ESG FOR
RETAIL INVESTORS

BY **SERVAAS HOUBEN**

ESG investment has become mainstream over the last couple of years for institutions. Sustainability reports have grown in detail and have extended besides qualitative goals and ambitions, into quantitative reports showing measurable progress on KPIs. Despite the increase in interest into ESG matters in the public domain by consumers reflected in climate protests and concerns, this has not yet translated in consumers becoming active EGS investors themselves: retail ESG investment in 2020 was lagging [1] with a share of 25% compared to the 75% institutional investment, despite retail investors owning 52% of global assets as per 2021.[2] As the share of retail investments in total assets under management is expected to increase to 61% by 2030, this provides a clear opportunity for individual investors to increase their ESG awareness and interest in sustainable assets.

RISE IN POPULARITY OF RETAIL INVESTMENT

Investopedia defines retail investors as 'A retail investor, also known as an individual investor, is a non-professional investor who buys and sells securities or funds that contain a basket of securities such as mutual funds and exchange traded funds (ETFs)'.[3] Hence retail investors are consumers who besides their pension, life insurance and other savings products which they let institutions manage for them, also invest part of their assets themselves.

The increase in retail investors as % of total market share increased during COVID-19 as consumers were forced to change their usual allocation of money spent between consumption and saving.[4] Due to lay-off during COVID-19 consumers also realized that besides their day-to-day job they needed an alternative source of income. COVID-19 saw the median age of retail investors decrease as more younger investors entered the market. Easy access to online brokerage platforms and IT savviness from the younger generation allowed younger consumers to access investment markets.

Nevertheless, the upward trend has not been the same between various countries. While retail investing is common these days in the US (15.2%) and particularly Australia (35%),[5] Europe has been lagging (7.8%). Public state pension, and generous company pensions might explain >

[1] GSIR-20201.pdf (gsi-alliance.org)

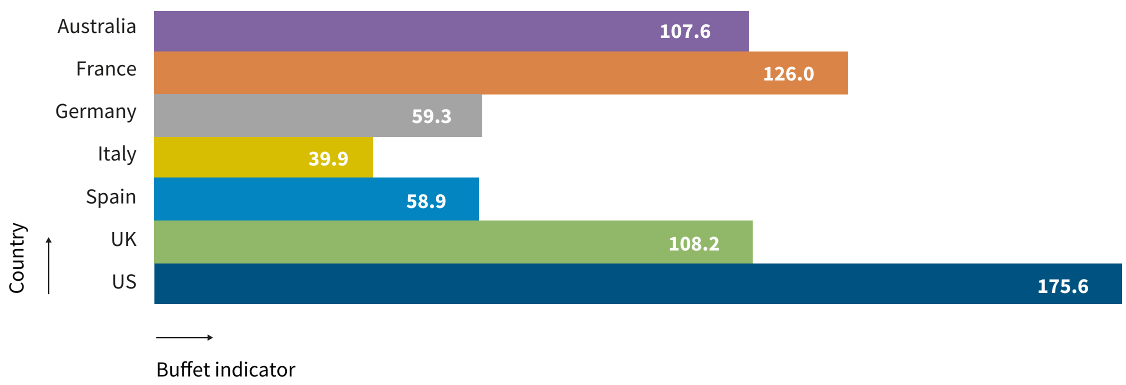
[2] The Institutional Share of Global Capital is Shrinking. What Does This Mean for Managers? (institutionalinvestor.com)

[3] Retail Investor: Definition, What They Do, and Market Impact (investopedia.com)

[4] Retail Investors Statistics in 2024 - Marketplace Fairness

[5] Europe Retail Investor Statistics and Data in 2023 (euronerd.com)

FIGURE 1: RATIO TOTAL MARKET CAP VS GDP



the lower level of interest in Europe. However also different preferences around loss aversion and lack of understanding of the stock market could be explanations. This lack of stock market interest is reflected in both the EU stock market size,[6] and capitalization vs GDP also known as the Buffett indicator[7] compared to other markets (figure 1)

