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Towards sustainable investing: How retail investors can create an impact

The long path from heart to wallet

2024

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Foreword

How sustainably do you live your life? When asked this question, we think of many things: How do I travel? What do I eat? How do I dress? How do I heat and cool my house?

But we rarely talk about how we invest our savings. Do I consider the impact I have with my savings on the planet and society? Am I managing risks and capturing opportunities created by social and environmental changes?

As a society, we feel an urge to change. Environmental and social challenges are more visible every day. But tackling them requires investment and a large part of financing this shift rests with individuals.

While Belgium is experiencing a growing trend in sustainable saving and investing, this only constitutes a modest fraction of overall financial holdings. The volume of sustainable investments, according to Forum Ethibel's criteria, reached €136.3 billion at the end of 2022 in Belgium[1]. This is a significant figure, yet it pales in comparison to the substantial €1,074 billion that Belgians currently hold in total financial assets, excluding savings and current accounts[2].

From a global standpoint, achieving net zero by 2050 would necessitate a total investment of $125 trillion directed towards low-carbon energy supply, as well as sectors such as transport, buildings, and industry (Glasgow Financial Alliance for Net Zero[3]). Clearly, substantial financial contributions from both private investors and the public sector are imperative to meet this goal.

That is why this report puts the spotlight on retail investors, asking: What is needed to convince them and their advisors to consider sustainability in their decisions? To find out, we conducted a study on Belgian retail investors' behaviour and preferences related to sustainability, together with our partner KBC, with input received from HEC Liège. This report is based on a survey on 1,000 Belgian retail investors aged from 25 to 75, four qualitative panel discussions and a review of the academic literature on the subject[4].

We hope this study will trigger investors, advisors, and policymakers to put our recommendations into practice. After all, our sustainable future depends on it.

Let's work together to boost the sustainability of retail investors.

Happy reading!

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5 highlights from our research

1

Potential for more sustainable investing waiting to be unlocked

- Among the surveyed investors 78% find sustainability important in their daily lives, but what sustainability means varies widely. Although environmental (E) topics are more top of mind, investors also value social (S) and governance (G) aspects.
- Already 62% have some sustainable investments, yet the allocations to this investment class are relatively low, even for those who find sustainability important.
- This indicates a potential for more integration of sustainable investments that could be unlocked.

2

Regulation helps to put sustainable investment preferences on the agenda, but investors use their own values to define sustainability

- The MiFID and IDD directives help put sustainable investment on the table. Investors confirm it adds value, even if some indicate that it can be difficult to match their personal values with the concepts defined in the regulations.
- People want to reflect their personal values in their sustainable investments and create a positive impact on topics important to them. This is also reflected in how they qualify products as sustainable: they look at their own values rather than the definitions set forth in the regulations. This leads to a mismatch between products investors consider sustainable and those qualified as sustainable by the regulations.
- Communicating sustainability preferences is usually done interacting with an advisor as part of a broader conversation. Investors who have already communicated their preferences show more sustainable investments in their portfolios. With only 38% indicating they have already communicated their sustainability preferences to their financial institution this creates opportunities to interact on the subject.

3

Information is a key factor for sustainable investment decision-making

- Investors rely on their financial institutions[5] for information, via conversations with their advisors or their website or app. Still, a multichannel approach is required to achieve maximum coverage.
- There is room for improvement on communication, both in terms of understanding the information currently available and making available additional information. Although the preferred channels vary between the different age categories, personal interactions are highly valued across all age categories.
- Investors expect their advisors not only to be knowledgeable about the topic, but also want them to bring a convincing story that is carried out through the entire financial institution.

4

Potential for labels to provide an objective assessment, but transparency is key

- Labels can potentially serve as a tool to provide a transparent and independent perspective on sustainability characteristics of investment products. Investors are inclined to put trust in these labels and tend to report a preference for products with a label.
- Nevertheless, investors are also sensitive to unsubstantiated marketing and greenwashing, creating a need to provide assurance on label objectivity and independence.

5

Sustainable and financial performance influences investor behaviour

- Financial return is important when investing and this is no different for sustainable investments. Younger generations are even more sensitive to financial return than older investors.
- There is no consensus on the financial performance of sustainable investments compared to traditional non-sustainable investments.
- Investors value information on the sustainability performance of their investments: they want to track the impact they make with their investments. Some quote it as a condition to invest sustainably, while others are even inclined to accept a lower financial return in exchange for a proven sustainability performance.

Moving forward

Considering the highlights of our research, we make the following recommendations for different stakeholders to shift capital flows towards sustainable investments.

a) Retail investors

Communicate with your advisor, whether it's in person, online or via other channels. Express your sustainability preferences. How do you want to reflect your personal values in your investments, and what impact do you want to make?
Let your advisor know what information you need to take sustainability into account in your investments. The information that retail investors are looking for is not always available today. Still, increasing demand from investors is likely to improve the availability of information and investment solutions over time. Many retail investors may not fully grasp the influential role they can play in directing capital flows.

b) Financial institutions (banks, brokers, investment platforms)

Interact with and inform your clients: Investors are interested in receiving more and tailored information on sustainable investing through various channels. Financial institutions are still the main source of information on the topic. Make sure to provide clear, understandable, and objective information, taking into account the most appropriate channel for the investor. This includes a combination of human interaction and digital platforms, which implies that it is also necessary to optimise digital channels. It is important to be aware that investors may have limited knowledge about sustainability. Although the environmental (E) aspects might be more top of mind, one should also discuss the social (S) and governance (G) aspects.

Explain the regulatory definitions and go a step further: European regulations on sustainability preferences help put the topic on the table and have merit, but the real value lies beyond. Clients are not interested in a tick-the-box exercise. They want to be able to reflect their personal values and make an impact. Keep this in mind when explaining the concepts and definitions set forth in the regulations.

Implement your own values throughout your organisation and empower your advisors: Investors expect their financial institution to walk the talk. This requires providing staff with the education and tools to translate the company's values into the investment conversation in a knowledgeable way.
Be transparent about financial and sustainability impact: There is no conclusive evidence about the relationship between sustainability and financial return, so be transparent about that. Focus on what retail investors are also keen to understand: what makes an investment sustainable. Assurance on the concrete impact can persuade investors to invest sustainably. Providing sufficient insight, as well as concrete and tangible examples of how investments contribute to sustainability objectives, will become an important differentiator for financial institutions.

c) Labels

Investors value a transparent and independent perspective on products and we believe labels can play an important role. However, a binary option (sustainable or not) is insufficient. Because themes are an intuitive way to communicate to investors about sustainability, **sub-labels** on various E, S and G topics may add value. Towards Sustainability has already started developing this. We also see that there is still a lack of awareness of labels and what they mean. Reinforced marketing campaigns are necessary.

d) Supervisors and regulators

When analysing the results of the Common Supervisory Action and Call for Evidence launched by ESMA on the topic, **focus on what consumers actually need** and how to translate this complex framework into a tool to conduct meaningful conversations with investors, while **enabling financial institutions** to take into account the preferences and personal values of their clients.

e) Policymakers

Information and understanding of the topic are key. Financial institutions play an important role in educating their clients. It is our view, however, that educating investors is not the sole responsibility of financial institutions. Other channels should play a role as well. There should also be a **focus on financial literacy in general education, schools, and even community services**. This was one of the main conclusions of our Financial Health study in 2023[6]. The Wikifin website, hosted by the FSMA, provides an overview of sustainable investing[7] and how to select a sustainable product (including labels)[8].

In addition, policymakers should **investigate other ways to encourage retail sustainable investing**. For example, in Luxembourg we see that the subscription tax rate was reduced for sustainable investment funds[9], and in Germany a specific regime was introduced for microfinance funds[10].

Introduction

Deloitte Belgium's Financial Services Week is an annual event with a different theme each year. In 2022 the focus was on sustainable and affordable housing. The following year, we looked at the Belgians' financial health.

The 2024 edition is focusing on an increasingly important topic: the role of retail investors in financing the sustainable transition. In our study, we ask questions about mindset and behaviour the behaviour of retail investors regarding sustainability. How are retail investors integrating sustainability into their portfolios? Do they even care about sustainability? Are they happy with the information they receive? Are they able to reflect their personal values in their investment portfolios?

Sustainability preferences

The transition to a low-carbon, more sustainable, resource-efficient, and circular economy in line with the Sustainable Development Goals is key to ensuring the long-term competitiveness of the economy of the European Union. In this context the EU concluded the Paris Agreement[11] in 2016, strengthening the response to climate change by, among other initiatives, making finance flows consistent with a pathway towards low greenhouse gas (GHG) emissions and climate-resilient development.

In this context, the European Commission presented the European Green Deal[12] in December 2019. It represents a new growth strategy to transform the European Union into a fair and prosperous society with a modern and competitive economy. The goal is to achieve no net GHG emissions from 2050 onwards, decoupling economic growth from resource use. This requires giving investors clear signals to (i) avoid stranded assets and (ii) reorient capital flows towards sustainable investments, crucial to achieve sustainable and inclusive growth.

This includes mobilising private money for sustainable economic initiatives and the so-called just transition: one that achieves a climate-neutral economy while alleviating any resulting negative socio-economic impacts. With this objective the Action Plan: Financing Sustainable Growth was developed, setting up an ambitious and comprehensive strategy for sustainable finance.

