actiam
PERSPECTIVE

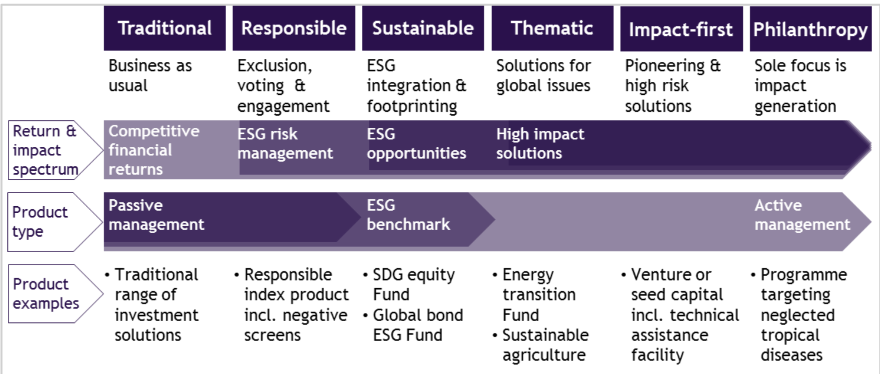
Impact investing:
the devil is in the detail

Gaining attention since the 1960s, following protests against the Vietnam War and becoming more widespread following a broadcast of the TV-show Zembla (March 2007) on investments of Dutch pension funds in companies associated with the production of land mines and cluster munition, social responsible investing (SRI) is nowadays gaining more traction than ever. Investment management companies have increasing attention for social, environmental and ethical values, ranging from risk management to actively maximizing investments that promote positive values. How to navigate your way through this fast-developing market?

IMPACT INVESTING: INDISPENSABLE PART OF RESPONSIBLE INVESTING

In 2006, the United Nations Principles for Responsible Investment (UN PRI) was released, leading to US $45 trillion in signatories' assets. This has doubled to nearly US $90 trillion in 2017. Signatories commit to incorporating environmental, social and governance (ESG) issues into investment practice, where consistent with their fiduciary responsibilities. A sub-segment of the SRI industry goes beyond eliminating investments and engaging with investees concerning products or ways of doing business that conflict with ESG values and beyond selecting best-in-class players. This sub segment of impact investors actively aims to generate measurable positive impact. The 229 investors that responded to the Global Impact Investing Network's (GIIN's) eighth Annual Impact Investor Survey held about US$ 228 billion in assets as of the end of 2017. These assets are largely invested in private markets.

Figure 1: Impact investing spectrum



COMBATING 'IMPACT WASHING'

Following on the launch of the Sustainable Development Goals and increased external pressure from governments, consumers and societal organizations, institutional investors are looking for ways to grow the level of investments targeting positive impact. A development that is to be cheered and supported from both business as well as societal perspective. "*Despite the increased interest in and number of product launches claiming to be impact investments, there is no common discipline for how to manage investments for impact and the systems needed to support this however. This has created complexity and confusion for investors, as well as a lack of clear distinction between impact investing and other forms of responsible investing*" (International Finance Corporation - IFC, 2018). This leaves a risk that the integrity of the market could start to decline. As such, investment management companies can offer products that claim to create positive impact and contribute to the SDGs, whereas in reality, this claim is sometimes far-fetched or too short sighted. These investment may not be anything but business as usual.

This is a publication of our Impact Investing team, consisting of 8 professionals with an average experience of 15 years in the industry.

ACTIAM is the responsible asset manager for more than one million people. With over 100 staff we manage €56.3 billion (ultimo June 2018) primarily for insurance companies, pension funds, banks and intermediaries. ACTIAM invests for its clients not only to achieve an optimal financial return, but also a social return. We do this by taking into account the consequences for the environment and society and continue to develop responsible investment solutions for the general public.

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Further growth of the impact investing segment should therefore go hand in hand with careful attention to the issue of impact washing. Increased transparency and development of standards are two developments that can help in tackling the risk of impact washing. In the most Recent GIIN impact investor survey, 80% of survey respondents opted for “greater transparency from impact investors on their impact strategy and results” while 41% said “third-party certification of what qualifies as an impact investment” would help (GIIN, 2018).

