Recognising the Impact of our Investments - *a popular choice?*

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Introduction

Sustainable and impact investing represent a huge opportunity for both the UK's investment management industry and British society. Driven by a triple helix of change – environmental, regulatory and social – demand from investors for products which demonstrate tangible positive impact is rising rapidly. How is regulatory pressure affecting this growing market, and how can the investment industry capitalise on the opportunities it presents?

On September 5, Acre's Banking & Finance team held a round table event to discuss how the UK's investment management industry could become the global market leader in sustainable and impact investing. Our intention was to create an open forum – one where attendees could share their perspectives and extensive industry experience – and encourage a robust debate.

We believe that there are significant benefits to taking a collaborative approach to developing the UK investment community's capabilities in this rapidly growing sector. Sustainable and impact investing represents opportunities on many fronts for both UK plc and British society. To capitalise on these opportunities, there is much to be done to develop the commercial and regulatory landscape of the investment industry. These discussions aimed towards mapping out that work and determining the key areas of opportunity for both organisations and the wider industry.

The discussion was chaired by Oonagh Harpur, Independent Non-Executive at KPMG. For each of the following topics, two expert speakers provided their perspectives to kick off a lively discussion.

1

Regulatory pressure

A review of the relevant recommendations from the High-Level Expert Group on Sustainable Finance (HLEG) and the UK Green Finance Task Force (UKGFT).[1]

2

Growing demand for Impact products

How to engage with individuals regarding their sustainability preferences when discussing either personal savings or choice of corporate pension provider, and the type of reactions they are likely to express.

3

Impact funds on offer today

An overview of the range of funds available for individuals or corporate pensions funds who want to acknowledge the impact of their investments when allocating their savings/ pensions.

Acre is the global leader in responsible investment recruitment with a track record of over ten years in the market. We work with a range of financial institutions to source ESG and sustainable investment professionals including banks, asset managers and private equity firms.

[1] Please refer to the end of the paper for links to both reports and other suggested reading

Foreword

Tom Le Quesne *Head, Government Inclusive Economy Unit, DCMS*

The UK government has supported the development of social impact investing over many years. Social impact investing has the potential to achieve multiple objectives: contributing to building a stronger society; enabling consumers to invest in line with their values, becoming more engaged with their savings in the process; and, further supporting the growth of the UK as a global financial centre.

In 2016, the Economic Secretary to the Treasury and the Minister for Civil Society asked Elizabeth Corley to lead an Advisory Group focused on Growing a Culture of Social Impact Investing in the UK. Following the publication of the Advisory Group's report, the Prime Minister asked Elizabeth to lead work across the financial services industry to implement the recommendations of the Advisory Group.

The work of the Advisory Group and the subsequent Implementation Taskforce has focused on bringing social investment into the mainstream of the financial services industry, complementing the development of the impact focused market under the leadership of Big Society Capital.

The breadth of engagement in this work has been exceptionally positive, and the growth of this sector is well reflected in the issues brought out in this round table. As a new area of market growth, key issues need to be worked through as scale develops. These issues, and some of the solutions to them, are succinctly and clearly captured in this round table, and the summary of the discussions.

The government looks forward to continuing to work with participants right across the financial services and social sectors to drive forward these efforts.

Elizabeth Corley *Former CEO, Allianz Global Investors and Chair, Implementation Taskforce for Growing a Culture of Social Impact Investing in the UK*

Being Chair of the Implementation Taskforce, created to grow a culture of social impact investing in the UK, has afforded me a privileged position to appreciate the rapid pace of change and development in this emerging field. This interesting and insightful paper is an important contribution to understanding better how much is happening. It covers ground from products to principles, from management to measurement, and from regulation to retail. There is much still to do in each of these areas but the excitement and potential in the field is undeniable.

Three things stood out to me when reading this paper as particularly important. The first is the need for the worlds of sustainability and impact to work closely together and in tandem. Whilst the consideration of environmental issues may be further advanced in some areas, there is much more in common between sustainable investment and impact investment than divides them. Mapping different areas of activity and recommendations, as has been undertaken here, is an important first step to being more than the sum of our parts.

The second is that while our focus as a Taskforce is on the UK, it is crucial that the UK remains deeply engaged and involved in broader developments in the EU and globally - be that anchoring activity in the framework of the Sustainable Development Goals, building on the work of the Global Impact Investing Network, or engaging with the Impact Management Project. The evolving EU Commission work will also be of significant relevance.

