

Call for Evidence on sustainability in suitability and product governance

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Q4: What is the main way firms currently provide information to retail clients about sustainable finance? For example:

- **Orally during the meetings with clients**
- **Through educational brochures or other (paper) documents**
- **Through dedicated website and apps**
- **A combination of the above**
- **Other**

In your opinion, are these approaches effective? Please provide details. Are retail clients satisfied with the quality of information provided?

An increase in sustainable finance competence should base on tailored, individual, sustainability-oriented profiles from financial consultant and retail investor perspective by certain cluster. The great importance of good advice from the intermediary industry becomes clear when you look at the number of contracts that are managed by German insurance companies, pensions, and pension funds, for example: At 86 million, that is more contracts than Germany has inhabitants. Looking at the typical relationship between financial intermediaries and private investors, three aspects indicate that the advisory process, which is important for private investors, often does not appear to be tailored to their advisory needs. First, the "the reign of confusion and trust". Retail investors are far away from telling their exact preferences and objectives spontaneously in financial

consulting ¹. Several factors could cause this. It starts with the lack of knowledge of one's own preferences and ends with the lack of trust in financial intermediaries ². In a UK study 44% of retail investors were less likely to invest sustainably because of the lack of trust in financial intermediaries ³.

Second, retail investors interact with financial intermediaries with information asymmetry according to the principal-agent-problem ⁴. The principal-agent-problem means, that consultants and asset manager own a better information setup compared to retail investors. This can lead to short term investment goals⁵ and advices to undiversified and expensive funds ⁶. Even with a standardized classification systems like the EU Taxonomy the information gap will not close fully to avoid any exploit or greenwashing⁷.

¹ 2° Investing Initiative, 'A Large Majority of Retail Clients Want to Invest Sustainably -' (2DII 2020) <<https://2degrees-investing.org/resource/retail-clients-sustainable-investment/>> accessed 31 January 2023.

² Maryna Brychko, Taras Savchenko and Paweł Piotrowski, 'Illelgal Activities of Financial Intermediaries: A Burden of Trust Crisis' (2021) 14 Journal of International Studies 172.

³ Department for International Development, 'Investing in a Better World' (Department for International Development 2019) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/834207/Investing-in-a-better-wold-full-report.pdf>.

⁴ Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305.

⁵ Sunit Shah, 'The Principal - Agent Problem in Finance' (1 March 2014) <<https://papers.ssrn.com/abstract=2574742>> accessed 9 February 2023.

⁶ Juhani T Linnainmaa, Brian T Melzer and Alessandro Previtero, 'The Misguided Beliefs of Financial Advisors' (2021) 76 The Journal of Finance 587.

⁷ Pontus Elmrin and Astrid Johansson, 'Facilitating Sustainable Investments - How the EU Taxonomy Is Expected to Change the Principal-Agent Relationship between Fund Managers and Retail Customers' <<https://gupea.ub.gu.se/handle/2077/65447>> accessed 31 January 2023.

Only aware investors can avoid negative externality in terms of availability and investment opportunities ⁸.

Third, "Understanding of why people invest sustainable". Not only in research it is important to understand, why people want to invest sustainable ⁹. The reason is simple. Institutional investors also invest on behalf of individuals, e.g., pension savers. Three main objectives found ¹⁰. The first is impact in real economy, which can be explained by self-transcendence as part of the personal norm ¹¹. Second avoiding feelings of guilt which refers to the fulfillment of social norms and third the optimization of returns. The last is led by logic that ESG brings opportunities of forward looking business models in the future ¹².

Theoretical and empirical foundation of the new client identification approach

Starting point of our own research is the 2020 representative survey study of the GEA on environmental awareness of the German population ¹³.

⁸ Sarah Auster and Nicola Pavoni, 'Limited Awareness and Financial Intermediation' (ECONtribute Discussion Paper 2020) Working Paper 043 <<https://www.econstor.eu/handle/10419/228846>> accessed 31 January 2023.

⁹ Rob Bauer, Tobias Ruof and Paul Smeets, 'Get Real! Individuals Prefer More Sustainable Investments' [2018] SSRN Electronic Journal <<https://www.ssrn.com/abstract=3287430>> accessed 6 January 2023.

¹⁰ 2° Investing Initiative (n 16).

¹¹ Christian A Klöckner, 'A Comprehensive Model of the Psychology of Environmental Behaviour—A Meta-Analysis' (2013) 23 Global Environmental Change 1028.

¹² 2° Investing Initiative (n 16).

