

A practitioner guide for *asset managers & asset owners*

To assess clients' and
beneficiaries' sustainability
preferences



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Imprint.

Department of Finance, School of Business and Economics, Maastricht University (UM) includes an excellent behavioural economists team with publications in top academic journals in finance and economics. The team strives to create practical applications and has already helped different pension funds and mutual fund providers to assess and integrate their clients' and beneficiaries' sustainability preferences.

2° Investing Initiative (2DII) is an international, non-profit think tank working to align financial markets and regulations with the Paris Agreement goals. 2DII coordinates some of the world's largest research projects on sustainable finance. Our team of finance, climate and risk experts develop research, tools and policy insights to help financial institutions and regulators hasten and adapt to the energy transition.

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Illustrator of this paper: Camille Vercellino

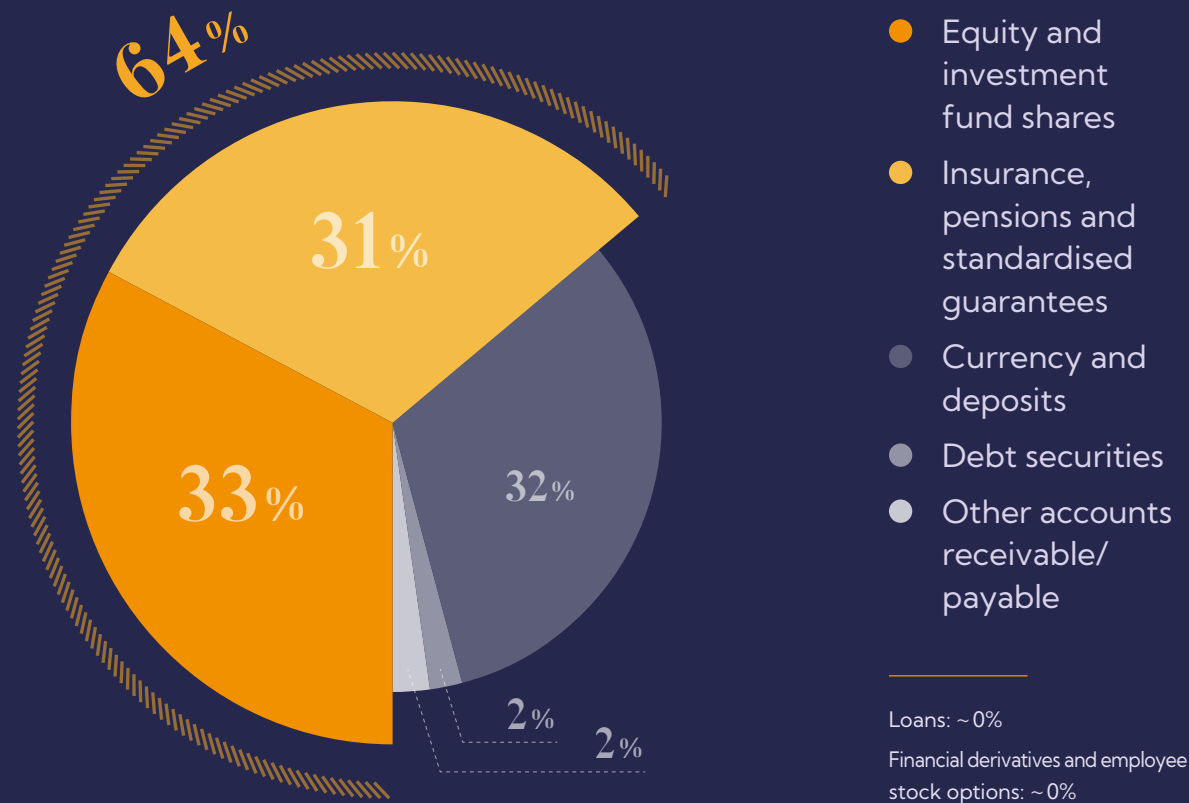
01 Why you should care.

In the European Union (EU), households own 35 trillion EUR in financial assets of which around one third is invested in equity and investment funds and another one third is invested in insurance, pensions, and standardised guarantees.



EU households own 35 trillion EUR financial assets

(Source: Eurostat 2022)



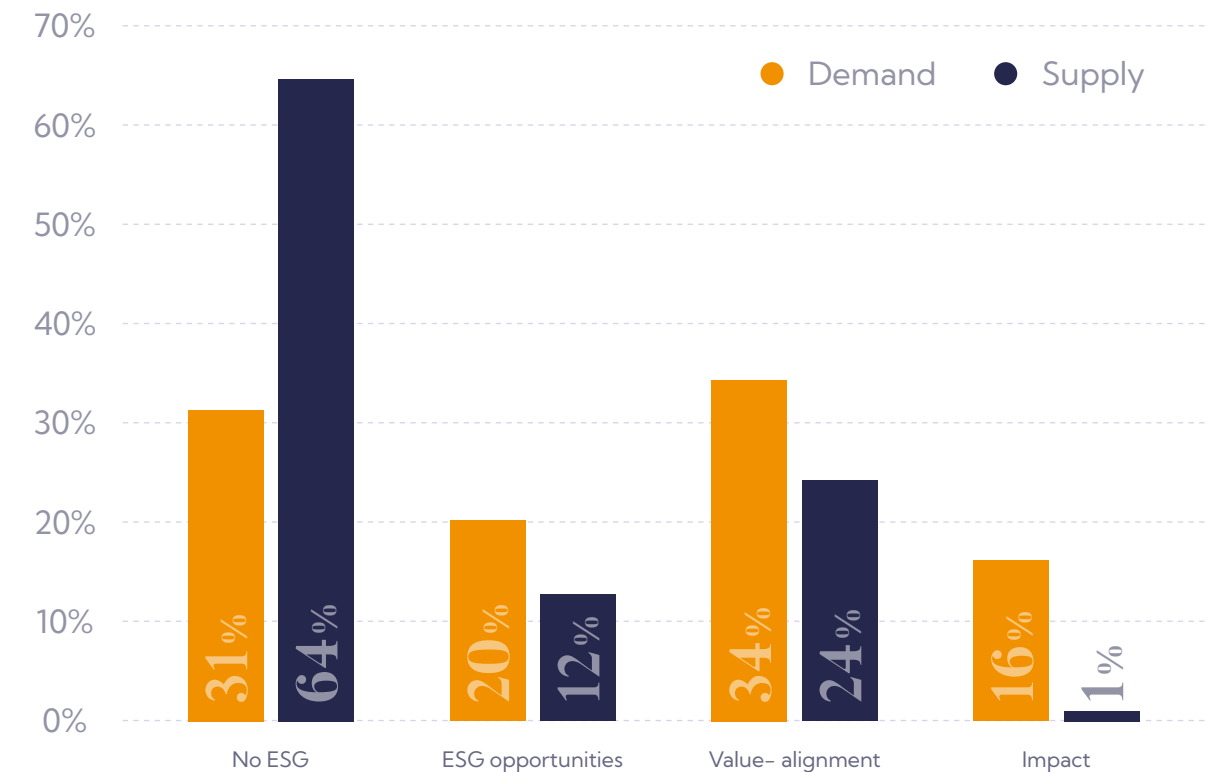
Most of this investment is not aligned with the sustainability motivations and preferences of EU investors. Currently, **60-70% of them repeatedly state that they actually want to sustainably invest their money.** This gap between the current investment and the appetite of EU investors represents **an untapped multi-trillion EUR opportunity for the European financial market¹.** Hence, those investment managers who truly

understand the sustainability motivations and preferences of their investors and manage to integrate them into their product offerings will have a significant competitive advantage compared to their peers.