Finally, what stood out for me was the importance of organisations understanding their place and role in the spectrum of capital, and understanding that spectrum as it moves from ESG (where trillions are under management); to impact investment (billions); to social or deep impact (millions). Gaining more consistency and clarity over what impact means, and how its integrity is maintained, is a central and crucial challenge. I endorse the comment that we must not let a valid desire to avoid 'impact-washing' lead us instead to 'impact paralysis'; there is a balance to be struck between welcoming and including new people to this movement and raising the bar for all of us in our work.

This is a valuable contribution to thinking on these important topics, and I congratulate Acre for having convened what was clearly both an interesting event and for having drawn expert individual perspectives together into an insightful paper.

1

Regulatory pressure

A review of the relevant recommendations from HLEG and the UKGFT

Expert views from:

Ingrid Holmes
Head of Policy & Advocacy, Hermes: Investment Management, Member of the European High-Level Expert Group on Sustainable Finance

Andrew Voysey
Director, Sustainable Finance, University of Cambridge Institute for Sustainability Leadership (CISL), UKGFT Advisor

"Do take this report seriously; there is a high degree of consensus throughout key departments in the European Commission on the report. Change is coming; expect new legislation, as recommended by HLEG, to be in place next year." - Ingrid Holmes

The HLEG report will lead to new legislation on taxonomy for sustainable investments as well as requirements for asset managers and insurers to consult their clients on their sustainability preferences.

There is an opportunity here for financial institutions to be facilitators of change rather than resistors.

"There are two common recommendations that came out of both the UKGFT and HLEG that relate very directly to how retail investors engage with the concept of 'impact'. First, investment advisors should be required to ask retail investors about their preferences on the sustainability impact of their investments as a routine component of delivering financial advice. Secondly, investment managers should more consistently and systematically disclose the impact of all funds to retail investors." - Andrew Voysey

These recommendations recognise the underserved retail demand for sustainable and impact investment opportunities. At least 40% of European financial assets are derived from household savings.

There is potential for regulation to have influence through a review of the financial advice process and working with the industry to establish a labelling scheme for these funds to both highlight their existence and add an element of protection for investors.

Failing to engage the retail investor represents a significant risk in terms of a lost opportunity that sustainable and impact investing represents to democratise change across the EU.

Discussion points:

"What will these recommendations mean post-Brexit? How likely are we to see regulation in the UK similar to what we are seeing from the EU?"

"Is the ambition of the EU's HLEG group to focus on climate/green finance, or more broadly on ESG issues across all sectors?"

- There was a strongly held view that the UK will align with, and most likely go further than, the EU.
- Due to the recommendations by UKGFT, there is growing consensus amongst both senior civil servants and ministers that sustainable finance represents significant opportunities for UK plc.
- There was concern that, due to the government's pre-occupation with Brexit, there may not be enough capacity to turn these proposals into legislation.
- A phased response from the UK Government is ongoing. The co-creation of the Green Finance Institute with the City of London is a key example. The Department for Business, Energy & Industrial Strategy has also allocated resources to develop standards for sustainable investment.
- The UK government was perceived to be focused more on the creation of green finance products than the broader reform objectives being driven at the EU level.
- The EU is aware of the opportunity that sustainable and impact investing represents to reform the financial system. HLEG is part of a much larger effort to point capital and financial markets towards sustainable outcomes. This is evidenced by the shareholder rights directive, due to come into force in 2019, which mandates a closer relationship between companies and shareholders in relation to ESG factors.

Growing demand for Impact products

How to engage with individuals regarding their sustainability preferences when discussing either their personal savings or choice of corporate pension provider. What type of reactions are they likely to express?

Expert views from:

Damian Payiatakis
Head of Impact Investing at Barclays

James Lawson
Co-Founder at Tribe Impact Capital

"Behavioural finance research from Barclays shows latent demand for impact investing from investors – 56% were interested, but only 15% had invested. However, once making a first investment, 90% indicate they would likely make another.

It also points to how impact investing may enable investors to overcome behavioural biases which hamper good investment decision-making as well as generating valuable emotional returns from holding impact investments." - Damian Payiatakis

Individuals are becoming more concerned with the impact their wealth makes, starting to move beyond the theory of investing focused purely on maximising profits.

To increase activity, awareness of impact investing needs to be raised among investors, particularly older investors.

Also, investor engagement increases when identifying specific causes; in fact, when shown a list of causes, such as education, climate change and healthcare, investors would allocate four times as much of their portfolio than when only using the generic concept of impact.

When individuals know where their investments are going, they appear more likely to overcome biases to get invested, endure short term fluctuations in markets, and hold onto their investments for the long term.

