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POLICY BRIEF

Sustainable Finance Literacy and the Determinants of Sustainable Investing

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Executive Summary

- Sustainable finance literacy (SFL) refers to retail investors' knowledge of regulations, norms, and standards for financial products with sustainable characteristics.
- Among Swiss retail investors, SFL is low.
- Low levels of SFL are associated with investing less in sustainable assets.
- Policymakers and industry stakeholders can increase SFL through information programs.
- Improving SFL could increase retail investors' sustainable asset holdings.

Outline

Sustainable financial products account for more than half of the inflow into European investment products. However, despite numerous regulatory and private-sector initiatives, no clear definition has yet emerged in financial markets that identifies an investment product as sustainable. Because of this lack of transparency, individual investors' knowledge of sustainable investment products becomes critical to making informed investment decisions. This policy brief presents the results of a household survey in Switzerland. We measured retail investors' knowledge about sustainable financial products and showed how this knowledge influences sustainable investments. We call this concept sustainable finance literacy (SFL).

To measure SFL, we differentiated between two approaches: first, a broad level of SFL that describes knowledge about sustainable finance in general. In a second measure, we evaluated the specific knowledge about the rules and definitions of sustainable investing. For our analysis, we surveyed a representative sample of 3.059 experienced retail investors in the German-speaking part of Switzerland between October and November 2021.

Our results show that the level of SFL is low among retail investors. Moreover, higher levels of SFL are associated with more sustainable investments. Unlike investors' intrinsic environmental preferences, policymakers and industry actors can address sustainable finance literacy. The level of SFL can be increased through educational and information measures. In consequence, educational efforts on SFL could increase sustainable investments.

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Sustainable Finance Literacy

We identified three main areas of specific knowledge related to sustainable investments that are likely to be essential for retail investors to make informed investment decisions: questions on the general concept, rules, labels, questions on requirements to get an ESG label, and questions on the impact on the real economy. The SFL indicator consists of 8 multiple-choice questions that cover these three major areas. A summary of the answers can be seen in Table 1.

Table 1: Results from multiple-choice questions on SFL

	% Correct
QUESTIONS ON THE CONCEPT, RULES, AND LABELS	
- ESG definition	26.41
- ESG rules	41.03
- Awareness of labels	12.68
QUESTIONS ON REQUIREMENTS TO OBTAIN AN ESG LABEL	
- ESG example	32.30
- ESG elements	4.48
QUESTIONS ON THE IMPACT ON THE REAL ECONOMY	
- ESG impact	52.24
- ESG engagement	47.92
- Impact definition	20.14

The first question asked about the meaning of the three characters in the ESG acronym, which 26.4% of the respondents correctly identified. Next, we asked if a product must meet a uniform set of criteria by the state regulatory authorities to be advertised as a sustainable finance product in Switzerland. For this question, 41% knew the correct answer: no. In the third question, we asked the respondents if they knew of a label that certifies a sustainable finance product, which was the case for 12.7% of the respondents.

The next area of questions asked if respondents knew that a sustainable finance product is not required to meet sustainability in the three areas but only in one of them. We asked if it was possible to call the shares of a company on the financial markets a sustainable finance product if that company shows a low environmental footprint but poor social practices. 32% answered correctly yes. The following questions asked how many of the three ESG components a company must be sustainable to be considered a sustainable company by the financial market. Strikingly, only 4.5% of the respondents answered that only one of the three elements must be satisfied. This result may indicate that the definition of sustainability in financial markets does not always align with public understanding.

The last three questions covered the impact of sustainable finance products on the real economy. Many retail investors are unaware that a sustainable finance product is mainly traded on secondary financial markets, which means that an investment in such a product has no direct and immediate impact on the real world. Therefore, the first question asked if investing in a sustainable fund that includes companies with a low CO2 footprint directly reduces global CO2 emissions (52.2% correct). In the following question, we asked if financial institutions that offer sustainable products proactively influence the behavior of the companies in which they are invested. 48% of the respondents correctly answered that this is not always the case. Our last question asked if there was a difference between sustainable and impact investing. Only 20% of the respondents knew there was a difference between the meaning of these two terms.

General Sustainable Finance Literacy

Survey respondents answered an open-ended question with a written response to determine the level of SFL in general. Specifically, respondents described what they think makes the difference between a traditional financial product and a sustainable financial product. Next, we extracted topics from the text responses with an artificial intelligence algorithm developed for this purpose.

Figure 1 reports the share of each topic extracted from the open-ended text answer. More than half of the respondents associate sustainable financial products with the environment, 26% with social characteristics, and only 5.8% with governance. Only 2.1% explicitly mentioned the ESG criteria or the United Nation›s Sustainable Development Goals. The exclusion of weapons and other dangerous products, such as tobacco, was cited by 6.9%. Of all respondents, 10.2% associated sustainable investments with general ethical practices. Some respondents highlighted financial aspects of sustainability, i.e., they related sustainable finance products to low-risk financial sustainability (8.5% of respondents), long-term investment horizons (7.8% of respondents), and less return (2.7% of respondents). A fraction of 8.7% answered that sustainable products are only a marketing strategy and constitute greenwashing. At the same time, 9.8% stated that sustainable products should have a form of certification or control about their sustainability characteristics. Finally,

