ARTICLE SERIES 4 OF 5 - SPOTLIGHT ON SDR: SEEING ESG CLEARLY

# Sources of sustainability support for advisers

LGIM

**The proliferation of sustainable strategies and evolving regulation can be a challenge for financial advisers to navigate. How can they manage their growing responsibilities, and what support is available?**

Building consumer trust and understanding is the cornerstone of forthcoming FCA regulation. With its principles of transparency, the framework seeks to support consumers in their sustainable investment journeys.

The Sustainability Disclosure Requirements (SDR), which are slated to come into force from 30 June 2023, seek to provide greater clarity and harmonisation of the rules for investment products that are marketed as sustainable in the UK. It serves to support the broader Consumer Duty rules, which come into effect from 31 July 2023 and require firms to act to deliver good outcomes for retail customers.

The transparency that SDR seeks to bring is important for all advisers regardless of whether they outsource investment management or run in-house portfolios.

'Advisers need to understand the funds they are recommending whether they are self-selecting or using a DFM [discretionary fund manager],' said Simon Munday, founder of Prosperity IFA in East Sussex. 'The time saved in investment research shouldn't detract from knowing where a client's money is invested.'

Particularly for smaller firms like Munday's, support from the wider industry can help advisers to meet their obligation to clients.

'We can't do everything – compliance, portfolio management and fund selection – on top of all the regular CPD and learning that is necessary for an adviser,' he said. 'We are financial planners. Our strengths lie in getting our clients from A to B on their financial journey. We utilise experts to help make that journey as uneventful as possible for clients.'

Below, we talk to two key figures driving LGIM's sustainability proposition: head of responsible investment strategy Amelia Tan and ESG policy lead Alexander Burr. They help us understand what is being done at both regulatory and asset management levels to provide support to intermediaries.

#### EDUCATION AND UNDERSTANDING

Increasingly, asset managers are taking on the role of educator to help advisers better understand the sustainable investment landscape and in particular the FCA's SDR consultation paper published in October.

LGIM sees itself as playing an important role in providing meaningful takeaways from the 179-page report.

'We're very keen to help advisers in any way possible,' said Tan. 'This series of articles is precisely one of the ways in which we think we can help – to give an initial feel for what's important, what the key takeaways are and what we think the asset management industry will do over time.'

#### MORE CONSISTENT AND BETTER DISCLOSURE

The implementation of the investment labelling regime proposed by SDR should provide support in terms of more consistent and better disclosures from fund managers.

'Advisers are already trying to ascertain what funds are doing, so we see this as the necessary support they require,' said Tan.

Proactive asset managers like LGIM are already focusing on disclosure to help advisers better understand their sustainable investment proposition.

'We've already been reporting on several key ESG metrics because we know that our clients are interested in how our funds are positioned, for example from a carbon emissions perspective,' said Tan.

'We are pleased that the FCA is seeking disclosure of active investor stewardship conducted by asset managers as a key tenet of SDR. It recognises the role that we play in bringing about real world change' added Burr. LGIM publishes annual and quarterly reports on its active ownership activities and its Climate Impact Pledge, a targeted stewardship campaign that began in 2016 to address the systemic issue of climate change.

LGIM's annual and quarterly active ownership reports outline how the firm has taken decisive action to address a broad range of ESG issues, globally. These reports detail how LGIM has exercised voting rights across its entire book and engaged with companies, policymakers, regulators and other stakeholders to deliver positive change, address critical ESG issues, and raise individual company and overall market standards.

Under its Climate Impact Pledge, LGIM commits to help companies limit their carbon emissions to net zero by 2050. Currently, the programme covers 1,000 companies and includes potential sanctions for those failing to meet minimum standards.

'LGIM has produced these comprehensive reports for many years now, and with the introducing of SDR, it is ever more important that advisers read them. They are a very helpful resource to get to grips with what a firm is actually doing, what it says about stewardship and how it is influencing real-world impact, not just in the UK but globally. They are a great repository of concrete examples of how LGIM engages to tackle systemic ESG issues, not only at a company level but also at a market level with policymakers and regulators.' said Burr.

#### A SIMPLER PRODUCT PROPOSITION

One of the key challenges that advisers face is that asset managers approach sustainable and responsible investing in different ways. Each has a range of funds doing a variety of things, which poses a challenge for advisers looking to ascertain the right fund for their client.

> **"We are financial planners. Our strengths lie in getting our clients from A to B on their financial journey. We utilise experts to help make that journey as uneventful as possible for clients."**
>
> Simon Munday, founder, Prosperity IFA

LGIM is evolving its product proposition to help advisers assess sustainability information. This includes pivoting its funds towards aiming to achieve real-world outcomes, as well as providing evidence of these outcomes by quantifying targets.

For example, many of LGIM's index strategies within its responsible investing offering combine engagement priorities with capital allocation to drive a proprietary index approach, known as 'engagement with consequences'. LGIM also incorporates forward-looking metrics such as temperature alignment to capitalise on improving analytics, so that investors who want an efficient exposure to ESG factors can participate more effectively.

'We're increasingly trying to adopt consistent approaches in how we target specific objectives for our fund ranges,' said Tan. 'We've built out more consistent frameworks for what can be rather ambiguous concepts such as "net zero" funds – to explain how you can achieve net zero in a portfolio across asset classes and investment styles. All of this is about bringing clarity but also simplifying the choice for advisers.'

### REGULATORY AND OTHER INDUSTRY GUIDANCE

The FCA will continue to help the financial services industry implement SDR through stakeholder engagement, such as roundtables and webinars, as well as published guidance.

The regulator has also provided a draft implementation guidance document in appendix two of the consultation paper, which Burr recommends reading. ‘It is a very welcome addition to help advisers understand what disclosures should look like,’ he said.

While there is no single responsible investment framework developed by the UK government, it is also worth looking at market-led initiatives relating to the labelling, classification and/or disclosure of sustainable investment products, which the FCA has considered and references in its consultation paper.

These include the Investment Association’s Responsible Investment Framework, the British Standards Institution’s sustainable finance standards programme, the guidance and resources produced by the Impact Management Project, and the CFA Institute’s voluntary ESG disclosure standards for investment products. Burr noted, ‘it is also worth being aware that as part of the broader package of sustainable finance policy in the UK, the government – under the leadership of the Green Technical Advisory Group or ‘GTAG’ – has also been looking into developing a UK science-based Green Taxonomy, which will also help bring greater transparency and comparability to investors. We encourage the government to continue with this development.’

### EXTERNAL ASSESSMENT AND TESTING

A number of firms already provide some measure of external assessment. Morningstar, for example, has started rating funds more consistently to make it easier to compare funds across asset managers.

Although the labelling system proposed by SDR – whereby fund managers will categorise sustainable funds as ‘focus’, ‘improvers’ or ‘impact’ funds – is self-assessed, some fund managers may seek external verification.

Some may also voluntarily conduct consumer testing of their proposed consumer-facing disclosures to ensure they are readily understood by investors.

‘At least for now, the FCA hasn’t mandated a specific template,’ said Tan. ‘It has described things that have to be disclosed but in terms of the language that is used and the format in which it is delivered, asset managers are being encouraged to test to make sure it is easy for people to understand.’

From the Consumer Duty to the SDR, the aim is to deliver good outcomes for investors. To do so, the emphasis must be on partnership across the financial services sector and a flow of two-way information between product providers like LGIM and distributors like advisers.

‘Ultimately, all of this is about trying to make sustainable investment so much more understandable for investors,’ added Tan. ‘Of course we want people to know what they’re investing in, so we are fully supportive.’