# Consumers accept more risk and lower returns on sustainable investments

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## In brief

- Experiments demonstrate that retail investors accept lower returns and more risk if investments are sustainable.
- Supervision of sustainable investments and marketing with sustainability claims is important precisely because sustainability sells.

**Calls from society for sustainable investing are growing ever louder. But to what extent are retail investors willing to accept more risk or a lower return in exchange for a sustainable investment? Online experiments conducted by the Dutch Authority for the Financial Markets (AFM) provide insight into that question.**

The transition to a sustainable society and economy is clearly visible in the financial markets. The range of investment products and services with a sustainable character available to consumers has increased considerably. This also offers non-professional investors the opportunity to make a positive and sustainable impact with their investments. Sustainable investments can, for instance, be made on the basis of environmental, social and corporate governance (ESG) principles.

Scholtens (2018) asserts that '*the scope of sustainable savings and investment for retail investors is limited, but is growing in relation to the total Dutch retail savings and investment markets*.' The figures from the early 1990s reflect a steady upward trend, with sustainable investments made by retail investors accounting for a 9% share in 2015. Due to the increased focus on sustainability and the United Nations Sustainable Development Goals, the expectation is that this trend will only continue.

Sustainability appears to be an increasingly important factor in the financial decision-making process. American research shows that investment funds, after receiving the highest sustainability rating from Morningstar, received a net inflow of more than USD 24 billion in invested capital in just 11 months. By contrast, funds with the lowest sustainability score witnessed a net outflow of USD 12 billion in the same period following publication of the scores (Hartzmark and Sussman, 2019). The researchers concluded that investors in the United States of America rate sustainability positively.

Riedl and Smeets (2017) conducted a study on why retail investors at Robeco want to invest sustainably. They concluded that investors are primarily intrinsically motivated. They find that both social preferences and social signalling explain socially responsible investment decisions. Financial motives play less of a role. The costs, expressed as the total expense ratio, of the socially responsible equity funds in this study were significantly higher than those of the regular funds, at 2.2% and 1.5% respectively

The studies suggest that sustainable aspects influence investment choices. The AFM therefore wants to obtain insight into the way in which information on sustainability is packaged and what the effect of marketing sustainable products is on consumer investment behaviour. '*Consumers and other customers must be properly informed and advised on sustainability factors to support their financial decisions. They will receive a product that is appropriate for their needs*' is one of the principles underlying the AFM's supervision of the sustainability principles (AFM, 2020).

## Two experiments

In the two experiments conducted with retail investors, the AFM investigated what the relative economic importance is of the generic characteristic 'sustainable' in relation to the risk or expected return on the investment. The experiments were carried out with online panels and focused on intentions rather than on actual trading behaviour. In 2015, a non-representative sample from the AFM Consumer Panel was used, and in 2018, the representative sample consisted of retail investors from the panel of Dutch market research agency GfK.

In both experiments, the respondents were shown a fictitious stylised advertisement, one half with greater emphasis on sustainability ('Investing for a sustainable world') and the other half without that specific focus ('Investing around the world'). The non-sustainable condition even emphasises the positive aspect of a diversified investment. In addition, the expected return or risk class varied. Figure 1 shows examples of the advertisements used.


*Figure 1: The advertisements shown, with the sustainable investment on the left and the non-sustainable investment on the right. In this example, the sustainable variant on the left is classified in risk category 6, whereas the non-sustainable investment on the right scores 5 on the investment risk meter (top right).*

The respondents expressed their preference by allocating €10,000 across these two investments. If all the other characteristics are otherwise identical, there is a significant preference for sustainable investing. For the four groups in which the risk and return were otherwise identical, the investors allocated between €6,283 and €6,973 on average to the sustainable variant (the four dark bars in Figure 2).

