1 March, 2019

Jess Foulds
The Investment Association
Camomile Court
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London
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Email: jess.foulds@theia.com

Dear Ms. Foulds,

CFA UK response to the Investment Association's consultation on sustainability & responsible investment

The CFA Society of the UK (CFA UK) is pleased to have the opportunity to share its views on the Investment Association's ("IA") consultation paper on sustainability & responsible investment.

As the introduction to your consultation paper references, sustainable and responsible investment is an increasingly significant area of policy for the investment sector. Given the growing interest shown by consumers and policymakers, it is important that there is clarity and distinction around the way in which these investment products are described. In this regard, the CFA UK applauds the IA's leadership in this area and the intent to encourage the development of both a common set of definitions and, potentially, a UK label giving recognition to those firms and funds understaking sustainable and/or responsible investing.

CFA UK recognises the growing importance of the markets for sustainable and responsible investment and is playing an increasing role in contributing to the integrity of these markets. This year CFA UK is to launch its ESG (Environmental, Social and Governance) qualification[1]. This aims to equip UK investment professionals with the necessary basic skills and knowledge to integrate ESG issues into their day-to-day roles.

Before commenting on the individual questions in your consultation paper, we want to raise a specific concern. Whilst we do not question that the IA is the appropriate body to coordinate the development of definitions and the possible development of a product label, the IA is not the only stakeholder in these debates and the nature of the IA's own governance means that it would not be the appropriate body to govern definitions and/or a product label. This consultation may be a useful exercise in understanding and helping to aggregate IA member views, but we do not believe the IA could or should unilaterally impose definitions and labels around sustainability and responsible investment. Any work towards that valuable end would best involve a broader set of stakeholders including NGOs, government observers, professional bodies and data providers.

[1] https://www.cfauk.org/esg

Through this consultation, the IA is already demonstrating its leadership in the area of sustainable and responsible investment. The association's reputation in this field would be further enhanced if it makes clear that the end-purpose of this exercise is the establishment of an independent body to govern definitions and label management.

In responding to this consultation, CFA UK would lastly wish to caution that the addition of a label, supported by clear definitions, must not in any way lead to confuse end-investors about either the investment risks or the historic returns that these funds respectively carry and achieve. Indeed, the more clarity and transparency that can be brought to risks and returns, especially over the longer-term, the better informed end-investors will be about the choices that they make or that are made on their behalf.

BACKGROUND: (Questions 1-3)

Please see the Appendix for a profile of both CFA UK and CFA Institute which also addresses the background questions in your consultation paper.

THEME A: SRI Definitions (Questions 4-8)

Qu4. Do you have any comments on any of the definitions as set out in this consultation document? In particular, we invite views on the proposed definition of 'impact investing'.

- We commend the IA's committee for the clarity and brevity of its proposed definitions. It is difficult to arrive at definitions that distinguish different approaches and the IA's consultation does this well.

- As regards the definition of "Impact Investing", we would propose to express this slightly differently (see underlining below) to make it clearer that these investments pursue a single investment objective – i.e. to generate financial return alongside positive, measurable impact. In addition, we believe that it would be helpful to incorporate intentionality into the definition. Impact investments have traditionally been seen as requiring intentionality (an *ex ante* stated purpose), additionality (making a difference) and materiality (the significance of the effect).

  "An investment approach where investments are made <u>with the intention</u> to generate positive and measurable social and/or environmental impact alongside a financial return. Impact investing approaches can deliver <u>above-market rate or</u> market rate returns, but they might also deliver, below-market rate returns dependant on the particular (balance of) objectives (financial and non-financial) expressed by the client".

- CFA UK has no other comments on the definitions provided, other than to note that the list is described as "non-exhaustive" and so makes room for other definitions to be added.

Qu5. Do you agree with the top-level split between "sustainable investment approaches" and "sustainability funds/mandates"?

- Yes, the definitional split makes sense.

- However, whether we agree with it depends on the purpose to which it is intended to be used. CFA UK would have concerns if the intention was for these definitions to be then incorporated into and used as the structure for your consultation's theme B - the possible product label.

