Can responsible investing encourage retail investors to invest in equities?

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Summary

The low participation of retail investors in the equity market is a concern for many countries. It is a necessary condition for the development of capital markets in Europe and a key factor for funding post-Covid economic recovery. Recently, savers' appetites for responsible investment has grown, but little is known about the consequences of this development on individual investment decisions.

Employee savings plans constitute a unique laboratory for studying these choices. In a recent research article (Brière and Ramelli, 2021), the impact of introducing responsible funds into the investment choices of more than 900,000 French employees was analysed. The addition of a responsible option to the menu of funds led to a 7% increase in the equity allocation of new investments. Given that the average equity allocation is around 13%, this increase is substantial and represents an encouraging result for retail investors' participation in the equity market. The role of social preferences further explains this phenomenon.

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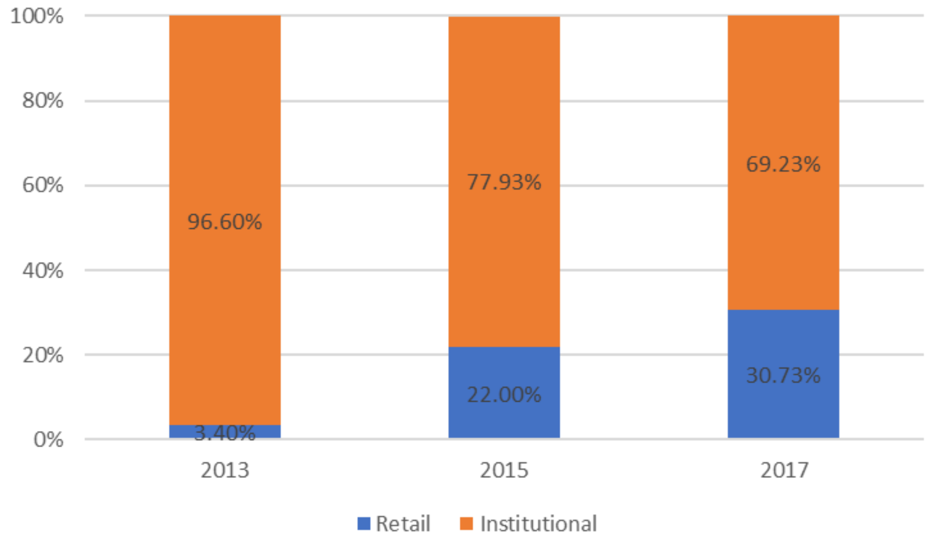
Socially Responsible Investing (SRI) is booming and becoming increasingly popular with retail investors

In a recent survey conducted by Vigeo Eiris for the Responsible Investment Forum, more than 60% of French people say they place importance on the environmental and social impacts of their investment decisions. This figure has grown rapidly, up from only 50% in 2013. **Today, around 40% of retail investors are ready to ask their financial advisor for socially responsible investments**. French people are particularly attentive to questions related to pollution, climate change, employment and human rights. This growing interest is reflected in a boom in the proportion of socially responsible financial products intended for individuals. Today, more than 30% of socially responsible assets managed in Europe (25% in the United States) are for individuals, compared to just 3% in 2013 (see Figure 1).[1]

Figure 1: Proportion of retail and institutional investors offering SRI in Europe



Source: Eurosif (2019).

