Finance and Sustainability

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GOOD STEFAN WEALTH MANAGEMENT | RBC DOMINION SECURITIES

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Agenda

- Introductions
- Portfolio Compliance – Know Your Client & Documentation
- Portfolio Governance – Investment Policy Statement (IPS)
- Socially Responsible Investing (SRI)
Compliance

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VICE PRESIDENT & WEALTH ADVISOR
Know Your Client (KYC)

- KYC is the process of verifying the identity of the client and assessing their suitability

- It is a data-driven process

- The initial goal was to prevent fraud, tax evasion, terrorism financing and other financial crimes

- Over time, the use of KYC has been varied. It includes
  - determining suitability
  - periodic assessment of risk tolerance
  - focus on the long term plan
Responsibility of the advisor

- Advisors must learn each client’s personal and financial circumstances, investment knowledge, time horizon, objectives and risk tolerance
- Advisors must know the risks and characteristics of the investments being recommended
- The recommended investments must be suitable for the clients given the KYC information

Responsibility of the client

- Clear and adequate disclosure
- Although KYC is a regulatory requirement, it has a dearth of valuable data that helps in determining suitability
Documentation
- Documentation is a legal requirement

- It summarizes the legal responsibilities and extent of authority to act

- Documentation has gone electronic at many organizations

- Fraud prevention and protection of privacy are two of the top reasons for additional documentation requirements

- Even though it is time consuming, documentation ultimately protects the client’s interest
When and where do we need new documentation?

Short answer – when there is a change of ownership or authority

With individuals, there are more changes in ownership (sole to joint), adding a child as beneficiary etc.

With institutions, there are more changes in authority (change in board members, signing officers, resolution etc.)
- Documentation needs to be timely

- Most boards have 4 or 5 members that need to sign a document

- While this is excellent practice, each member needs to be aware that a delay with one person could hold up the entire process

- Documents cannot be stale-dated (six months)

- Have an internal person verify that data is filled correctly. A seemingly simple error could make the document void

- Common errors include, signing in the wrong spot, a correction that was not initialed, incorrect date etc.
Consequences of delayed or improper documentation

- Regulations prohibit advisors from acting on an account unless they have proper and complete documentation.

- For example, firms have a timer that provides 30-90 days for account updates and failing to comply will lead to the account being restricted until the documentation is received and approved.

- This usually leads to a frustrating experience for the client. But keep in mind that firms have no incentive to keep your account restricted.

- We are all fiduciaries. A board has a fiduciary duty towards the beneficiaries. Advisors have a fiduciary duty to the board.

- We all have a shared responsibility to keep the process as smooth as possible.
Governance

Investment Policy Statement (IPS)

JACK GOOD, CIM
VICE PRESIDENT & INVESTMENT ADVISOR
What is an IPS?

- It is a formal document that is drafted between the advisor and the client. It is a best practice in our industry but not all advisors utilize an IPS.

- The purpose of the document is to identify the goals of the client and create an acceptable framework to achieve them.

- It governs the investment relationship between the advisor and the client.
Why is an IPS important?

- It sets the framework to achieve the required objectives while remaining compliant with any constraints.
- It provides for better continuity when there is a change at the client’s organization or the portfolio management firm.
- It serves as a clarification tool in case of a conflict and protects the client and the advisor.
- Clients with an IPS are more likely to adhere to their plan.
Structure of an IPS

A well-constructed IPS should address the following:

**Objectives**
1. Risk
2. Return

**Constraints**
1. Time Horizon
2. Liquidity
3. Tax
4. Legal
5. Unique Considerations
Structure of an IPS

- At a minimum, it should include the following:
  1. Objectives - the purpose of your portfolio
  2. Constraints - your limitations
  3. Evaluation - method to evaluate performance
  4. Review schedule - a minimum frequency of updates
Objectives

- Purpose of the portfolio – as specific as possible

- Establish an acceptable level or risk and a commensurate return
Objectives: Risk & Return

- Return expectations should be reasonable commensurate with risk

- Clear differentiation between Required return and Desired return

- Required Return = Needs (less risky investments)

- Desired Return = Wants (riskier investments)

- Inflation and taxes are important sources of risk
Constraints

- **Time Horizon & Liquidity**: By far the most important of the constraints for most clients.

- **Tax & legal considerations**: Tax is usually very important for individuals and legal considerations are usually important for institutions.

- Tax has a direct and permanent impact on returns.

- Advisors and clients know that these factors are important but it is difficult to enforce or be reminded consistently without a written IPS.
Challenges of not having an IPS

- Misalignment with objectives
- Too much or too little risk
- Abandoning strategy at the worst possible time (buying high, selling low)
- Deteriorating client-advisor relationship
Housekeeping items

- An IPS must be written and signed by both parties – the advisor and the client

- It needs to be reviewed at least once a year and updated as necessary

- For discretionary portfolios where the client is not involved in everyday decision-making, there must be an independent division monitoring the advisor’s adherence to the IPS
Socially Responsible Investing (SRI)

SRI RAGHAVAN, CFA, CIM
ASSOCIATE INVESTMENT & WEALTH ADVISOR
What is SRI?

- Investing with a focus on all stakeholders – shareholders, society, employees, customers, the entire ecosystem
Investing = Long-term; Trading = short-term

A short-term trader focuses on price. Gain or loss is driven by supply-demand, news and momentum

A long-term investor focuses on value creation. In the long-term, returns mimic value creation

Any business that does not treat its stakeholders well, is unsustainable in the long-term
Objectives of a Socially Responsible Investor

- Ethical behaviour (corporate governance)
- Clean environment (renewable energy)
- Social Justice (fair wages, no human rights violations)
- Health (no tobacco companies)
Some common types of SRI

1. Sustainable Investing
2. Impact Investing – community focused
3. Thematic Investing – climate change etc.
SRI is gaining traction...
* ESG – Environmental, Social and Governance

Source: US SIF Foundation
Top Specific ESG Criteria for Money Managers 2018

- Climate Change/Carbon: $3.00 Trillion
- Tobacco: $2.89 Trillion
- Conflict Risk: $2.26 Trillion
- Human Rights: $2.22 Trillion
- Transparency and Anti-Corruption: $2.22 Trillion

Source: US SIF Foundation
Challenges

- SRI could mean different things for different investors. This makes standardization a complex task
- Availability of investments
- Herding – as something gets incessantly popular, it leads to overvaluation
- Investing in overvalued securities implies lower returns. This leads to poor investing experience
- People with good intentions could end up losing money as a result losing interest in the cause
Transitioning to a socially responsible investment portfolio

- Define Socially Responsible Investing for your institution

- Keep in mind that a fund company’s definition of SRI may not align with your institution

- Utilize a step-by-step approach
  1. Define your timeframe to achieve a socially responsible portfolio
  2. Remove the SRI violators
  3. List your replacements
  4. Invest at the right price

- As the investable universe expands, it will get easier to align a portfolio to be fully comprised of socially responsible investments
In summary

- SRI provides a sense of satisfaction by investing for the greater good
- Since long term results depend on all stakeholders, SRI could help eliminate some poor performers
- Make a positive impact on society
- You don’t have to choose between returns and sustainability
Thank you!