TIIP THE INVESTMENT INTEGRATION PROJECT

Approaching the Tipping Point:

Recommendations for building the marketplace for system-level investing

The Investment Integration Project

Spring 2022

Disclosures

Humanity United and UBS Optimus Foundation provided support for this research.

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In 2020, against the backdrop of the Covid-19 pandemic, Humanity United, UBS Optimus Foundation and others launched Moving the Market (MtM), an initiative to shift investor considerations to include social impacts across asset classes. Through a pooled fund, the initiative aimed to "move the market" by funding projects to support investor demand for socially responsible investing and advanced approaches to accounting for social impacts in investment decision-making.

At the same time and given the extraordinary social and economic fallout caused by the Covid-19 pandemic, MtM also supported a parallel project to investigate the implications of the pandemic on investor decision making on systemic issues. Led by The Investment Integration Project (TIIP), the project resulted in an assessment of how the pandemic affected the structure of capital markets and identified ways to promote widespread consideration of systemic issues in the financial industry. This body of work built on TIIP's near decade long effort to help investors recognize the interconnection between social, environmental, and financial systems, and shift the financial system from vulnerable to resilient, from extractive to regenerative, and toward long-term sustainability – and to encourage them to adopt system-level investing.

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To build on growing interest by the financial industry in addressing these systemic issues, TIIP, Humanity United, and UBS Optimus Foundation continued this partnership to conduct a year-long Industry Needs Project that sought to answer three fundamental questions: *Do asset owners, intermediaries, and other financial industry stakeholders understand what* system-level investing *is? Are they ready to adopt* system-level investing *approaches? What is the path forward for the financial industry and toward industry transformation?*

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The "Approaching the Tipping Point: Recommendations for Building the Marketplace for System-level Investing" roadmap is the result. The plan focuses on activities that can be executed over the next two to five years to quickly equip the financial industry with tools and strategies to manage existing systemic social and environmental challenges and drive broader industry transformation.

Industry transformation of the type envisioned here is a lofty goal, to be sure, and it will not be easy. It will require a major cultural shift and the hard work and dedication of an entire ecosystem of champions for system-level investing – including thought leaders and experts on things like data, measurement, and regulation (e.g., fiduciary duty). Progress will likely be incremental at first. But the financial industry must at least try. We are approaching the tipping point. The long-term performance of investments and global well-being depend not only on it acknowledging systemic issues, but on it doing something about them.

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Introduction

The social and environmental challenges of the 21st century are new, different, and fundamentally destabilizing. Many of these challenges are systemic in nature; they are complex, interconnected global issues with multiple contributing factors. They impact entire economies and societies, threatening the global financial system and long-term investment returns across all asset classes.[1]

Income inequality, for example, is stirring nationalistic protectionist sentiments, upending democracies, and inciting trade wars. Human rights abuses, including modern slavery and human trafficking, are triggering war and conflict, and weakening societies. Systemic racism and sexism are stunting economic growth and fracturing social cohesion. Rapidly worsening climate change is accelerating natural disasters; these disasters are leading to mass migrations that threaten jobs and increase exploitation of the women and girls that comprise a disproportionate percentage of refugees. Military invasions of sovereign democracies are displacing millions of people and endangering global food and energy supplies.

More than ever before investors are adopting sustainable investing to manage the risks that environmental and social challenges pose to investment, increase value over the long term, and express their beliefs. They are increasingly recognizing the social and environmental impacts of specific investments, designing their portfolios accordingly, and seeking Environmental, Social, and Governance (ESG) benefits alongside financial return.

According to the Global Sustainable Investment Alliance, nearly 36% of professionally managed assets across Europe, the United States, Japan, Canada, and Australasia were invested using sustainable approaches (US$35.3 trillion) as of early 2020.[2] This represents an increase of nearly 15% since 2018 and more than 55% since 2016 and includes things like ESG integration, negative exclusionary screening, and shareholder action. A growing number of investors are also signing on to the Principles for Responsible Investment (PRI), which guides them in managing ESG risks and using sustainable investing to enhance returns. The number of PRI signatories has seen substantial growth over the past 15 years – from 63 when it launched in 2006, to 1,501 in 2016, to nearly 5,000 today.[3]

While the growing adoption of sustainable investing is laudable, many existing sustainable investing approaches do not address the *systemic* nature of many of today's most pressing social and environmental challenges. ***Such systemic challenges require system-level solutions*****, solutions like "system-level investing."** System-level investing helps investors to manage the risks (and rewards) of the social, environmental, and financial systems that provide a stable, resilient foundation for investments across all asset classes.

It guides investors in understanding their impact on social, environmental, and financial systems and in wielding their influence (and that of the collective financial community) to strengthen these underlying systems toward the goals of achieving competitive returns in the short term, increasing value over the long term, and supporting global sustainability.[4] This differs from many sustainable investing approaches (e.g., ESG integration and impact investing) that focus on environmental and social factors in so much as they relate to the performance of specific companies or investments and not that of broader systems.

The financial industry is increasingly concerned about systemic challenges and investors are increasingly open to integrating system-level investing into their investment practices. Notable financial industry leaders—including Hiro Mizuno (United Nations Special Envoy on Innovative Finance and Sustainable Investments [former Chief Investment Officer, Japan Government Pension Investment Fund]) and Mark Carney (Vice Chairman and Head of Impact Investing, Brookfield Asset Management [former governor, Bank of England])—have acknowledged the interconnection between global social, environmental, and financial systems.[5]

Some of the world's most influential asset owners—including the California State Teachers' Retirement System (CalSTRs), the Church of England Pensions Board, Guys' and St. Thomas' Foundation, and UAW Retiree Medical Benefits Trust—have adopted the approach (see Box 1). The Investment Integration Project (TIIP) has spent the better part of the past decade providing thought leadership about system-level investing, developing commensurate theoretical frameworks, and providing "how to" guidance to early adopters, forward-thinking investors, and industry associations in adopting the approach.

In recent years, organizations like the Predistribution Initiative, the CFA Institute, and The Shareholder Commons have also begun specializing in various aspects of system-level investing.

Further, events like the fallout from the ongoing Covid-19 pandemic—coupled with recent racial reckonings around the world, the fear and uncertainty related to Russia's invasion of Ukraine, and ever-present and horrifying warnings about the irreversible impacts of climate change—have pushed discussions about the vulnerabilities and tipping points of interconnected global social, environmental, and financial systems to the forefront of financial industry discourse.

The acknowledgement of systemic interconnection by industry leaders, adoption of system-level investing by notable investors, and the prevalence and confluence of a series of major systemic challenges suggest that **now is the time for industry-wide embrace of system-level investing.**

System-level investing: Approaching the tipping point

	Notable industry leaders are speaking out about systemic challenges and their interconnection with investment.
	Influential asset owners have adopted system-level investing – providing early case studies of the approach in action.
	TIIP and others have established theoretical frameworks for the adoption of system-level investing.
	Current events (e.g., the Covid-19 pandemic, Russia's invasion of Ukraine, and dire warnings about climate change) have pushed interconnected systemic challenges to the forefront of industry discourse.

More specifically, it is time to accelerate system-level investing progress beyond its current phase of uncoordinated innovation—defined by a group of "disruptive innovators" executing "disparate entrepreneurial activities"—to formalize centers of ideas and activities and to develop a shard infrastructure for implementation of the approach (marketplace building). Doing so will set the financial industry on a course toward *capturing the value of the marketplace* and, ultimately, *maturity*, ensuring that it can manage systemic social and environmental challenges over time (see Figure 1).[6]

Figure 1. Phases of industry evolution in the context of system-level investing

Uncoordinated innovation	Marketplace building	Capturing the value of the marketplace	Maturity
Investors or small groups of investors engaging in disparate (sometimes conflicting) system-level investment activities	Centers of system-level investing ideas and activity and shared infrastructure start to develop	System-level investing becomes part of mainstream investment activity; investors can easily access needed infastructure and support	System-level investing reaches a relatively steady state

Note: Adapted from "Phases of industry evolution" introduced in Monitor Institute (2009). Investing for Social & Environmental Impact: A Design for Catalyzing and Emerging Industry.

Box 1. Early adoption of system-level investing

The California State Teachers' Retirement System (CalSTRS) (US$318.1 billion AUM). CalSTRS has asserted that climate change is a systemic risk and developed a multi-year, multi-asset class, internally managed Low-Carbon Index for passive equity management. It also co-leads Climate Action 100+, an initiative of 700 investors (including some of the largest in the world) focused on pressuring the world's biggest carbon-emitting corporations to reduce their carbon footprint, critical to ensuring the global economy meets Paris Agreement goals. As of 2022, Climate Action 100+ had gotten major companies the likes of Ford Motor Company, Duke Energy, BP, American Airlines, Dominion Energy, Unilver, Walmart, BASF, and Engie to agree to net zero carbon emissions or carbon neutrality by 2050.

The Church of England Pensions Board (£3.7 billion AUM). In 2020, after several dams controlled by the Brazilian mining company Vale burst in the span of a few years, destroying nearby towns, and killing over 250 workers and residents, the Pensions Board, which owns stock in Vale, created a coalition of investors to demand new global safety standards in the mining industry, to be enforced by an independent body. As a result, Vale and other global mining companies agreed to undertake annual audits of their dams, implement new safety standards, and commit to public reporting – and, in doing so, improved the overall health of the mining industry in Brazil and the social and financial systems that that industry contributes to.

Guys' & St. Thomas' Foundation (£600 million AUM). The Foundation has started investing its endowment in line with its mission to improve health and well-being in the UK, recognizing that relying on grantmaking alone would be insufficient to achieve its goals. This includes, for example, the foundation's investment in SMASH app (Save Money and Stay Healthy) in 2020. SMASH gives 13-to-24-year-olds a 20% discount on healthy food options at food-to-go retailers (e.g., fast food restaurants) with the goal of reducing childhood obesity and improving health. If successful, the solution could be scaled through a similar 20% Value-added tax (VAT) reduction in healthy foods. The foundation also partners with ShareAction to encourage investors to consider health and its underlying social factors in investment decision making through the Long-term Investors for People's Health program. The program encourages shareholder action like the recent resolution aimed at Tesco to encourage the company to sell more healthy food. The Foundation's commitment to improving health across the UK via a diversity of approaches aims to improve broader health systems of the country.

UAW Retirees Medical Benefits Trust (US$63 billion AUM). UAW advocates for more comprehensive standards and data disclosure around income inequality. The Trust houses the Human Capital Management Coalition (HCMC), which is supported by 32 institutional investors with US$6 trillion in assets under management. In 2020, the US Securities and Exchange Commission (SEC) amended its rules for how public companies disclose workforce information in response to a petition filed by the HCMC in 2017. UAW also co-chairs the Investors for Opioid and Pharmaceutical Accountability (IOPA), which engages with opioid manufacturers, distributors, and retail pharmacies on opioid business risks that have implications for long-term shareholders, communities, and the economy. By the end of 2020, the IOPA had gotten 15 companies – including eight opioid manufacturers and three major opioid distributors – to submit or commit to submitting oversight reports. UAW's efforts to work across entire industries – and not just with individual companies – aim to improve various components of the broader social system in the US.