Fund managers can be transparent in both the financial as well as non-financial targets of their investment products. That way, it is clear to the audience which range of the impact spectrum is targeted and how a fund fits within their investment portfolio (figure 1).

The premise of mainstreaming impact is a challenging task due to the required careful selection of (private) portfolio companies, variety across companies, levels of risk and expected returns. It is therefore key for institutional investors to be critical towards the marketing potential of the term impact investing and carefully select specialized investment managers. A thorough manager selection can help to find the right candidate for the job. Recently, several industry tools are developed to facilitate this process.

STANDARDIZATION AND HELPFUL TOOLS IN THE ASSESSMENT OF IMPACT INVESTMENTS

From the moment the term impact investing was embraced in 2007, the sector has developed rapidly in terms of the number of investments, as well as in the development of standards. These mainly relate to the investee side, in order to offer protection to vulnerable groups.

In a phase in which the industry is witnessing some growing pains in its transitioning from niche market to viable investment option for a broad range of investors, the market responds by developing new standards in this respect as well.

For an investor to be able to judge whether there is a true intention, effort and potential to generate positive impact, such standards can be helpful to screen viable market opportunities without needing to be a seasoned impact expert.

The following, three-step approach will help in screening the impact potential when performing due diligence on an investment opportunity in an efficient manner.

1. **Selection of investment type and thematic area.**
   Based on the ALM requirements, institutional investors can screen for impact investing opportunities. A general rule of thumb is that private investments have higher potential for impact than listed investments, just as investment targeting developing countries (of course, a careful consideration follows during the selection of an investment product whereby also the likelihood of achieving the desired impact is taken into account). In addition, an investment theme can be selected based on the fit with the sponsor or with the potential to generate impact. The recently developed UN PRI Market Map can be of practical help in this process.

PRI Market Map

The PRI Market Map[2] links 10 societal themes with specific Sustainable Development Goals and their respective targets and indicators, and provides information to improve knowledge and awareness of the impact investing sector. Its goal is to bring more clarity to the process of identifying mainstream impact investing companies and thematic investments so that asset owners and fund managers can better assess opportunities in this market.

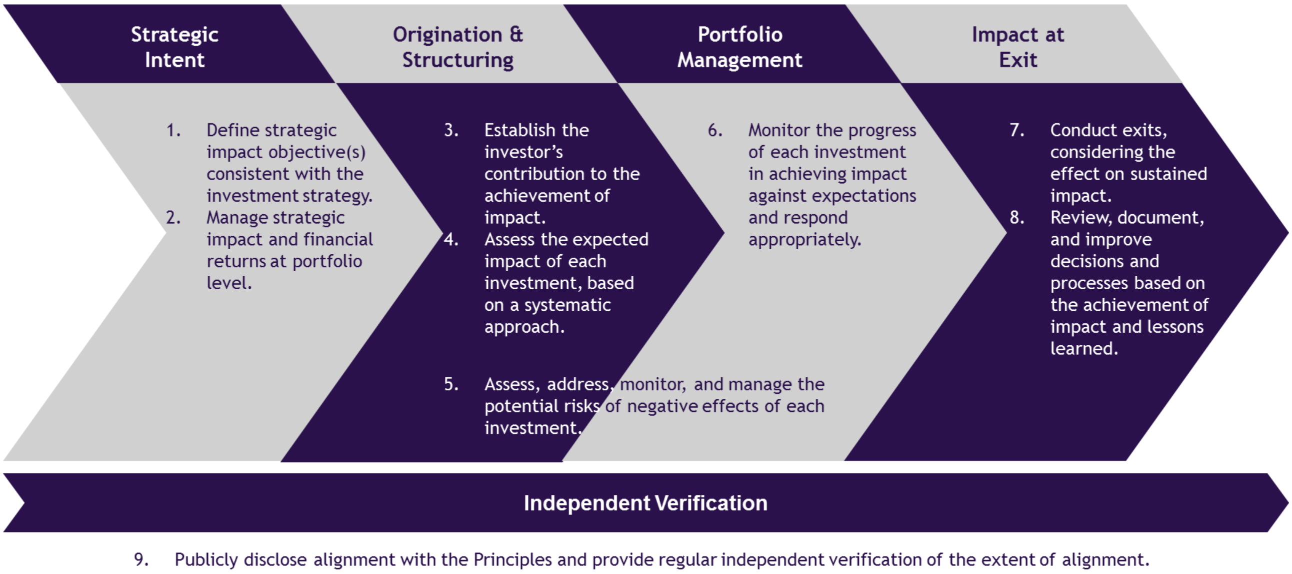
[2] Access the PRI Market Map via https://www.unpri.org/thematic-and-impact-investing/impact-investing-market-map/3537.article