"Over the past five hundred years we've become more and more distant from what our money is doing - or could do. Impact investing is bringing back the connectivity between an individual and their wealth. When we think about impact investing, we start with the belief that every action we take has an impact - so our role is to find those net positive impacts and align them for our clients and their portfolios. We don't see impact investing as a niche asset class or investment, but a philosophy." - James Lawson

In our role, the first and the last question to a wealth holder is always: "What is really important to you?".

This type of question is hard to ask and even harder to answer. Both of which have probably deterred many financial institutions. But there are frameworks out there to help, such as the SDGs, that can be used to translate an individual's values into individual portfolios.

Discussion points:

The issue of "impact washing" was raised, where products labelled as "impact investments" are unchallenged because the definition of what constitutes impact investment has not been established.

"Which of the many frameworks should we equip investment advisors with when discussing impact or sustainable investment products with clients?"

- The discussion noted that, in most cases, advisors currently lack an understanding of impact investing as a concept. There is also a lack of clearly labelled associated products.
- Impact investments should not be an asset class. Rather, impact investing is a philosophy to apply across all asset classes.
- There was also a warning not to combat "impact washing" with "impact paralysis". This is where labelling concerns prevent people making an impact investment, structuring new products, or even discussing the principle with clients.
- Ethical investing is an exclusive and negative way of approaching sustainability issues. In contrast, impact investing is inclusive, offering investors the opportunity to invest in companies that drive positive change on social and environmental issues that are important to them.
- A consensus must be reached on a basic framework for financial institutions. It is then their responsibility to develop their own approaches to provide clarity for employees and clients.
- Fundamentally, it is possible to comply with the current regulatory frameworks in the UK while adopting an impact-conscious approach to engage with clients in a deeper, and consequently more productive, fashion.

Impact funds on offer today

An overview of the range of funds available for individuals or corporate pension funds who want to acknowledge the impact of their investments when allocating their savings/pensions.

Expert views from:

Damien Lardoux
Head of Impact Investing at EQ Investors

Julia Dreblow
Founder, SRI Services and FundEcoMarket.co.uk

"There are at least 91 regulated retail on-shore funds with sustainability/impact themes, with different strategies and approaches." - Julia Dreblow

Of these 91 funds, 49 say that they aim to generate a 'positive impact', with 32 saying they measure 'social impact'.

29 funds are sustainability-themed, 24 are ethically balanced funds, nine are environmentally-themed, three are socially-themed, two are led by ESG strategies. 21 funds are in large cap and nine in small cap equities.

There has been a significant increase in fund launches with an impact focus over the last two years in comparison to the previous 10.

"We have to differentiate impact investing from ESG screening, otherwise there is a risk that we will confuse investors." - Damien Lardoux

There are now a tremendous variety of options to achieve positive impact through investments in a wide variety of sectors beyond global equities. Reference was made to regional equity mandates, bonds and alternatives.

However, there are still significant commercial opportunities for the investment management sector to deliver new products filling the gaps.

ESG investment strategies are now quite common across the asset management industry. Their analysis focuses on the operational side of a company and aims at selecting those companies that are taking environmental, social and governance considerations the most seriously. This is very different to impact investing where businesses are looking to make a positive impact on society and the environment through their products and services.

A product cannot be labelled 'impact', according to the definition provided by GIIN[2], if it does not actively seek to measure and report on its social and environmental performance.

Impact investment offers the potential for substantial financial returns, however, historically such investments had only been suited to higher net worth investors.

Over the last few years, we have seen a democratisation of impact investing with a fast-growing number of investment funds focusing on making a positive impact on society and the environment.

Discussion points:

"What measures can be taken to ensure these impact funds are doing what they say they are?"

"How can we assess the potential for investment managers and their products to deliver positive social and environmental impact?"

"How does the institutional investment sector approach this subject?"

- Despite a growing amount of literature explaining the different forms of sustainable investing, there was consensus that, to guide investors, there needs to be better categorisation of funds which claim to offer impactful outcomes.
- Some perceive that a significant portion of ESG/Impact funds are unable to prove their claimed positive outcomes, making it hard to justify the fees charged.
- To transparently demonstrate impact within their funds, asset managers need to declare the impact achieved at the portfolio level, not cherry pick only a few holdings or case studies.
- The FCA has published proposed rules and guidance designed to improve disclosures within the industry, so that investors have all the necessary information to assess products. This will include the social and environmental impact achieved by those products.
- The growing requirement for evidence of an active stewardship function reflects that the purpose of asset managers should be much wider than purely a market participant focused on fiduciary duty in a traditional sense.
- Impact funds, when offered by asset managers alongside an investment approach which integrates ESG across all

[2] Global Impact Investing Network

their funds, should also result in a stewardship function which seeks evidence of positive impact vs ESG factors/SDGs from investee companies.