What does the financial industry need to build the marketplace for system-level investing and support widespread adoption of the approach?

With funding from Humanity United and UBS Optimus Foundation, The Investment Integration Project (TIIP) launched ***The Industry Needs Project*** to identify *where the financial industry is* vis-à-vis system-level investing and to *provide the industry with a commensurate path forward.* For the first part of the two-part project, TIIP conducted an industry needs assessment that included an examination of financial industry stakeholders' concerns about systemic social and environmental issues, awareness of system-level investing, readiness to adopt the approach, roadblocks to doing so, and need for related information and support. For the second part of the project, TIIP used the findings from the industry needs assessment to develop a plan to build the marketplace for system-level investing and encourage widespread adoption of the approach toward the ultimate goal of industry transformation.

After first providing a brief primer on system-level investing (**System-level Investing**), the remainder of this report summarizes the findings from the industry needs assessment (**The State of the Industry**) and outlines ways that the financial industry can formalize centers of ideas and activities and develop a shared infrastructure for implementation of the approach that supports a higher volume of activity; that is, a plan for *building the marketplace* for system-level investing (**The Path Forward**). It also offers initial ideas for *capturing the value of the marketplace* to help ensure that system-level investing becomes part of mainstream investment activity and that investors can easily access needed infrastructure and support.

The plan focuses on activities that can be executed over the next two to five years to quickly equip the financial industry with tools and strategies to manage existing systemic social and environmental challenges. The first phase of the plan – **awareness** – focuses on increasing awareness about system-level investing and systemic issues and, when possible, suggests ways to build on work already done or currently underway by TIIP and others to help investors understand the what, why, and how of system-level investing. The second phase – **adoption** – focuses on fortifying industry structures to facilitate the widespread adoption of system-level investing, which includes considering topics like data, evaluation, and regulation: topics for which much progress has been made related to sustainable investing but for which the financial industry faces more questions than answers in terms of system-level investing. Figure 2 below summarizes the goals and activities associated with these two phases. Corresponding figures later in the report (in The Path Forward) provide additional details about how each phase responds to specific needs identified in the research.

Figure 2. The path forward for system-level investing

	Phase 1: Awareness Increase awareness about system-level investing and systemic issues to support investors' adoption of the approach			Phase 2: Adoption Fortify industry structures to enable widespread adoption of system-level investing	
	1	2	3	1	2
Goals	Ensure that investors understand what makes an issue systemic, and what system-level investing is and is not (provide definitional clarity) and why they should adopt it	Empower investors to start integrating system-level investing into their investment practices to increase adoption of system-level investing	Facilitate opportunities for collaboration and peer exchange to improve and otherwise advance adoption of system-level investing	Develop standardized systems for monitoring, evaluating, and reporting on investors' impacts on systemic issues	Advocate for changes to global regulatory frameworks to ensure that they do not impede – and in fact support – widespread adoption of system-level investing
Next steps	Curate existing resources on the what and why of system-level investing Adapt and amend existing resources so that they are clear, concise, and reflect industry consensus related to system-level investing Disseminate and otherwise amplify information about system-level investing	Develop and provide investors with easy-to-use plug-and-play toolkits, guides, and templates to support successful adoption of system-level investing – including information about how to adapt conventional approaches and adopt advanced techniques to purse system-level goals	Build a system-level investing community of practice that facilitates interactive discussions and the productive exchange of ideas and best practices	Examine available ESG data and existing monitoring, evaluation, and reporting frameworks; determine whether and how investors can adapt them to measure their impacts on systemic issues and progress toward system-level goals Assemble a working group to recommend a standardized system for monitoring, evaluating, and reporting investors' impacts on systemic issues	Pressure regulators to make changes to global regulatory frameworks to ensure that they support widespread adoption of system-level investing

Industry transformation will not happen overnight and no one entity can build the marketplace for system-level investing alone. Doing so will require the hard work and dedication of an entire ecosystem of champions for system-level investing – including thought leaders and experts on things like data, measurement, fiduciary duty, evaluation, and marketing (among others) – and progress will likely be incremental at first.

The Path Forward details two sequential phases and a series of related activities, some of which can usefully build on the existing body of work on system-level investing or efforts currently underway, and others of which represent new and relatively uncharted territory. It suggests first targeting asset owners with long-term interests (e.g., pension funds, foundations, endowments, family offices, insurance companies, and sovereign wealth funds) – building demand for the approach among influential institutional investors to incentivize intermediaries (e.g., asset managers, financial advisors, and consultants) to follow suit.

Industry transformation is a lofty goal to be sure, and it will not be easy. But the financial industry must at least try – it cannot afford not to. We are approaching the tipping point. The industry's long-term survival and global well-being depend not only on the financial industry acknowledging systemic issues, but on it *doing something* about them.

System-level Investing

Finance and investment are built on the predictability and reliability of society, the financial system, and the environment. Stable systems enable healthy markets; unstable systems lead to reduced or negative market returns. The systems that underpin the market are the greatest source of overall absolute performance for investors: all investors benefit from the performance of the overall market, driven by the performance of the economy.[7] The decisions of investors as market participants have economy-wide implications, drive the movement of benchmark indexes, and impact the fate of these systems (whether they recognize it or not).

Systemic challenges are complex, interconnected, and fundamentally destabilizing. They have multiple contributing factors, impact entire economies and societies, and threaten the entire financial system and long-term investment returns across all asset classes. They include, for example, income inequality, consumer health and safety, human rights, social equity and diversity, climate change, biodiversity, natural resources and sustainable land use, shareholder rights, and market transparency. Of course, investors should care about all these issues for ethical reasons, but investors are particularly well-suited to manage a subset of systemic issues that conform to the following criteria:[8]

- **Consensus.** There is broad consensus as to the legitimacy and general importance of the issue among a wide range of credible stakeholders, and broad consensus as to whether the issue relates to a public good that supports private activities.

- **Relevance.** The issue has substantial potential to impact positively or negatively (is relevant to) the long-term financial performance of investors' portfolios across industries and asset classes.

- **Effectiveness.** Investors can effectively impact the system and its ability to provide a common public good and support private activities.

- **Uncertainty.** There is uncertainty as to the nature and extent of the risks or opportunity costs related to the challenge.

Climate change is the systemic issue atop of many investors' minds, and for good reason. Climate change and its related challenges could reduce global GDP by as much as 14% by 2050 should average temperatures rise by 2.6 degrees Celsius, and by as much as 18% if temperatures rise by 3.2 degrees Celsius.[9] Further, a recent Financial Stability Board report estimates that an average temperature rise of 2 degrees Celsius could reduce global financial asset values between 0.7% and 4.2%.

This says nothing of the humanitarian toll of climate change and related extreme weather events, including increased respiratory disease and changes in the prevalence and geographical distribution of food- and water-borne illnesses and other infectious diseases.[10] But while climate change is certainly very important, there are many systemic social challenges that are inextricably connected to climate change that require investors' attention (see Box 2).

Box 2. Systemic social issues are important too, really important

Income inequality and forced labor are just two of the many systemic social issues that can impact investment returns across all asset classes.

Income inequality. Income (and wealth) inequality—both between and within countries—is substantial. The world's richest 10% of people currently earn 52% of global income while the poorest 50% earn just 8% of global income. In the U.S., the richest 10% captures 45.5% of total income while just 13.3% goes to the bottom 50%. Corporate and government policies and practices that enrich shareholders and marginalize workers (e.g., stock buybacks, tax evasion, fissuring, limitations on collective bargaining) are in large part to blame for these statistics. And although some degree of income inequality can serve as an incentive to promote hard work, the extreme income inequality that exists within and across countries today contributes to: (a) slowed economic growth; (b) limited upward mobility and labor force participation; and (c) social unrest and political dysfunction.

Income inequality is not just bad for individual people and countries; it harms global well-being and disrupts interconnected global economic, social, and political systems. Investors across all asset classes depend on the health of these systems to ensure the smooth functioning of financial markets and, ultimately, support returns. When income inequality leads to one or more of the consequences identified above, investments can suffer.

Forced labor. On any given day, approximately 25 million people (mostly women and girls) are victims of forced labor, one of the primary forms of modern slavery– working under threat or coercion across nearly every corporate sector to produce goods and services that end up in "legitimate commercial channels" (e.g., agriculture, apparel, construction, electronics). Beyond the obvious ethical concerns posed by forced labor, the practice precludes consumers and investors from knowing the true cost of producing a good or service which, in turn, results in incorrect pricing and corporate valuations. The many and complex drivers of the issue and its underlying causes – including, for example, exploitative extractive capitalism and migration resulting from war and conflict, poverty, and climate change – and its global prevalence make forced labor an issue that investors cannot diversify away.

1. What is system-level investing? How is it different from conventional and sustainable investing?

System-level investing is an investment approach centered on adapting both existing, conventional investment techniques and utilizing new tools to manage the risks and rewards of the social, environmental, and financial systems that provide a stable, resilient foundation for investments across all asset classes. Using these techniques and tools, investors—be they institutions, families, or individuals—can better recognize the scope and scale of their impact and influence on social, environmental, and financial systems, and intentionally manage this impact toward the goals of:[11]

Minimizing long-term systemic risks;

Capitalizing on related opportunities for long-term value creation; and

Building resilient systems that support investments across all asset classes.

Investors adopt system-level investing and pursue these goals alongside their ongoing management of portfolio risks and rewards and their pursuit of competitive returns.

It can be helpful to think about system-level investors vis-à-vis conventional and sustainable investing (see Table 1). Conventional investment approaches focus on avoiding individually risky securities and diversifying investment portfolios to maximize short-term returns. They do not intentionally consider environmental or social risks or the impact that investors have on environmental or social issues, instead leaving such issues to be sorted out through market efficiency and by governments.[12] Sustainable investment approaches integrate environmental and social considerations into security valuation and risk management, but typically only insomuch as these issues materially impact short-term returns.[13] Whereas sustainable investors may ask, “What are the carbon emissions and working-condition consequences of our investment?”, system-level investors consider “What can we do to minimize the risks of climate change globally and prevent abusive labor throughout all supply chains?”

