
STUDIA IURIS

JOGTUDOMÁNYI TANULMÁNYOK / JOURNAL OF LEGAL STUDIES

2025. II. ÉVFOLYAM 4. SZÁM



Károli Gáspár Református Egyetem
Állam- és Jogtudományi Doktori Iskola

A folyóirat a Károli Gáspár Református Egyetem Állam- és Jogtudományi Doktori Iskolájának a közleménye. A szerkesztőség célja, hogy fiatal kutatók számára színvonalas tanulmányaik megjelentetése céljából méltó fórumot biztosítson.

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A tipográfia és a nyomdai előkészítés: CSERNÁK KRISZTINA (L'Harmattan) munkája.

Nyomdai kivitelezés: Prime Rate Zrt., felelős vezető: TOMCSÁNYI PÉTER

Honlap: <https://ajk.kre.hu/index.php/jdi-kezdolap.html>

E-mail: doktori.ajk@kre.hu

ISSN 3057-9058 (Print)

ISSN 3057-9392 (Online)

URL: KRE ÁJK - Studia Iuris

<https://ajk.kre.hu/index.php/kiadvanyok/studia-iuris.html>

HOW DO INVESTMENT PROVIDERS MANAGE ESG PREFERENCES BY RETAIL INVESTORS? HOGYAN KEZELIK A BEFEKTETÉSI SZOLGÁLTATÓK A LAKOSSÁGI BEFEKTETŐK ESG-PREFERENCIÁIT?

VERONIKA LAKATOS¹

ABSZTRAKT ■ Az elmúlt évtizedekben a környezetvédelmi, társadalmi és irányítási (ESG) kérdések egyre nagyobb jelentőségre tettek szert a lakossági befektetők körében. Sokan érdeklődnek az ESG-befektetési lehetőségek iránt. Pozitív fejlemény, hogy a szabályozás 2022 augusztusától a pénzügyi szolgáltatóknak is lehetőséget biztosít ezeknek a preferenciáknak az összegyűjtésére az EU-ban. A fenntarthatósági preferenciákat a kiterjesztett alkalmassági értékelés során gyűjtik össze, amelyre a befektetési tanácsadási és portfóliókezelési szolgáltatások esetében van szükség. Sajnos a fenntarthatósági preferenciák esetében a lakossági befektetők gyakran nem rendelkeznek a döntéshozatalhoz szükséges ismeretekkel, és nem mindig kapnak megfelelő tájékoztatást a tanácsadóktól. Ezenkívül az ügyfelek hamar rájöttek, hogy az ESG-preferenciák megjelölése korlátozza befektetési lehetőségeiket, ezért inkább nem határoztak meg preferenciákat. Ennek ellenére a lakossági ESG-befektetések aránya szerencsére folyamatosan növekszik, de sajnálatos módon a szabályozás jelenleg nem játszik támogató szerepet ebben.

KULCSSZAVAK: ESG-befektetés, fenntarthatósági preferenciák, alkalmassági értékelés, befektetési tanácsadás, portfóliókezelés

ABSTRACT ■ Environmental, social and governance (ESG) issues have become more important in the last decades among retail investors. Many people are interested in ESG investment possibilities. It is a positive development that regulation also gives financial service providers the possibility to collect these preferences in the EU since August 2022. Sustainability preferences are collected in extended suitability assessment, which are required by investment advisory and portfolio management services. Unfortunately, in the case of sustainability preferences, the knowledge necessary for decision-making is often lacking among retail investors, and they do not always receive adequate information from advisors. In addition, customers quickly realized that indicating ESG preferences limited their investment

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choices, so they preferred not to indicate them at all. Despite this, the proportion of retail ESG investments is luckily constantly increasing, but regrettably, regulation does not currently play a supporting role in this.

KEYWORDS: ESG investment, sustainability preferences, suitability assessment, investment advice, portfolio management

1. GOAL OF SUITABILITY ASSESSMENT

Savings are the part of our income that we do not spend on consumption, so savings are generated by accumulated material reserves over a given period. It involves foregoing spending a certain proportion of our income in order to achieve a later, material goal. In general, you can invest by using the amount you have already saved, which means that the amount you have saved previously will be invested later in some form of investment. Investing is therefore the use of a fixed sum of money, usually over a longer period of time, with a view to its accumulation. It typically involves the purchase of a financial asset such as a bank deposit, share, bond or other financial instrument, or of something of value, usually property or cryptocurrencies.

