Investor Sustainability Preferences: Empirical Insights and Regulatory Analysis

Insights into Swiss asset owners' preferences

December 2022

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Acknowledgments

This report was made possible by a partnership between UBS AG and the Research Network of Sustainable Finance.

The principal investigator and lead author of the report was Professor Kern Alexander, University of Zurich. Professor Alexander led a research team at the University of Zurich that included Dr. Emmeline Cooper and Dr Salome Kohler.

The authors would like to thank Dr Salome Kohler for excellent research assistance in designing the survey questions and analysing the responses.

The study was further supported by the valuable guidance of an Advisory Group at UBS AG.

1. Introduction

Understanding the preferences and attitudes of financial services clients has become an important strategic objective for many banks and financial firms and has become a legal requirement in the European Union.[1] As the financial risks posed by climate change and other environmental and social sustainability factors grow and become more apparent, the directors and senior management of financial institutions, along with trustees of investment and pension funds, are confronted with the business risks of managing their customers' and beneficiaries' capital, and ensuring that their capital is invested to achieve the highest risk-adjusted return while reducing environmental, social and governance risks for investors.

Regulatory reforms are directly addressing the responsibility and obligation of financial institutions and investment funds to manage these risks more efficiently by increasing their engagement with their customers and beneficiaries regarding their preferences and attitudes towards sustainability. Such engagement can contribute to a better understanding of how financial institutions can deploy their clients' and beneficiaries' capital more effectively to address sustainability concerns and support the broader economy in transitioning to a more sustainable level in conformity with international treaty commitments[2] for carbon reduction and to fulfil the United Nations Sustainable Development Goals.

Alongside an overview of recent regulatory reforms, this study provides empirical analysis of the preferences and attitudes of UBS AG's Swiss clients towards sustainability and ESG issues. This empirical analysis is based on a questionnaire survey that was distributed digitally to UBS institutional and wealth management clients in Switzerland between July and December 2021. The survey provides a detailed insight into the following areas of enquiry: respondents' views and perceptions of ESG risks, portfolio allocation and sustainable investment approaches, ESG issues in-depth, and the outlook for sustainable investing, including expected shifts in strategy over the next five years. Finally, it touches on the key obstacles which hinder sustainable and ESG investing. Throughout this study, the term 'sustainability' covers the full breadth of environmental, social and governance (ESG) issues. In addition, the term 'ESG' is referred to when used in specific regulatory recommendations, as well as in the questionnaire, which examines each of these issues in greater depth.

Survey tools have examined the perspectives of retail investors towards sustainable and responsible investing. For example, studies have addressed the investment barriers to retail

[1] See Market in Financial Instruments Delegated Regulation 2017/55 and the Insurance Distribution Directive Delegated Regulation 2017/2359. See discussion below at notes 23-26 and accompanying text.

[2] The Paris Climate Change Treaty has committed its signatory countries to limit global warming to 1.5°C above pre-industrial levels. To achieve this, the Paris Agreement commits countries to "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development." See Paris Agreement to the United Nations Framework Convention on Climate Change, Dec. 12, 2015, T.I.A.S. No. 16-1104, art. 2(2)(c) (Paris Agreement).

investors (Gutsche and Zwegel, 2020[3]), their consideration of responsible issues (Berry and Junkus, 2013[4]), their decision frames (Glac, 2009[5]), the factors influencing their decisions (Mclachlan and Gardner, 2004[6]) and their links to investment choices (Vyvyan and Brimble, 2007[7]). The perspectives of finance professionals have also been explored, such as investment advisors' attitudes to risk and return in sustainable investing (Paetzold, Busch and Chesney, 2005). And in addition, the motives, characteristics and behaviors of mutual fund managers (Przychodzen et al, 2016[8]), and the integration of ESG issues into asset management (Van Duuren, Plantinga and Scholtens, 2016[9]).

Further to these, Krueger, Sautner, and Starks (2020[10]) survey of institutional investors focuses on their perceptions of climate risk and its financial materiality. This study is unique in that it is the first study to conduct a digital survey that largely focused on the preferences, attitudes and views of asset owners (not professional investors, such as asset managers), including the views of trustees of pension funds who act for their beneficiaries by approving the investment strategies that are implemented by asset managers for a diverse range of environmental, social, and governance issues and risks. The questionnaire is specifically designed for an investor community that consists primarily of asset owners for whom the European Union and Swiss institutional and regulatory context is relevant.

The paper contributes to the academic literature by analysing the results of the first systematic survey of asset owners' understanding of, and approaches to, ESG and sustainable investing and the role of regulation in facilitating the transition in asset owner preferences and attitudes. The survey's findings highlight how ESG risks are understood, and the implications of that for portfolio allocation and ESG investing. While most survey respondents consider financial and market risks to be most important, a lesser – but still significant - number of respondents consider operating, reputational and environmental risks to be most important. The survey also shows that the most preferred sustainable investment approaches are 'exclusions (negative screening)' and 'ESG integration approaches', followed by 'Best-in-class approaches' and then 'stewardship'.

[3] Gunner Gutsche and Bernhard Zwergel, 'Investment Barriers and Labeling Schemes for Socially Responsible Investments' (2020) Schmalenbach Business Review 72 111

[4] Thomas. C. Berry and Joan C. Junkus, 'Socially Responsible Investing: An Investor Perspective' (2013) Journal of Business Ethics, 112 4 707

[5] Katherina Glac, 'Understanding Socially Responsible Investing: The Effect of Decision Frames and Ttrade-off Options' (2009) Journal of Business Ethics 87 41

[6] Jonathan McLachlan and John Gardner, 'A Comparison of Socially Responsible and Conventional Investors' (2004) Journal of Business Ethics, 52 11

[7] Victoria Vyvyan, Chew Ng, and Mark Brimble, 'Socially Responsible Investing: The Green Attitudes and Grey Choices of Australian Investors' (2007) Corporate Governance: An International Review, 15 370

[8] Justina Przychodzen, Fernando Gómez-Bezares, Wojeick Przychodzen and Mikel Larreina, 'ESG Issues Among Fund Managers—Factors and Motives' (2016) Sustainability 8 1078

[9] Emiel van Duuren, Auke Plantinga and Bert Scholtens, 'ESG Integration and the Investment Management Process: Fundamental Investing Reinvented' (2016) Journal of Business Ethics, 138 3 525

[10] Philipp Krueger, Zacharias Sautner, and Laura T. Starks, 'The Importance of Climate Risks for Institutional Investors' (2020) The Review of Financial Studies, 33 3 1067

In addition, legal and regulatory concerns are viewed by many respondents as a significant motivating factor that is driving the shift to sustainable investing. Among social issues considered by asset owners in their investment approaches, general labor conditions were viewed as highly significant, followed by health and well-being, access to medicine and health care, responsible consumption and production and economic inequality. The survey indicates that growth in sustainable investing is likely to be constrained by four obstacles: inadequate certification of sustainable assets, insufficient disclosure about the risks of sustainable investing, lack of adequate passive sustainable investment approaches, and insufficient information about sustainable investing offered by financial institutions. The study concludes that the outlook for sustainable investing is strong with a majority of respondents indicating a deeper integration of ESG risks into their investment processes.

The paper is divided into three parts. Part 1 provides an introduction to the overall purpose and content of the report. Part 2 analyses the regulatory background of sustainable finance and analyses regulatory developments in the European Union and Switzerland. The discussion of Swiss regulatory developments shows that banks and financial firms are beginning to adopt broader engagement approaches for their clients as part of enhanced due diligence to know their customers regarding the types of sustainable finance products and investments they may want to purchase. Part 3 addresses the empirical insights emerging from the survey of Swiss asset owners. It explores these survey respondents' views and perceptions of ESG risks, portfolio allocation and sustainable investment approaches, and their relative importance and the outlook for sustainable investing, examining investment approaches and expected shifts in strategy over the next five years.

2. Regulatory Context

A study of UBS AG's Swiss client and investor attitudes and preferences towards sustainable finance is important for Swiss policymakers in light of Switzerland's commitments to reduce its carbon emissions as required by the 2015 Paris Climate Change Treaty ('Paris Agreement'), which was reaffirmed by the Glasgow Climate Change Summit (COP26) in 2021. Similarly, the European Union has substantially revised its entire financial services law and regulatory framework to achieve two objectives: (1) to improve the management of financial risks related to environmental and social challenges; and (2) to reorient capital flows towards sustainable investments. This section will discuss the EU regulatory initiatives that are relevant to this study. First the regulation of the suitability assessment required of banks as part of their MiFID II obligation to conduct sustainability assessments of clients and customers. And second the regulation of pension fund trustees and managers to ensure that they take account of sustainability factors in deciding how to allocate capital in pension fund portfolios. The section will then discuss Switzerland's regulatory initiatives in these areas, focusing on how they support the business strategy of gaining an enhanced understanding of clients' and beneficiaries' preferences and attitudes towards ESG and sustainability challenges.

2.1 European Union Regulatory Initiatives

The European Commission's Action Plan on Sustainable Finance consists of directives and regulations that seek to provide more information to investors and customers about the reliability and trustworthiness of sustainable financial products and investments. The Sustainable Finance Disclosure Regulation (2019/2088) requires all regulated financial institutions and firms to disclose ESG risk exposures and provides guidance for determining the 'greenness' of financial products and investments.[11] These classifications of economic activity and definitions of different shades of green for financial products and investments are cross-referenced in other EU financial legislation that regulates the distribution and sale of retail products, investments and insurance and for prudential requirements for credit institutions. For instance, the Regulation on Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs) and the Insurance Distribution Directive (IDD)[12] requires the financial firm selling such products and investments to disclose all related ESG information.[13] Such information is required to be consistent with Articles 8 and 9 of the Sustainable Finance Disclosure Regulation (SFDR) that provide guidelines on how to define respectively 'light green' and 'dark green' financial products.

The European Commission has stated that "*(b)y providing advice, investment firms and insurance distributors can play a central role in reorienting the financial system towards sustainability*." Bank and investment firms implement this objective through the rules governing the distribution and sale of financial products and investments under the Directive on Markets in Financial Instruments (MiFID II),[14] and the Markets in Financial Instruments Regulation (MiFIR).[15] Insurance firms adhere to this requirement under the Insurance Distribution Directive. Under the MiFID II/MiFIR and IDD, European regulators have adopted conduct of business rules consisting of a conflict of interest regime and a product governance regime to govern the marketing, sale and distribution of investment securities and insurance products. These rules require that each financial firm carry out a suitability assessment of its customers that assesses their financial situation, knowledge and experience, and investment objectives.

The European Commission adopted amendments to the MiFID Delegated Regulation 2017/5565 and the IDD Delegated Regulation 2017/2359 requiring a firm to include sustainability factors in its suitability assessment of customers. The suitability assessment should consist of information on "investment objectives", including information on customer sustainability preferences, and the policies and procedures for understanding how sustainability factors of financial instruments are selected for clients. It should also include a suitability report that states how the advice meets the client's sustainability preferences.
The European Securities and Markets Authority (ESMA) has given direction to these requirements by issuing guidelines that

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[11] SFDR, article 8 provides guidance on defining 'light green' financial products and investments, while article 9 provides guidance on defining 'dark green' financial products and investments.
[12] Directive 2016/97/EU (as amended)
[13] EU Regulation 1286/2014/EU of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)(as amended).
[14] Directive 2014/65/E (MiFID II)
[15] Regulation 648/2012/EU

'*it would be a good practice for firms to consider non-financial elements when gathering information on the client's investment objectives, and […] collect information on the client's preferences on environmental, social and governance factors.*[16]

The EU legislative and regulatory reforms to incorporate sustainability factors into financial law and regulation are important steps in transitioning the European economy to a more sustainable economic path and in meeting Europe's carbon reduction commitments under the Climate Change Treaty. Reflecting these reforms, there is evidence that Swiss private banks have become increasingly active in asking clients about their sustainability preferences (CSP, 2022[17]). Further, the EU regulatory changes have influenced other countries outside the EU including Switzerland in developing their own policy and regulatory reforms to meet the challenges of climate change and other ESG objectives.

2.2 Swiss Regulatory Initiatives

As part of the mandate to achieve a more sustainable economy, the Swiss Council of States (Ständerat) adopted in 2019 two official requests (postulates) for the Federal Council (Bundesrat) to issue two reports entitled respectively "Wie kann die Schweiz die Finanzmittelflüsse klimaverträglich ausrichten?"[18] (climate compatibility of finance flows) and "Nachhaltigkeit fördern dank zeitgemässen Anlagerichtlinien"[19] (promoting sustainability through modern investment guidelines).

The first official request (Postulate 19.3966) asks the Federal Council to demonstrate how the objective set forth in article 2 paragraph 1 (lit. c) of the Paris Agreement[20] ("Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development") can be fulfilled as well as to suggest appropriate measures for implementation. The second request (Postulate 19.3950) asks the Federal Council to examine and report on how the provisions of the Swiss pension fund ordinance (BVV 2[21]) can be adapted in order not to pose obstacles to sustainable investments by pension funds.

The Swiss banking and financial services industry have generally supported the Swiss government's initiatives to promote financial flows to more sustainable and lower-carbon sectors of the economy. For instance, the Swiss Bankers Association (SBA) in June 2020 issued their "Guideline for the integration of ESG considerations"[22] (Guideline) as well as several

[16] ESMA, Guidelines on certain aspects of the MiFID II suitability requirements (2018), paragraph 28. https://www.esma.europa.eu/sites/default/files/library/esma35-43-1163_guidelines_on_certain_aspects_of_mifid_ii_suitability_requirements_0.pdf

[17] Center for Sustainable Finance and Private Wealth 'CSP Sustainable Investing Capabilities of Private Banks' (UZH PwC 2022)

[18] Postulate 19.3966 | Klimaverträgliche Ausrichtung und Verstärkung der Transparenz der Finanzmittelflüsse in Umsetzung des Übereinkommens von Paris | Geschäft | Das Schweizer Parlament

[19] Postulate 19.3950 | Nachhaltigkeit fördern dank zeitgemässen Anlagerichtlinien | Geschäft | Das Schweizer Parlament

[20] A9RB768.tmp (un.org)

[21] SR 831.441.1 - Verordnung vom 18. April 1984 über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge (BVV 2) (admin.ch).