Table 1. Conventional vs. sustainable vs. system-level investing

Conventional	Sustainable	System-level
• Do not consider ESG factors as relevant and material in their security valuation, and view such factors as political or subject to other conflicts of interest • Primary goal is to maximize returns in as short a time as possible without consideration of such factors	• Consider ESG factors as potentially relevant and material in security selection and portfolio risk management • Seek to understand and, when appropriate, improve the ESG performance of specific investments regarding their market value (e.g., via proxy voting and engagement with individual companies on financially material ESG issues) • Primary goal is to allocate assets to strong ESG performers while maximizing returns in as short a time as possible	• Intentionally manage the risks and rewards of the social, financial, and environmental systems that provide a stable, resilient foundation for investments across all asset classes, and their impact on these systems • Use a range of techniques to manage these risks and rewards, set explicit goals for their impact on systems, and measure their progress toward those goals • Seek to preserve and enhance foundational social, financial, and environmental systems in the long term while nevertheless achieving competitive returns in the short term

2. How do investors adopt system-level investing?

System-level investing can include allocating investments to asset classes well-suited for addressing different social and financial system issues. This means that in addition to examining the extent to which different asset classes align with their risk appetites and return expectations, investors should also consider the potential system-level impacts of their investments—whether and how different asset classes help to fortify or detract from the health of social and financial systems. Investors can leverage the corporate disclosures related to public equities, for example, to pressure companies to operate efficiently and in theirs and the public's long-term interests; and they can use fixed income markets to help fund public goods and support social infrastructures that build a long-term foundation for economic stability and hence for investment opportunities.

System-level investing can also include adapting conventional investment practices to contend with social and financial system risks and invest in related solutions. Specifically, this means:

- **Reflecting social and financial system concerns in investment beliefs.** Investors often state their beliefs—their guiding assertions—about how financial markets work and how their activities relate to those markets in Investment Policy Statements or Investment Beliefs Statements. Investors can integrate their beliefs about the importance of, and interconnection between, the health of social and financial systems in these statements and the related threats to or opportunities for their investment portfolios.

- **Emphasizing systemic issues in security selection and portfolio construction.** Security selection and portfolio construction are the incorporation of risk-control and related considerations into the investment process. Investors can include in this process setting of standards or minimum thresholds for conduct for whole industries based on problematic business models or issues (e.g., human rights).

- **Engaging with holdings about social, environmental, and financial system issues.** Investors commonly communicate with corporate managers when dissatisfied with a company's financial performance and sometimes to improve their ESG policies and practices and reduce ESG risks. Investors can extend this engagement beyond activism or engagement with individual firms by joining in efforts to change systems at the core.

- **Evaluating and selecting managers based on their consideration of social, environmental, and financial system issues.** Manager selection involves the incorporation of investment criteria into the selection and monitoring of external vendors used to manage assets. Investors can ensure that their external managers' beliefs and actions reflect alignment with investors' beliefs about and commitments to addressing systemic social, environmental, and financial issues.

System-level investing can also include the adoption of new techniques that are explicitly designed to help investors to fortify environmental, social, and financial systems (i.e., minimize undesirable outcomes and maximize desirable outcomes). These techniques stress collaborative action, building shared knowledge bases, setting industry standards, and approaches to creating a rising tide of investment opportunities for all investors. In doing so, they focus on key leverage points that can strengthen overall systems, enhance their resilience, and ensure their long-term sustainability. They can be grouped according to three broad or overarching tactics: field-building, investment enhancement, and opportunity generation. Table 2 describes these techniques.

Table 2. Advanced system-level investing techniques

Field-building	
Self-organization	Create collaborative organizational structures across the investment industry to build its capacity to address systemic challenges.
Interconnectedness	Increase the flow of information and communication about social, financial, and environmental systems among peers, with clients, and with the public at large.
Polity	Engage in public policy debates about governmental rules and regulations that can have a positive impact on whole systems relevant to investments.
Investment enhancement	
Diversity of approaches	Use of a diverse range of investment tools to address complex systemic challenges.
Standards setting	Establish standards that discourage investments in industries and countries with practices that violate broadly accepted standards or norms, or to contribute to the development of such standards.
Solutions	Identify investments that both profit from the most pressing system-level challenges and resolve them positively.
Opportunity generation	
Additionality	Invest in underserved people and address unmet social or environmental needs or markets.
Locality	Invest to strengthen the social or environmental systems within a given geographic area—a city, state, region, or country.
Evaluations	Look beyond quantifiable price and evaluate the potential of systems to provide the stability and predictability necessary to create a fertile field for investment opportunities.
Utility	Maximize the alignment of specific investments within a portfolio's asset classes with the social or environmental functions that these asset classes were designed to serve.

Note: See TIIP's publication Effective Investing for the Long-term: Intentionality at Systems Levels for more information about these tools.

3. Why should investors adopt system-level investing?

There are any number of reasons why investors should adopt system-level investing. Paramount among them are:

1. Finance, economics, politics, commerce, and society have changed over time. Investment must evolve as well to keep up with the challenges of the times.

2. Modern technology and increased globalization mean that everything and everyone is more interconnected than ever. Investors must consider this increased interconnectedness and complexity.

3. Finance represents between 20-25% of the world's GDP and markets are the mechanism by which capital is allocated. Investors' decisions substantially impact the systems of which they are a part.[14]

4. Social, financial, and environmental systems impact the risks and rewards that investors derive from investing. It is in their long-term interests to support the health and resilience of systems, especially to the extent that their actions may otherwise contribute to negative systemic impacts on investments.

Because investors play key roles in the complex, interconnected systems that are increasingly impacting the performance of their portfolios, it is in their interest to positively influence these systems to effectively ensure their health and preservation.

The State of the Industry

For the first part of *The Industry Needs Project*, TIIP conducted an industry needs assessment to better understand the extent to which investors are adopting system-level investing and what roadblocks might be getting in the way of their doing so. This included surveying nearly 100 investors (asset owners and managers), financial advisors, and other industry stakeholders and collecting focus group and interview data to assess financial industry system-level investing knowledge and needs and to answer two fundamental questions:

1. Do investors, financial intermediaries, and other industry stakeholders understand what system-level investing is?
2. Are they ready to adopt system-level investing approaches to address systemic challenges? What support do they need?

The remainder of this section summarizes the findings from this data collection (see also Figure 3) and Attachments A and B contain additional information about project data collection. In short:

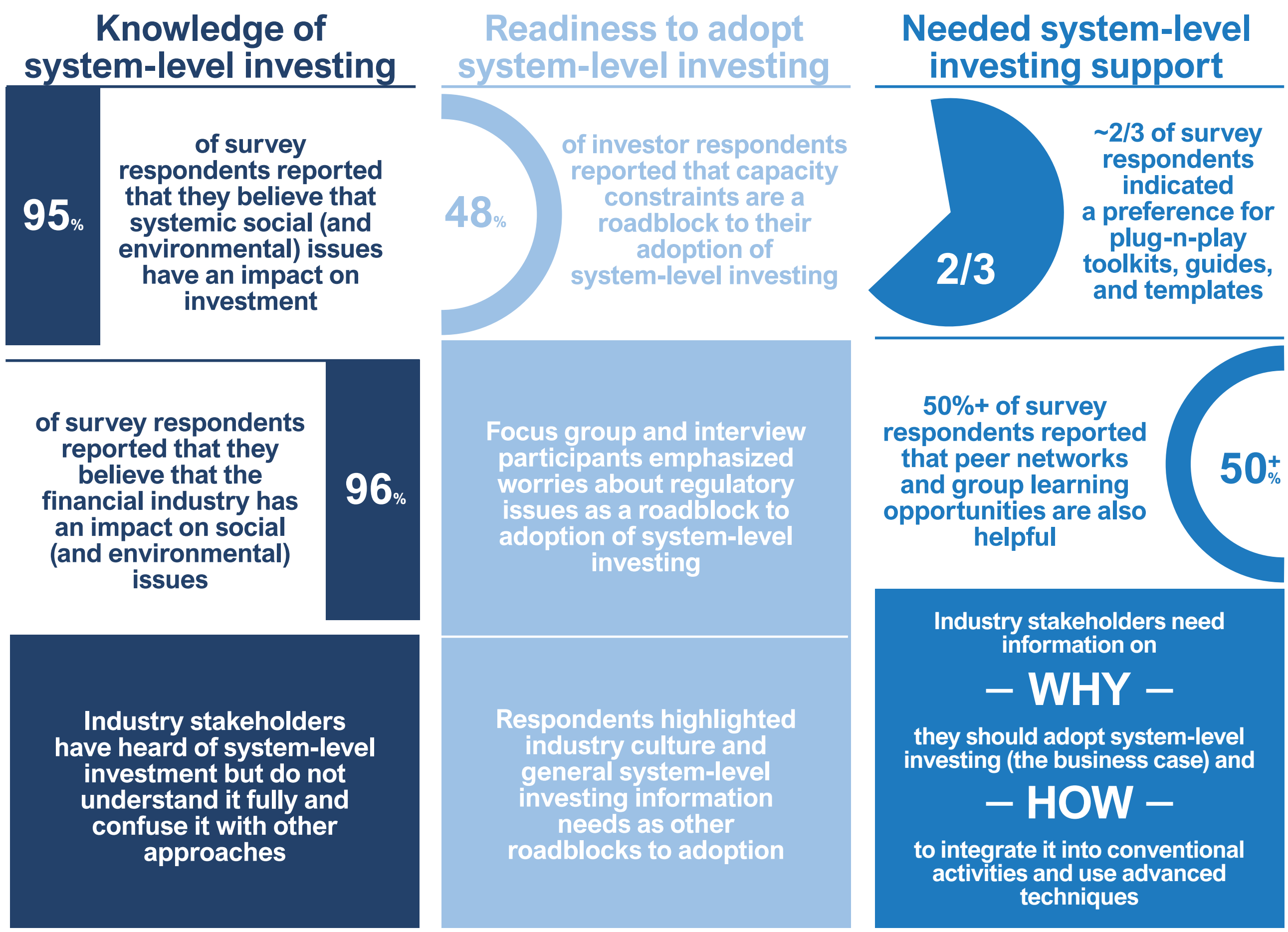
- Many industry stakeholders are aware of and concerned about systemic social and environmental issues and the interconnection between these issues and the financial industry.

- Capacity constraints, regulatory uncertainty, ingrained industry culture, and a general need for more information—including information about systemic social issues—are among the roadblocks preventing their adoption of system-level investing to address these issues.

- Industry stakeholders need information about the basics of system-level investing; the business and legal case for adopting it; straightforward "plug-and-play" guidance for how to do so; and opportunities to engage in group learning, collaborate, and exchange ideas and best practices.

- All system-level investing resources must: (1) convey information in "bite sized" pieces that make system-level investing and systemic issues more digestible; (2) bring system-level investing to life with vivid examples (e.g., case studies or narratives); (3) be tailored to meet the unique needs, goals, and experience levels of different industry stakeholders; and (4) target asset owners including pension funds, foundations, family offices, endowments, insurance companies and sovereign wealth funds (and the consultants that guide their investment decisions) given their longer-term interests.

