



WHITE PAPER

Navigating the Sustainability Challenge in Wealth Management

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By Peter Czerepak, Dean Frankle, Hans Montgomery, Bingbing Liu, Ella Rabener, Olivia Shipton, Harriet McPhail, Thomas Lloyd

The drive to achieve net-zero carbon emissions by 2050 and limit global warming to 1.5 degrees centigrade (2.7 degrees Fahrenheit) over pre-industrial levels is becoming a top priority for both the public and private sectors internationally. One of these channels is wealth management, through which customers can support sustainability by their investment behavior.

According to [a report](#) co-authored by BCG and the Global Financial Markets Association, as much as \$150 trillion may be needed globally through 2050 to achieve the targeted climate-change goals.

Wealth managers thus find themselves in the position of needing to identify, develop, and commercialize products that are compatible with or actively promote environmental themes, while also ensuring that such products have the potential to generate a level of return commensurate with traditional investments.

To be successful in this initiative, players need to be proactive in their approach to managing an ever-evolving regulatory environment, shifting client demands, a scarcity of data-driven metrics, and a rapidly growing need for sufficient internal expertise to knowledgeably and professionally advise clients on sustainability.

Amid much uncertainty, one certainty remains: wealth managers that make understanding and activating sustainable investing a top priority—and that offer a truly personalized customer experience—will put themselves in position to capture a once-in-a-generation opportunity.

Addressing the Regulatory Maze

A host of sustainability-related regulatory measures are becoming front and center on C-suite agendas. Moreover, these can vary by market and therefore add complexity to wealth managers' efforts to identify and develop compliant funds.

For example, the EU Sustainable Finance Disclosure Regulation (SFDR), aimed at providing a clearer window into the market for sustainable investment products and hindering greenwashing, mandates that financial services providers publicly reveal their processes for determining the sustainability-friendliness of various offerings. Related amendments to the Markets in Financial Instruments Directive (MiFID) II require wealth managers to query clients on their ESG (environmental, social, and governance) preferences and to comply with them.

Moreover, in November 2022, the European Parliament and Council of the European Union enacted the Corporate Sustainability Reporting Directive (CSRD), which mandates that large corporates make their environmental and social impact activities public on a regular basis in order to provide full transparency. In the United States, the Securities and Exchange Commission (SEC) has put forth guidelines requiring companies to provide details of their approach to ESG and sustainability.

What does all the attention from regulatory agencies really mean for wealth managers? First and foremost, it signals that ESG and sustainability issues are here to stay. These issues need to become a part of daily business operations and client interactions. If anything, compliance pressures will become more intense over the next 25 years as 2050 inexorably approaches and stakeholders hear the net-zero clock ticking louder and louder.

Second, wealth managers serve all types of clients—investors with highly diverse risk profiles, backgrounds, and investment tastes—including those not inclined toward ESG investing, which can create a tightrope of sorts for financial institutions (FIs) to walk. ESG backlash does exist, and is essentially about several claims: that eco-friendly investments have not proved they can deliver the same level of return as traditional investments; that focusing on ESG hinders portfolio diversification and raises risk by avoiding sectors perceived as high carbon-emitting (such as those related to fossil fuels or the defense industry); that there are no fully objective criteria regarding what makes an investment “sustainable” or not; and that greenwashing—misleading investors as to the climate-sensitive “greenness” of an investment offering—is rampant and difficult to weed out.

In our view, wealth managers need to take a thoughtful, data-driven approach with clients that clearly outlines the performance of sustainable-tagged funds versus those of non-green funds. They must also gather client data in an efficient manner, with questionnaires on sustainability preferences being short, easy-to-understand, and engaging. The key elements to sustainability-related client interactions are simplicity and transparency, with the wealth manager clearly describing its strategy and the rationale behind it. Being prepared to explore each client’s predispositions, and having the expertise and products to meet the demands of sustainability-focused investors, is of the essence.

