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SUSTAINABLE INVESTING

The Millennial Investor

By Julian Seelan

INVESTMENTS & WEALTH INSTITUTE®
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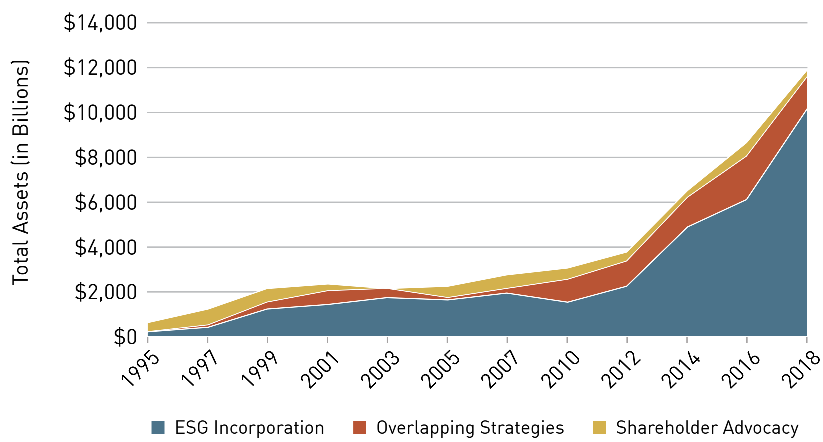
Figure 1

GROWTH IN SUSTAINABLE INVESTING FUNDS



Source: US SIF (2018)

Wealth and asset managers have seen a significant influx of client funds flow into sustainable investments. In fact, this investment strategy has grown 38 percent since 2016 and currently accounts for 26 percent of the assets under management (AUM) in the wealth and asset management industry.[1]

Demand for sustainable investments is being driven, in part, by millennials who prefer to invest in alignment with personal values. Because millennials are poised to receive more than $30 trillion of inheritable wealth, sustainable investments will continue to grow in demand.[2] As a result, fund managers increasingly are allocating resources to develop products and capture this emerging client segment.

When assets change generations, firms typically lose 70 percent to 80 percent of those assets.[3] Consequently, the wealth and asset managers who supply millennials with value-based investment options will be strongly positioned to attract new assets to the firm as well as retain beneficiary millennial clients.

SUSTAINABLE INVESTING AND ITS BENEFITS TO FIRMS

Sustainable investing, also known as socially responsible investing (SRI), is the process of incorporating environmental, social, and governance (ESG) factors into investment decisions. Individuals who invest sustainably choose to invest in companies, organizations, and funds with the purpose of generating measurable social and environmental impact alongside a financial return. Impacts are spread across various sectors, from renewable energy and climate change, to health, safety, and community development.

Sustainable investing enables individuals to select investments based on values and personal priorities. Initially, sustainable investing negatively screened companies and industries, which often led investors to sacrifice returns for value-aligned investment choices. In recent years, however, investors have used positive screening of ESG risk factors to create a modern, best-in-class investment approach that generates performance that is in line with—and often exceeds—market benchmarks. This shift toward market outperformance in several sustainable investing products has contributed to the increase in demand for these products, especially as fiduciaries look to serve their clients by generating returns and also assessing impact.

Providing sustainable investing opportunities enables firms to capture financial returns for clients and also to realize intrinsic returns not replicated elsewhere. These intrinsic returns lead to deeper connections between the clients and their investing habits, creating long-term customer appetite.

DRIVING MARKET GROWTH

Sustainable investing has experienced a compound annual growth rate of 17.44 percent, increasing AUM from $8.7 trillion in 2016 to $12.0 trillion in 2018, according to The Forum for Sustainable and Responsible Investment's 2018 report (see figure 1).[3] Additionally, the number of available sustainable investing funds has increased 89 percent since 2016 as shown in figure 1.

This market growth is being driven by millennials as well as evolving macroeconomic trends. With an estimated 2-billion-person growth in the world's population by 2050, global demand for food, water, and energy will drive the need for innovative improvements in infrastructure to address increased demand for resources. Demand for sanitation and clean water, innovations in energy generation and distribution, improved health care, and more-efficient transportation provide an abundance of opportunity for sustainable investment growth. As these investments continue to display a track record of market outperformance, investors of all types will demand that their wealth and asset managers provide products that outperform and align with their values.

