Diverging opinions on standardised reporting

In November, **Tell Media Group**, in cooperation with **Federated Hermes**, **Impax Asset Management** and **Stewart Investors**, organised a roundtable discussion in Oslo with Norwegian investors, focusing on impact investments in listed equities. Tell Media Group founder Niklas Tell moderated the discussion.

By: **Niklas Tell** Photo: **Christer Salling**

The discussion started out with Niklas Tell asking the investors how they would define impact investing and to what extent terminology is a challenge.

GEORG SKARE LUND: "We have a fairly narrow definition of what impact investing is. In short, it should be an investment that contributes to a better world in a positive way and we think it should satisfy a few criteria. One is materiality. Another is additionality – it should facilitate something that's not already covered in the market and we also think there should be an intention behind it. We also think that it should be possible, at least conceptually, to measure."

LARS ERIK MANGSET: "The term impact investing has been narrow for a long time and especially this aspect of additionality has been a strong criteria that has been central to the attention. However, I think that the term is up for revision. When we're talking about more traditional impact investing, typically in the unlisted space, I think that the definition holds. What we're seeing though is this more general aspect of creating a relationship between corporate action and what the investors are working for. With the ESG backlash we're seeing, I think it's increasingly important for investors and asset managers to be clear about the intention of what's being done. Is it about reducing volatility and financial risk or are you trying to contribute to something positive? I think it's especially important to be very clear about what you mean when talking about impact, especially in the listed space. Here, I think we should distinguish between impact alignment and impact generating. The impact generating investments would be the stuff that's additional whereas impact alignment will be more relevant in the listed space. In essence, it's the companies that are generating the outcome and as an investor you align yourself with that outcome. I think it's a very interesting terminology and it's also actually a draft from Eurosif, which is looking into a classification system for sustainable investments."

PER KRISTIAN GILLESHAMMER: "I would like to challenge some of the points that have been made. Firstly that there needs to be an intention behind it. Principally, I agree but impact is impact whether or not the intention behind it was there in the first place, so intentionality would be the first criteria to go in my mind. Also, I like the nuance you're making regarding generating and aligning. But I think the intended end result is the same – so it's simply different routes to get to the same end goal."

LARS ERIK MANGSET: "But when we're talking about impact investing, it implies that you're doing something as an investor. You will have companies that will generate the outcomes and then you have to ask yourself if they will do it with or without you. When you bring that perspective into the equation, I think that intentionality will be relevant."

MARTIN TODD: "I would make a differentiation between investing in companies that are having impact today – you can call that enterprise impact or company impact – and the investor impact. For the latter, it's about the impact you're having as an investor, which could be an impact on the cost of capital for example. For this, engagement over time is critical. When it comes to the terminology, I don't think it has been quite as warped as ESG as a term has been. I think most people have a pretty reasonable grasp on what impact is whereas I think there's still a huge amount of confusion when it comes to ESG and sustainability in terms of different interpretations."

BARBARA HEAP: "We believe that you need to have intentionality and also that you need to be able to quantify it. We've been providing measurement of impact for the past seven to eight years and we even have that externally verified. Additionality is a trickier question. On the private equity side, there's no question that we have additionality because we're financing projects that wouldn't exist if we weren't backing them. It's less clear cut on the listed equity side and I think it's more about being aligned, as Lars Erik mentioned earlier. But we should not underestimate the impact we can have on firms through engagement."

NIKLAS TELL: SO IS THE CHALLENGE NOT SO MUCH THE TERMINOLOGY AND DEFINITIONS BUT RATHER THE MEASURING AND REPORTING?

CHRISTOPHER MCGOLDRICK: "Listening to our discussion, I actually feel sorry for savers. As an industry, we're creating words that are essentially meaningless. What we're aiming to do is to enlarge people's purchasing power through investing in companies that are doing something good for the world. With regards to the term impact, I feel quite cynical. In an industry such as ours, it's often used for asset gathering and as a marketing tool rather than something that should be integral to the investment process. What we're really saying is that we're looking at a range of problems that the world faces and we then supply capital – people's savings – to help companies solve these problems."

LARS ERIK MANGSET: "I would like to come back to measuring and reporting because it's often not done in the way it should be done. The way it should be done is by looking at the chain of events of inputs, activities, outputs, outcomes and then impact. As opposed to ESG which rely on policy and processes associated with outputs, impact must focus on outcomes, which are more controllable and measurable than the potential impact that spins off from the outcomes. It's important that we do these measurements in a trustworthy, credible and transparent way that gives the necessary confidence to the investors that they're actually contributing to something. Sometimes you may need a more qualitative sort of reporting but other times it's very measurable. If you're replacing diesel generators with renewable energy and energy storage solutions at certain hospitals in sub-Sahara Africa, you can absolutely measure the outcomes of that intervention."