The arena of sustainable investments clearly represents a huge opportunity for forward-thinking wealth managers. But how exactly can they capture it?

A Growing Opportunity for Wealth Managers

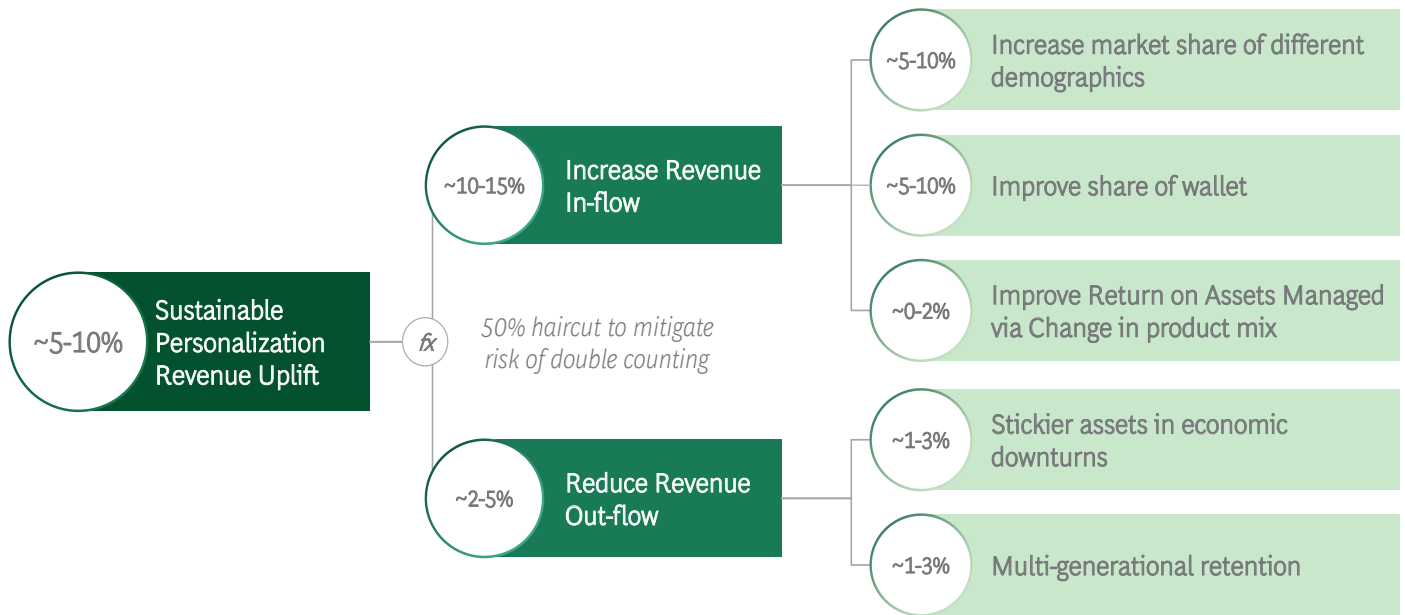
Demand for sustainable investing is high and growing—especially among younger generations. According to a 2022 survey carried out by Stanford Research, investors under 41 years of age want wealth managers to take an active stance on climate change and diversity. They also believe that investment advisors should take client views on environmental and social topics into account when making portfolio suggestions.

According to the survey, roughly a third of US Millennial and Gen Z investors say they are willing to sacrifice more than 10% of their wealth if that can help bring about environmental improvements. About 85% of the same demographics say they want fund managers to support environmental causes even if it lowers the value of their investments. About 70% of young investors say they’re very concerned about issues such as carbon emissions and renewable energy sourcing, and 82% want investment managers to use their size and voting power to influence the social policies and practices of the companies they recommend. According to [BCG’s 2022 Global Wealth Report](#), sustainable investing is growing at three to five times the pace of traditional investing. By 2026, this asset class is projected to account for 8% to 17% of privately invested wealth, up from 4% to 11% in 2021.

