Sustainable investment preferences and how they are delegated

Chapter 5

Summary of the findings

According to a recent amendment to the EU-wide MiFID II regulation, financial institutions are required to elicit their clients' sustainability preferences. Through this regulation change, sustainability has found a natural entry point into consultations between financial advisors and clients. This dissertation explores the impact of sustainability-related financial advice on investment behavior. Comprising three distinct chapters, it delves into the dynamics of financial advisors' role in promoting sustainable investments.

In Chapter 2, I investigate implications for pricing through a study involving 415 professional advisors in the US and Europe. These advisors manage investment portfolios on behalf of clients, who submit either a conventional or a socially responsible investment mandate. The results show that financial advisors charge a premium for sustainable investment mandates, with the study design ruling out differences in effort, skill, or costs as explanations. Instead, the results are consistent with price discrimination, where advisors exploit clients' sustainable investment preferences to extract additional profits.

Furthermore, this premium is primarily imposed on sustainable investment clients with low or unknown financial literacy. Interestingly, the premium diminishes when advisors know clients' financial literacy to be high. The results further indicate that providing advice to sustainable investment clients presents an opportunity for advisors to earn higher fees, with sustainable investors being as likely as conventional clients to pay for advice, even at a premium.

In the Chapter 3, I administer a field experiment with clients of a European universal bank to examine the impact of perceived social norms on sustainable retail investments. I provide retail investors with information about peers' inclination towards sustainable investing during an investment decision. My results show that peer information raises the amount allocated to stock funds labeled as sustainable. This effect is primarily driven by participants initially underestimating peers' propensity to invest sustainably. Further, treated individuals indicate an increased interest in additional information on sustainable investments, primarily on risk and return expectations. However, by analyzing account-level portfolio holding data over time, I find that peer information does not affect the sustainability of investor portfolios over the months following the experiment.

In Chapter 4, I exploit a large dataset from a European bank to gain deeper insights into how retail investors react to negative environmental, social, and governance (ESG) news concerning companies in their portfolios. The dataset connects investor trading records, dividend income, and consumption-saving behavior at the individual level. The sample consists of 18,566 individual investors and covers a 24-month period from July 2017 to July 2019. I merge this customer data with daily firm-level ESG news sentiment scores from Truvalue Labs. I find that retail investors do not sell in response to scandals that expose socially irresponsible business practices of firms in their portfolio. However, investors do react to these news by showing an increased consumption response. Specifically, investors consume approximately twice as much out of dividends associated with negative ESG news sentiment, compared to income from companies without negative ESG news. I control for selection effects and rule out attention and adjustments to the dividend payout size as mechanisms. Instead, the results are consistent with laboratory evidence showing that people who earn money by violating social norms counter resulting negative emotions with mood-enhancing behavior, such as increased consumption. This aligns with the principles of emotion regulation theory. I demonstrate the applicability of emotion regulation theory outside of the laboratory in an important real-world context, financial markets.

Overall, this dissertation shows that financial advisors may foster sustainable investing by providing information to clients during the buying decision, even though this information does not affect the sustainability of portfolios in the long-term. However, selling behavior is less influenced by new information on the sustainability of firms. The findings also reveal that financial advisors charge a premium for sustainable investing mandates and clients who cannot signal high financial literacy bear the burden of higher fees.