TD Wealth

Behavioural Finance
& Sustainable Investing

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Behavioural Finance and Sustainable Investing

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Introduction

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There are many ways Canadians refer to sustainable investing (SI), such as "green investing," "responsible investing" and "ethical investing". These terms all represent an investment framework that seeks to generate a difference, along with a higher risk-adjusted return than traditionally allocated portfolios.

We went directly to more than 1,500 affluent and emerging-affluent Canadian investors to find out what they valued as important, how they wanted to support their sustainability priorities, and also to uncover how the Big Five personality traits impacted sustainable investment decisions. We are pleased to share some of the insights from this research with those who may find it useful in their ongoing work to further sustainable investing, including those in the financial services industry, partners, peers and academics in the field of behavioural economics.

Important caveats when reviewing the insights:

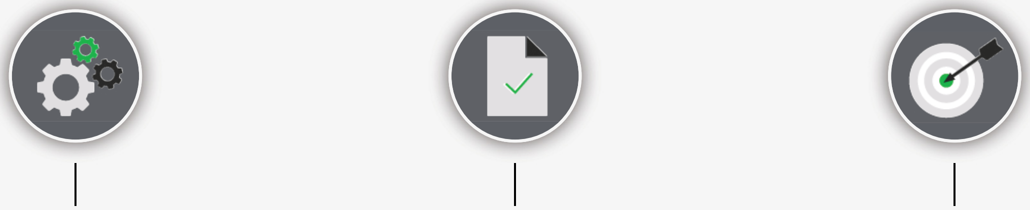
1. We are not seeking to imply causality in either direction. Personality traits may be the cause of the behaviours noted, or they may be the outcome.
2. The research was conducted on affluent and emerging-affluent Canadians and should not be misapplied to the Canadian general population.

Let's start with a few basics

To begin, a simple definition of sustainable investing will help lay the groundwork. SI is based on the premise that portfolios that are invested in countries and corporations that view the need for sustainable solutions as an investment opportunity are in a better position to potentially grow and protect capital.

Typically, sustainable investing falls into three broad categories across public and private markets, but individual interests may be more specific. The three categories are: (1) Environmental, Social and Governance (ESG) Integration; (2) Values Based Investing; and (3) Impact Investing.

Sustainable Investing



ESG Integration

Investment case for companies, industries, countries and regions leading on material ESG risk and opportunity management

Values Based Investing

Negative screening based on certain business involvement or controversial behavior

Impact Investing

Intentionally targeting positive environmental, and social outcomes

For illustrative purposes only.

1. Environmental, Social and Governance (ESG) Integration

To begin, ESG Integration balances traditional approaches to allocation with ESG-related criteria to improve long-term outcomes:

- **Environmental criteria such as:** climate change, pollution controls, clean energy, resource sustainability.
- **Social criteria such as:** human rights, work and safety standards, gender equality, community relations.
- **Governance criteria such as:** executive compensation, board composition, corruption policies, shareholder rights.

2. Values Based Investing
This approach involves negative screening based on certain business involvement or controversial behaviour.

3. Impact Investing
Impact Investing intentionally targets positive environmental and social outcomes.

Behavioural Finance & Sustainable Investing - Our Study

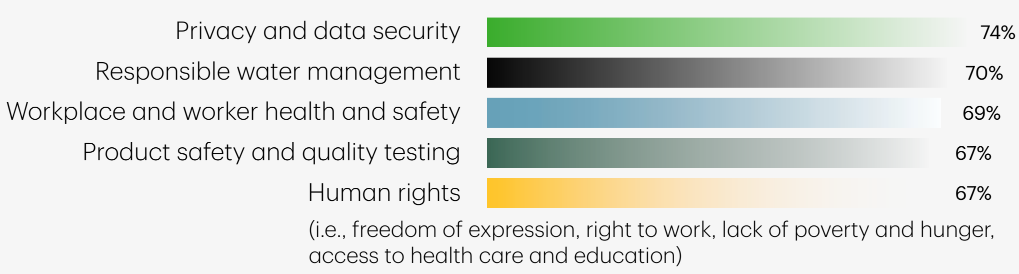
In our study, we found that approximately one of 10 (8%) respondents are currently investing in SI-related mandates and strategies. However, six of 10 (62%) expressed an intention to pursue sustainable investing in the next 12 months. It's encouraging that 70% of women want to include SI mandates in their portfolio (vs. only 55% of men) and 79% of Emerging-Affluent (vs. only 61% for Mass-Affluent and 61% for High-Net-Worth).