[22] Swiss Bankers Association, 'Guidelines for the Integration of ESG considerations into the Advisory Process for Private Clients' (Swiss Bankers Association 2020).

position papers and recommendations[23] for enhancing sustainable finance. The Guideline provides that a bank's fulfillment of its due diligence and suitability assessment obligation under the Financial Services Act 2020 (FinSA) should require that the bank does "assess the client's potential investment restrictions, if there are any", and that "[a] structured interaction with the client is necessary to determine [its] investment profile, which not only takes into account traditional preferences, but also ESG preferences in a standardized approach as defined individually by each financial service provider".[24]

In June 2022, the SBA published binding minimum requirements for its members regarding the integration of sustainability criteria into investment advice and portfolio management.[25] These new guidelines focus on the advisory process to help clients understand and influence the impact of their investments from an ESG perspective.[26]

The Federal Council responded on 24 June 2020 to the Council of States' official requests by adopting a Report[27] and an Action Plan[28] on sustainability in the financial sector. The report references the SBA's Guideline by stating that the financial sector is active in this field in developing sustainable business strategies.[29] It asserts that government policy should not play a primary role in influencing customer demand for more information about how ESG factors affect their investments and can help achieve ESG objectives.

Nevertheless, the report states that consumers should be provided with information to make informed decisions about how their investments are affected by and are impacting ESG goals. In order to advance this goal, the Federal Council launched Swiss Climate Scores for climate transparency in financial investments in June 2022. The Swiss Climate Scores should provide institutional and private investors in Switzerland with information on the extent to which their financial investments are compatible with international climate goals. The Federal Council recommends that Swiss financial market players apply the Swiss Climate Scores to financial investments and client portfolios.[30]

The report further states that regulatory intervention may be necessary if the measures taken by financial firms do not achieve the desired goal of providing more meaningful information

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[23] Swiss Bankers Association, 'Principles and Recommendations - Sustainable Finance - Topics - SwissBanking', accessed 23 June 2022.
[24] Swiss Bankers Association, 'Guidelines for the Integration of ESG considerations into the Advisory Process for Private Clients' (Swiss Bankers Association 2020, 8).
[25] Swiss Bankers Association, https://www.swissbanking.ch/_Resources/Persistent/a/5/e/0/a5e0845f065a60699df88910ae675b7082e69411/SBA_Guidelines_investment_advice_and_portfolio_management_EN.pdf (June 2022, entered into force on 1 January 2023).
[26] Swiss Bankers Association, https://www.swissbanking.ch/en/news-and-positions/press-releases/sba-introduces-self-regulation-in-the-area-of-sustainable-finance (June 2022).
[27] The Federal Council, 'Sustainability in Switzerland's Financial Sector – executive summary' accessed 24 June 2022 ; Der Bundesrat, 'Nachaltigkeit im Finanzsektor Schweiz – umfassender Bericht' accessed 24 June (The Federal Council, 2020).
[28] Swiss Federation, 'Sustainable Finance Guidelines' accessed 24 June 2022
[29] The Federal Council, 2020, p. 39.
[30] The Federal Council, https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-89524.html (June 2022).

for customers about how their investments are affected by ESG risks and can impact ESG developments in the economy. The report moreover states that Swiss policymakers should monitor international regulatory developments, particularly in the European Union, regarding how regulators are treating ESG risks in the financial sector.

On 17 November 2021, the Federal Council responded to the Council of States first request[31] (Postulate 19.3966) by adopting another report.[32] This report observes that, according to the PACTA climate compatibility survey in Switzerland of 2020, 30% of participating Swiss financial firms asked their customers about their ESG preferences.[33] However, only 5% of these firms conducted the questioning in a systematic and standardized manner. Most financial institutions have only asked their customers about their attitudes and preferences towards sustainability if the customer has specifically requested such information. The Federal Council's report further mentions that this practice contradicts recent surveys and studies, according to which consumers and insured persons who are asset "owners" have strong views about climate and other sustainability objectives and want their views to be considered in their investment strategy. Furthermore, the report recommends that financial product distributors should have the necessary organizational infrastructure to identify the sustainability preferences and attitudes of their customers in a systematic manner and based on this to develop an investment strategy that takes account of their customers' preferences and desires.

The Federal Council's report further states that the effective design of a firm's assessment and subsequent monitoring of their customers' preferences and attitudes towards sustainability should be based on a systematic use of screening tools, and comparable questionnaires that include as many of their customers and related market actors as possible. To achieve this, the Federal Council proposes four regulatory options:

(1) Adapting the Financial Services Act 2020 (FinSA) to include a suitability assessment of customers regarding their sustainability preferences and attitudes that is similar to that required by the Market in Financial Instruments Regulation and Directive II (MiFID II).

(2) Establishing minimum requirements for the systematic design of a standardized questionnaire and compilation of data to enquire and assess the preferences and attitudes of customers towards climate change and other environmental sustainability phenomenon.

[31] Der Bundesrat, 'Wie kann die Schweiz die Finanzmittelflüsse klimaverträglich Ausrichten?' (Der Bundesrat, 2021).
[32] Based on this report, there is a Motion for law revision "Für eine klimaverträgliche Ausrichtung der Finanzmittelflüsse" pending in the National Council, https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20213757.
[33] Der Bundesrat, 'Wie kann die Schweiz die Finanzmittelflüsse klimaverträglich Ausrichten?' (Der Bundesrat, 2021, p. 27-28).

(3) Regulating the self-regulatory efforts of financial professional associations, including the further adaptation of the SBA Guidelines to make them applicable to other financial sectors, such as the insurance industry.

(4) Strengthen consumer protection to address greenwashing.

The Federal Council has not yet adapted its report to the request (Postulate 19.3950) of the Council of States. The amended report is expected to be issued in 2023. However, the Federal Council has already argued in its statement of 28 August 2019 that the current legislation does not limit pension funds from investing sustainably. According to the Federal Council, sustainable investments are not *per se* riskier than traditional investments and therefore can be incorporated into overall pension fund investment strategy.[34]

Moreover, the recent legal literature suggests that there is a high probability that the Swiss Financial Market Authority (FINMA) will use its discretion under FINSA 2020 to require an obligation similar to that of the MiFID II obligation that financial firms conduct a systematic inquiry as to customer preferences and attitudes towards sustainability. According to this view, Swiss financial services providers are encouraged to begin integrating sustainability factors into their suitability tests and assessments under FINSA.[35]

Similarly, other legal commentators assert that article 71 of the Occupational Pension Act (BVG[36]) and article 51 of Ordinance BVV 2 require that the trustees of Swiss pension funds take into account all risks that affect the liquidity and risk-adjusted returns of pension fund investments. This requirement can be interpreted as requiring trustees to consider also the growing evidence that sustainability factors affect the liquidity and financial returns of investment funds.[37] Based on this growing evidence, it is incumbent on the trustees of Swiss pension funds to consider sustainability factors and their potential impact on the liquidity and risk-adjusted returns of pension funds. It would be reasonable to infer that such a duty would also necessarily require that pension fund trustees inquire from their beneficiaries about their preferences and attitudes towards sustainability, and whether beneficiaries would like sustainability factors to be incorporated into the overall risk assessments and strategy for pension fund investments. Nevertheless, there is no such explicit legal obligation in article 71 BVG and article 51 of Ordinance BVV 2 that pension fund trustees conduct such an inquiry with pension fund beneficiaries.[38]

[34] See FN 19.
[35] MARTIN ECKERT/TAMARA TEVES/ROMINA LAUPER, Nachhaltigkeit und Finanzmarktrecht, GesKR 2020, pp. 411, 423 (Nachhaltigkeit und Finanzmarktrecht | Recherche | Swisslex); see also IVANOVIC DUSAN/WOHLHAUSER YANNICK, Sustainable Finance in der Schweiz, GesKR 2022, pp. 160, 178-184.

[36] SR 831.40 - Bundesgesetz vom 25. Juni 1982 über die berufliche Alters-, Hinterlassenen- und Invalidenvorsorge (BVG) (admin.ch)
[37] HANS ETTLIN, in: Marc Hürzeler/Hans-Ulrich Stauffer, Berufliche Vorsorge, Basler Kommentar, Basel 2021, Art. 71 BVG N 56 f. (Berufliche Vorsorge(Hürzeler, Marc (Hrsg.); Stauffer, Hans-Ulrich (Hrsg.)) - Schulthess Buchhandlungen - Kommentare, Repetitorien, Fachinformationen)
[38] HANS ETTLIN, in: Marc Hürzeler/Hans-Ulrich Stauffer, Berufliche Vorsorge, Basler Kommentar, Basel 2021, Art.71 BVG N 56 f. (Berufliche Vorsorge(Hürzeler, Marc (Hrsg.); Stauffer, Hans-Ulrich (Hrsg.)) - Schulthess Buchhandlungen - Kommentare, Repetitorien, Fachinformationen)

To conclude, recent regulatory developments in the EU and in Switzerland reflect a growing recognition among policy makers of the need for financial institutions, first, to offer enhanced sustainability disclosures and, second, develop enhanced understanding of their clients' and beneficiaries' sustainability preferences. In both these jurisdictions, enhanced disclosure involves not only financial institutions disclosing the financial risks to investors associated with environmental and social sustainability challenges but also enhanced suitability assessments of customers regarding sustainability issues including the impact on sustainability objectives of financial products and services. Regarding the latter, it should be emphasized that an enhanced understanding of customers' sustainability preferences is encouraged through the systematic use of suitability assessments which move beyond simply traditional financial preferences, to include the consideration of broader sustainability preferences.

3. Survey of Asset Owners: Empirical Insights

In Part 3, we build on the understanding of the regulatory context and its implications for financial institutions outlined in Part 2. This previous discussion highlighted regulations which require financial institutions to have a sufficiently informed understanding of their clients' preferences to sustainability and ESG issues. Reflecting this regulatory focus, we examine the preferences towards sustainability and ESG of UBS AG's institutional and wealth management clients in Switzerland. While the focus of regulation is largely on individual client suitability assessments, this study addresses this question by taking a broader approach and surveying a sample of the client population. Using a survey tool, we identify how UBS institutional and wealth management clients view sustainability and ESG risks and issues, the ways in which they have integrated their views into their investment approaches and strategies, their perspectives on the future of sustainable investing, and the obstacles which hinder sustainable and ESG investing.

Digital survey tools offer the benefit of a systematic approach to the collection of opinions, providing anonymised insights on clients' preferences as a whole, rather than on an individual client by client basis. As such, this approach provides strategic insights on the Swiss market which UBS serves.

3.1 Methodology

To gain an in-depth insight into the sustainability preferences of institutional and wealth management clients, we offered these UBS clients in Switzerland the opportunity to participate in an in-depth, digital, self-completion questionnaire, specifically designed for this investor community and the Swiss context. The survey questionnaire was available between July and October 2021, providing a snapshot of Swiss institutional and wealth management clients' perspectives towards sustainable investing, on the cusp of Glasgow Climate Change Summit (COP26) in 2021.

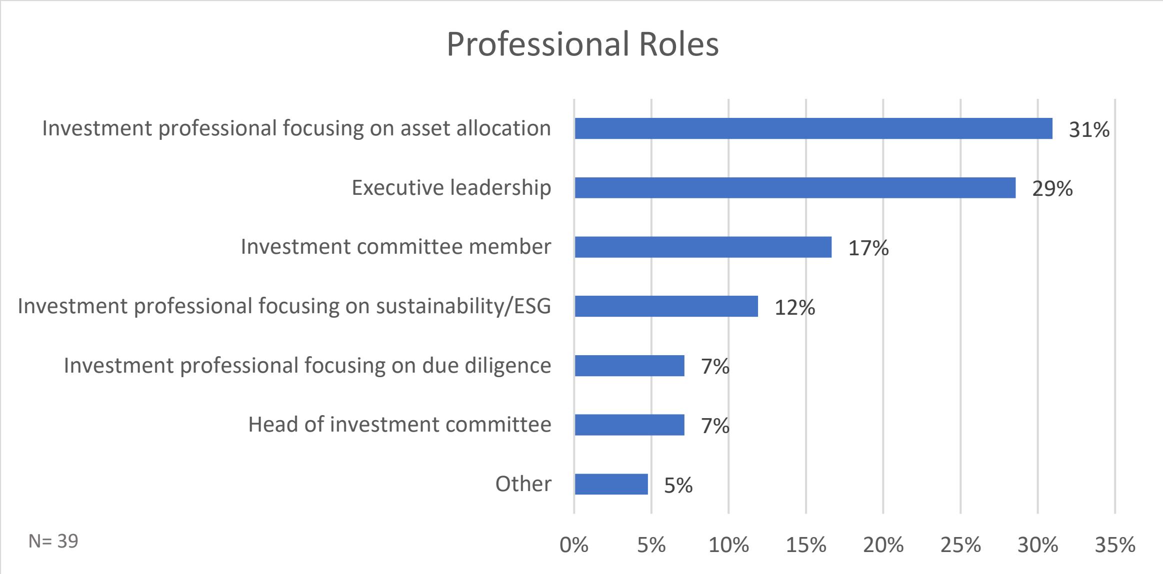
Thirty-nine respondents took part in the comprehensive survey in which respondents self-completed a questionnaire. Along with questions about investor characteristics, the survey had four question themes: 'ESG views and preferences' (54 questions), 'ESG integration and activities' (12 questions) and 'ESG in the future' (20 questions). It was designed to be completed in approximately 15-20 minutes The findings provide us with an insight into how this specific group of asset owners are responding to the sustainability challenge.

Where the survey findings do not add to 100% that is as a result of rounding issues. Figure 1 is an exception as this is result of multiple coding, when respondents' have stated they have more than one professional role.