¹2° Investing Initiative (2022), "What do your clients actually want? Understanding and estimating household demand for sustainable financial products"; ²° Investing Initiative (2023), "6 National Country Reports"

Example: Mismatch between sustainability motivations of supply and demand in France

(Lipper Database analysis 2022²)



As the above figures show, a large portion of EU households hold their money in actively or passively managed investment funds, insurances, and pensions. However, almost no product developer or investment manager systematically understands what their investors really want.

Therefore, new expertise and tools are needed to successfully integrate investors'

preferences into the development and management of new product offerings. But sustainability motivations and preferences can strongly vary across EU investors which requires **sophisticated and scientifically sound methodologies to elicit their preferences.**

²2° Investing Initiative (2022), "Jumping the barriers to sustainable retail investment in France"

Sustainability motivations in the EU*

Multiple motivations possible, people who select more than one motivation have to **prioritize their motivations**

*These heuristics for sustainability motivations are also used by other sustainable finance researchers, industry associations, industry participants and national regulators.

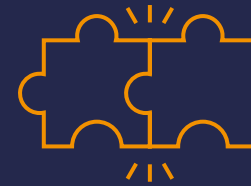


IMPACT



I want my money to be invested in a way that **contributes to change** in the real economy.

Your goal is that your investment contributes to a **change in the real economy**, for example saving CO2 emissions or improving working conditions in the supply chain. Your goal is to **have an impact**, regardless of the sector of the company.



VALUES ALIGNMENT



I want my money to be invested in such a way that the companies I invest in **align with my values**.

Your goal is that your investment is in line with your values. Your aim is to **distance yourself from certain corporate activities**, such as arms production or human rights violations, or to **signal your support for certain corporate activities**, such as climate protection, regardless of the effect or impact on the behaviour of the companies.



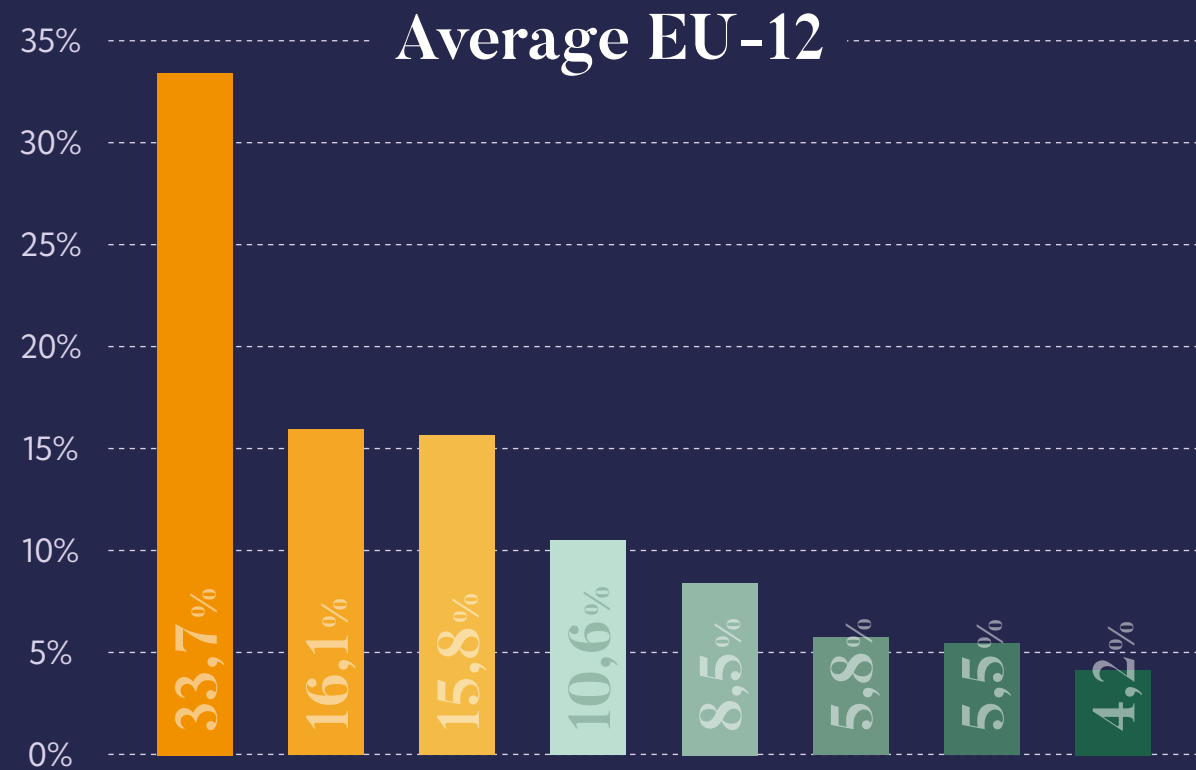
RETURN



I want my money to be invested in a way that achieves the **maximum possible return**.

Your goal is that your investment is to maximize the financial performance. Your aim is to **achieve the maximum possible return** with your investment for the level of risk you accept.

Sustainability motivations in the EU



- Mix of values, impact & return
- Pure return
- Mix of values & return
- No clear profile
- Pure values
- Pure impact
- Mix of values & impact
- Mix of impact & return



Impact-oriented investors per country

02 Overview of surveys and experiments.

To elicit sustainability preferences in varying institutional contexts.



In this part, we discuss the various contexts in which decision-makers at financial institutions elicit preferences from their beneficiaries and investors. **Our focus is on the different types of financial products** ranging from defined benefit and contribution pension plans to mutual funds.

Moreover, we highlight other dimensions that will influence **our advice on the methods to elicit those preferences**. We also highlight the differences between countries as well as the differences between the types of financial institutions that offer these products.

In this part of the replication kit, we first discuss the central questions and sub-questions in our research projects. Second, we provide some general guidelines for conducting surveys and field experiments which originate from the academic literature.