¹³ Martin Stallmann, *Repräsentativumfrage Zum Umweltbewusstsein Und Umweltverhalten Im Jahr 2020* (Umweltbundesamt 2022) <<https://www.umweltbundesamt.de/en/publikationen/repraesentativumfrage-umweltbewusstsein-0>> accessed 30 January 2023.

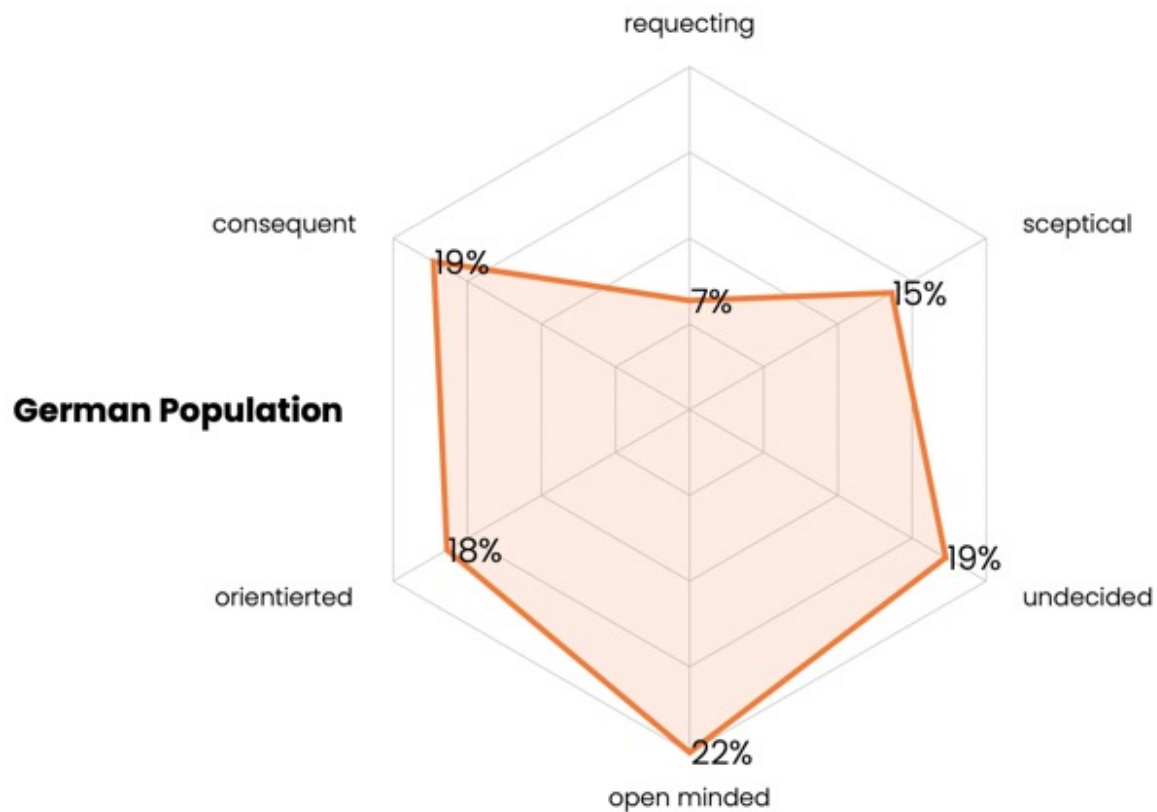


Figure 1: Distribution of environmental awareness types, Source: German Environmental Agency (2022) Scientific report on the representative study on environmental awareness and environmental action 2020

This survey is conducted every two years as a representative survey of the German population. When analyzing the data of this study, one goal of the GEA consists in identifying population segments, which differ in their environmental awareness as well as their attitudes, norms, perceived control and intentions to perform pro-environmental behaviour. Based on cluster analyses, the authors define six different population segments (for the methodological details see Stallmann, 2022). *Figure 1* presents the names and sizes of the identified six population segments. We want to outline, that

the groups are separated by criteria like environmental and climate attitudes, environmental behaviour and willingness to change.

Based on this segmentation, an approach for tailor-made advice can be derived for the advisory process of retail investors. In this way, it can be identified to which segment retail investors belong and whether sustainability is an important criterion for them in their investment decisions. However, the major disadvantage of the GEA approach is its time-consuming nature. Now, about 35 minutes of interview time are required to collect the data that is included in the cluster analyses. Our central research goal is therefore to develop an approach that only requires as much information that can be collected in about 1.5 minutes and is thus, applicable in counselling practice.