The survey respondents represent a mixture of asset owners, who describe themselves as public pension funds (36%), private pension funds (41%) and other institutions (e.g., foundations, insurance companies and other) (23%). The majority (77%) have CHF 5 billion or less assets under management. Of these, 41% have less than CHF 1 billion, and 36% have between CHF 1 billion and CHF 5 billion. Fewer are managing between CHF 5 billion and CHF 10 billion (13%) or over CHF 10 billion (10%). Nine in ten (90%) describe their investment horizon as long or very long, with the majority (77%) saying very long.In terms of their professional role responsibilities, around three in ten (31%) have responsibility for asset allocation, or for executive leadership (29%). A further 19% have responsibility for due diligence or sustainability/ESG. Slightly fewer (24%) are involved in governance activities through investment committees, whilst 5% have other roles[39].

[39] Some respondents have multiple roles.

Figure 1: How would you describe your institutional role?



In the following sections we discuss the empirical insights realised from this survey, providing a snapshot of survey respondents preferences towards sustainability and ESG issues. These address the themes below.

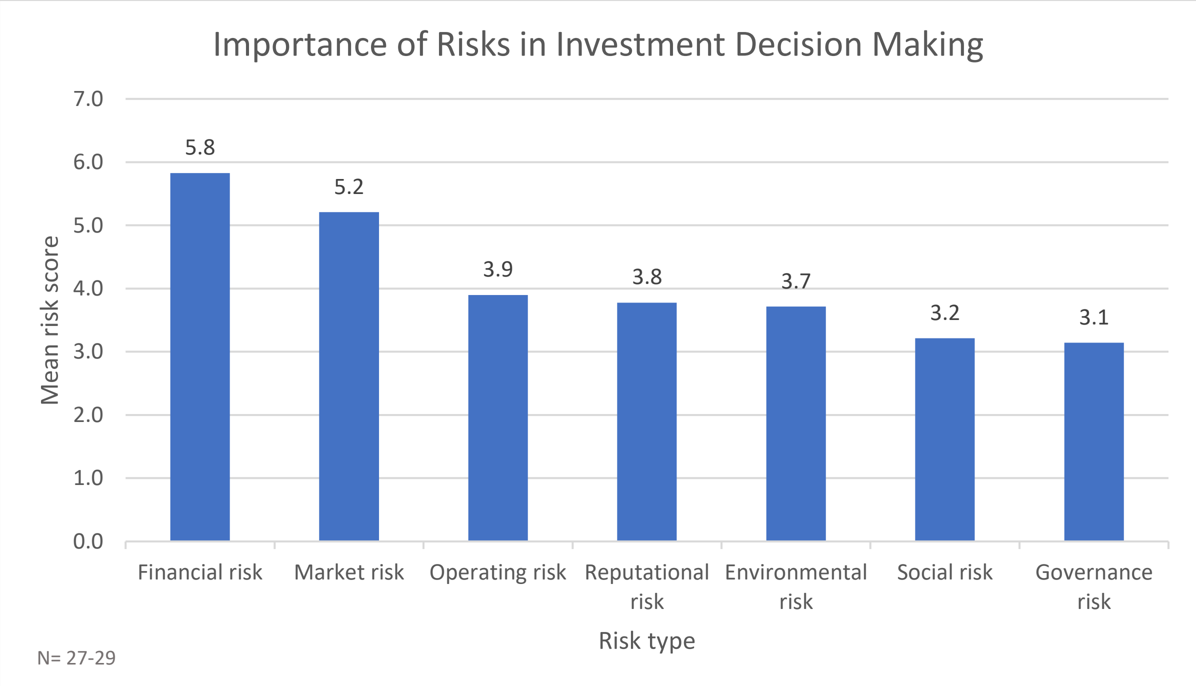
- Perceptions of risk. An examination of understandings of ESG risks, motivations for considering these in their investment management, and their expectations for when specific environmental, social and governance risks will have an impact.
- Portfolio allocation and sustainable investment approaches. An overview of portfolio allocation and the integration of sustainability and ESG issues into investment strategies and approaches.
- Environmental, social and governance issues. An in-depth picture of survey respondents' perceptions of the key environmental, social and governance risks and their relative importance.
- Outlook for sustainable investing. An overview of the approaches used to incorporate ESG risks in investing, examining expected shifts in strategy over the next five years.
- Obstacles. An examination of the potential obstacles to investing in sustainable assets, addressing the extent of their impact.

3.2 Perceptions of Risk

3.2.1 How do Asset Owners Perceive Sustainability Risks?

Risk is central to all investment decision-making, and the consideration of sustainability issues is widely seen as an effective way to manage risk (TCFD, 2017[40]). Among survey respondents, financial risk, followed by market risk are considered the most important risks in their investment decision-making (mean risk scores of 5.8 and 5.2, respectively). In contrast, operating risk and reputational risk are viewed as less important (mean risk scores of 3.9 and 3.8, respectively). Environmental risk receives a similar risk score (3.7) to operating and reputational risks, while social and governance risks are considered relatively less important (mean risk scores of 3.2 and 3.1, respectively).

Figure 2 Understanding of sustainability risks: Rank the following seven criteria according to its importance in your investment decision, where 7 is the most important and 1 is the least important.



3.3 Environmental, Social and Governance Risks

All investors manage risks, over different horizons. Survey respondents were asked in more detail about specific ESG risks and their expected occurrence. ESG risks may impact in the longer-term (beyond the next ten years), in the medium-term (two to ten years), in the short-term (less than two years), immediately (today), or not at all.

[40]TCFD 'Recommendations of the Task force for Climate Related Financial Disclosures' (TCFD 2017)

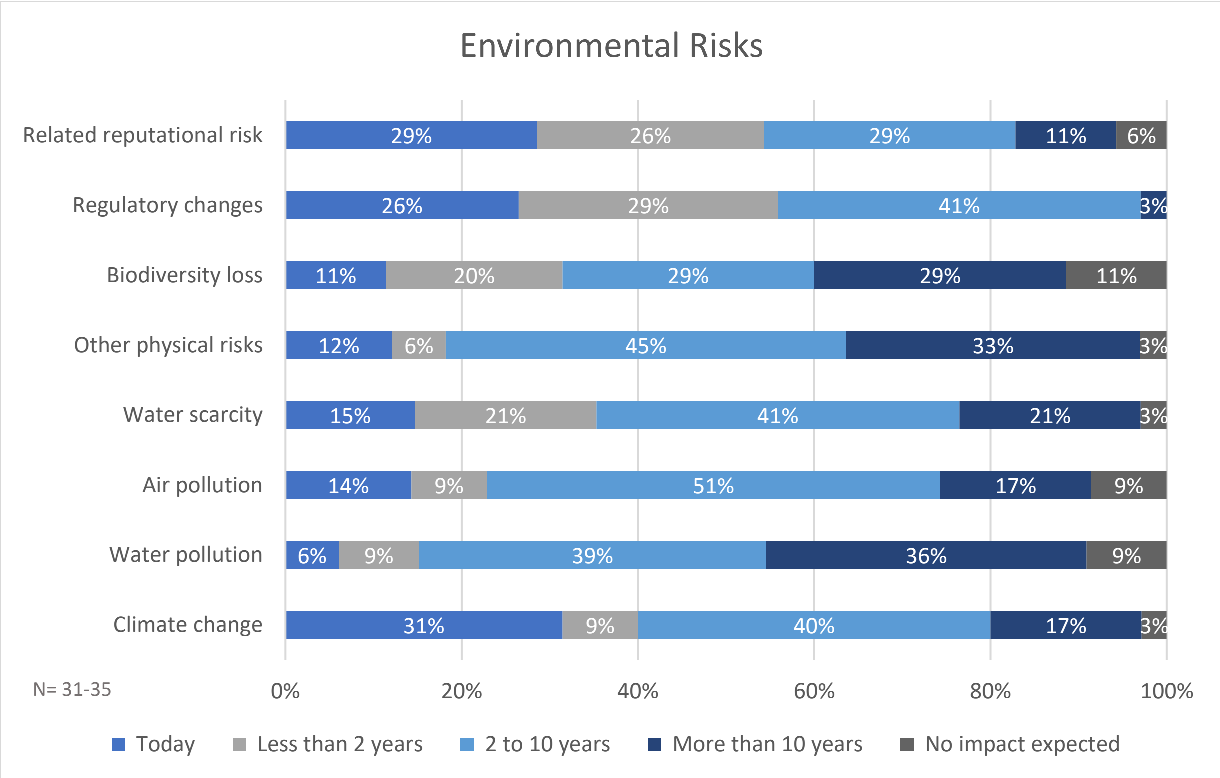
3.3.1 Environmental Risks

When asked about the expected financial impact of a range of environmental risks, on average, only 6% expect no impact. Relative to other risks, water pollution (36%), other physical risks (33%), and biodiversity loss (29%) are viewed as the top three long-term risks (with expected impact in more than ten years). Air pollution (51%), other physical risks (45%), water scarcity, and regulatory changes (41% each) are viewed as the top medium-term risks (with expected impact between two to ten years). In the short-term (expected impact less than two years), a similar pattern emerges with regulatory changes (29%), related reputational risk (26%) and water scarcity (21%) the most impactful risks.

Notably, climate change is not only seen as a risk with medium-term impact (40%), but also the highest rated immediate risk, with impact expected today (31%), followed by related reputational risk (29%), and regulatory changes (26%).

Figure 3: Environmental risks

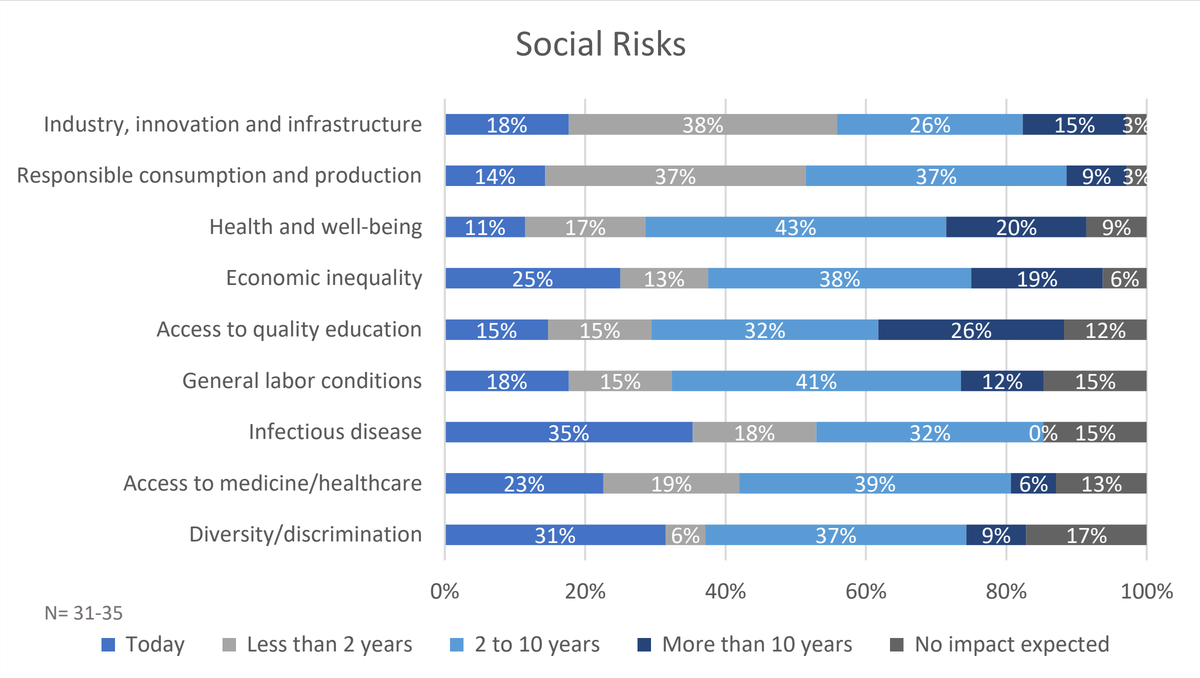
When do you expect ESG risks to have a financial impact on assets in your current portfolio?:



3.3.2 Social Risks

In comparison with environmental risks, respondents view social risks as having slightly less financial impact with, on average, 10% suggesting these will have no impact. The top three long-term social risks, relative to others, are access to quality education (26%), health and well-being (20%), and economic equality (19%) (expected impact more than ten years). In addition, health and well-being is perceived as a risk that will also impact in the medium-term (two to ten years) (43%), along with general labor conditions (41%), and access to medicine/healthcare (39%). The social risks with expected impact in the short-term (less than two years) are industry, innovation, and infrastructure (38%), responsible consumption and production (37%), and, in addition, access to medicine/healthcare (19%). Immediate social risks with impact today are infectious disease (35%), diversity/discrimination (31%) and, in addition, economic inequality (25%).