Third, we introduce the financial institutions we cooperated with in our research projects. The different backgrounds of the institutional contexts allow us to investigate several relevant survey tools. We then discuss each case in detail by highlighting the specific institutional context (country, type of financial

institution, and type of product) and our main research results. Moreover, we explain the chosen elicitation method in these contexts.

This overview will help future decision-makers in the financial institutions to choose **the most appropriate method to elicit the sustainability preferences of their beneficiaries and investors**. In the last section we summarise our findings and conclude.

Key research questions driving the method of the survey and experiments

The primary goal of the surveys and experiments is to **improve the quality of the method to elicit the sustainability preferences** from the beneficiaries of various contexts of pension plan arrangements and clients of mutual funds.



Individuals have access to financial products in different institutional contexts. In many cases, they do not have any or just have **limited choices in selecting the appropriate investment solution**, both in the dimension of risk and sustainability. A good example is a **defined benefit (DB)** pension plan in which participants have no say in any of the strategic or tactical investment choices of the plan. This lack of involvement includes the extent to which the plan integrates sustainability into its investments. Another example is the (collective) **defined contribution (DC)** pension plan in which participants have some choice in the investments

but not on the exact composition of the plan (including the sustainability profile). In contrast, retail investors who buy mutual funds can buy and sell those funds without any restrictions.

These varying contexts demand different methods for the elicitation of preferences. For instance, in a DB plan, the board decides on its sustainability profile. Nonetheless, many boards (especially in the Netherlands) are interested in their beneficiaries' sustainability preferences. However, most beneficiaries are not used to making decisions and hence lack experience in doing so.

1. How do you elicit true sustainability preferences from the beneficiaries of DB pension plans?

KEY SUB-QUESTIONS

- Is there a difference between a **hypothetical context** (beneficiaries answer hypothetical questions) and a **real context** (beneficiaries' answers directly affect decision-making)?
- Do beneficiaries prefer sustainability and integrating it into portfolios?
- Are the elicited preferences for sustainability **stable through time**?
- Is there a relationship between general risk preferences and sustainability preferences?



In most cases, the beneficiaries of DC pension plans are used to making certain financial decisions. They can choose the risk profile (strategic asset allocation) and increasingly select specific options of their liking. The board responsible for the DC plan decides on its structure and the extent to which it integrates sustainability.

This responsibility explains why these boards, as fiduciaries, are increasingly interested in eliciting the sustainability preferences of their beneficiaries. Moreover, their beneficiaries' financial illiteracy and lack of knowledge on sustainability can markedly influence their decision-making.

2. How do you elicit true sustainability preferences from the beneficiaries of DC pension plans?

KEY SUB-QUESTIONS

- How effective is an **incentivised investment game** (identified preferences) in eliciting preferences and overcoming a **hypothetical bias**?
- How do **stated and identified preferences** relate to each other?
- Do individuals make use of moral wobble options to act selfishly while maintaining a positive self-image?
- The different contexts of our surveys and experiments also allow us to investigate the following research questions:
 - How does the institutional context affect the method of elicitation?
 - Which of the competing explanations for sustainability preferences is most valid?

Pension plans in the Netherlands are either industry-wide or company-specific. However, in many cases, companies delegate the management of these plans to third parties. Asset managers structure the plans, while the company's management decides on the exact offerings. However, beneficiaries only have a limited choice in the selection of the offering. In this delegated context, either the owner (smaller companies) or

senior officials (larger company) often represent the management. Again, these companies are increasingly interested in finding out how their employees (the beneficiaries) think about integrating sustainability into the plan as they decide on the default options for investments that they will present to their staff. Preferably, these options are highly correlated with beneficiaries' preferences.

3. Is management able to correctly assess beneficiaries' sustainability preferences?

KEY SUB-QUESTIONS

- Do the **default options** by the company align with beneficiaries' preferences?
- How well can management predict whether their beneficiaries will **switch away from a default option**?
- How can the pension provider and the company's management help beneficiaries to **make the best choice of a default option** (potentially by switching options)?
- Is there a difference between smaller (owner generally knows employees well) and larger companies (senior officials are a greater distance from employees)?



Finally, the retail sector allows individual investors to buy and sell mutual funds at virtually any time. It is crucial for fund suppliers to have a comprehensive understanding of investors' motives for making ESG or sustainable investments. For

instance, investors may have heterogeneous beliefs on the return versus risk trade-off in ESG funds, they may hold various ambiguous attitudes on and perceptions of the ESG label of these funds, or they simply have different social norms.

4. What is the driving motive (force) for mutual fund investors to buy sustainable investments: beliefs about the risk versus return trade-off, ambiguous perceptions and attitudes, or social norms?

KEY SUB-QUESTIONS

- How to measure **ambiguous perceptions and attitudes**?
- Which attributes of a mutual fund (cost, risk, sustainability etc.) are most important for retail investors and how does this relate to the sustainability profile of the fund?
- Do index investors experience a trade-off between costs and a sustainability profile?



General guidelines to conduct surveys and (field) experiments

In her 2022 NBER working paper, Stantcheva (2022)³ has provided an excellent guide for “how to run a survey”. She showed that **surveys could be used to elicit perceptions, knowledge and beliefs, attitudes, and reasoning**. These are important factors in the context of investing. Stantcheva offers guidance on the complete survey process.

” ...from the design of the questions and experiments to the recruitment of respondents and the collection of data to the analysis of survey responses. It covers issues related to the sampling process, selection and attrition, attention and carelessness, survey question design and measurement, response biases, and survey experiments...

This guide shows that **surveys and experiments can be prone to many potential biases** if not prepared and run properly. These biases can lead to wrong inferences about the preferences and beliefs of those who participated in the survey. In the end, this error could lead to financial products that do not match investors’ preferences.

In the EU context, many financial institutions now have to measure investors’ risk and sustainability preferences (following MIFID legislation)⁴. This measurement creates a **not-to-be-underestimated additional task for these organisations**. Setting up and running these surveys and experiments requires investing in knowledge in this field and the use of additional resources. Moreover, asking financial institutions to survey their own investor base may also come with potential governance challenges. Surveys can direct clients in a certain direction or to a certain solution that may be more in line with the objectives of the financial institution than with those of the investor.

For this reason, many organisations choose to either use very simple surveys or delegate the process to external

agencies. Both of these options have challenges. Simple surveys may lead to many biases of which one, in the context of sustainable investments, is the social desirability bias. People have the tendency to give socially desirable answers to survey questions, for instance, because they contribute to their self-image. On the other hand, external agencies are generally very expensive (especially when targeting a specific context which requires specific survey methods) and very often fail to fulfil many of the issues mentioned in Stantcheva (2022). Moreover, in certain contexts, there may be legal or cultural factors that determine how surveys can be set up. We will not repeat the practical advice mentioned in the survey guide, but we would like to offer a few thoughts that may help those who release and conduct surveys, those who participate in surveys and experiments, and those who oversee these processes. Nowadays, when an academic research team conducts a survey, **several actions have to be completed** before they can start.