However, setting up the plan revealed the need to clarify that sustainability factors should be taken into account by advisors as part of their duties towards current and potential clients[13]. To achieve this, the Markets in Financial Instruments Directive (MiFID), the Insurance Distribution Directive (IDD), and their delegated regulations were amended[14] to specify the duties of investment and insurance advisors and portfolio managers[15] in relation to sustainability. These duties include the obligation to gather information on and take into account the sustainability preferences from the current or potential client. Through this interaction, the EU expects to encourage investors to set sustainability preferences and thereby direct more capital flows towards sustainable economic activities. These requirements were applied on 2 August 2022.

This is also a key focus area for regulators and supervisors, nationally and internationally. In this context both ESMA[16] and EIOPA[17] introduced further recommendations on integrating sustainability preferences into their existing guidelines on the assessment of suitability. Next to this, ESMA launched a Common Supervisory Action (CSA) on the MiFID II sustainability requirements, to assess financial institutions' progress in the area[18]. Concurrently, ESMA issued a Call for Evidence (CfE)[19] on integrating sustainability preferences in the suitability assessment and product governance arrangements, to gather input from stakeholders on consumer needs, industry initiatives, and challenges in this area.

The journey: one year later

Knowing that financial institutions were making efforts to introduce sustainability into their investment offerings and frameworks, we were curious about how this was perceived by clients:

- Do retail investors understand sustainability? Do they care?
- Are they already taking into account sustainability factors for their investments?
- Is understandable information for making informed decisions available to them, and are they able to reflect their values in their investment portfolios?
- How do they assess sustainability performance along with, or next to financial return?

To get a clearer picture, in the second half of 2023 Deloitte and KBC carried out a market study[20] on how sustainability translates into the retail customer's investment journey. Based on our conclusions, we believe different stakeholders can take concrete actions that will lead to an increase in sustainable investment.

1. Sustainability is important – even if everyone still has their own interpretation

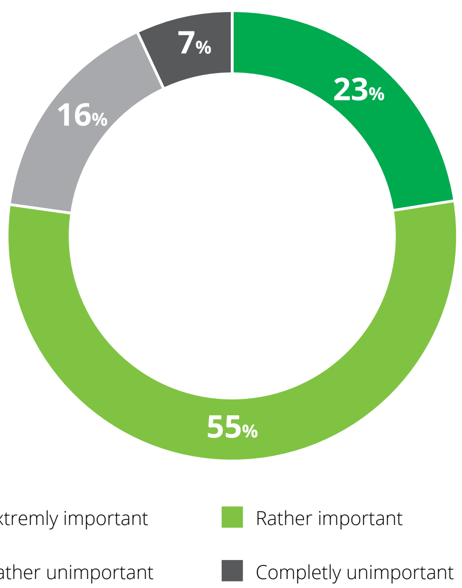
Understanding sustainability

We see that 78% of respondents indicate that sustainability is important in their daily life, and they take it into account in their everyday choices, such as buying products, planning travel, etc.

Perspectives on what sustainability is vary widely and are personal, but some topics are more top of mind than others. Intuitively, investors will focus on the environmental (E) aspects, but when presented with more options they do value social (S) and governance (G) aspects as well. Overall, most Belgians may benefit from further information on what sustainability means.

In general, respondents indicate they find sustainability important in their daily lives: taking it into consideration when buying products, planning travel, supporting initiatives, and more. A large majority, 78%, say sustainability is 'extremely important' or 'rather important'.

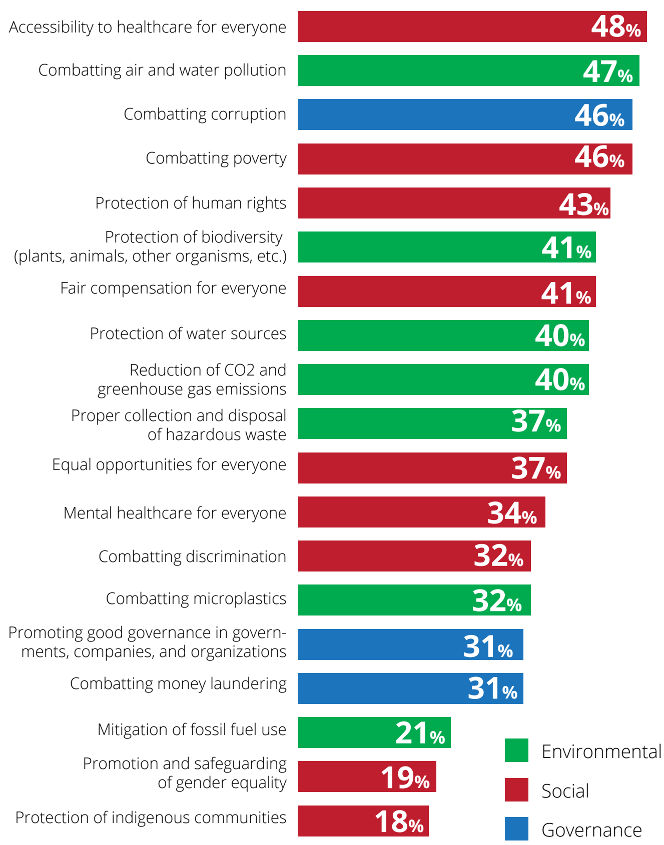
Figure 1.1: How important do you consider sustainability in the choices you make in your daily life (e.g., the products you buy) or other activities (e.g., travel)?



When we asked participants in our panel conversations what the terms 'sustainability' and 'ESG' meant for them, we saw quite different interpretations, but the focus was on environmental topics.

Via the survey, we asked all respondents which topics out of a list of nineteen they believe are important. When given options, we see they focus not only on 'traditionally' environmental aspects, but also very much on social topics and to a lesser extent on governance.

Figure 1.2: To which of the following environmental, social, and governance (ESG) topics do you personally attach importance?



Although environmental topics might be more top of mind when people talk about sustainability, every angle is deemed important to a certain extent. This indicates that what sustainability means varies widely and is personal, but some topics are more relevant than others. It would be beneficial to provide more information to Belgians on the different angles sustainability covers.

So we now know that sustainability is important in daily life, but how does that translate to retail investor portfolios?

> "I didn't know social topics such as elderly health care are also sustainable – I'd like to invest in that theme"

2. Unlocking the potential to convert sustainability preferences into investment decisions

Potential for growth – but how to tap into it?

Already 62% of survey participants have some sustainable investments, yet the allocations to this investment class are relatively low, even for those who find sustainability important.

The regulations help put sustainable investment on the table, and investors confirm it adds value, even if some indicate that it can be difficult to match their personal values with the concepts defined in the regulations. This is also reflected in what product they tend to define as sustainable: they look at their own values instead of the definition set forth in the regulations.

People want to express personal values in their sustainable investments and create a positive impact on topics important to them. These values differ between investors and also evolve with the broader economic context.

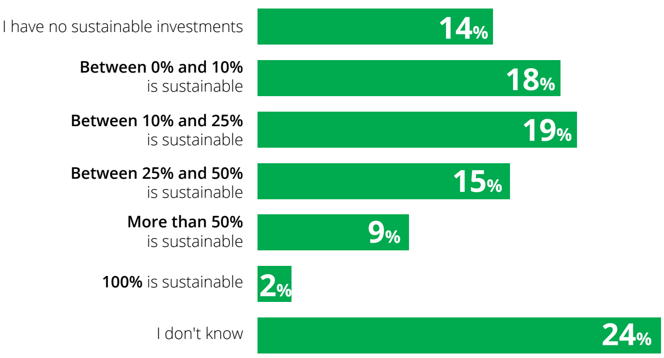
Investors who already communicated their preferences show more sustainable investments in their portfolios. With only 38% indicating they have already communicated their sustainability preferences to their financial institution, this creates further opportunities to interact on the subject.

a) Sustainability in investments today

Already today, we see 62% of participants say they have at least some positions in their portfolio which they believe are sustainable. Still, this is less than the 78% who tell us they find sustainability important in their daily life. Also interesting is that 24% don't know whether they have sustainable investments or not.

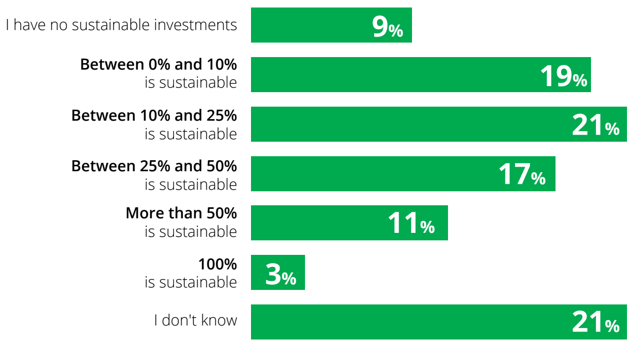
If we then look at the composition of the portfolios though, we see that the percentage of investments that are considered sustainable is relatively low. We see that 14% think they have no sustainable investments and 37% consider between 0% and 25% of their portfolio as sustainable.

Figure 2.1: What percentage of your total personal investment portfolio do you consider as sustainable?



Even if we only take into account the 78% who find sustainability to a certain extent important, it is remarkable that these figures are not significantly different.

Figure 2.2: What percentage of your total personal investment portfolio do you consider as sustainable? (for respondents who find sustainability important)



In these figures we need to take into account the fact that sustainable investing is a relatively new concept and that some of the investments not considered 'sustainable' can be historical positions in the portfolio. Investors could be reluctant to fully convert traditional positions to sustainable variants. In addition to sustainability, other elements come into play. For example, simply taking the initiative requires time and effort, transaction costs, taxation, etc.

