BRIEFING: DELIVERING IMPACT IN PUBLIC MARKETS

Impact investing has long been associated with private markets, leading to the development of practices specific to private asset classes. However, an investment landscape limited to private markets is incomplete. Public markets play a crucial role in the growth of companies aiming for significant scale. Asset managers are now developing strategies seeking to leverage the power of public markets to achieve environmental and social outcomes and make impact investments accessible to a wider range of investors.

But as this segment of the market evolves, key questions arise:

1. How can public market asset classes create impact?
2. What are good practices for identifying, generating, managing, and communicating impact in public markets?
3. How can investors adhere to new UK regulations for investment products claiming to deliver impact?

The Impact Investing Institute, in partnership with WHEB Asset Management and Friends Provident Foundation, brought together leading public market investors to share their experience and ideas for advancing good impact investment practice. Participants in the workshop included Aviva Investors, Cazenove, Columbia Threadneedle, EQ Investors, M&G, Montanaro, Regnan, Schroders, Snowball, Tribe Impact Capital, and Wellington Management. While the workshop took place under the Chatham House Rule, anonymised insights are summarised below.

Key takeaways

- **Public markets offer opportunities to achieve scale and accessibility for impact investing, by influencing large companies and sovereigns to mitigate harms and improve environmental and social impact.**

- **Emerging regulation, including the new Sustainability Impact label launched by the UK Financial Conduct Authority, is likely to enhance integrity and transparency of impact products. However, implementing new regulation is not without challenges, particularly in the context of public market investments. Investors would appreciate more guidance from the regulator on reporting and assurance requirements, and circumstances in which litigation risk might arise.**

- **There are particular innovations that would drive significant improvements in the market. These include the development of standard impact metrics, indices, and benchmarks. There is appetite amongst public market impact investors to work together to solve these problems.**

What matters when it comes to environmental and social impact in public markets?

The opportunity to generate impact at scale

The main advantage of public market impact strategies is the potential for scale. While private markets investments may offer more direct ways of financing and influencing, the activities of listed companies and sovereigns (in the case of bonds) are generally at a much bigger scale. Public market investments are more immediately available to a greater range of investors, for example, retail investors. Public markets therefore offer opportunities for all kinds of investors to invest in a way that seeks to avoid harm and deliver positive impact for people and planet.

What does 'good' look like?

Public market impact investments have not yet reached their full potential. Besides recent market headwinds against sustainable investment strategies in general, asset managers also encounter specific problems when they develop public market impact investment strategies. There remains some debate over what counts as "good" impact investment in public markets. Moreover, there is still a widespread lack of knowledge in mainstream finance and among advisers about impact investing in public markets, including confusion about its role in a portfolio and where it can fit, and its unique benefits – e.g. in terms of diversification and scale.

There is no standardised way for investors to assess their impact, both in terms of how they attribute the impact generated by the companies in their portfolio, and the impact they generate themselves through their engagement with companies to help them do better for people and the planet. This lack of clarity might weaken credibility of investor's impact claims, exposing them to criticism from clients, regulators, and wider stakeholders (such as civil society and NGOs) on the actual impact of their investments and how they help to create it. Impact investors in public markets are increasingly using tools developed in private markets (like theories of change) and counterfactuals (such as avoided carbon emissions). These, however, are still in their relative infancy.

A way forward

The above are generally seen as 'growing pains' due to the fast growth of impact investing in public markets and there are also positive developments that can improve integrity in the market.

Clients and regulators are becoming better informed and able to grasp the realities, opportunities, and trade-offs of impact investing in public markets. Data providers are becoming more adept at measuring outcomes and impact, enabling them to offer more reliable and relevant data and insights for investors, thus reducing the workload of data collection and analysis.

Companies are disclosing more data, of higher quality, more regularly, on their environmental and social impact, mainly because of regulatory demands. They are increasingly setting and disclosing their key impact goals and indicators, beyond net zero targets, to align with the UN Sustainable Development Goals and other global frameworks. Investors can therefore increasingly use this information to assess and influence both the outcomes companies are generating and areas where companies can do better. The latter are the areas where investors can engage to achieve their own contribution to impact.

Investors themselves are beginning to agree on key impact indicators, by sector or asset class, to enable consistent measurement and reporting of impact outcomes and contributions across different funds and strategies. Increased consistency would support the development of impact benchmarks that reflect the social and environmental performance of companies and funds, as well as their financial returns, and allow investors to compare and improve their impact results. The adoption in public markets of practices that are common in private markets, such as linking fund managers' pay to their impact performance and the increasing use of third-party impact verification, is also likely to boost the integrity of impact approaches.

What do investors think about the FCA's Sustainability Disclosure Requirements and the Sustainability Impact label?

The UK Financial Conduct Authority (FCA) has recently introduced the Sustainability Disclosure Requirements (SDR), which include a suite of four labels for sustainable finance products. From July 2024, investment managers who want to offer funds with sustainability and impact claims to UK customers will need to use these labels, following their rules. The workshop focused on the Sustainability Impact label.

Raising the bar

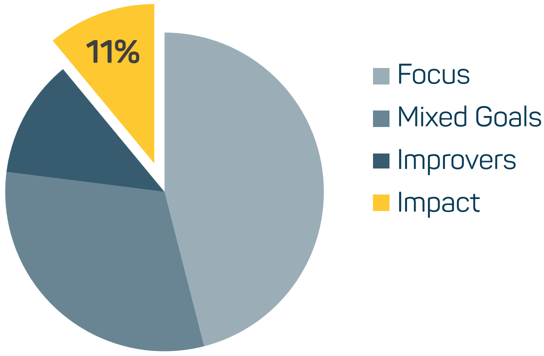
The Sustainability Impact label has broad backing. It is ambitious yet realistic, and likely to help consumers find their way and enhance clarity and confidence in impact approaches. Its principle-driven approach makes it flexible and fit for public market strategies. Investors welcome its requirement that funds state their intentionality and have a theory of change.