- The survey team needs to get **ethical approval** for the intended method. This approval means that the team

needs to specify ex ante the research question and who and how many subjects are involved. Generally, an independent committee reviews whether the research proposal harms or hurt people in any way.

- The team needs to make sure that information about individuals is **treated in line with the General Data Protection Regulation (GDPR)** which is rooted in EU law.
- Most surveys are also pre-registered by researchers which forces researchers to **ex ante specify the research questions and analysis methods** thereby preventing spurious or incidental results.

In the research projects that we highlight in the remainder of this chapter, we apply many of the issues mentioned in the survey guide. Before we showcase these projects, we would first like to introduce the financial institutions we cooperated with in the past few years.

³Stantcheva, S. (2022), “How to Run a Survey: A guide to creating your own identifying variation and revealing the invisible”, NBER Working Paper 30527.

⁴Markets in Financial Instruments Directive 2014 commonly known as MiFID 2, is a legal act of the European Union. Together with Regulation No 600/2014 it provides a legal framework for securities markets, investment intermediaries, and trading venues.

List of cooperating financial institutions

The Maastricht University (MU) team worked together with **several pension plans, asset managers, and mutual funds** that spanned several financial products and two countries. We thank these organisations wholeheartedly for their willingness to contribute to research that improves the method of eliciting sustainability preferences.

The list of cooperating research partners shows that we conducted survey and field experiments in very different contexts. Our experiences can serve as a knowledge base for future academic experiments, and it can inform practitioners in the field when they set up preferences measurement tools.

Pensioenfond Detailhandel (PD, Netherlands)

PD is a large Dutch pension plan (around 30 billion EUR of assets under management (AUM)) that provides a DB pension plan to close to one million Dutch beneficiaries in the retail sector. The plan has been very eager to understand its beneficiaries' preferences on sustainability. This industry-wide pension plan operates in a not-for-profit context which is quite common in the Netherlands. Most of the occupational pension plans in the Netherlands are not-for-profit and the social partners (employers and employees) play crucial roles. Moreover, the Dutch occupational pension market is one of the largest (especially when measured in terms of percentage of GDP) and most highly regarded in the world.

Universities Superannuation Scheme (USS, UK)

Established in 1974, **USS is the largest private pension plan in the UK** and is primarily used by universities and higher education institutions. USS provides retirement and health insurance as well as life insurance for its members – who are academic staff. USS is a hybrid pension plan that is both a DB and a DC plan. Our cooperation has been focused on the DC part.

Nationale Nederlanden and BeFrank (NN and BF, Netherlands)

NN is an international financial services company with a strong presence in many European countries and Japan. Its roots lie in the Netherlands, with a rich history that stretches back over 175 years. NN has 16,000 employees; it provides retirement services, pensions, insurance, banking, and investments to approximately 20 million customers. NN Group comprises Nationale Nederlanden, ABN AMRO Insurance, Movir, AZL, BeFrank, OHRA, and Woonnu. NN operates in a competitive market. In our projects, we cooperated with Nationale Nederlanden (which provides occupational pension solutions to Dutch companies, especially smaller ones) and BeFrank (which provides occupational pension solutions to Dutch companies, especially larger companies). Both NN and BF were interested in discovering which sustainability preferences the employees of their clients (the companies) held.

Meesman Indexbeleggen (MI, Netherlands)

MI is a boutique mutual fund that provides Dutch retail investors with an umbrella of index investment vehicles in both equity and fixed income markets. MI's investment philosophy is that retail investors in the long term are best off with low-cost, broadly diversified passive portfolios.

03 Overview of *elicitation* methods in different contexts.

In this section, we discuss **five cases** in which the MU team developed surveys or experiments. For each case, we provide a table with a summary of the **key background information and context as well as the main elicitation methods used**. These methods are a function of the product, the legal context, and the financial institution's context.



CASE #1

Pensioenfonds Detailhandel (PD)

 The Netherlands

Type of financial arrangement:

Collective defined benefit (DB) pension plan

Type of financial institution:

Not-for-profit pension plan

AuM:

30 billion euro

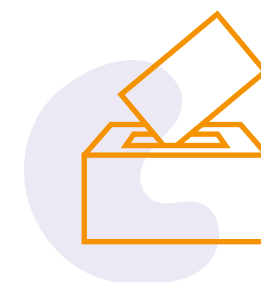
Freedom of choice level participant:

Low: (former) employees in the retail sector have to join PD and mandatorily have to contribute to the plan. They also have no say in the pension and investment policies.

- Key research questions -

To summarise, this project addresses several **key research questions on the elicitation of beneficiaries' sustainability preferences:**

- How do you elicit true sustainability preferences from the beneficiaries of DB pension plans?
- Is there a difference between a hypothetical context (beneficiaries answer hypothetical questions) and a real context (beneficiaries' answers directly affect decision-making)?
- Do beneficiaries prefer sustainability and integrating it into portfolios?
- Are the elicited preferences for sustainability stable through time?
- Is there a relationship between general risk preferences and sustainability preferences?



Elicitation method study 1

Binding referendum (consequential vote) with ex ante commitment of the board to execute the voting outcome. **Members get a vote, but the deciding body is the board.**



Elicitation method study 3

Additional survey focused on measuring (general) risk preferences of Detailhandel beneficiaries, including two questions on sustainability preferences.

2018

2020

2022



Elicitation method study 2

Additional (follow-up) survey in a COVID context investigating whether the social preferences measured in study 1 were stable. Moreover, the plan made a few additional decisions in making the portfolio more sustainable. These were also put forward in this survey (without a vote).

The first two studies which the MU team conducted took place in the **Netherlands** and were on a **collective DB plan** from PD. Across the globe, most beneficiaries are not directly involved in any of the strategic choices made by pension plans. The non-involvement of the ultimate asset owners holds for strategic decisions on the design and governance of DB and DC plans but also for strategic choices on the plans' investment programmes. Notably, beneficiaries **generally are not part of the debates on sustainable investments** in which non-financial preferences oftentimes play a prominent role.

As part of study 1, the board of PD gave its members a real vote on its future sustainable investment policy. Beneficiaries faced the choice of whether they wanted to **increase the investment focus on the**

UNs' Sustainable Development Goals (SDGs) through engaging with companies that underperformed

on the selected SDGs. Because of the above-described features of this collective pension plan, the members' benefits were at stake that made their choice highly relevant to their (perceived)

future financial situation. We informed the beneficiaries that implementing SDGs meant that financial returns were not the only factor to take into consideration.

Making investments with these goals in

Implementing SDGs meant that financial returns were not the only factor to take into consideration

mind meant that considering the effect of investing on the environment and on the wider society was important. We

are not aware of any pension plan that gave its members a consequential vote on the investment policy of the whole plan.