Figure 3. Summary of findings from the industry needs assessment



1. Knowledge of system-level investing

Investors and other financial industry stakeholders are aware of and concerned about systemic issues (and *environmental* issues in particular) but do not necessarily know how to address them.

Investors, financial advisors, and other industry stakeholders reported on the project survey that they are aware of and concerned about systemic issues. Further, nearly all the survey respondents (95%) asserted that they believe that systemic issues have an impact on investments, and that they believe that the financial industry has an impact on social and environmental systems (96%).

Focus group participants and interview respondents largely confirmed this apparent awareness and concern about systemic issues but cautioned that it does not necessarily mean that investors and other stakeholders understand the complexities of these issues or know how to deal with them. They also noted that while investors are mostly aware of and concerned about systemic environmental challenges and their intersection with investment, few are as focused on or knowledgeable about systemic social issues.

More than half of investors, financial advisors, and other industry stakeholders (55%) also reported on the project survey that they are familiar or very familiar with system-level investing—and more than 1/3 reported that they have adopted the approach. However, focus group participants and interview respondents reported that while a select few individual investors might engage in system-level investing, investors overall are not familiar with system-level investing and that those that claim to have heard of it do not fully understand what it is or how to adopt it. They suggested that most investors confuse system-level investing with other approaches and commonly lump sustainable, impact, responsible, and system-level investing together as "ESG" (e.g., "it all gets lumped into the ESG bucket" and "isn't it the same thing as ESG?"). They cautioned that claims by investors that they engage in system-level investing should be met with skepticism given the prevalence of "greenwashing" and "social washing".[15]

2. Readiness to adopt system-level investing

Roadblocks ranging from capacity constraints to regulatory uncertainty and ingrained industry culture are inhibiting the widespread embrace of system-level investing by investors.

Survey, focus group, and interview respondents collectively identified a series of "roadblocks" that help to explain the apparent disconnect between *awareness of and concern about* systemic challenges and adoption of system-level investing to address them (see Figure 4). Those roadblocks identified by survey respondents, and reinforced during interviews and focus groups, include:

Capacity constraints

Nearly half of survey respondents reported that capacity constraints are a roadblock to their adoption of system-level investing. According to interview respondents, **investors either do not have (or cannot find) the qualified personnel or institutional knowledge required to undertake system-level investing** or are unsure how to effectively deploy existing staff to adopt the approach.

Regulatory uncertainty

Relatively few survey respondents cite regulatory uncertainty as a roadblock to their adoption of system-level investing, but about half of focus group and interview respondents emphasized "regulatory issues" as a major roadblock to adoption of system-level investing. They echoed a well-known **concern that consideration of social or environmental issues in investment strategy conflicts with managers' and advisors' legal obligation to act in the best interests of their clients.**

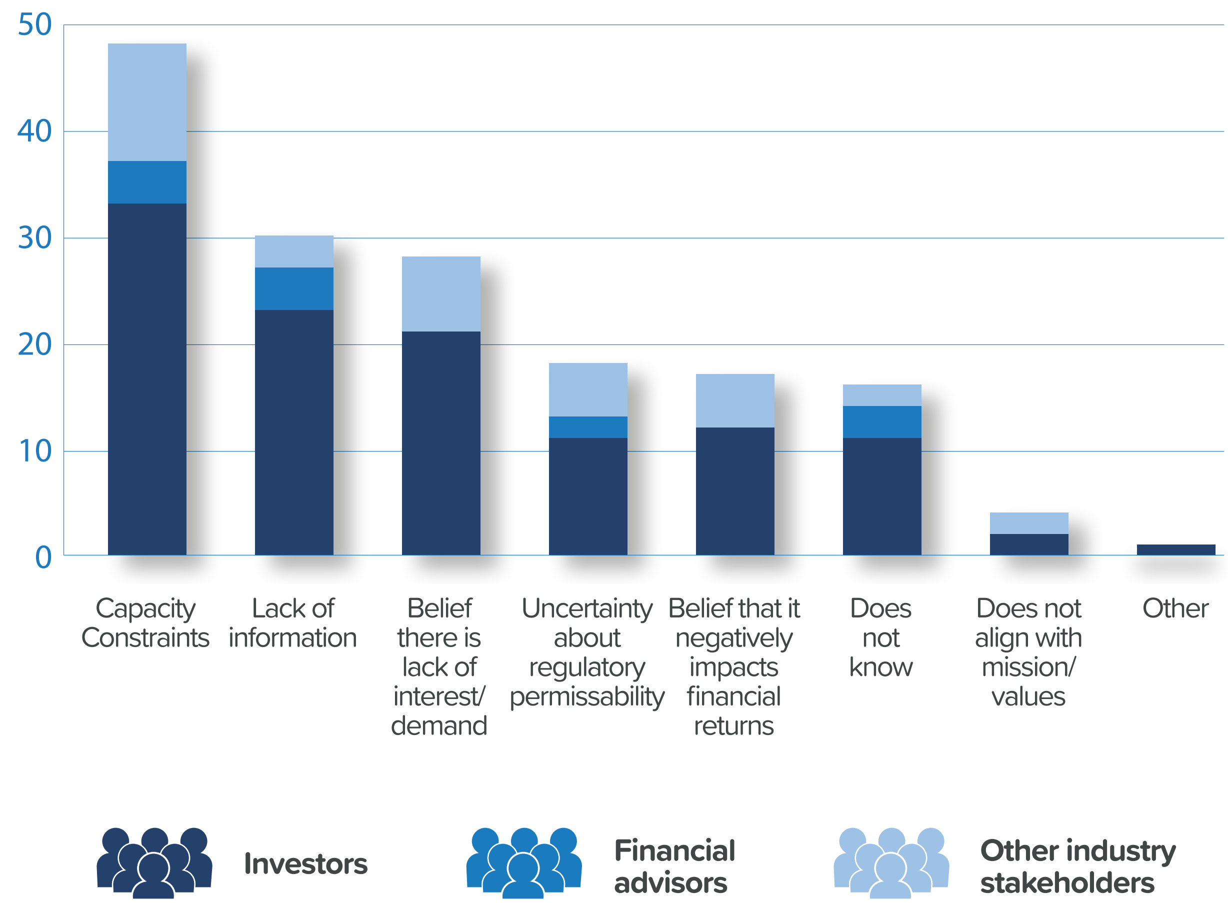
Lack of information and interest, myths about financial performance

Nearly 1/3 of survey respondents identified **lack of information and lack of interest/demand as roadblocks** to adoption of system-level investing, and about 1/5 of survey respondents identified the **belief that system-level investing negatively impacts investment returns** as a roadblock to implementation. None of the focus group or interview respondents explicitly identified these issues during data collection, but they did imply that investors need more information about what system-level investing is and that they believe that it might negatively impact returns.[16]

Financial industry culture

Focus group and interview respondents of all types indicated that the financial industry has a **deeply ingrained culture that (a) emphasizes quarterly reporting and short-termism, (b) discourages change and "lacks imagination," and (c) can make it difficult for investors to challenge the status quo** and consider the bigger picture and longer-term implications of their actions.

Figure 4. Common system-level investing roadblocks by stakeholder type



Source: The Investment Integration Project (TIIP). *The Industry Needs Project* survey. 2021.

3. Needed system-level investing support

Investors and other financial industry stakeholders need clear, straightforward, accessible information on the what, why, and how of system-level investing.

Survey, focus groups, and interview respondents reported that they need information on the what, why, and how of system-level investing. These information needs can be summarized as:

- **What system-level investing is.** A notable portion of survey respondents indicated that they need information about what system-level investing is and background information about specific social and environmental issues. Given focus group and interview respondents' skepticism that survey respondents are as familiar with system-level investing as they claim to be, it may be safe to assume that the need for such information is even greater than reported on the survey.

- **Why to adopt system-level investing (the business case).** Focus group and interview respondents were insistent that effectively establishing the business case for why investors and other industry stakeholders should adopt system-level investing—the third most cited information need on the project survey—is essential to ensuring its widespread adoption. This includes providing data related to the financial benefits of doing so (i.e., investment returns), helping stakeholders better understand client demand for such approaches, clarifying related regulatory issues, and explaining both the risks and opportunities related to addressing systemic issues.

- **How to adopt system-level investing.** Survey respondents cited "how to" guidance, including information about how to integrate system-level investing into conventional investment activities (e.g., security selection and portfolio construction) and how to leverage advanced techniques as two of their top three information needs. Many survey and focus group respondents concurred, with one asset manager noting that those few investors who understand the what and why of system-level investing rarely know how to integrate it into practice.

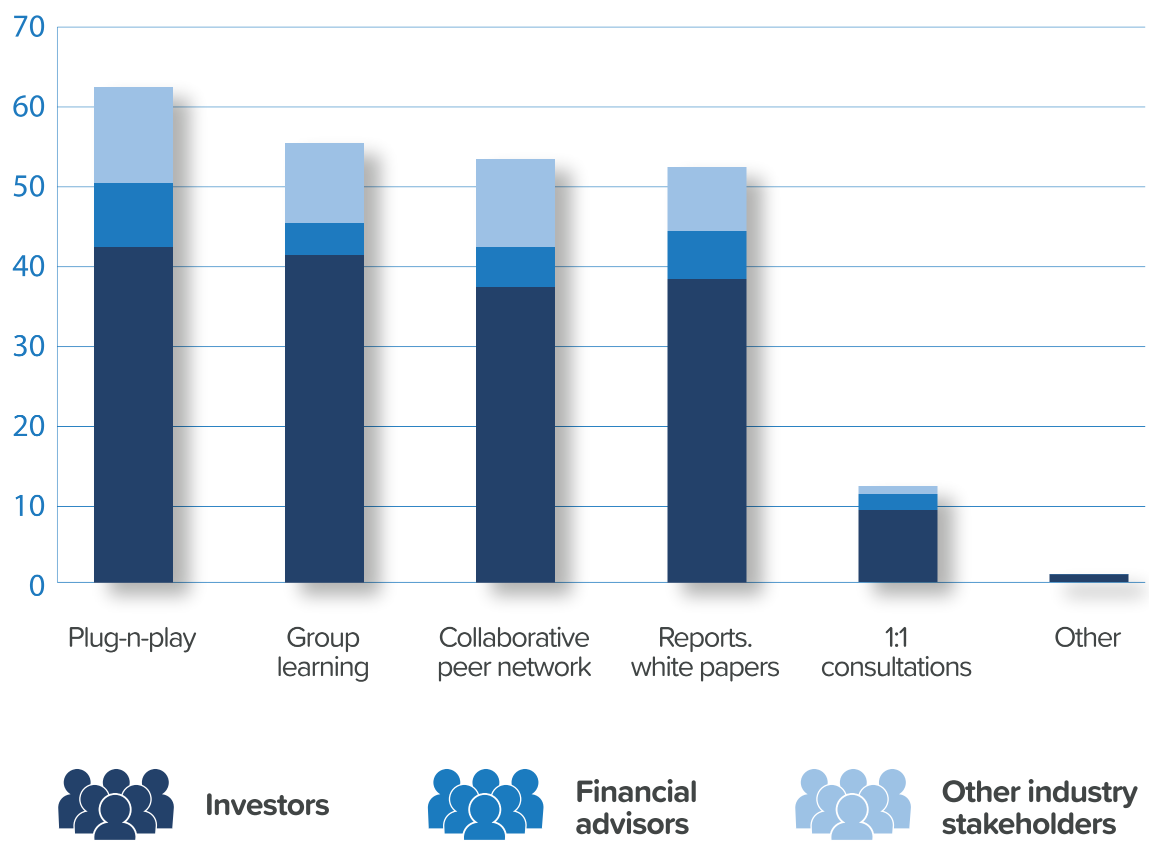
- **How to evaluate system-level investing approaches and monitor progress.** Information about performance assessment and due diligence was the second most cited information need by survey respondents (and the most cited information need by investor survey respondents). Participants from one focus group also emphasized the need for standardized methods for evaluating the progress of investors' system-level investing approaches over time and to answer, "what are you actually shifting in the world?", and those from another group suggested that any system-level investing performance monitoring be done using existing data sources and within existing reporting frameworks.

