're just as interested in seeing clean oceans as they are clean air or sustainable labor practices.

I think what that really reflects is the holistic nature of the way that they think about ESG. And the fact that if we look at these populations, particularly that ESG motivated population, this is almost something that they apply in their life, not just in their portfolio. So we see a very strong connection between the choices that they make in their consumption and the choices that they make in their investments.

So again, I would say a very holistic approach for ESG motivated and ESG ready as appropriate. As we think about ESG pragmatic and ESG skeptical, I would say particularly the pragmatic group may have one or two themes that they care about. So they believe in the theme and they want see it expressed in the portfolio because they think it will have a material impact on overall returns.

Emily Larsen: One thing I found very interesting during this conversation is that you don't need to have an ESG motivated or ESG ready client to make a conversation about responsible investing valuable. Your clients appreciate that you're trying to better understand them and align their perspective with their strategies.

We want to thank Kristi for making time to share this work and her passion around boldly growing the good. Before we let her go, here are some final thoughts from Kristi.

Ben Jones: If you were to summarize our entire conversation today in one or two sentences, how would you do that?

Kristi Mitchem: I would say it's all about getting at the essence of who your clients are, and the more that you understand who your clients are and how they think, I think the better attuned you can be to their needs. I think that that's what separates a good advisor from a great advisor. And I think getting their ESG signature, understanding who they are as an ESG persona ,can again, just help an advisor to elevate the game.

Ben Jones: Excellent. If you were to write your surgeon general's warning label for this episode, what would it say?

Kristi Mitchem: My surgeon general's warning, I think for this episode, would be probably not to miss it, that this is a really important conversation that needs to happen. And the one reason why I'm so excited about this tool is I think it helps advisors find an easy way in to an important conversation that can sometimes seem, I think, a little difficult to initiate.

So that's why I'm so excited about it. That's why I think it's so interesting, because it sparks a dialogue. And again, I think that dialogue can lead an advisor to understanding more about the essence of the client and therefore really excelling at delivery.

Ben Jones: Thank you for listening to Better Conversations, Better Outcomes. This podcast is presented by BMO Global Asset Management. To access the resources discussed in today's show, please visit us at www.BMOGAM.com/betterconversations.

Emily Larsen: We love feedback and would love to hear what you thought about today's episode. You can send an email to BetterConversations@BMO.com.

Ben Jones: And we really respond.

Emily Larsen: We do.

Ben Jones: If you thought of someone during today's episode, we would be flattered if you would take a moment and share this podcast with them. You can listen and subscribe to our show on Apple Podcasts or whatever your favorite podcast platform is. And of course, we would greatly appreciate it if you would take a moment to review us on that app.

Ben Jones: Our podcast and resources are supported by a very talented team of dedicated professionals at BMO, including Pat Bordak, Derek Deveraux. The show is edited and produced by Jonah Geil-Neufeld and Sam Peers Nitzberg of Puddle Creative. These are the real people that make the show happen. So thank you, and until next time, I'm Ben Jones.

Emily Larsen: And I'm Emily Larson. From all of us at BMO Global Asset Management, hoping you have a productive and wonderful week.