J.D. POWER

Wealth Management Insight
September 2020

The Rapidly Evolving Implications of ESG in Wealth Management

From the onset, 2020 stood poised to be the year of environmental, social and governance (ESG) investing. Now, nine months in, with the fabric of the country having been tried and tested, this category stands to become a supernova, pulling virtually every facet of the economy into its path.

In January, BlackRock, the world's largest asset manager that oversees roughly $7 trillion in investments, announced that it would put ESG goals at the center of its investment strategy. The day of the announcement, the firm experienced its largest one-day inflow ever, with $1.5 billion in new investments pouring into one of its funds. The firm quickly followed the announcement by launching a new sustainability-focused ETF, which received more than $600 million in investment in its first week.

As a relatively tranquil winter gave way to the tumultuous spring, the trend persisted, even in the face of COVID-19. A Morningstar article spotlighted that "during the second quarter, sustainable fund flows in the U.S. continued at a record pace of $10.4 billion, bringing net inflows for the first half to $20.9 billion, compared with the $21.4 billion of net inflows for all of 2019."

By the summer, many firms large and small, multinational and local, were eager to join the discussion on social justice. And by early September, when wildfires left the skies over some Pacific Coast cities, a disconcerting share of orange, all facets of ESG had taken prominent space on center stage. As this awareness has permeated the minds of not only the collective public, but investors as well, the question remains how exactly this will play into their financial decision-making process?

J.D. Power has been exploring this issue for several years, taking the pulse of professional asset managers, advisors and individual investors as they make critical decisions about where to invest. The following Wealth Management Insight assembles the collective observations of various wealth management constituencies on the real role of ESG in the investment decision-making process.

Advisors Choose Asset Managers Based on ESG

The superstar investment team is dead. Long live the socially conscious asset manager. According to the J.D. Power 2019 Advisor Digital Engagement Study, which evaluates how financial advisors interact with asset management firms digitally and how that digital experience affects future intentions to invest client assets, ESG is the second-most important factor wealth managers consider when evaluating a prospective new asset manager, right behind "helps me do my job better" and ahead of "solid investment returns."

By contrast, that asset manager's reputation for having a "world-class investment team" is sixth on the list of most important considerations for wealth managers.

This is a big deal. In the current market environment, where wholesalers are disappearing, fees are being compressed and interactions are becoming increasingly digital, asset manager brand image and selection is being driven by perceptions of environmental and social awareness. Returns, of course, are still important, but it is clear that wealth managers are looking for something more for their clients.

Millennials Put Their Money Where Their Hearts Are

Younger wealth management clients appear to be factoring social issues into their investment decision making process. According to the J.D. Power 2020 Full-Service Investor Satisfaction Study, 56% of investors under age 35 rate their advisory firm a 9 or 10 (on a 10-point scale) on social causes. That compares with just 47% among those over age 40.

Overall, across the study sample, wealth management clients who scored their firm a 9 or 10 for social causes had average satisfaction scores of 922 (on a 1,000-point scale). This compares with an average satisfaction score of 739 for those who scored their firms at 6 or less. Additionally, 76% of clients scoring firms with a 9 or 10 on social causes say they "definitely will" recommend their investment firm to friends and family vs. just 32% among those scoring their firm as a 6 or less.

Millennials[1] are also much more likely to want to be directly involved in investment selection, even when they are working with a professional advisor, so they are bringing that social consciousness into the decision-making process. Nearly half (44%) of Millennials who currently work with a financial advisor describe themselves as "Validators," those who view the financial advisor as a sounding board for their ideas rather than someone they expect to manage investments on their behalf.

By contrast, just 19% of Boomers fall into this category, underscoring a significant shift taking place in how investment decisions are made. Millennial preferences may continue to change as their wealth and complexity of needs increases over time, but as the first generation of digital native investors, with always-on access to information on companies and investment research tools, they are unlikely to evolve in the same way Boomers have.

Beyond Lip Service – ESG Gets Real

For many years, ESG was little more than a novelty in the wealth management industry – a specialist category where things like socially-aware mutual funds and sustainability-focused ETFs would appeal to niche subsets of investors. That is no longer the case.

ESG has gone mainstream. While BlackRock's January manifesto was a potential tipping point the movement has been building for some time, as evidence by the perspectives of investors gathered over the last several months of J.D. Power syndicated studies. It is still early in the industry's evolution toward a more socially conscious approach to investing, but it's very possible we will look back at 2020 as the year that ESG moved from novelty to mainstream as noted in a recent CNBC Story in which 14 of 17 ESG-

[1] J.D. Power defines generational groups as Pre-Boomers (born before 1946); Boomers (1946-1964); Gen X (1965-1976); Gen Y (1977-1994); and Gen Z (1995-2004). Millennials (1982-1994) are a subset of Gen Y.

focused ETFs and funds outperformed the S&P 500 from Jan. 1 to May 15, according to S&P Global Market Intelligence.

For the financial firms at the center of this rapid shift in investor priorities, now is the time to move beyond simply paying lip service to ESG issues. Firms must find ways to more effectively "prove" their commitment and demonstrate to various stakeholders that this is an important topic to the organization. Key questions that leaders must ask include:

- Are you collecting and communicating the right ESG metrics?
- Are you delivering that information to the right individuals in the right way?
- Is the quality and accessibility of information adequate?
- What improvements are needed to achieve the transparency needed for firms to demonstrate they are truly walking the walk and well as talking the talk?

Methodology

This J.D. Power Wealth Management Insight is based on data collected in the J.D. Power 2019 Advisor Digital Engagement Study, the J.D. Power 2020 Full-Service Investor Satisfaction Study, and J.D. Power 2020 U.S. Self-Directed Investor Satisfaction Study. It includes feedback from more than 11,000 individual investors and asset managers.

Find out More

This J.D. Power Wealth Management Insight was authored by Mike Foy, director of Wealth Management Intelligence at J.D. Power. Please contact us at the numbers below to connect with Mr. Foy or to learn more about the underlying research.

Media Contacts:

Brian Jaklitsch; East Coast; 631-584-2200; brian.jaklitsch@jroderick.com
Geno Effler, J.D. Power; West Coast; 714-621-6224; media.relations@jdpa.com