Although this feels counterintuitive, these conclusions are in line with what academic researchers found in Sweden. They also found that pro-environment households are not more likely to make green financial decisions[21]. The researchers suggest this may be due to the complexity of investment decisions. It is easy to understand that commuting by bike is more sustainable than by car. But how do we assess which investment is sustainable?

> "I never thought about sustainability when making investment decisions but maybe I should do this more in the future."

> "Investing for me is not about sustainability but looking for financial returns. Committing to sustainability in my personal life and my investments are two different things."

> "I prefer to invest my money to get a decent return and then invest it in tangible ecological projects, such as improving the energy efficiency of the house of my grandchildren."

Clearly, there is potential for more integration of sustainability in investments. But how do we translate the appetite for sustainability in daily life to more sustainability in investments?

b) Incorporating sustainability preferences triggers a valuable conversation, but is it fit for purpose?

As described in the introduction, European regulations have been amended to include an obligation for investment advisors to learn their client's sustainability preferences and take them into account when providing investment advice or managing clients' investment portfolios.

The first step is for advisors to ask clients if they have sustainability preferences in general.

More than one year after the introduction of the new requirements, we see that 38% of investors indicate that they have already expressed their sustainability preferences (including both 'I have preferences' and 'I don't'). We see that younger generations have a higher coverage ratio, as do people with larger portfolios, where personal advice and periodic interactions are more common.

Figure 2.2: Have you ever communicated your sustainability preferences to the bank/ platform/broker where the majority of your investments are held? (by age)

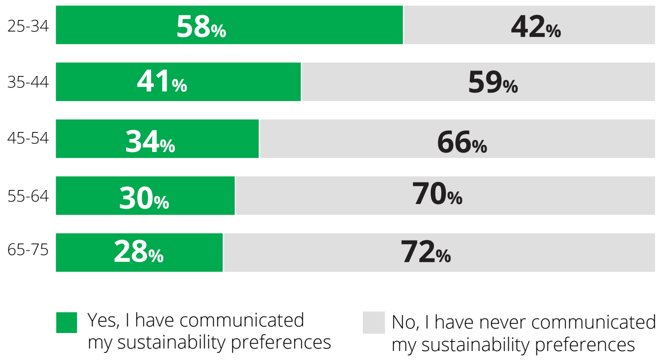
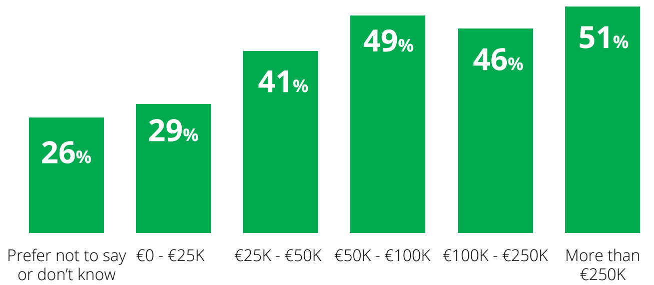


Figure 2.3: Percentage that communicated sustainability preferences (by portfolio size)

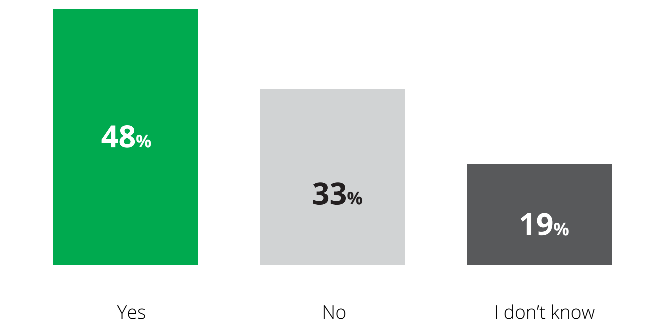


When clients indicate they have sustainability preferences, advisors are required to go a step further and gather more details on what they entail. More concretely, advisors need to collect more information on three aspects:

- Do clients want to invest a certain amount of their portfolio in environmentally sustainable investments, as defined in the EU Taxonomy Regulation[22]?
- Do clients want to invest a certain amount of their portfolio in investments contributing to ESG-related purposes as defined in the Sustainable Finance Disclosure Regulation (SFDR)[23] ?
- Do clients want to take into account certain Principal Adverse Impacts (PAI) and avoid investing in companies or sectors that might have an adverse impact on sustainable goals?

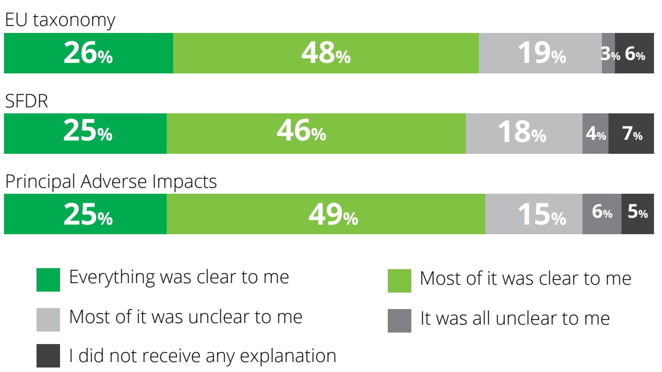
To gather the information required for this next step, advisors are obliged to explain these technical concepts. When asked, we see that about half the survey participants claim to have received this info, a third say that they did not receive and a fifth can't remember.

Figure 2.4: Received information about EU Taxonomy/SFDR/PAI



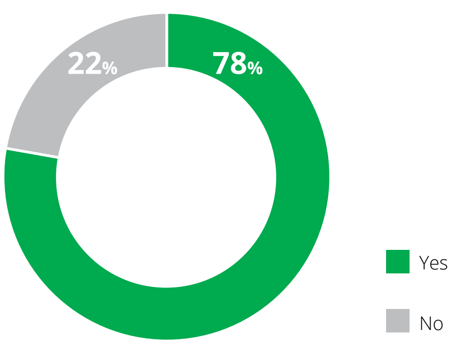
Among respondents claiming they received information, the majority indicated it was fit for purpose and they understood the most of it.

Figure 2.5: Which explanation at that time was clear to you?



Further, we see that 78% of respondents who received an explanation of the regulations indicated that the information added value for them. It proves that introducing, e.g. classifications and taxonomies through regulation – no matter how complex they may be perceived – is useful to set standards that get the conversation going in a meaningful way.

Figure 2.6: Was this explanation regarding EU taxonomy, SFDR, and/or principal adverse impacts valuable in integrating ESG aspects into your investment choices?



From the panel discussions, it appeared they had very different experiences. Those who already had communicated their preferences indicate that this was done via a conversation with their advisor.

For some it was a positive conversation, with good explanations and context. For others, it felt like a quick tick-the-box exercise, oriented towards getting them to not indicating any preferences.

> "Asking for my sustainability preferences came across as an obligation, rather than something they were really interested in."

> "When I went for an interview to discuss general investments, I also received a paper to sign whether there was interest in investing in sustainable investments as well.
> It was not something seen as standard procedure but specifically discussed."

Participants in the panel discussions also indicated that, although the concepts of Taxonomy, SFDR and PAI were clear to them after the discussions (which they saw as valuable), they nevertheless felt that these concepts didn't serve to facilitate a discussion about what sustainability aspects were actually important to them.

> "I don't think it is concrete enough. What you personally find sustainable is not asked."

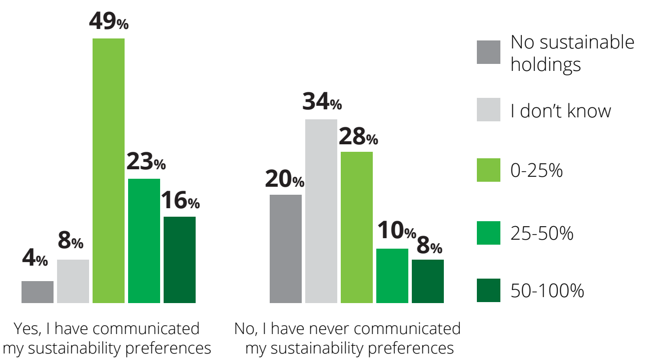
This is an important reflection because it means that, when talking about sustainability in general, and sustainable investments in particular, people are not always able to match the concepts introduced by the legal definitions with their personal values and preferences.

The question now is: to what extent does the obligation to learn clients' sustainability preferences lead to more sustainable investment decisions?

c) Translating preferences into investment decisions

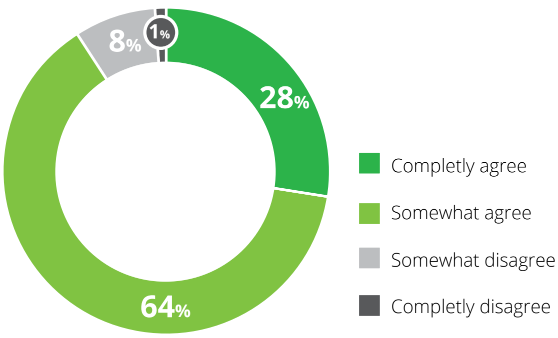
People telling us they communicated their sustainability preferences to their advisor tend to have a larger amount of investments they consider to be sustainable.

Figure 2.7: Sustainable holdings when sustainability preferences are communicated or not



Interestingly, 92% of respondents who have already communicated their sustainability preferences believe that their financial institution's product offering is at least somewhat sufficient to meet them.

