

November/December 2022

Sustainable Investing

A TRUSTEE'S FRIEND OR FOE?

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Estate Planning Feature Impact Investing/ESG Investments
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People are seeking purpose and meaning from many activities that once were purely transactional. Many are focused on making their careers more fulfilling.¹ Sustainably sourced materials and fair labor practices are driving consumer demand.² The term "sustainable" is being used to describe everything from fossil fuel alternatives to bamboo toothbrushes. Yet, when it is paired with "investing," it continues to perplex fiduciaries, grantors, and beneficiaries alike. This dual-purpose investing—to produce both a competitive return and a positive outcome as evaluated by environmental, social, and governance (ESG) criteria—is testing our traditional application of fiduciaries' duties and investment models. In this article, we will explain how sustainable investing's dual purpose may be consistent with fiduciary duties but also uniquely suited to satisfying the basic psychological needs of our beneficiaries by driving better engagement both within and among generations.

As wealth planning advisors, we always have given our clients expert technical advice. But today they are asking us to help them meet broader goals of enabling their family members to live purposeful and meaningful lives and help foster family unity. We often are trained in the fields of finance, investments, or law. We likely entered the field because of an intrinsic interest, priming us to believe others also will find these topics engaging. However, our clients have a wide range of interests and talents that often do not center around finance. This is why as advisors we might struggle to engage clients whose talents and interests lie outside the technical world of investing. We believe that sustainable investing,

combined with another rising trend—family values statements—may help us to create more-engaging relationships with our clients by satisfying both their technical and emotional needs. The purpose of a family values statement is to create consensus around shared values and project those values into a vision of collective future success. Where there is client demand for sustainable investing, a family values statement can provide a framework that inspires a healthy dialogue among family members.

Although recent concerns over a global recession, inflationary pressures, and rising interest rates have tempered inflows,³ the Global Sustainable Investment Alliance reports that sustainable investments make up approximately \$35.3 trillion in global assets representing 35.9 percent of total global assets under management (see tables 1 and 2).⁴ New sustainable funds continue to launch at an impressive rate offering more options to interested investors (see figure 1).

Table 1

SNAPSHOT OF GLOBAL SUSTAINABLE INVESTING ASSETS, 2016–2018–2020 (USD BILLIONS)

Global sustainable investment at \$35.3 trillion

Region	2016	2018	2020
Europe*	12,040	14,075	12,017
United States	8,723	11,995	17,081
Canada	1,086	1,699	2,423
Australasia*	516	734	906
Japan	474	2,180	2,874
Total (USD billions)	22,839	30,683	35,301

Note: Asset values are expressed in billions of U.S. dollars. Assets for 2016 were reported as of December 31, 2015, for all regions except Japan, which reported as of March 31, 2016. Assets for 2018 were reported as of December 31, 2017, for all regions except Japan, which reported as of March 31, 2018. Assets for 2020 were reported as of December 31, 2019, for all regions except Japan, which reported as of March 31, 2020. Conversions from local currencies to U.S. dollars were at the exchange rates prevailing at the date of reporting. In 2020, Europe includes Austria, Belgium, Bulgaria, Denmark, France, Germany, Greece, Italy, Spain, Netherlands, Poland, Portugal, Slovenia, Sweden, United Kingdom, Norway, Switzerland, and Liechtenstein.

**Europe and Australasia have enacted significant changes in the way sustainable investment is defined in these regions, so direct comparisons between regions and with previous versions of this report are not easily made.*

Source: Global Sustainable Investment Alliance

Table 2

SNAPSHOT OF GLOBAL ASSETS UNDER MANAGEMENT, 2016–2018–2020 (USD BILLIONS)

