

INSIGHTS FROM CFA SOCIETY SINGAPORE

Words matter: Setting standards for responsible investing terms

Inconsistent terminology creates problems for investors, asset managers and regulators



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INNOVATION often comes with new words and terminology; developments in responsible investments are no exception. As people strive to communicate new sustainable investing concepts and strategies, they sometimes use different words to express similar ideas or the same words to express different ones.

This has led to confusion, particularly around five key approaches:

- Screening
- ESG integration
- Thematic investing
- Stewardship
- Impact investing

The International Organization of Securities Commissions (IOSCO) has issued a call to action, challenging global volunteer standard-setters to develop common sustainable finance-related terms and definitions. The CFA Institute, the Global Sustainable Investment Alliance (GSIA), and Principles for Responsible Investment (PRI) answered IOSCO's call and teamed up to harmonise their definitions of these critical responsible investment concepts.

While responsible investing has changed in many ways over the decades, its distinguishing feature – the overlay of a normative framework that establishes a particular notion of responsibility – has remained constant. But the meaning of responsibility differs from one person to the next, so responsible investment may include aspects of sustainability, fiduciary duties, morality, or some combination thereof.

Until about 10 years ago, responsible investment was a niche interest, the main focus of which was avoiding industries that clients would judge to be morally objectionable, such as tobacco or gambling. As its appeal grew, however, new thinking and approaches emerged. Today, market participants apply a variety of strategies, including the five above, individually or in combination, even if what they entail isn't always clear.

Inconsistent terminology creates three problems:

1 Clients, and especially retail investors, have a harder time understanding what a fund or strategy is offering. For example, a client may believe that a fund deploying ESG integration means that the portfolio of investments will contribute positively to society. But in fact, the manager may simply evaluate ESG information as part of the investment analysis process. As a result, clients may select a product ill-suited to their objectives.

2 Inconsistent terminology can create legal, compliance and repu-



Responsible investing is no longer a niche segment, and deploys a variety of strategies.
 PHOTO: PIXABAY

tation risks for asset managers. Terms with multiple meanings make miscommunication more likely among internal teams and between an asset manager and its clients, partners and regulators. As several recent regulatory enforcement actions show, such miscommunication can sometimes rise to the level of misstatement or misleading.

3 It makes writing and enforcing rules more difficult for regulators. When asset managers describe similar practices using different terms, or different practices using

the same terms, regulators may not fully understand what managers are doing and not be able to respond with an appropriate regulatory policy. If inconsistent terminology also makes its way into regulations, those regulations could be unclear to market participants and thus be less effective.

Standardised definitions for greater consistency

The jointly published resource from CFA Institute, GSIA, and PRI supports regulators, asset managers, and investors alike by aligning

their definitions and providing detailed explanations and practical guidance for using these terms. It creates a common language for regulators to reference when developing standards to improve market integrity and for asset managers to communicate their responsible investment practices with accuracy and precision, thus facilitating more informed investment decisions by their clients. Establishing clear and consistent technical terminology will increase trust and efficiency in the marketplace.

Client needs will continue to evolve, and the industry will continue to innovate, but these five responsible investment approaches have matured to the point when it is time to call them by their proper names. The CFA Institute, GSIA, and PRI encourage regulators and market participants at large to follow their lead.

The writer is a director of global industry standards at CFA Institute, and is responsible for the research, development, and promotion of ESG codes and standards.