

# IIF Sustainable Finance Working Group Report

## The Case for Simplifying Sustainable Investment Terminology



October 2019

As global efforts to channel more private sector investment towards sustainable development ramp up, one key barrier has been the sheer proliferation of terms referring to “sustainable investment.” In a 2019 survey, the IIF Sustainable Finance Working Group (SFWG) polled member firms on their views: a significant majority agreed that industry alignment around simplifying terminology and product names into a few broad categories could greatly advance the goal of scaling up sustainable finance. To help drive progress towards this goal, this short note sets out the case for simplification and proposes three such categories as a starting point for discussion: “Exclusion,” “Inclusion” and “Impactful,” leaving “Philanthropic” as a separate category distinct from sustainable investment.

Governments around the world have committed themselves to an ambitious set of targets outlined in the Paris Agreement on Climate Change and the UN Sustainable Development Goals (SDGs). However, reaching these targets will require channeling far more investment that is aligned with key policy objectives. For example, in its [World Investment Report 2014](#), the United Nations Conference on Trade and Development (UNCTAD) estimated that meeting the SDGs in 2030 will require investments of USD 5 to 7 trillion per year. To achieve Paris Agreement targets, the [International Energy Agency](#) has estimated that energy sector investments would need to double over the next several decades—and that by 2050 95% of the world’s electricity supply will need to be low carbon, 70% of new cars will need to be electric, and the CO<sub>2</sub> intensity of the building sector will need to fall by 80%. These are daunting targets.

This transition can only occur if the private sector works in tandem with the public sector—hence the many policy initiatives in train to steer more private funding towards the SDGs. Thankfully, with more than USD 300 trillion of [global wealth](#), there is a massive pool of potential capital to tap into. A key piece of the puzzle will be to help those who ultimately own the wealth—asset owners and their clients—understand how to align their investments with these investment needs. ***This goes well beyond altruism or philanthropy: aligning investment with sustainable development will ensure long-term wealth preservation.*** Greater focus on these long-term considerations will be needed to address risks associated with climate change—not just the direct physical damage, but transition issues such as “stranded assets” (e.g., an abandoned coal mine) or displacement of workers in fossil fuel industries. Indeed, more emphasis on “funding the transition” is already evident in a range of [public](#) and [private sector](#) initiatives intended to support financing for new, climate-resilient opportunities. Yet

the SDG gap remains massive: some \$2.5 trillion per year according to the OECD.

What is holding us back from reaching more deeply into pools of private capital—including at the retail level? Many point to terminology: in well-intentioned efforts to help clients invest in sustainable products and services, ***the financial services industry has inadvertently created a proliferation of terms that may confuse rather than clarify investment objectives and outcomes.*** Indeed, the October 2019 [IMF Global Financial Stability Review](#) notes that: “Standardization of ESG investment terminology...could support market development, address greenwashing concerns, and reduce reputational risk.”

The IIF SFWG, with over 150 members in more than 20 countries, believes there is significant scope for rationalizing this rapidly expanding universe of sustainable investment terms. This would benefit investors, financial firms, regulators and other key stakeholders, and should garner widespread industry support. The easier it is to understand the purpose of an investment, the easier it will be to support clients, supervise markets, and measure progress toward sustainable outcomes.

In this short note, we sketch out definitions and highlight sources of confusion in sustainable investment terminology that may delay the development of sustainable finance products and prevent private capital from achieving intended goals. We conclude by setting out a proposal to clarify and simplify terminology through standardization around key concepts for sustainable investing. This paper was produced by the IIF SFWG whose members include commercial and investment banks, asset managers, and insurance companies from a broad range of jurisdictions across both developed and emerging markets.