According to a survey analyzed by the Global Impact Investing Network,[4] more than 90 percent of respondents indicated that impact investments have met or exceeded their financial expectations. Research comparing the performance of several leading SRI indexes versus broader market benchmarks has shown that SRI indexes are statistically equivalent in financial performance.[5] The study cites the outperformance of the FTSE4GOOD US SRI index, an index containing firms that meet a very high ESG standard, which achieved annual returns of 10.68 percent and 16.28 percent returns on three- and five-year bonds, respectively, compared to 8.84 percent and 14.60 percent returns achieved by the S&P 500.

The opportunity to maintain strong financial performance coupled with values-based investing is extremely attractive to many types of investors, especially millennials.

As millennials begin to engage with wealth and asset managers, they will continue to disrupt the industry due to their sizeable population, amount of inheritable wealth, and preference for digital channels of communication. Additionally, millennials are more likely to select investments that align with their values than previous generations. According to one survey, 77 percent of millennials cite owning ESG or including impact investments in their portfolios.[6]

Wealth and asset managers must recognize the demographic changes characterizing the quickly changing investment industry. Firms must mobilize quickly to develop the capabilities and products needed to serve the more than $4 trillion market—and support the coming surge of the millennial generation through sustainable investing.

HABITS OF THE SOCIALLY RESPONSIBLE MILLENNIAL INVESTOR

As millennials accumulate wealth, firms should shift strategies to accommodate the needs of the socially responsible investor.

One study surveyed nearly 1,000 high-net-worth (HNW) individuals across the United States and found that millennials are incorporating sustainability into their investment decisions as well as their overall consumer behavior:[7]

- 88 percent of millennials and 70 percent of Generation X review the ESG impact of their investment holdings.
- 66 percent of HNW millennials work for or own a company that is actively integrating positive ESG values into products, services, or policies.
- 46 percent of millennials who have a professional advisor currently discuss ways of aligning their wealth goals and strategy with personal values.
- Millennials are the first generation of women to grow up with mothers who primarily worked full-time outside the home. They are more likely than any other age group to work full-time and to have created the majority of their own wealth. Additionally, 46 percent of all HNW women, and 68 percent of women executives, own or are interested in ESG investments

Millennials tend to identify inequalities throughout the world such as climate risk, world hunger, poverty, and access to health care—ultimately creating a heightened sense of global responsibility and driving demand for sustainable investments.

ADAPTING TO THE CHANGING COMPETITIVE LANDSCAPE

Although sustainable investing still can be used to create a competitive advantage, adopting socially responsible practices quickly is becoming a requirement for doing business in the investment industry. Embracing this industry trend means changing existing cultures, processes, technology, and training programs to align with sustainable investing.

Driving corporate culture to accept sustainable investing as the norm rather than a preference will challenge managers to defy the status quo. As firms work to evolve corporate culture, they must foster change at the executive level. Four key practices have the capacity to cascade change throughout the organization:

- First, corporate values must reflect the core tenets of sustainable investing. Firm executives must create overarching value statements to make sure the organization holds itself accountable.
- Second, employees will look to leadership to influence firm culture and establish a precedent for a new industry perspective. Without visible adoption by executive leadership, formally stated culture and values lack significance and authenticity.
- Third, firms must train advisors on how to have targeted and effective conversations with clients around sustainable investing. Training and communication play key roles in strengthening firm culture, especially when compared with other firm initiatives.
- Finally, firms should seek to hire passionate sustainability veterans who have proven they understand how to motivate teams and influence change. Clearly defining the new role also will serve as an additional signal to the organization of its commitment to the

Figure 2

WHY SUSTAINABLE INVESTING MATTERS NOW

SUSTAINABLE INVESTING TRENDS AND STATISTICS

~1/4 of every dollar of assets under management in the U.S. was invested in SRI strategies in 2018 (totaling over $12 trillion dollars)