CHRISTOPHER MCGOLDRICK: "What you're saying is that you're trying to separate the wheat from the chaff and establish authenticity of the outcomes. We're firm believers that not everything that can be measured is worth measuring

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Head of manager selection at Storebrand Asset Management. He joined the company as a management trainee in 1996 and was involved in starting up the unit-linked business of Storebrand. He has held different positions relating to long-term saving and worked in the manager selection unit since it was established.

LARS ERIK MANGSET
Head of sustainable finance at Grieg Investor. He joined the consultancy earlier this year from a position as chief advisor climate change at KLP. He has previously worked as an applied researcher and industrial consultant at Det Norske Veritas and also as a biodiversity officer at WWF.

and vice versa. It comes back to the narrative about an investment and being held to account by investors. We would rather explain our actions in a narrative than coming up with a nice graph for the purposes of marketing."

GEORG SKARE LUND: "Not being able to quantify can mean two things. One is that you don't have the numbers that you need and that can be ok. But it's worse if you don't know what numbers you need."

BARBARA HEAP: "We look at impact as an outcome of the investment process and spend a lot of time on quantifying the impact that the companies in the portfolio have and I think that's a key differentiator. As we've mentioned earlier, if you're investing in listed equities, your investment is not necessarily providing additionality but what we're doing is measuring the impact of the products and services that the companies are producing. We look at the carbon they use and the carbon they avoid. We look at water treated and saved use and the amount of materials recovered and waste treated. In terms of data, we don't have data for every single company but we engage with those companies to improve the data and there's a positive feedback loop because as they become more aware of what investors want, they seek to improve their own operations. We have a separate team that work with measuring and reporting. It's labour intensive and it does take up a lot of time but the positive feedback loop is there."

PER KRISTIAN GILLESHAMMER: "What I'm hearing is this: we can't measure it perfectly so why measure? It becomes a case where the perfect is the enemy of the good enough. I think you have to start somewhere and then you get that positive feedback loop."

MARTIN TODD: "We've been measuring the impact from the companies in our portfolio for the last three years. It's an evolving process and we will continue to refine it because we find it very useful for monitoring the progress these companies make across different sustainability themes. And as Barbara mentioned, the feedback that we can bring with us into the engagement process is very important. When it comes to industry standardised metrics on measuring impact, I think that's years away so we will just continue to refine what we do and try to get better."

NIKLAS TELL: ARE STANDARDS EVEN SOMETHING DESIRABLE OR IS IT BETTER THAT EACH ASSET MANAGER EXPLAINS WHAT THEY DO? OR WOULD YOU LIKE AN ARTICLE 9 SO YOU CAN JUST CHECK THAT BOX?

MARTIN TODD: "This of course opens up a larger discussion about SFDR. I think the risk with these frameworks is that it implies that one size fits all. It's yes or no when there's just so much more nuance to it and I'm not sure how impact measurement standards for the industry would look like. I think the most important thing is transparency and disclosure and the onus is, of course, on the portfolio manager. I should be able to explain the process to ensure that the end investor understands how the money is being managed."

LARS ERIK MANGSET: "I don't think it would be a good idea to try to standardise the impact matrix itself but I think it would be good to at least have some standards as to how you assess the impact. It should not be prescriptive. You can take an analogy from critical safety regulations. It used to be all about a check list that you needed to go through. We've moved away from that to a more goal-based or functional-based regulation where each actor needs to provide an argument on how they fulfil that goal. I think some of the same thinking can be used for standardising impact measurements. Basically saying that to assess impact, there will be certain standardised steps that each manager would need to be transparent about but that the outcomes and impact effects are recognised as being case-specific in many instances."

CHRISTOPHER MCGOLDRICK: "We believe in radical transparency and that's why we list all companies that we hold in each of our strategies. We also point out what issues we might have with each company and what engagement we're doing. When it comes to standardisation, I wonder how that should happen in an industry such as ours when we can't even agree on a common definition of profit after tax."

PER KRISTIAN GILLESHAMMER: "You said earlier that you feel sorry for the savers out there because they would not be able to follow our discussion. Wouldn't some sort of standardisation help in that process?"