The label only applies to products for UK retail clients for the time being, but it could affect how other investors approach sustainability and impact, especially since the FCA may in future apply the regime to products for institutional investors. The label could also have an influence on regulation in other markets – including possible changes to the EU's Sustainable Finance Disclosure Regulation (SFDR).

Grappling with challenges

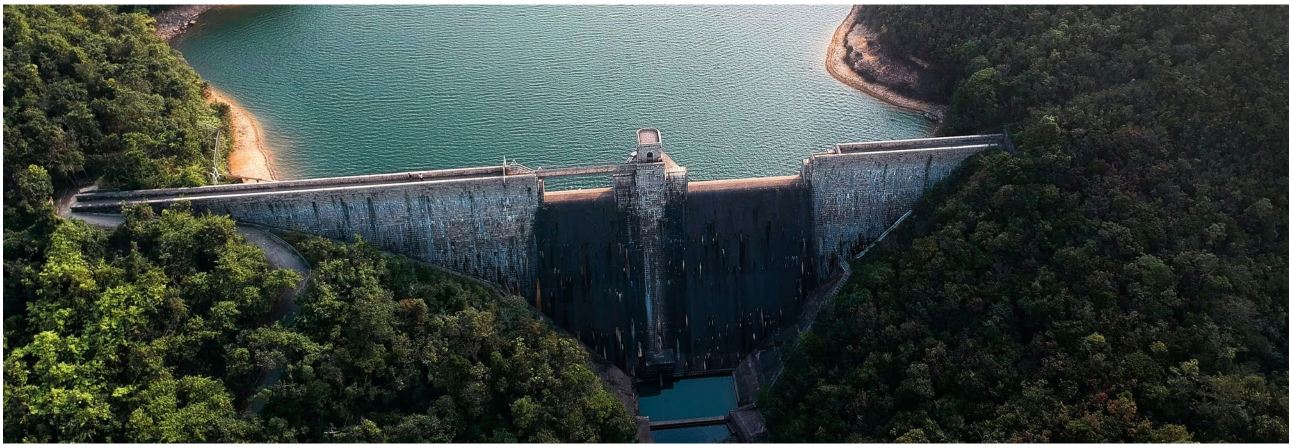
While they broadly support the Sustainability Impact Label, investors are experiencing challenges in implementing it. According to market data (see figure 1), it will likely have the lowest adoption rate of the labels, especially in the first year of implementation. This reflects the fact that impact funds typically make up a smaller share of the sustainability funds market. But difficulties expressed by investors seeking to launch public market impact products may also limit the label's adoption at scale, given the comparative size of public markets.

Figure 1: Expected distribution of SDR labelled funds by end 2024 (Source: Morningstar)



Specific challenges for adoption in public markets include lack of clarity on what kind of evidence is suitable and what standards will be expected to demonstrate impact, including investor contribution. Investors worry about legal risk arising from disputes over their impact statements. Although there is broad support for the use of external assurance, which can help reduce this risk, the market for impact assurance remains underdeveloped. Lawyers and assurance are very expensive, which may prevent smaller, innovative firms in the field from getting the services they need to comply with label requirements.

To solve these issues, investors are looking for more guidance from the FCA, as well as examples of good practice. It is also expected that the assurance market will improve in quality and reliability to meet the higher demand that the label should create. Investors also noted the importance of educating other market participants, such as independent financial advisers (IFAs), to help them understand the labels, so that they are more confident in promoting labelled funds to consumers.



What do asset owners think?

Institutional asset owners have large amounts of capital and mostly invest in public markets. Their preferences matter for the development of public market impact strategies. To capture these perspectives, the Impact Investing Institute and Friends Provident Foundation (an asset owner itself) interviewed different UK asset owners, including Aon, Brunel Pension Partnership, Dunhill Medical Trust, and the University of Edinburgh, to understand their opinions on impact in public markets.

The asset owners were generally interested in public market impact strategies and understood the difficulties and limitations. They asked for more honest discussions with fund managers about the possibilities, trade-offs, and limitations of impact investment in public markets. They also wanted more information and data to help them assess managers' impact intentionality and how it fits with their objectives, and appreciated both qualitative and quantitative information, including on the outcomes of engagement.

What next?

Market leaders in public market impact investing are eager to work together more, to support market growth and maintain high standards of integrity. A shared goal is to determine what makes a 'good' impact investment in public markets, both in general and for specific kinds of investments - in different assets, topics, and sectors, and with different company profiles and sizes.

Investors also want to work together to create standards and measures that would provide a shared basis for understanding impact investment. Industry-standard templates, starting with impact reporting for public market investments, are broadly considered a 'quick win' to facilitate the implementation of SDR and the Sustainability Impact label.

Resources

WHEB and Friends Provident Foundation: Unleashing the Potential of Impact Measurement in Listed Equities: The crucial role for asset managers

Financial Conduct Authority (FCA): Policy Statement: PS23/16: Sustainability Disclosure Requirements (SDR) and investment labels

Global Impact Investing Network: Guidance For Pursuing Impact In Listed Equities

Impact Frontiers: Impact Performance Reporting Norms