## Investors invest sustainably, even if the return is lower or the risk is higher

*Amount invested in sustainable variant (from a total of €10,000)*

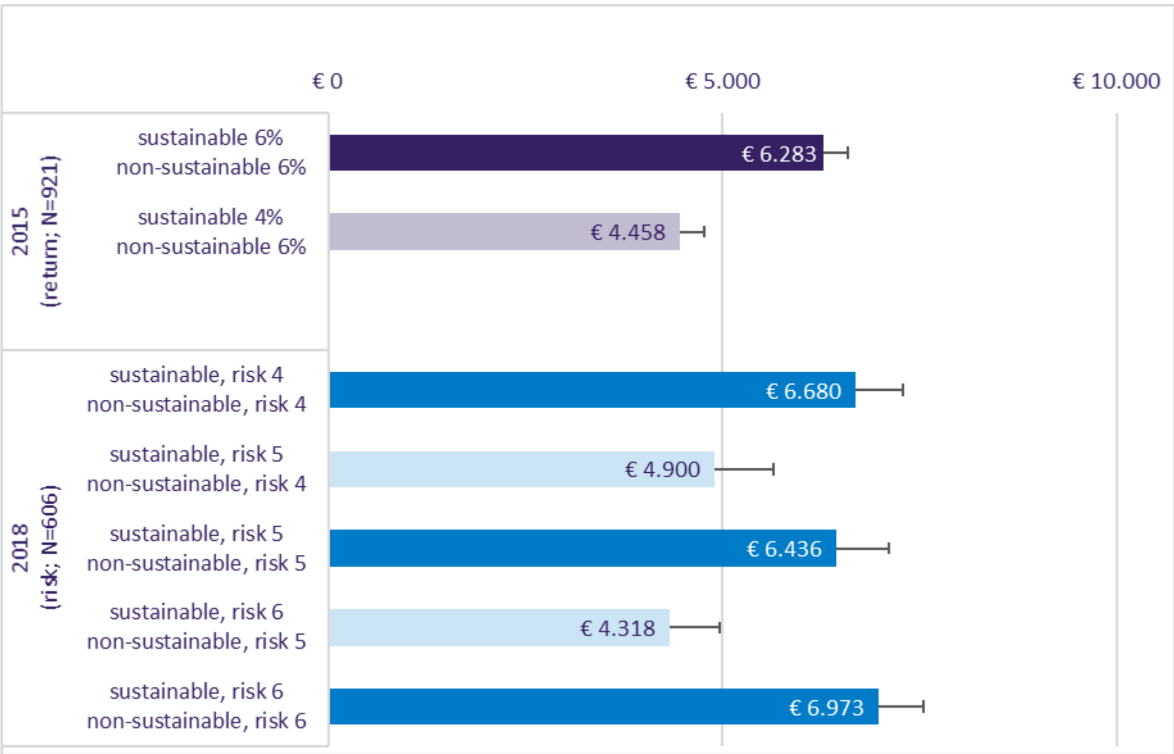


*Figure 2: Sustainable versus non-sustainable or 'regular' investment. In the dark bars, the risk and return were identical between the sustainable and the regular investment. In the light-purple bar, the return on the sustainable investment is lower. In the light-blue bars, the risk is higher for the sustainable investment. The amounts are averages with a 95% confidence level.*

The experiment conducted with the AFM Consumer Panel in 2015 included testing how the preference for sustainability compares with the expected return. If the non-sustainable offer has an expected 6% return and the sustainable offer a 4% return, the allocation shifts and the average investment in the sustainable offer is €4,458.

A similar experiment, in which the risk category of the investment varied, was conducted in the autumn 2018 edition of the AFM Consumer Monitor. The risk category can vary from 1 to 7, with bond funds often classified in category 4 and equity funds often classified in higher categories, such as 5 or 6. The higher the risk category number, the higher the risk. The risk meter featuring the seven risk categories is a legal requirement and is standardised. If the risk classification for the sustainable investment is one category higher – i.e. with a higher risk – the allocation of the €10,000 shifts to a fifty-fifty allocation. In the case of a sustainable offer in risk category 5 and a non-sustainable offer in risk class 4, the average investment amounted to €4,900 (or 49%), in the sustainable variant.

For the two groups with an identical risk profile between the sustainable and non-sustainable variants, around 40% opted to invest the total amount in the sustainable variant, whereas 10% opted to invest nothing in the sustainable variant. If the sustainable investment is one risk category higher than the non-sustainable investment, 23% invest the full €10,000 in the non-sustainable variant.

## Conclusions and policy implications

In conclusion, the sustainable aspect of an investment appears to make a sustainable investment as attractive on average as a regular investment if the expected return on a regular investment is a couple percentage points higher. The same applies to risk: based on the legally required risk categorisation of seven categories of risk, an investment without any emphasis on sustainability that is graded one risk category lower is approximately as attractive as the sustainable investment carrying a higher risk.

Customers are willing to sacrifice some returns in order to invest sustainably. Or in a nutshell: ‘Sustainability sells’. It is not possible to establish which particular aspect of sustainability attracted investors here, as only the generic, abstract concept of sustainable was used. Investors were free to interpret it in their own way. An alternative explanation that we cannot rule out either is that the respondents had no interest in investing globally (‘around the world’) and therefore opted for the sustainable version.

Given that customers are willing to sacrifice some returns in order to invest sustainably, it is important that products and services labelled as ‘sustainable’ actually do have a sustainable impact. ‘Greenwashing’, a practice in which market parties falsely promote non-sustainable products as sustainable in slick marketing campaigns to boost sales, must be prevented. It compromises the customer’s interests, and such misuse will erode the added value of sustainable characteristics in the long term.

Financial enterprises must therefore ensure that the sustainable products they offer are actually sustainable. It is their responsibility to communicate the advantages of their product, including sustainability, in a fair and balanced manner. The positive aspects of a product or service should not detract from the potential disadvantages of a product either, such as the costs or risks associated with it. All in all, customers must be able to make an informed choice for sustainable products, and be able to rely on the information and marketing activities of financial enterprises relating to these aspects being correct, clear and not misleading. The AFM supervises compliance with the legal requirements for the provision of information. It is also of paramount importance that the information on sustainable characteristics is not misleading nor paints an unduly rosy picture of sustainable performance to investors.

The development of legislation incorporating a shared definition of what is sustainable will contribute to greater transparency and better information in the sustainable investment market. European policy makers are working with the market on a taxonomy containing a classification of specific economic activities that can be classified as ecologically sustainable (European Commission, 2020).

Sustainability is becoming a more prominent item on the agenda for both consumers and financial enterprises. Investor confidence in sustainable products and services is vital in both the short and the long term. 'Sustainability sells' is therefore a matter that market parties, the legislator and the supervisory authorities must take into consideration to ensure the proper functioning of the developing market for sustainable investing.

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