- CFA UK sees the potential for clients to be easily confused/green-washed. For example, if (say) a <u>firm</u> were to adopt "a sustainable investment approach", but continued to offer <u>some</u> funds that were not "sustainability funds/mandates", how would those funds (that were <u>not</u> sustainability funds) be labelled and marketed? If they were labelled as having a "sustainable investment approach" (based on the firm's investment process), we have concerns that clients could confuse that with the "sustainable funds" label and believe that the actual funds followed a sustainable or responsible investing mandate (when in fact they would not).

Qu6. Do you agree with our categories as they appear at the next level? i.e. "Stewardship/Active Ownership", "ESG Integration", "Negatively Screened Investments", "Positively Managed Investments" and "Impact Investing".

- Yes, other than to point out that, at the firm level, "Stewardship/Active Ownership" and "ESG Integration" are not exclusive - a firm is likely to combine both of these categories in a variety of different ways for different products. Again at the firm level, it also seems to us that "ESG integration" is possibly more widespread than "Stewardship/Active Ownership", so it might make sense to list that first.

Qu7. Do you agree with our categories as they appear below "Positively Managed Investments"? i.e. "Thematic Investing" and "Best-in-Class".

- We do not see impact investing as a form of positive screening. Impact investing is a different form of investment where the intended output is not solely a positive financial return, but also an intended, measurable impact on a social or environment factor, such as one or more of the UN's Sustainable Development Goals.

Qu8. Please provide any additional comments you may have.

- We have no additional comments.

THEME B: Possible Product Label

Qu9. Do you think the UK market needs a label? Please give your reasons.

- Retail investors express interest in sustainable and responsible investments, but they find it difficult to distinguish between strategies and approaches. Also, platforms and advisers find it difficult to direct clients to products that will meet their needs. Labelling which makes it easier for consumers and distributors to see the different kinds of sustainable and responsible investments that are available could build confidence by giving consumers and distributors clear guidance about the nature of the different investment opportunities.

- Claims that the UK retail funds market is plagued by funds pursuing greenwashing practices are both long-standing and intensifying as sustainable and responsible investing moves more centre-stage[2]. This points to a need for labelling, provided it is well-governed and with robust oversight. To prevent mis-selling, we need to educate consumers about the different types of sustainable and responsible investments that are available to them. A labelling system accelerates that process and makes it more accessible.

- The UK retail market might trust a UK label more than one from an international provider. Assuming Brexit proceeds, this is possibly another reason to support the UK having its own label. In the long-term, we would hope that best practice would converge amongst the different label-providers across Europe and worldwide and that, whilst the UK label might be retained for products distributed in the UK, there would be a global organisation behind the governance of it.

Qu10. Do you support the IA producing such a label? Please give your reasons.

- No.

- CFA UK believes the IA should play an important role in the development of a labelling system but should not be responsible for its governance. The IA's own paper acknowledges the importance of good governance, alongside compliance and verification processes.

- CFA UK recommends that the IA should work with the regulator and other stakeholders to establish an independent governance group to oversee the development of the labels, assignment of the labels and firms' continuing right to use the labels.

- The IA would find it difficult independently to undertake the actions that will be required for consumers and others to build and maintain confidence in labels.

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[2] https://www.investmentweek.co.uk/investment-week/opinion/3019330/industry-greenwashing-threatens-credibility-of-responsible-investing

Qu11. Do you agree that any label should be voluntary with the possibility of an additional verification process? If not, please outline your reasons and, if possible, suggest an alternative approach.

- CFA UK would not support a voluntary label without sufficient verification checks in place. We believe the distinction between a "voluntary" label and a "verified" label would be lost on the average UK retail consumer. Over time we would have concerns about the label itself becoming tainted and at risk of abuse.

- In our opinion, the label provider would ideally establish an on-line portal through which applicants could submit the necessary materials to support their submission. This would ensure a stored inventory of data for audit purposes. A help-desk resource would probably be necessary, especially in the initial phase, to support applications. The label provider should then either have sufficient resource to assess each application or at least to sample-check a sufficient number of applications on an ongoing and revolving basis. Decisions around treatment of firms that are found to have used the label but (either inadvertently or deliberately) been in breach of the required standards would need to be subject to robust independent governance.