Moreover, with multi-generational wealth transfer projected to exceed \$80 trillion through 2045 in the US alone, wealth managers need to prepare to meet the financial goals of younger generations in order to avoid losing them to competitors. In this vein, personalization will become more critical than ever. Although any client with means sufficient to be engaged by the private banking sector would rightfully expect a certain degree of bespoke service, not all wealth managers do this well or utilize all the data available to them. They need to adopt a more data-driven approach that leads to highly-personalized, segment-of-one recommendations.

Personalization is already gaining recognition as a key driver of both revenue and client retention in wealth management, and understanding client values on sustainable investing is becoming a critical dimension to consider. We have estimated that properly capturing clients' sustainability preferences and integrating them into personalized client journeys could lead to a potential 5% to 10% revenue uplift. (See Exhibit 1).

Exhibit 1: Sustainable, Personalized Client Journeys Could Lead to a ~5-10% Revenue Uplift



Capturing the Sustainability Flag

A number of players have moved ahead forcefully, focusing on the type of client-data gathering and analysis that enables highly personalized recommendations and service. Some of these firms are seeing positive results in terms of assets under management (AuM) growth and improved client retention.

Moreover, analysis of the fintech space suggests that some fintechs are starting to realize the value and revenue potential of sustainable investing, and are moving fast to capture it. Most of these players are still focusing on the B2B space, forging solutions that enable incumbent wealth managers to create sustainable, personalized investment portfolios for their clients. In recent years, however, digital investment-advisor fintechs have seized the opportunity to capture a share of the growing number of sustainable investors directly, finding heavy backing from VCs.

Overall, in our view, there are five key sustainability areas that wealth managers should leverage to capture the considerable value that is at stake. (See Exhibit 2).

Exhibit 2: Wealth managers can use a digital solution to capture sustainability preferences and personalize client sustainability journeys



Identifying Client Sustainability Preferences



Visualizing Preferences in Proposals



Increasing Sustainability Personalization



Reporting and Data



Change management and Training

Identifying client preferences. Wealth managers first need to help clients understand what sustainability means for their portfolios. They should then design and implement a suitably granular, digital questionnaire to identify clients' sustainability preferences and embed it within the onboarding process. For existing clients, this can be on-demand or part of regular, ongoing reviews. To deliver impactful outcomes, concepts should be presented and explained in simple terms and the questionnaire should avoid being overly lengthy or complex.

The results of the questionnaire should be linked to internal sustainability classification of financial products, and the wealth manager should ensure that this classification is both well-documented and consistent with external marketing. Several fintech players are already active in this space, including the French startup Neuroprofiler, which aims to help financial advisors better assess the risk profiles of their clients for business and regulatory purposes, providing them with online, MiFID-compliant and gamified questionnaires based on behavioral finance. In the UK, Dynamic Planner helps enable advisory firms to match people with appropriate portfolios.

Visualizing preferences in proposals. Investors want to be able to visualize how their sustainability preferences are being met in their portfolios. Wealth managers should thus provide an interactive tool that allows clients to update their preferences and view a suggested asset allocation that meets them. The tool should also show projected performance results on return vs. risk, as well as gauge distance from financial goals. Few incumbent wealth managers have developed tools that enable such transparency, but several fintechs are moving in this direction. Clarity AI aims to provide wealth managers with a customizable, scalable sustainability tech kit, including APIs to visualize social and environmental impact and financial performance and AI powered recommendations to rebalance the portfolio to optimize impact and performance.