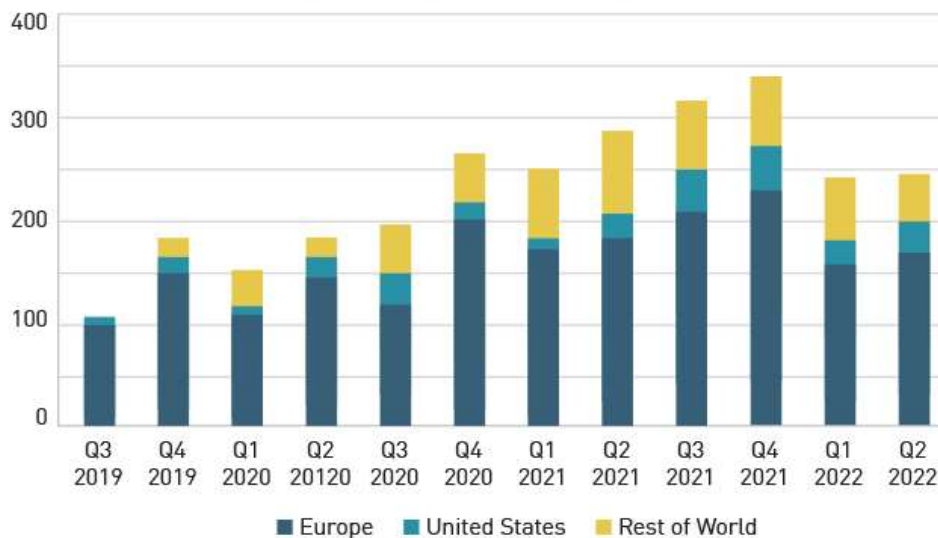
Regions	2016	2018	2020
Total AUM of regions	81,948	91,828	98,416
Total sustainable investments only AUM	22,872	30,683	35,301
% sustainable investments	27.9%	33.4%	35.9%
Increase of % sustainable investments (compared to prior period)		5.5%	2.5%

35.9% of total assets under management are sustainable investments

Note: Asset values are expressed in billions of U.S. dollars. Global assets are based on data reported by Europe, United States, Canada, Australia, New Zealand, and Japan for the purpose of the 2016, 2018, and 2020 GSIRs.

Figure 1

GLOBAL SUSTAINABLE FUND LAUNCHES PER QUARTER



Source: Morningstar Direct, Morningstar Research Data as of June 30, 2022

MIND THE FIDUCIARY GAP

This growing demand seems poised to transform the investment landscape. One significant group of investors, however, remains largely on the sidelines: trustees of personal trusts. A recent *Wall Street Journal/Barron's* Intelligence Group investor survey of 200 high-net-worth investors, sponsored by Northern Trust, showed that 81 percent of all respondents expressed interest in ESG investing. Curiously, the level of interest in ESG investing was higher among trust participants, including grantors (87 percent), beneficiaries (88 percent), and trustees (89 percent). Yet, when it comes to acting on these preferences, only 23 percent of respondents reported making investment decisions based on ESG criteria. ⁵

Why is there a gap between interest and execution for trust participants?

Commonly held interpretations of fiduciary duties and traditional trustee tools present hurdles to implementing sustainable investing for many trustees. We propose that a family values statement may help us to fulfill our fiduciary duties while engaging our clients and building intrinsic motivation among family members toward a common goal. Sustainable investing may be the missing link to addressing our clients' goals of family unity.

SOLVING FOR ULTIMATE LONGEVITY: MULTI-GENERATIONAL PLANNING

Although the term longevity often is used to describe a person's lifespan, its meaning in wealth planning is a little different. Family members have individual lifespans, but families persist through generations. In the context of wealth planning, "longevity" often is used to describe a trust or other vehicle with a long time horizon that potentially could impact multiple generations.

A "wealth creator" is someone who has amassed wealth in excess of their lifetime spending needs. This excess financial wealth often is used to fund estate-planning vehicles that economically impact future generations, many of whom the wealth creator will never meet. Multigenerational planning, however, is challenging for humans because it is at odds with our evolutionary development. From a psychological perspective, it is hard for humans to conceive of these extremely long time periods; we have a tough enough time trying to accurately assess how we will feel mere days from now (Pilin 2021), let alone making multigenerational predictions. Still, several trust jurisdictions—both in the United States and around the world—have statutes allowing trusts to exist well beyond any imaginable lifetime, and some can exist perpetually. These statutes afford tax and liability benefits to grantors who create longstanding irrevocable (i.e., cannot be changed) trusts. In return for these benefits, the grantor must relinquish control of the assets and commit to trust terms today that will guide the trustee over this extended period of time.

Case study: One client specifically designed his trust to last 600 years. Trying to predict the multitude of possible scenarios and potential beneficiary needs that might arise over such a long time is mind-boggling. As a point of reference, William Shakespeare died in 1616—more than 400 years ago. If Shakespeare had created an irrevocable trust during his lifetime, it would still be valid today in more than 20 U.S. jurisdictions. ⁶ Can you imagine what the terms of his trust might have been and how relevant they would be today?