When asked about their preferred ways of receiving such information, survey, focus groups, and interview respondents alike reported the following as their "resource type" preferences (see also Figure 5):

- Almost 2/3 of survey respondents indicated a preference for **plug-n-play toolkits, guides, and templates.** Interview and focus group respondents noted that such tools are a way to simplify complex ideas and to help investors effectively and efficiently integrate them into practice.

- More than half of survey respondents reported that **peer networks and group learning opportunities** would also be helpful ways to receive information about system-level investing. Interview and focus group respondents from across stakeholder groups were equally enthusiastic about collaborative peer exchange networks and group learning, noting that they provide a forum for building consensus and enable investors to pool resources (e.g., money, ideas, qualified personnel) to collectively influence entrenched norms and create durable change.

Figure 5. System-level investing resource needs by stakeholder type



Source: The Investment Integration Project (TIIP). *The Industry Needs Project* survey. 2021.

Finally, focus group and interview participants noted that the highest level decisionmakers (e.g., CEOs and CIOs) do not have the time to read and digest research reports. They also suggested that investors might be intimidated by system-level investing and overwhelmed by the suggestion that they can influence entire systems. They nearly unanimously and emphatically stated that to address these issues, all system-level investing resources must:

Keep things short and simple

and convey information about system-level investing in "bite sized" pieces to make a seemingly complex approach more digestible and accessible

Tailor information to different stakeholder groups

(e.g., asset owners, asset managers, wealth managers, consultants) to address their unique needs, goals, and experiences

Bring system-level investing to life

with vivid examples of peers' system-level investing activities and successes using the approaches in practice

Target asset owners with long-term interests,

such as pension funds, foundations, endowments, family offices, insurance companies, and sovereign wealth funds (and the consultants and advisors that guide their work)

The Path Forward

The industry needs assessment made it clear that financial industry stakeholders are concerned about systemic issues and their interconnection with investment. It also made it clear that a series of roadblocks—including capacity constraints, regulatory uncertainty, deeply ingrained industry culture, and a general need for more information—are impeding investors' adoption of system-level investing to address these issues, let alone widespread embrace of the approach.

Financial industry stakeholders asserted that to address these challenges, they need:

- A better understanding of system-level investing;
- The case for adopting the approach;
- Guidance for how to adopt system-level investing;
- Approaches for system-level investing performance assessment and due diligence; and
- Assurance that the regulatory environment supports system-level investing.

They noted that they would prefer to receive such information via:

- Plug-n-play toolkits, guides, and templates; and
- Opportunities to learn from and collaborate with peers.

Stakeholders emphasized that all the above should be tailored to meet the needs of different industry segments and convey complex and overwhelming concepts in a digestible way using real life examples. They also suggested that initial efforts to increase adoption of system-level investing should target assets owners with long term interests.

For the second and final part of *The Industry Needs Project*, TIIP used the findings from the project industry needs assessment to answer one final question:

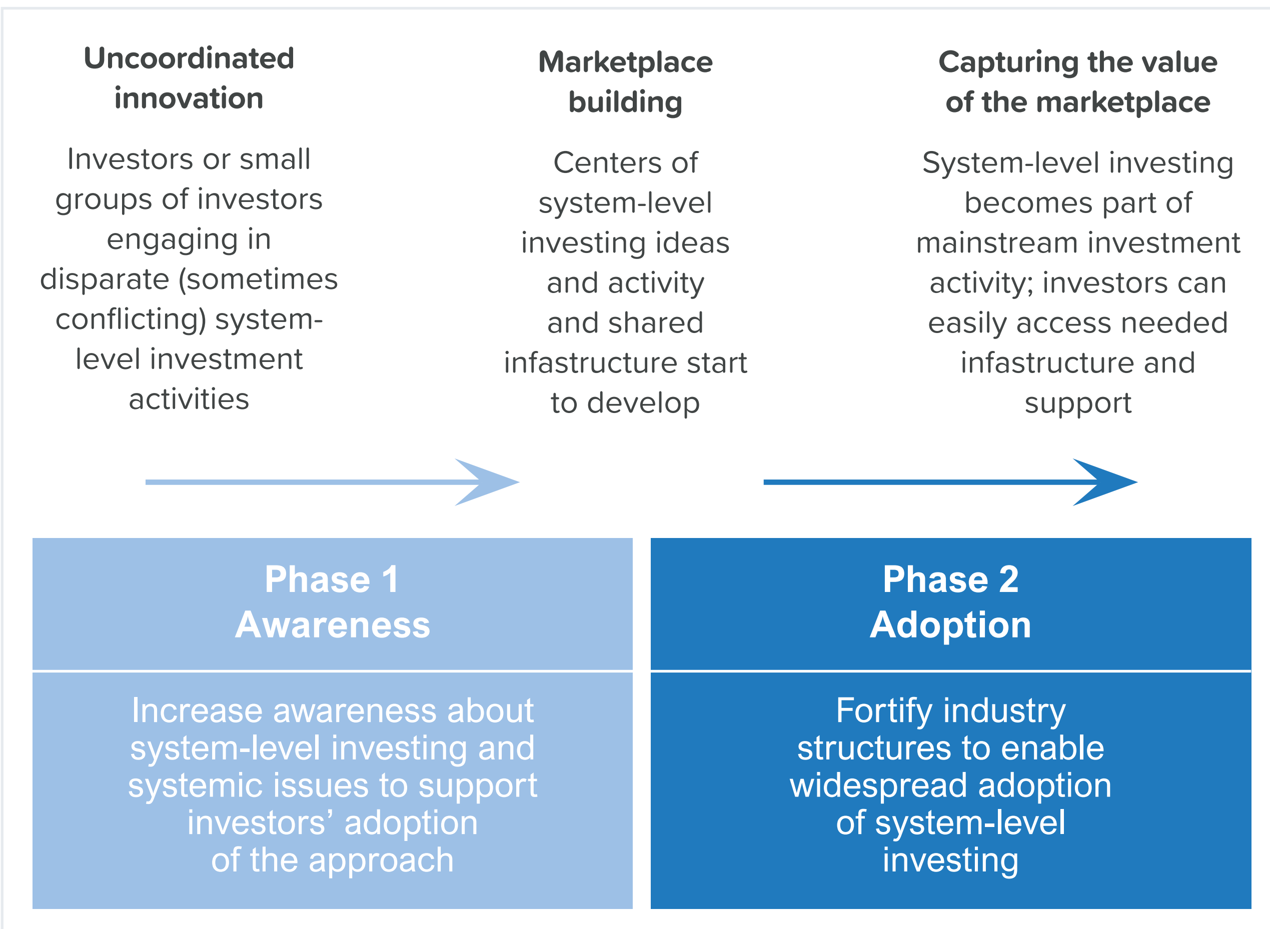
What is the path forward for the financial industry and toward industry transformation?

The remainder of this section outlines a plan for meeting the financial industry where it is – for capitalizing on investors' increasing concern about systemic issues and openness to integrating the approach into their investment practices. It provides a path forward for building the marketplace for system-level investing – for formalizing centers of ideas and activities and developing a shared infrastructure for implementation of the approach and supporting a higher volume of activity.

It also offers initial ideas for *capturing the value of the marketplace* to help ensure that system-level investing becomes part of mainstream investment activity and that investors can easily access needed infrastructure and support.

The plan focuses on activities that can be executed over the next two to five years to quickly equip the financial industry with tools and strategies to manage systemic social and environmental challenges. The first phase of the plan – **awareness** – focuses on **increasing awareness about** system-level investing **and systemic issues** and, when possible, suggests ways to build on work already done or currently underway by TIIP and others to help investors understand the what, why, and how of system-level investing. The second phase – **adoption** – focuses on **fortifying industry structures to enable widespread adoption of system-level investing**, including related to things like data, evaluation, and regulation. Much progress has been made on these topics with respect to sustainable investing but there are more questions than answers when it comes to system-level investing.

Figure 6. Building the market for system-level investing



Note: Adapted from "Phases of industry evolution" introduced in Monitor Institute (2009). Investing for Social & Environmental Impact: A Design for Catalyzing and Emerging Industry.

Phase 1: Awareness

Despite investors' apparent concern about systemic issues and interest in addressing the interconnection between these issues and investment, few investors seem to know about or understand what system-level investing is (and how it differs from sustainable investment), why it is important, or how to adopt it to manage the risks and rewards of these issues (save for notable early adopters highlighted elsewhere in this report). Further, while many investors readily acknowledge that environmental issues like climate change are urgent systemic challenges, fewer investors appear to be as aware of and as concerned about similarly troubling systemic social issues.

The first phase of industry transformation, therefore, directly addresses three distinct needs identified during the industry needs assessment, including the needs for:

1. A better understanding of systemic issues (and systemic social issues in particular) and the what and why of system-level investing

2. Guidance on how to start adopting system-level investing

3. Opportunities to learn about and from peers

This phase targets asset owners with long-term interests, such as pension funds, foundations, endowments, family offices, insurance companies, and sovereign wealth funds. Doing so will help to build demand for the approach among influential institutional investors to incentivize intermediaries (e.g., asset managers, financial advisors, and consultants) to follow suit. Figure 7 summarizes the goals and discrete next steps related to addressing each of the above-mentioned needs.