## 1. OVERVIEW—DUELING DEFINITIONS

What's in a name? No matter how defined, the scale of global investments that target sustainability goals is massive. For example, the most recent [biennial survey of sustainable investing](#) from the Global Sustainable Investment Alliance (GSIA) noted that global “sustainable investing assets” were USD 30.7 trillion at the start of 2018, a 34 percent increase since its last report in 2016 and over a third of global assets under management. Still more ambitious in scope is the estimate from the UN-convened Principles for Responsible Investment (PRI), a network of global investors committed to considering environmental, social and governance (ESG) issues in their investment processes. The PRI [cites more than 2000 signatories](#) with over USD 80 trillion in investments. These figures highlight the significant volume of activity intended to align capital with sustainable outcomes.

***The divergence between these two widely cited estimates of the size of the sustainable investing market highlights the lack of alignment on what is being measured.*** The PRI uses the term “[responsible investment](#),” which it defines as “an approach to investing that aims to incorporate ESG factors into investment decisions, to better manage risk and generate sustainable, long-term returns.” The PRI further notes that responsible investment differs from the narrower category of socially responsible investing (SRI) or impact investing, which it describes as approaches that “seek to combine financial return with a moral or ethical return.” Having set out these two categories, the PRI urges all signatories to adhere to the broader goals of responsible investment, arguing that responsible investment does not imply lower returns—and could even mean longer-term outperformance given that considering ESG risks and opportunities could have a materially positive financial impact.

Like the PRI, the GSIA defines “sustainable investing” as an “approach that considers...ESG...factors in portfolio selection and management.” However, the GSIA takes a more inclusive definition of sustainable investing that does not distinguish this from related terms such as responsible investing and socially responsible investing. To capture information on the scale of investments tracked by sustainable investment associations in different geographies, the GSIA uses a set of seven different terms: negative/exclusionary screening; positive/best-in-class screening; norms-based screening; ESG integration; sustainability-themed investing; impact/community investing; and corporate engagement and shareholder action.

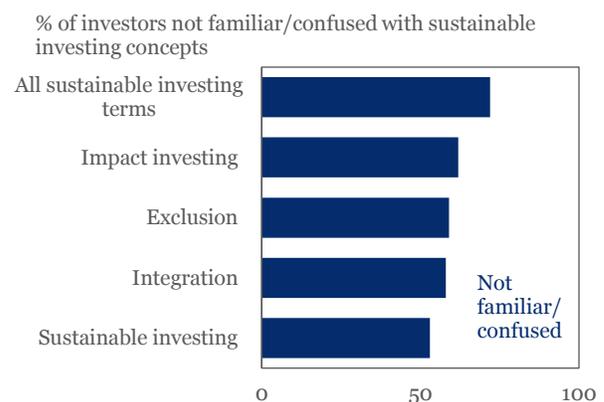
Thus, the GSIA definition of “sustainable investing” is in theory broader than the PRI definition of “responsible investing”. However, the GSIA volume figure is less than half the size of the PRI signatory figure. That could be read as a

difference between a statement of intent and the actual practice. However, the fact that two different terms “responsible investing” and “sustainable investing” are being used—and the numbers are vastly different—underscores questions about what is being measured and whether a common language is being spoken by the marketplace. Indeed, some private sector financial firms such as JPMorgan have suggested that [the true size of ESG investment universe](#) may be as small as USD 3 trillion. Clearly there is a risk of confusion. The next section explores in more detail and lays out the potential consequences.

## 2. LACK OF CLARITY BREEDS CONFUSION

A closer look at definitions in the marketplace highlights the proliferation: one [attempt to quantify the problem](#) found that ***firms are using close to 80 different terms to describe various forms of sustainable investing.*** At best, this confusion makes it hard to compare investment products and for clients to understand the differences in offerings. At worst, it facilitates greenwashing—intentionally misleading investors or giving them a false impression about how well their investments are aligned with their sustainability goals. Some financial firms have clearly documented these concerns: in a [2018 survey](#) of more than 5000 high net worth individuals globally, UBS found that 72% of these investors find sustainable investment terminology confusing (Chart 1).