34% of sustainable funds offered in 2018 finished the year in the top quartile of their respective Morningstar categories

86% of millennials are interested in sustainable investing

33 brand new sustainable funds were launched in 2018

55 existing funds added ESG criteria to their investment processes

54% of women want to invest in companies with a high degree of corporate social responsibility (however 70% of these women have not heard of sustainable or responsible investing)

341 sustainable funds are currently available to U.S. investors—approximately 12% of these funds are passive strategies

SRI has grown by **38%** over the past two years, with assets climbing from $8.7 trillion in 2016 to more than $12 trillion in 2018

54% of investors view ESG investing as a fiduciary responsibility (more than double the percentage from 2017)

70% of asset managers believe they have a responsibility to address global sustainability issues through their investments

90% of institutional investors say that portfolios integrating ESG factors are likely to perform as well or better than non-ESG investments

development of robust sustainable investing capabilities for advisors.

CHANGE PROCESS AND TECHNOLOGY

Success for adopting sustainable investing will be measured by how quickly firms deliver robust offerings to target client segments. Core front office functions must have capabilities that enable advisors to optimally service clients. Onboarding platforms and asset allocation models will require modification to accommodate investors' sustainability preferences. Additionally, product research tools must arm the advisor with a new library of information.

THE FUTURE OF SUSTAINABLE INVESTING

Adapting to a sustainable investment environment will be a challenge for firms and will require changes to existing culture, technology, and processes. Firms must prioritize advisor awareness of millennial values and assure that advisors are fully trained and equipped with the tools required to have meaningful discussions around sustainable investing. It is imperative that financial services firms recognize their changing client demographics and mobilize quickly to serve a changing client base. The firms that are most adequately prepared to address sustainable investing and intergenerational wealth transfer together will capitalize on the acquisition of new clients and serve their current clients more effectively.

We see an opportunity ahead for wealth and asset management firms to redefine the standard for investment options in an industry that soon will be dominated by the socially responsible millennial investor. To capture market share and gain a competitive advantage in this evolving industry, we believe wealth and asset managers must adopt values-based investment options to serve a new era of investors.

Julian Seelan is the sustainable investing lead for wealth and asset management clients at Ernst & Young. He has more than 12 years of financial services and management consulting experience. He has spent the past six years focused on sustainable and impact investing. He earned a BA in economics and business from Kalamazoo College, and a master's degree in sustainability management from Columbia University. Contact him at julian.seelan@ey.com.

ENDNOTES

1. "Report on US Sustainable, Responsible and Impact Investing Trends, 2018," The Forum for Sustainable and Responsible Investment, https://www.ussif.org/files/Trends/Trends%202018%20executive%20summary%20FINAL.pdf.
2. According to "The Millennial Perspective," millennials refers to approximately 80 million U.S. individuals born between the years 1980 and 2000. Millennials are the largest generation in U.S. history, surpassing the baby boomer generation by 20 million people.
3. See endnote 1.
4. Jon Hale, "What Are Sustainable Funds and How Have They Performed? Morningstar Blog," Morningstar.com, 2018, www.morningstar.com/blog/2018/01/31/sustainable-funds.html.
5. "Responsible Investing: Delivering Competitive Performance." Nuveen TIAA Investments (July 2017), www.tiaa.org/public/pdf/ri_delivering_competitive_performance.pdf.
6. Fang Block, "Wealthy Millennials Fuel Impact Investing Gains." *Barron's*, (June 26, 2018), www.barrons.com/articles/wealthy-millennials-fuel-impact-investing-gains-1530048196.
7. "2018 U.S. Trust Insights on Wealth and Worth." *U.S. Trust Bank of America Private Wealth Management* (June 2018), ustrustaem.fs.ml.com/content/dam/ust/articles/pdf/insights-on-wealth-and-worth-2018/press_release.pdf.

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5619 DTC Parkway, Suite 500
Greenwood Village, CO 80111
Phone: +1 303-770-3377
Fax: +1 303-770-1812
www.investmentsandwealth.org