Go Green or Go Home: Employees Want Their 401(K)S To Reflect ESG Goals

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Alena Koval from Pexels

Putting away retirement savings has been common practice for employees for decades, but where that investment goes and what it supports has often been a mystery. Today's employees, however, don't just want to secure their own future. They want to help save the world.

In 2020, a total of $2.3 trillion was invested in impact funds, which support companies, organizations and funds that aim to generate a measurable and positive social or environmental impact — along with a financial return. That's equivalent to just about 2% of all global assets under management, but the interest in these funds is gaining momentum, especially among the youngest and globally-minded generations in the workforce.

"We have a really clear theory of change," says Zach Stein, co-founder of Carbon Collective, an online investment advisory that prioritizes investing in sustainable businesses. "What is the world that we're trying to build and how do we get there through investing?"

Only 37% of 401(k) and 403(b) plan participants said they were offered ESG-related investment options — which prioritize environmental, social and governance goals — by their employer, according to the Schroders 2021 U.S. Retirement Survey. Of the employees for whom ESG-focused options were available, nine out of 10 chose to invest in them, the survey found, and 69% said they would or might increase their overall contribution rate if ESG options were offered.

"We've had a lot of people who have said, 'it's not my fault — I was born into a world run by fossil fuels. It's corporations' and governments' fault, they're the ones who caused all of this. I shouldn't have to do anything,'" Stein says. "[But] you can make change, and the ability and the magnitude is really extreme."

In fact, Stein explains, most of the social causes employees care about — climate change, gender equality, queer issues and gun control — can be supported through existing retirement funds and programs. But the average employee often has no idea, and may feel confused or misled by the wide-reaching term "ESG."

"ESG was built as an ethical risk evaluation tool," Stein says. "It was not intentionally used for values-based [impact investing] and it doesn't really deliver."

The kind of modern-day ESG investing that is going to change the world, Stein says, is called impact investing, and it's when the target date fund isn't just aiming to do no harm, but rather to actively fix a social, political or environmental issue. According to a recent survey by LRN, an ethics insights research company, 94% of employees said it was "critical" or "important" that the company they work for is ethical.

"We're seeing a whole shift in power," says Andrew Behar, CEO of As You Sow, a California-based non-profit that advocates for more transparency and sustainability in retirement investments. "And it's going to shift the entire nature of capitalism and allow an economy based on justice and sustainability to emerge, because that's what people want."

For years, employees have trusted their companies and large custodians like Vanguard and Blackrock to invest their 401(k)s for them. But as the concept of sustainable investing becomes more popular, employees are realizing that the default investment options offered by most companies are potentially putting their money into funds that support deforestation and mass incarceration.

"They're becoming aware," Behar says. "And the structure of the corporations, the structure of the boards, and the priorities of the boards will shift, because people on the board are going to see that without a climate plan, without a path toward racial justice, they will be removed. They will be replaced."

But the question remains: once employees have identified the problem, will they be able to find the resources to fix it? Brian Haney, certified fund specialist and the founder of insurance agency The Haney Company, is working to make sure that they can.

"I encourage clients to think about what kind of vision and mission they want for their money," he says. "One question I have started asking clients is, 'Are you funding what you're fighting? Can supporting companies that operate by certain values not only be good for our conscience, but for our portfolio as well?'"

Despite industries' hesitance to incorporate sustainable options due to the fear of low performance, the return data has actually shown the opposite. Roughly 90% of studies find a non-negative relationship between ESG funds and financial planning, according to the Journal of Sustainable Finance of Investment. In fact, the majority of studies see a positive trend.

“Studies of longer-term historical performance suggest that ESG strategies have performed similarly to comparable traditional investments on an absolute basis and a risk-adjusted basis,” Haney says. “And several have outperformed.”

Companies like As You Sow and Carbon Collective — which offer employees a corporate 401(k) sustainability scorecard and provide employees with sustainable plan options, respectively — can help on the path forward, but the grunt work starts in the office. Change will start if enough employees come together and question their retirement plans, bringing those questions to HR and demanding change in their own ecosystem.

“The world only changes when enough individuals decide to change it,” Stein says. “The world won’t change until enough people can imagine what a changed world looks like — where you can taste it and smell it and hold onto it.”