SELF-DETERMINATION THEORY AND SUSTAINABLE INVESTING

Towle (2022) addresses four myths associated with ESG investing. One of these myths is that ESG factors are "feel-good" factors, not drivers of return. Towle offers a substantive argument about how ESG factors may contribute to returns,

but the myth's larger premise suggests that it is inherently wrong to obtain psychological gratification from making an investment. We will examine how this gratification may be valued by our clients who are interested in sustainable investing by triggering "intrinsic motivation," or the desire to achieve a goal because one wants to rather than out of obligation.

Decades of research using self-determination theory (SDT) has identified three basic psychological needs that humans of all continents and income brackets share (Ryan and Deci 2019). These needs are relatedness (the need for meaningful social relationships), autonomy (the need to own one's actions), and competence (the need to make a meaningful impact with one's skillset). Fulfilling all three needs leads to the emergence of intrinsic motivation, or the pursuit of a goal for internal reasons—pursuing a goal because one wants to do so.

The SDT framework further suggests that most types of goals humans pursue could be categorized broadly as being either intrinsic or extrinsic (Niemi et al. 2009). Whereas intrinsic goals reflect internal pursuits—related to the three basic needs—such as personal growth, the promotion of social connections, and the maintenance of physical well-being, extrinsic goals aim to achieve some kind of external reward, such as financial wealth or positive evaluation by another person (e.g., status or fame). Because intrinsic goals are inherently centered around basic needs, pursuing these types of goals is more closely connected to well-being than is the pursuit of extrinsic goals (Niemi et al. 2009).

Indeed, fulfilling the needs of relatedness, autonomy, and competence can lead to myriad beneficial outcomes. For example, in a recent large-scale investigation of more than 48,500 European residents, Martela et al. (2022) found that the fulfillment of all three needs was associated with increased happiness, life satisfaction, and meaning. They also predicted decreased depressive symptoms above and beyond other explanatory variables such as socioeconomic status. In other words, people lead happier, more fulfilling lives when they have significant relationships, feel that they have control over their actions, and believe they can make an impact. These people pursue goals that are more likely to be met as they are guided by intrinsic rather than by extrinsic interests (Vansteenkiste et al. 2010).

Here, we propose that sustainable investing's unique attribute—the positive outcome goal—may allow advisors to meet all three basic psychological needs of a beneficiary by encouraging intrinsic motivation and enhanced well-being.

RELATEDNESS

Family harmony is not created in a vacuum. It requires family members to interrelate and create shared meaning among them. For most, relationships with family members are the first relationships that one forms. Thus, the family unit serves as an important ingredient of developing an individual's sense of meaning and values.

Multigenerational trusts are designed to accommodate multiple concurrent beneficiaries with a wide range of ages, talents, and interests. By integrating both quantitative (investment performance) and qualitative (personally meaningful) factors, sustainable investing provides a unique framework for trust beneficiaries to have open conversations that can help them get to know, respect, and build trust among their peers. Importantly, creating shared meaning across a group weaves the fabric of their own shared reality (Rossignac-Milon and Higgins 2018). This process of sharing more about yourself with others has been proven to bring people closer together and strengthen bonds, and it may contribute to long-term family unity (Sprecher and Treger 2015).

AUTONOMY

Sustainable investing's goal of a positive outcome broadens the investing dialogue from a purely analytical debate to one that has the potential to engage a broader subset of our clients because it allows us to engage their principles and passions. By starting the dialogue, we offer clients the opportunity to opine on their own values, to disclose more about themselves, and feel more connected to the investment process.

COMPETENCE

Just like a financial advisor may struggle to confidently discuss an unfamiliar issue, beneficiaries of a trust may be challenged to stay engaged if finance is not their forte. There are no learning models that support learning a new skill through avoidance. Drawing our disengaged clients into the dialogue is critical to us maintaining the relationship and for them to obtain competence in investing.

Although investment professionals make up only a narrow slice of society, individual clients are experts in their own lives. With the added element of personal meaning that sustainable objectives bring to the conversation, beneficiaries may be able to make personal connections with the investment plan, allowing themselves to be drawn in and thus building their competence. Fostering these interests engages clients in the conversation and nurtures the intrinsic motivation that drives them to want to be active participants.

In sum, SDT offers useful insights into what drives meaning and goal pursuit, and why specific goals impact each of us differently. Humans find meaning from social relationships, having the ability to make their own choices, and having an opportunity to make an impactful difference with their unique skillsets (Martela et al. 2022). Likewise, meaningful intrinsic goal pursuit benefits one's wellbeing (Niemi et al. 2009). Thus, incorporating meaning into investing by considering sustainable goals has the potential to bring beneficiaries closer together and create unity among them.

