Investors in search of impact Strategies, innovations and challenges

July 2017

a novethic study

Investors seek to enhance and to measure the social and environmental impacts of their responsible investment strategies. This movement has generated the development of initiatives and new products organised in particular around the Sustainable Development Goals. Carrying great promise, these actions must overcome methodological challenges to ensure their credibility.

SDGs: the new reference framework

Since their adoption by the 193 Member States of the United Nations in September 2015, the 17 **Sustainable Development Goals (SDGs)** have emerged as the new standard for businesses and investors who wish to report on their social and environmental impacts. **The collective commitments made by major investors**, most of which are based in northern Europe, and the launch in Paris of the Principles for Positive Impact Finance in January 2017, marked two important steps for this movement. **87 investors** have committed themselves to collaborative initiatives promoting investment in the Sustainable Development Goals. However, the financing needs are estimated at $2.5 trillion additional dollars per year in developing countries alone.

Beyond existing barriers of responsible investment strategies

Responsible investment is entering a new era where merely stating that environmental and social criteria are considered is not enough. It must be combined with quantified targets that are measured over time. This results in a convergence **between responsible investment** on the one hand, adopted by investors who consider environmental, social and governance (ESG) risks in their investment process, and, on the other, the dynamic but narrower market of **impact investing**. The latter, based on actively seeking a social and environmental return on investment, traditionally through the financing of unlisted companies, is being invested by large investors with new requirements.

Methodological and credibility challenges

New markets and products are emerging, such as green bonds and social bonds. Investors also have access to a growing number of funds, indexes and approaches organised around impact themes and the Sustainable Development Goals (SDGs). Such proliferation is a **source of innovation**, but also a source of risks to their **credibility**, in view of the more or less robust impact strategies of some products, that might be called "impact washing". Identifying and measuring positive impacts requires effective methodologies, in particular for investors seeking to expand their actions to listed equities. This study offers an overview of these impact strategies, which reflect the profound changes taking place in the responsible investment market.

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Impact, a new step of responsible investment

Emerging nearly ten years ago, impact investing is structured around pioneering investors explicitly seeking to generate tangible social and environmental benefits through their investments. Impact investing targets companies, organisations and funds that provide solutions to **environmental and social challenges alongside a financial return**.

Responsible investors seeking to transform the economy to make it low-carbon and inclusive are converging towards this approach. Responsible investment historically developed around taking environmental, social and governance (ESG) risks, whether ethical or financial, into account when making investment decisions. It is gradually evolving toward selecting companies with the best ESG practices. Combining the **explicit search for positive environmental and social** with returns constitutes an important qualitative leap that blurs the lines between responsible investment and impact investing. This constitutes what Novethic qualifies as a "sustainable investment" strategies. These strategies, which aim at investing in sustainability solutions, have a strong impact on investment portfolios, which differ significantly from mainstream benchmarks.

These approaches are mainly being pursued by northern European pension funds, which hope to apply them to a growing part of their portfolios, including listed equities. These investors are primarily motivated by their desire to **align with their beneficiaries expectations** regarding the contribution of their investments to a sustainable economy. This movement can be observed **elsewhere in the world**, such as in France, where some asset owners are striving to contribute more substantively to **the "social and solidarity economy"**. The table below shows the gradation of these different objectives and approaches, from the incorporation of ESG criteria in investment policies to the intentional targeting of measurable impacts.

Spectrum of ESG and impact approaches

	Traditional	Responsible investment	Sustainable investment	Impact Investing	Philanthropy
	Financial return on investment				
		ESG risks and opportunities			
			Ambition to finance a more sustainable economy		
				Intention to achieve measurable impacts	
Objectives	Financial returns	Financial returns considering ESG criteria	Financial returns and financing sustainable development	Pre-defined and measurable social and environmental objectives. Competitive or below-market financial returns.	Social and environmental objectives with no expectation of financial return
Approaches	No consideration of ESG criteria	Exclusions, best-in-class, ESG integration, shareholder engagement	SRI approaches with a strong impact on portfolios: thematic investments, best-in-universe	Picking companies based on their social/ environmental impact	Donations
		Impact measurement			
Examples of products	All financial products with no ESG approach	Responsible investment funds (all asset classes)	Equity investment funds Infrastructure funds Green real estate funds Gren bonds, Social bonds	Private equity funds financing enterprises with strong social impact	

Source: Novethic

Investor initiatives promoting the Sustainable Development Goals

The Principles for **Positive Impact Finance**

In January 2017, the United Nations Environment Programme - Finance Initiative (UNEP FI) launched the "Principles for Positive Impact Finance" with a group of banks and investors totalling $6.6 trillion in assets. These principles aim at channelling the hundreds of billions of dollars managed by banks and investors towards financing the SDGs.

The four principles are **guidelines for financing sustainable development** intended for banks, investors and auditors, and can be applied to any type of financial instrument. Principle One defines Positive Impact Finance as that which serves to deliver a positive contribution to one or more of the three pillars of sustainable development (economic, environmental and social), once any potential negative impacts have been duly identified and mitigated. The next thee principles deal with frameworks, transparency and the assessment of Positive Impact Finance. The members of this initiative have established working groups to further implement the Principles.

The viewpoint of Tatiana Bosteels, Hermes IM

Tatiana Bosteels is Director of Responsibility & Head of Responsible Property Investment at Hermes Investment Management. She is involved in the Positive Impact initiative.

What does the Positive Impact initiative bring to responsible investors ?