CHRISTOPHER MCGOLDRICK: "Possibly but ultimately I think standardisation leads to gaming and companies trying to find a way to come out better within that system. I think the best solution for savers would be to have total transparency and for savers to ask questions."

GEORG SKARE LUND: "I agree with you. I also think that standardising the measures of impact would be dangerous because then you would have retail investors looking at that measure to decide which fund is the best based on those numbers."

LARS ERIK MANGSET: "I'm curious to hear what you're doing, Barbara, because you seem to have some sort of standards when you measure impact."

BARBARA HEAP: "We focus on key indicators but we come up against all of the issues about standardisation because companies report in different ways. I agree with Martin and I do think we're years away from having a standardised reporting. Some things are also very difficult to standardise – especially when it comes to social impact. I also think it may help in terms of educating investors to gain a better understanding of what they're investing in. Being 100 per cent transparent is one way to go but I'm not sure that investors have the time or appetite to dig into every single fund, so maybe we need to meet them halfway by providing them certain types of standardised reporting."

PER KRISTIAN GILLESHAMMER: "Maybe the most standardised measurement is greenhouse gases and I don't know if we will be able to manage 1.5 degrees but the movement we're seeing now would never have been possible without greenhouse gas accounting. Counting, evaluating, setting targets and having numbers to relate to is critical. You can be as transparent as you want but if you don't have the numbers and the standards, we would not have the movement that we have today."

NIKLAS TELL: ARE WE REALLY TALKING ABOUT ENVIRONMENTAL IMPACT WHEN TALKING ABOUT IMPACT INVESTING?

LARS ERIK MANGSET: "Historically, I think it was more social impact with microfinance and things like that. Now we also see a lot in the climate space with a focus on biodiversity, so today I think the focus is on social and environmental issues. Not very much on governance, however."

BARBARA HEAP: "For us, impact is separate from ESG and governance issues would fall under ESG. It again comes down to intentionality. That said, every company should be measured on ESG factors and every company should be engaged with on their ESG."

CHRISTOPHER MCGOLDRICK: "Would you be able to invest in a company that has great impact but terrible ESG?"

BARBARA HEAP: "No. We have the minimum criteria that

ROUNDTABLE – IMPACT INVESTING

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Lead portfolio manager of the sustainable global equity strategy and co-portfolio manager of the impact opportunities strategy at Federated Hermes. He joined the firm as a senior analyst on the European equities team in 2013. Prior to that, he was an investment director at Scottish Widows Investment Partnership.

CHRISTOPHER MCGOLDRICK
Senior investment analyst at Stewart Investors. He joined the team in 2013 having previously worked for a London-based investment bank where he was a research sales specialist in Asian equities. Before that, he worked as an analyst at Baillie Gifford and Edinburgh Fund Managers.

BARBARA HEAP
Portfolio specialist at Impax Asset Management. She joined Impax in 2020 from JPMorgan Asset Management. She started her career in 1989 at Nomura Research Institute and moved into asset management at Clerical Medical Investment Management and then British Airways Pension Investment Management.

we follow and one example in Tesla. It's obviously having an impact on the electrification of the car industry and cleaner transport but the company doesn't meet our ESG criteria. To us, it's two separate things. The sustainability aspect is what a company does and ESG is how it does it."

PER KRISTIAN GILLESHAMMER: "I would say it's definitely very much about climate and biodiversity today and the reason is that it's a burning issue for the planet right now. There's a reason why the green taxonomy is out there already moving ahead, while the social taxonomy is postponed. I don't know about the other's viewpoints on the taxonomy but I'm a huge fan and I'm sad to see the social taxonomy not getting the traction it needs."

MARTIN TODD: "I think this to some extent reflects the fact that we can agree globally that carbon emissions is a fairly good indicator for environmental issues whereas social issues tend to be a bit more local when it comes to what's relevant. However, to us these social and environmental issues are intricately linked. What's important environmentally will have a bearing on society and the other way around as well so we consider them all pretty important. One reason why there's more focus on environmental issues is that it tends to lend itself to quantification more easily. There's just more agreement about what's important."

GEORG SKARE LUND: "We've also talked about the importance of providing a financial return so we sometimes see familiar, big index names in impact funds, such as Microsoft or Alphabet. You could argue that it provides digital inclusion but if they intentionally believe that or if it's an excuse to have a big benchmark name in the fund, I don't know."