People with savings can choose from a range of investment types. Some of them require less financial experience on the part of the investor, are more predictable, less risky and less affected by external factors. Other types require more in-depth financial knowledge, require the investor to understand different processes, are more exposed to external factors and are fundamentally riskier. When choosing the right type of investment, it is important to clarify the financial knowledge and experience of the investor in order to select the right investment for the client. The three defining characteristics of investments are return, risk and liquidity. The return is the profit that can be made on an investment, while the degree of risk is influenced by a number of factors. Liquidity is the speed with which an investment can be converted into cash. An investment can satisfy two criteria at the same time. High returns, liquidity and low risk do not go hand in hand, and concessions must be made on one or the other.²

In 2000, the Lisbon Treaty set out the idea of a single European market that could make Europe a leading global economy by 2010. After consulting industry, it soon became clear that creating such an integrated market would not be easy. For example, it would require a virtually complete restructuring

² ZVI BODIE – ALEX KANE – ALAN J. MARCUS: *Befektetések*. Budapest, Aula Kiadó Kft., 2005, 12.

of the financial market. To achieve this, the European Commission has set up a framework for legislative changes (the Financial Services Action Plan), which contains recommendations that provide the framework for a single European market for financial services.³

So, it was in 2000 that the EU started to develop the ground-breaking new regulation. The new Directive Markets in Financial Instruments (known as, hereinafter: MiFID) was designed to remove barriers for service providers, thereby promoting competition and a level playing field and ensuring a high level of investor protection across Europe.⁴ The rapid globalisation of financial markets was an opportunity that Europe could not afford to miss. MiFID has included several consumer protection provisions to ensure that investors can use the services of investment firms with confidence, wherever they are in Europe and wherever investment firms are based in Europe. As a result of the new regulation, service providers had to classify clients into three groups before providing services to them. These groups are retail client, professional client and eligible counterparty. The purpose of the categorisation is to reflect the specific characteristics of each type of client, such as their level of knowledge, financial literacy, different levels of risk and the level of protection required. Eligible counterparties receive the least protection and retail customers the most. Accordingly, financial service providers are obliged to provide different amounts of information to different categories of customers.

When retail clients seek investment advice or portfolio management, they rely more heavily on the investment firm than in other cases, such as for simple services without advice. Therefore, in this case, the client needs the reassurance that the investment firm understands their individual needs and circumstances and can therefore recommend the right products. MiFID provides for a process called the suitability assessment, whereby the investment firm asks questions to understand what types of investments would be suitable for the client.⁵

Suitability assessment is a key element of investment protection under MiFID. This applies to any type of investment advice (whether independent or not) and

³ Financial Services Action Plan (FSAP), <https://eur-lex.europa.eu/EN/legal-content/summary/financial-services-action-plan-fsap.html>.

⁴ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

⁵ Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, Article 35.

portfolio management. Investment firms providing investment advice or portfolio management must make appropriate personal recommendations to their clients or take appropriate investment decisions on behalf of their clients. The financial services advisers are required to obtain information on the client's loss tolerance and risk tolerance and then provide services according to the client's needs. When managing an individual portfolio or providing investment advice, an investment firm should undertake a suitability assessment. Portfolio management is the activity called whereby a portfolio manager handles clients' assets in a predetermined way, i.e. investing them in investment assets of his or her choice, with the aim of generating a return. The main actor in portfolio management is the investor, i.e. the client who wishes to invest his savings or a certain part of his assets. Investors can also design and manage their own portfolio. In most cases, however, not all individuals have the necessary expertise. So, they entrust their assets to investment companies, which use them to buy securities or other assets. By portfolio management service, investment companies have portfolio managers who manage their clients' assets according to predefined rules. The assets purchased by the portfolio managers remain the property of the clients and are held in their own securities accounts.

By investment advice service, the advisor helps clients with their financial planning and investment strategy, based on a deep understanding of their needs. The right investment advisor supports the client in achieving his or her financial goals. They can also recommend specific financial instruments, considering the client's return needs, risk tolerance and capital position. Importantly, the advisor does not have control over the client's assets.