Organizations like TIIP, The Predistribution Initiative, The Shareholder Commons, the CFA Institute, and investors, industry associations, and academics alike have provided early thought leadership about system-level investing, developed theoretical frameworks, and produced a library of related resources. As such, the financial industry does not have to spend time "reinventing the wheel" during this first phase of industry transformation. Rather, it can instead focus on identifying, curating, and adapting and improving on work that has already been done to ensure that the resources developed as part of this plan reflect best practices and industry consensus.

Figure 7. The path forward for increasing awareness of system-level investing

Phase 1: Awareness

Increase awareness about system-level investing and systemic issues to support investors' adoption of the approach

	1	2	3
Needs	A better understanding of systemic issues (and systemic social issues in particular) and the what and why of system-level investing	Guidance on how to start adopting system-level investing	Opportunities to learn about and from peers
Goals	**Ensure that investors understand what makes an issue systemic, and what system-level investing is and is not (provide definitional clarity) and why they should adopt it**	**Empower investors to start integrating system-level investing into their investment practices to increase adoption of system-level investing**	**Facilitate opportunities for collaboration and peer exchange to improve and otherwise advance adoption of system-level investing**
Next steps	Curate existing resources on the what and why of system-level investing Adapt and amend existing resources so that they are clear, concise, and reflect industry consensus related to system-level investing Disseminate and otherwise amplify information about system-level investing	Develop and provide investors with easy-to-use plug-and-play toolkits, guides, and templates to support successful adoption of system-level investing – including information about how to adapt conventional approaches and adopt advanced techniques to purse system-level goals	Build a system-level investing community of practice that facilitates interactive discussions and the productive exchange of ideas and best practices

Goal 1

Ensure that investors understand what makes an issues systemic, and what system-level investing is and is not (provide definitional clarity) and why they should adopt it

Given industry stakeholders' confusion about the fundamentals of system-level investing and requests for information expressed during the industry needs assessment, key activities of the first phase of industry transformation—and related to the goal of **ensuring that investors understand what makes an issue systemic and what system-level investing is and is not and why they should adopt it**—should include:

- Curating existing resources on the what and why of system-level investing
- Adapting and amending existing resources so that they are clear, concise, and reflect industry consensus related to system-level investing
- Disseminating and otherwise amplifying information about system-level investing

The very first step on the road to widespread adoption of system-level investing is clearly answering important questions, including, "What makes an issue systemic and which systemic issues should investors care about?", "What is system-level investing and how does it differ from conventional and sustainable investing?" and "Why should investors adopt system-level investing?" Of course, answering these questions will not be enough – stakeholders must ensure that the resources (and the vocabulary, concepts, and basic principles contained in them) are frequently and effectively conveyed to the key decision makers that are best positioned to act on them.

Goal 2

Empower investors to start integrating system-level investing into their investment practices to increase adoption of system-level investing

Among the system-level investing information disseminated by TIIP and others are various resources that provide instructions on how to adopt system-level investing. However useful these reasources are, they primarily focus on providing an introduction to system-level investing to those who are hearing about the approach for the first time rather than introducing tools that investors can use to integrate system-level investing into their investment practices. Further, capacity constraints, including time to dedicate to integrating system-level investing, were among the roadblocks to system-level investing identified during the industry needs assessment.

Key activities of the first phase of industry transformation related to the goal **of empowering investors to start integrating system-level investing into their investment practices to increase adoption of system-level investing** therefore should include:

Developing and providing investors with easy-to-use plug-and-play toolkits, guides, and templates to support successful adoption of system-level investing – including information about how to adapt conventional approaches and adopt advanced techniques to purse system-level goals.

The section on system-level investing at the start of this report provides an indication of the substantive answers to the “what is system-level investing?” and “why should we adopt it?” questions that might be usefully adapted and included in among these resources.

Goal 3 Facilitate opportunities for collaboration and peer exchange to improve and otherwise advance adoption of system-level investing

A somewhat surprising takeaway from the industry needs assessment was financial industry stakeholders’ (including asset owners and asset managers) request for opportunities to learn from and collaborate with peers around system-level investing. The financial industry is a traditionally thought of as a competitive, zero-sum industry in which investors “keep their cards close to their chest”.

But—perhaps because of the relative newness of system-level investing and its purpose to help investors address big, global problems—stakeholders suggested that such opportunities for collaboration and partnership could also enable consensus building and help to create durable change.

Another of the key activities of the first phase of industry transformation and related to the goal of **facilitating group learning and peer exchange** should include:

Building a system-level investing community of practice that facilitates interactive discussions and the productive exchange of ideas and best practices.

While there are financial industry associations that facilitate learning and collaboration related to sustainable investing (broadly defined), investors do not yet have a community of practice that facilitates the exchange of ideas related to system-level investing – the community of practice recommended here would be the first of its kind.

Associations dedicated to sustainable investing, however, provide existing networks of socially and environmentally minded investors that the financial industry can leverage in the development of a system-level investing community of practice – either a new, standalone community or one that is integrated into an existing community. They include, for example:

Council of Institutional Investors (CII)	CII is a non-profit association of employee benefit funds and plans, state and local investment entities, foundations, and endowments focused on enhanced corporate governance, shareholder rights, and long-term value creation. It supports is 310 members through education, advocacy, and engagement.[17]
The Global Impact Investing Network (GIIN)	The GIIN is dedicated to increasing the scale and effectiveness of impact investing around the world via building ecosystem infrastructure and support activities, education, and research. The GIIN is comprised of over 360 organization in approximately 50 countries.[18]
Interfaith Center for Corporate Responsibility (ICCR)	ICCR is a coalition of 300 global institutional investors committed to using shareholder advocacy to identify and mitigate ESG issues at investee companies. ICCR facilitates corporate dialogue, initiates shareholder resolutions, hosts industry roundtables, and advocates public policies that support investors' ESG engagement with companies.[19]
International Corporate Governance Network (ICGN)	ICGN develops and promotes principles for corporate governance, investment stewardship, and long-term value creation; connects investors to discuss these issues; and provides commensurate educational opportunities. Its members are based in 45 different countries.[20]
Principles for Responsible Investment (PRI)	An investor initiative executed in partnership with UNEP FI and the UN Global Compact, PRI's goal is to grow investor interest in environmental, social, and corporate governance issues (ESG), share best practice and support signatory needs in their fulfilment of the six PRI Principles. PRI is made up of nearly 5,000 signatories, comprised of pension funds, insurance companies, sovereign/development funds, investment managers and service providers.[21]
Money Management Institute (MMI)	MMI is an industry association for financial services firms focused on facilitating opportunities to connect and collaborate (e.g., conferences and peer connections) and providing educational resources and thought leadership to its 128 member firms. It includes resources related to sustainable investing and system-level investing among its offerings.
Toniic	Toniic's mission is to empower impact investors to promote a global ecosystem of stakeholders who create positive social and environmental impact. Toniic facilitates peer gatherings, has built an online community and network, and supports investors on their impact journey. Toniic is comprised of around 500 high net wealth individuals, family offices, and foundations in more than 25 countries.[22]

At a minimum, the community of practice should: (a) facilitate interactive discussion platforms; (b) host system-level investing events (e.g., conferences or similar gatherings); and (c) offer small group system-level investing education sessions.

Beyond supporting investors on their system-level investing journeys, these group learning and peer exchange endeavors would help to:

- Galvanize collaborative action on pressing systemic issues;
- Establish a shared vision of system-level investing across the financial industry;
- Identify new examples of system-level investing in practice;
- Enable ongoing assessment of system-level adoption, roadblocks, and solutions; and
- Help to ensure that stakeholders are not working at cross-purposes.

In the hyper-competitive financial world, investors rarely collaborate with their peers. Managing social, environmental, and financial systems such that they benefit all stakeholders—and create a rising tide of opportunity for all investors—will require coordination and collaboration.

Phase 2: Adoption

Increasing awareness about systemic issues and the what, why, and how of system-level investing is a critical first step to industry transformation, but the financial industry cannot scale its adoption of system-level investing without approaches to evaluate impact along the way or in an unfavorable regulatory environment. In fact, industry stakeholders—and investors in particular—indicated during the industry needs assessment that they need information about system-level investing performance assessment and due diligence and emphasized "regulatory issues" as a roadblock to their adoption of the approach.

As such, the second phase of industry transformation focuses on facilitating widespread adoption of system-level investing by directly responding to the two needs identified above, including:

- Processes for measuring the impacts of investors' system-level investing approaches
- A regulatory environment that supports widespread adoption of system-level investing

Whereas the first phase ("awareness") targeted asset owners with long-term investment horizons, this phase should be broader in scope – targeting not only asset owners, but also targeting the other industry stakeholders that play a crucial role in facilitating their work (e.g., asset managers, financial advisors, and consultants). Figure 8 summarizes the goals and discrete next steps related to addressing each of the above-mentioned needs.

While there is a library of existing resources that provide much of the scaffolding from which to increase awareness about system-level investing in phase one, the financial industry has done less work to date on impact measurement or regulatory advocacy vis-à-vis system-level investing. Thankfully, standards setters and other industry stakeholders across the U.S. and Europe and European regulators, for example, have made considerable progress along these fronts related to sustainable investing, progress that the financial industry can usefully build on in service of system-level investing.

Figure 8. The path forward for enabling widespread adoption of system-level investing

Phase 2: Adoption

Fortify industry structures to enable widespread adoption of system-level investing

	1	2
Needs	Processes for measuring the impacts of investors' system-level investing approaches	A regulatory environment that supports widespread adoption of system-level investing
Goals	**Develop standardized systems for monitoring, evaluating, and reporting on investors' impacts on systemic issues**	**Advocate for changes to global regulatory frameworks to ensure that they do not impede – and in fact support – widespread adoption of system-level investing**
Next steps	Examine available ESG data and existing monitoring, evaluation, and reporting frameworks; determine whether and how investors can adapt them to measure their impacts on systemic issues and progress toward system-level goals Assemble a working group to recommend a standardized system for monitoring, evaluating, and reporting investors' impacts on systemic issues	Pressure regulators to make changes to global regulatory frameworks to ensure that they support widespread adoption of system-level investing

Goal 1

Develop standardized systems for monitoring, evaluating, and reporting on investors' impacts on systemic issues

Widespread adoption of system-level investing and the ability to build the marketplace for the approach depends in large part on ensuring that investors can (a) effectively measure and evaluate systemic considerations related to companies, asset managers, and fund managers, and (b) can effectively evaluate their impacts on systemic issues and progress toward achievement of their system-level investing goals. It was not surprising, therefore, that information about performance assessment and due diligence was the second most cited information need by survey respondents (and the most cited information need by investor survey respondents) and that focus group respondents emphasized the importance of progress measurement and being able to answer: *"what are you actually shifting in the world?"*

Key activities of the second phase of industry transformation related to the goal of **developing standardized systems for monitoring, evaluating, and reporting on investors' impacts on systemic issues** should include:

- Examine available ESG data and existing monitoring, evaluation, and reporting frameworks; determine whether and how investors can adapt them to measure their impacts on systemic issues and progress toward system-level goals

- Assemble a working group to recommend a standardized system for monitoring, evaluating, and reporting investors' impacts on systemic issues

For the past two decades investors, standards setting agencies, and industry associations have been developing and refining approaches to collecting ESG data and measuring and reporting on companies' and investors' environmental and social impacts. Although none of these approaches have been designed to monitor and evaluate system-level investing approaches, the financial industry should (a) examine whether they are fit for purpose for such analysis and, if not, (b) determine whether and how they could be usefully adapted for doing so.

