impact investing institute

The Impact Investing Institute's follow-up to the roundtable with the FCA on DP21/4: Sustainability Disclosure Requirements and Investment labels

31st January 2022

1. ABOUT US

The Impact Investing Institute was launched in 2019 with a simple mission: to accelerate the growth and improve the effectiveness of the impact investing market in the UK and internationally. Our vision is for lives to improve, as more people choose to use their savings and investments to help solve social and environmental challenges, while seeking a financial return. We want to see more capital contributing to the well-being of people and the planet – as set out in the United Nation's Sustainable Development Goals (SDGs).

We are an independent, non-profit organisation, which brought together two influential initiatives: the Government's Taskforce for Growing a Culture of Social Impact Investing in the UK and the UK National Advisory Board on Impact Investing. We are part of the GSG – the Global Steering Group on Impact Investing Network, which brings together leaders from finance, business, and philanthropy to solve some of the world's most pressing social and environmental challenges.

2. WHAT WE DO

Our Theory of Change describes how we plan to achieve change in the short-, medium- and long-term. We run a series of research, education and advocacy programmes designed to bring about the market conditions to enable impact investing to flourish. We want to make it easier for financial market players, including asset managers, to invest with impact which is consistent with their purpose. We seek to support schemes in making investments which create opportunities to generate positive, measurable environmental and social impact alongside a competitive risk-adjusted return.

"Impact is defined as a change in outcome – positive or negative." We believe that a key element of positive impact is "additionality" – this is the concept that takes impact investing beyond "just" ESG. It asks that this type of investment makes more of a difference than merely considering, or failing to consider, ESG factors in the investment process. A "true" impact investor must be additive in some way – they have to show that their investment creates different and more positive outcomes compared to what would have happened with more traditional, ESG-integrated investment approaches.

We have worked with organisations and policymakers to develop and implement strong sustainability standards in the following ways:

- We responded last September to the FCA's consultations, CP21/17 and CP21/18, on enhancing climate-related disclosures. In our response, we called on the FCA to require organisations, including asset managers, to report on the 'S' factors and to create a comprehensive bond standard which recognises the social co-benefits from green bonds

- We responded last February to the Financial reporting Council's (FRC's) consultation on the future of corporate reporting. In our response we strongly endorse the FRC's proposal for a Public Interest Report, particularly as stakeholders Increasingly expect companies to declare their work towards global sustainability goals. We also offered to provide further information about how such an initiative could be run and who, alongside the institute, could drive it

- We responded in 2020 to the International Financial Reporting Standard (IFRS) Foundation's consultation on Sustainability Reporting. In particular, we called on the IFRS to demonstrate Its commitment to: (i) Interoperability between enterprise-value focussed sustainability reporting standards and wider sustainability disclosures and (ii) integration of existing reporting standards

- We produced a briefing paper on making outcome reporting both easier and more accessible where we called for the mandatory reporting of environmental and social outcomes, alongside economic ones. The paper also advocated the creation. of: (i) a governing body for global standards of sustainability reporting and (ii) public depositories of data metrics

- We published a report, in partnership with Deloitte, on technology-enabled impact reporting practice across the investment chain. It argues that without significant action from progressive keystone players, the rate of change in impact reporting practice will be insufficient to meet society's global challenges including the climate emergency.

- As part of the ESG Social Housing Working Group, we helped develop the Sustainability Reporting Standard for Social Housing. The Standard makes it easier for housing providers to report on their ESG performance in a transparent, consistent and comparable way and attract more private impact capital to help tackle the UK's deepening housing crisis.

3. KEY RECOMMENDATIONS

The Impact Investing Institute hosted a roundtable on 'DP21/4: Sustainability Disclosure Requirements and Investment labels' for the FCA on 6 January 2022. It focused on impact labelling, the tiered structure approach, and the transitioning category. Below is a summary of our recommendations and attached is a summary of the roundtable itself.

3.1 High-level features of impact investing

We strongly welcome the FCA's recognition of the growing prominence and importance of impact investing. We agree with the consultation's list of the appropriate high-level features of impact investing, but a careful approach is required in defining these features from a regulatory standpoint.

"Impact" should require evidence of additionality at the portfolio level, but a pragmatic approach should be taken to define additionality and determine the necessary level of and evidence for additionality. This level could increase over time.

Effective active ownership is additional, and therefore should qualify as “impact”, if undertaken with the intention of delivering progress towards the delivery of measurable economic, social and environmental outcomes (in line with our outcomes reporting paper here). Such stewardship activities, including targeted engagement, should be carefully defined, and measured against clear targets, and reported publicly in line with best practice under the FRC Stewardship Code. A roadmap of the stewardship requirements of the label would be welcome.

