



Building a better
working world

Sustainable investing

How the millennial generation invests its wealth

Why sustainable investing matters now

Wealth and asset managers have seen a significant influx of client funds flow into sustainable investments. In fact, this investment strategy has grown 107.4% annually since 2012 and currently accounts for 18% 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. Since millennials are poised to receive more than US\$30 trillion of inheritable wealth, sustainable investments will continue to grow in demand. As a result, fund managers are increasingly allocating resources to develop products and capture this emerging client segment.

According to an EY study,² when assets change generations, firms typically lose 70% to 80% of those assets. Consequently, the wealth and asset managers who supply

millennials³ 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, 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 as fiduciaries look to serve their clients by not only generating returns, but also assessing impact.

Providing sustainable investing opportunities enables firms to not only capture financial returns for clients, but 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.

¹Report on US Sustainable, Responsible and Impact Investing Trends, 2014; *The Forum for Sustainable and Responsible Investment website*, http://www.ussif.org/Files/Publications/SIF_Trends_14.F.ES.pdf, accessed 1 June 2016.

²'The experience factor: the new growth engine in wealth management,' accessed 1 June 2016.

³According to 'The Millennial Perspective,' millennials refers to approximately 80 million US individuals born between the years 1980 and 2000. Millennials are the largest generation in American history, surpassing the baby boomer generation by 20 million people.

Driving market growth

Sustainable investing has experienced a compound annual growth rate of 107.4%, increasing AUM from US\$1.0t in 2012 to US\$4.3t in 2014, according to The Forum for Sustainable and Responsible Investment's 2014 report (Figure 1).⁴ Additionally, the number of available sustainable investing funds has nearly tripled since 2008, as shown in Figure 2.

Figure 1: The time is now, as sustainable investments see triple digit growth numbers since 2012

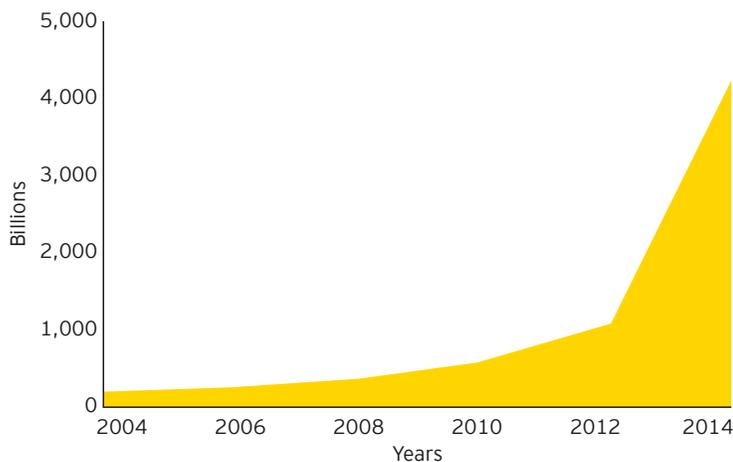


Figure 2: Growth in sustainable investing funds

Year	2004	2006	2008	2010	2012	2014
# of Funds	200	231	338	493	720	925

This staggering market growth is being driven by not only millennials, but also evolving macro-economic trends. With an estimated addition of 2 billion people by 2050, global demand for food, water and energy will drive the need for innovative improvements in infrastructure to address the resource demand associated with a growing population. Clean water and sanitation, 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 not only outperform, but also align with their values.

A recent study by Morgan Stanley,⁵ which evaluated more than 10,000 funds and managed accounts, shows that 'Investing in sustainability has usually met, and often exceeded, the performance of comparable traditional investments.' This is on both an absolute and a risk-adjusted basis, across asset classes and over time.' This study illustrates the outperformance of the MSCI KLD 400 (an index containing firms that meet a very high ESG standard), which achieved an annualized return of 10.2% since 1990. During this same span, the S&P 500 achieved an annualized return of 9.7%, a difference of 45 basis points.

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, inheritable wealth and preference for digital channels of communication. Additionally, millennials more consistently select investments that align with their values than previous generations. According to a recent Morgan Stanley survey, 84% of millennials cite investing with a focus on ESG impact as a central goal.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 over US\$4t market – and support the coming surge of the millennial generation through sustainable investing.

The habits of the socially responsible millennial investor

As millennials accumulate wealth, firms should shift strategies to incorporate the desires of the socially responsible investor. According to Greg Cobb, Director of Fixed Income for Boyd Watterson Asset Management, 'the industry is moving from a passive investor population, which is dependent on the income from defined benefit and pension plans to a population that is self-funding via their defined contribution plans. These millennials will demand more active involvement in their own investments as they wish to be more actively involved in controlling their own destiny. Along with this more active approach will come more activist tendencies.'⁷ Additionally, according to a Morgan Stanley study,⁸ when compared with non-millennial investors, millennials are incorporating sustainability not only into investment decisions, but overall consumer behavior:

- ▶ Millennial investors are nearly twice as likely to invest in companies or funds that target specific social or environmental outcomes.
- ▶ 29% of investors in their 20s and 30s seek a financial advisor that provides values-based investing. Millennials rank this priority third in a list of nine identified priorities.
- ▶ 17% of millennials indicate they seek to invest in companies that use high quality ESG practices, compared with 9% of non-millennial investors.
- ▶ 15% of millennials indicate they would exit an investment position due to objectionable firm activity, compared with 7% of non-millennial investors.
- ▶ 15% of millennials indicate they would rather purchase products from a sustainable brand, compared with 7% of non-millennial investors.
- ▶ Millennials are achieving greater integration of their money and values by seeking personal fulfillment in their careers, applying a global consciousness to purchases, and investing in sustainable, impactful business models.