The role and importance of the establishment and maintenance of a multi-stakeholder working group dedicated to this purpose will be critical. Such a group should include representatives from investors, data providers, ratings agencies, academia, think tanks, regulators, and the people and environments that are ultimately impacted by the choices of the financial system. It would operate with the goal of helping to inform and develop a standardized method for evaluating system-level progress.

Initiatives underway by the Taskforce for Climate-related Financial Disclosures, the Taskforce on Inequality-related Financial Disclosures, and the Impact Management Platform (led by the Organisation for Economic Co-operation [OECD] and the United Nations Environmental Program Finance Initiative [UNEP FI]) provide examples of this kind of effort to develop and promulgate voluntary corporate and investor disclosure and risk management frameworks as they relate to specific systems.

Table 3 contains a list of those organizations at the forefront of the provision of ESG data, monitoring, evaluation, and reporting—many of which do some combination of the above—that should be among those examined as part of this exercise and potentially invited to participated in the related working group.

Table 3. Organizations at the forefront of ESG data, monitoring, evaluation, and reporting

Organization	Description
CDP	Collects information from 13,000+ companies worldwide related to climate change, water security, and deforestation and provides each with a score based on their transparency and activities
Bloomberg	Reports ESG data for 11,800 publicly listed companies from over 100 countries, for 410,000+ active securities; organized this data 2,000+ fields that span various sustainability topics
Global Impact Investing Network IRIS+	Provides 26,000+ users and 16,000 organizations with data and tools to measure and manage their impact; aligns with other standards and analytics platforms
Global Reporting Initiative)	Utilized by over 10,000 organizations; develops standards and reporting frameworks for corporate disclosure that relate to organization- and sector-specific environmental and social standards
Institutional Shareholder Services	Provides corporate ESG ratings on 9,700 issuers, ESG country ratings on 670 sovereign issuers including 120 countries, ESG fund ratings on 25,700 funds and ESG climate coverage on 25,000 companies
International Financial Reporting Standards Foundation	IFRSF's International Sustainability Standards Board (ISSB) provides investors and other capital market participants a standardized "global baseline" set of companies' sustainability disclosures; focuses on the ESG information around "single materiality"
Moody's	Conducts ESG assessments on 5,000+ large cap-companies and 300 global sustainable bonds and loans
Morningstar	Provides data on ESG risk management at a fund level relative to its peer group for 40,000 funds and 12,000 companies; data is generated from 55 fund metrics and 13 company metrics
MSCI	Generates ESG Ratings for 8,500 companies and 680,000+ fixed income securities worldwide; the ratings are one part of MSCI's larger ESG data, research, and analysis services

Organization	Description
Principles for Responsible Investment	Collects responsible investment data annually from its nearly 5,000 investor signatories (mostly asset owners) via its standardized reporting system; reports and underlying data are available to the public
S&P Global	S&P Global Trucost provides environmental data on 15,000+ companies in 170 countries and 600,000 fixed income issuances and green bonds
World Benchmarking Alliance	Assesses and ranks the world's 2,000 most influential companies on their contribution to the U.N. Sustainable Development Goals

Due diligence of asset managers' system-level investing activities is one area of data, monitoring, evaluation, and reporting that TIIP has focused on in recent years and for which it has developed early guidance that can be usefully updated and adapted.[23] Among other things, this guidance suggests that an investor can assess an asset manager's capabilities and approach to system-level investing using the following framework of considerations:

1. **Does the manager articulate beliefs or principles that are clear, actionable, inspirational, and adaptable to be effective?** Managers should be able to discuss their beliefs about social or environmental systems in the context of value creation, risks and opportunities, and their ability to influence the system's evolution. The manager's stated beliefs also serve as a "north star" that can guide investors assessment of the manager's consistency over changing circumstances.

2. **Can the manager justify why they focus on specific systemic issues?** Like the justification that investors consider in focusing on a particular systemic issue, managers should be able to describe the rationale for their focus to reassure that their interests are not solely personal, political, or otherwise secondary.

3. **Has the manager chosen appropriate places to exert influence?** Complex systems have influence of varying degrees. Savvy managers will select places to exert influence that suit their unique skills and resources and maximize their potential to have positive influence on the system. Managers should be prepared to discuss with investors why they have made the leverage point decisions that they have.

4. **Has the manager chosen techniques designed to create impact at the system-level, and is there evidence that the techniques have been applied skillfully?** A manager's assessment of the place most likely to introduce change to a system as well as their ability to apply thoughtful and effective techniques to that leverage point will be important to their ability to actually have positive impact. Managers with good intentions but lacking evidence of skillful application of system-level investment techniques are less likely to be successful.

5. **Have the manager's actions generated desirable outcomes?** Because systemic change usually occurs over a long time horizon, investors should look for evidence of positive, perhaps incremental contributions or progress by a manager to achieving positive systemic impact.

6. **Has the manager contributed to positive change of the system?** Having positive impact on the evolution of a system is of course the point of system-level investing, and so finding evidence of a manager's contribution to real change is important and desirable. System-level investors understand, however, that while change can't happen without investor influence and effort, investors alone can't effect change, and certainly no individual asset manager can create change on their own.

Another effort by TIIP led to the identification of four foundational characteristics of social, environmental, and financial systems. Investor actions that strengthen any of the four characteristics mitigates systemic risk, while investor actions that weaken any of the four will increase systemic risks.[24] They include:

- **Adaptability:** the environment, society, or the financial system's ability to adjust to shocks and major disruptions (i.e., high adaptability, or self-regulation, helps systems better adjust to unanticipated external shocks).

- **Clarity:** the coherence, flow, access to, and transparency of information about and within a system (i.e., information flows among actors and about system components—and their interrelationships— enables investors' ability to understand their influence and act accordingly).

- **Connectivity:** the quality of interconnection between key stakeholders and dimensions of a system, addressing gaps and underserved components of a system (i.e., systems so structured have positive feedback loops that increase their health and resilience).

- **Directionality:** market incentives structured to encourage positive changes in stakeholder behavior (i.e., healthy systems are those in which influential actors enhance positive characteristics and align their actions with the systems' fundamental goals).

With these in mind, investor can then establish goals against which to measure progress; assess potential usefulness of the system-level investing techniques; and measure whether system-level change is taking place.

Goal 2

Advocate for changes to global regulatory frameworks to ensure that they do not impede– and in fact support – widespread adoption of system-level investing

Focus group and interview participants emphasized "regulatory issues" as a major roadblock to adoption of system-level investing. While they directly highlighted confusion about whether system-level investing conflicts with managers' and advisors' legal obligation to act in the best interests of their clients (i.e., fiduciary duty), they seemingly inferred that existing regulations in the U.S. and elsewhere impede adoption of system-level investing. A path forward to widespread adoption cannot exist if global regulatory frameworks do not support it, or investors are confused about its regulatory permissibility.

It is critical, therefore, that the second phase of industry transformation focus on **advocating for changes to global regulatory systems to ensure that they do not impede – and in fact support – widespread adoption of system-level investing.** Specifically, this should include:

Pressuring regulators to make changes to global regulatory frameworks to ensure that they support widespread adoption of system-level investing.

While it is policymakers and regulators—not investors—that are responsible for changing regulations and laws related to investing practices, investors can (and should) wield their collective power and influence to advocate for needed reforms. There are two initial ways that regulators – at investors' urging – can create a regulatory environment that better supports system-level investing, described below. First, regulators can clarify that system-level investing aligns with fiduciary duty. Second, these same regulators must ensure that corporations disclose relevant social and environmental data to their investors for analysis.

Request clarification that system-level investing does not conflict with fiduciary duty. The existence and specifics of investors' fiduciary obligations vary by country but, broadly speaking, investors' fiduciary obligations require that they manage assets prudently, loyally, and with impartiality, place their clients' interests above their own, and act in good faith in the interests of their clients (including, for example, current and future retirees for pension funds).[25]

As recently as 2021, legal experts from organizations like the UNEP FI, well-respected law firm Freshfields Bruckhaus Deringer, and prominent legal minds (including Keith Johnson, former Co-Chair of the Institutional Investor Services Group) have argued that not only does consideration of systemic environmental and social risks by investors align with their fiduciary duty, but that it is in fact a legal obligation of that duty.

They note, for example, that institutional investors are legally required to balance "inter-generational risk" – that is, they must balance the immediate return needs of plan participants with the threats that systemic issues like climate change pose to the future value of the portfolios of their youngest beneficiaries.[26] Further, financial industry regulators in countries like the U.S., the U.K., and France have suggested that ESG factors can be financially material and impact long-term risk-adjusted returns. However, none of these regulators clarified the relationship between system-level investing and fiduciary duty.

Despite all the above, financial industry stakeholders indicated that they are still uncertain about whether consideration of ESG issues, let alone of systemic environmental and social issues, aligns or conflicts with their fiduciary duty. They need clear, direct, specific, unequivocal regulatory guidance that their fiduciary duty does not impede—and in fact supports—adoption of system-level investing.

Pressure regulators to require corporations to disclose environmental and social data that is useful for system-level analysis. Investors should urge regulators to mandate standardized, best practice-aligned, decision-useful corporate social and environmental risk disclosures across industries and throughout supply chains. Such mandatory disclosures would enable investors and other industry stakeholders to assess and track companies' exposure to, contribution to, and management of social and environmental risks. They not only help to hold corporations accountable to policymakers and the public for their actions, but it can also help investors accurately assess value and make prudent long-term investment decisions that enhance (not undermine) systems. These data should be useful not just for portfolio-level analysis, but also for investors to examine systemic risks and to understand their and their investee companies impact on systemic challenges and contributions to solutions.

For the better part of the past decade, several organizations have established recommendations and frameworks for voluntary disclosures from which mandatory system-level disclosure regulations might be built. They include, for example, CDP (formerly the Carbon Disclosure Project), Global Reporting Initiative, the International Reporting Standards Foundation, and the Taskforce for Climate-related Financial Disclosures (see Table 6 for more information on the organizations and efforts).