Next to obtain consequential choices, four other criteria should be satisfied. First, the **beneficiaries have to care about the outcome**. Second, the authority can enforce payments by voters. Third, the elicitation involves a yes or no vote on a single project (similar to a referendum). Fourth, the probability that the proposed project would be implemented is weakly monotonically increasing with the proportion of yes votes. Our discrete-choice field survey (survey 1) satisfied all four criteria. Beneficiaries' pension savings were at stake, and the board guaranteed it would implement the outcome of the voting, which satisfied the first and second criteria. Further, we gave the beneficiaries a consequential vote with only two choices whereby the probability that more sustainable

investments would be implemented was weakly monotonically increasing with the proportion of yes votes, which satisfied the third and fourth criteria.

We also conducted a follow-up survey (study 2) that both confirmed the results of study 1 (large majority wants to extend and intensify the sustainability programme) and also confirmed the PD board's decision to set up index portfolios with a clear tilt towards sustainability (without a vote). Finally, the MU team also conducted a risk preference survey among the beneficiaries of PD (study 3). In that survey, we also integrated a few questions on sustainable investments. Interestingly, the beneficiaries were less enthusiastic about further extending sustainable investments (beyond study 2).

More detailed information about the survey questions and the experimental method can be found in:

- R. Bauer, T. Ruof, and P. Smeets (2021), "**Get Real! Individuals Prefer More Sustainable Investments**", *Review of Financial Studies*, 34(8), pp. 3976–4043. This also includes the survey.
 - R. Bauer, K. Goedker, and P. Smeets (2022), "**Eliciting Risk Preferences of Pensioenfond Detailhandel's Participants**", Powerpoint presentation summarising study 3 with Pensioenfond Detailhandel.
 - R. Bauer, and P. Smeets (2023), "**Pension Funds and Sustainable Investment**", Chapter 8 in: *Pension Funds and Sustainable Investments* (eds. Olivia Mitchell, Brett Hammond, and Raimon Maurer), Oxford University Press.
- Supporting videos:
- P. Smeets, "**Individuals want more sustainable investments**"
 - P. Smeets, "**Why do investors pay higher fees on sustainable investments?**"



Other issues that were considered

- **Social desirability bias:**
Financial incentives and the consequential vote mitigated this problem to a large extent.
- **Representation bias:**
We checked whether the political preferences of the people in the sample were similar to those in the Netherlands: no big differences.
- **Social signalling instead of social preferences:**
We checked the potential effect using political voting preferences; social signalling played a role but did not change the key result of the experiment.
- **Financial and sustainability illiteracy:**
We prepared the surveys well by thoroughly testing them with several pilots and by making sure that questions were clearly formulated and that respondents could find information while doing the survey. Moreover, we tested whether removing the responses of people who were potentially confused (they either did not finish the survey or did not answer our built-in comprehension question correctly) would alter the key conclusion. It did not in this case, but we advise using this procedure when evaluating surveys on financial decision-making.
- **Status quo bias:**
We framed the key question in different ways to make sure that there would be no status quo bias. See the Get Real paper for more details (pp. 4007–4008).
- **Pivotal voting concerns:**
We asked beneficiaries to estimate the percentage of their peers who would choose three SDGs, four SDGs, or opt for “no opinion”. The beneficiaries who predicted the share of those in favour of four SDGs would be close to 50% should be perceived as being more pivotal than beneficiaries with a prediction far away from 50%. Following this outlined expectation, we predict that a gap will arise between subjects with predictions close to 50% and subjects with predictions far away from 50%, with the latter showing greater support for more sustainable investments. We define “pivotal” voters as those with predictions between 40% and 60%. We found no difference between pivotal and non-pivotal voters. Second, we asked beneficiaries to estimate how many of those 25,000 invited would participate in the experiment. The median estimate is 10,000 participants. We define a pivotal voter as someone who estimates that less than 10,000 would participate (meaning the voter had a relatively higher probability of being pivotal). Again, we did not find a gap.
- **Other standard survey quality issues**
(e.g., randomisation of questions, repeating the survey regularly etc.)

Nationale Nederlanden (NN)

 The Netherlands

Type of financial arrangement:

Collective defined contribution (DC) pension plan.

Type of financial institution:

Institutional asset management providing pension plans to companies (for profit).

Additional relevant remark:

Survey includes financial incentives for beneficiaries.

AuM: 140 billion euro

Freedom of choice level participant:

Low to medium: beneficiaries are offered a pension solution (balanced plan) by their employers with varying levels of sustainable investments. Employers decide on the default, whereas beneficiaries decide whether they take the default option or whether they change the method. Beneficiaries cannot decide on individual investments.

- Key research questions -

To summarise, this project addressed three **key research questions on the default options proposed by management** (and provided by NN) and how the chosen default options align with beneficiaries' sustainability preferences:

- Does the default option proposed by the company align with beneficiaries' preferences?
- How well can management predict what their beneficiaries want (sustainability preferences) and what they will do (switch or not)?
- How can the pension provider and management help beneficiaries to make the best choice (potentially by switching default options)?

Employers and beneficiaries make decisions (given the offering by NN). Hence, we survey both groups (two separate surveys). In the context of NN, companies are relatively small on average. This size means that the owner of the company in many cases is involved.



Beneficiaries' survey

In the beneficiaries' survey, we first offer balanced plans with varying characteristics and attributes (sustainability rating according to Morningstar, fee level, active or passive management style, and ask beneficiaries which they prefer and how much).

We also add a question on risk preferences (stated preference), questions on financial literacy, and questions on pension knowledge. Finally, we also ask about the beneficiaries perceived rating of their own company on the topic of sustainability (E, S, and G).

STEP 1



Employers' survey

In the next stage, we ask employers to predict the responses of their beneficiaries, and subsequently we ask for the employers' responses to the same questions. We repeat this procedure for the additional questions mentioned above.

Some of the (treated) employers will receive information about the actual answers of their beneficiaries after which we will also test for their willingness to switch or not (based on beneficiaries' actual answers).

STEP 2

This project highlights the effect of the company's owners (NN) – on the default option in the beneficiaries' pension plan. Since default options are generally very strong, it is important that decision-makers can assess their beneficiaries' sustainability preferences.

It is important that decision-makers can assess their beneficiaries' sustainability preferences.

Our procedure also shows the extent to which decision-makers respond to any differences in preferences. These responses will help us better understand how DC pension plans can be set up to cater to the needs and preferences of beneficiaries.

This context (asset manager that provides pension plan services to a company that decides on a default option for beneficiaries) did not allow consequential voting on the method like in the first case.

This sample had a lower number of employees per company (smaller companies), but a higher number of employer–employee pairs (as there are more companies in the sample).