Chart 1: Confusion in sustainable investing terminology



Source: UBS

Another investment firm, Schroders, in an online survey of 22,000 investors from more than 30 countries, had similar findings. For example, more than 50% of the individuals in all regions stated that they refrained from investing more in sustainable products due to lack of information and/or understanding about what is considered sustainable investing. In an attempt to counteract this, Schroders [produced a guide](#) to the more than 50 individual terms that an investor needs

to know when it comes to sustainable investing. However, **having so many terms—even with explanations—still adds a layer of complexity that may be challenging, particularly for retail clients.**

Institutional investors face many of the same challenges. For example in 2018, Aon [surveyed 223 institutional investors globally](#) and found that over 25% cited lack of agreement on terminology as a reason for the dearth of responsible investing (Chart 2) and almost 50% believed industry agreement on terms and definitions would make responsible investing more accessible (Chart 3). Many other commentators have noted [potential challenges](#) created by this confusion, not least the risk of greenwashing. Regulators are also increasingly recognizing this risk, which appears to be the motivation behind certain elements of the [EU Sustainable Finance Action Plan](#) and recent regulatory initiatives such as the [new ESG fund registration scheme](#) by the Hong Kong Securities and Future Commission. **As the regulatory community gears up to address issues around sustainable investment terminology, it will be important to convey industry perspectives on potential solutions.**

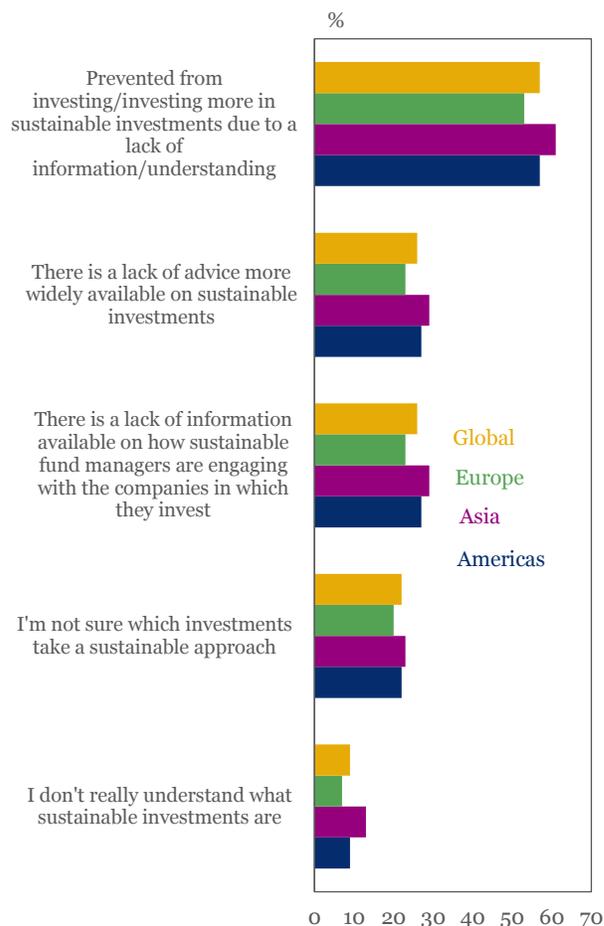
### 3. SOLUTION IN SIGHT—BETTER ALIGNMENT

The IIF SFWG conducted a survey among its member firms on the topic of sustainable investment terminology. Specifically, we asked if there are currently too many overlapping sustainable investing terms and product names. Nearly all respondents agreed this was the case. Notable comments included:

- “...the use of different terms relating to sustainable investing is confusing for investors. We need simple common language to explain these different approaches...”
- “...mainstreaming of responsible investment, which we welcome very much, is leading to both misunderstandings in adaptation as well as the wish/need to create a marketing USP by creating new products or simply marketing existing products under a variety of different names, which is understandable, but adds much more to the confusion than the solidification of the markets. Simplifying and standardizing terminology would certainly help.”
- “There could be more simplification to avoid misunderstanding and better guide the respective parties including investors, issuers, lenders and monitoring bodies.”