When managing an individual portfolio or providing investment advice, an investment firm should undertake a suitability assessment. The suitability test assess the client's knowledge and experience, financial situation (incl. ability to bear financial losses) and investment objectives (incl. risk tolerance).⁶

In portfolio management and investment advice, a deeper relationship of trust is established between the service provider and the client than in other investment services. For these services, the client authorises the provider to enter transactions on the basis of the provider's professional competence (portfolio management) or on the basis of the provider's financial knowledge (investment advice). For the former, it is of particular importance that the investment provider is aware of the client's knowledge of financial instruments and of his risk tolerance and willingness to take risks. The latter provide essential information for portfolio

⁶ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast), Article 25.

management and investment advice. In the context of investment advice, a service provider may only give a personal recommendation to his client concerning a financial instrument or transaction and, in case of portfolio management, may only acquire for the benefit and at the risk of his client a financial instrument, which is suitable for him. Therefore, the investment service provider must obtain reasonable assurance that the particular transaction he proposes or undertakes is not only in line with the client's investment objectives but also with his financial capabilities. If the investment service provider considers that the financial instrument or transaction is not suitable for the client or has not been able to determine its suitability due to a lack of the necessary information, it is obliged to refuse to execute the client's order.

Changes in the years following the global economic crisis in 2008 have led to a rethinking and revision of the existing regulation regime, MiFID in the European Union. The crisis has highlighted many problems and mistakes in the market, and the European Commission has proposed amendments to this Directives and regulations, (known as, hereinafter: MiFID II.). The European Commission has worked long and hard to develop a single set of rules that will effectively protect investors and bring transparency to the whole financial market. To ensure that customers invest their money in the product best suited to their needs, the new Directive MiFID II extends the previous rules on customer protection. The result has become known in the investment market as MiFID II. and MiFIR, and financial service providers will have to comply with these rules from 2018.

The investment service provider shall compose the questions to be able to assess, on the basis of the client's answers, whether the client's experience and risk-bearing capacity in relation with the financial instruments recommended for investment advice; or to be purchased in the context of portfolio management are appropriate for informed investment decision-making thus ensuring personalised service. When constructing the questions in the tests, the investment adviser should aim to ask questions that provide a reasonable basis for assessing with reasonable certainty the client's knowledge and previous trading experience. The test should also disclose, to the extent necessary, the client's income situation and investment objectives.

The investor protection function of the suitability tests can achieve its intended purpose if the provider contributes to the content of the test by compiling relevant questions, by designing an appropriate assessment methodology for customer responses and by the customer's honest answers to the questions. However, the protection of clients' interests must not be compromised in relation with the economic interests of investment service providers. Therefore, service providers

must ensure that the investor protection function of the suitability tests is not compromised by sales pressure.

Suitability test as a protection system can only work effectively if customers are honest and attentive enough to complete the questionnaire. The most carefully designed service provider test is useless if customers do not answer them according to their real knowledge and experience. And if the service provider gives a warning about the transaction or financial instrument, it is worth taking it into account and carefully weighing up the risks before using the investment service.

2. REGULATING THE ASSESSMENT OF SUSTAINABILITY PREFERENCES AMONG RETAIL CUSTOMERS

The European Union aims to actively promote sustainable financing as a contribution to tackling climate change and social problems. This is also part of the EU's Green Deal, the EU also wants financial markets to support the transition to a green economy.⁷ A sustainable finance action plan by the Commission in 2018 was set out three objectives, which included reorienting capital flows towards a more sustainable economy. One way of reaching it, is strengthening financial stability by incorporating environmental, social and governance (ESG) factors into investment decision-making.⁸

More and more investors want to invest in products that are environmentally, socially and governance (ESG) responsible. With sustainability preferences, the suitability assessment considers not only financial but also ethical and value-based considerations. Investment firms providing investment advice or portfolio management services must assess clients' ESG preferences from August 2022.⁹ The Regulation of European Commission requires firms providing investment services (portfolio management and investment advice) to identify the sustainability preferences of the client. The new regulation requires financial service providers to ask their clients about their sustainability preferences and the extent to which they want these preferences incorporated into their

⁷ The European Green Deal, <https://ec.europa.eu/stories/european-green-deal/>.