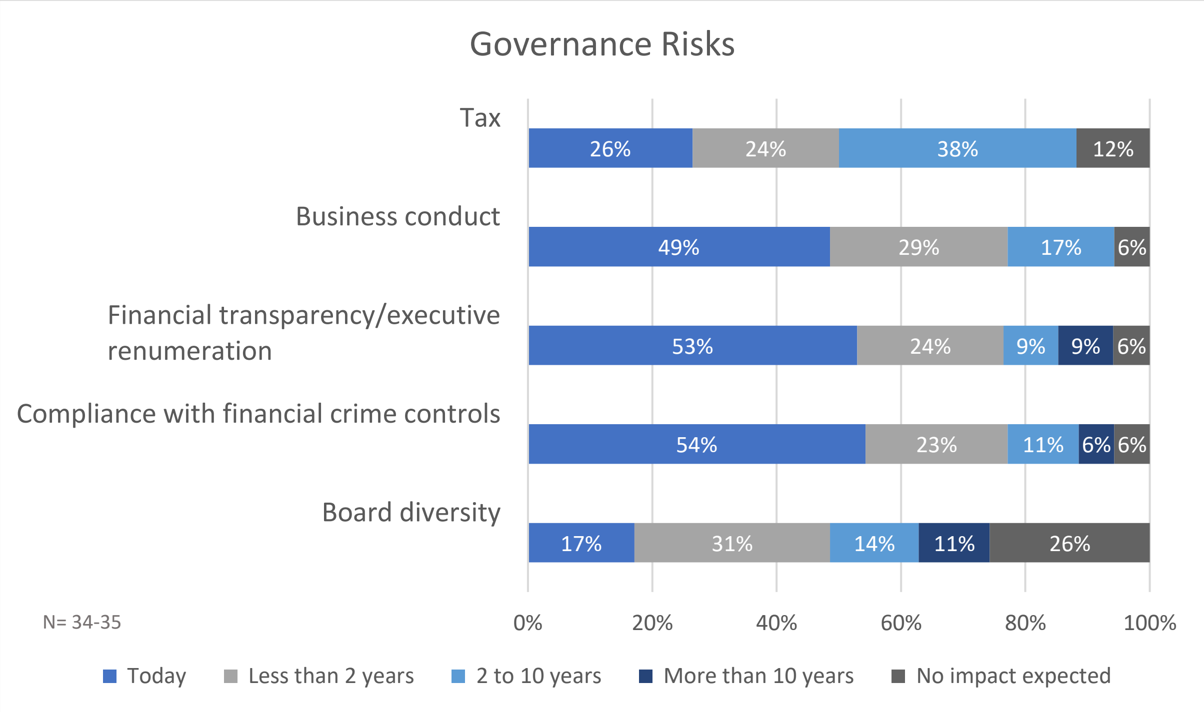
Figure 4: When do you expect ESG risks to have a financial impact on assets in your current portfolio?: Social risks



3.3.3 Governance Risks

Looking at the governance risks, on average, 11% expect no financial impact from these risks. However, in comparison with environmental and social risks, there is greater variation in how governance risks are viewed. Governance risks are predominantly perceived as shorter-term risks, with only board diversity (11%), financial transparency/executive renumeration (9%), and compliance with financial crime controls (6%) viewed as governance risks which will impact in more than 10 years. The top two medium-term risks (with impact between two to ten years) are tax (38%) and business conduct (17%). Short-term risks (with expected impact in under two years), are board diversity (31%) and business conduct (29%). Around half also view compliance with financial crime controls (54%) and financial transparency/executive renumeration (53%) as risks that pose an immediate impact today.

Figure 5 When do you expect ESG risks to have a financial impact on assets in your current portfolio?: Governance risks



3.4 Portfolio Allocation and Sustainable Investing Strategies and Approaches

Equities, fixed income, and alternative securities are each important asset classes within survey respondents' portfolios. Survey respondents have 50% or less of their portfolios in equities (100%), with the majority of these investing between 21-40% (80%). Around three quarters (78%) have between 21-50% of their portfolios invested in fixed income, although fixed income allocations, for a minority (3%), go up to 71-80% of portfolio allocation, reflecting more diverse approaches to fixed income investing. Alternative securities are invested in more sparingly, with over half (57%) investing 10% or less in this asset class. The average portfolio allocation includes 39% fixed income, 28% equities and 13% alternative securities.

As shown in Figure 7 overleaf, different approaches are taken to passive investing but on average 57% of assets are invested passively.

3.4.1 Portfolio Allocation

Figure 6 What percentage of your portfolio is invested in fixed income, equities and/or alternative securities?: Portfolio allocation

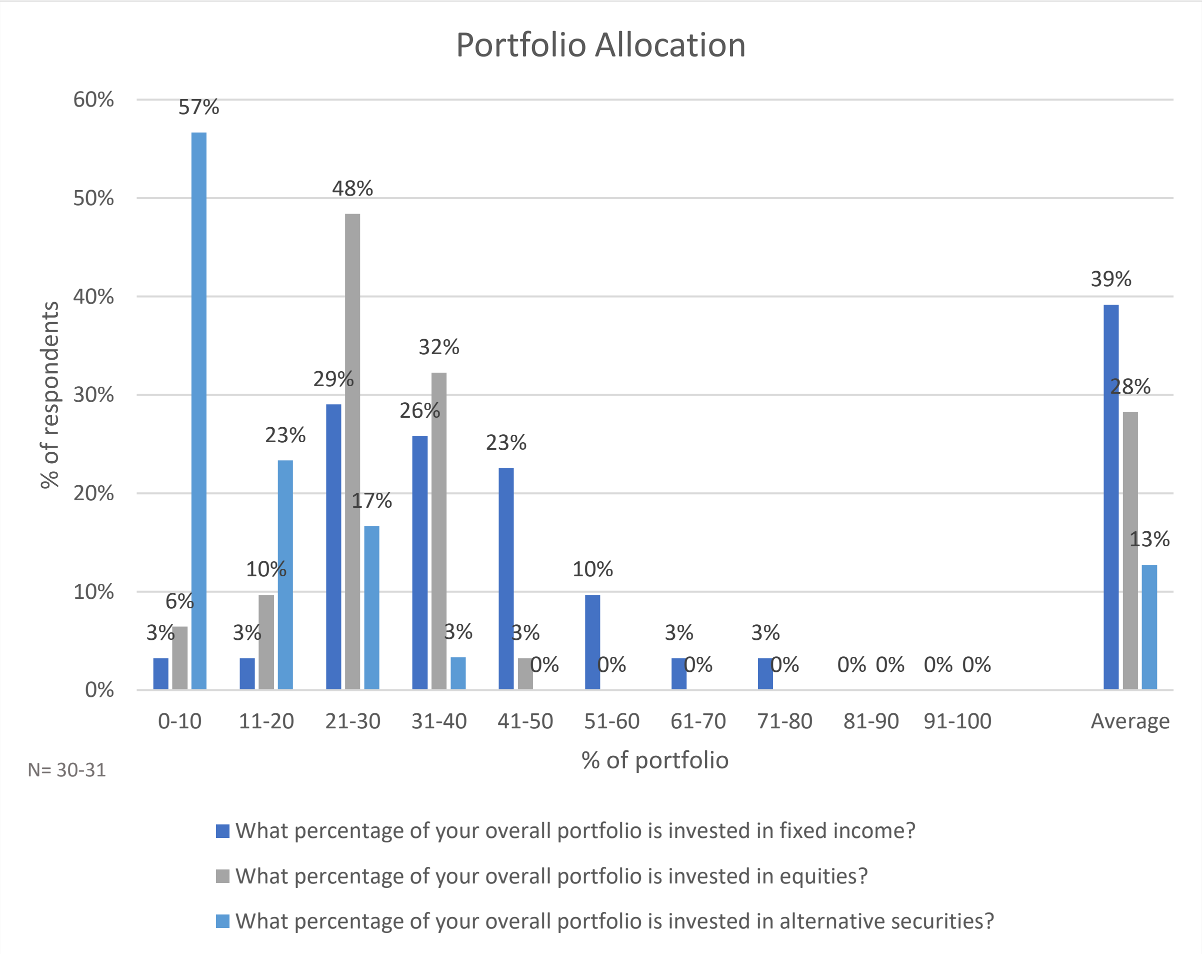
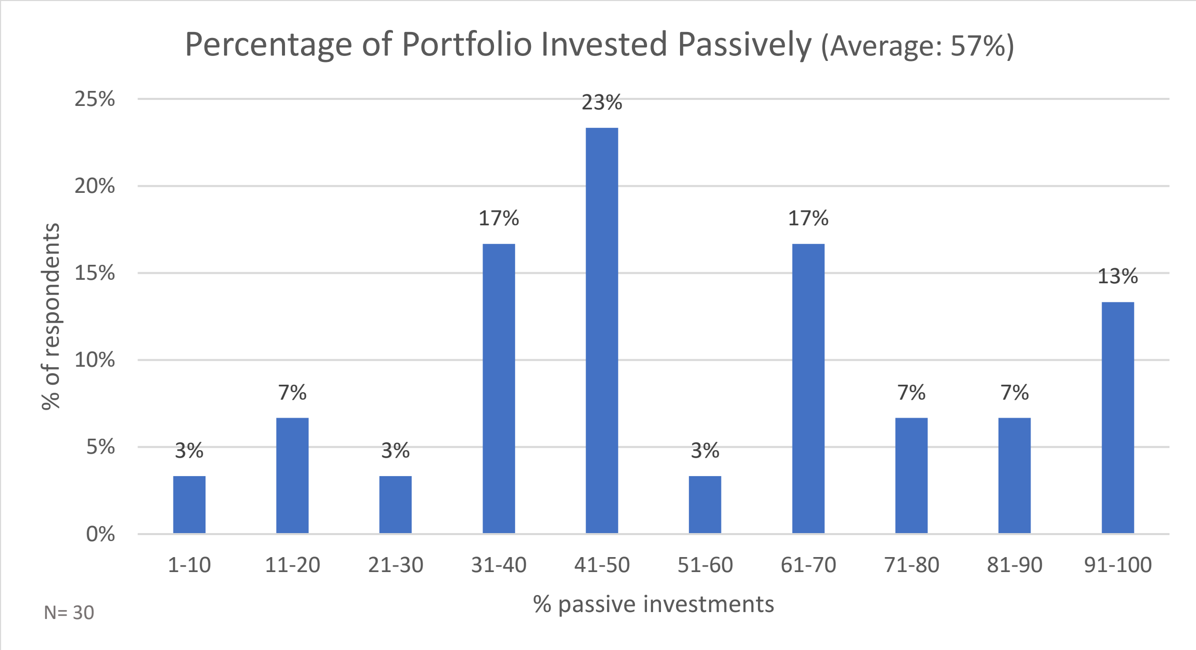


Figure 7: What Percentage of Your Portfolio is Invested Actively versus Passively?



3.4.2 Sustainable Investment Approaches

On average, 38% of respondents' assets are managed using sustainable investment approaches. Beneath this average lies some diversity in approaches. A sizable minority (31%) manage over half (51% or more) of their assets according to sustainable investment approaches. Slightly fewer (27%) invest between 26-50% of their assets sustainably, while four in ten (42%) – again a sizable minority – invest 25% or less.

The findings indicate differences in the proportion of assets managed sustainably by private and public pension funds. Around a quarter of private pension funds (23%) manage 25% or less of their assets using sustainable investment approaches. In contrast, only 4% of public pension funds have less than 25% in sustainable assets. Just under a quarter (23%) of private pension funds, and just over a quarter (27%) of public pension funds manage between 26-75% of their portfolio according to sustainable investment approaches. For all asset owners, small minorities manage 76% or more of their assets using sustainable investing approaches (private pension funds and other owners 4% each, public pension funds 0%).

Figure 8 Sustainable investment approaches: What is the percentage of your institution's assets managed using sustainable investment approaches?

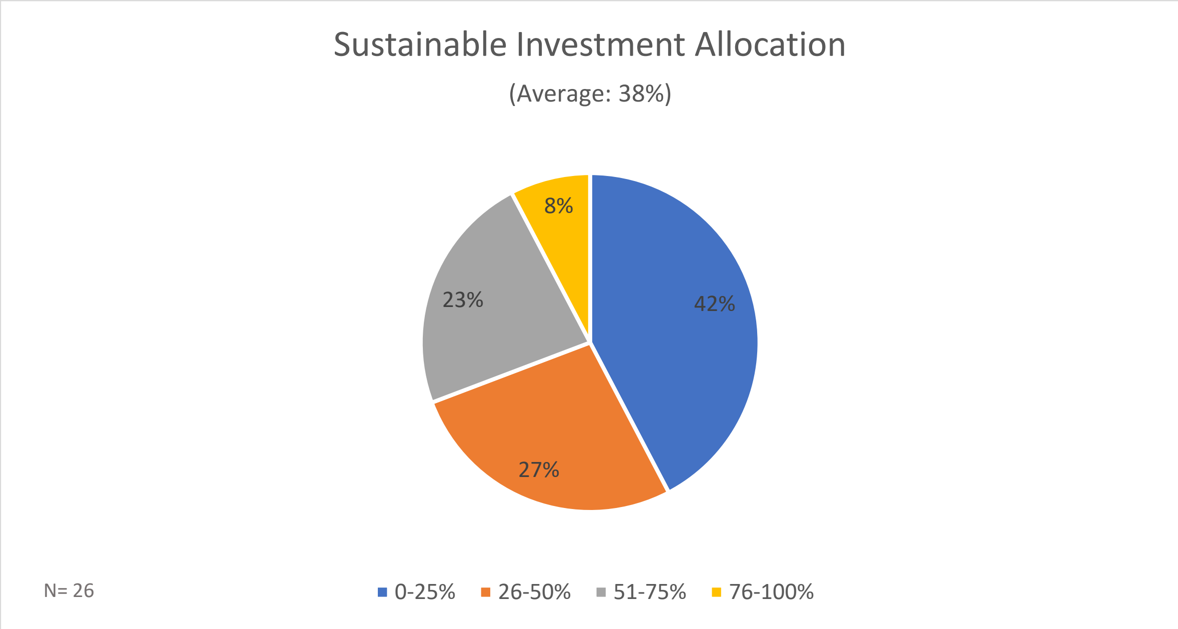
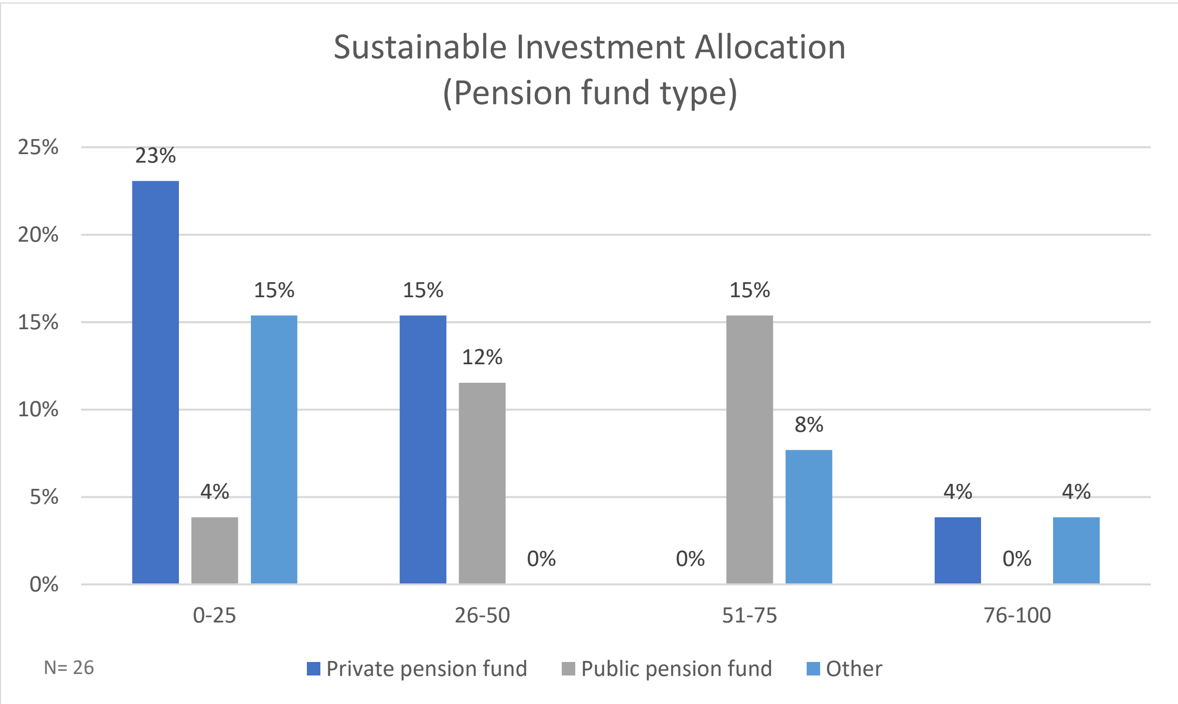


Figure 9 Sustainable investment approaches: What is the percentage of your institution's assets manged using sustainable investment approaches (Pension fund type)



3.4.3 Investments in Environmental, Social and Governance areas

The consideration of environmental, social and governance issues in investing is commonly bundled together into composite terms such as 'ESG', or 'sustainable investing'. However, in practice, investors may incorporate these issues to differing degrees. When asked about the percentage of their current ESG investments invested in either environmental, social or governance areas, the findings indicate that these areas garner different weights in survey respondents' ESG investment portfolios.