COPING WITH MARKET VOLATILITY

Despite the risk averseness of the European retail market, changes in life expectancy and family composition create ideal circumstances for long term investment. The worldwide trend in longevity is particularly the case in Western Europe which has seen consistent increases in life expectancy after the second world war due to improved medical treatment and lack of life changing events such as wars, natural disasters, or regime shifts (communism to capitalism). Furthermore the decrease in fertility rates and increase in women's labor participation in Europe have resulted in an increase in wealth accumulation. Lastly the European retirement ages have increased over time due to longevity which forced governments to increase retirement ages to ensure the dependency ratio (workers vs non-workers) remains sustainable for the working part of the population.

The accumulation of wealth (and hence buffers), and higher retirement age thus allow European retail investors to cope with (stock) market volatility and receive the benefits of higher long term returns which come with the higher short term risk exposure.

RISE IN POPULARITY OF PASSIVE INVESTMENTS

The rise of exchange-traded funds (ETFs) has been spectacular over the past decade and continuous growth is expected soon.[8] ETFs provide several benefits like low expense ratios, tracking of market indices, high levels of liquidity, transparency around investments and expenses, and capturing long term market-, social-, and megatrends. As ETFs follow another market index, this also avoids any emotional regret which is present with active stock picking and thus results in lower levels of bias. >

6 Global stock markets by country 2023 | Statista

7 Buffett Indicator: Global Stock Market Valuations and Forecasts (gurufocus.com)

8 ETFs To Account For 24% Of Total Fund Assets By 2027, Reveals New Study (oliverwyman.com)

The ETFs benefits have resulted in an increase in the number of ETFs,[9] and an increase in the number of sustainable/green ETFs. Easily accessible and low-cost trading platforms (sometimes without commissions)[10], allow even retail investors with limited means to become active in the stock market. Bourses like Euronext have been launching ESG indices like the BEL ESG index launched in February 2023.

Lastly, companies like Morningstar have started labelling investments based on their level of sustainability by given them a rating which will also help non-expert investors with limited time or means, to get quick access to ESG information.

ESG MARKET INTERESTS

Surveys have generally found that millennials are interested in ESG investing, which may increase ESG assets in retail investing soon. However this interest hasn't translated yet at the same level of interest as institutional investors: in the Netherlands an annual benchmarking of pension funds is published and remarkably the larger funds turn out to be the front-runners when it comes to sustainability.[11] Pension funds are active in their communication around sustainability by ways of sustainable and responsible investment policies, policy papers on specific items (e.g. climate change, human rights, water scarcity), or by publishing a separate sustainability report, or designating sections of their annual reports to sustainable investments, inclusion or carbon footprint.

As pension funds are ultimately run by their beneficiaries, this confirms the interest in ESG from the wider public.

RETAIL INVESTMENT IN SUSTAINABLE ASSETS – A WIN-WIN

An increase in life expectancy/higher retirement age, smaller families, and increasing female labor force participation, all indicate an increase in wealth accumulation for retail investors in the coming decades. Although consumers have shown their concern for climate change via protests or during election campaigns, they haven't yet fully converted this concern in becoming a more active investor. Becoming more involved in investment themselves, consumers can put their money where their mouth is and have a more direct impact on companies and their sustainability approach. Furthermore investing themselves will make consumers more aware of the risks and opportunities involved and increase their financial education, make better financial decisions, making them less dependent on government or employers.

The current ESG implementation approach tends to be rather top-down: (government) organizations like the UN, PRI, and others provide a roadmap for change which isn't always embraced by the public. Getting consumers involved in ESG investment themselves could be the missing puzzle piece ensuring bottom-up ESG integration occurs as well. <

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9 Invest For Progress: 5 Reasons Why ETFs Are Booming (forbes.com)

10 Best ETF Brokers & Platforms for December 2023 (tradingplatforms.com)

11 VBDO Benchmark pensioenfondsen 2023