Individuals remain cautious about investing in the equity market

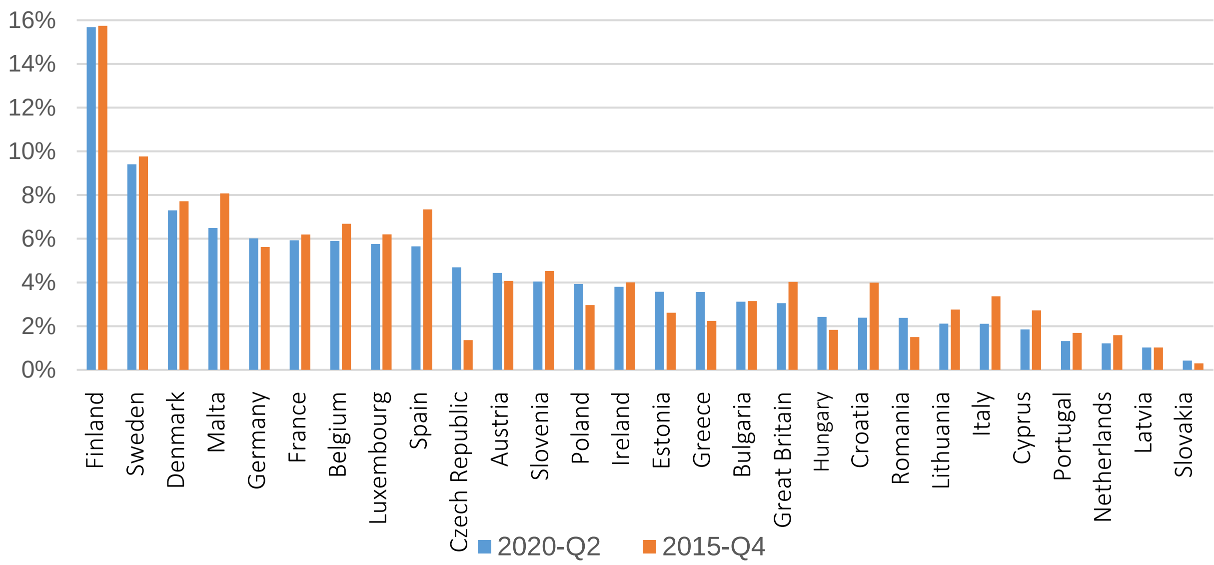
At the same time, the **low participation of individual investors in the equity market** is a concern for many countries. Low interest rates and longer life expectancy make it essential to invest part of a savings allocation in risky assets in order to achieve an adequate level of pension. Retail investment in equities is also a necessary condition for the development of capital markets in Europe, as stressed by the European Commission and ESMA.[2] This participation is very low in most European countries. The proportion of household investment in listed equities (excluding pension and mutual funds) does not represent more than 6% in France and Germany, for example (see Figure 2). These figures are in line with the average for European

[1] Eurosif et US SIF (2019) data.

[2] Steven Maijoor, "Building the EU Capital Markets Union while Fostering Global Financial Markets", ASIFMA Annual Conference in Tokyo, ESMA, October 2019.

countries. Participation is somewhat higher in Nordic countries (Finland, Sweden and Denmark). It is rather significant to note that, during the Covid-19 crisis, we saw a notable change in behaviour. In March 2020, at the peak of the crisis, individuals invested heavily in the equity market, as evidenced by AMF (2020), which reported more than 150,000 new investors in the French market since 2018. In the US, major trading platforms[3] saw the growth of new accounts rise by 170% during the first quarter of 2020. Young people seem to have participated significantly in this movement, seeing the fall in equity prices as an opportunity to invest.[4] That said, it is still too early to know whether this movement is linked to a desire to speculate in the short term in a few flagship stocks, particularly technology, or if it will generate a longer-term diversified investment in stocks.

Figure 2: Share of listed equities in households' financial wealth (excluding unlisted equities and other equity investments), Q2 2020 vs Q4 2015



Sources: Eurostat, Observatoire de l'Epargne Européenne (2020).

This low participation of individual investors in the equity market is of concern to many public decision-makers and a puzzle for academics. **Risk aversion** seems at first glance to be the essential explanatory factor, followed by the **lack of time and attention** that individuals have to devote to their savings. This could be accentuated by **low financial literacy** (Van Rooij, Lusardi and Alessie, 2011). But researchers have shown that behavioural factors could also play a role, such as **trust**: investors' trust in their environment (Guiso, Sapienza, and Zingales, 2008), but

[3] Charles Schwab, TD Ameritrade, Etrade, see https://www.cnbc.com/2020/05/12/young-investors-pile-into-stocks-seeing-generational-buying-moment-instead-of-risk.html

[4] Youth favourite trading app Robinhood registered 3 million new accounts in Q1 2020.

also trust in financial markets, which depends on past experienced performance (Malmendier and Nagel, 2011). Finally, it can also be influenced by non-financial factors, what economists call "**social preferences**". These preferences are linked to the cultural environment and personal values of each individual. They play an essential role in consumption decisions (Vinson, Scott, and Lamont, 1977), political preferences and responsible investment choices. Hong and Kostovetsky (2012), for example, have established the link between the political inclinations of American portfolio managers and their choice of securities as being more or less responsibility-orientated. Riedl and Smeets (2017) have shown the role of these preferences in the responsible investment decisions of individuals. These social preferences also have an impact on purely financial choices, and on the propensity to invest in equities in particular.[5]

Can offering responsible investing make a difference and encourage savers to invest in equities?

