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Why ESG & Sustainability in Wealth Management Should be Driven by Client Centricity and not the Regulators

One thing we know in this ever more complex world in which we live is that work titles are getting longer, and the longer titles seem to go to those in 'newer' areas of endeavour, such as Dr Marcus Fenchel, Transformation Expert for Sustainable Finance and Corporate Responsibility at Finalix Business Consulting and a self-avowed champion of ESG. But what Hubbis found when we interviewed him recently was someone who is concise, lucid, imaginative and market sensitive in his approach to his mission at the Swiss-based firm, where he designs and implements transformation and organisational development programmes for the financial services industry in response to sustainable finance and ESG challenges. The major takeaway from the discussion was that Marcus sees huge opportunities for the private banks and wealth managers around sustainability and ESG in client investments but worries that the European Union's new sustainability regulatory model, if it is mirrored in Asia, will stifle potential for the wealth industry participants. Why? Because the banks and wealth managers will be unable to express and differentiate themselves with client-centric strategies and approaches in the areas of sustainability and ESG if they are penned in by rules and administrative burdens that are excessively restrictive and onerous.

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Dr Marcus Fenchel
Finalix Business Consulting

In his LinkedIn profile, Dr Fenchel highlights that he is a sustainable finance and transformation professional with more than 20 years of experience in financial services and business consulting. He says his key capabilities are developing sustainable finance strategies and implementing ESG concepts; introducing cross border product offerings; driving innovation and transformation projects; preparing and leading complex decision-making processes; and building and leading organisations, departments, and teams.

Responding to necessity

Marcus explains that much of his time is spent working with Swiss banks, and that he is currently working on a sustainable finance project under the European Union Action Plan at a Swiss Wealth Manager. The European Union Action Plan consists of several legislation packages regarding ESG and as many Swiss banks have a large European client base, they need to respond to and fulfil these new regulatory guidelines.

Proclamations from on high

He explains that there are three core elements to these regulations. The first is the EU taxonomy, wherein the EU defines processes in different sectors, providing the basis for banks to evaluate which of their investments are sustainable, partly sustainable, or perhaps not sustainable.

The second element is SFDR, Sustainable Finance Disclosure Regulation, which defines three distinct categories of products, Article 6, Article 8 and Article 9 products, which are more or less not sustainable, partly sustainable, or in Article 9 fully sustainable. "The banks and wealth managers now need to classify on their own, their products according to one of the three categories," Marcus reports.

banks and wealth managers now have to explain what those three categories are – essentially based on the definitions provided by the EU - and then ask them to respond to which of these sustainable investment categories they want to invest in and to what extent.

"Due to the complexity and technical character of the three categories of sustainable investments, it really is a major challenge for the banks and wealth industry to explain these categories to clients and then build profiles on them based on their preferences," he says. "And then of course, they must fulfill those preferences instantly with the as-is offering."

Fulfilment, he reports, is achieved by percentages, for example a client might want 50% of their portfolio invested according to one of the three categories, whilst the other 50% don't have to be invested sustainably. This sounds doable in the first place, however, because the data to actually evaluate the fulfilment of the clients sustainability preferences will not be available until 2023, most investment products only achieve very low percentage values according to any of the three sustainable investment categories.

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The third EU package relates to the MiFID regulation, which he says has been amended by so called sustainability preferences. "All clients need to be asked for their sustainability preferences regarding their investments," he explains, "and the clients will reply according to three different categories of sustainable investments determined by the regulator. In short, the EU defines what sustainability actually is."

Packaged but challenging for clients and banks

But Marcus says there are key challenges around this, as the

The cart before the horse?

Moreover, Marcus says there is a major gap between the EU's guidance and regulations and the actual needs that the clients have in reality regarding ESG. "This comes to the heart of the dilemma," he states. "Regulators and the banks and wealth managers are so busy creating ESG compliance rules and ESG-compliant products and reporting but not actually asking what clients want."

The result is there is a major and even expanding chasm, or in the old English language saying, the cart is often before the horse.

Listen to the clients? Hmmmmm...

"When it comes to their ESG objectives, clients in practice have a number of key goals," Marcus reports. "One is to improve the risk return ratio, and they believe ESG might help although there is not yet really enough evidence to prove that. Secondly, clients want to align the portfolios with their personal values and thirdly they want to actually achieve some degree of positive change and impact."

And surprisingly the EU hardly seems inclined to match its rules and guidance to any of the three client's ESG objectives. What this means, Marcus elucidates, is that these clients are now being corralled into three categories that they do not actually want nor understand and do not necessarily fit them at all.

Adjusting to the brave new world

For the banks, Marcus says they must therefore work out how to conduct their ESG compliance in the manner least painful for themselves and therefore the clients. The most efficient way is to adapt existing products, so they qualify under each of the three categories, even though only to a small extent.