Figure 2.8: The sustainable product offering of my main bank/platform/broker is sufficient and aligned with my personal preferences



This seems to contradict concerns raised by the financial sector[24] regarding a potential mismatch between investor expectations and financial instruments with sustainability features, which would prevent them from satisfying their clients' sustainability preferences. One concern was the lack of sufficient data to qualify investment products as environmentally sustainable (as defined in the EU Taxonomy Regulation), and/or contributing to ESG-related purposes (as defined in the SFDR), or to obtain assurance on whether (and which) PAIs are taken into account. Another concern was the lack of clarity on how to qualify products not subject to the SFDR, such as shares and bonds.

Following our panel discussions it became clear that panellists tend to qualify investment products as sustainable when aligned with personal values, rather than following the definitions set forth in the regulations. As a consequence, many products they considered sustainable would not fit regulatory definitions, due to lack of clarity or data, such as specific shares in companies they considered sustainable, but also participation in local initiatives.

This difference in definition might lead to inconsistencies between client expectations and financial institutions' offerings. These might even impact the way sustainability preferences are registered. Regulation allows investors to change their preferences, if their financial institution is not able to meet their sustainability preferences based on its available product offering and considering the client's personal situation and risk preferences. This could lead to a situation where investors need to formally declare that they have no, or very limited, sustainability preferences, while they actually do take into account certain personal values or preferences when making investment decisions.

> "I invested in shares of the company 'Beyond Meat', a producer of plant-based meat substitutes. I believe eating less meat reduces our environmental impact."

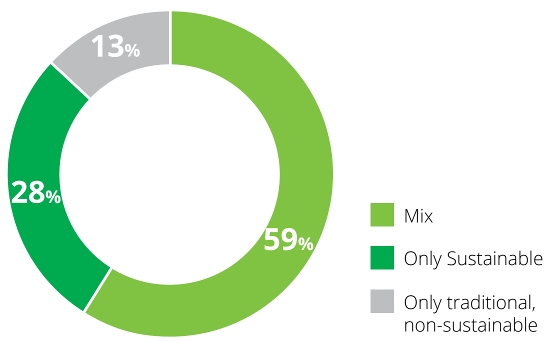
> "I like to invest in local initiatives close to me. I invested in a community supported agriculture project in my neighbourhood."

> "I would not invest in tobacco or weapons, but I would consider a company in transition, under certain circumstances, to be sustainable."

d) Main drivers for incorporating sustainability factors in future investment decisions

When respondents were asked how they would compose a new investment portfolio, 59% indicate they would include sustainable investments in a mixed portfolio, containing both sustainable and traditional, non-sustainable positions. Going a step further, 28% would build a fully sustainable portfolio and only 13% would not include sustainable products in their portfolio.

Figure 2.9: Composition of new portfolio



An important caveat to keep in mind is that investors, and in particular retail investors, exhibit preferences for ESG integration depending on the economic context. Research found that investor allocation to green or social investments is not solely driven by current climate and social concerns but also influenced by economic uncertainty[25] . In general, there is a higher preference for socially responsible stocks during good times and vice versa[26].

The question is then what the main drivers are for investors to consider sustainability aspects in their portfolios and how they would take these into account when building a new investment portfolio. We therefore focused on people indicating that they find sustainability important in daily life. We provided them with three options for considering sustainable investments in their portfolio. The most popular reason is alignment with personal values. However, the most important conclusion is that there is no outlier. This means that not only do investors prioritise different ESG topics, they also have different preferences of why they need to be reflected in their portfolio.

Figure 2.10:Why consider sustainability in your portfolio? (*)

(*) Multiple answers were possible

In the panel conversations, we asked which values participants considered important for their investments and we see that, although opinions varied, they typically want to exclude investments in companies or sectors they believe have a negative impact, e.g. gambling, tobacco, controversial weapons, human rights issues, etc. Additionally we asked what they understood by 'creating a positive impact', and here reference is made to companies focusing on specific topics, e.g. reducing social inequality, cutting greenhouse gas emissions, etc.

Due to diverse personal values and different understandings of how to create positive impact, the definition of sustainable investments also differs between investors. An exclusion strategy of heavy carbon emitters may be considered sustainable by someone with a climate risk management angle, but not by someone who prefers to see social values reflected in their portfolio.

> "Companies trading in weapons or tobacco? Not in my portfolio, whatever the return."

> "If a fund excluding tobacco and weapons underperforms a fund that includes them, I will choose the better performance."

> "If fossil fuel companies were to perform better than renewable energy companies, I would switch to fossil fuel immediately. But for the weapon or tobacco sectors, I would seriously hesitate to invest in them, even if they were to outperform."

> "Besides my funds, I sometimes invest in companies that I can consciously create an impact with. If I get a financial return, all the better, but with this I mainly want to invest in something that makes the world a better place. E.g. investing in cooperatives that build windmills."

We note that there is no intuitive link between what the panel participants indicate they find important and consider sustainable, and the concepts used by the regulations to determine investors' sustainability preferences. Nevertheless, the regulations give a good guiding framework to start the systematic exploration of the investor's personal preferences.

Having discussed sustainability preferences and how they translate to more sustainable investment, in the next section we will review another driver of sustainable investment decisions. High sustainable finance literacy[27] is key: what do we need to do to bring as many investors as possible to that level?

3. Investors need information to gain confidence

Information channels & adequacy, the role of labels

Investors rely on their financial institution for information, via conversations with their advisors or from their website or app. In terms of understanding what's available today, there is room for improvement, and additional information would be greatly appreciated. Although the preferred channels vary between different age categories, personal interactions are highly valued overall. Still, a multichannel approach is required to achieve maximum coverage.

Investors expect their advisors to not only be knowledgeable about the topic, but also bring a convincing story that applies throughout the entire financial institution. This requires providing staff with the education and tools to translate the company's values into the investment conversation.

Labels have the potential to serve as a tool to provide a transparent and independent perspective on the sustainability characteristics of investment products. Investors are inclined to trust these labels and tend to report a preference for labelled products. Nevertheless, investors are also concerned about unsubstantiated marketing and greenwashing, creating a need to provide assurance on label objectivity and independence.

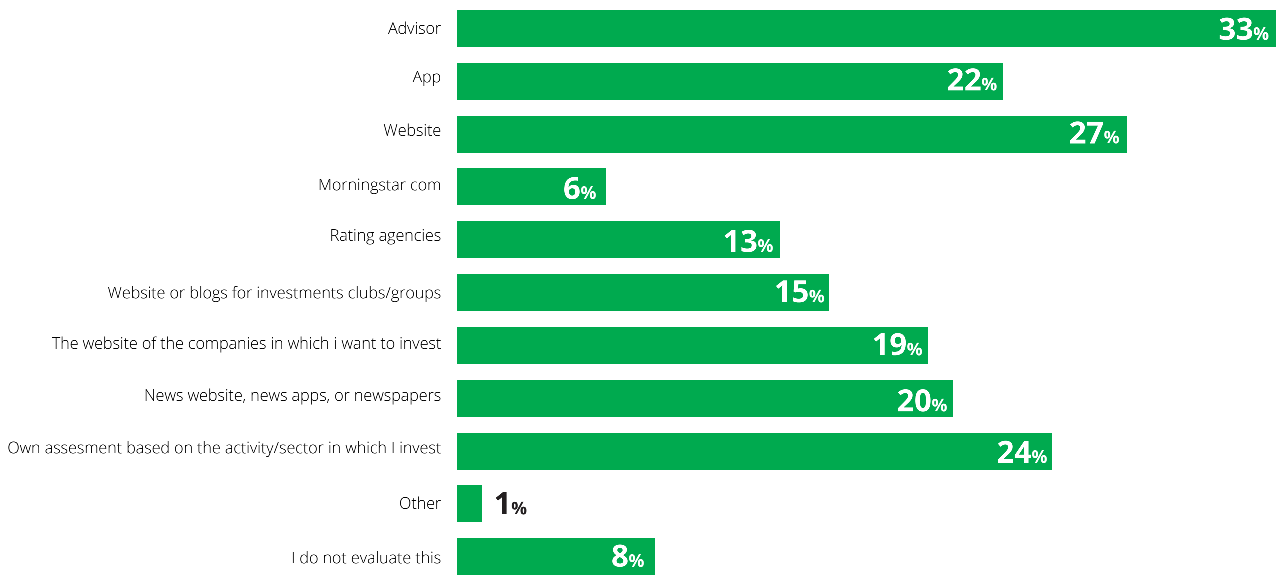
a) Today, investors rely mostly on their financial institution for information

We see that today, investors who already have sustainable holdings typically rely on their financial institutions (most commonly their bank, but sometimes an insurance broker or trading platform) for information on sustainability factors related to their investments.

Despite the increase in digital solutions, a conversation is still the preferred way of interacting with the advisor, closely followed by the institution's website and the app.

Nonetheless, this doesn't mean that these investors aren't looking for their own information. We find that a quarter (also) conduct these sustainability evaluations themselves, based on the sectors and companies they invest in. This can be done in several ways (through their advisor, by using their main platform's app or website, consulting rating agencies like Moody's or Sustainalytics, etc.).