CASE #3

BeFrank (BF)

 The Netherlands

Type of financial arrangement:

Collective defined contribution (DC) pension plan.

Type of financial institution:

Institutional asset management providing pension plans to companies (for profit).

Additional relevant remark:

Survey includes financial incentives for beneficiaries.

AuM: 7 billion euro

Freedom of choice level participant:

Low to medium: beneficiaries are offered a pension solution (balanced plan) by their management with varying levels of sustainable investments. Management decides on the default option, whereas beneficiaries decide whether they take the default option or whether they change the method. Beneficiaries cannot decide on individual investments.

- Key research questions -

To summarise, this project addresses three key research questions on the setting of the default options for pension plans by management (and provided by BF) and how the chosen default options align with beneficiaries' sustainability preferences.

- Does the **default option proposed by the company** align with beneficiaries' preferences?
- How well can management predict what their beneficiaries want (sustainability preferences) and what they will do (switch or not)?
- How can the pension provider and management **help beneficiaries to make the best choice** (potentially by switching default options)?

Management and beneficiaries make decisions (given the offering by BF). Hence, we survey both groups (two separate surveys). In the context of BF, companies are relatively large on average. This size means that the management (CEO, CFO, or HR by expectation) of the company in many cases is involved.



Beneficiaries' survey

In the beneficiaries' survey, we first offer balanced plans with varying characteristics and attributes (sustainability rating according to Morningstar, fee level, active or passive management style, and ask beneficiaries which they prefer and how much). We also add a question on risk preferences (stated preference), questions on financial literacy, and questions on pension knowledge. Finally, we also ask about the beneficiaries perceived rating of their own company on the topic of sustainability (E, S, and G).

STEP 1



Management's survey

In the next stage, we ask management to predict the responses of their beneficiaries, and subsequently we ask the management for their responses to the same questions. We repeat this procedure for the additional questions mentioned above. Some of the (treated) employers will receive information about the actual answers of their beneficiaries after which we will also test their willingness to switch or not (based on beneficiaries' actual answers).

STEP 2

This project highlights the effect of key decision-makers – in this case management (BF) – on the default option for the beneficiaries' pension plan. Since default options are generally very strong, it is important that decision-makers can assess their beneficiaries' sustainability

preferences. Our procedure will also show the extent to which decision-makers respond to any differences in preferences. These responses will help us better understand how DC pension plans could be set up to cater to the needs and preferences of the beneficiaries.

Further, this context does not allow a method with consequential voting as detailed in the first case. This sample does address a larger number of employees per company in the sample (larger companies), but a lower number of employer-employee pairs (as there are fewer large companies).



CASE #4

University Superannuation Scheme (USS)

United Kingdom

Type of financial arrangement:

Collective defined contribution (DC) pension plan (as part of a DB-DC hybrid).

Type of financial institution:

Private pension plan (not-for-profit)

Additional relevant remark:

Investment game includes financial incentives for beneficiaries.

AuM:

100 billion euro

Freedom of choice level participant:

Low to medium: beneficiaries are offered a number of DC plans with varying levels of sustainable investments. The USS board decides on this plan structure and the extent to which sustainability is integrated into the portfolio management process. Pension plan beneficiaries (employees of universities) decide which plans to invest in. Beneficiaries cannot decide on individual investments.

- Key research questions -

To summarise, this project addresses four key research questions on the elicitation of beneficiaries' sustainability preferences:

- How do you elicit true sustainability preferences from the beneficiaries of a DC pension plan?
- How do stated and identified preferences relate to each other?
- How effective is an **incentivised investment game (identified preferences)** in eliciting preferences and overcoming hypothetical bias?
- Do individuals make use of moral **wiggle room** options to act selfishly while maintaining a positive self-image?



The identified preferences

The investment game



Stated preferences

Two additional questions to independently measure sustainability preferences

STEP 1

STEP 2

STEP 3



Moral wiggle room

Extra element in investment game

In general, when measuring preferences, two main pitfalls arise: hypothetical bias and exploiting moral wiggle room. We propose a practical solution to these pitfalls that identifies the underlying preferences instead of the stated preferences.

One of the most common forms of measurement is to directly ask clients or investors about their sustainability preferences through surveys. This method elicits the “stated preferences” of respondents. This approach is cheap, simple, and easy to implement. However, survey questions are hypothetical, and people often claim to behave in a certain way, but they usually do not back up these claims through actions. The difference between the stated and observed behaviours is called the “hypothetical bias” or “hypothetical gap” and is present in many instances. For example, people often claim to care about animal welfare but buy the cheapest meat.

In order to overcome the hypothetical bias and to measure preferences truthfully, a survey needs to meet several conditions:

- First, it needs to **consist of consequential choices** that the surveyor will implement.
- Second, participants have to **care about the outcome**.
- Third, the survey must consist of a **simple yes or no vote** on a single project.
- Finally, the probability that the proposed project would be implemented must increase with the proportion of yes votes, or put differently, **there must be no reason for respondents to strategically answer the survey**.

Unfortunately, committing to implement a survey’s outcomes is often unfeasible in practice since neither the management nor the board wants to delegate important decisions. In this case, the USS is a UK pension plan in which participants are offered a hybrid pension arrangement (a mix of DB and DC). We focus on the DC part in which beneficiaries choose the plans they want to invest in. In the (legal) context of the UK, offering a binding referendum to beneficiaries is not straightforward as the interpretation of fiduciary duty and trust law is different from continental Europe. Hence, the plan’s board could not commit to following the majority’s voice (as in the Detailhandel case).

For this reason, **we developed a more practical alternative to elicit the “underlying preferences” of the beneficiaries**. We developed an incentivised task that resembled a real-life scenario. In this case, the hypothetical bias was less of a concern given sufficiently strong (financial) incentives in the task. The difficulty lay in designing a task that was appropriate to measure the preferences we were interested in. We propose using an investment game to identify the underlying preferences for sustainable