⁸ Communication from the Commission to the European Parliament, the European Council, the Council, the European, Central Bank, the European Economic and Social Committee and the Committee of the Regions Action Plan: Financing Sustainable Growth, COM/2018/097 final, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0097>.

⁹ Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms, https://eur-lex.europa.eu/eli/reg_del/2021/1253/oj.

investments. The main changes are collecting information from clients on their sustainability preferences (identifying client preferences for different types of sustainable investment products and the extent to which they wish to invest in them), assessing sustainability preferences (identifying products that meet the client's sustainability preferences) and organisational requirements (staff are adequately trained on sustainability issues and keep up-to-date records of client's sustainability preferences).

From August 2022, clients' ESG preferences will have to be assessed and this has been included in the suitability tests used in the European market. The main change in the client interview process is the need to collect information from clients on their sustainability preferences: to identify the client's preferences for different types of sustainable investment products and the extent to which they wish to invest in them. In the sales process, the client should be informed beforehand about the concept and components of sustainability preferences and then asked whether the client would like to include this category in their investments. These could be investment products that meet the definition of sustainable investment in the Taxonomy Regulation,¹⁰ or that meet the definition of sustainable investment in the SFDR,¹¹ or financial instruments that take into account the main adverse impacts on sustainability factors, in which case the client can specify the qualitative or quantitative elements. Once the client's preferences have been identified, the preferences indicated must be assessed, i.e. products that meet the client's sustainability preferences must be identified. To this, it is essential that the service provider's staff receive appropriate training on sustainability issues.

We can further examine the category opportunities in detail. According to the Taxonomy Regulation, a sustainable investment is an investment in an economic activity that aligns with a limited number of recognised sustainable objectives and activities, and is subject to a technical screening criteria. The Taxonomy Regulation specifies six EU environmental objectives:

1. Climate change mitigation,
2. Climate change adaptation,
3. Sustainable use and protection of water and marine resources,
4. Transition to a circular economy,
5. Pollution prevention and control,
6. Protection and restoration of biodiversity and ecosystems.

¹⁰ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, Article 2.

¹¹ Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, Article 2.

Generally, an economic activity may be considered “environmentally sustainable” under the Taxonomy Regulation if it meets the following conditions (known as the technical screening criteria):

1. Makes a substantial contribution to at least one of the EU’s six environmental objectives,
2. Does not cause significant harm to any of the other EU environmental objectives to which it is not aligned,
3. Meets prescribed minimum ESG safeguards,
4. Meets the technical screening criteria set out by the EU TR.

The EU SFDR definition of a sustainable investment is broader and accommodates investments outside the Taxonomy Regulation definition subject to base conditions being met. These include:

1. A measurable contribution of an environmental and/or social objective: From an environmental perspective, this could include key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land; or similar measurements of the production of waste or greenhouse gas emissions. From a social perspective this could include an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations; it could also include an investment in human capital or economically or socially disadvantaged communities.
2. No significant harm to any other environmental and/or social objective.
3. Good governance practices at investee companies, particularly with respect to sound management structures, employee relations, remuneration of staff and tax compliance.

Importantly, the MiFID definition does not recognise those investments that only have environmental and/or social characteristics as sustainable investments.

Principal Adverse Impact Indicators (hereinafter: PAIs) look at the material effect investments can have on a wide range of environmental and social considerations, regardless of any financial impact. For example, an investment in a commodity producer may be profitable from a purely financial standpoint, but PAIs might include an extraction process that is harmful to the environment and poor safety standards that put workers at risk.

The EU SFDR does not provide one comprehensive definition for PAIs but instead identifies specific Principal Adverse Impact Indicators (hereinafter: PAIIs) and their corresponding PAIs, which are based on actual metrics for measurement. Some of the PAIIs and PAIs are grouped together in related categories. For

example, “Greenhouse gas emissions” is a broad PAII grouping for six PAIIs, each with their own corresponding PAI. Other categories, such as “Emissions to water”, are not further divided.