Further, European regulators have taken initial steps to require large, publicly held companies in certain industries to report environmental and social risk information to the public and their investors – and U.S. regulators, too, though to a lesser extent. Investors should vocalize that future iterations of such frameworks integrate commensurate requirements for small- and medium-sized enterprises (SMEs) and privately held entities, and that they enable examination of systemic outcomes.

Notable of these regulations include:

- **The EU's proposed Mandatory Human Rights Due Diligence Legislation** would require companies to disclose data on worker protections and labor conditions using standardized metrics that allow for comparative analysis across countries and industries, and to examine and address their impact on human rights or be subject to sanctions.

- **EU's Sustainable Finance Disclosure Regulation (SFDR),** a component of the broader Sustainable Finance Framework, will require investment funds to disclose data related to a series of environmental and social indicators as of 2023.

- **The Enhancement and Standardization of Climate-Related Disclosures for Investors,** proposed in 2022 by the US Securities and Exchange Commission (SEC) would require publicly listed companies to disclose information about climate-related risks and risk management and their short-, medium-, and long-term impacts on the business and financial statements.

Pressure regulators to otherwise ensure that global regulatory frameworks support widespread adoption of system-level investing. Per the earlier mention, PRI, UNEP FI, and the Generation Foundation recently partnered with Freshfields Bruckhaus Deringer to execute the "A Legal Framework for Impact" project, which examined and reported on whether regulations across eleven jurisdictions adequately enable investors to pursue system-level investing (what they refer to as "investing for sustainability impact" [or, IFSI]) and considerations for reform (e.g., clarifying that investors can pursue sustainability impact alongside financial return, encouraging stewardship on sustainability factors, and strengthening the market infastructure for IFSI).[27] It did so broadly speaking and within the specific legal frameworks for each of the eleven jurisdictions examined (including the U.S., the E.U., the U.K., China, and Japan). The global financial industry must now amplify these reccomendations and collectivelly pressure global regulators to advance them.

Industry Leadership

No one entity can build the marketplace for system-level investing alone. Achieving the goals and executing the activities outlined in The Path Forward require the hard work and dedication of an entire ecosystem of champions for system-level investing – including thought leaders and experts on things like data, measurement, evaluation, and fiduciary duty.

Founded in 2015, The Investment Integration Project (TIIP) has been at the forefront of introducing the financial industry to system-level investing and providing early thought- and practice- leadership. TIIP is poised to lead the execution of the plan for industry transformation, but the plan will not be successful without support and contributions from many other people and organizations.

Organizations including the CFA Institute, the Interfaith Center on Corporate Responsibility, The Predistribution Initiative, Preventable Surprises, and The Shareholder Commons - and individuals like Keith Johnson, Jon Lukomnik, James Hawley, Mirtha Kastrapeli, and Jake Barnett (Wespath Benefits and Investments) and Patrick Peura (Allianz Investment Management SE) - have all made notable contributions to financial industry discourse on what system-level investing is and why investors should adopt it. All could (should) help lead the various components of the first phase of industry transformation. As should industry associations like the International Corporate Governance Network, the Principles for Responsible Investment, SHARE Canada, and Toniic – each of which are offering or developing research, tools, and programming meant to support investor integration of system-level investing.

There is also no shortage of organizations that have made significant contributions to data, monitoring, evaluation, and reporting related to sustainable investing that should undoubtedly be among those organizations that contribute to similar efforts for system-level investing. These organizations are described in Table 6 above but include: Bloomberg, CDP, the Global Impact Investing Network, Institutional Shareholder Services, International Financial Reporting Standards Foundation, Moody's, Morningstar, MSCI, S&P Global, and the World Benchmarking Alliance.

The financial industry should also seek counsel from outside people and entities with expertise related to systemic challenges – including, for example, the Cambridge Center for Risk Studies and the Stockholm Resilience Center at Stockholm University – and those focused on system-level evaluation efforts – including, for example, Michael Quinn Patton (Principles-focused evaluation) and the Academy for Systems Change.

Conclusion

The global financial system is approaching the tipping point, one that will eventually see system-level investing ushered in as a mainstream investment philosophy. Its long-term survival and global well-being depend not only on the financial industry acknowledging systemic issues, but on it doing something about them. It is time for industry-wide embrace of system-level investing. This type of larger industry transformation is a lofty goal, and one that will require consistent, difficult, even evolutionary changes in behavior from a variety of stakeholders. However, due in no small part to our industry needs assessment, and the larger *Industry Needs Project*, the financial community now has the starting point to chart this path forward.

The starting point is clear: global financial industry leaders must target asset owners with long-term interests (e.g., pension funds, foundations, endowments, family offices, insurance companies, and sovereign wealth funds) – building demand for the approach among influential institutional investors to incentive intermediaries (e.g., asset managers, financial advisors, and consultants) to follow suit. The path these stakeholders must take can be split up into two distinct phases: increasing awareness about system-level investing and systemic issues and subsequently fortifying industry structures to enable widespread adoption of system-level investing.

Charting the course around these two phases, the financial industry can strive to achieve a series of discrete goals and execute commensurate activities, some of which can usefully build on the existing body of work on system-level investing or efforts currently underway and others of which represent new and relatively uncharted territory.

Fundamental to industry transformation is changing the ingrained financial industry culture which, in its current state, impedes meaningful progress from being made across most areas of the industry. While the two phases of awareness and adoption will push the financial community from the current period of uncoordinated innovation to marketplace building, a change in the financial industry culture will solidify this growth, stripping away short-termism, and subsequently encouraging change, imagination, and challenging of the status quo.

The plan does not stop here. There must be a push to constantly re-evaluate the state of the industry and plan accordingly based off this new information. With sufficient funding and resources, a larger industry survey should be conducted to build on the findings from our industry needs assessment and recommendations outlined in *The Path Forward*.

The Industry Needs Project marks the start of industry transformation. It also provides a start at analyzing where industry stakeholders stand today and a start at providing the framework for future awareness building around system-level investing. It also provides a start at illustrating the activities and information needed for widespread adoption of system-level investing and a start at highlighting the future projects needed to fill in the gaps. Most importantly, it is a start at supporting investors' next steps to move past the tipping point.

Attachments

Attachment A. Project focus group and interview respondents

Focus groups

Focus group with representatives from **financial advisory organizations**

Glen Macdonald
Senior Vice President and Institutional Consultant
The Wilshinksy Group and Graystone Consulting (Morgan Stanley)

Victor Orozco, CSRIC™
Managing Partner, Director of Operations
Bair Financial Planning (The Wealth Consulting Group / LPL Financial)

Focus group with representatives from **industry associations**

John Berger
Director of Operations and Impact Solutions
Toniic

Georges Dyer
Co-Founder and Executive Director
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Matt Orsagh
Senior Director, Capital Markets Policy
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Morgan Slebos
Director of Sustainable Markets
Principles for Responsible Investment

Tim Williams
Senior Vice President and Director, Education Initiatives
Money Management Institute

Focus group with representatives from **standards setting organizations**

Emily Gaston
Analyst, SASB Standards Financial Sector
Value Reporting Foundation

Lissa Glasgo
Senior Manager, IRIS+/IMM
The Global Impact Investing Network

Emilie Goodall
Financial System Lead
World Benchmarking Alliance

Interviews

Interviews with representatives from **asset owners**

Michael Cappucci
Managing Director, Compliance and Sustainable Investing
Harvard Management Company

Scott Connolly
Assistant Secretary
Australian Council of Trade Unions

Harry Keiley
Board Chair
California State Teachers' Retirement System

Shannon O'Leary
Chief Investment Officer
St. Paul & Minnesota Foundation

Eri Yamaguchi
ESG Investment Officer
NYS Common Retirement Fund

Interviews with representatives from **asset managers**

John Hoeppner
Head of US Stewardship and Sustainable Investments
Legal & General Investment Management

Andrew Wetzel
Senior Vice President, Portfolio Manager
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Director of Global Communications
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Director of ESG Investing and Global Investment Stewardship
Thornburg Investment Management

Interviews with representatives from **other industry stakeholders**

Mike Clark
Founder Director
Ario Advisory

Attachment B. Project survey respondent summary

Table B1. Respondents’ organization type

Investors	**69**	**70%**
Asset owners	16	16%
Asset managers	34	35%
Unspecified investor type	19	19%
Financial advisors	**11**	**11%**
Other industry stakeholders	17	17%
Industry associations	11	11%
Standards setters	4	4%
Some other industry stakeholders	2	2%
Did not answer	**1**	**1%**
Total	**98**	**100%**

Table B2. Respondents’ organization headquarters

Africa	2	2%
Asia	5	5%
Australia/NZ	3	3%
Europe	21	21%
N. America	64	65%
S. America	1	1%
Did not answer	2	2%
Total	**98**	**100%**

Table B3. Respondents’ organization size (assets)

≤ $5 million	27	28%
> $50 million to ≤ $100 million	9	9%
> $100 million to ≤ $250 million	8	8%
> $250 million to ≤ $500 million	1	1%
> $500 million to ≤ $1 billion	7	7%
> $1 billion to ≤ $50 billion	16	16%
> $50 billion to ≤ $100 billion	2	2%
> $100 billion	14	14%
Did not answer	2	2%
N/A	11	11%
Did not answer	1	1%
Total	**98**	**100%**

Table B4. Respondents’ organization engages in responsible, sustainable, thematic, or impact investing (or provides related services)

Yes	85	87%
No	11	11%
Does not know	2	2%
Total	**98**	**100%**

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Project funders

Humanity United

Humanity United (HU) is a philanthropic organization dedicated to cultivating the conditions for enduring peace and freedom. HU recognizes that we live in a deeply interconnected world, where we are all united by the challenges and opportunities we face. HU supports and works alongside partners who are working to advance human dignity and change the systems that enable violent conflict and human exploitation around the world.

HU focuses on two broad areas of work, peacebuilding and combating forced labor and human trafficking, supporting programs in specific geographic contexts around the world. HU also invests in journalism, advocacy and policy change, and strategic communications to bring attention, accountability, and action to these issues.

HU is a member of The Omidyar Group, a diverse collection of independent organizations and initiatives that pursue different ways to improve the lives of people and societies.

UBS Optimus Foundation

The UBS Optimus Foundation is a grant-making foundation that offers UBS clients a platform to use their wealth to drive positive social and environmental change. The Foundation selects programs that improve children's health, education and protection, ones that have the potential to be transformative, scalable and sustainable as well as programs tackling environmental and climate issues.

The UBS Optimus Foundation Network consists of the UBS Optimus Foundation in Switzerland, its branch in Hong Kong and the representative office in China, its sister organizations UBS Optimus Foundation Europe Deutschland, UBS Optimus Foundation UK and UBS Optimus Foundation Singapore, as well as a donation platform in the United States.

The Foundation pursues social impact in a variety of ways, from traditional charitable giving to Social Finance. It is specifically focused on social and environmental returns.

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Additional Notes

Box 1

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