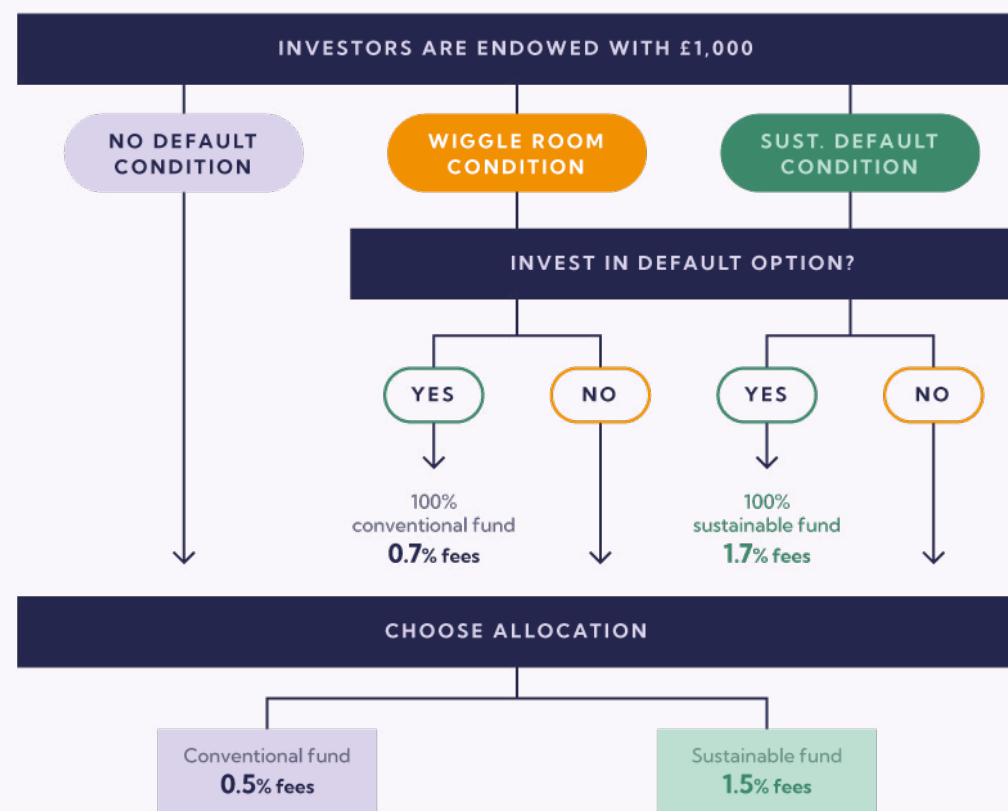
investing. In our design, each beneficiary received an endowment of £1,000 that was divided between two plans: a sustainable one and a conventional one. The sustainable plan was relatively expensive with a fee of 1.5% of the invested amount, while the conventional plan was cheaper with a fee of only 0.5%. The fee structure created a performance trade-off for sustainable investing as well as the general observation that fees of sustainable plans were higher.

To provide a financial incentive, we implemented the investment decisions of five randomly selected beneficiaries. After six months, these beneficiaries received £50 plus or minus the returns of their portfolio, net of fees. This incentive structure had two main advantages. First, the payout was influenced by both gains and losses that made the task more realistic. Second, we actually bought the assets that the beneficiaries chose which meant that the responses had real consequences. These consequences increased the stakes of the experiment. The amount invested in the sustainable plan represented the underlying preferences for sustainable investing.

In this design, the beneficiaries were asked to make an active investment choice. In reality, this is often not the case as they can avoid making such decisions by relying on default options. This is particularly worrisome in our setting, given the prosocial nature of sustainable investing. **Economists have uncovered a series of occasions when people actively avoid a prosocial action.** In a famous

study, behavioural researchers placed charity solicitors in front of one of two entrances into a supermarket. They found that people avoided entering through the door with the solicitor because they did not want to feel pressured into giving to charity. This behaviour is **consistent with the idea that individuals desire to pursue self-interest while maintaining the illusion of behaving pro-socially.**

Overview of the investment game:



In the context of investment decisions, opting for a default option is often an alternative to making active decisions. Some people might use the default as an excuse to not invest sustainably. We propose a manipulation of the baseline experiment to test if this is an issue in the population of investors. In addition to allocating the £1,000 between the sustainable and conventional plans, beneficiaries also had an additional option to “wiggle out”. For a small additional fee of 0.2%, they could choose a default option which was to invest the entire endowment in the conventional plan. Importantly, beneficiaries could implement the same allocation at a smaller cost to themselves by choosing to invest all their endowments in the conventional plan. However, the default option allowed them to “sneak out” of sustainable investing, as it could be seen as an excuse not to invest sustainably while maintaining the illusion of behaving pro-socially. This was because, by choosing the default option, participants were not actively forgoing investments in the sustainable plan. We call this the “moral wiggle room” option.

To complement the measure of the underlying preferences, we also added two questions to our survey that were aimed

at measuring the stated preferences for sustainable investing. The first question made the potential performance trade-off of sustainable investing salient, while the second question did not. The extent to which the stated preferences were sensitive to the performance trade-off was informative of the strength of these preferences. Specifically, we asked the following:

1. Does the pension plan deliver returns for its beneficiaries by allocating savings among various investment opportunities, for example, among the different companies to invest in?

UK pension plans have a legal duty to act in the best financial interests of their beneficiaries and management. This duty means that they are typically required to allocate their investments based on what they think will produce the best long-term financial outcomes by factoring in sustainability considerations, such as environmental, social, and governance (ESG) issues. Suppose you could directly control how your pension was invested. How much should your pension plan invest in a sustainable way, even if this potentially lowers the pension you get in retirement?

2. How important is it to you that [your pension plan] sustainably invests your money?

If not specifically stated otherwise, our measure of (stated) sustainable preference is the simple average of the answers to these two questions that are measured on a scale from one to seven. By eliciting a measure of stated preference, we were able to compare the measure of the underlying preference that we developed in the previous section with a more commonly used metric of sustainable investing preferences. Question 1 was asked in the survey before the investment game, while Question 2 was asked after the investment game. There is a possibility that, by doing so, we primed the respondents and therefore overestimated their underlying preferences for sustainable investing. We chose this approach because we expected it to measure the preferences with a smaller bias than starting with the relatively extensive investment game as we expected the priming effect to be larger in this case.

More information:

- R. Bauer, M. Ceccarelli, K. Gödker, and P. Smeets (2023): [“Measuring sustainability preferences of pension members: A methodological proposition and a case study of a UK pension fund”](#), Netspar Design Paper 228

CASE #5

Meesman Indexbeleggen

 The Netherlands

Type of financial arrangement:

Index mutual fund (in an umbrella structure)

Type of financial institution:

Mutual fund company (for profit)

Additional relevant remark:

TBD

AuM: 1 billion euro

Freedom of choice level participant:

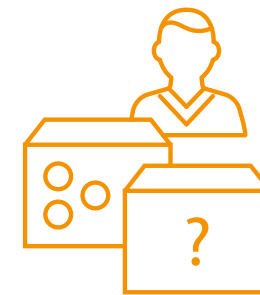
Medium to high: retail clients can decide freely to buy or sell Meesman funds. Meesman offers the fund (umbrella) structure which is a mix of fixed income and equity funds.

- Key research questions -

To summarise, this project addresses three key research questions on the elicitation of mutual fund investors' sustainability preferences:

- How do you elicit the true sustainability preferences of private investors in a mutual fund index?
- How do you measure **ambiguous aversion, attitudes, and perceptions?**
- How do you measure the beliefs on sustainability in a mutual fund context?