The regulatory direction is the right one, as retail investors have shown a strong interest in ESG investments over the last decade. Numerous market surveys and analyses support this. According to an international survey 88% of investors globally express interest in sustainable investing, 86% of European investors are interested in investing in ESG. Interest is highest among Gen Z (99%) and Millennials (97%). More than half of investors plan to increase their sustainable investment allocations in the next year, while only 3% globally plan to decrease.¹² A survey of French and German financial markets also shows that two thirds of retail investors want to make sustainable investments. Interest parallels age, with younger investors showing a higher interest in ESG investments.¹³

3. STRUCTURE OF CUSTOMER INTERVIEWS IN THE REFLECT SUSTAINABILITY PREFERENCES

Explaining the concept of ESG and the investment categories discussed in the previous chapter to the client does not seem simple. Customer meetings can be divided into three steps according to suitability preferences:

1. Explain the different categories of sustainability preferences to provide sufficient information to enable the client to make an informed decision about clients’ sustainability preferences,
2. Identify with the right questions the client’s sustainability preferences,
3. Make a financial product recommendation according to the information revealed by the client.

It is important to emphasize that the financial suitability takes precedence over the sustainability preferences. Sustainability preferences shall only be assessed once the financial suitability – based on investment objectives, financial situation and knowledge and experience – has been successfully passed.¹⁴

¹² Morgan Stanley, Institute for Sustainable Investing. Sustainable Signals Individual Investors 2025, <https://www.morganstanley.com/press-releases/morgan-stanley-sustainable-signals-report>.

¹³ A Large Majority of Retail Clients Want to Invest Sustainably, Survey of French and German retail investors’ sustainability objectives, March 2020, 29.

¹⁴ ESMA Guidelines on certain aspects of the MiFID II suitability requirements (ESMA35-43-3172) Paragraph 81.

As a first step, the investment firm must explain to the client the different categories of sustainability preferences which are allowed by the regulation. The service provider should explain the meaning by environmental, social and governance considerations. This is a preliminary explanation that provides sufficient information to enable clients to make informed choices and effectively represent their own sustainability preferences. It should also explain the differences between products with sustainable attributes and products without sustainability attributes. The ESMA Guidelines emphasise that companies should also explain in detail the terms and concepts used when referring to environmental, social and governance aspects.¹⁵

In order to help customers understand the different categories of sustainability and make informed investment decisions, firms are required to explain the terms and the distinctions between the different types of sustainability preferences and between relevant products in clear and non-technical terms. So, service provider will define precisely what types of financial instruments are considered appropriate to a customer's sustainability preferences. This is a rather narrow definition of how a client can express sustainability-related investment objectives. This information should be provided in simple language and in a way that is understandable to retail clients.

It is important that the information and explanatory material provided to customers are designed to suit their different levels of financial literacy and/or interest in sustainability issues. In all cases, explanatory material for customers should provide accurate and sufficient information on the key features that explain sustainability preferences and the broader sustainability motivations.

Investment firms will also develop client information materials to ensure that sustainability preferences are explained effectively. Investment firms shall be free to choose the format of client information material, which may consist of one or more of the following:

- a script that the investment firm can use to explain sustainability preferences in a dialogue during the client meeting;
- online briefings or short videos explaining sustainability preferences, which can be viewed either before or during the client meeting; or
- a leaflet explaining the sustainability preferences, which can be shared with the client either before or during the client meeting.

Throughout the process, service providers should take a neutral and unbiased approach so as not to influence customer responses.

¹⁵ ESMA Guidelines on certain aspects of the MiFID II suitability requirements, 03/04/2023 ESMA35-43-3172, Paragraph 27.

The second step is to ask the customer if they have individual sustainability preferences.

If the client has sustainability preferences, the minimum proportion of investments should be determined for the first and second categories, and for the third category, which main adverse impacts should be considered, including quantitative or qualitative criteria justifying the given consideration. Where the customer reports preferences regarding the 'minimum percentage' referred to the first and second preferences, undertakings may collect this information in terms of the minimum percentage instead of the exact percentage. These percentages shall be presented in a neutral manner towards the customer and in sufficient detail. For example, services providers may assist the customer in determining the minimum percentage by providing approximate standardized minimum percentages, e.g. 'up to 20%, up to 25%, up to 30%, etc'.

If the client has suitability preferences, only the range of sustainable financial instruments listed can be offered to the client or traded on behalf of the client. Otherwise, if the answer is no, a wider range of financial instruments may be offered, if they meet the MiFID II eligibility requirements.

The third step is product recommendation. The information on sustainability preferences and sustainability goals are used to filter the available product universe to identify suitable financial products. Where the client has more than one sustainability goal, the client should prioritise. The prioritization will help to recommend a product which is most suitable if not all sustainability goals can be met, and the client agrees to amend her or his sustainability goals.