Evidence

To further test the impact of this reduction, we concluded four LinkedIn Surveys with different questions and 723 participants in total. The median time for completing the survey was between 2:45 and 3:36, depending on the questionnaire for between 18 and 23 everyday questions towards sustainability.

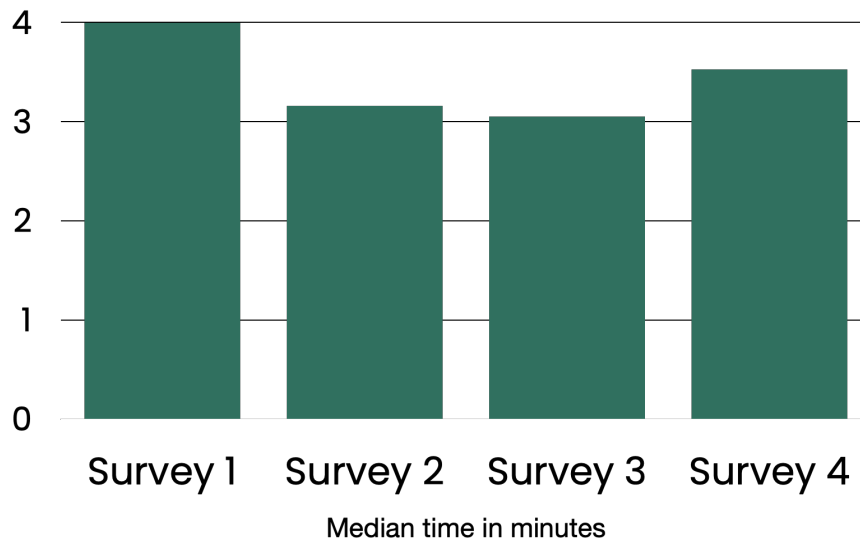


Figure 2: Median Time of each LinkedIn Questionnaire with reduced questions

In Figure 2 it can be seen, the amount of time needed for each questionnaire is not only dependent on the number of questions, but also on their complexity. Comparing the average amount of response time throughout all four surveys (3:13 minutes) with the amount of time it takes to answer the full GEA-questionnaire (around 35 minutes), a significant reduction of >90% was reached. This gives clients and advisors the opportunity to assess clients' sustainability preferences for sustainable investments in a low-threshold and time-efficient manner.

Practical implications

Clustering people into groups is not a new idea. Marketeers build personas for two decades with this procedure. The advantages of doing so, is to reduce the complexity and figure out common patterns, in our case of sustainable action regarding finance products. New is our data-driven approach with an incremental approach, which enables to classification to

become more specific and more accessible using the given findings and additional data collected by us or other initiatives.

With this, we can compute individual ESG-profiles which not only fulfil the regulatory requirements, but also target retail investor information needs of a low barrier entry and a useful classification which is not biased by the action-value-gap. Based on this, individual recommendations that are really tailored to the customer can be given. By combining this with training for intermediaries, e.g. using a " glossary of sustainability", regarding sustainability preferences, sustainable finance strategies, value and dimension we could enable financial advisors to fulfil their role of valuable consulting. It is also imagineable to compare the sustainability preferences between consultants and their customers, to generate a better fit and more individual consultation. In addition, specific learning journeys can be reached to remove all barriers for both parties. While the results are more than satisfying for customers and intermediaries alike, they have their limitations.

Q6: Are there practical examples of questions used to collect information from clients on their sustainability preferences that you can share with ESMA? (as for other parts of this CfE, respondents can opt for their input to ESMA not to be made public)

Yes sure. As described earlier we filtered the most import feature for sustainability and mapped those with investing motivation and actual regulatory requirements.

'1. I am actively involved in environmental protection and nature conservation.'

'2. I don't think climate change is that dramatic, so I don't see any need to



slow it down.'

'3. when shopping, I choose products with environmental labels such as the Blue Angel, the EU organic label or the EU ecolabel.'

'4. for the sake of the environment, we should all be willing to cut back on our current standard of living.'

'5. I am willing to switch to (or already have) a green electricity tariff.'

'6. I am willing to eat fewer meals with meat (or already do).'

'7. I am willing to use the car less often for everyday trips (or already do).'

'8. I am willing, for the sake of climate and environment, to live in less living space.'

'9. It makes me angry when I see Germany missing its climate protection targets.'

'10. Through our way of life, we are partly responsible for the consequences of climate change in poorer countries.'

'11. I buy food from controlled organic cultivation.'

'12. When it comes to the consequences of climate change, many things are very exaggerated.'

