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Sustainability preference elicitation under MiFID II – a market survey

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Executive Summary

Since August 2022, European banks have been required to record clients' sustainability preferences under the MiFID II regulations. We present the results of a survey of banks to understand the practical consequences of this rule. We find that banks implement the regulation in different ways with no clear emergence of a common practice yet. Our main results indicate that, on average, only 5% of clients express a preference for sustainability. This figure is low compared to the fraction of clients who have invested in sustainable products, which is on average 40%. We explore possible reasons for this gap and offer suggestions for improving the measurement of sustainability preferences.

Sustainability Requirements for Investment Firms under MiFID II

An important pillar of the EU's "European Green Deal" is to provide financing for the transition. One of the three main objectives captured under this pillar is to reorient capital flows towards a more sustainable economy. In this spirit, the EU revised its investor protection regime, with the new Markets in Financial Instruments Directive II (MiFID II). The new provisions require financial institutions to integrate sustainability in their product governance and suitability processes. Specifically, this means that firms must gather information on clients' sustainability preferences, make sure that investments meet sustainability criteria, and clarify how products align with sustainability-related objectives[1].

Survey

We conducted a survey with wealth managers in Liechtenstein and Switzerland to evaluate their implementation of ESG preference elicitation as required by MiFID II. The questionnaire was sent to ten wealth managers, of which six responded. The Swiss institutions surveyed are all engaged in cross-border activities and, therefore, are subject to MiFID II regulations. The survey focused specifically on client relationships that fall under MiFID II. It contained questions about the preference elicitation process, the aggregate client responses, and the sustainable investment offering. The responding institutions collectively manage assets for over 40'000 MiFID II clients. This number is a conservative estimate based on the sum of reported figures. Not all responding institutions reported the absolute number of clients affected, which means the true number is greater. Results are presented in an anonymized format. We thank all participating institutions for sharing valuable data with us. We also thank Patrick Schmucki at KPMG for establishing contacts.

Approaches to ESG Preference Elicitation

According to the survey results, banks use various methods to determine client preferences for sustainable investment products. These methods differ in the number of categories considered, the number of questions asked, and the time required (see Table 1). Most banks use three categories, some use four or even five. On average, discussing sustainability preferences takes about 7 minutes and preferences are recorded with 2 to 3 questions. Sometimes, the elicitation process can take substantially longer, depending on the client's level of interest. In all surveyed institutions, this process is conducted in the presence of a client advisor.

Table 1: Characteristics of the Elicitation Process

Bank	**Nr. of Sustainability Categories**	**Nr. of Questions**	**Duration (in min.)**
1	3	4	10
2	3	1	5
3	4	4	10
4	-	5	-
5	5	1	5
6	3	1	5
Average	3.6	2.7	*7*

The range and availability of sustainability-focused financial products also vary across institutions. Some institutions offer their clients a wide variety of different funds, others offer direct access to securities, some offer different mandates, and yet others offer a combination of those approaches. As a result, interpreting survey responses regarding product offerings was challenging. Nonetheless, one observation that can be made is that the way of implementation of the MiFID II requirements is closely aligned with how each institution has structured its product portfolio.

Clients' Sustainability Preferences

The main part of our survey focused on understanding the sustainability preferences as measured under the MiFID II regulation. Although the surveyed institutions categorize clients differently (see Table 1), they all use a baseline category plus one or more additional categories that reflect varying levels of sustainability preference, such as "responsible" and "sustainable". To compare across institutions, we use two categories for further analysis: Baseline (no sustainability preference) versus all other categories combined (some sustainability preference).

We find that a relatively small number of clients express a sustainability preference (see Table 2). On average, banks record a MiFID II sustainability preference for only 4.9% of clients, ranging from 0% to 16.2%. This figure is based on data from a total of over 40’000 clients in scope of the MiFID II requirements. Although this is not a representative sample, it is nonetheless a large sample of real clients and is, therefore, a reasonable estimate of the prevalence of MiFID II sustainability preferences among bank clients. It remains uncertain whether the figure is higher or lower for institutions that did not respond to our survey and for institutions based in other European countries.

The range from 0% to 16% can be attributed to two main factors. First, it could be that clients of one institution have different preferences than clients of another institution. For example, if a bank targets clients with sustainability interests, the figure might be higher. Second, the method used to elicit sustainability preferences could play a role. Given that there is considerable variation in how these preferences are elicited, this is also a reasonable explanation.

Table 2: Sustainability Preferences and Investments of MiFID II clients (total N>40’000)

Bank	**Clients with a sustainability preference**	**Clients with sustainable investments**
1	16.2%	-
2	1.0%	35.0%
3	5.3%	38.0%
4	2.0%	82.0%
5	0.0%	5.7%
6	-	-
Average	*4.9%*	*40.2%*

In addition to client preferences, we also collected data on clients’ holdings of sustainable investment products. We asked participating institutions for the fraction of clients that have at least some investments that can be classified as sustainable under MiFID II and related European regulations. We find that, on average, 40.2% (5.7% to 82%) of clients hold at least some sustainable investments.

Figure 1 highlights the gap between sustainability preferences and sustainable investment holdings. For every bank surveyed, more clients hold sustainable investments than have explicitly stated a sustainability preference. On average, this difference is a factor of eight. Even considering potential differences in how institutions define sustainable investments, there appears to be a systematic gap between the number of clients who express MiFID II sustainability preferences and those who hold sustainable investments.

