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Swipe to invest: the story behind millennials and ESG investing

MSCI ESG Research LLC

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Millennials and ESG

In recent years, adoption of environmental, social and governance (ESG) investing has accelerated in part due to momentum from key industry organizations such as the Principles for Responsible Investment (PRI), availability of better ESG data and tools, and demand from the next generation of investors known as millennials. According to analysis by the Pew Research Center,[1] millennials are defined as those born between 1981 and 1996. With ages between 24 and 39 in 2020, members of this generation have entered their prime earning years.

A 2018 survey indicated that 87% of high net worth (HNW) millennials considered a company's ESG track record an important consideration in their decision about whether to invest in it or not,[2] while another found that 90% of millennials wanted to tailor their investments to their values.[3]

Q: What is ESG investing?

A: ESG Investing – a term that is often used synonymously with sustainable investing, socially responsible investing (SRI) or mission-related investing – can be defined as the consideration of ESG factors alongside performance factors in the investment decision-making process.

A 2019 Morgan Stanley Institute for Sustainable Investing survey of high net worth investors found that 95% of millennials were interested in sustainable investing.[4]

The collection of studies referenced here and linked at the end of this paper suggested that millennials, as well as women and, increasingly, individual investors of all ages and genders, are interested in directing their investments toward companies with good ESG records. This reflects a desire for their money not just to earn a return but to align with their personal values and contribute to the social good. The research suggested these investors are asking more questions of their wealth managers and are scrutinizing their investments to understand what they own and how it impacts society and the planet at large.

Why millennials matter

Millennials are a large demographic representing 79.4 million people in the U.S. alone, and immigration could lead to an increase in this number to 81 million by 2036.[5] This group is also poised to inheret a significant amount of wealth.

[1] https://www.pewresearch.org/fact-tank/2019/01/17/where-millennials-end-and-generation-z-begins/
[2] US Trusts' Insights on Wealth and Worth 2018
[3] Morgan Stanley Institute for Sustainable Investing: Sustainable Signals -- The Individual Investor Perspective (2019)
[4] Morgan Stanley Institute for Sustainable Investing: Sustainable Signals -- The Individual Investor Perspective (2019)
[5] Chiavarone, S. "This is how millennials are shaping the new economy." *CNBC,* Sept. 2, 2019.

"We're in the middle of a $30 trillion intergenerational wealth transfer from baby boomers to their children," says Dave Nadig of ETF.com. "And those kids—not really millennials only, but people from 25 to 40 years old – simply think about their investment decisions differently."

"Demand for sustainable investments is being driven, in part, by millennials who prefer to invest in alignment with personal values," said a 2019 report by Julian Seelan, the sustainable investing lead for wealth and asset management clients at Ernst & Young. Firms typically lose 70% to 80% of assets when transferred from one generation to the next. [6] "Consequently, the wealth and asset managers who supply millennials [with] ESG investment options will be strongly positioned to attract new assets to the firm as well as retain beneficiary millennial clients."

Interest in sustainable investing among the general population of investors jumped from 71% in 2015 to 85% in 2019, and in millennial investors from 84% in 2015 to 95% in 2019, according to Morgan Stanley Institute for Sustainable Investing. [7] In years past, women were more likely than their male counterparts to factor sustainability into investment decisions, and see the benefits of doing so. However, Morgan Stanley indicated this difference in interest dropped from 17 percentage points in 2017 to three in 2019. [7]

According to Pew Research Center analysis[8] of new census data,[9] in 2017, households headed by a millennial earned more than young adult households did at any time in the past 50 years. Pew reported that this growth could be partially attributed to millennial women, who are working more and being paid more than similarly aged women in previous years.