Investors positively engage in SRI, and therefore retail mutual fund suppliers strive to offer (passive or active) funds with ESG features to attract investments. It is crucial for fund suppliers to have a **comprehensive understanding of investors' motives for making ESG investments**. For instance, investors may have heterogeneous beliefs towards the return versus risk trade-off of ESG funds, they may hold various ambiguous attitudes and perceptions towards the ESG label of the funds, or they simply follow different social norms.



Ellsberg urn

To measure ambiguity aversion

STEP 1

STEP 2



Discrete-choice experiment

Conjoint-type analysis

Heterogeneous beliefs among clients are likely and interesting to study, especially in this context of index investments. Meesman offers broadly diversified passive funds based on an index with a small tilt (some exclusions) to sustainability. Arguably, these index investors think carefully about diversification and costs. But how this preference relates to sustainability preferences and how these investors (implicitly) decide on which to prioritise is unclear.

Therefore, without accurately knowing their beliefs, ambiguous perception, and norm-following propensity, mutual fund suppliers may fail to correctly match their products to investors.

From a theoretical perspective, apart from true financial considerations, existing explanations of SRI behaviour have been limited to social preferences and signalling, that is **investors' selfless care about the well-being of others or the society and their tendency to improve their self-image**. However, this is probably not the complete picture. Several alternative explanations exist and have never been formally tested. The financial consideration is just saying that investors pursue high ESG just because they consider that they can generate a superior return or risk performance relative to low ESG stocks or funds. This consideration has been proposed and investigated in the literature, but to our knowledge, the existing methods are problematic. Therefore, these elicited beliefs may not match investors' true beliefs, or worse still, they may be systematically biased.

We now briefly introduce **the concept of ambiguity**. The **financial market is characterised by uncertainty**, meaning that future outcomes are not known for sure, but there is a set of possible outcomes which may happen with some probabilities. Although this is often referred to as risk, economists have found that risk is a calculable uncertainty, that is, when both future outcomes and their probabilities are perfectly known. However, this is generally not the case. **Investors are far from having a clear idea of those probabilities. This is a situation called ambiguity.** Just like risk preferences, every person also has an attitude towards ambiguity that is mostly varying degrees of aversion. It is connected to ESG because ESG is a new and widely adopted concept that could be perceived as a label to reduce the amount of ambiguity. Investors may want to invest in high ESG funds because it **resolves ambiguity at least along the dimension of sustainability**, even though they may not have a clue about how this is related to financial returns.

Risk is a calculable uncertainty, that is, when both future outcomes and their probabilities are perfectly known.

From a practical perspective, our surveys among Meesman investors adopted novel methods to elicit their beliefs, ambiguous perception, and norm-following propensities. For instance, to solve the above-mentioned problems in eliciting beliefs, we first asked an investor to state the maximum and minimum possible expected return of a fund during some future periods. Then we asked them to repetitively divide this stated space into equally likely subspaces by choosing between two lotteries. We kept asking for these choices until a desired level of precision was reached. By doing so we obtained the investor's median expected return of the fund. All the questions were incentivised and disguised as choices between lotteries, making it harder for respondents to identify the purpose of the study, game the system, or to hedge. To make the method portable to a field setting, we also tested the performance of an unincentivised version. Moreover, we designed and validated novel methods to elicit ambiguous perception and norm-following propensity.



We already obtained results from our virtual lab experiment using these methods on student subjects at Maastricht University. We adapted the virtual lab experiment to a survey experiment for Meesman's investors to elicit their beliefs towards the return of index funds and their ambiguous perception. Then we can also compare the difference between index fund investors and other investors. Furthermore, we can profile ESG index fund investors and elaborate on their motives for investing in ESG index funds. As a result, Meesman could update its fund umbrella for its investors with heterogeneous beliefs towards ESG financial performance and achieve precision marketing to further enlarge its AUM because of a better understanding of its investors' motives.

This project aimed to bridge the gap in both theory and practice with a comprehensive understanding of the

underlying reason for ESG investments. The successful elicitation of investors' beliefs and norm-following propensities and identification of the role of ambiguous attitudes can find empirical support for the theoretical proposition that these factors can indeed lead to a preference for ESG investments. Moreover, the project will have important implications for practitioners. For instance, funds can incorporate our tools into their investor profiling in order to obtain a reliable measure of their beliefs, ambiguous perceptions, and norm-following propensities towards ESG. This measure could help them achieve precision marketing. That is, they would not only design products that cater to the specific demand of different segments of investors with heterogeneous beliefs and ambiguous perceptions but also apply different marketing strategies to attract the appropriate investors.

More information:

- Bauer, R., B. Dong, and P. Jiao (2022). "[Belief elicitation in the domain of socially responsible investment: Altruists going on an ego trip of pursuing wealth](#)". Working paper.



04 Key findings and the *road ahead*.

By setting up and conducting the six large-scale projects that we describe in this paper we have learned a few key things:



Key findings

By setting up and conducting the six large-scale projects that we describe in this paper we have learned a few key things:

- **Surveys and experiments may be prone to many biases.** When setting up a survey or experiment of any kind, it is key to take this into account. Similarly, when interpreting the analysis of results, it is important to realise that other factors may explain the results. This is particularly important in the context of MIFID in which financial institutions must elicit the sustainability preferences of customers. Financial institutions may construct poor-quality surveys or, even worse, make use of the private investors' biases to their own advantage.
- **Context matters:** our results show that a financial institution's context is important. The legal setting may differ among countries; individuals may respond differently in various financial institutional settings; and individuals' preferences, beliefs, and literacy may vary considerably depending on the jurisdiction.
- Our results also show that **individuals can be in different delegation contexts.** They either make their own decisions (mutual funds), delegate certain key decisions and implementation to plans (DC pension plan), or even fully delegate (mandatorily) in a DB pension plan. We also have to be careful about the generalisation of results because of these differences. More research is needed.
- Many **different types of elicitation can be used that vary from stated preferences to identified preferences in the field to investment games.** A combination of these instruments can be very powerful and soften the potential biases in any of them. Further innovation is necessary as it will further fine tune the methodologies we present.
- Response rates to surveys and field experiments are generally low (despite financial incentives which are key in this context). This is an important topic for future research. How can we motivate investors to participate?

The road ahead

The above summary shows that the **high-quality governance of survey and experiments is absolutely key.** There are many concerns about ethics, GDPR, and wrong incentives (and more) for financial institutions. It also shows that we need to further develop elicitation methods in both the domain of surveys and experiments and related and in other domains from different sciences (e.g. political science). A good example would be setting up a deliberative forum of representative investors or participants who will be much better informed about the inherent trade-offs and dilemmas than survey participants and who will also be able to provide unheard voices and arguments which inform decision-makers. These new insights can contribute to making financial products that both contribute to the goals the EU has set and to the preferences and beliefs of its citizens that invest in financial products.



You still have questions or want to know more? Get in touch with us:

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