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3 QUESTIONS TO ASK YOUR FINANCIAL ADVISER IF YOU ARE SERIOUS ABOUT SUSTAINABLE INVESTING

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Interested in sustainable investing but not comfortable tackling all the extra due diligence that goes into picking stocks and funds?

A financial adviser may be able to help find funds that use environmental, social and governance metrics that align with a client’s values. But clients need to go beyond the usual questions about fees and qualifications and dig into how well that person understands the topic.

In a sign of growing interest in ESG and sustainable investing, groups like the CFA Institute offer financial advisers course work to receive an ESG certificate, and the College for Financial Planning has a Chartered SRI Counselor designation program. But these are still not widely used, and ESG is misunderstood.

Yet the dollars flowing to this style are growing sharply. There are nearly 440 ESG-focused exchange-traded funds and mutual funds available according to

Morningstar, and more are added almost daily. With that number of funds launching, finding an adviser who knows how parse through the offerings matters.

Here are three questions to ask to find out how well your adviser knows ESG, and one question the adviser should ask you.

1. What are your ESG investing options?
Since ESG investing is just entering the mainstream, a lot of advisers may simply point to a few ETFs or mutual funds offered by their firm that can be part of a portfolio rather than offer a complete portfolio option.
If that's the case, you don't need to pay a financial adviser for ESG advice since he or she is unlikely to know much about sustainable investing.

2. How do you approach ESG?
ESG-focused financial advisers should be able to explain how they construct a sustainable investment portfolio, says Peter Krull, CEO of Earth Equity Advisors.

Sustainability focused advisers use traditional economic and fundamental analysis metrics such as price to earnings and debt levels, but they also include sustainability metrics, such corporate governance, product safety, environmental track record or other sustainability metrics that are important to a business's operations.

Having all that traditional and sustainable research at hand helps with client conversations, Krull says.

For example, his firm doesn't own any fossil-fuel producers or consumers. That means NextEra Energy NEE, +0.20% won't appear in any of its mutual funds or ETFs, even though it's a popular holding in many ESG funds.

"They have a big wind component, but they still have a big coal component. And they're polluting the Everglades," he says.

Advisors who incorporate use ESG metrics supplied by third-party providers as an add-on after their traditional financial analysis are unlikely to offer a holistic, sustainable investing portfolio.

3. How do you choose funds?
When interviewing a financial adviser to build a sustainable portfolio using funds, Krull says to ask how they create the allocation.

Aside from his firm's fossil-fuel-free stance, he looks for the fund's sustainability mandate, which means sustainability is a central feature of the strategy. Krull reviews each of the fund's holdings and weighs whether a particular stock makes sense.

“They need to ask if the adviser is doing the due diligence on what the holdings of each of the funds are. I think that is one of the most important things that you can ask, because if they’re just picking a fund by its name, then anybody can do that,” Krull says.

He’s particularly critical of the popular sector-neutral index ETFs that make up a number of asset-allocation programs geared to ESG investors. Sector-neutral index ETFs seek to mimic the broader market exposure, but have few screens to exclude companies since these funds pick firms from every market sector, including traditional energy.

“These ETFs are just using pure metrics. There isn’t a human who oversees this and questions if a company should be in an ESG portfolio. It is not about relativity within your sector. It’s about relativity within the marketplace. Less bad is still bad,” he says.

The biggest ESG ETF by assets under management is a sector-neutral fund, iShares ESG Aware MSCI USA ETF ESGU, -0.06% with $22.4 billion in AUM. Not only are nine of the 10 largest holdings the same as the SPDR S&P 500 500 ETF Trust SPY, +0.03% SPX, +0.06%, but the iShares fund also holdings fossil-fuel producers Exxon Mobil XOM, +0.19% and Chevron CVX, +0.01%. That may surprise investors who don’t look at all the holdings.

Fund costs still matter, too. Actively managed mutual funds will cost more than passive index funds, and some niche funds will cost more than a broad-based fund. With the proliferation of new ESG funds, especially U.S. large-cap funds, a financial adviser with an ESG focus should consider costs and holdings not just what a fund is called, says Andrew Poreda, ESG analyst for Sage Advisory.

“Shoving someone with an actively managed fund that charges 75 or 80 basis points in fees is not good if there’s a better product out there that will accomplish the same thing for less,” Poreda says.

Turning the tables

Now for the question both Krull and Poreda say an adviser should ask a potential client:

What do ESG and sustainability mean to you?

An adviser well-versed in sustainable investing should ask a potential client this question early in the conversation, Poreda says.

“You can’t put ESG into this one-size-fits-all box, because one of the challenges with ESG is that there are a lot of views, even from asset managers. What Sage views as ESG may not be the same as BlackRock,” Poreda says.

ESG needs to be included as part of the initial, detailed conversation about the client’s overall goals such as risk tolerance and time horizon because they’re all linked together, he says. For example, if a client wants an animal-rights or a carbon screen, that person needs to see how much of the total investing universe is eliminated from their portfolio depending on the screen or screens. That could lead to a give-and-take so that investment goals and social values can align.

“If you say I don’t want these different sectors in my portfolio, that’s great. But there may be a diversification challenge that affects the overall portfolio,” Poreda says, adding later, “if financial advisers aren’t asking those questions, if they’re just shoving that ESG product at them, I think that can be problematic.”

Krull says that because ESG and sustainable investing is about personal values, so don’t be afraid to ask the adviser about their values.

“The reality of the situation is, if you’re going to be working with somebody who is helping you with values-based investing, it is also important that that adviser’s values are also aligned with yours, because you’ll be able to connect with them better,” he says.