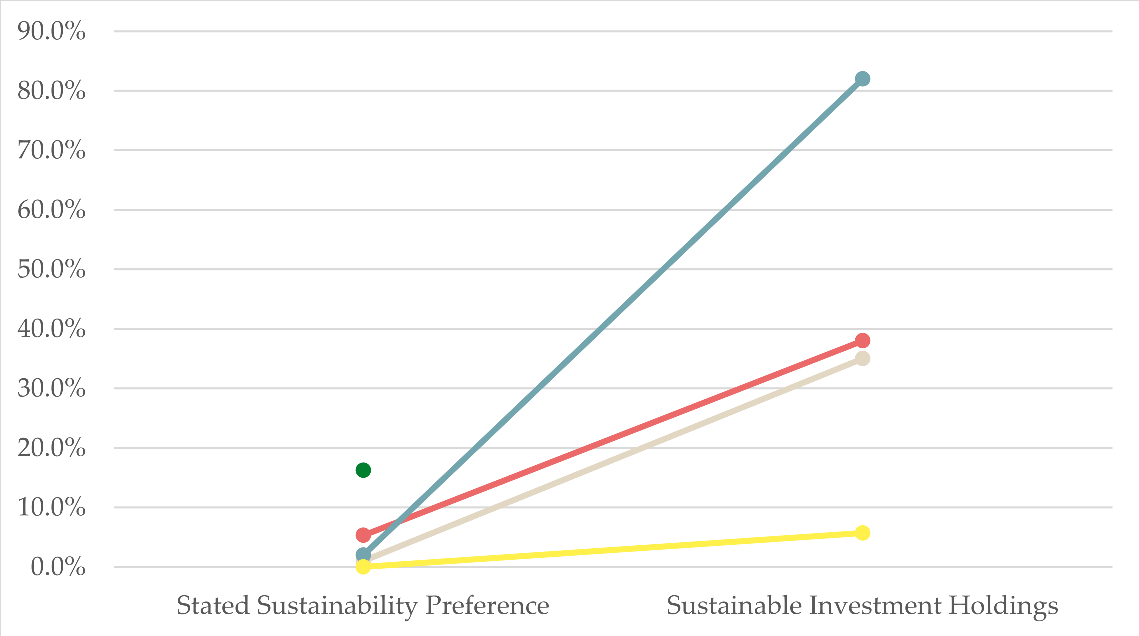

Figure 1: Stated Sustainability Preference vs. Sustainable Investment Holdings. Different Institutions are shown in different colors.

Discussion

Our survey results reveal a large gap between MiFID II sustainability preferences and sustainable investment holdings. In the following, we discuss potential explanations for this gap.

1.1 Limited Explicit Preferences for ESG Products

One possible explanation for the gap is that client preferences for sustainability are, in fact, around 5%. The figures rely on data from a substantial number of real clients and thus must be taken seriously. However, this explanation seems unlikely for two reasons: First, it contrasts sharply with the fact that, on average, 40% of clients hold sustainable investments—a figure that applies to the same clients and comes from the same institutions. Second, it contrasts with academic surveys that suggest that 50% to 75% of investors have a preference for sustainable investments[2–4]. While these figures come from different samples and are generated with different methods, they also suggest that the figures based on MiFID II preferences seem very low.

1.2 Strategic Under-Reporting of Sustainability Preferences

An alternative explanation is that the way in which sustainability preferences are collected under MiFID II underestimates the true level of sustainability preferences because clients have no advantage from expressing them. Indicating a preference usually limits their investment options to only sustainable products. By not expressing a preference, clients keep access to a broader range of investment options, including sustainable products. This could explain why some clients state no sustainability preference to maintain the full menu of options and yet invest in sustainable products. Potentially, if the process were reversed, such that clients could only access sustainable investment products if they indicated a preference, the recorded numbers might be much higher. Client advisors may implicitly support this strategic under-reporting. Such a practice would be problematic from a compliance point of view. At the same time, one could argue that it is in the client's interest. We note that this is only a potential explanation for the data, there is no evidence for non-compliance in our data.

1.3 Effects of the Choice Design

Another reason for the low figures on sustainability preferences may lie in the way the choice is designed. Two aspects are worth highlighting in this regard. The first is that, in practice, indicating a sustainability preference often means committing 100% of the invested money to sustainable products and none of the invested money to regular products. Research on investment holdings shows that most clients prefer to invest some of their funds into sustainable products while keeping a fraction of traditional investments[3]. Second, it is well known from other product markets that those clients who do not have a strong preference go along with the default. Given that sustainability preferences are commonly presented as an "opt-in" choice, this might play a role in the results. The observation that 5% of clients have a preference for sustainability does not imply that 95% have a preference against sustainability. It is possible that the results would flip when clients were asked to "opt-out" of sustainable investments.

Implications

The requirements to elicit sustainability preferences under MiFID II are relatively new and implementation practices are still evolving. Our survey offers an analysis of current practices based on a limited sample of Swiss wealth managers. Overall, we conclude that clients express sustainability preferences less frequently than expected. This may partly reflect the reality on the ground, but it may also be driven by how the elicitation process is set up. Based on the observations, we can give the following three implications:

1. Financial institutions should take care to comply with the regulation while integrating sustainability preferences into their sales and advisory process in a way that genuinely benefits clients. In particular, banks should carefully consider how design choices affect measured preferences and the overall advisory process.
2. Regulators should evaluate whether the mandatory recording of sustainability preferences is achieving its intended goal of directing more financing towards sustainable businesses. They should monitor the implementation of MiFID II and consider whether the regulation and its guidelines need adjustments. It

may also be worth considering whether a mandatory recording of sustainability preferences is a useful approach in the first place.

3. Market observers should be cautious when interpreting statistics of MiFID II preferences. The results may depend a lot on the way in which preferences are measured, and there is a risk that MiFID II sustainability preferences understate the actual importance and prevalence of sustainability preferences in the market.

We hope that the results and implications of this survey help readers to better understand the current practice of sustainability preference elicitation under MiFID II and provide inputs for the continuing evolution of sustainable finance.

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