FinancialPlanning

ESG

Is private equity ownership an ESG risk? Moody's thinks so

By Tobias Salinger June 29, 2023, 8:31 p.m. EDT 6 Min Read

The largest wealth management firms received widely varying ESG grades from Moody's, highlighting an ongoing industry debate about the impact of private equity capital.

Only 1 of 13 major wealth management firms, Charles Schwab, has the highest grade of "positive" from Moody's Investors Service, while Focus Financial Partners, Osaic's holding company and Cetera Financial Group's parent firm have "highly negative" marks. Wells Fargo and Morgan Stanley got "moderately negative" scores. Seven other companies fall in the "neutral-to-low" positive ESG rating.

As a different measure than the ratings agency's more familiar overall corporate debt issuer grades, the marks offer another reminder that ESG criteria can often be subjective and that Moody's analysts view the high leverage of private equity-backed firms as a governance risk in addition to a negative factor in their credit. The private equity firms and some financial advisors who work at wealth management firms that have obtained their capital reject that perspective.

PORTFOLIO MANAGEMENT

FinancialPlanning

June 20, 2023 3:38 PM

After Focus unveiled its agreement in February to go private in a deal with Clayton, Dubilier & Rice valuing the firm at more than $7 billion, a Moody's note described the move as "credit negative" and worsening its governance "since such owners have historically promoted aggressive strategies and financial policies." In contrast, many industry experts argued that the firm had made a smart decision to drop its publicly traded status with the private equity owner.

Moody's ratings display a "general bias" against private equity firms engaging in "old school LBO financial engineering," but many of the buyout firms today are focusing more on "management practices and improving organizational efficiency," said Rick Van Kuren, the director of research at LVW Advisors, a Pittsford, New York-based registered investment advisory firm owned by Focus. The Moody's ESG scores nevertheless can "shift the frame of reference" on the "multitude of risks that you need to consider" when investing, Van Kuren said.

"You're looking at issues from a slightly different viewpoint, and I think that's really helpful," he said. "We do not try to influence our clients as far as their specific ESG goals and objectives. ... When we're talking to them, we're trying to explore with them and help them identify what are the things that are most important to them, and then to make sure that their investment portfolio is in alignment."

WEALTH MANAGEMENT

The battle for the soul of ESG

Agency's ESG scores

Moody's assigned the following ESG "credit impact scores" to the 13 wealth management firms on a five-point scale, ranging from 5 or "very highly negative," which none of the companies received as their grade, to 1 or "positive."

- 4 or "highly negative": Focus Financial Partners, Advisor Group Holdings (now Osaic), Aretec Group (parent of Cetera Financial Group)
- 3 or "moderately negative": Wells Fargo, Morgan Stanley
- 2 or "neutral-to-low" positive: Raymond James, FMR (parent of Fidelity Investments), JPMorgan Chase, UBS, Ameriprise, LPL Financial, Bank of America (parent of Merrill)
- 1 or "positive": Charles Schwab

Out of the five companies with "moderately negative" or "highly negative" ESG scores, Wells Fargo and Focus Financial declined to comment on Moody's assessments while Osaic, Cetera and Morgan Stanley didn't respond to emails.
Representatives for Moody's didn't respond to requests for an interview with an analyst to discuss the agency's ESG scores, either. At least 20% of the 10,400 rated issuers from all industries receiving ESG scores have "highly negative" or "very highly negative" grades, the agency said in an April blog noting that "ESG considerations have a material credit impact on nearly a quarter of rated issuers." Just 3% have "positive" ratings. Since 2019, the agency has "won over 50 awards for its market-leading ESG capabilities," according to its website.

Schwab, which has received negative ESG grades from other organizations evaluating its impact in different ways, is the only firm to get a "positive" rating for governance. Private equity-backed Focus, Osaic and Cetera are in "highly negative" territory for governance alongside scandal-plagued but environmental risks as well.

ESG

Banks, tech firms and wealth managers fail ESG screen

August 12, 2021 12:00 PM

All 13 of the companies have "highly negative" or worse grades in the "social" category, with Wells Fargo the only issuer getting a "very highly negative" mark in that area. The harm to clients and the companies' reputations from enforcement cases and cybersecurity risks involving customers' personal information is driving the agency's social assessments of the firms, as displayed in a note that Moody's posted last month about Ameriprise's credit.

"Ameriprise faces high industrywide customer relations risk in relation to its sale of products and significant interaction with retail customers against a background of regulatory focus on the fair treatment of customers, which is mitigated by well-developed policies and procedures," analyst Shachar Gonen wrote in the note. "High cyber and personal data risks, amplified by increasing digital product distribution, are mitigated by a strong technology framework. High exposure to demographic and societal risks can make the operating environment more difficult; however, an aging population supports the demand for the firm's longevity and financial planning products."

Critical take on private equity

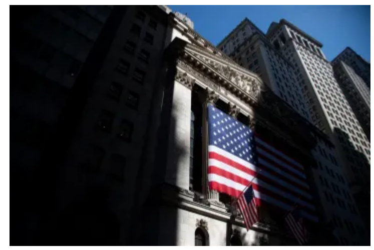
The negative governance scores for private equity-backed wealth management firms comes as the industry is grappling with the impact for the long term as the group of investors flock to RIAs and brokerages and fuel record consolidation. Critics warn that high levels of debt may hamper services to advisors and clients, but many executives with the firms say that the private equity capital is giving them the ability to invest more in technology and operational upgrades.

"Private equity firms have a strong record of responsibly investing in companies, improving sustainability and building better businesses across our nation. Private equity managers are some of equity advocacy group the American Investment Council, said in an email. The group's membership includes Clayton, Dubilier, Bain Capital, Genstar Capital, KKR, Kelso & Company, TA Associates, Warburg Pincus and other private equity firms that have invested in wealth management in recent years.

ESG

Greater ESG data still leaves questions unanswered

May 31, 2023 6:38 PM



Clayton, Dubilier's deal to buy Focus is enabling the firm to "shed the short-termism of being a publicly traded company, but its risk-taking capacity would increase and independent corporate oversight would be limited," Moody's analyst Rokhaya Cisse wrote in the March note.

A "credit opinion" report on Osaic from last month also demonstrates how Moody's sees the ESG risks of many firms in the industry. The firm has "low environmental risk" since it displays "little direct exposure to carbon transition or physical climate risk," analyst Gabriel Hack wrote in the study. Hack's analysis, however, warned of much greater risks from the firm's governance.

"The firm's private equity ownership structure has led to aggressive financial and strategic policies evidenced by a high tolerance for maintaining elevated debt leverage in the normal course of business and engaging in large-scale, transformative acquisitions," Hack wrote. "The experienced management team has a track record of successful execution of business strategy, including effective integration of large M&A targets and navigating challenging operating environments where financial flexibility was limited. [Osaic's] private equity sponsor Reverence Capital Partners has effective control of the company and there is limited independent oversight at the board level."

Tobias Salinger Chief Correspondent, Financial Planning