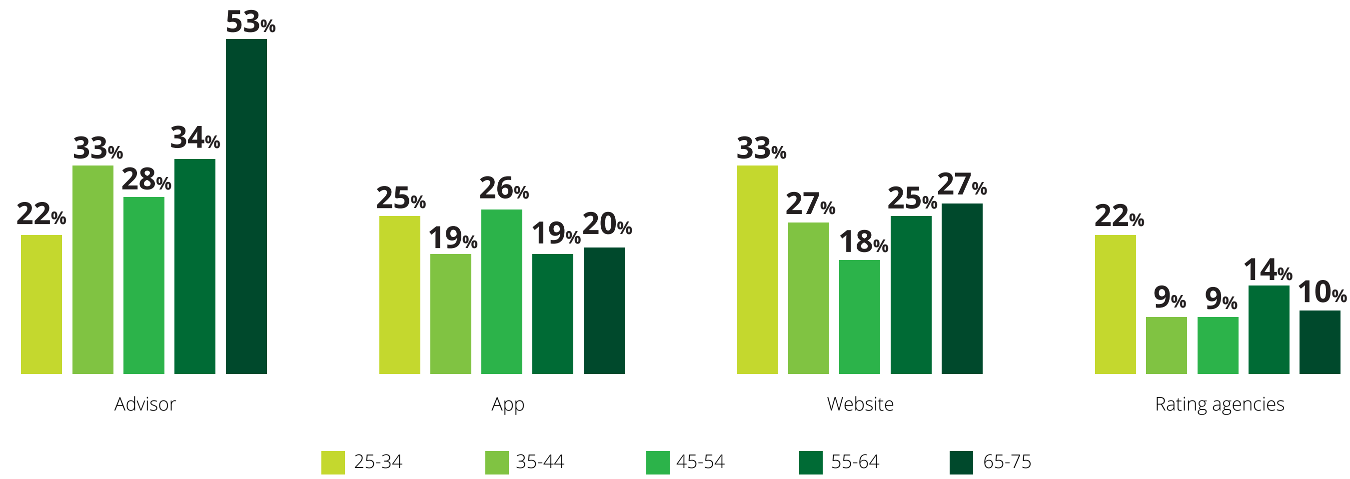
Figure 3.1: How do you evaluate the sustainability profile of your investments? (*)



(*) Multiple answers were possible

Preferences differ somewhat across age categories, but the most important conclusion is that a multichannel approach is required to have maximum reach. Plainly, the expansion of digital banking in Belgium is likely to further diversify these channels[28]. For example, by offering robo-advisory tools, publishing financial market insights, and enabling profitability analysis.

Figure 3.2: Channels to evaluate a portfolio's sustainability profile by age (*)



(*) Out of respondents who already hold sustainable investments

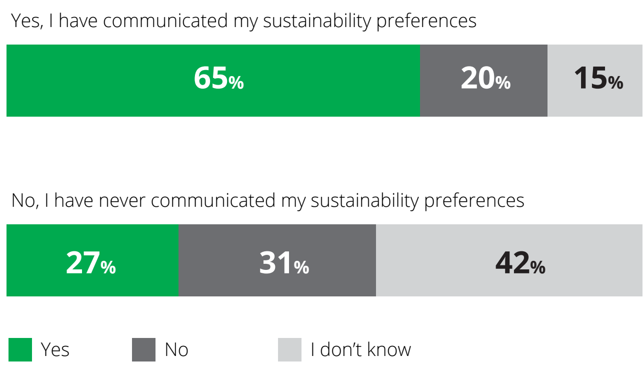
b) Investors want a convincing story supported by objective data, accessible through different channels

i. How clear and useful is information today?
An important medium financial institutions use for communicating the sustainability information of financial products is the so-called pre-contractual information and periodic information, such as Key Information Documents (KID), prospectuses, specific information on different concepts of sustainability (Taxonomy, SFDR, and PAI), etc.

Today 42% of investors indicate they find the information they received sufficiently clear.

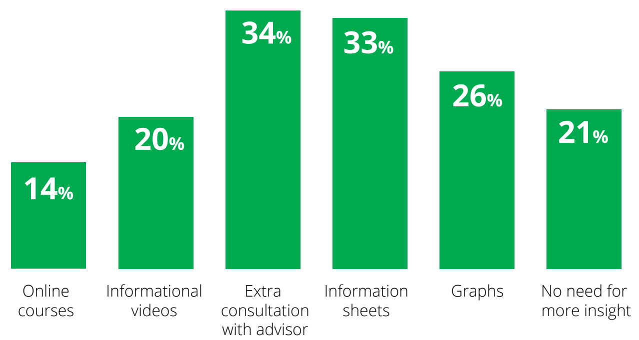
However, investors who have communicated their sustainability preferences are much more confident with the information they received with 65% indicating they find the information sufficiently clear. This shows again that having interactions on sustainability gives confidence and raises awareness on sustainability.

Figure 3.3: Does the documentation (pre-contractual/periodic) provided by your main bank/platform/broker for investments give sufficient information about the sustainability characteristics of your investments?



ii. What information is missing?
Respondents were also asked what they need to gain more insight on sustainability characteristics and the impact of investments. Only 21% indicated they did not need more information.

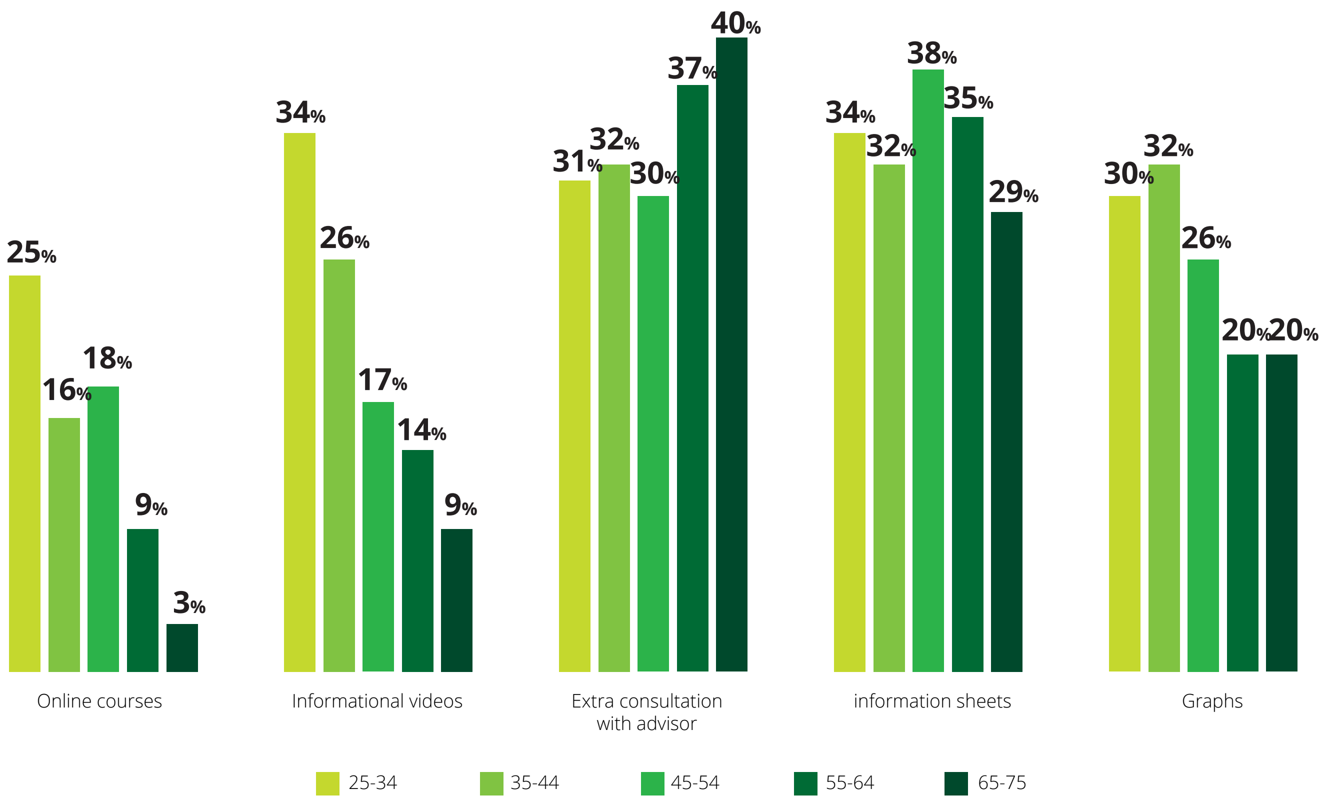
Figure 3.4: What do you need to gain more insight into the sustainability characteristics of your investments? (*)



(*) Multiple answers were possible

The type of information respondents would like to receive differs according to age. Among younger respondents, there is a greater preference for online tools, specifically informational videos and online courses.

Figure 3.5: Information preferences by age (*)



(*) Multiple answers were possible

While this is intuitive for the digitally-savvy generation, we were surprised to see that the desire to consult an advisor is popular in all age categories. This shows that personal interaction is still highly valued, although this does not necessarily mean a traditional one-to-one conversation. Extra consultations can also be facilitated via video chats, dedicated information sessions, or other means.

Other information that would be appreciated includes information sheets and readable charts and graphs (via website, app, etc.).

Following the panel discussions, participants indicated that they value additional, clear and objective information, relevant to their situation and reflecting their values.

On the other hand they indicated that when interacting with their advisors, they also appreciate that they are knowledgeable and that these values are carried out through the entire financial institution. They don't want a tick-the-box exercise but a convincing overall approach.

> "My banker knows me and my mother. He knows the themes and sectors we are interested in, and our portfolio reflects our preferences very well."

> "On one hand, my banker pushes a sustainable product on me. On the other, the bank is in the news for financing weapons, fossil fuel, etc. I want an advisor who walks the talk."