Survey respondents invested 50% or less of their ESG investments in social or governance related investments (both 100%). Of these, most invested 25% or less of their ESG investments in social and governance areas (71% and 67%, respectively). A different pattern emerges for environmental related investments. For these investments, around a third (36%) invest 25% or less of their ESG investments in this area, but more (64%) invest 26% or over in this area.

Figure 10 Investments in environmental, social and governance areas: Approximately, what percentage of your institution's current ESG investments belong to the…?

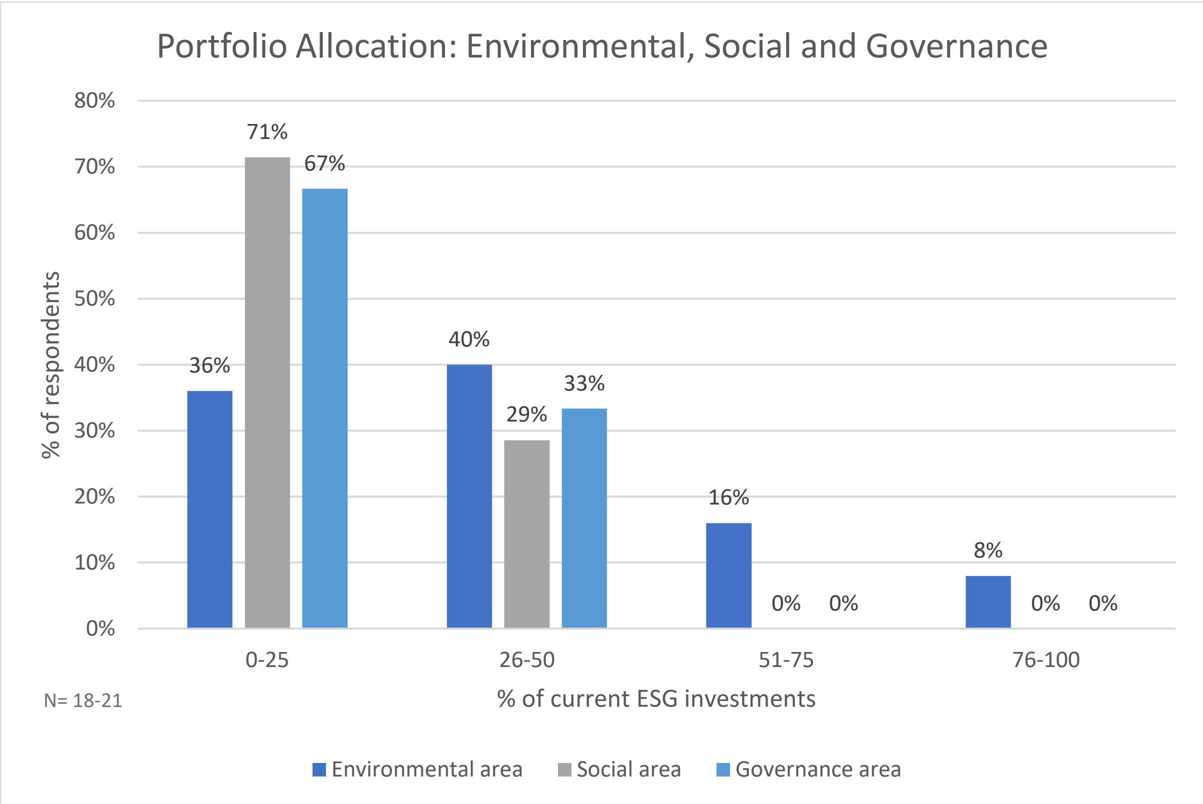
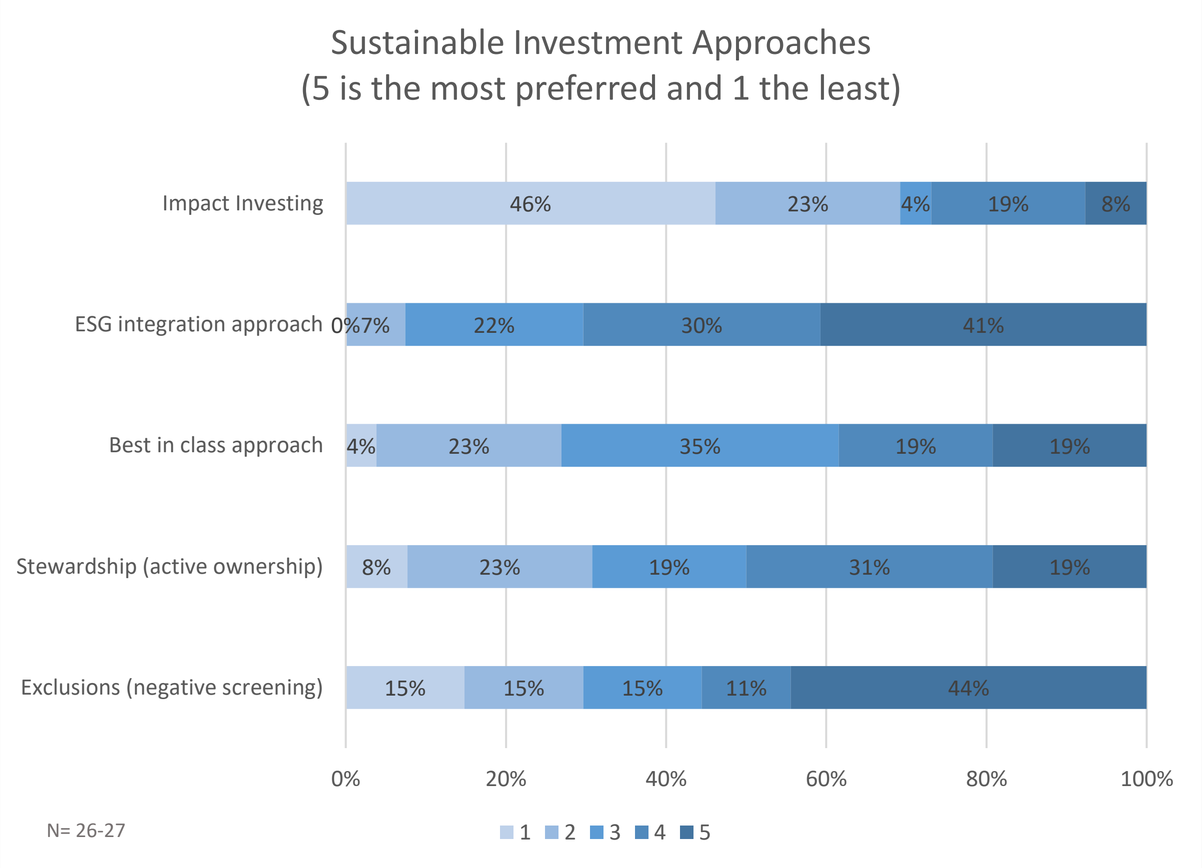


Figure 11 Please rank the following sustainable investment approaches. 5 is the most preferred and 1 the least: Sustainable Investment Approaches

When asked about their specific sustainable investment approaches, respondents offer two clear preferences: 'exclusions (negative screening)' and 'ESG integration approach' are most preferred by four in ten (44% and 41%). 'Best in class approaches', and 'stewardship' are most preferred by around half as many (both 19%), and 'impact investing' is most preferred by around one in ten (8%).



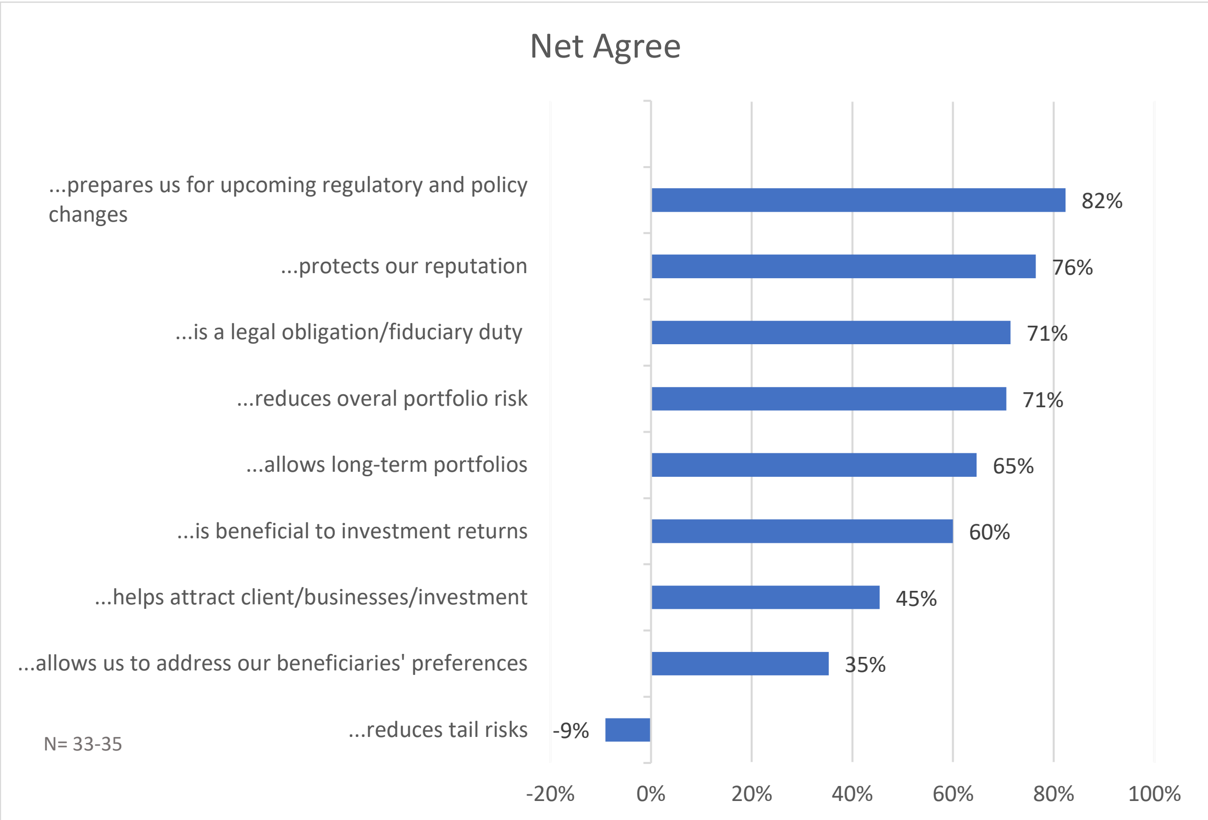
3.4.4 What are the Motivating Factors for ESG integration into Investment Management?

In recent years, the market for ESG assets has boomed (BIS, 2021[41]; IMF, 2019)[42], and interest in sustainable investing among institutional investors has grown, along with interest among supervisory bodies[43]. In the context of this growing interest across the industry, what is motivating survey respondents to consider sustainability and ESG risks? Respondents were provided with nine reasons for incorporating ESG risks into their investment management, which they agreed or disagreed with, and the 'net agree' scores (agree-disagree) summarise the strength of their positive opinions.

[41] Michela Scatigna, Dora Xia, Anna Zabai and Omar Zulaica, 'Achievements and Challenges in ESG Markets' (BIS Quarterly Review 2021)
[42] IMF 'Global Financial Stability Report: Lower for Longer' (IMF, 2019)
[43] As an example, the International Organisation of Pension Supervisors (IOPS) Annual Report 2021 states it is developing IOPS ESG guidelines.

The consideration of ESG risks in investment management is driven predominantly by legal, regulatory and reputational concerns[44]. The majority of survey respondents agreed that considering ESG prepares them for upcoming regulatory and policy changes (+82 net agree), protects their reputation (+76% net agree), or is part of their legal obligation/fiduciary duty (+71% net agree). But in addition, the business case for considering ESG risks is also widely accepted. Specifically, ESG considerations are seen to reduce overall portfolio risk (+71% net agree) – although notably, ESG issues are not associated with a reduction in unpredictable tail risks (-9% net agree). Furthermore, ESG is perceived as offering the potential for building long-term portfolios (+65% net agree) and realise beneficial investment returns (+60% net agree). Additionally, ESG is seen to attract client/business/investment (+45% net agree) and improve responsiveness by addressing beneficiary preferences (+35% net agree).