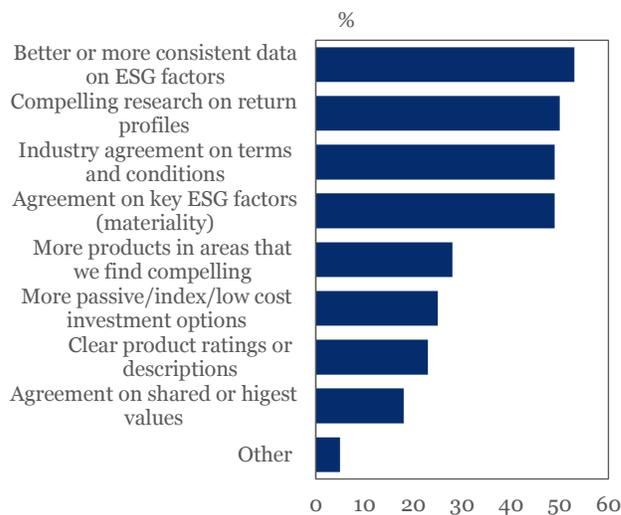
At the same time SFWG firms were asked to confirm the problem, we asked them to comment on a potential grouping of terms around three or four categories. These were distinguished based on their financial performance target, the manner in which ESG impacts are achieved, and whether

Chart 2: Lack of information on sustainable investments



Source: Schroders [Global Investor Study](#)

Chart 3: Survey question—what would make sustainable investing more accessible?



Source: Aon [Global perspectives on responsible investing](#)

outcomes can be measured. Firms generally agreed with the idea of using the following categories of investments (see Appendix):

- **Exclusion investments:** those actively avoiding investing in unsustainable corporates or countries based on screens or other ways to identify particular issues or outcomes of concern.

- **Inclusion investments:** those actively investing in sustainable corporates and countries based on consideration of underlying data about issues or outcomes.

- **Impactful investments:** those seeking to have a direct, positive measurable impact on society and/or the environment while targeting market, or better, financial returns.

Exclusion, Inclusion and Impact have been used here for illustrative purposes, as they are the most commonly cited industry terms to describe the respective investment approaches. Alternative terms to best reflect these broad categories may be agreed upon through further input and financial industry discussions. In addition, some (but not all) firms, believed that having a clearly defined philanthropic investment category would be helpful for those products or approaches that *are* willing to sacrifice some degree of market return. The Appendix outlines a potential way to group the terms that are currently being used in the marketplace, including one group pertaining specifically to philanthropy. The concept of a limited number of groupings has seen support elsewhere—for example, Mercer Consulting has suggested a somewhat similar approach to [incorporating ESG and climate change considerations](#) into the investment process.

#### 4. NEXT STEPS—MARKET-BASED STANDARDS

The IIF has long valued the role of international standards in facilitating market development and economic growth (see [here](#) for example). While not suggesting a move towards an international regulatory standard at this time, the IIF SFWG does believe the time is ripe for the industry to begin a process to coalesce around standards that will help grow the sustainable finance market. There is precedent for such activity. For example, the [Green Bond Principles](#) (GBP), (voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance of a green bond) started as a discussion among investors, issuers, and intermediaries facilitated by the World Bank in November 2013. The first guidelines were published in January 2014, and by March 2015 the International Capital Market Association (ICMA) [started to serve](#) as the

secretariat to the GBP, which has since become a market standard used globally.

The IIF has been instrumental in helping shape or maintain industry-based approaches not only on regulatory topics but also broader market standards. For example, the IIF serves as the secretariat to the Group of Trustees for the *Principles for Stable Capital Flows and Fair Debt Restructuring*—a set of market-based, flexible guidelines for the behavior of sovereign debtors and private creditors with the aim of promoting and maintaining stable capital flows, financial stability and sustainable growth. The IIF has also developing standardized ways to monitor global debt, building on long-standing IIF monitoring of global capital flows. This classification work offers the clear [benefit to the market](#) of having agreed ways to define and categorize debt and capital flows terms. A similar approach can be taken to categorizing sustainable investments.