> "The term "sustainable" is generic and only used for marketing purposes. Banks do a lot of ESG-washing. They can call it whatever they want, but you have to see which actual companies are being invested in."

This implies a need to train advisors and to provide them with the right tools to support understanding, but also to convincingly translate the institution's own sustainability policies and focus areas. This is clearly an area of investment where benefits can be reaped in terms of the quality of the customer relationship. As the dust starts to settle on the big regulatory initiatives, it may be a good time to accelerate the efforts in this area.

iii. Can labels provide a solution?

Towards Sustainability

In February 2019 Febelfin, the Federation of the Belgian financial sector, introduced a sustainability label: Towards Sustainability. Their mission? To offer clarity regarding the sustainability strategies of financial products. Consequently, a financial product will only receive the label after fulfilling a set of portfolio- and process-level requirements and review by an independent third party.

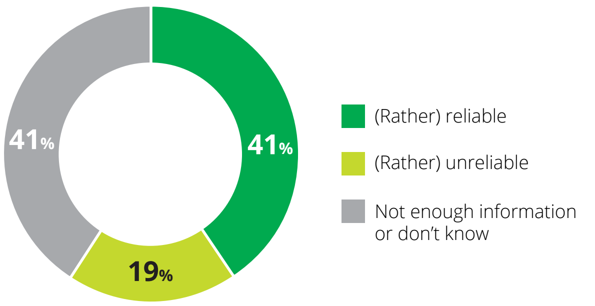
At the time of writing, over 750 products from more than 100 managers have been awarded the Towards Sustainability label. This initiative extends its reach to over 10 countries, allowing products governed by foreign legislation to be eligible for the label.

As a result, it stands out as one of the most comprehensive labelling initiatives for financial products in Europe.

A specific type of information when it comes to sustainable investment are sustainability labels, such as the Towards Sustainability label, which is most known on the Belgian market.

In general, sustainability labels are perceived positively by those who know and understand them. However, a substantial number of individuals express a lack of sufficient information or don't have an opinion about labels. We see that 41% of investors find these labels to a certain extent reliable, another 41% indicate they don't know, or do not have enough information on this topic. Only 19% believe labels are (rather) unreliable. Labels would certainly benefit from additional market awareness efforts.

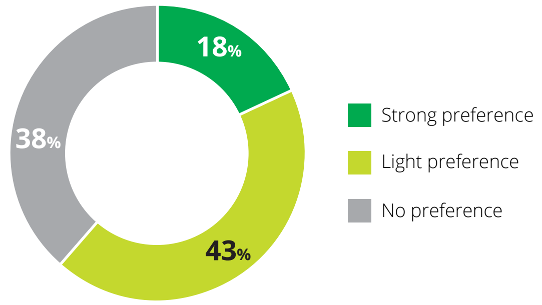
Figure 3.6: Opinion about sustainable labels



This seems to be in line with research covering 953 retail investors from 6 markets: Germany, France, the United Kingdom, Italy, Sweden, and Switzerland. Their research shows that investors tend to trust certified sustainable products, particularly intuitive decision-makers[29]. It has also been shown that investors consider other sustainability indicators as well. Various papers have demonstrated positive investor reaction to ESG ratings[30], which provide investors with an easy-to-grasp indicator of a fund's sustainability strategy.

When we asked investors whether they prefer products with a sustainability label when they are looking to invest sustainably, we see that a majority indicates they have a certain preference for products with a label but we can also not ignore that 38% does not report a preference for a label.

Figure 3.7: Preference for labels when looking to invest sustainably



This paradigm is also supported by the panel discussions. On the one hand participants look for a transparent and independent perspective on products, but also one that is understandable, such as a label, score, or theme.

On the other hand they are also sensitive to greenwashing and they need the necessary confidence that the labels are in fact granted based on objective criteria and data and are not just a marketing tool.

> "The label "Towards Sustainability" was developed by a banking association, I therefore don't know if it is really neutral. In my opinion it has to be an external player who can be considered as neutral."

> "Sustainability is often sold as a uniform concept, while there is a lot of variation and personal preferences can differ. Labels are considered less in investment products than in consumer products. It would be interesting if, for example, you could determine which ESG factor your investment scores well on."

It is therefore important for labels to provide the necessary assurance on their independence and objectivity by being transparent on the methodology used to attribute the label to certain products.

So far, we have seen that there is a lot of potential for sustainable investment to grow. But what about the returns of those investments, and how do investors react to them? And is there such a thing as a sustainability performance that can complement financial performance?

4. Evaluating performance: the intersection of financial and sustainable returns

Obviously, financial return is important when investing, and it's no different for sustainable investments. Interestingly, younger generations are even more sensitive to financial return than older generations.

There is no consensus on the financial performance of sustainable investments compared to traditional non-sustainable investments.

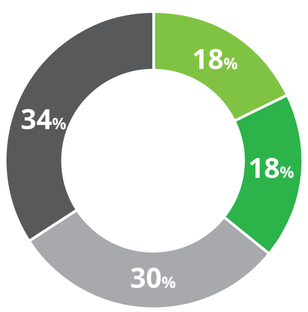
Investors value information on their investments' sustainability performance: the impact on ESG factors such as mitigating climate change or reducing social inequality. They want to track this impact, which some quote as a condition to invest sustainably. Meanwhile, others can even accept a lower financial return in exchange for proven sustainability performance.

We believe that the availability of objective information on sustainability return will become a differentiator for financial institutions.

a) Expectations on the financial return of sustainable investments

Respondents have mixed opinions on the financial return[31] they expect from sustainable investments compared to traditional, non-sustainable investments.

Figure 4.1: When comparing similar investments (e.g., investment funds, ETFs, etc.) where one considers ESG aspects and the other does not, what do you expect in terms of financial returns?



In our panel conversations, some participants expressed a firm belief in the potential of sustainable investment in the long term, and others expected sustainable investment to have a lower return.

> "In the longer term, I believe sustainable companies will also be profitable."

> "Sometimes it is better to directly support a non-profit organisation than to accept the lower returns of a so-called sustainable investment product."

When looking at the existing research, we see that there is no straightforward answer. In a systematic literature review[32] conducted in 2023, three main claims regarding the sustainability-performance relationship are presented:

- Integration of ESG criteria may **decrease systematic risk**, potentially resulting in lower expected returns[33].
- Demand for sustainable products might create a p**remium for environmentally-friendly assets**, contributing to reduced returns.
- Certain ESG indicators, such as good governance and high employee engagement, may offer f**orward-looking information**, potentially generating higher-than-normal returns.

The collective findings highlight the nuanced and varied nature of research outcomes in this domain.

Even when there is no clear answer on the question of how sustainable investments perform compared to traditional non-sustainable investments, it is relevant to analyse how investors behave when their investments do not generate the expected returns, and prepare communication strategies to guide that behaviour in the investor's best interest.

b) Investor behaviour in case expectations of sustainable investments are not met

Obviously, financial return was highlighted by our panellists as an important factor when investing, and this is not different for sustainable investments.

> "I would rather do a fiscally interesting gift to a non-profit than investing in a sustainable investment and getting a -2% return."

> "If I had more money I might be more conscious of sustainability in my investments, as I wouldn't need to focus that much on return."

In the survey, we polled how investors would react if their investment returns were not in line with their expectations. Would they change their portfolio from sustainable to traditional if the former underperforms, or vice versa? In general, investors are willing to move in both directions if their current portfolio underperforms.

Figure 4.2: Over the past 2 years, you have compared the financial returns of your investment portfolio, which is sustainable and excludes certain controversial activities, with a similar traditional, non-sustainable portfolio.

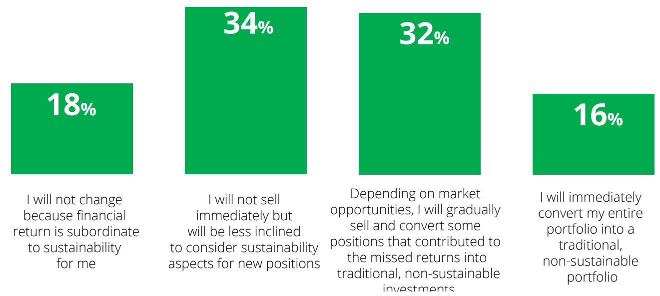
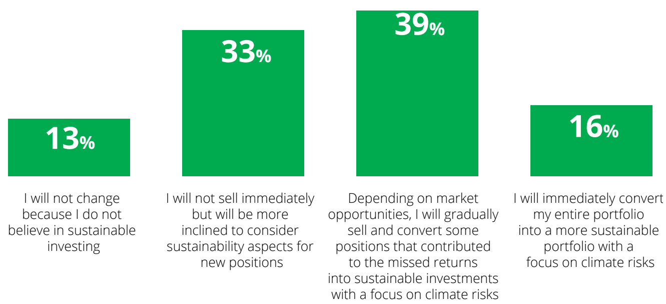


Figure 4.3: The financial return of your portfolio has been negative over the past 3 years because your bank/platform/broker did not consider the ESG risks of the companies in which you invested.



The younger age categories are more likely to prioritise return and move more quickly between investments[34].