Figure 12 Motivating factors for ESG Integration: To what extent do you agree with the following statements? Incorporating ESG Risks in investment management…



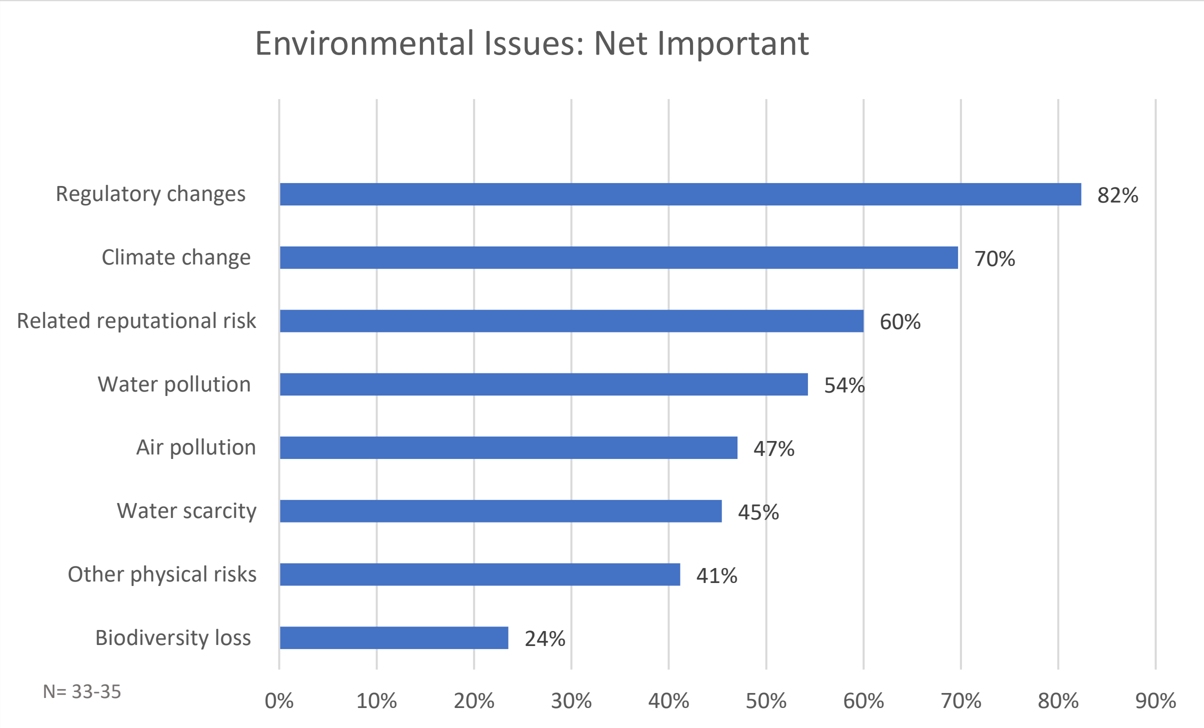
[44] The importance of regulation for motivating private banks to address sustainability risks has also been recognized (Center for Sustainable Finance and Private Wealth 'CSP Sustainable Investing Capabilities of Private Banks' (UZH PwC 2022)

3.5 In Detail: Environmental, Social and Governance Issues

3.5.1 Environmental Issues

Examining survey respondents' attitudes to environmental issues in more detail, it is evident that some issues have greater importance than others. Mirroring earlier findings on motivations for ESG investing, regulatory changes related to environmental issues is the top-of-mind environmental concern (82% net important score). Climate change receives a net important score of +70%. Following these, related reputational risk (+60%), water pollution (+54%), air pollution (+47%), water scarcity (+45%) and other physical risks (+41%) are rated important. While biodiversity loss is an emerging concern across the industry (Finance for Biodiversity Foundation, 2022[45], CSP, 2022[46]), it is currently viewed as the least important environmental issue (+24%).

Figure 13 How important are the listed factors below when it comes to the decision to invest in ESG assets?: Environmental issues



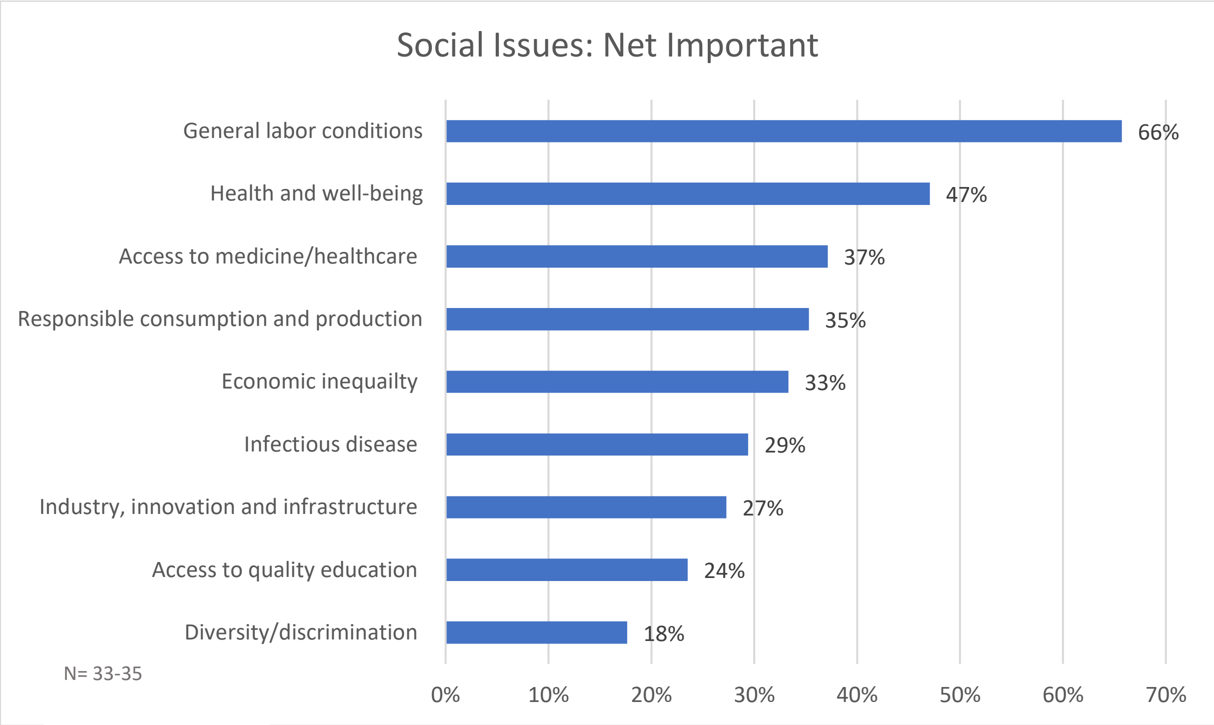
3.5.2 Social Issues

Among the social issues considered in ESG investing, general labor conditions are viewed as highly significant, receiving a net important score of +66%. This is followed by health and well-being (+47%), access to medicine/healthcare (+37%), responsible consumption and production (+35%), and economic inequality (33%). Social issues considered relatively less

[45] The Finance for Biodiversity Foundation 'Finance and Biodiversity' (The Finance for Biodiversity Foundation 2022)
[46] Center for Sustainable Finance and Private Wealth 'CSP Sustainable Investing Capabilities of Private Banks' (UZH PwC 2022)

important are infectious disease (+29%), industry, innovation and infrastructure (27%), access to quality education (+24%), and diversity/discrimination (18%).

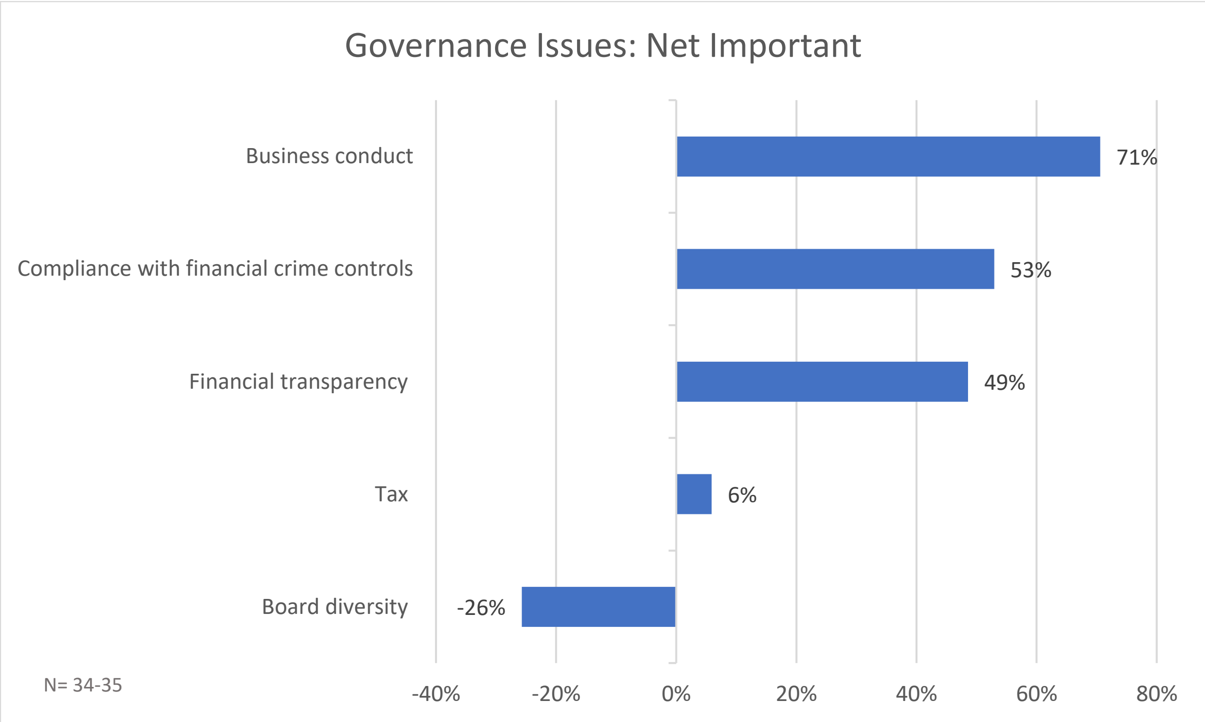
Figure 14 How important are the listed factors below when it comes to the decision to invest in ESG assets?: Social issues



3.5.3 Governance Issues

When asked about governance issues, survey respondents emphasize general business conduct as the most important issue (+71% net important score). To a lesser degree, compliance with financial crime controls, and financial transparency, are considered important (+53% and +49%, respectively). Tax is regarded as less significant issue (+ 6%), while board diversity is seen as relatively unimportant (-26%) – a finding that mirrors the earlier finding that respondents perceive board diversity as a longer term, rather than immediate, governance risk.

Figure 15 How important are the listed factors below when it comes to the decision to invest in ESG assets?: Governance issues



3.6 The Outlook for Sustainable Investing

Will the market for sustainable and ESG investing continue to be sustained in the long-run, or is it subject to over valuation? (Boyde, 2021[47]). Survey respondents are expecting to incorporate ESG risks further in their investment process and refine their investment strategies. When asked what approaches they will be taking over the next five years, a significant majority of survey respondents plan to 'use their own approach and preferences for ESG/sustainability analysis' (92%), 'train employees on ESG' (84%), 'require ESG/sustainability reporting from asset managers' (83%), 'have a dedicated allocation to ESG', have a 'dedicated ESG team' (80% each), or use 'positive inclusion approaches' (78%). Of these top five approaches, two in particular stand out as gaining popularity – for the next five years, there is a 58 percentage point increase in interest in 'training employees', and a 54

[47] Emma Boyde 'ESG Outperformance Looks Set to End, Study Suggests' *Financial Times* (London 6 July 2021)

percentage point increase in ‘using own approach and preferences on ESG’, compared with their use in previous five years.

Around seven in ten plan to ‘use third party ESG ratings’ (75%), ‘have ESG mandates/strategies/ in asset class exposures’ (74%) and perform active engagement activities and voting (70%). In particular, using ‘third party ESG ratings’ and having ‘ESG mandates’ are gaining in popularity, with a 25 and 21 percentage point increase in interest for the next five years. Around six in ten (64%) plan to delegate ‘active engagement activities and voting’, mirroring activity in the previous five years.

In contrast, two investment approaches are losing their popularity among survey respondents. Notably, there are fewer investors who expect to use none of these approaches to incorporating ESG risks (a decrease of 27 percentage points). And the use of ‘negative/exclusionary screening’ is losing popularity as an approach, with a decrease of 22 percentage points in the next five years.

In a nutshell, the outlook for sustainable investing – from the perspective of survey respondents – is strong, with signs of a deeper integration of ESG risks into their investment processes.