It's important to me ... but I'm a bit nervous about my investments

It was exciting to discover that 91% of current SI investors said that sustainable investing was important to them. Where it becomes fascinating is the "why." When asked why they engage in sustainable investing, 84% said they believe that SI can offer higher returns. Nearly half (49%) said they want to make investments that align with their personal values, signaling a strong connection to investing in their beliefs. Thirty percent said they want to encourage and push companies to engage in more pro-social and pro-environmental practices. These two respondent answers are sometimes called "positive-screening." Conversely, 21% chose a "negative-screening" reason — that they want to discourage companies from engaging in practices that are not aligned with their personal values, and avoid them in their portfolios.

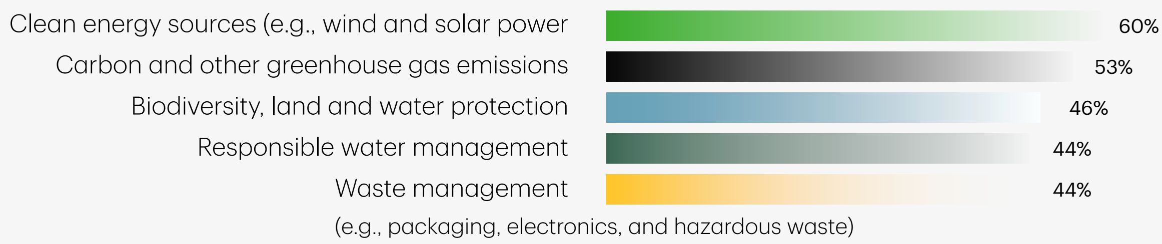
One might assume that sustainable investing must also be a significant part of current and future investor portfolios as well. However, when it came down to their investments, they appeared to be a bit more cautious. Around half (51%) of current and future investors allocate or intend to allocate less than 25% of their portfolio to SI investments, whereas only 17% would allocate more than 50% of their portfolio to sustainable investing. But the question remains: If nearly all SI investors say sustainable investing is important to them, why does their behaviour suggest otherwise? We found further clues in the data.

One such clue may be found in the specific types of SI issues that were important to affluent Canadians. Privacy and data security was the top issue, selected as "very important" by 74% of respondents. This makes sense given significant news stories about data breaches at large companies in the past few years. Privacy and data security is typically considered a governance issue (the G in ESG), and while it was the No. 1 issue in our study, it was not an SI issue that investors would be willing to consider for their portfolios (if an investment like this existed). Another possible explanation in the data comes from looking at the top five "very important" SI issues for investors in the study. Three of them were social issues (the S in ESG).



**The 2022 study uses the terminology "ESG investing". In this whitepaper, TD Wealth uses the term "sustainable investing (SI)" to reflect shifting language preferences. These terms, however, are synonymous and interchangeable.*

While social issues dominated the list of ESG issues that investors deemed 'very important' to them, the data uncovered a very different story when it came to the issues that investors considered important to their actual investment strategy. All of the top five investing issues were environmental.



There are numerous hypotheses to explain the difference between the importance of sustainable investing to clients and their actual investing practices. One of the most logical may be that what people feel doesn't always translate into what people do. In the field of Behavioural Science, this is called the "say-do gap." An investor may feel very strongly about a social issue such as human rights, but when it comes to their investment strategy, they do something completely different. Another possible explanation may be that investors who have already included environmentally focused mandates or strategies in their portfolios see them as having a proven track record of performance compared to those focused on social issues, which are just starting to gain in popularity. Another possible explanation is that the "status quo effect" could be at play. Those currently investing in environmental funds, for example, may already see themselves as SI investors and therefore may not see the need to diversify their holdings into other SI areas.