The regulator was aware that the current availability of investments with the required sustainability features that meet clients' sustainability preferences may be limited. However, ESMA advises that firms should collect all information concerning client sustainability preferences even when they do not have any funds included in their product range that would meet the client's sustainability preferences at the time the information is collected. In this situation, the firm should clearly indicate that there are currently no products available that would meet those preferences, and the client should be given the possibility to adapt their sustainability preferences. Firms can still recommend products that do not meet the sustainability preferences of the client, but only once the client has adapted their preferences. The firm's explanation and the client's decision should be documented in the suitability report.¹⁶

¹⁶ Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms.

4. EXPERIENCE IN COLLECTING ESG PREFERENCES IN THE EUROPEAN MARKET

In the period following the introduction of the new regulation regarding tightening and extension of suitability tests, both regulators and market participants have continuously assessed the changes brought about by the new rules. The European Commission has continued to review the experience of the regulation and has identified two main problems¹⁷: inadequate information available to investors and intermediaries, risks to competitiveness and optimal functioning of EU financial markets. The new framework does not always strike the right balance between providing meaningful and targeted information to investors and ensuring a competitive trading environment in the EU.

European market research shows that the average client conversation lasts 27 minutes, during which a suitability test is completed.¹⁸ This is a surprisingly small amount of time – considering how much information needs to be shared and explained with the client. The results of a 2022 mystery shopping campaign show that in 98 percent of conversations, advisors explained sustainability preferences, but this was not comprehensive. Most advisors link the explanation of sustainability preferences to clients in relation with environmental or social considerations related to their investments (75 percent). Less than 40 percent of advisors explain the different categories of sustainability preferences, and it is very rare for advisors to explain concepts such as major adverse impacts or no significant harm. This means that clients cannot be considered to have become familiar with the relevant concepts (unless they have done their own research outside the meeting) and therefore should not be expected to make informed decisions. The results also show that very few advisors assess the minimum proportion of investments that should be invested in accordance with sustainability preferences.¹⁹

This means that clients cannot be considered to have become familiar with the relevant concepts (unless they have done their own research outside of the meeting) and therefore should not be expected to make informed decisions. The results also show that very few advisors assess the minimum proportion of investments that should be invested in accordance with sustainability preferences.

¹⁷ Inception Impact Assessment, Review of the MiFID II/MiFIR framework, FISMA (C3), [https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=PI_COM:Ares\(2020\)1006290](https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=PI_COM:Ares(2020)1006290).

¹⁸ Assessing client sustainability preferences... lost in the maze? Results of a European mystery shopping campaign assessing financial advisor's compliance with new regulatory requirements for the assessment of client sustainability preferences, February 2023, 29.

¹⁹ *Ibid.* 23.

These results could generally be inferred from advisors' low level of knowledge – but this does not seem to be obvious to many clients. This raises two main questions whether both client and advisor are lost. On one side: Is it that advisors actually have low levels of knowledge (either in terms of knowledge and competence related to inform clients on sustainable finance topics, or in terms of sustainability preferences required by the regulatory process)? On the other side: clients themselves do not have enough knowledge for the low level of advisor knowledge to be noticeable and obvious to them? The regulation requires client advisers to be trained to explain to the client costs and risks of investment services and financial instruments selected for their clients, including any sustainability factors.²⁰ Service providers must offer appropriate training for their employees.²¹ Regulatory requirements for education vary between the member states of the EU.

A comprehensive survey was conducted for the Swiss market in 2024. The discussion of sustainability preferences takes an average of 7 minutes by client interviews, with an average of 2,7 questions assessing preferences. Among banking clients, 4,9 percent of retail investors indicated a sustainability preference, but on average 40,2 percent of clients had at least ESG investments.²²

Based on interviews with Hungarian institutions, it can be said that ESG preference is indicated by only a few percent of retail clients.²³ Customer interviews connected to investment advice or portfolio management include a part of ESG preferences. A process description helps employees understand what and how to ask customers and mandatory questions must be answered. According to the experience of Hungarian commercial banks and insurance, 2-5 percent of their clients indicate ESG preferences. Based on the experience of service providers, this could be explained by clients being steered in this direction by advisors, or customers themselves realizing that having ESG preferences significantly limited their options. However, after completing the suitability assessment, there is interest in ESG products – without any obligation.

