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ARTICLE

ESG and millennials - putting their money where it matters

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The rise of ESG investing (Environmental, Social and Governance) is abundantly clear. The increase in demand is being driven by a change in investor's interests, including millennials. This demand is being met by a drive for increased regulation in the area (discussed in our briefing on https://maples.com/Knowledge-Centre/Industry-Updates/2020/06/European-Commissions-Published-Initiatives-on-Sustainable-Finance) which will bring about changes to organisational requirements, operating conditions and risk management bringing to the fore a focus on sustainability.

This article looks in further detail at (i) who can be defined as a millennial and what drives their investment decisions, (ii) what is ESG; and (iii) the growth of regulation in the area in ESG and how millennials are at the forefront of the increase for demand in ESG investing.

Millennials and what drives their investment decisions

Millennials can be defined as individuals born between the years 1981 to 1996[1]. Individual interests drive investment decisions leading to sustainable investments with the millennial generation believing their investment decisions will make an impact[2]. The mainstream adoption of sustainable investing reflects growing investor confidence that they can generate impact alongside financial returns[3].

Millennials are increasingly interested in investing in companies with good ESG records[4] and according to a recent survey millennials are twice as likely to invest in a stock or fund if social responsibility is part of the value creation thesis, with two thirds of millennials seeing their investment decisions as a way to reflect their social, political or environmental practices[5].

The chance to benefit from strong financial performance together with investing based on personal values and priorities is attractive to most investors, in particular millennials. According to a survey, 84% of millennials cite investing with a focus on ESG impact as a central goal[6]. Furthermore, millennials are achieving greater integration of their money and values by seeking personal fulfilment in their careers, applying a global consciousness to purchases and investing in sustainable impactful business models.

Studies show that millennials are set to receive more than $30 trillion in inheritable wealth, with which the demand for sustainable investments will proceed to increase[7]. This is leading to a shift in the profile of investors. Bank of America Merrill Lynch predicts that over the next two to three decades millennials could put between $15 trillion and $20 trillion into U.S. domiciled ESG investments[8]. Fund managers will therefore need to adapt and allocate resources to capture this group of investors.

Millennials are seeking to achieve greater integration of their finances with their values. Fund managers that will thrive in an era where millennials are at the forefront of investments are those that can meet the change in investor demands and remain flexible to enable investors align their investment decisions with their personal priorities. Investors are now not only focused on financial returns but also on nonfinancial outcomes. Fund managers that will succeed are those that are willing to seize the opportunity to focus on the ever increasing demand for value based investments and

ESG investing.

Millennials and a new type of investment fund

The trend towards plant-based diets common amongst millennials is also creating investment opportunities. An investment fund specifically designed for animal rights advocates and environmentalist, appealing to the millennial cohort, the first of its kind is trading on the New York Stock Exchange (NYSE). Displaying as VEGN as the ticker symbol for the exchange-traded fund, its full name Vegan Climate Exchange Traded ETF which excludes stocks that "rely on animal exploitation" instead selecting companies whose businesses do not test products on animals, or use animal derived products, fossil fuels, plastic or agrochemicals[9]. It also excludes companies tied to fossil fuel use and production, military and defence and human rights abuses according to its factsheet.

Holding such investments is a way to pressure companies to change their behaviour in order not to miss investors[10].

Technology is also driving ESG investing. Big data combined with algorithms has enabled analysis of the environmental, social and governance performance of companies on a scale that manual assessments cannot match[11]. Innovation in food technology is driving a new protein revolution as innovative plant based alternatives are being produced and investors are looking to capitalise on plant-based profits. Millennials have grown up in an age of digital change. When it comes to careers, dietary choices and where to purchase products, millennials are increasingly influenced by purpose and impact.

What is ESG?

ESG refers to a subset of non-financial performance indicators. "ESG investing" can be defined as the consideration of ESG factors alongside performance factors in the investment decision-making process[12]. The term "ESG investing" now includes a broad range of investment objectives and beliefs. It is a term that is often used synonymously with sustainable investing, socially responsible investing or mission-related investing.