2. **In-house development or manager selection**
   In order to have a quick scan of the true impact potential of an investment product or in case step 1 is outsourced in the form of a mandate, investors can now turn to IFC’s Operating Principles for Impact Management (Figure 2). By simply covering these 9 questions in a manager search or self-reflection, investors can easily compile and compare information on the degree of impact washing and the potential to generate positive impact.

IFC - Investing for Impact: Operating Principles for Impact Management

IFC, in consultation with external stakeholders has recently published a draft version of “Investing for Impact: Operating Principles for Impact Management” (hereafter: Principles). The objective is to establish a common discipline and market consensus around the management of investments for impact and help shape and develop this nascent market. The Principles provide a reference point against which the impact management systems of funds and institutions may be assessed.

Figure 2: Investing for impact: operating principles for impact management



3. **Deep-dive into processes**
   Following the first two steps, it is crucial to take a closer look at the actual integration of impact alongside risk and return requirements throughout the investment process. Figure 3 describes an example of a high-over process with regards to responsibility & impact for each phase of an investment.

Finally, The GIIN Initiative for Institutional Impact Investment supports institutional asset owners seeking to enter, or deepen their engagement with, the impact investing market, by providing educational resources, performance research, and concrete case examples.

INCREASING POSITIVE IMPACT DETERMINS FUTURE GROWTH

The impact investing industry is developing faster than ever before and so are tools for investors to identify impact washing. These are highly welcome, as institutional investors do not always have the in-house resources to do so. There is no doubt that the fund managers that are actively looking to generate positive impact, are keen to further develop the sector along with its growth potential. This article offers a three step approach that can help to increase the potential to generate impact and prevent impact washing by asking a number of predefined questions. As such, the impact generated can increase hand in hand with the intention and claim of many investors to increase the level of sustainable and impact investments.

Figure 3: Process flow of extra-financial investment requirements

1. DEALSOURCING	Term-sheet	✓ Check compliance with minimum non-financial standards ✓ Get an understanding of the potential for positive impact (value creation) + measurement
	Due diligence	✓ Check outstanding questions regarding compliance with minimum non-financial standards ✓ Check contribution to positive impact goals of the fund
2. APPROVAL	Investment Committee	✓ Check outstanding questions regarding compliance with minimum non-financial standards ✓ Check contribution to positive impact goals of the fund and how this is secured ✓ Negotiate on potential additional non-financial terms in the contract
	Contracting	✓ Adopt potential additional non-financial terms and/or impact covenants in the contract
3. INVESTMENT	Monitoring	✓ Regular assessment of compliance with minimum non-financial standards ✓ Regular assessment of compliance with non-financial covenants in the contract ✓ Regular assessment of contribution to positive impact, i.e. value creation ✓ Regular assessment of status regarding potential additional indicators following a potential revision of the fund's responsibility & impact framework ✓ Day-to-day portfolio management based upon incidental events ✓ Regular reporting on ESG risk and impact management
4. RENEWAL & TOP-UP	Re-assess	✓ For all potential loan renewals and top-ups, process steps 1,2 and 3 should be followed if a) The previous transaction was approved longer than 1 year ago b) The transaction has a different nature than the previous transaction c) If there is any other reason to conduct non research

Sources: What is Impact Investing. https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing and Eighth Annual Impact Investor Survey. https://thegiin.org/research/publication/annualsurvey2018.