BARBARA HEAP: "We have Microsoft in one of our strategies and it has been included in the environmental markets universe. The reason is the resource efficiency of using some of their products. So it's not about 100 per cent of their business but rather specific parts of its business. And jumping ahead to a different question about small versus large caps, it's clear to us that smaller companies can be good at providing information about the benefits of their products because they're very focused on a specific product and have thought quite a lot about the beneficial impact of these products. Not in order to being able to report to investors but really to explain to their clients what those products are aiming to do."

NIKLAS TELL: IS THERE A BALANCE BETWEEN THE FINANCIAL RETURN AND HOW MUCH IMPACT YOU'RE GETTING AND DO YOU HAVE TO CHOOSE ONE OVER THE OTHER?

BARBARA HEAP: "For us, it's the financial returns. We start by defining the universe so we know that these companies are investable. Then we do our ESG analysis, which is a second hurdle, and from that point we focus on building a portfolio that provides the best financial return. So impact is not the target but we do believe we're impact aligned – to use the terminology discussed earlier."

LARS ERIK MANGSET: "If you look at the fund space, I think you will see both. There are areas where you will have an impact without sacrificing returns, such as impact funds where blended finance structures are in place coupled together with actors with proven track records. But of course, we have also seen the contrary, such as funds operating in high impact areas such as sustainable agriculture in sub-Sahara African countries or funds that aim to halt deforestation. These funds sometime give less competitive financial conditions but compensate for that by providing clear and credible impact change theories. So it may sometimes be the case that you need to sacrifice a little bit when it comes to returns but that doesn't mean investors don't reach their financial targets."

CHRISTOPHER MCGOLDRICK: "To your question if there is a trade-off, I would say not at all. We started in 2005 with a firm believe that sustainability would be the driver of financial returns."

LARS ERIK MANGSET: "But that assumes that there's always a commercial driver for impact and that's not the case. Take the example of removing plastic from the ocean – then you don't necessarily have that that strong correlation."

CHRISTOPHER MCGOLDRICK: "I would disagree because if you don't take care of that, there's a risk of a liability in the future. The same goes for food companies that have been using too much sugar and are now facing a sugar tax. It's a financial issue and it's about reducing future liabilities."

GEORG SKARE LUND: "When we talk about the financial return, it's on the one hand about the profitability of the company but for an investor you also need to take valuations into consideration. At least if you're an active investor. Even if you find a great company or sector, the price could be too high, so that also matters when you invest."

CHRISTOPHER MCGOLDRICK: "I agree and we hate to overpay. We're very Scottish about that."

PER KRISTIAN GILLESHAMMER: "In the literature, you divide ESG into ESG 1.0, ESG 2.0 and ESG 3.0 where the first is investments with a little bit of ESG on the side. ESG 2.0 would be a 50/50 split with returns on the same level and then 3.0 is impact at the cost of financial returns. At KLP, our core functionality is securing future pensions and we would certainly do investments that would touch the 3.0 space. But for the majority of our portfolio, we could never move beyond 2.0 and I assume it's the same for any investor with a fiduciary duty to maximise the value for stakeholders."

NIKLAS TELL: BARBARA, YOU MENTIONED EARLIER THAT THE IMPACT MEASUREMENT TAKES A LOT OF TIME. ARE THESE STRATEGIES MORE COSTLY IN GENERAL?

BARBARA HEAP: "It's time consuming but I wouldn't say they're more costly. We have a separate team that works on the reporting and measuring. It's an outcome of the investment process, so it's not our investment team that measures it."

GEORG SKARE LUND: "So you're a specialist boutique and focused on these issues but you're also competing with larger firms. I assume you would argue that you provide a different service?"

BARBARA HEAP: "I think we provide additional reporting to the financial reporting and this helps our investors to see much more of what the investments are doing. But you're right, we're not competing with passive strategies. We're competing with other active strategies. So the price is higher than for a passive strategy but not because we run an impact strategy. It's because we're active managers."

GEORG SKARE LUND: "But the additional reporting will come at a cost."

BARBARA HEAP: "I'm not sure that I agree with that. It's undeniable that we have a team but it's not a significant part of our overall costs, so I'm not sure I would say that it's costlier when you consider the other benefits."

NIKLAS TELL: MARTIN, I ASSUME THAT YOU'RE PROVIDING SOME REPORTING AS WELL. WHAT'S YOUR TAKE ON THIS?

MARTIN TODD: "Investors obviously need to pay attention to the fees they're paying. I think some of the more cynical players in the industry have used ESG and sustainable investing to justify charging a lot more. We don't charge any more for an impact fund compared to one of our 'normal' equity funds."