THE TRUSTEE DILEMMAS

Modern trust laws in a growing number of states permit trustees to consider sustainable investing factors, but common misperceptions still leave many trustees presuming that sustainable investing is inconsistent with their fiduciary duties (Ditelberg 2021). Grantors drafting trusts today can add provisions specifically permitting sustainable investing. Many of the trusts currently being administered, however, were drafted long ago and lack this specific language. If the trusts are governed by a jurisdiction that has adopted ESG factors into their statutory provisions, trustees have the authority to consider these factors. If not, the path to sustainable investing requires a careful analysis of the fiduciary duties themselves in the context of the trusts' purpose.

When considering sustainable investing in trusts, three fiduciary duties cause concern: the duties of prudence, loyalty, and impartiality. We discuss each of these three duties in more detail below, examining the fiduciary dilemma inherent in each, offering potential solutions for each, and showing how sustainable investing may contribute to building connectivity among and across

generations or beneficiaries.

DUTY OF PRUDENCE

Trustees are required to invest trust assets prudently. Trust assets must be both individually suitable and collectively appropriate. The statutory guidance, however, is intended to be flexible and adaptive rather than overly prescriptive. It thus requires carefully documented due diligence in the investment selection process and ongoing monitoring, taking into consideration performance, risk-return characteristics, and fees.⁷ When looking at the portfolio as a whole, no single factor, ESG or non-ESG, will ensure or deny that a specific asset is prudent (Schanzenbach and Sitkoff 2020). All trust portfolios, sustainable or traditional, must meet the prudent standard.

Fiduciary dilemma: Trustees and their advisors historically have been concerned that sustainable investments suffer from inferior performance relative to traditional investment strategies, rendering them imprudent.

Potential resolution: Although prudent principles remain steadfast, sustainable investing strategies and the investable universe have changed immensely in recent years. Today's sustainable active management has eclipsed its exclusionary ancestor (i.e., excluding particular investments from one's portfolio) and is focused on proactively selecting companies expected to produce increased long-term marketable advantages through reputational goodwill or reduced regulatory burdens.⁸

Assuming the universe of prudent investments includes sustainable options based on risk and performance metrics, the secondary purpose of creating a positive outcome may allow trustees to solve another issue with which they often struggle: beneficiary engagement.

As advisors, we have been taught that investment decisions are to be made in a quantitative vacuum, devoid of all human emotions. After all, there are no qualitative factors in an efficient frontier optimization analysis, and there are no inputs for emotional attachment to an asset in a Monte Carlo simulation. Any emotional driver is treated as an inconvenient variable that does not fit into these purely quantitative equations. Unfortunately, research shows that emotions and decision-making are inseparable (Lerner et al. 2015). Many of us have

experienced clients who have declined our well-prepared advice based on an emotional reason.

Because the analysis of sustainable objectives includes both financial and non-financial key indicators, it may allow us to engage with a broader client base and provide an outlet for clients' emotions. Discussing environmental issues or employment practices may spark our clients' interest and drive engagement with the investment process. Also, incorporating factors that are meaningful to our clients makes the portfolio more personally relevant to them by reflecting their interests and passions.

Case study: During a quarterly performance review, I realized my trust beneficiary, "Joe," was not engaged. Glancing over, I saw that he was carefully considering a chart that inadvertently had been placed upside down in the manager's thick presentation booklet. The investment manager was cheerfully explaining the chart and Joe was nodding intently, but I knew he was completely lost. When I quietly invited him to turn the chart right side up, he smiled awkwardly, shrugging as if to say it really didn't matter because he was not interested in it anyway.

A successful businessman, Joe had the capability to understand the chart; he just didn't have the desire. Both his parents and grandparents had created a cadence of quarterly investment meetings to manage their wealth. He was there out of a sense of responsibility and tradition, not genuine interest in how his trust was performing. In other words, Joe was at the meeting because he felt obligated to be there, not because he wanted to be there.

Joe was, however, passionate about the outdoors. He was a skier, hiker, whitewater rafter, and fly fisherman. He lit up when we discussed environmental issues. He was concerned about the changing weather patterns that were evident in his shortened ski season. He would become passionate when discussing the depleted supply of fish in the rivers that were subject to water contamination. What if that performance report had included data on how his portfolio was aligned with reducing global warming that was impacting his ski season? What if the manager had been able to link the dialogue to companies that were actively trying to restore water quality at his favorite fly-fishing location? Maybe we could

have tapped into Joe's intrinsic motivation and had a more engaged beneficiary.

