Lecture 1: Investor Profiles as a Decision Framework

Cross-Faculty Curriculum for Sustainable Finance

University of Liechtenstein | University of Kassel | University of Luxembourg

Module Alignment

This lecture addresses **Module 4 Learning Outcome 1** from the aggregated high-level curriculum.

Aligned Module Learning Outcome

Module Learning Outcome 1: Understand the elements of a personal investor profile and describe the role of time horizon, liquidity needs, risk capacity, risk tolerance, and sustainability preferences.

Learning Objectives

By the end of this lecture, learners can:

- explain what an investor profile is and why it is a necessary starting point for evaluating any investment product or strategy;
- describe the role of time horizon and liquidity needs in shaping which investment options are feasible (independent of personal preferences);
- distinguish risk capacity (ability) from risk tolerance (willingness) and explain why suitability depends on both;
- explain how sustainability preferences can be expressed as investable priorities (for example general ESG, exclusions, themes, stewardship expectations, or outcome ambitions);
- describe how clearer preference statements (strength, level, and evidence expectations) reduce confusion and improve the quality of later product comparisons.

Description

This lecture introduces the investor profile as the conceptual bridge between sustainable finance ideas and real-world investment choices. Earlier modules establish the vocabulary needed to interpret sustainability in finance: definitions of sustainable finance, ESG language, the actors and roles in the system, and the reasons sustainability claims and approaches can be contested. Module 4 turns that knowledge into a practical decision perspective. The starting point is not the product. The starting point is the investor profile: a structured way to describe objectives, constraints, and preferences so that later product evaluation becomes transparent and consistent.

A useful teaching claim is that most "bad" investment decisions are not caused by a lack of information about products, but by unclear objectives and constraints. The investor profile is therefore framed as a short decision document that answers three questions:

- What is the investment for (objective)?
- What constraints apply (time, liquidity, and risk limits)?

- What preferences matter (including sustainability preferences), and how strong are they relative to other features such as costs and diversification?

The emphasis is on clarity rather than precision. The profile is a way to make trade-offs discussable.

The lecture then introduces four foundational concepts that tend to determine suitability regardless of sustainability intent. First, time horizon: how long the money can realistically remain invested. Horizon matters because it changes what short-term losses mean. A longer horizon does not eliminate risk, but it changes the feasibility of riding out drawdowns and the plausibility of strategies that rely on long-term change (for example stewardship and transition narratives). Second, liquidity needs: whether the investor might need access to the capital on short notice. Liquidity is treated as a constraint rather than a preference; it can override other ambitions simply because it determines whether an investor may be forced to sell at an unfavourable time.

Third, the session unpacks the difference between risk capacity and risk tolerance. Risk capacity is the ability to bear losses without jeopardising essential goals or obligations. It depends on factors such as financial buffers, income stability, debt, and the timing of cash needs. Risk tolerance is the willingness to accept uncertainty and temporary losses. It is behavioural and psychological, and it often changes under stress. The conceptual takeaway is that capacity sets the outer boundary of what is reasonable, while tolerance influences whether a plan is likely to be followed. Treating them as separate helps explain why enthusiasm alone cannot justify risk exposure, and why a technically suitable plan can still fail if the investor cannot stay with it.

Fourth, return orientation is introduced as a plain-language way to express the stability-versus-growth trade-off. Some investors prioritise capital preservation and predictability; others prioritise long-term growth and accept fluctuations as the price of that goal. This is presented as a preference dimension that should be made explicit to avoid hidden assumptions in later product comparisons.

With this foundation in place, the lecture brings sustainability preferences into the investor profile as a decision-relevant component rather than a moral add-on. Sustainability preferences are presented as varying along three practical dimensions. One is preference strength: how much sustainability should matter when financial characteristics are otherwise similar. Another is preference level: whether the preference is broad (general ESG characteristics), values-based (basic exclusions and alignment), thematic (priority themes), or oriented toward outcomes and contribution logic. The third is specificity and evidence expectations: whether general assurances are sufficient or whether the investor expects clearer substantiation and regular reporting. The goal is not to prescribe a single preference style, but to show that different preferences imply different product features and different kinds of information needs.

The lecture closes by preparing the ground for the next session. Lecture 1 provides the conceptual language and distinctions; Lecture 2 applies them through a structured assessment and translation into a simple product short-list logic. In other words, this lecture explains what the profile is made of and why it matters. The next lecture demonstrates how to operationalise it.

Discussion Questions

1. What is the difference between risk capacity and risk tolerance? Describe a plausible situation in which a person has high tolerance but low capacity, and explain why that matters for suitability.
2. Why can time horizon and liquidity needs act as constraints that override preferences? Give an example where an investor's sustainability ambition is clear, but the horizon or liquidity constraint forces a different implementation approach.

3. Sustainability preferences can be broad, thematic, or outcome oriented. What are the advantages and disadvantages of each style when it comes to making real product choices and explaining them to others?

Cross-Faculty Perspective

In a mixed cohort, the investor profile works as a shared frame that connects finance, regulation, sustainability knowledge, and personal decision-making. Students with business or finance backgrounds can translate profile elements into implications for diversification, volatility, and product structure. Students with law or public policy backgrounds can connect profiling to investor protection and to why suitability and disclosure exist in regulated markets. Students from environmental sciences and engineering can help make sustainability preferences concrete by clarifying what different environmental goals imply operationally and over time. Students from social sciences and humanities can surface how values, identity, and social context shape preferences and how people experience risk in practice. Mixed groups can use the profile language to disagree constructively: the task is not to align values, but to make objectives, constraints, and trade-offs explicit.

Resources

- ESMA, investor protection and intermediaries (entry point for suitability, disclosure, and investor education materials).
  https://www.esma.europa.eu/investor-protection
- EUR-Lex, MiFID II Directive (Directive 2014/65/EU).
  https://eur-lex.europa.eu/eli/dir/2014/65/oj
- EUR-Lex, MiFID II Delegated Regulation on organisational requirements and operating conditions (Regulation (EU) 2017/565).
  https://eur-lex.europa.eu/eli/reg_del/2017/565/oj
- EUR-Lex, Integrating sustainability preferences into MiFID II suitability (Commission Delegated Regulation (EU) 2021/1253).
  https://eur-lex.europa.eu/eli/reg_del/2021/1253/oj
- OECD/INFE, financial literacy and investor education resources (background for risk, horizon, and decision readiness).
  https://www.oecd.org/financial/education/
- ESMA, Guidelines on certain aspects of the MiFID II suitability requirements (main document PDF).
  https://www.esma.europa.eu/sites/default/files/2023-04/ESMA35-43-3172_Guidelines_on_certain_aspects_of_the_MiFID_II_suitability_requirements.pdf
- Riedl and Smeets (2017), Why Do Investors Hold Socially Responsible Mutual Funds? (working paper PDF).
  https://arnoriedl.com/pdffiles/RiedlSmeets%28WhyInvestorsHoldSRI%29_Jan2017_vWP_n.pdf
- Kölbel and Weder (2024), Sustainability preference elicitation under MiFID II – a market survey (report PDF).
  https://assets.kpmg.com/content/dam/kpmgsites/ch/pdf/kpmg-ch-sustainability-preference-elicitation-report.pdf