■ **The bottom line.** Advisors need to ask more than "which SI issues are important to you?" if they want to build the right SI strategy for their clients. A thorough discovery process that includes exploration of the client's goals and risk tolerance can help to focus potential sustainable investing recommendations to the client's specific needs. Remember that, just because an issue is important to a client, it does not mean that they will want to make it part of their investing strategy.

Perceptions and misconceptions

We've all heard the phrase "a person's perception is their reality," and it couldn't be truer when it comes to sustainable investing. We asked those who were aware of sustainable investing to describe it in their own words.

Those who felt positively about sustainable investing tended to describe it factually and precisely. For instance:

> *"Investing in companies that consider environmental and social issues in their business plans and practices, and that practice good governance, inclusion and diversity"*
>
> *"It stands for environmental, social and governance — it's a three-pillar approach to investing that goes beyond purely financial metrics to evaluate a company's performance as it pertains to balancing goals within each of those pillars while being profitable"*

However, the descriptions provided for those who felt negatively about sustainable investing were more emotional and visceral, such as:

> *"A wishy-washy virtue-signalling way of investing. Concentrate on returns instead"*
>
> *"An economics version of greenwashing"*

This exercise highlighted a vast discrepancy in the perceptions of sustainable investing. We did, however, see a number of hints in the data that may help understand why.

Eighty-four percent of SI investors believed SI investments could offer higher returns, but those who were non-investors or not interested were significantly more skeptical. Only 31% believed the same to be true.

Additionally, 63% of the non-investor/not-interested group believed SI investments represent higher risk, with 56% believing that it also meant sacrificing performance. Only 21% were willing to deprioritize performance in order to feel good about the companies they invested in. By comparison, 63% of current investors were willing to deprioritize performance in order to feel good about the companies they invested in.

Perhaps non-investors were more skeptical about sustainable investing because they hadn't been exposed to the facts and figures by their advisors, or maybe they've read negative reports in the media.

■ **The bottom line.** Get the facts straight about risks and returns of sustainable investing. This may help both skeptical and current investors feel comfortable about including SI investments in their portfolios. For advisors, it's important to dig deep into your client's attitudes and beliefs in order to find out what is really going on, so you can suitably address their questions or concerns.

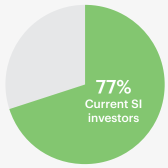
Intrigued but bewildered

Six of 10 people in the study said they are engaging or will engage in sustainable investing. This is an extremely positive signal to the industry. However, the bigger question is how to do it. Shockingly, over one-third (35%) of those who intended to invest in SI over the next 12 months had no idea how to do it or how much to invest. Given the scarcity of factual and easy-to-understand information, it's no wonder respondents felt overwhelmed or unsure about how to add SI to their portfolios in a way that aligned to their own goals, risk profiles and time horizons.

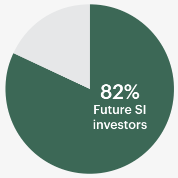
Answering even a few simple questions may give greater clarity to future investors and may open the door to bigger conversations about a sustainable investing strategy. As with many things in life, people just want to be asked.

■ **The bottom line.** Advisors just need to start the conversation. The odds are in their favour (six in 10) that their clients will want to further the discussion. Clients, meanwhile, may want to add it to the list of topics they wish to discuss with their advisor on their next visit. Their advisor may not even be aware that they want to learn more about sustainable investing and how to add it to their portfolio.

An experienced and knowledgeable advisor may be part of the solution. Consider these data points from the survey:



77% of current SI investors have had a conversation with their advisor about utilizing SI mandates or strategies.



82% of future SI investors have not had a conversation with their advisor about utilizing SI mandates or strategies.