²⁰ MiFID II, Article 25.

²¹ ESMA Guidelines for the assessment of knowledge and competence (ESMA71-1154262120-153 EN) Paragraph 106.

²² JULIAN KÖBEL – CAMILLA WEBER: Sustainability preference elicitation under MiFID II. St. Gallen 12 September 2024.

²³ Personal interviews in Spring 2025.

5. THE ROLE OF SUSTAINABLE FINANCIAL LITERACY IN SUSTAINABLE INVESTMENTS

Sustainable financial literacy plays a key role in shaping investment decisions. It is essential to provide basic financial education that allows people to make better investment decision, so that they can better orient themselves in the financial world. The Former U.S. Federal Reserve Board Chairman BEN BERNANKE opined that: *“In our dynamic and complex financial marketplace, financial education must be a life-long pursuit that enables consumers of all ages and economic positions to stay attuned to changes in their financial needs and circumstances and to take advantage of products and services that best meet their goals. Well-informed consumers, who can serve as their own advocates, are one of the best lines of defence against the proliferation of financial products and services that are unsuitable, unnecessarily costly, or abusive.”*²⁴

Providing basic information about ESG criteria and portfolio selection strategies can have a significant impact on individuals’ knowledge of sustainable products and, consequently, their likelihood of engaging in such investments. Financial decisions are generally highly influenced by individual knowledge and experience, and sustainable financial decisions require not only financial literacy but also a thorough understanding of the sustainability criteria applied to the relevant financial products.

An interesting experiment to examine the impact of sustainable financial literacy on ESG investments was to provide a group and a control group with or without an informational brochure on ESG investments. The brochure contained simple information on sustainable investment considerations and focused on three key dimensions: ESG criteria, sustainable investment strategies, and the regulation of sustainable investments in the European Union. According to the experiment, increasing sustainable financial literacy increases the likelihood of sustainable investments by 4-9%. It was further examined the result using causal mediation analysis and find that 4-5% of this increase is directly attributable to increases in sustainable finance literacy.²⁵ So for retail investors sustainable financial literacy should be more important – also in the eyes of regulators.

²⁴ BERNANKE, B.S. Statement of the Chairman of the Board of Governors of the Federal Reserve System at a Hearing Conducted by the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia of the Committee on Homeland Security and Governmental Affairs; Board of Governors of the Federal Reserve System: Washington, DC, USA, 2011, <https://www.federalreserve.gov/newsevents/testimony/bernanke20110420a.htm>.

²⁵ ALIX AUZEPY – CHRISTINA E. BANNIER – FLORIAN GÄRTNER: Looking beyond ESG preferences: The role of sustainable finance literacy in sustainable investing. *CFS Working Paper Series*, 2024 (719), <https://doi.org/10.2139/ssrn.4773211>.

Many service providers consider expanding customer knowledge as a task. A lot of informational materials have been created in the past period – even in playful form. In the European market we can even find examples of cooperation between service providers. There is an independent preliminary sustainability preference survey in the German market where customers can assess their preferences and familiarize themselves with the questions.²⁶ The role of knowledge was also recognized by the service provider.

6. SUMMARY

During investment advice or portfolio management, it has become part of the client discussion that ESG topics must be adequately, clearly and in detail discussed and based on this information, the client must give a well-founded answer to the question of whether he has ESG preferences. The investment firm must explain to the client the different categories of sustainability preferences which are allowed by regulation and after the information is provided, the client's needs must be assessed. Only a few percent of customers indicate ESG preferences based on service provider information, so many customers indicating that they have no ESG preferences on the European market. This low percentage of having ESG preferences may be explained by the fact that customers have recognised that, due to regulation, the labelling of ESG preferences very much limit their choice or the service providers' staff are steering customers into this direction. By indicating ESG preferences in the suitability tests, the range of choices is significantly reduced for the client. Thus, clients, whether on their own initiative or on the advice of their service providers, do not indicate an ESG preference. However, when choosing investments, they may decide in favour of ESG investments; the likelihood of this increases if the client has information and knowledge on ESG topics.

²⁶ <https://www.myfairmoney.eu/>.

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