Perhaps sustainable investing, where there is beneficiary demand, could provide the missing link to connect our beneficiaries' interests with their investment portfolios, allowing us to build more meaningful relationships as we adhere to the duty of prudence.

DUTY OF LOYALTY

When managing trust assets, trustees must put the beneficiary's interest before their own and act in the sole interest of the beneficiary.

Fiduciary dilemma: The sustainability dilemma with the duty of loyalty is twofold. First, trustees must put the beneficiaries' interest before their own. They must overcome any presumption that the sustainable objective reflects the trustee's self-interest. Second, as previously stated, a sustainable investment is intended to produce both a competitive return and a positive outcome. The positive outcome represents sweeping objectives with impacts that cannot be limited to the specific trust beneficiaries. You cannot have cleaner air for only the fifth generation of the Doe family, or clean water exclusively for the third and fourth generations of the Blackacre family. The broad positive outcomes cause some professionals to believe they create an impermissible benefit to non-beneficiaries and, by definition, are not in the sole interest of the trust beneficiaries.

Potential resolution: In order to satisfy the duty of loyalty, the trustee would need to first show that the motive for sustainable investing is coming from the beneficiaries themselves and does not represent the trustee's own sustainable goals or agenda. A consensus family values statement can be used to document a group of beneficiaries' sustainable investment objectives. Signed by all beneficiaries eligible to receive distributions, it demonstrates that the trustee is representing the beneficiaries' interests. Next, the trustee must demonstrate that incorporation of the sustainable objective is in the interest of the beneficiary. Decades of psychological research, informed by theories such as SDT, teach us that the pursuit of intrinsic goals leads to positive psychological outcomes. By listening and incorporating beneficiaries' goals for their investments, trustees help align extrinsic pursuits with intrinsic interests, maximizing financial returns

helping examine persons with multiple interests, maximizing material returns and beneficiaries' well-being (Niemiec et al. 2009; Ryan and Deci 2019).

DUTY OF IMPARTIALITY

An extension of the duty of loyalty, the duty of impartiality requires the trustee to be concurrently loyal to all trust beneficiaries. Impartiality applies to both current and future beneficiaries, even those unborn.

Fiduciary dilemma: Trustees of longterm trusts must balance the oftencompeting priorities of multiple beneficiaries and simultaneously representing all their interests when managing trust assets. In other words, trustees of long-term trusts have the unenviable task of making decisions today that will impact future generations of beneficiaries, most of whom they will never meet.

Potential resolutions: A common trustee concern is that one could not possibly predict future beneficiaries' values and, in turn, their sustainable investment objectives. When examining all decisions a trustee must make in administering a long-term trust, however, sustainable objectives are not as big an outlier as they first may seem. Trustees routinely make investment selection and portfolio construction decisions for a long-term trust, taking into consideration the current beneficiaries' tax status, income requirements, and collective principal distributions. This is all done within the context of reasonable projections for the future beneficiaries' needs, and with the understanding that adjustments to the portfolio can be made over time. Trustees can't possibly anticipate the future beneficiaries' tax status or distribution needs, but, even with the lack of information, they can make reasonable assumptions and create a balanced portfolio designed to benefit both the current and future beneficiaries.

We can apply the same process to incorporating sustainable investing goals into a trust. Trustees can integrate the current beneficiaries' sustainable objectives, staying within the acceptable range of prudent investing as measured by traditional risk and return characteristics. Perhaps there will be a day when balancing multigenerational beneficiaries' sustainable investing goals will be as commonplace as striking a balance between growth versus value, reinvesting versus income distribution, or allocating an expense between principal and income.

FIDUCIARY TOOLS: FIT FOR PURPOSE?

Trustees are caught in juxtaposition between the drastically increased time horizon that long-term trusts afford and the ever-increasing speed of change in the modern world. When challenged with a new decision, a trustee can look to a broad base of fiduciary law for answers, i.e., a mosaic of legal precedence, statutory law, and legal treatises. However, if a trustee is presented with a case of first impression, such as sustainable investing, historic sources may not offer clear guidance. Various fact patterns and the constantly changing economic landscape often set off a series of events that ultimately provide trustees with reliable statutory guidance or court precedence, but typically there is a long period of time building up to this legal clarity during which trustees are left to make judgments based on their experience and guidance from their counsel.