- There needs to be a balance between encouraging innovation in product development and protecting customers.
- Impact investing cannot be done in a passive way. It takes an active approach to investment management. Value must be clearly evidenced to justify the higher associated fees.
- It is crucial to seek out managers who can evidence systematic integration of ESG factors into the investment process. Robust proprietary analysis should be used in conjunction with that of external data providers.
- Seeking evidence of strong ESG integration can be a means of selecting investment managers, as opposed to looking for specialist products. Recognising impact in this way represents good investment process, which could then drive positive impacts across a much wider asset base.

The institutional view:

- There are catalytic factors driving change. These take the form of regulatory changes to influence behaviour, demographic changes of beneficiaries, and the quality of ESG data available to underpin decisions and validate investment processes.
- Opinion remains mixed among the asset owner community. This is even more marked when looking beyond the UK at the global market.
- There is a trend of seemingly innovative products being launched which then fail to deliver. There is often a gap between the language used in the marketing and the portfolio construction process.
- Ethically conscious clients, such as charities, are now moving away from an exclusion-based approach, in favour of trying to achieve positive impact through their investments. But they are finding it difficult to demonstrate impact in a compliant way to their trustees.

Concluding comments

Regulation aimed at creating a more sustainable financial system is seen as a key source of political capital, at both the EU and national level. This regulation will continue to grow in scope and detail. It will seek to force the issue further into the public consciousness and drive investors of all shapes and sizes to publicly acknowledge the environmental and social impact of their investments.

Research clearly shows that there is money to be made through effectively engaging with individuals to discuss the impact of their investment choices. For the most innovative organisations the rewards are even greater; Products which focus on a specific issue (NAACP Minority Empowerment ETF), theme (Green Climate Fund), or region (East London Impact Fund), generate on average four times the levels of investment that more general impact funds attract, and even higher levels of persistency. In fact, impact-aligned investment products could be the desperately needed catalyst to drive increases in household savings and help offset the looming pensions savings gap crisis.

However, we cannot educate if the educators are confused. There is a pressing requirement for greater consensus on taxonomy to remove barriers to increased investment flows into impact aligned products and strategies. It is not performance concerns that are holding most investors back, but the perceived vagueness and lack of consistency in ESG/Impact products. Products and portfolios that deliver competitive rates of return while transparently evidencing net positive impact will be of great value to those who can produce them at scale.

There is also a philosophical question for investors to grapple with: is impact investment merely an allocation within your existing portfolio, or is it an acknowledgement that all investments have consequences? From this event, it was clear that recognising impact across the entire portfolio represents both a fundamentally sound investment process and a means to engage in a deeper, more meaningful way with clients.

Our research shows that the commercial opportunities for those firms who invest in developing their capabilities to take advantage of this triple helix of rapidly changing environmental, social and regulatory drivers are significant. Furthermore, the demographic backdrop intensifying the evolution of how individuals view their investments is extraordinary.

The risks of not preparing for the impending changes are potentially even greater. There is a widespread feeling that the investment industry needs to be rehumanised to ensure its ongoing relevance and utility. Recognising the environmental and social impact of all investment decisions, as opposed to viewing impact investing as a niche product type, represents an incredible opportunity to do just that.

Ian Povey-Hall

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We provide global financial institutions and investors access to the most established network of sustainable & impact investing talent, helping our clients build teams that not only outperform the markets, but also support the transition to a sustainable economy.

Get in touch to discuss team structures, hiring trends and compensation levels across the sustainable and impact investing landscape:

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Note Taker: **Edward Boyd,** Vice President, Energy and Sustainability Club at Imperial College Business School

Suggested reading

UK Green Finance Task Force

Final report of the High-Level Expert Group on Sustainable Finance

Tribe Impact Capital - 'Investing for Humans'

Barclays - Motivations for Impact Investing

Fund EcoMarket

FCA - response to Law Commission recommendations on pension funds and social investment

EQ Investors - Impact Report

The Impact Management Project

Aon - Global perspectives on responsible investing

FCA & The Pensions regulator - Joint regulatory strategy

Law Commission - Fiduciary Duties of investment Intermediaries

The IFC - Operating Principles for Impact Management

GIIN - Roadmap for the Future of Impact Investing: Reshaping Financial Markets

Hermes Investment Management - Impact Investing Made Simple

Independent report: Growing a Culture of Social Impact Investing in the UK

UNPRI - Impact Investing Market Map

CONSCIOUS INVESTING - Practitioners' views on holistic investing approaches that benefit people and the planet