ESG's three central factors comprise of[13]:

Environmental – criteria which examines a company's conservation of the natural world including factors such as climate change and carbon emissions, air and water pollution, biodiversity, deforestation, energy efficiency, waste management, water scarcity; **Social** – criteria which examines how company takes into consideration of people and relationships including factors such as customer satisfaction, data protection and privacy, gender and diversity, employee engagement, community relations, human rights and labour standards; and **Governance** – criteria which examines the standards in place for how a company is governed, including factors such as consideration of board composition, audit committee structure, bribery and corruption, executive compensation, political contributions and whistleblowing schemes.

Sustainable investing is the process of incorporating ESG factors into investment decisions. Sustainable investing allows individuals to make investment decisions based on values and personal priorities, with the purpose of producing a social and environmental result together with a return on investments[14].

Millennials are looking to companies and products that have an ESG focus when making investment decisions.

For further details on ESG factors in the investment process please see the Maples Group Guide to

Sustainable Investment Funds at maples.com/esg.

Millennials driving regulatory change

This surge in demand by millennials for sustainable investment opportunities has led to diverse approaches and inconsistent definitions of sustainability concepts and has led to a fear of "green washing" by investors and regulators alike.

The European Commission has alleviated fears of green washing through its response to the Paris Agreement[15] and the UN 2030 Agenda for Sustainable Development and the recommendations from the High-Level Expert Group on Sustainable Finance with its Action Plan on Financing Sustainable Growth (the Action Plan). The Action Plan will impose a number of regulatory requirements on investment managers in relation to their sustainable products and which in turn will ensure millennial investor demand is met with respect to investing in regulated sustainable products. The Action plan aims to (i) move capital towards sustainable investment in order to achieve sustainable growth and inclusion, (ii) maintain sustainability in risk management; and (iii) foster transparency and long-termism.

The European Commission's Action Plan includes[16]:
A. establishing a clear and detailed European Union (EU) classification system or “Taxonomy” for sustainable activities;
B. establishing EU labels for green financial products to help investors to easily identify products that comply with green or low-carbon criteria;
C. foster investments in sustainable projects by exploring measures to improve the efficiency and impact of instruments aiming at investment support;
D. incorporating sustainability when providing investment advice, including amending MiFID II and the Insurance Distribution Directive and introducing delegated acts to ensure that sustainability preferences are taken into account in the suitability assessment;
E. developing sustainability benchmarks, including developing climate benchmarks and ESG disclosures for benchmarks;
F. better integrating sustainability in ratings and research and exploring how credit rating agencies could more explicitly integrate sustainability in to their assessments;
G. introducing measures to clarify asset managers' and institutional investors' duties regarding sustainability;
H. incorporating sustainability in prudential requirement and exploring the feasibility of reflecting sustainability in prudential rules;
I. strengthening sustainability and accounting rule-making by enhancing climate and sustainability-related information provided by corporations; and
J. fostering sustainable corporate governance and attenuating short termism in capital markets.

As part of the Action Plan the European Commission has published a raft of legislation which includes:

The Disclosure Regulation[17] which seeks to impose additional disclosure requirements to investors with regard to sustainable related disclosures by financial market participants (such as AIFMS and UCITS management companies) and financial advisers (firms authorised under MiFID) in relation to financial products (e.g. AIFs and UCITS). The Disclosure Regulation, initiated on 10th March 2021 introduced additional requirements and common criteria for investors to determine what activities are environmentally sustainable and additional requirements for ESG products with certain characteristics to enable investors to identify the share of investments funding environmentally sustainable activities. The Disclosure Regulation is also supplemented by amendments to Level 2 legislation, in particular Commission Delegated Regulation (EU) 231/2013 supplementing AIFMD in order to incorporate sustainability risks. The European Supervisory Authorities have also published a joint consultation paper in respect of ESG disclosures which sets out the proposed regulatory technical standards to be

incorporated into a European Commission delegated regulation supplementing the Disclosure Regulation.