SI investment decisions are rooted in personality

All respondents completed the 50-item IPIP representation of the Goldberg (1999) markers for the Big Five factor structure, an evaluative psychological framework that assesses five dimensions of personality: Conscientiousness, Agreeableness, Reactiveness, Extraversion and Openness. The Five Factor Model questionnaire is also used at TD Wealth as part of the Discovery Process for the Wealth Personality™ assessment.

Given our focus on wealth management, we were eager to determine if the Big Five personality traits had any impact on the sustainable investing decisions of affluent Canadians (like those in our study with more than $100,000 in investible assets). And the data showed that hunch to be true.

Let's start with **current SI investors,** those who are currently investing in SI as part of their portfolio. As mentioned earlier, only 8% of affluent Canadians in our study are current SI investors. According to our data, they tend to be highest in both the Openness trait as well as the Conscientiousness trait. This intuitively makes sense given that, traditionally, people who score highly on the Openness trait tend to be innovative, enjoy new experiences and are open to new ideas. Regarding Conscientiousness, people higher on this trait tend to be disciplined, diligent and are thoughtful about their obligations.

Future SI Investors — that is, those who plan to invest in SI in the next 12 months (62% of affluent Canadians in our study) — also have the trait of high Conscientiousness; however, they also have the trait of high Agreeableness (cooperative, polite, friendly). Future investors also have strong Openness, but not nearly to the same extent as current investors mentioned above.

One reason for this may be that future investors are still unsure about how to invest in SI (as mentioned earlier) and are looking for the proper guidance and support from their advisors to help them along the path. They are open to the idea but are not quite ready to invest without help.

The personality traits of the **Non-investor/Not-interested** group were no surprise. These investors were lower in Agreeableness (questioning, assertive) and lower in Openness (pragmatic, traditional) than their current and future SI investor counterparts. These two personality traits signal a cohort that may have either closed their minds to sustainable investing without knowing accurate information, or alternatively have researched the issue and have decided it is not for them.

■ **The bottom line.** Advisors who know a client's Big Five traits may be better positioned to help that client decide on the right sustainable investing approach for them. As always, an understanding of our own investing blind spots as uncovered by TD's Wealth Personality™ profile can help gain self-awareness and possible short-sightedness when it comes to all investing, including sustainable investing. Even the savviest of investors can't see their own blind spots. An advisor can help by using a structured discovery process that includes goal-planning and a risk assessment.

Appendix

I. Methodology

An online survey was conducted by TD Wealth from October 22 to November 9, 2021, by Maru Group in English and in French with geographic distribution across Canada. The final sample size was n=2,210.

Respondent breakdown as follows:

Gender*

- Female 47%
- Male 53%

Affluence

» Advised Emerging Affluent (25-34 yrs. of age with HHI $100,000+)	7%
» Advised Mass Affluent ($100,000 - $1 million investable assets)	55%
» Advised High Net Worth ($1 million+ investable assets)	25%
» DIY only Investor (no screen for HHI or asset level)	13%

Maru Group and Anthony Damtsis from TD Wealth analyzed the data. The study was not longitudinal, and therefore no conclusions can be drawn regarding the movement through life stages and its implications for wealth, financial behaviours or sustainable investing.

All respondents completed the 50-item IPIP representation of the Goldberg (1999) markers for the Big-Five factor structure, an evaluative psychological framework that assesses five dimensions of personality: Conscientiousness, Agreeableness, Reactiveness, Extraversion and Openness. The Five Factor Model questionnaire is also used at TD Wealth as part of the Wealth Personality™ assessment.

*With respect to gender, respondents were asked the following question: What gender do you most identify with? (female/male). As such, the researchers recognize and would like to highlight the limitations of the data to provide behavioural finance commentary or analysis with respect to gender identity.

II. References

Goldberg, L. R. (1999). A broad-bandwidth, public domain, personality inventory measuring the lower-level facets of several five-factor models. In I. Mervielde, I. Deary, F. De Fruyt, & F. Ostendorf (Eds.), Personality Psychology in Europe, Vol. 7 (pp. 7-28). Tilburg, The Netherlands: Tilburg University Press.