If trustees want to act on beneficiaries' requests to implement sustainable investment objectives before the courts or legislatures set enforceable precedence, precious few tools are at a trustee's disposal to provide comfort.

Non-judicial settlement agreements (NJSAs), beneficiary consents, and court orders all can bind current beneficiaries—and, in the right fact patterns, future beneficiaries. Although these tools have the benefit of giving the trustee clarity on the issue at hand, they are cumbersome in practice because they often presuppose a breach of trust and have specific representation rules based on traditional family structures. Another major downside to these traditional tools is that they inherently have a time horizon mismatch for long-term trusts. Each of these options uses a static perspective at a specific point to create a ruling that intentionally binds future beneficiaries for the nearly perpetual time horizon afforded to dynasty trusts today.

Unlike NJSAs, beneficiary consents, or court orders, a family values statement is developed and updated through a dynamic process that reflects a consensus of the current beneficiaries' sustainable objectives and allows for future beneficiaries to contribute to incremental course corrections. Because of their ability to be adapted over time, family values statements are a good fit for the long-term time horizon of a multigenerational trust. The process by which the

statement is formed is just as important as the statement itself. By engaging a group of beneficiaries in a meaningful dialogue, a trustee can access the three main components to generate intrinsic motivation.

An engaged trustee can use the non-binding consensus statement to inform the investment process, ultimately owning the final decision and choosing assets within prudent investing parameters.

EXAMPLE FAMILY VALUES STATEMENT

Our family believes that everyone has a right to clean air and water. As such, we're committed to climate-aware investments that seek to promote more ecological practices around the globe. We therefore ask that our investment team use ESG factors in their due diligence, asset selection, and monitoring processes to identify investments making a positive environmental impact. As a family, we are committed to reassessing this statement periodically to ensure its continued relevance.

THE SUSTAINABLE OPPORTUNITY: EMBRACING THE WHOLE

Families are seeking more purpose and meaning from their wealth. Because sustainable investing integrates goals that are both intrinsic (personally meaningful positive outcomes) and extrinsic (financial returns), it may be the missing link to bringing more meaning to the investment dialogue and creating a framework that engages across multiple generations of a trust. By helping beneficiaries express their values through sustainable investing and family values statements, trustees may be able to fulfill their fiduciary duties and enable their beneficiaries to build an enduring family culture that satisfies the clients' needs for both financial security and family harmony (Wesley and Robles 2015).

Case study: We recently met with a group of estate-planning attorneys in Florida. When polled, they did not have any ESG investments, but they had heard rumblings and came together to discuss so they could be prepared when the topic arose. As I described our process of leveraging family values statements to help families find common ground, build open and repeatable communication patterns, and develop shared objectives, there was an audible gasp in the room. I paused and asked the attorney who gasped if something had resonated with her. She was the firm's leading fiduciary litigation attorney. She responded slowly, explaining she was going through a mental checklist of all her current and past

explaining she was going through a mental checklist of all her current and past clients and could think of none who had any of these characteristics.

Perhaps integrating the findings of behavioral sciences into our wealth management practices could help our families build healthy communication patterns and family cultures that prove to be a risk mitigator as well.

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CONTINUING EDUCATION

To take the CE quiz online, go to www.investmentsandwealth.org/IWMquiz

ENDNOTES

1. See Casabona (2021), O'Boyle (2021), O'Connell (2019), and A. Schragger (2022).
2. IBM Institute for Business Value. 2022. Balancing Sustainability and Profitability: How Business Can Protect People, Planet, and the Bottom Line, <https://www.ibm.com/downloads/cas/5NGR8ZW2>.
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6. American College of Trust and Estate Counsel, https://www.actec.org/assets/1/6/Zaritsky_RAP_Survey.pdf?hssc=1.
7. Legal Information Institute at the Cornell Law School, https://www.law.cornell.edu/wex/fiduciary_duty#.
8. The May/June 2022 edition of the *Investments & Wealth Monitor* has many articles exploring potential benefits of incorporating ESG factors into a portfolio. These potential benefits include identifying companies with lower cost of capital, greater employee satisfaction, and reduced bankruptcy risk, among other material factors. <https://investmentsandwealth.org/publications/investments-and-wealth-monitor/2022/may-jun-sustainability-investing>.