BARBARA HEAP: "And regulators are paying more attention as well. Regulation is moving to require additional reporting and we've already baked that into our business."

NIKLAS TELL: AS INVESTORS, IS THERE ANYTHING WHEN IT COMES TO REPORTING THAT'S CURRENTLY LACKING?

LARS ERIK MANGSET: "I think transparency is really key for us to understand the methodology and to really understand how an asset manager is thinking around impact. Let's take the example of avoided emissions, which is something that's frequently used – whether it's renewables or technology. When we receive a presentation about that, everything goes back to a baseline assumption and then thanks to this or that emissions will be reduced by say 30 per cent. Now, if there's anything we know for sure it's that the baseline is wrong. We then need to understand the reasoning of how they come up with the baseline that's being used. What are the assumptions and are these reasonable assumptions? Just getting a number for avoided emissions is good for illustration purposes but it's not enough. We need to get the same understanding as the asset manager and that goes back to transparency."

PER KRISTIAN GILLESHAMMER: "I would like to go back to the discussion of quantifying and standardising impact measurements. I know that there are mixed feelings about standardised impact reporting in the room but the market wants it. The current jungle of impact reporting makes it impossible for someone like me to aggregate it up from several funds to one large portfolio consisting of several funds. That's why the taxonomy is such a welcome addition. What does it mean to be taxonomy aligned? I don't know and I've spent countless hours on the taxonomy. But at least there's agreement out there that being taxonomy aligned is a good thing and that's making the economy fit for 2055."

CHRISTOPHER MCGOLDRICK: "I just think the taxonomy ignores nuance. For us, investing is very much about nuances and operating in the grey areas. It's often not black or white. One reason for why we've got so many taxonomies is that regulators like to regulate."

NIKLAS TELL: WHAT HAVE YOU SEEN IN TERMS OF AN ESG BACKLASH? COULD THAT EVEN BE A GOOD THING FOR IMPACT INVESTING?

LARS ERIK MANGSET: "We've seen this huge increase in the interest for ESG and sustainability and for many years, green funds were also performing very well. That led to many just jumping on the train without actually looking under the hood. Now when they're looking under the hood, they realise that ESG doesn't have a direct connection to outcomes. It's not even part of the mandate of the ESG data providers to have an idea on outcomes and this takes us back to the late 1990s or early 2000s when it wasn't called ESG. It was called non-financial risk management. I think for many of us who have been working on this for a long time, we're not surprised. But to your question – yes, I think it's very positive for impact because impact has always been impact."

NIKLAS TELL: IS THE REASON BEHIND THE HEADWINDS THAT IT WENT FROM ESG INTEGRATION AND RESEARCH AND INTO PRODUCTS AND MARKETING?

MARTIN TODD: "I think it's a case of misunderstanding the role ESG plays in investments. One example was the tweet Elon Musk sent saying that ESG is a scam because Tesla was kicked out of an ESG index in favour of Exxon Mobil. That's a classic misunderstanding of the role that ESG plays in investments as an input. It's about understanding the risks and the operations of a business. ESG is not an investment approach but rather an input to an investment process."

NIKLAS TELL: IN ESSENCE, YOU SHOULDN'T NEED TO CALL IT SOMETHING SPECIAL.

BARBARA HEAP: "Correct. It's just part of the investment process. We don't think of ourselves as an ESG fund and as I've already explained, we think sustainability is what a company does and ESG is how it does it. There's always a risk when you start to label things and I think it's critical that we as managers understand our obligation to explain to investors what we do and how we do it."

LARS ERIK MANGSET: "I think a positive aspect is that this area has gained a lot more attention and it's likely to become more complicated for managers to make claims without them being contested. I think we're moving into an era where you will be contested much more, which should result in asset managers being more careful. Hopefully that will also increase the quality of the work."

PER KRISTIAN GILLESHAMMER: "Earlier this year, I had a meeting with the consumer supervision authority with regards to marketing. Their message was that we need to stop using words such as green, sustainable and climate friendly – a long list of very common terms used by marketing – and they said if you say that you are climate friendly, describe exactly what you mean by that. I think that's refreshing for the whole financial system."

MARTIN TODD: "I'm optimistic. I have filled out a lot of these SFDR documents and it puts a huge amount of onus on the manager to make claims on sustainable investment. I think any manager that looks at that might take a step back from making too strong claims and I think we will see less greenwashing in the future on the back of that." ●