- To prevent the costs associated with establishing and running this infrastructure becoming a barrier to entry to smaller firms in the sustainable and responsible investment sector, we would recommend that these costs are defrayed not entirely as a fixed cost, but instead proportionate to the size of the fund or firm applying for the label.

Qu12. Do you agree that the UK retail market should be the target audience? If not, please outline your reasons and, if possible, suggest an alternative approach.

- Largely. The institutional market is generally better-equipped to undertake its own (or advised) due diligence on an asset manager's investment process, though it would nevertheless benefit from the uniform framework that a label would bring, especially one supported by third-party verification.

Qu13. Do you agree that we should develop two separate labels – one for sustainable Investment Approaches and one for Sustainability funds and mandates? If not, please outline your reasons and, if possible, suggest an alternative approach.

- We believe the label would best operate at a fund level. If labels were to be given at both the fund- and firm-level then great care would need to be taken to provide clear distinction between the two labels and so avoid the situation we outline in our answer to question 5.

Qu14. Given the proliferation of labels across Europe, what would make you choose this label over other competing labels from other European countries?

- No comment.

Qu15. Do you agree with the measures of success as we have outlined them?

- No.

- Applying market forces – the number of funds and the AuM related to them - to be the measures of success has some merit. Left on their own, however, there is no check-and-balance to ensure the quality and rigour behind the label.

- To underline this point, a label which was voluntary, relatively easy for asset-managers to secure, inadequately policed and insufficiently robust in measuring and auditing real sustainable and responsible investment might be very successful in signing up a large number of funds and AuM, but it would have utterly failed in its core purpose and indeed compounded the problem which it set out to address.

- While we agree that the adoption rate is a valid measure of success, we disagree that success should be measured on asset flows. It is arguable that relative flows between funds holding the label and those not carrying the label might be a valid measure of success, but we would also argue against that.

- The correct measures of success would be changes in the confidence of consumers in their understanding of what the label is telling them and their interest in investing in sustainable and responsible investments. The correct measure of success would be an increase in these rates over time with no specific periods in which the measure declined year-on-year.

- The purpose of this activity should be to build and protect the integrity of these new markets in which the UK has the opportunity to play a leading role. Increased asset flows should be the outcome, but not the aim.

DISCLOSURE: (Questions 16-32)

Please see the Appendix for a profile of both CFA UK and CFA Institute which explains we are a professional organisation rather than an investment firm and hence not in a position to answer these questions.

With regard to questions 29-32 relating to the UN SDGs, CFA UK has looked at this particular topic in the past and would say that, whilst we recognise the UN SDG's importance at a national and international governmental level, we do not believe they are readily applicable as an measurement tool for investors.

We are grateful for the opportunity to respond to this consultation. Should you wish to discuss our answers, please get in touch. This is a subject of high importance for CFA UK.

In compiling its response to this survey, CFA UK has not surveyed its membership.

Yours sincerely,

Will Goodhart,
Chief Executive
CFA Society of the UK

Andrew Burton
Professionalism Adviser
CFA Society of the UK

With thanks to contributions from the CFA UK Professionalism Steering Committee

CFA Society
United Kingdom

About CFA UK & CFA Institute

CFA UK: serves nearly 12,000 leading members of the UK investment profession.

- Its mission is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests.

- Founded in 1955, CFA UK is one of the largest member societies of CFA Institute (see below) and provides continuing education, advocacy, information and career support on behalf of its members.

- Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute: is the global association for investment professionals.

- Its mission is to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society.

- It awards the Chartered Financial Analyst® (CFA), and Certificate in Investment Performance Measurement® (CIPM) designations worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.

- As of 1st February 2019, CFA Institute has more than 165,000 members in 162 markets, of which more than 160,000 hold the Chartered Financial Analyst® (CFA) designation.

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