Wealth managers are preparing for this new generation of investors. 43% of the affluent millennials who responded to a 2019 Investopedia Affluent Millennial Investing Survey said they use a financial advisor. Those surveyed said they trust financial advisors more than they trust TV shows, books, newspapers, podcasts, websites, magazines, or online video content.[10] More than any other generation of

[6] Seelan (2019). "Sustainable Investing: The Millennial Investor," Investments & Wealth Monitor. https://investmentsandwealth.org/getattachment/bbdef004-2fe8-4e71-a445-918a270b5ff7/IWM19MarApr-TheMillennialInvestor.pdf

[7] Morgan Stanley Institute for Sustainable Investing: Sustainable Signals -- The Individual Investor Perspective (2019)

[8] https://www.pewresearch.org/fact-tank/2018/12/11/young-adult-households-are-earning-more-than-most-older-americans-did-at-the-same-age/

[9] Fontenot, Semega and Kollar (2018), "Income and Poverty in the United States: 2017." United States Census Bureau.

[10] Investopedia's Affluent Millennial Investing Survey 2019

investors, millennials have also been flocking to robo advisors (though only 20% of affluent millennials Investopedia surveyed currently used them and a Charles Schwab report found that even among millennials, 79% would want their robo advisor to augment their offerings with access to human advice[11]). Ellevest, Motif, Merrill Edge, and other robo advisors offer ESG portfolios to help attract and retain their clients.

The interest from millennial investors and HNW millennials in particular has already helped drive the rapid growth in ESG investment. In a 2018 U.S. Trust Wealth and Worth survey, Bank of America Merrill Lynch said that they could "conservatively estimate" USD 20 trillion of assets growth in U.S.-domiciled ESG funds over the next two decades, equivalent to the value of the S&P 500 today.[12] Overall, sustainable investing in the US has experienced a compound annual growth rate of 13.6 percent since 1995 and increased assets under management from $639 billion to $12.0 trillion in 2018.[13]

Nearly USD 4 billion flowed into ESG funds in the first three quarters of 2019. The year-end total in 2018 was USD 5.5 billion, which at the time was a calendar-year record, but sustainable funds were on track to triple that during the waning months of 2019.[14]

[11] Charles Schwab. "The Rise of Robo: Americans' Perspectives and Predictions on the use of Digital Advice" https://content.schwab.com/web/retail/public/about-schwab/charles_schwab_rise_of_robo_report_findings_2018.pdf

[12] Bank of America Merrill Lynch, ESG Matters – US. "10 reasons you should care about ESG" https://www.bofaml.com/content/dam/boamlimages/documents/articles/ID19_1119/esg_matters.pdf

[13] US SIF Report on US Sustainable, Responsible and Impact Investing Trends 2018

[14] Hale (2019). "Sustainable Investing Interest Translating Into Actual Investments," Morningstar. https://www.morningstar.com/articles/952254/sustainable-investing-interest-translating-into-actual-investments

How wealth managers are responding

"The No. 1 question I get from advisors is how to handle the coming generational wealth transfer," said ETF.com's Dave Nadig, "ESG has emerged as one of the dominant answers to that question."[15]

Wealth managers subscribe to MSCI ESG Research for various reasons. Through these relationships we have observed that wealth managers are building out ESG capabilities in five key areas in response to the growing demand for ESG investing options:

Screening on managed accounts

Wealth managers may offer negative screening through separately managed accounts (SMAs). Negative screening refers to the exclusion of stocks from a portfolio. We have observed a range of criteria being used to screen SMAs, including traditional socially repsonsible investing (SRI)screens like alcohol, tobacco, and weapons as well as faith-based screens for Catholic or Islamic investors. Business ethics screens including involvement in issues like child labor and animal testing have also been popular. In recent years, we have also seen screening on emerging issues like fossil fuel involvement, nuclear power, and for-profit-prisons.

With more ESG data on mutual funds and ETFs, we have also observed the growing use case for screening funds on criteria such as ESG quality or the directional movement of MSCI ESG Ratings, or momentum, of a company or fund..