"Yes, they need to invest time and effort, but they can do so based on the existing products to a large extent," he says. "But in practice this is a major burden for them, and they are siloed into an external definition, losing their own freedom to define and refine how they interpret sustainability and ESG. This is certainly not a benefit for the banks - they are being forced to undergo a painful and painstaking regulatory process. They must obtain the data, adapt their advisory tools, train client advisors, and report - it costs a lot of money and frankly, they do not like it at all, nor do their clients."

So, why did the EU regulate sustainable investments at all,

A Short Note on Finalix Business Consulting and Dr Marcus Fenchel

Finalix is a consulting boutique with a focus on the financial industry. Originating from Switzerland, the company was founded in 2001 and opened an office in Singapore in 2019.

Finalix supports a wide range of financial services providers from banking - universal banks, private banks, asset managers, and private equity corporations - to insurance. The company focuses on digitisation and transformation projects covering key senior roles on the business side as product owners, SMEs, and stream leads.

Finalix prides itself on offering clients a set of consultants that have on average more than 12 years of significant work experience with renowned consulting companies and senior roles in the financial services industry. They bring strong skill sets, fast adaptability to new environments, and instant value delivery to their projects.

One such expert is Dr Marcus Fenchel, who started his career as Senior Consultant at PwC, afterwards moved on to the Swiss Federal Institute of Technology to conduct research on sustainable banking and then spent more than 10 years in different leadership roles at UBS where he managed the lifecycles of several product lines and lead innovation and transformation projects of all sizes.

Before joining Finalix, Marcus served as Managing Partner and Head Delivery at the FinTech company Sixsentix and was Senior Associate at Noveras, a consulting boutique for cross-border banking services. Furthermore, Marcus is a lecturer for sustainable finance and investment management at Zurich University and Kalaidos University in Switzerland and has published several articles and books on sustainable banking. Marcus holds a PhD in sustainable banking and master degrees in business administration, environmental technology and organisational psychology.

and why has the EU taken this technical approach? A key objective of the EU Action Plan is to reorient capital flows towards sustainable investment, and finance the required transformation towards a sustainable economic system. When looking at the breath-taking growth rates of sustainable investments during the last years one could think that this objective of the EU Action Plan is already achieved or at least on a good way. However, the lack of a common definition of sustainable investment forced banks to introduce their own definitions, which were not always very precise and their fulfilment often hard to verify. Consequently, sustainable investment products provided by banks sometimes hardly deviated from non-sustainable products and therefore didn't contribute to the required transformation process. The phenomenon of greenwashing was born and at the same time the need to introduce a common definition of sustainable investment arose to fight greenwashing. Only the regulator can tell why the approach needed to be so technical and is not aligned with client's sustainable investment goals.

Working within the boundaries

Nevertheless, Marcus and Finalix are working assiduously to help the banks meet their obligations. "Whether or not this all makes sense, the obligation is there, and they must meet them, however painful the process," he says. "We support them in a wide variety of ways, including the incredibly painful document generation, adaptation of advisory tools and administrative work processes."

But what concerns Marcus most is that such is the sheer weight of compliance on the banks and wealth managers that there is little, or no intellectual, personal, or financial capacity left over at the banks to think about this topic strategically.

Taking the initiative away

"Sadly, it has become 'how' not 'why' and that is truly regrettable," he reports. "It is unfortunate because the banks and others are no longer focusing on the opportunity in all this, which is to develop sustainability and ESG strategies for their clients that differentiate them as institutions, and that further engage the interest and attention of those clients. And that is also exactly where Finalix and I try to help our customers in maintaining a focus on developing an excellent strategy, truly focusing on the client's actual ESG needs."

Marcus expands his view to Asia, noting that Europe is the first region to have really pushed the ESG topic from a regulatory perspective, as mentioned above, this has been triggered by the growing trend of greenwashing during the last years.

Hope for Asia

"It is just beginning in Singapore, in Hong Kong and elsewhere," he reports, "but there is a time lag of several years. We need to see how things develop, but what I sincerely hope is that the regulators in the region do not simply push aside the client's needs as they charge towards regulation. I do think it can all be done a lot better regarding client needs than it has been developing in Europe."

He closes the conversation by highlighting that despite what he sees as significant missteps in Europe, there is huge business potential around ESG and sustainability.

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Common sense and client centricity

"The growth of ESG related investments was overwhelming over the last years and will stay huge ahead," he reports. "I believe the banks and the wealth industry out in Asia should be developing their own ESG business strategies with focus on client's ESG needs, aligned hopefully to some sensible guidance from the regulators, but not dictated by non-client friendly regulations and then interpreted by compliance teams rather than business teams. The business opportunity is huge if you avoid greenwashing and get your ESG strategy right." ■