Figure 4.4: Would you move from a sustainable portfolio to more traditional investments if the former underperforms? (by age)

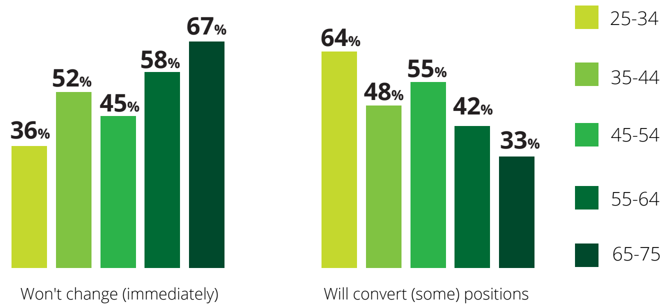
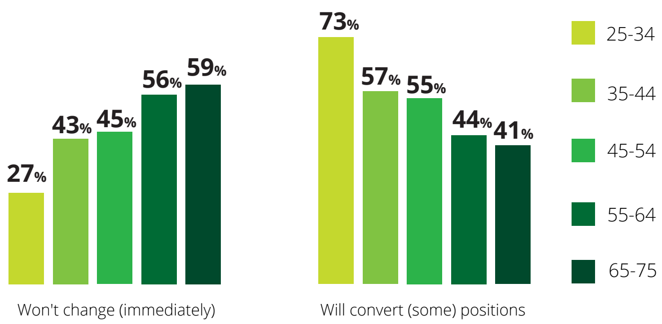


Figure 4.5: Would you move from a traditional portfolio to more sustainable investments if the former underperforms? (by age)



Some quotes from our panel conversations add additional flavour: there are many different attitudes towards financial return.

> "I invested in a sustainable product which returned 2% less than a savings account. I sold and will never invest again in ESG."

> "I'm young and am building my financial wealth – I don't have the capacity to give up financial gains in return for sustainability."

> "I am over 60 so for me the return isn't that important anymore. I have therefore more capacity to accept the lower returns of sustainable investment than younger generations."

As we were interested to see the tolerance for underperformance, we asked investors who indicated they would convert at least some positions at what levels of underperformance they would switch their positions. We find that action is triggered from 3% underperformance.

Figure 4.6: Conversion from sustainable to traditional investments when missed return is X%

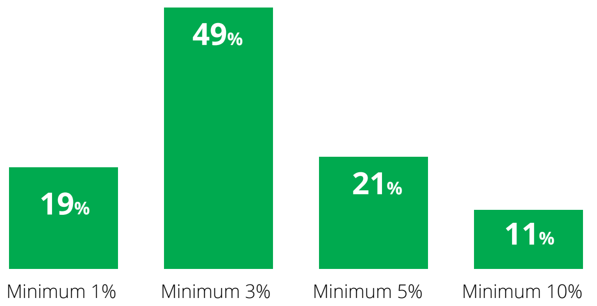
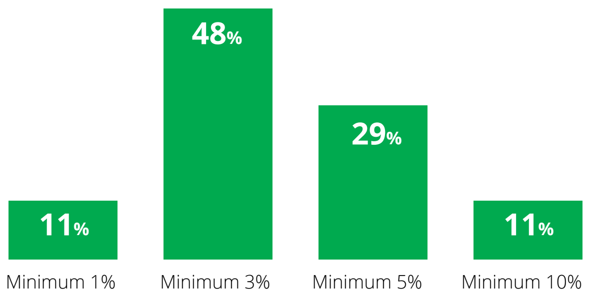
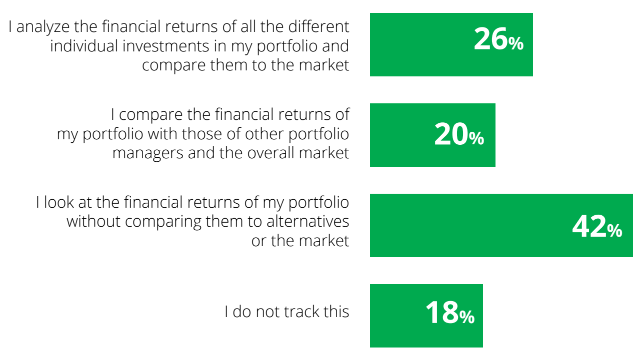


Figure 4.7: Conversion from traditional to sustainable investments when missed return is X%



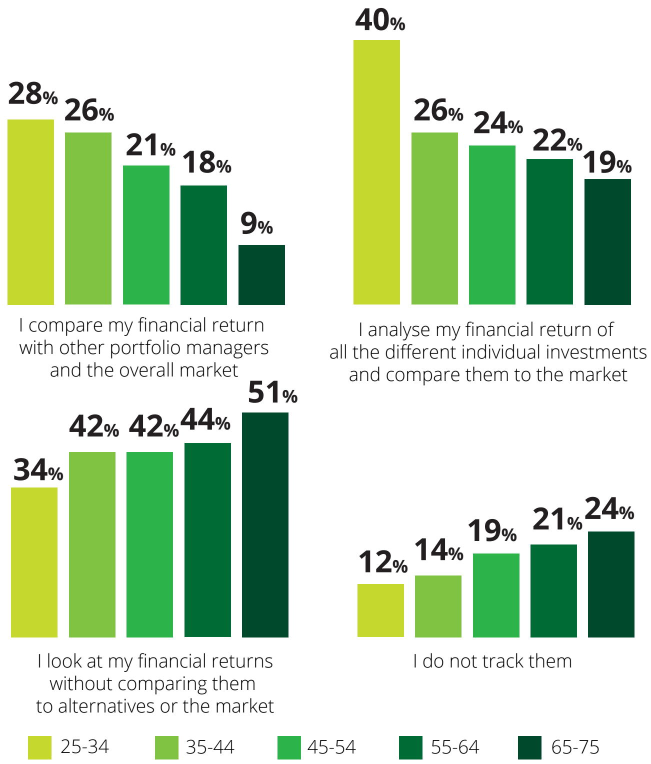
An important factor to keep in mind when considering investors' behaviour towards financial return is that it is not always well informed or rational. We see that 18% of our survey participants don't track the investment return, and 42% do not compare it to the evolution of the overall market. This lack of financial literacy was also highlighted in our Financial Health study[35] in 2023. Education therefore remains key when interacting with investors on performance.

Figure 4.8: How do you track the financial returns of your private investments?



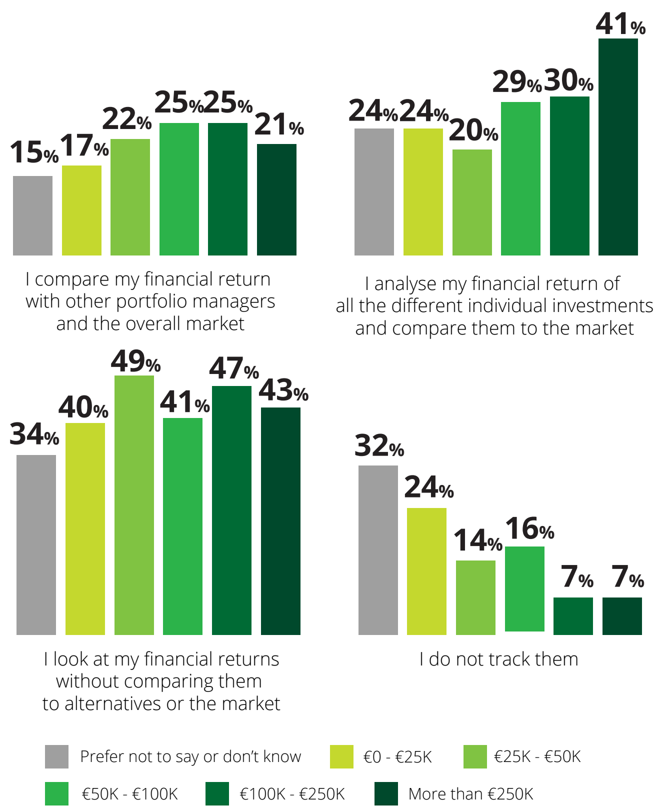
If we then look at how each age group responded, it is clear that the intensity of tracking financial performance decreases with age. However, we also see greater tracking in larger portfolios.

Figure 4.9: How do you track the financial returns of your private investments? (by age) (*)



(*) Multiple answers were possible

Figure 4.10: How do you track the financial returns of your private investments (by portfolio size)?(*)



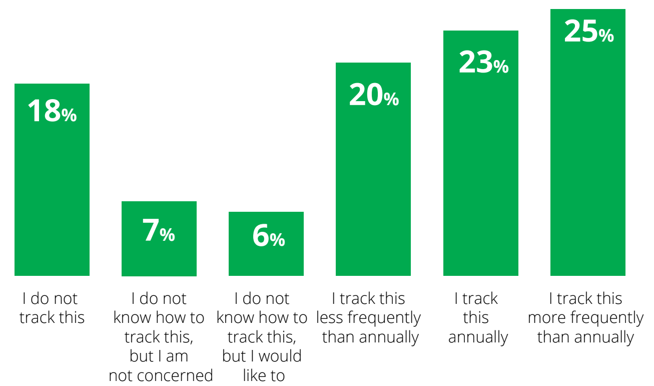
(*) Multiple answers were possible

c) Importance of evaluating sustainability performance – a motivator to better develop?

Besides looking at financial performance, we also want to know whether investors track the impact they made with their investments and whether their sustainability objectives were reached.

We see that more than two out of three investors with sustainable investments track their sustainability performance. In addition, almost half conducts such assessments annually or more frequently.

Figure 4.11 How often do you track your investments' sustainability performance?



Again, here we see that investors with sustainable investments often rely on their advisors to gather information on the obtained sustainability performance.