Due diligence and manager research

In our experience, due diligence and manager research teams have been leveraging ESG data to better understand the ESG characteristics of managed products and funds. We see due diligence integrating ESG into fund research and selection to complement their efforts to understand manager capabilities and processes. ESG reporting and data may help align what managers say they are doing with ESG outcomes. For example, where a manager says they are building a portfolio designed to minimize exposure to climate change risk, due diligence and research teams may

[15] Dave Nadig, CEO of ETF.com, Quote in "MSCI ESG Fund Metrics Launches on Leading Market Data Platforms" https://www.msci.com/documents/10199/43bb7b79-f281-4727-b194-19b91460e1a0

leverage ESG reporting to measure the carbon footprint and performance on climate change risk management of a portfolio and compare it to a benchmark.

Portfolio construction and management

We observe that wealth managers are integrating ESG factors into portfolio construction and management. While some wealth managers convert a portion of their client's portfolio allocation to an ESG or impact strategy, increasingly we've seen wealth managers seek to build portfolios based on a strategy that is entirely ESG. A number of model ESG portfolios launched by wealth managers integrate ESG across the total portfolio, often in the form of a multi-manager model.

Reporting and transparency

We observe that retail investors are increasingly asking for more transparency on the ESG characteristics of their investments, wanting to "know what they own". Not only are individuals asking their wealth managers to consider ESG in their portfolio, they also want to understand the benefits of doing so. Reporting may provide wealth managers with the ESG data to respond to client queries and also to help point out things that may not be obvious or that are unknown to investors, e.g. "You have limited exposure to companies with significant environmental controversies compared to a benchmark". MSCI is increasingly supporting wealth managers who are providing transparency into the ESG characteristics of client portfolios, individual companies and funds.

Marketing and education

We observe wealth managers increasingly place emphasis on education and marketing to both internal and external stakeholders. Internal education on ESG may be fundamental to helping their advisors engage with the next generation of millennial investors. External education and marketing on ESG can be an opportunity to deepen client relationships, to increase client retention and to attract new assets.

At MSCI ESG Research we provide wealth managers with content and tools designed to support their education and marketing efforts, including introductory content to help investors learn about what ESG is and reporting capabilites that allow managers to market the ESG characteristics of their portoflios.

Highlights from the studies

USD 30 trillion

wealth transfer from baby boomers to 75 million millennials to take place over the next few decades.[16]

88%

of high-net worth millennials are actively reviewing the ESG impact of their investment holdings.[17]

89%

of millennials expect their financial professional to do a deep dive into a company's ESG factors and history with ESG issues before recommending an investment opportunity.[18]

2X

57%

of millennial investors have intentionally stopped investing or declined to invest in a company because of the impact that company's products or services have on people's health and well being.[19]

95%

of millennial investors were interested in sustainable investing as of 2019 up 9 percentage points from 2017.[20]

85%

of individual investors were interested in sustainable investing as of 2019 up 10 percentage points from 2017.[21]

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[16] Accenture. The "Greater" Wealth Transfer – Capitalizing on the Intergenerational Shift in Wealth, 2012: https://www.accenture.com/us-en/insight-capitalizing-intergenerational-shift-wealth-capital-markets-summary
[17] Bank of America. 2018 Insights on Wealth and Worth
[18] Allianz ESG Investor Sentiment Study 2019
[19] Allianz ESG Investor Sentiment Study 2019
[20] Morgan Stanley Institute for Sustainable Investing: Sustainable Signals -- The Individual Investor Perspective (2019)
[21] Morgan Stanley Institute for Sustainable Investing: Sustainable Signals -- The Individual Investor Perspective (2019)

The studies

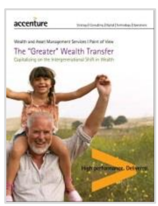
Below are 13 studies published about the growing demand for ESG investing options. From time to time we may publish updates to this article to reflect new information.