The Taxonomy Regulation which provides for a framework to classify environmentally sustainable economic activities. The Taxonomy Regulation establishes the conditions to create a unified classification system and sets out the criteria and factors to be taken into account for a product or activity to be deemed “environmentally sustainable”. The Taxonomy Regulation sets out a list of economic activities with performance criteria for their contribution to the six Environmental Objectives namely (i) climate change mitigation; (ii) climate change adaptation; (iii) sustainable use and protection of water and marine resources; (iv) transition to a circular economy; (v) pollution prevention and control and protection; and (vi) restoration of biodiversity and ecosystems (**the Environmental Objective**).

In order for an activity to qualify as being “environmentally sustainable”, it must substantially contribute to one of the Environmental Objectives, while also complying with each of the following criteria: (i) do no significant harm to any of the Environmental Objectives; (ii) comply with technical screening criteria; and (iii) meet minimum social and governance safeguards.

The Taxonomy Regulation applies to “financial market participants” when marketing financial products (including AIFs, UCITS, pension products or schemes and portfolio investments), individual EU member states and the EU with regard to existing or potentially new eco-labelling or other legislative measures and companies subject to the Non-Financial Reporting Directive[18]; and **The Low Carbon Benchmark Regulation**[19] which creates a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks that will provide investors with additional information on the carbon footprint of their investments. The Low Carbon Benchmark Regulation requires an explanation of ESG factors in the benchmark statement and an explanation of how ESG factors are reflected in a benchmark's methodology. The Low Carbon Benchmark Regulation amends the EU Benchmark Regulation[20] to provide for (i) ESG disclosures applicable to all benchmarks (with the exception of currency and interest rate benchmarks), (ii) Paris alignment disclosures applicable to all benchmarks; and (iii) the creation of the Paris-aligned benchmarks and climate transition benchmarks;

Further to the publication of the Action Plan, the European Commission has also announced a European Green Deal which sets out a roadmap for making the EU's economy sustainable and further moves sustainable objectives to the core of EU policy[21]. The European Green Deal proposes a Renewed Sustainable Finance Strategy to ensure that the EU's financial systems support the transition of businesses towards sustainability in a context of recovery. It will build on the Action Plan and focuses on three main areas namely (i) strengthening the foundations for sustainable finance by creating an enabling framework, with appropriate tools and structures, (ii) increasing opportunities for citizens, financial institutions and corporates to enhance sustainability; and (iii) reducing and managing climate and environmental risks while ensuring social risks are taken into account where relevant[22].

Regulators are emphasising the importance of compliance by firms and encouraging firms to be proactive in the area relating to ESG considerations. The proposals and legislation referred to above aim to incorporate ESG issues into governance standards that apply across the financial sector and have an impact on a number of EU financial services regulatory regimes, including MiFID II, AIFMD, the UCITS Directive and Insurance Distribution Directive. There are many other legislative proposals at various stages of the EU's legislative began to become effective from 2020 onwards and these also include the Corporate Non-Financial Reporting Directive, an EU Green Bond Standard, EU Ecolabel, Corporate Governance, Solvency II[23] and Credit Ratings.

The increase in legislation is an indication that ESG matters are growing in importance and reflects the demand for funds that have an ESG focus which has driven the need for greater regulation in the area, millennials being a core driver of such demand.

Next steps

It is likely that it is no longer companies that will just be fielding ESG-related disclosure requirements. Rather it is anticipated that investors, both asset owners and asset managers, will see escalating demands as regulators ramp up scrutiny beyond primarily issuers to focus on the business of ESG investing.

Notwithstanding the greater appetite for ESG investing by millennials, the demand for greater regulation in the area is now being driven by the European Commission, regulatory bodies and the financial services sector, the question is whether investors including millennials are prepared for such scrutiny[24].

Historically, investors generally have welcomed regulatory and quasi-regulatory measures that target issuers, as most of these regulations led to improved data disclosure and transparency on their portfolio companies[25]. The European Commission is proposing that investment advisers ask clients directly about their sustainability preferences, and take them into account when assessing the range of financial instruments to be recommended[26]. The reach to investors, including the millennial investor could be significant[27].

For further details on ESG investing, please see maples.com/esg

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