Given the importance of industry alignment around fewer sustainable investment terms, the IIF and the members of its Sustainable Finance Working Group will work with initiatives such as GSIA and PRI that currently track sustainable investment volumes in an effort to move toward a more common language. Efforts towards alignment around fewer categories of sustainable investments will also support and be consistent with the [Operating Principles for Impact Management](#). Developed in consultation with the investment management industry and launched in April 2019, these widely supported principles are designed as an end-to-end impact investment process with five elements: strategy, origination and structuring, portfolio management, exit, and independent verification.

By setting out the case for rationalizing sustainable investment terms—and a proposed solution—the IIF Sustainable Finance Working Group hopes to contribute to a better understanding of the scale of global sustainable investing and market development. More importantly, alignment around fewer, simpler sustainable investing terms will enhance transparency and bolster confidence in the integrity of the market. Working with initiatives pursuing similar goals, we hope to promote a common language that can support a common understanding of what we are trying to accomplish. Simplifying investment terminology may not be the silver bullet to achieve the goals of the Paris Agreement or the SDGs; however, it is an essential and necessary part of the solution.

## APPENDIX

Proposed standardized term	Exclusion investments	Inclusion investments	Impactful investments	Philanthropic investments
<b>Simplified explanation</b>	Actively avoid investing in unsustainable corporates and countries	Actively invest in sustainable corporates and countries	Seek to have a direct, positive impact on society and/or the environment with your money, while also targeting market or better financial returns.	Seek to have a direct, positive impact on society and/or the environment with your money, and willing to earn sub market financial returns to do this.
<b>Financial performance</b>	Market/market minus	Market/market plus	Market/market plus	Market minus
<b>Environmental and/or social impact of investment</b>	None	Indirect	Direct	Direct
<b>Measurement of direct impact of investment</b>			Yes	Optional
<b>Measurement of indirect impact of investment</b>		Optional	No	Optional
<b>Current terms used</b>	Best-in-class screening Biblical investing Clean investing Divestment <b>Ethical investing</b> <b>Ethically minded investing</b> Exclusionary screening Faith-based investing <b>Impact</b> <b>Impact investing (II)</b> Jewish investing Negative screening Norms-based screening <b>Positive screening</b> <b>Screening investing</b> Shariah investing Values-based investing	Aligned B-Corporation (B-Corp) Best-in-class screening Climate bonds Environmental, social and governance investing (ESG) ESG corporate bonds ESG equity themes ESG focused <b>ESG integration</b> ESG investing ESG thematic investing <b>Ethical investing</b> <b>Ethically minded investing</b> Focused integration Gender-lens investing Gender-smart investing Green bonds Green investing High ESG rating equities <b>ESG integration</b> <b>Impact investing (II)</b> Improving ESG equities Integration Long term investment themes Mission-aligned investing <b>Positive screening</b> Responsible investing <b>Screening investing</b> SI focused SI integration Socially responsible investing (SRI) Socially -conscious investing SRI equity themes Sustainability indices Sustainability themed investing Sustainability themes Sustainable bonds Sustainable thematic investing Tactical ESG Thematic investing <b>Values-based investing</b>	Active ownership Collaborative engagement Company activism Company engagement Company executive collaboration Corporate activism Corporate engagement Development finance institute bonds/DFI bonds SDG engagement <b>Impact</b> <b>Impact investing (II)</b> Multilateral development bank bonds/MDB bonds Shareholder action <b>Triple bottom line</b>	Blended finance Blue bonds Community investing Development finance institute bonds/DFI bonds Development Impact Bonds Humanitarian Impact Bonds <b>Impact</b> Impact bonds Impact capitalism Impact economy <b>Impact investing (II)</b> Social bonds Social enterprise Social entrepreneurs Social finance Social Impact Bonds Social impact investing Social investing Sustainable finance <b>Triple bottom line</b> Universal ownership

bolded terms = terms currently used capriciously that need to be used in a single category

Exclusion, Inclusion and Impact have been used here for illustrative purposes, as they are the most commonly cited industry terms to describe the respective investment approaches. Alternative terms to best reflect these broad categories may be agreed upon through further input and financial industry discussions.