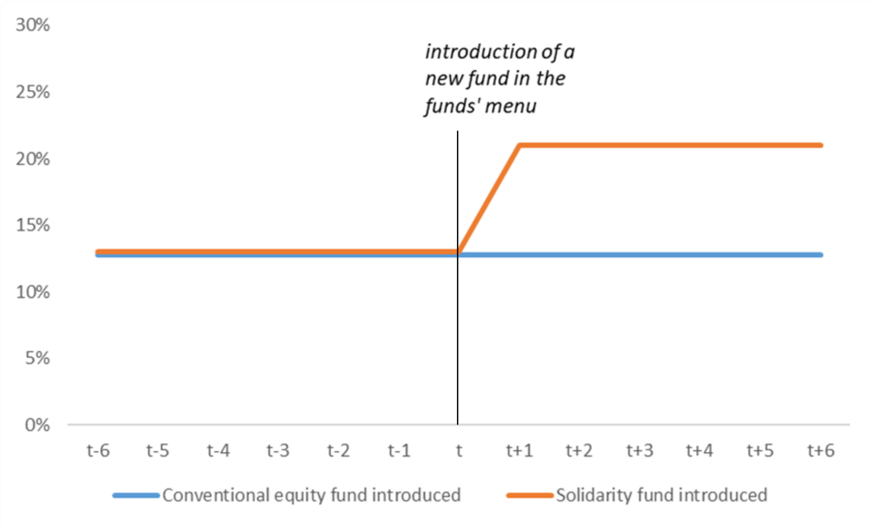
In a recent study (Brière and Ramelli, 2021), we analysed the impact of introducing solidarity funds to the menu of funds offered in employee savings plans for nearly 900,000 employees in 6,500 companies. Solidarity funds offer a particularly interesting framework for analysis. Since a 2008 law was introduced in France,[6] they are mandatory in the selection of funds offered by companies to their employees and exist in several forms: equity, diversified or bond funds. These funds invest in companies of a social and solidarity nature (promoting access to housing, employment, care, education, the preservation of natural resources, etc.), which are given this label by an independent organisation, Finansol.

Our research indicates that **when solidarity equity funds are offered to savers, they invest more in equities than when this offering is not available** (to the order of 2%, in absolute value, compared to an average allocation of around 12%, i.e. a relative increase of 17%). The addition of a solidarity fund to the funds' menu is even associated with **an absolute increase of almost 7% in the equity allocation of new investments** made during the year, compared to the existing allocation. Conversely, we find that adding a conventional equity fund has no impact on the overall allocation of individuals. Young people were particularly sensitive to the introduction of solidarity funds in the offering. Our estimates show that a 30-year-old has invested an average of 3.2% more than a 50-year-old.

[5] Kaustia and Torstila (2010) have shown that in Finland left-wing voters invest less in equities. These findings are not new. Shiller (1984) cites a 1954 survey of the attitude of New York Stock Exchange investors, seeking to understand the reasons for low participation in the stock market. In addition to the lack of information available, another key factor cited was a "vague sense of prejudice against the stock market", with participation in the stock market not being consistent with the overall values of some of the respondents.

[6] Loi de Modernisation de l'Economie, 2008-776, August 2008.

Figure 3: Evolution of the portion invested in equities during a new payment, depending on the type of fund introduced in the offering



Source: authors' calculations.

Note: graphic representation of the effect, based on the estimated coefficient.

Two reasons can explain the difference in reaction to the inclusion of responsible versus conventional equity funds. The first possible explanation is that investors consider that responsible funds will perform better than traditional funds, an unlikely assumption in the case of funds combining a dual financial and societal objective. The second possible explanation is that **responsible investing makes equities more attractive to certain categories of investors who, for cultural or social reasons, would not have invested in equities**. Thus, our results confirm that the decision to invest in equities is not only linked to financial factors, but that it can also be influenced by the supply and presentation of funds, especially responsible ones.

Our results show that responsible funds are able to bring more retail investors to the equity market. In a context where the low participation of individuals in the equity market worries many countries, this result is potentially important and encouraging for the financing of sustainable growth. Our results also have important policy implications in the current European debate. We need to ensure that retail investors receive **adequate information on the ESG risks and opportunities of their investment**. *In the absence of international consensus on ESG disclosure requirements,* EU regulation and guidance will be key. The adoption of Non-Financial Reporting Standards should bring more transparency to European firms' ESG policies, while the EU Taxonomy Regulation and the Disclosure Regulation should help fund managers to classify products and disclose how ESG factors are integrated into their investment process.

Finally, having a **good understanding of ESG preferences of retail clients is another challenging issue to tackle**. The European Commission proposal to amend MIFID II to ensure that wealth managers will take into account clients' "sustainability preferences" as part of the overall suitability process will be an important step in that process.

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