'13. Germany's climate protection goals should be more ambitious because we are currently doing too little to fulfill the Paris Agreement (limiting global warming to 1.5 degrees if possible).'

'14. What do you think is causing climate change?'

'15. I donate money to environmental or conservation groups.'

Q28: Are firms making use of ESG rating/scoring systems for products mapping in terms of sustainability? If yes, please provide details.

Yes, and I make an example. 14 % of adult Germans are consistent in terms of sustainability. All of the following is based on more than 3.000 datasets in terms of sustainability. These consequential persons have high scores in all

dimensions of environmentally friendly measurements. Behavior meets their high standards for environmental thinking and further change. The perceived barrier and opportunities to act in an environmentally friendly and sustainable way in terms of protecting planetary boundaries determines aspiration and reality.

What is the composition of this cluster?

More than 55% are male. Consequentialists are by far the youngest group and on average 8 years younger than the average. The highest percentage of university graduates is found here and the group has significantly better school education than the average. This group is much more likely to live with children and their parents under the same roof than any other group. The number of households with 5 or more persons is significantly higher than in any other group. Accordingly, there are much fewer single-person households. 27% earn €6,000 or more, whereas the proportion with an income of up to €2,000 is also 10%. Over 30% live in large cities, by far the largest figure. On the other hand, the group is rather underrepresented in places with less than 20,000 inhabitants. The number of private residential buildings built after 2000 is particularly high in this group. On average, there is more than 170 square meters of living space available. 75% have 110sqm or more.

The European Union's Sustainable Development Goals are known. Nevertheless, 30% do not know the SDGs. Again, 30% estimate their level of knowledge to be very good. Nearly 10% have little or no knowledge of the ESG factors. Just under 80% rate their knowledge of them as very strong.

How does this cluster feel about finance?

ESG aspects play a minor to subordinate role. However, depending on the topic area, they could certainly attract interest. Another possibility is to stabilize the investment strategy with the help of ESG aspects. The prerequisite is that they fit harmoniously with costs, security, profitability and liquidity.

60% would like to see a basic and general consideration of sustainability in investments.

35% would like to prioritize environmental and/or social issues themselves. The remaining approx. 5% do not wish any consideration. The desired minimum percentage of the investment to achieve environmental goals and/or social goals should be as follows:

Environmental > 60%	Social >40%
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65% would like to see a significant contribution to the achievement of goals according to the strict requirements of the EU taxonomy for environmental goals and 51% for social goals.

Just under 13% wish to make a contribution to the achievement of objectives (according to the less stringent requirements of the EU Disclosure Regulation) for environmental objectives and 32% for social objectives.

22% wish only to avoid adverse impacts on sustainability factors for environmental objectives and just under 17% for social objectives.

The investment targets should also be those companies and facilities that are in transformation, i.e. that have made a binding commitment to achieve sustainability factors while maintaining the required transparency?

Yes: 35%	No: 65%
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So which ESG strategy comes into question?

Best-in-Class (in combination with exclusion criteria or standards-based screening): Within an industry, category or class, companies are selected that perform best with respect to ESG criteria set by the product provider.

Theme funds (in combination of other ESG strategies): Investment products dedicated to a specific sustainability theme. These include, for example, renewable energy or water funds.

Exclusion criteria (in combination of further ESG strategies): If a company, industry, or country violates ESG criteria set by the product provider, that investment or investment class is excluded from the investment product.

Norms-based screening (in combination of other ESG strategies): Companies and countries included in the investment product are excluded if they violate international standards and norms selected by the product provider. These include, for example, the UN Global Compact, the OECD Guidelines for Multinational Enterprises or the ILO core labor standards. The application of standards-based screening is mandatory as part of the declaration of adverse sustainability impacts (Art. 4 Transparency Ordinance) and for the implementation of the Taxonomy Ordinance.

Different standards apply depending on the application.

ESG integration: Explicit inclusion of ESG criteria defined by the product provider in traditional financial analysis.

Engagement: In addition to asset management, the product provider also aims to engage in a long-term dialog with companies to improve their behavior and performance in the area of sustainability. This includes, for example, reducing CO2 emissions, improving labor rights or establishing a sustainable supply chain.

Active shareholder engagement: In addition to asset management, the product provider also exercises shareholder rights at general meetings to positively influence corporate policy regarding ESG criteria.

Q34: Have firms noticed increased demand by clients of financial instruments with sustainability features? Please provide any relevant available statistics on this topic (e.g. percentage of clients asking information about these products; trends over time). Furthermore, please explain if factors such as age, gender, level of education or level of income/wealth play a role in the demand for financial instruments with sustainability features.