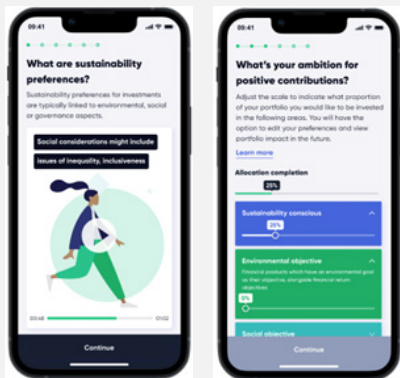
Increasing Sustainability Personalization. It can be said that wealth management essentially boils down to two core elements: sound investment advice and a trusted relationship. Highly personalized service based on insights from customer data is already becoming the standard in retail and digital banking, but wealth managers have traditionally relied on the experience and expertise of the relationship manager. These RMs cannot do

everything on their own, however, which is why wealth managers need to provide them with automatic prompts based on client profiles and behavioral analytics. Product recommendations should align with client sustainability preferences, as well as with financial goals and risk profiles. A further step is to develop the ability to send informational prompts directly to clients. Overall, the degree to which a client feels special, well-advised, and highly-valued—all a function of bespoke, customized, personalized service—determines the staying power of the relationship. For example, Arabesque AI has developed a platform that enables the wealth manager to customize financial and sustainability objectives before applying its portfolio optimization tool.

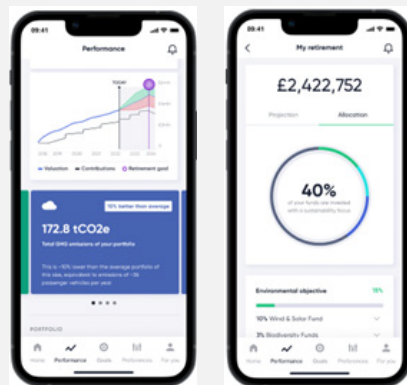
Linking these first three elements together can create a powerful platform that RMs can use to initiate value-based discussions with their clients and offer tailored recommendations. We have designed a solution to capture client preferences and personalize sustainability journeys, as illustrated below (See Exhibit 3).

Exhibit 3: Wealth managers can use a digital solution to capture sustainability preferences and personalize client sustainability journeys

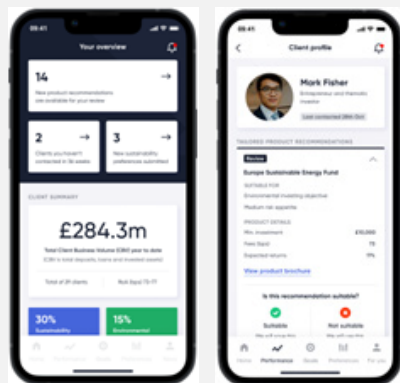
Client sustainability preferences questionnaire:



Portfolio visualization tool:



Sustainability personalization with targeted RM recommendations:



The final two elements—reporting and data, and change management and training—are vital to supporting the platform highlighted above.

Reporting and data. Wealth managers need to develop centralized data flows that include robust product-tagging systems. Such systems facilitate product recommendations based on clients' sustainability and risk profiles. Wealth managers also need to ensure that their data infrastructure enables tailored impact reporting that focuses on the financial and sustainability metrics that clients care about most, and that internal data systems support automatic reporting.

Indeed, continuous monitoring, management, and reporting on the sustainability of investment portfolios is a major pain point for wealth managers. Recognizing this, some fintechs have focused on the data and reporting side of sustainable investing. For example, FactSet ESG Investing Solutions aims to power ESG strategies with cutting-edge data, analytics, research, and expertise in all phases of the investment process. London-based Net Purpose offers investment-grade data on the social and environmental outcomes of companies and portfolios.

Change management and training. Wealth managers need to roll out mandatory sustainability training for all client-facing teams in order to ensure the level of core knowledge needed to support sophisticated client conversations. In particular, RMs need to be “activated” on sustainability-related offerings—meaning basic and recurring training not only on the key tenets of sustainable investing and on the range of investment vehicles appropriate for varying preferences and risk profiles, but also on all regulatory aspects of the sector. Sustainable investing needs to become as much a part of the RMs daily spectrum of activities as the basic principles of salesforce effectiveness and pricing discipline.