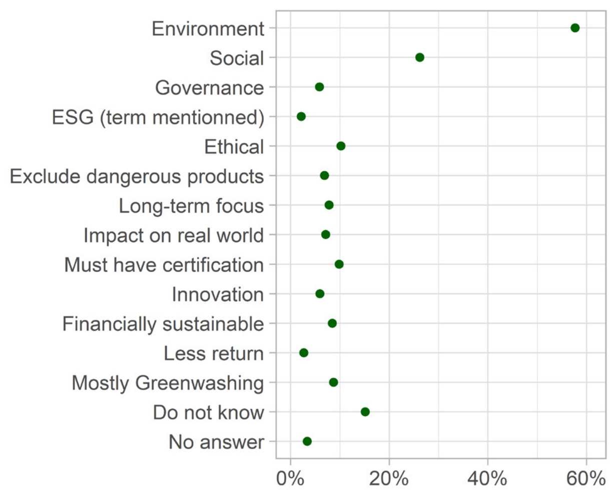

Figure 1: Share topics mentioned by respondents to describe a sustainable finance product.

15.1 % of the respondents did not know the difference between a traditional and a sustainable finance product.

Determinants of Literacy

The level of general SFL, based on the open-ended question, is measured by the number of topics in each response. Because respondents were not restricted in their writing, they mentioned several topics in their answers. The SFL score from the multiple-choice questions is the sum of correct responses.

Figures 2 and 3 show the number of topics per respondent for each literacy measure. On average, respondents mentioned 2.4 points out of a maximum of 8. The general SFL based on open-ended questions follows a similar distribution, with more respondents having low scores. Respondents mentioned, on average, 1.6 topics and a maximum of eight topics. Both SFL scores clearly show that the knowledge about sustainable finance products is generally low. This lack of knowledge on the investor side constitutes an apparent barrier to a well-functioning market for sustainable finance products.

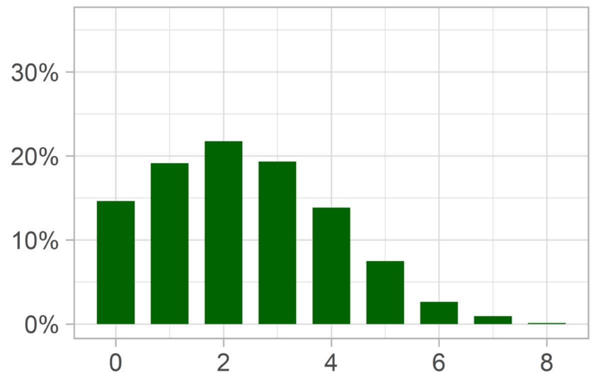

Figure 2: Distribution of SFL scores based on multiple-choice questions.

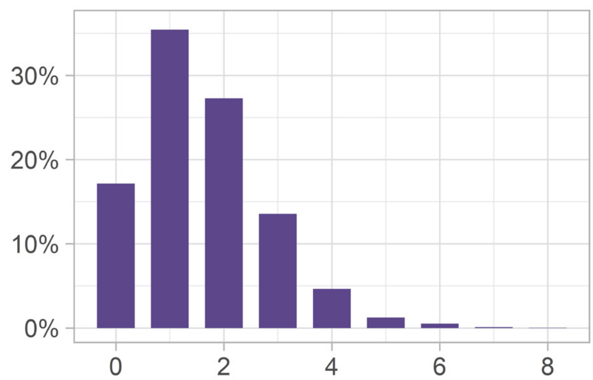

Figure 3: Distribution of SFL scores for the general measure based on open-ended responses.

Both SFL scores correlate with education, where a higher level of education among respondents implies a higher SFL score. The SFL, based on multiple-choice questions, is lower for older respondents, respondents with a lower income, and women. This gender gap is a known phenomenon that also prevails in classical financial education, where the level of financial literacy is lower among women. In contrast, the general measure for SFL, based on open-ended text answers, does not suffer from a gender gap. Moreover, higher scores in the general SFL are also not associated with differences in age or income.

Both measures of SFL are equally associated with owning sustainable finance products. Respondents with a high score in either of the literacy measures tend to hold sustainable finance products more frequently. Furthermore, the higher probability of sustainable investments is among respondents with a high score in both literacy measures. This finding implies that the general measure from the text answer, and the specific knowledge from MC questions, are complementary in explaining sustainable finance literacy.

Implications and Policy Recommendations

We find a low level of knowledge about sustainable finance in a survey of financially engaged households with a high degree of classical financial literacy. This sobering result reveals that the speed at which sustainable investing has gained traction and become mainstream has disadvantaged retail investors. It is necessary to compensate for the retail investors' information disadvantage. For this purpose, it is high time to establish transparent and legally binding regulatory standards beyond a loose set of voluntary recommendations.

However, rules alone are not sufficient. Launching information campaigns on sustainable finance to increase public awareness and understanding of sustainable investments is equally critical. In addition, policymakers can use educational measures to increase the level of SFL. Unlike environmental preferences, another key driver for investors to hold sustainable assets, investors' literacy can be addressed by policies. Further, the financial industry could also profit from increasing the information about sustainability provided to investors, as this would also increase SFL and could lead to higher demand for these products. Ultimately, retail investors have great potential to contribute to a sustainable transformation of the economy.

References

Filippini, Massimo and Leippold, Markus and Wekhof, Tobias, Sustainable Finance Literacy and the Determinants of Sustainable Investing, Swiss Finance Institute Research Paper (2022). Link: http://dx.doi.org/10.2139/ssrn.3997285

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