Figure 16 Which approaches, if any, have you taken in the past five years or plan to take in the next five years to incorporate ESG risks in your investment process?: Approaches to Incorporating ESG Risks

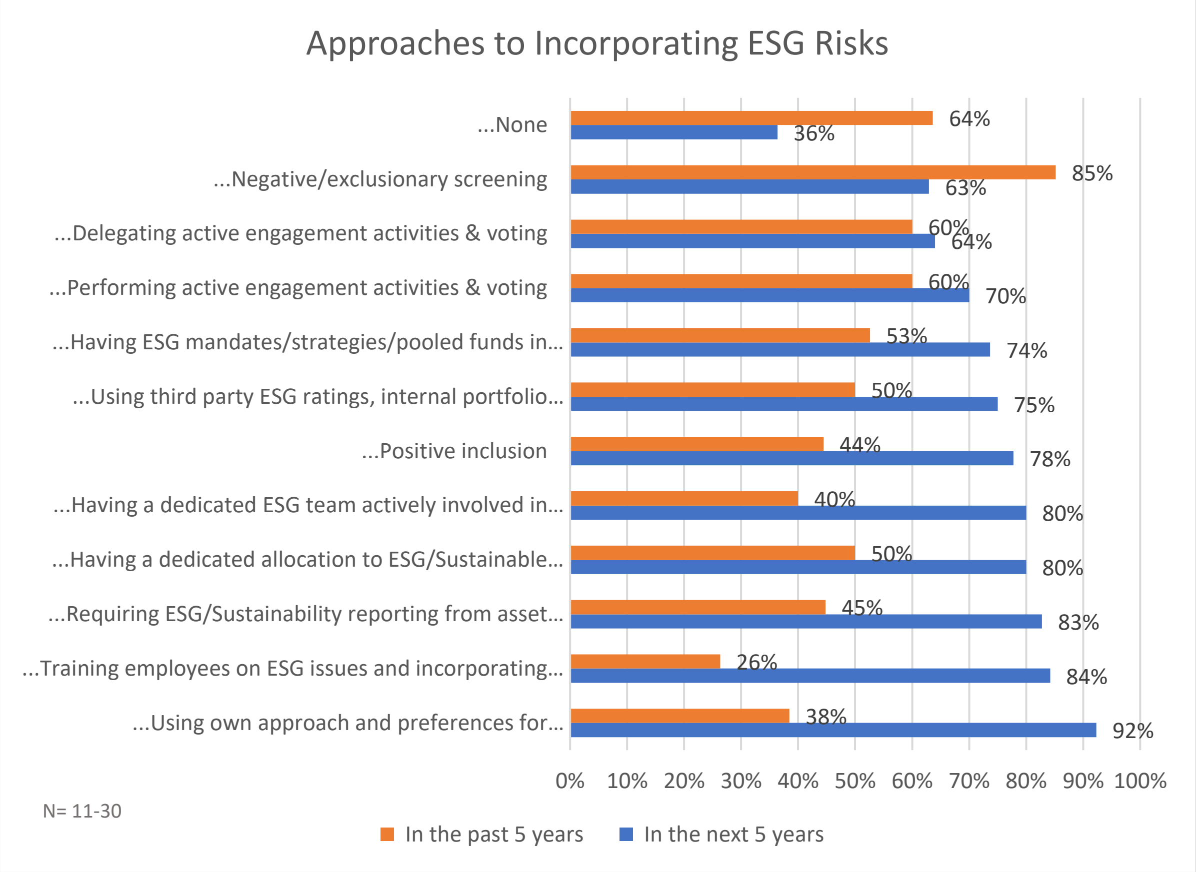
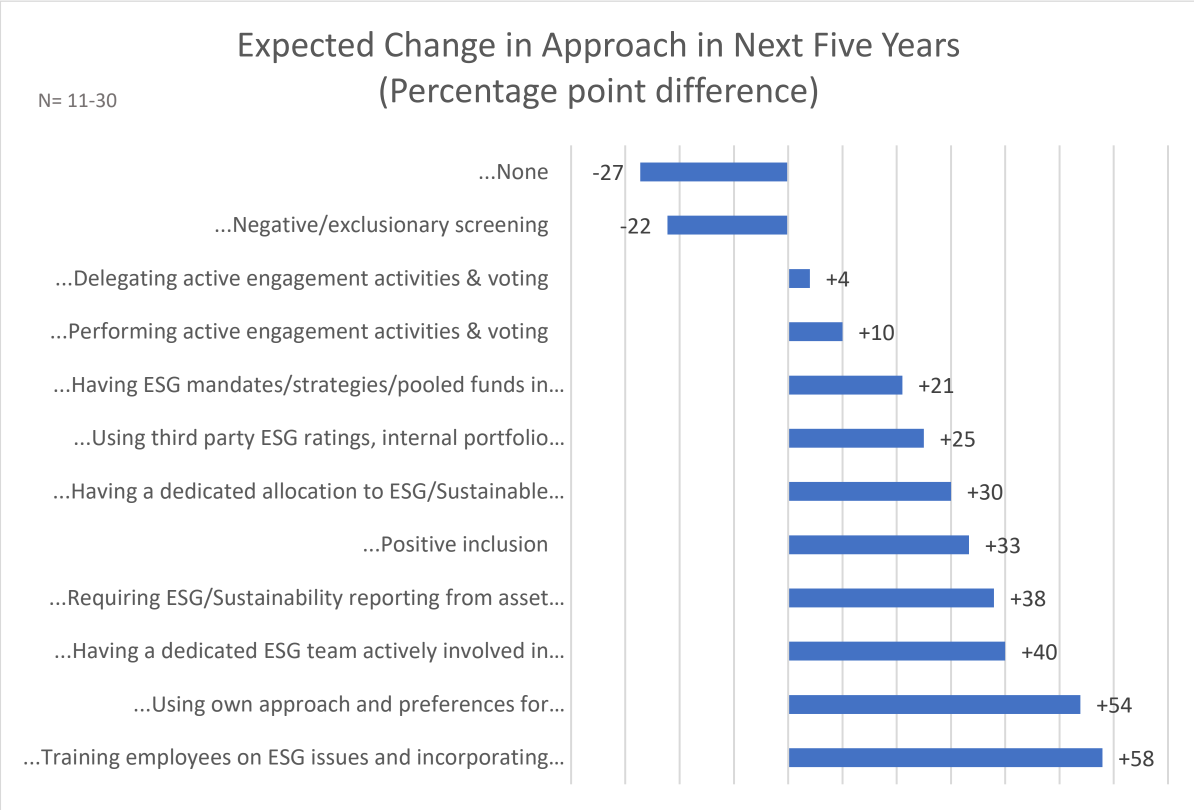


Figure 17 The outlook for sustainable investing: Which approaches, if any, have you taken in the past five years or plan to take in the next five years to incorporate ESG risks in your investment process?: Expected Change in Approach in Next Five Years



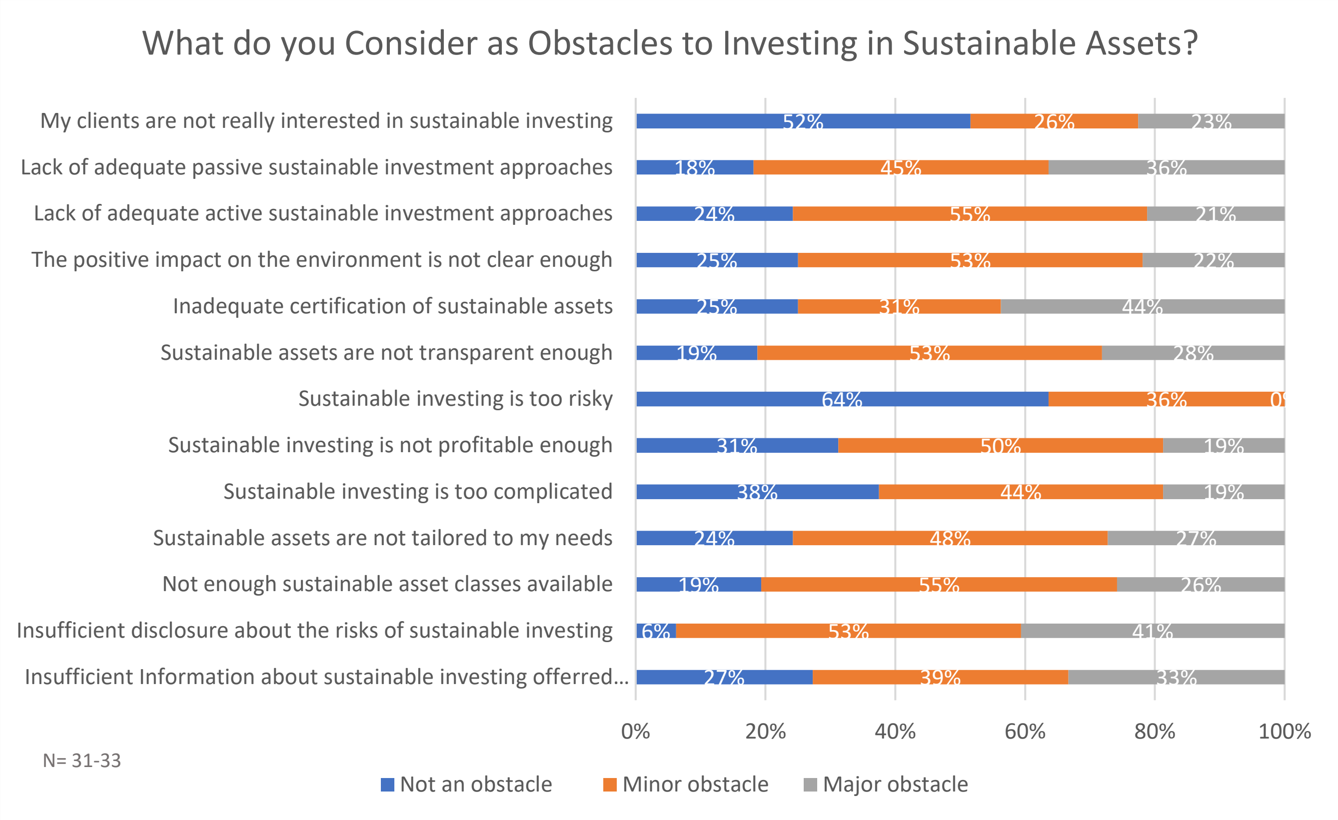
3.7 Obstacles to Investing in Sustainable Assets

When asked which obstacles pose the biggest challenges, the most commonly mentioned (by at least three in ten) 'major' obstacles are: 'inadequate certification of sustainable assets' (44%), 'insufficient disclosure about the risks of sustainable investing' (41%), 'lack of adequate passive sustainable investment approaches' (36%), and 'insufficient information about sustainable investing offered by the bank' (33%).

Other obstacles, perceived as 'minor' by around half of survey respondents, include 'not enough sustainable asset classes available', and 'lack of adequate active sustainable investment approaches' (55% each), 'the positive impact on the environment is not clear enough', 'sustainable assets are not transparent enough', 'insufficient disclosure about the risks of sustainable investing' (53% each), and 'sustainable assets are not tailed to my needs' (48%). Slightly fewer mention 'lack of adequate passive sustainable investment approaches' (45%) and 'sustainable investing is too complicated' (44%).

Despite these sizable proportions who view many of these as either 'major' or 'minor' obstacles some issues are, conversely, not perceived as problematic. Most notably, six in ten (64%) do not see 'sustainable investing is too risky' as an obstacle. Furthermore, survey respondents are broadly spilt as to whether ‘lack of client interest’ presents an obstacle (49%) or not (52%). This may reflect the shift in social attitudes on sustainability issues over recent years.

Figure 18 What do you Consider as Obstacles to Investing in Sustainable Assets?



Some obstacles resonate more strongly for particular types of pension funds. Of the top four most mentioned 'major' obstacles, the survey findings suggest private pension funds are more likely to mention 'insufficient disclosure about the risks of sustainable investing' (47%) and 'lack of adequate passive sustainable investment approaches' (39%) compared with public pension funds (22% and 21%, respectively). In contrast, the differences are minor between how private and public pension funds view the 'inadequate certification of sustainable assets' (28% vs. 22%) and 'insufficient information about sustainable investing offered by the bank' (30% vs. 27%) between private and public pension funds.

Differences also exist, although to a lesser degree, between pension funds of different sizes (assets under management). In particular, pension funds with either CHF 1 billion or less or between CHF 1 billion to CHF 5 billion are more likely to find 'inadequate certification of sustainable assets' an obstacle (28% and 31% respectively) compared with those managing over CHF 5 billion (16%).

Figure 19 What do you Consider as Obstacles to Investing in Sustainable Assets? (Type of pension fund)

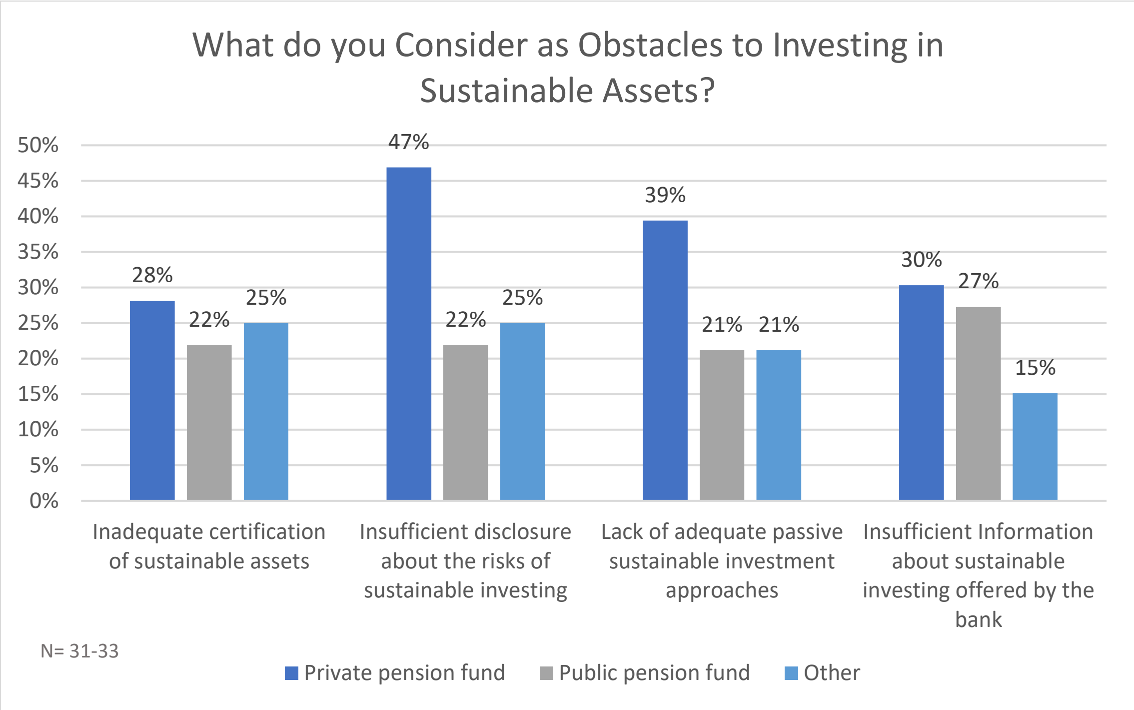
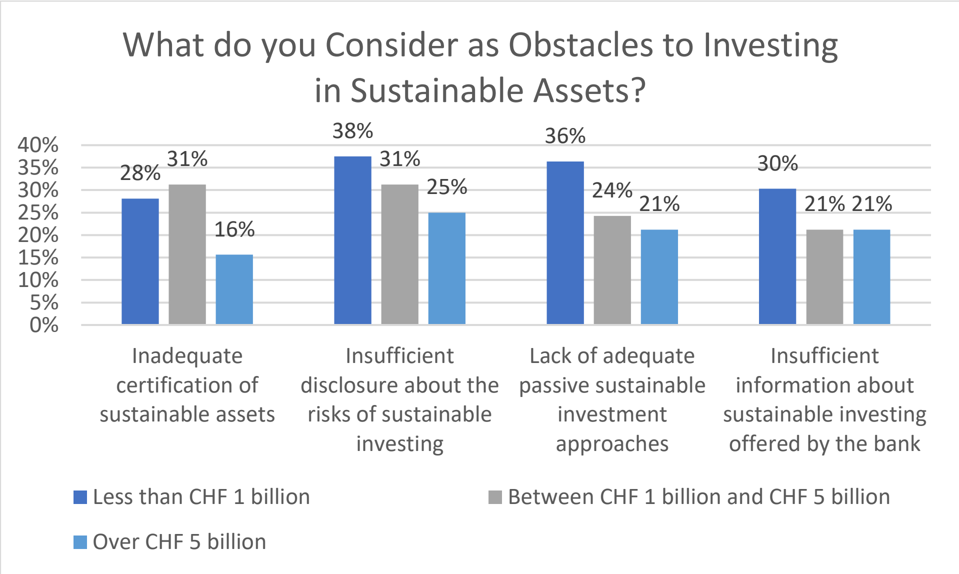


Figure 20 What do you Consider Obstacles to Investing in Sustainable Assets? (Size of Fund, Assets under Management)



3.8 Empirical insights: Conclusion

This survey provides an opportunity to understand in greater depth Swiss asset owners' understandings of, and approaches to, ESG and sustainable investing.