⁴"Report on US Sustainable, Responsible and Impact Investing Trends, 2014," *The Forum for Sustainable and Responsible Investment* website, http://www.ussif.org/Files/Publications/SIF_Trends_14.F.ES.pdf, accessed 1 June 2016.

⁵"Study Shines Light On Sustainable Investing," Morgan Stanley website, <http://www.morganstanley.com/ideas/sustainable-investing-performance-potential>, accessed 1 June 2016.

⁶"Sustainable Signals: The Individual Investor Perspective," Morgan Stanley website, https://www.morganstanley.com/sustainableinvesting/pdf/Sustainable_Signals.pdf, accessed 1 June 2016.

⁷Greg Cobb, Boyd Watterson, Director of Fixed Income, interviewed by Ernst & Young LLP, 1 June 2016.

⁸"Sustainable Signals: The Individual Investor Perspective," Morgan Stanley website, https://www.morganstanley.com/sustainableinvesting/pdf/Sustainable_Signals.pdf, accessed 1 June 2016.

Millennials 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

Change the culture

While sustainable investing can still be used to create a competitive advantage, adopting socially responsible practices is quickly 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:

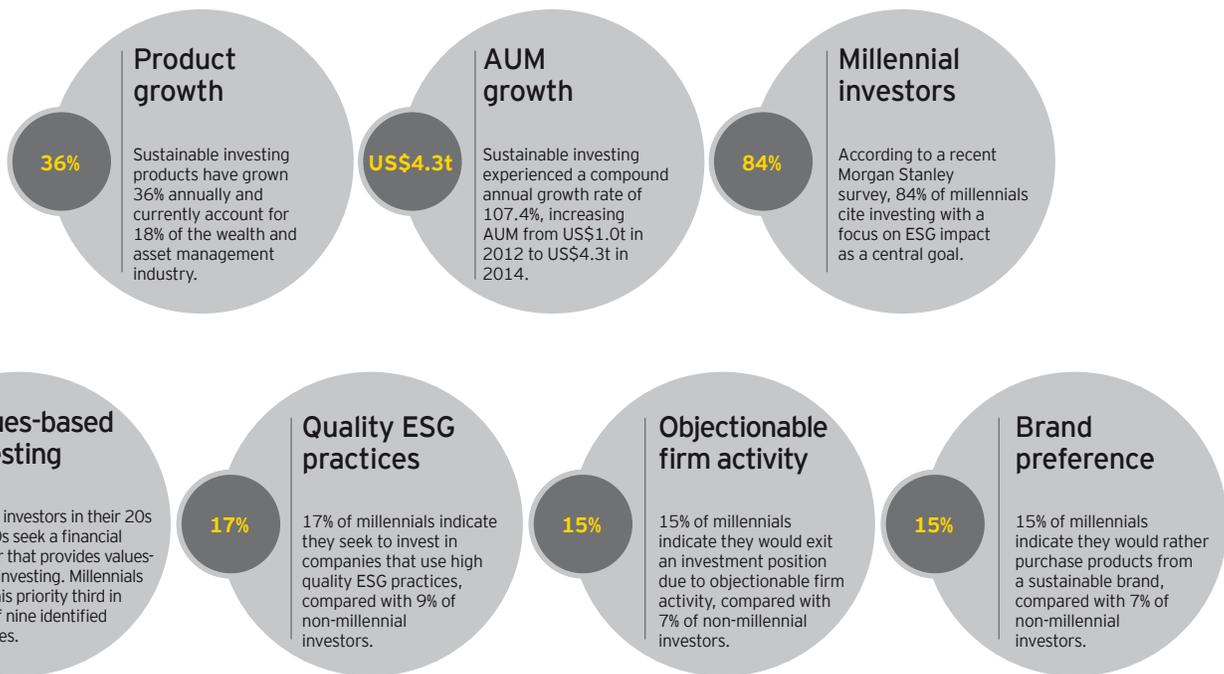
- ▶ First, corporate values must reflect the core tenets of sustainable investing. Firm executives must create overarching value statements to make sure the organization holds itself accountable.

- ▶ Secondly, 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 will also serve as an additional signal to the organization of its commitment to the development of robust sustainable investing capabilities for advisors.

Process and technology change

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.

Why sustainable investing matters now



The future of sustainable investing

Adapting to a sustainable investment environment will be a challenge for firms and will require changes to the existing culture, technology and processes. Our view is that firms must prioritize advisor awareness of millennial values and assure 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 an increasing client base. Firms most adequately prepared to address sustainable investing and the intergenerational wealth transfer together will not only capitalize on the acquisition of new clients, but also effectively serve their current client base.

Given the imminent intergenerational wealth transfer, we see an opportunity ahead for wealth and asset management firms to redefine the standard for investment options in an industry that will soon 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. At EY, our teams can provide extensive industry experience that will support firms as they evolve to meet the new needs of the millennial investor. Whether it's new digital offerings or strategic initiatives to capture this ever-growing market share, we are here to help, and together continue to build a better working world.

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