There should also be a specific guidance on what is necessary to meet the additionality requirement in private markets.

The "Dear AFM Chair" letter of 19 July 2021 from Nick Miller differs somewhat from the Discussion Paper in its description of products qualifying as "impact", e.g., in assigning active engagement to the impact category, rather than to the transitioning category. The letter's definition of impact was excellent, and possibly better than the Discussion Paper's in certain details.

3.2 General approach – tiered structure and labels

We broadly support the approach behind the tiered structure and other labels.

We believe that community investing should be defined and positioned as a subset of impact investing. We welcome the FCA’s reference to community investing, which shines a light on important impact investment practices such as gender-lens investing and place-based investing.

3.3 “Transitioning” category

The sub-category of "transitioning" funds is problematic in the Paper in that it conflates two independent dimensions of sustainability:

1. high vs. low content of underlying investments categorised as sustainable on the one hand; and
2. active advocacy by the investment manager to influence investee enterprises toward greater sustainability.

In the spectrum of sustainability from "not promoted as sustainable" to "impact", "aligned" is considered more sustainable than "transitioning", implying that content trumps advocacy. Our view is that active stewardship makes a greater contribution to driving improved sustainability outcomes (and ultimately delivery of the SDGs) than level of sustainable content. We would rank a low-content/high advocacy fund higher in sustainability than a high-content/low advocacy fund, whereas the Discussion Paper does the reverse.

3.4 “Responsible” criteria

We would not agree that ESG integration is an appropriate minimum criterion for "responsible" investment products, with no specific sustainability goals. ESG integration has become virtually universal among global investment managers, and is widely used in portfolios that have no claim to sustainability, as a tool to identify financial risk to portfolios, and to a lesser extent, investment

opportunities. Using it as a minimum criterion for "responsible" would effectively promote the vast majority of products out of the "not promoted as sustainable" category.

As the minimal category of sustainable investing, we would expect "responsible" products to reflect a systematic approach to integrating sustainability factors into the investment process across all sectors, regions, and companies. This should include substantive evidence of pro-activity in sustainability, e.g., exclusions, active ownership, above-market weighting of investments qualifying as sustainable, tracking targeting and reporting of improvement in minimum set of ESG outcomes.

3.5 Disclosures

We do not think it appropriate at the outset to mandate third-party verification of this disclosure regime, but investment management firms may well elect to use them to increase consumer confidence. One consideration is that the increased cost of such verification would likely be passed on to consumers.

More importantly, the area of sustainability verification is new and evolving. Approaches and methodologies that we have seen in the market to date (i.e., sustainability rating agencies) are inconsistent with each other, largely opaque, and in many cases do not enjoy the full confidence of investment managers. A mandate for verification at this stage of evolution would create a false impression of the reliability and quality of the assessments.

In addition, there isn't likely to be enough verification capacity in the near term to service the entire inventory of sustainability-labelled investment products in scope for this proposal.

All disclosure should be provided in a machine-readable format. Aside from being the norm in a modern investment operation, the amounts of data required are large and will increase as methodologies develop. This would facilitate benchmarking and comparison by the users of sustainability information.

The principal approach to measuring the impact of the proposed measures should be surveys of users, both retail and institutional, to assess their satisfaction and understanding and their view of usefulness. In addition, the FCA should assess samples of disclosures provided by investment managers against the FCA's understanding of the standards.

3.6 Scope

All FCA-regulated investment products and firms should be in scope for labels and disclosure, considering that products "not promoted as sustainable" will have a light disclosure obligation, and therefore the SDR will not be a burden. This requirement would also apply to discretionary and advisory portfolios constructed partially or fully from disclosing products.

3.7 Ongoing engagement

We recommend that the FCA engage with any UK-based, industry-facing organisation that has published views, or otherwise has expertise, on disclosure standards for sustainable products. You

should also engage selectively with European and global disclosure initiatives, as a large proportion of UK-based asset managers are also active in other disclosure jurisdictions, and in particular, Europe.

With respect to labels, disclosure and standards relating to impact investing, we would be pleased to engage directly with FCA. We can make further introductions and provide insight on impact definitions and disclosure in jurisdictions outside the UK, e.g., Europe and the US.

We are grateful for the opportunity to host a roundtable for the FCA during this consultation. We would welcome the opportunity to continue to contribute to the FCA's thinking, to help drive practical, effective progress in this vital area.