First of all, the findings highlight how ESG risk is understood, and the implications of that for portfolio allocation and ESG investing. While financial and market risk are most important among survey respondents (5.8 and 5.2 mean risk scores), the importance of environmental risk (3.7) is close to that of operating risk and reputational risk (3.8 and 3.9, respectively). An average of only one in twenty respondents (6%) expect no impact from environmental risk, with an average of one in ten expecting no impact from social and governance risks (10% and 11%, respectively). These expectations are reflected in portfolio allocations, with around a quarter (24%) investing 50% or more of their ESG investments in the environmental area. In comparison, all (100%) of respondents invest 50% or below of their ESG investments in social and governance areas.

Furthermore, the survey suggests some diversity in the extent to which sustainability concerns are integrated into portfolio allocations. For example, four in ten (42%) manage 51-75% of assets using sustainable investment approaches, around three in ten (27%) manage between 26-50%, and around a quarter (23%) manage under 25%. The most preferred sustainable investment approaches are 'exclusions (negative screening)' and 'ESG integration approach', mentioned by four in ten (44% and 41%). 'Best in class approaches', and 'stewardship' are most preferred by around half as many (both 19%), and 'impact investing' is most preferred by only one in ten (8%).

In addition, there is evidence that legal and regulatory concerns are a significant motivating factor and are driving the shift to sustainable investing. The majority of survey respondents agreed that considering ESG prepares them for upcoming regulatory and policy changes (+84 net agree), protects their reputation (+76% net agree), or is part of their legal obligation/fiduciary duty (+71% net agree). The business case for considering sustainability issues as part of investment decision making is also significant, but to a somewhat lesser degree. For example, ESG considerations are seen to reduce overall portfolio risk (+71% net agree), rather than add to it (64% do not see sustainable investing as 'too risky').

Mirroring earlier findings on motivations for ESG investing, regulatory changes related to environmental issues, along with related reputational risk, are the main concerns, with net important scores of +82% and +60%, respectively. These are followed by water pollution (+54%), air pollution (+47%), water scarcity (+45%) and other physical risks (+41%). While biodiversity loss is an emerging concern across the industry (Finance for Biodiversity Foundation, 2022[48]; CSP, 2022[49]), it is currently viewed as the least important environmental issue (+24%). Among the social issues considered in ESG investing, general labor conditions are viewed as highly significant, receiving a net important score of +66%. This is followed by

[48] The Finance for Biodiversity Foundation 'Finance and Biodiversity' (The Finance for Biodiversity Foundation 2022)

[49] Center for Sustainable Finance and Private Wealth 'CSP Sustainable Investing Capabilities of Private Banks' (UZH PwC 2022)

health and well-being (+47%), access to medicine/healthcare (+37%), responsible consumption and production (+35%), and economic inequality (33%). Social issues considered relatively less important are infectious disease (+29%), industry, innovation and infrastructure (27%), access to quality education (+24%), and diversity/discrimination (18%). When asked about governance issues, survey respondents emphasize general business conduct as the most important issue (+71% net important score). To a lesser degree, compliance with financial crime controls, and financial transparency, are considered important (+53% and +49%, respectively). Tax is regarded as less significant issue (+ 6%), while board diversity is seen as relatively unimportant (-26%).

In essence, the outlook for sustainable investing among asset owners is strong, with respondents signalling a deeper integration of ESG risks into their investment processes. While the majority (64%) of respondents have used no sustainable investment approaches in the past five years, significantly fewer (36%) expect to use none in the next five years.

And finally, the survey indicates that growth in sustainable investing is most likely to be constrained by four obstacles, each of which are perceived as ‘major’ obstacles by at least three in ten respondents: inadequate certification of sustainable assets (44%), insufficient disclosure about the risks of sustainable investing (41%), lack of adequate passive sustainable investment approaches (36%), and insufficient information about sustainable investing offered by the bank (33%).

4. Conclusion

This study explores the question of how understandings of asset owners' preferences on sustainability and ESG can be enhanced. Addressing this question is crucial for financial services providers, not only from a regulatory perspective, but also given the interest among asset owners in integrating sustainability and ESG in their investment[50] and, as this study shows, in refining, and advancing, their sustainable investing strategies.

In the first part of this study, we discussed the regulatory context. Regulatory authorities have addressed the question of how financial service providers should engage with their clients to understand their preferences for sustainability and ESG issues better. Specifically, the regulatory context in the EU and in Switzerland is shaped by a growing recognition among policy makers of the need for financial institutions to offer enhanced sustainability disclosure - involving not only disclosure of financial product or services sustainability risk exposures, but also disclosure of these products or services sustainability impacts. Additionally, enhanced understanding of clients' and beneficiaries' sustainability preferences is encouraged by regulatory requirements to systematically use client focused suitability assessments. These assessments should address not only financial preferences, but also the consideration of broader sustainability preferences.

To gain an enhanced, in-depth, insight into the sustainability preferences of asset owners, a digital, self-completion questionnaire was offered to UBS institutional and wealth management clients in Switzerland. This survey tool captured their detailed preferences on ESG and sustainability issues, offering a systematic method for gathering in-depth understandings of preferences.

In the second part of this study, we draw on these survey findings to present a snapshot of Swiss asset owners' perspectives towards sustainable investing. In summary, this empirical evidence offers the following insights:

Perceptions of risk. Financial risk and market risk are survey respondents' top concerns in investment decision-making (mean risk scores of 5.8 and 5.2, respectively). The importance of environmental risk (3.7) is close to that of operating risk and reputational risk (3.8 and 3.9, respectively). However, environmental, social and governance risks are nonetheless expected to have an impact. An average of only one in twenty respondents (6%) expect no impact from environmental risk, with an average of one in ten expecting no impact from social and governance risks (10% and 11%, respectively).

Environmental, social and governance risks. Respondents were asked about the expected financial impact of a range of environmental, social and governance risks. Relative to other

[50] As an example of how the Swiss pension industry is viewing sustainability and ESG: Hanspeter Konrad, 'Pension Funds in the Age of Political Moralism' in *Swisscanto Pension Funds Study* *(Swisscanto 2021)*

environmental risks, water pollution (36%), other physical risks (33%), and biodiversity loss (29%) are viewed as the top three long-term risks (expected financial impact in more than ten years). Air pollution (51%), water scarcity, and regulatory changes (41% each) are viewed as the top three medium-term risks (expected financial impact two to ten years). In the short-term (expected impact in less than two years), a similar pattern emerges with regulatory changes (29%), related reputational risk (26%) and water scarcity (21%) the most impactful environmental risks. Notably, climate change is not only seen as medium-term risk (40%), but also an immediate risk, with impact expected today (31%). Additional risks with immediate impact today are related reputational risk (29%), and regulatory changes (26%).

In comparison with environmental risks, respondents view social risks and governance risks as having slightly less financial impact with, on average, one in ten suggesting these will have no impact (10% and 11%, respectively). In summary, the top three most impactful social risks are: industry, innovation and infrastructure, and responsible consumption and production (both 97% expect a financial impact[51]), along with economic inequality (94% expect a financial impact). For governance risks, the top three most impactful are business conduct, financial transparency/executive renumeration, and compliance with financial crime controls (94% expect a financial impact).

Portfolio allocation and sustainable investment approaches. This survey of Swiss asset owners illustrates attitudes towards sustainable investing, along with the incorporation of sustainability into their investment approach. On average, these investors manage 38% of their portfolio sustainably. Beneath this average lies diversity in approach. A sizable minority (31%) manage over half (51% or more) of their assets according to sustainable investment approaches. Slightly fewer (27%) invest between 26-50% of their assets sustainably, while four in ten (42%) – again a sizable minority – invest 25% or less.

When asked about their specific sustainable investment approaches, respondents offer two clear preferences: 'exclusions (negative screening)' and 'ESG integration approach' are most preferred by four in ten (44% and 41%). 'Best in class approaches', and 'stewardship' are most preferred by around half as many (both 19%), and 'impact investing' is most preferred by only one in ten (8%).

Legal and regulatory concerns are driving the shift to sustainable investing. The majority of survey respondents agreed that considering ESG prepares them for upcoming regulatory and policy changes (+84 net agree), protects their reputation (+76% net agree), or is part of their legal obligation/fiduciary duty (+71% net agree). The business case for considering sustainability issues as part of investment decision making is also significant, but to a lesser degree. ESG considerations are seen to reduce overall portfolio risk (+71% net agree), rather than add to it (64% do not see sustainable investing as 'too risky'). Furthermore, ESG is perceived as offering the potential for building long-term portfolios (+65% net agree) and realise beneficial investment returns (+60% net agree). Additionally, ESG is seen to attract

[51] These expectations refer to impact over any timeframe, in comparison with having 'no impact'.

client/business/investment (+45% net agree) and improve responsiveness by addressing beneficiary preferences (+35% net agree).

Environmental, social and governance issues in-depth. When asked which ESG issues are considered in ESG investing, respondents identified their most important environmental, social and governance issues. For the environment, regulatory changes related to environmental issues, along with related reputational risk, are the most top of mind environmental concerns, with net important scores of +82% and +60% respectively. These are followed by water pollution (+54%), air pollution (+47%), water scarcity (+45%) and other physical risks (+41%). While biodiversity loss is an emerging concern across the industry (Finance for Biodiversity Foundation, 2022[52]; CSP, 2022[53]), it is currently viewed as the least important environmental issue (+24%). For social issues, general labor conditions are viewed as highly significant, receiving a net important score of +66%. This is followed by health and well-being (+47%), access to medicine/healthcare (+37%), responsible consumption and production (+35%), and economic inequality (33%). Social issues considered relatively less important are infectious disease (+29%), industry, innovation and infrastructure (27%), access to quality education (+24%) and diversity/discrimination (18%). On governance, survey respondents emphasize general business conduct as the most important issue (+71% net important score). To a lesser degree, compliance with financial crime controls, and financial transparency, are considered important (+53% and +49%, respectively). Tax is regarded as less significant issue (+6%), while board diversity is seen as relatively unimportant (-26%).

Outlook for sustainable investing. The outlook for sustainable investing appears strong, with signs of a deeper integration of ESG risks into respondents' investment processes. In the next five years, a significant majority of survey respondents plan to 'use their own approach and preferences for ESG/sustainability analysis' (92%), 'train employees on ESG' (84%), 'require ESG/sustainability reporting from asset managers' (83%), 'have a dedicated allocation to ESG', have a 'dedicated ESG team' (80% each), or use 'positive inclusion approaches' (78%). Of these top five approaches, two in particular stand out as gaining popularity - there is a 58 percentage point increase in interest in the next five years in 'training employees', and 54% in 'using own approach and preferences on ESG', compared with their use in previous five years. In contrast, two investment approaches are losing their popularity among survey respondents. Notably, there are fewer investors who expect to use none of these approaches to incorporating ESG risks (a decrease of 27 percentage points). And the use of 'negative/exclusionary screening' is losing popularity as an approach, with a decrease of 22 percentage points in the next five years.

Obstacles to sustainable investing. Finally, future growth in sustainable investing is most likely to be constrained by four challenges, the most commonly mentioned 'major' obstacles:

[52] The Finance for Biodiversity Foundation 'Finance and Biodiversity' (The Finance for Biodiversity Foundation 2022)
[53] Center for Sustainable Finance and Private Wealth 'CSP Sustainable Investing Capabilities of Private Banks' (UZH PwC 2022)

inadequate certification of sustainable assets (44%), insufficient disclosure about the risks of sustainable investing (41%), lack of adequate passive sustainable investment approaches (36%), and insufficient information about sustainable investing offered by the bank (33%). Other obstacles, perceived as ‘minor’ by at least half of survey respondents, include ‘not enough sustainable asset classes available’, and ‘lack of adequate active sustainable investment approaches’ (55% each), ‘the positive impact on the environment is not clear enough’, ‘sustainable assets are not transparent enough’, and ‘insufficient disclosure about the risks of sustainable investing’ (53% each). Conversely, the least problematic issues is risk, with six in ten (64%) not regarding sustainable investing as ‘too risky’, and half (52%) who do not see ‘lack of client interest’ as an obstacle.

To conclude, this study provides an overview of the regulatory context for engaging with client preferences, and an indication of the perspectives of asset owners in Switzerland. Motivated by both regulatory changes and the business case, survey respondents are expecting to address sustainability and ESG to a greater extent in the future, integrating these issues even further into their investment strategies. In this context, achieving an enhanced understanding of asset owners’ preferences on sustainability and ESG will be crucial for realising effective sustainability asset management.