During the panel discussions, however, participants also indicated it was difficult to get a good view on the impact of their investments, even though they say that they want certainty about the fact that their investment also contributes to reaching their sustainability goals.

They want to track the impact they made with their investments, which some quote as a condition to invest sustainably, while others are even inclined to accept a lower financial return in exchange for a proven sustainability performance.

> "I want certainty about the ESG impact of my investments if I chose to invest in that."

> "As long as we don't have total transparency on the sustainability characteristics, I'll always go for the more profitable fund."

> "I look for investments over the long term. I accept a bit less profit if I know my children will reap the benefits of that."

Moreover, in the available literature and research we see that certain investors are willing to pay a higher price or accept lower financial performance for a proven sustainability return. One study depicts different kinds of preferences or concerns investors have with regard to sustainability. It considers the following profiles[36]:

- **ESG-aware investors** consider ESG criteria as a source of financial value[37]. These investors tend to be highly sensitive to the performance of their sustainable investments. They are likely to prefer ESG integration and thematic investment style over ethical or norm-based screening[38].
- **ESG-lover investors** are driven by norms and ethics and opt for socially responsible investment. These investors usually perform negative or positive screening of the investment universe[39]. They have non-pecuniary motives and benefit from a non-financial dividend. As a consequence, they are willing to pay a higher price for sustainable investments, in particular for certified products[40].This willingness to pay is primarily driven by an emotional valuation of potential impact[41]. In addition, these investors tend to be more loyal to sustainable investments, accepting some underperformance and being less sensitive to the financial performance of their investments[42].
- **ESG-unaware investors** do not consider sustainability criteria in their investment decisions.

This investor segmentation varies over time and has been shown to significantly impact financial market prices and expected returns[43].

Based on the above we believe it is an important differentiator when a financial institution is able to provide objective information on the sustainability performance of the investment products it offers. Although we understand that the data necessary to provide this information is not always available yet, this will be a topic that we believe will gain importance over time. Different stakeholders should be encouraged to reflect on how sustainability performance can be tracked in an objective and efficient way, and communicated in an engaging manner to retail investors.

5. Why KBC as a partner for this study

Climate change is one of the major challenges of the 21st century and has led to a wider debate around sustainability. Already in 2015, the United Nations Sustainable Development Goals were created, which address several ESG themes. Achieving these goals requires action from each of us.
As a bank-insurer, we take our responsibility seriously. Sustainability is one of our strategic pillars and we play an important role in the transition to a more sustainable future.

It is important that we, as a leading corporate in Belgium, reduce our footprint and make a positive impact on society. Both our employees and our customers are encouraged to take up this challenge together.

At KBC, sustainability is much more than empty words and promises. It is a real management objective and a strategic part of our organisation. The social, environmental, and economic challenges we face today require a thoughtful and appropriate response from the financial sector.
Within the field of responsible investment, KBC already launched its first responsible fund in 1992. This made us a Belgian pioneer in what was then still a niche market. In the meantime, we have built more than 30 years of expertise and continue to fulfil our pioneering role.

We regularly review our methodology on sustainable investments taking into account new societal and regulatory developments and we develop new investment solutions accordingly. Through our digital assistant Kate, as well as KBC Mobile, KBC Live, and the network of KBC branches, we aim to bring these concepts and products to the investment portfolios and mindsets of everyone.

Ambition and vision are important, but it is also essential to regularly take stock of investor needs and preferences in a more holistic way. Are investors concerned about sustainability? What does it mean to them? Which themes concern them most? In which areas do we need to step up our efforts to better inform and convince them?

KBC's sustainability story is flourishing, and this study aspires to provide both us and the Belgian place financière important insights to further enrich our approaches towards sustainable investing and investors.

6. Research Methodology

Approaching the topic using both quantitative and qualitative data, the study covered three overall areas of enquiry:

1. Is the retail investor concerned with sustainability topics?
2. How are such concerns being translated into investment portfolios?
3. Do the possibilities align with investors' expectations?

'Thought process' survey

To collect quantitative input a survey was proposed. In September the approach and scope were outlined. A questionnaire and the target audience were defined in October. In November Ipsos conducted the survey, with analysis and report writing taking place in December.

The questionnaire investigated the 'ideal retail investor's thought process', which was based on the following building blocks.

- How important is sustainability in their daily life, and how is this reflected in retail investment portfolios today?

- Where do respondents get their information on sustainability and investment from? Does the MiFID process help? What is the perception around sustainability labels?

- How do investors follow up the sustainability profile and performance of their investments, and what is their appetite to integrate sustainability into their future investment choices?

- How do they perceive the link between sustainability and financial return, and how does this relationship impact investment decisions?

- How is sustainability performance demonstrated, and how do these results affect financial returns?

The survey enrolled 1,000 investors from within the Belgian population. We selected only those possessing investments in financial instruments other than traditional pension-saving products, filtering out candidates under 25 and over 75.

In order to have a good representation of Belgian society, within this subset we achieved sufficient diversity based on various factors.

- Gender: 59% men, 41% women
- Age: +/-20% for each decennial segment: 25-34, 35-44, 45-54, 55-64, 65-75
- Region: 10% Brussels, 55% Flanders, 35% Wallonia
- Family situation: mix of singles, couples and families
- Education level: 43% up to secondary school degree, 32% bachelor's degree, 25% master's degree or higher
- Primary investment platform, bank or broker: eight different entities, with at least 30 respondents (the threshold for statistical significance)

- Range of invested asset ranges
  - 29% less than €25,000
  - 22% from €25,000 to €50,000
  - 28% from €50,000 to €250,000
  - 9% over €250,000
  - 12% prefer not to say, don't know

Panel discussions

Qualitative input was collected through panel discussions with about 20 participants selected by Ipsos, using questions based on input from Deloitte and KBC. There were four panels: two in Dutch and two in French. In addition to possessing financial investments, participants were required to have an interest in sustainable investments, whether or not these were already in their portfolio. In choosing participants, a good mix was made in terms of educational background, gender, age and main banking institution.

Literature study

To further test the conclusions drawn from the quantitative and qualitative data, researchers from HEC Liège reviewed the academic literature available on the subject. The relevant conclusions were integrated into our report to show where results either confirm our conclusions or nuance them.

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We would also like to thank the Chair in Sustainable Finance of HEC Liège for their valuable academic insights, and in particular Marie Lambert and Céleste Hardy

Marie Lambert
Professor of Finance

Céleste Hardy
PhD Student

Footnotes

1 https://www.forumethibel.org/nl/publicaties/ersis-studies
2 https://www.nbb.be/doc/dq/n/dq3/histo/cnf23iii.pdf
3 https://www.gfanzero.com/netzerofinancing/
4 The methodology is further described in section VI of this document.
5 In this report, 'financial institution' refers to different types of companies providing investment advice, advice on insurance products or portfolio management, such as, but not limited to banks, undertakings for portfolio management and investment advice, brokerage firms, intermediaries in banking and investment services, insurance undertakings, insurance intermediaries.
6 https://www2.deloitte.com/be/en/pages/financial-services/articles/financial-health.html
7 https://www.wikifin.be/nl/sparen-en-beleggen/ethischduurzaam-beleggen-en-bankieren/wat-duurzaam-beleggen
8 https://www.wikifin.be/nl/sparen-en-beleggen/ethischduurzaam-beleggen-en-bankieren/hoe-selecteer-je-het-juiste-duurzame
9 Tax regime introduced by Luxembourg's 2021 budget law, published in the Luxembourg Official Journal on 23 December 2020
10 https://www.gesetze-im-internet.de/kagb/__222.html
11 Council Decision (EU) 2016/1841 of 5 October 2016 on the conclusion, on behalf of the European Union, of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change
12 Communication from The Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions : The European Green Deal (COM/2019/640 final)
13 Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms.
14 Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms; Commission Delegated Regulation (EU) 2021/1257 of 21 April 2021 amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance
requirements for insurers and insurance distributors and into the rules on conduct of business and investment advice for insurance based investment products.
15 To enhance readability, we will use the term 'advisor' or 'investment advisor' in this report. It should be understood that herewith we refer to all persons providing investment advice or portfolio management as defined under MiFID as well as persons providing advice on insurance products as defined by IDD.
16 ESMA publishes final guidelines on MiFID II suitability requirements (europa.eu)
17 https://www.eiopa.europa.eu/eiopa-publishes-guidance-integrating-customers-sustainability-preferences-suitability-assessment-2022-07-20_en
18 https://www.esma.europa.eu/press-news/esma-news/esma-launch-common-supervisory-action-mifid-ii-sustainability-requirements
19 https://www.esma.europa.eu/sites/default/files/2023-06/ESMA35-43-3599_Call_for_evidence_on_MiFID_II_suitability_and_sustainability.pdf
20 The methodology is further described in Section VI of this document.
21 Anderson, A., & Robinson, D. T. (2022). Financial literacy in the age of green investment. Review of Finance, 26(6), 1551-1584.
22 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088
23 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector
24 Concerns were raised by many stakeholders in their responses to ESMA's consultation on integrating sustainability risks and factors in MiFID II. This was also confirmed in ESMA's Call for Evidence on the integration of sustainability preferences in the suitability assessment and product governance arrangements (§19 - Q10). The same concerns were raised by the insurance sector following EIOPA's consultation on IDD guidelines on the integration of customer sustainability preferences in the suitability assessment under IDD (see feedback statement).
25 D'hondt, C., Merli, M., & Roger, T. (2022). What drives retail portfolio exposure to ESG factors? Finance Research Letters, 46, 102470.
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