1 U.S. Trust: **Insights on Wealth and Worth**
2018

Source:
https://newsroom.bankofamerica.com/system/files/2018_US_Trust_Insights_on_Wealth_and_Worth_Overview.pdf

2 Morgan Stanley: **Sustainable Signals – Individual Investor Interest Driven by Impact, Conviction and Choice**
2019

Source:
https://www.morganstanley.com/pub/content/dam/msdotcom/infographics/sustainable-investing/Sustainable_Signals_Individual_Investor_White_Paper_Final.pdf



3 Accenture: **The "Greater" Wealth Transfer -- Capitalizing on the Intergenerational Shift in Wealth**
2012

Source:
https://www.accenture.com/t20160505t020205z__w__/us-en/_acnmedia/pdf-16/accenture-cm-awams-wealth-transfer-final-june2012-web-version.pdf

4 Bank of America Merrill Lynch: **ESG Matters – US 10 reasons you should care about ESG**
2019

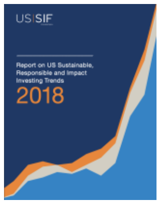
Source:
https://www.bofaml.com/content/dam/boamlimages/documents/articles/ID19_1119/esg_matters.pdf

5 Ernst & Young: **The Millennial Economy**
2018

Source:
https://www.ey.com/en_us/tax/the-millennial-economy-2018

6 Investments & Wealth Institute: **Sustainable Investing – The Millennial Investor**
2019

Source:
https://investmentsandwealth.org/getattachment/bbdef004-2fe8-4e71-a445-918a270b5ff7/IWM19MarApr-TheMillennialInvestor.pdf



7 US SIF Foundation: **Report on US Sustainable, Responsible and Impact Investing Trends**
2018

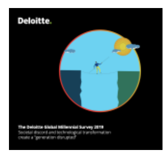
Source:
https://www.ussif.org/files/Trends/Trends%202018%20executive%20summary%20FINAL.pdf

8 Investopedia: **The Affluent Millennial Investing Survey**
2019

Source:
https://www.investopedia.com/the-investopedia-affluent-millennials-study-4769751

9 Morningstar: **Sustainable Investing Interest Translating Into Actual investments**
2019

Source:
https://www.morningstar.com/articles/952254/sustainable-investing-interest-translating-into-actual-investments



10 Deloitte: **The Deloitte Global Millennial Survey 2019**
2019

Source:
https://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/deloitte-2019-millennial-survey.pdf

11 Allianz: **ESG Investor Sentiment Study**
2019

Source:
https://www.allianzlife.com/-/media/files/allianz/pdfs/esg-white-paper.pdf

12 Bank of America Merrill Lynch: **ESG: Impact on Companies Doing Business in America and Why They Must Care**
2019

Source:
https://www.bofaml.com/content/dam/boamlimages/documents/articles/ID18_0725/esg_impact_on_businesses.pdf

13 Investments & Wealth Institute: **U.S. Sustainable, Responsible, and Impact Investing Trends**
2019

Source:
https://www.ussif.org/files/Article/IWM19JanFeb_US_SRITrends2018.pdf

Appendix: Defining ESG

Incorporating ESG considerations in the investment process has been referred to in many ways, including sustainable investing, socially responsible investing, mission-related investing and impact investing. MSCI groups the various names and practices into three common approaches that investors have used to achieve distinct ESG objectives: values-based investing, impact investing and ESG integration.

Values-based investing aims to align investments with an organization's or individual's ethical values by expressing preferences for what industries and companies they invest in. These preferences may take the form of values-driven exclusions, whereby these investors avoid companies involved in business activities that conflict with their ethical, religious, environmental, social or other values-based convictions. Values-driven exclusions are not implemented for financial reasons.

Impact investing targets investments to generate positive social or environmental impacts in line with the investor's views or mission. These strategies sometimes put the positive impact at par or ahead of financial returns and, therefore, may not seek to provide superior risk-adjusted returns.

ESG integration aims to assess long-term financial risks and opportunities related to ESG issues as a core component of building a resilient and sustainable portfolio for the specific purpose of enhancing long-term risk-adjusted returns.

Although these three approaches have distinct objectives, they are not mutually exclusive, and investors may blend elements of each approach.

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