We also analyzed this question with the help of 2° Investing Initiative¹⁴. Is interest in sustainable financial products (SFPs) high in different countries?

¹⁴ <https://2degrees-investing.org/wp-content/uploads/2022/07/Integrating-client-preferences-for-sustainable-investment.pdf>
<https://2degrees-investing.org/wp-content/uploads/2023/02/Annex-1-VF-Eng.pdf>



And is it sufficiently covered by having SFPs? Is this uncovered interest higher in the countries compared to Germany?

People with high sustainable interests, having no sustainable products can be analyzed by easy factors based on the available data within the mentioned papers from 2^o Investing Initiative `:

People with high sust. interests, having no sust. products:

Denmark, 41.7% -> 1.01*

Estonia, 52.0% -> 1.26

Germany, 41.4% -> 1.00

Greece, 77.9% -> 1.88

Ireland, 65.0% -> 1.57

Romania, 75.6% -> 1.83

Average index: 1.47

* country percentage / Germany percentage

people with high sust. interests, having no sust. products

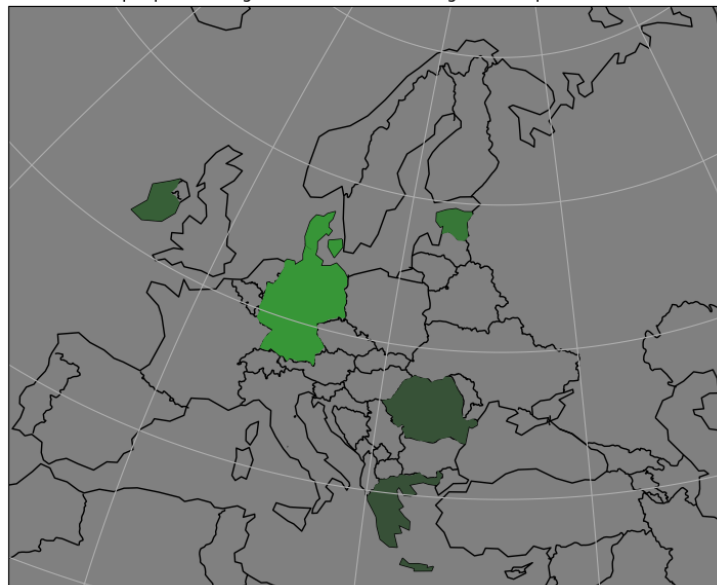


Figure 3: Proportion of people that have higher sustainable interests

Details: (answers 3+4 vs. 1+2) and having no SFP (2 - no vs. 1 - yes) A7r2] I am interested in sustainable finance solutions.

[A9]: Are any of your current financial investments in sustainable products?

Based on the German dataset we conduct gender, age, having sustainable interests and investments are good predictors of `motivation`. This is

applicable for long and short term investments here for the investment motivation: creating impact.

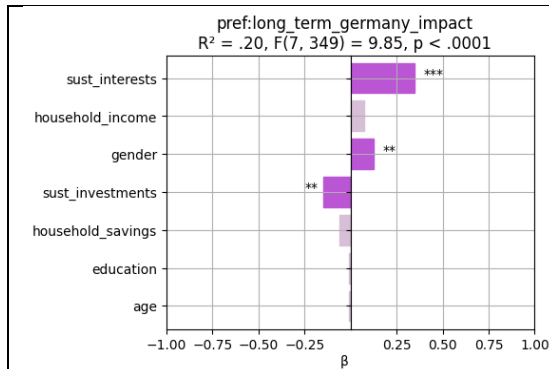


Figure 4: Predictors of long term investment motivation based on "impact" in Germany

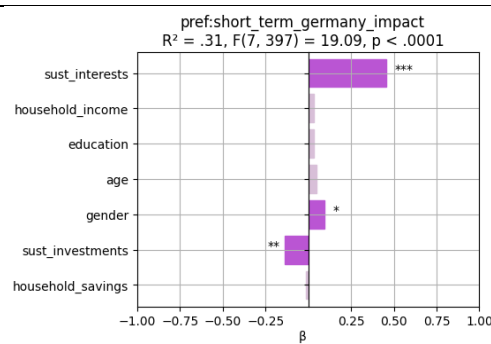


Figure 5: Predictors of short term investment motivation based on "impact" in Germany

The same is possible for the investment motivation on value conformity and maximum return expectation and for sure the mix out of this. For further contact our researcher and data scientist: D. Valko (valko@choyze.de)