Wealth managers considered to be sustainable investing leaders are demonstrating several ways of ensuring that client-facing teams are well-equipped. These methods include: having a dedicated, specialized team that can be pulled into client conversations as needed, or leveraging embedded experts that rotate through teams; offering a sustainability, e-learning certificate for client-facing teams (developed with an academic partner), as well as varying the modality of training (such as to incorporate live role-play); and rolling out employee trainings to tackle sustainability-linked reputational risk and regulatory changes.

Actions Speak Louder Than Words

Succeeding at sustainable investing, with so many variables in play and so many pitfalls to avoid, can be a bit like navigating a minefield. But wealth managers that reach the safe side with their strategies intact and their capabilities well-honed will be competitively advantaged for the rising client demand that is sure to continue. In our view, there are ten imperatives that forward-looking wealth managers should act upon now to get themselves into position:

- **Make sustainability a firm-wide priority**, with ambitious top-down and interim targets.
- **Position sustainable investing as a default option**, and provide interactive tools for asset allocation that meet client sustainability preferences and risk limits.
- **Provide holistic offerings with alternatives**, in addition to off-the-shelf thematic funds (such as private-market, co-investment for ultra-high-net-worth clients).
- **Engage with industry groups**, such as GFANZ, and integrate sustainability into core brand positioning.

- **Establish firmwide policies with unambiguous stances** on exclusion (such as no investment in coal) and inclusion (such as determining what counts as “sustainable”).
- **Automate the matching of client preferences** to sustainability tags on products.
- **Establish a central data office** to support the automation of data flows through to client reports on portfolio performance and impact.
- **Measure and report transition and risk metrics** across client portfolios, and implement measures to prevent greenwashing.
- **Embed sustainability as a standing agenda item** at Executive Committee meetings and in core decision-making processes; also, form cross-functional working groups to drive change.
- **Provide mandatory training** to client-facing teams to ensure core sustainability knowledge, and supplement this with smaller specialized teams for client conversations.

To be sure, there’s no escaping the reality of climate change and the threat it poses to the planet. For this reason, sustainable investing will undoubtedly, albeit gradually, become a key element of the mainstream financial-services landscape. In our view, building core capabilities in this space—on data, investment solutions, and personalization—will be relevant for all incumbents. This is true even in markets, such as the US, where sustainable investing has become somewhat politicized and wealth managers are having to make strategic decisions on their brand positioning. Ultimately, wealth managers that make the effort to understand this tectonic shift in the investment terrain—and thoroughly prepare for it—will benefit their clients, the global net-zero community, and themselves.

About the Authors

Peter Czerepak is a managing director and senior partner in BCG's Boston office and leads the wealth and asset management practice globally. You may contact him by email at czerepak.peter@bcg.com

Dean Frankle is a managing director and partner in BCG's London office and leads the wealth and asset management practice in EMESA. You may contact him by email at frankle.dean@bcg.com.

Hans Montgomery is a managing director and partner in BCG's Chicago office, and leads the wealth management segment for North America. You may contact him by email at montgomery.hans@bcg.com.

Bingbing Liu is a managing director and partner in BCG's Shanghai office and leads the wealth and asset management practice in APAC. You may contact him by email at liu.bingbing@bcg.com.

Ella Rabener is a managing director and partner in the Berlin office of Boston Consulting Group. She is a core member of the corporate innovation and digital business-building arm of BCG. You may contact her by email at Rabener.Ella@bcg.com

Olivia Shipton is a partner in BCG's London office and a member of the leadership team for the wealth management segment. She also leads our efforts around sustainability and net-zero in wealth management. You may contact her by email at shipton.olivia@bcg.com

Harriet McPhail is a senior associate in BCG's London office and an active member of BCG's financial institutions and climate & sustainability practice areas. You may contact her at mcphail.harriet@bcg.com

Thomas Lloyd is a senior solution analyst in BCG X based in the London office, with a focus on the FinTech Control Tower. You may contact him at Lloyd.Thomas@bcg.com

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