"At Hermes, we have been challenging our definitions of risks and fiduciary duty, moving towards the delivery of holistic return, which is really looking at outcomes beyond financial performance. We need to deliver financial returns, but we can also not look at an investment in isolation from its environment. And so we need to look at how we can also deliver positive, real world impacts for our clients and our beneficiaries, which include a large number of pension funds and small beneficiaries. I believe positive impact is based on three key principles :

1) Intentionality – the objectives in terms of real-world impacts, and the targets and indicators that we are going to use to do that ;
2) Monitoring of the outcomes
3) Developing trust in the industry on these issues through transparency, including through verification and certification.

Engagement with companies is also an essential way to achieve positive impacts as an investor. In the working groups of the Positive Impact Initiative, we are developing common definitions and frameworks on these issues, and we work on assessment methodologies and impact measurement indicators."

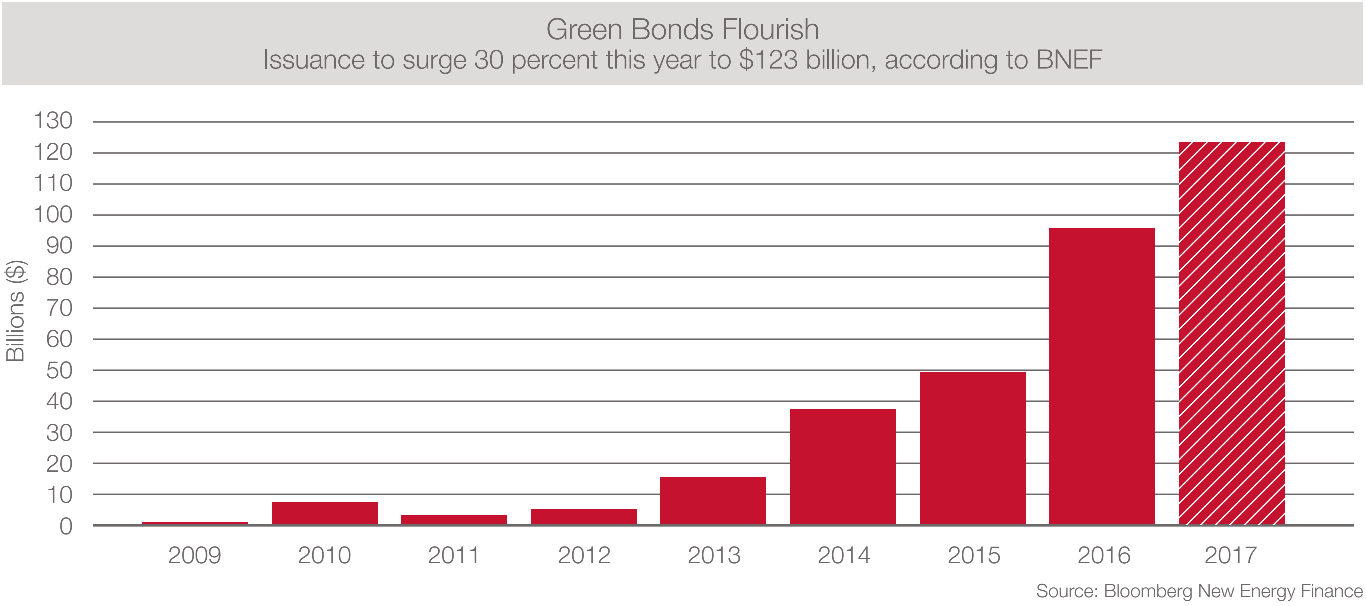
Commitments from **Dutch and Swedish investors**

Dutch and Swedish investors are particularly involved in the movement for SDG investing. In a statement published in September 2016, APG PGGM, the Swedish pension funds AP1, 2, 3 and 4, MN, Actiam and Kempen deem it essential to invest pension fund assets in the SDGs, and to do so at scale. They emphasise that these investments must meet their financial risk and return requirements.

In December 2016, 17 Dutch investors also published a report in which they pledged to invest in the SDGs and explore the ways forward to achieve this goal. The two largest Dutch pension funds, ABP and PFZW, have set targets for 2020 to invest respectively €58bn and €20bn in sustainability. Their fund managers, APG and PGGM, have created dedicated portfolios. In Sweden, six of the seven largest asset owners have stated that they would start integrating SDGs into their business, corporate governance and investment approach.

The development of impact strategies in responsible investment

The Global Sustainable Investment Alliance (GSIA), which collates data from regional sustainable investment forums, defines impact investing as a sustainable investment strategy. Its 2016 market survey shows that with **248bn dollars in assets**, impact investing remains the least common strategy, but the one that shows the **highest relative growth** (+146% between 2014 and 2016). In total, responsible investment strategies are applied to nearly $23 trillion of assets in 2016.



This growth is attributable in part to the inclusion by GSIR of both **green bonds** and **social bonds** in impact investing. These bonds finance **projects with environmental or social value added**. According to Bloomberg New Energy Finance, green bonds issuance is expected to reach $123bn in 2017. The social and sustainability bonds market, which reached $15.6bn in issuance mid-2016, is enjoying strong growth. The largest social bond issuance in history (€2bn) took place in June 2017 and was well oversubscribed.

The green and social bond markets are facing the challenge of harmonizing practices. The Green Bonds Principles, as well as the Social Bonds Principles adopted in June 2017, identify four core bond components: 1. The use of proceeds, which must be channelled to green/social projects; 2. The communication of a process for project evaluation and selection; 3. The actual allocation of proceeds; 4. Reporting. These principles also provide rudimentary taxonomies for eligible projects. Since June 2017, the hybrid category for sustainability bonds also has concise guidelines. Furthermore, the Climate Bond Initiative provides additional taxonomies combined with certifications for environmental projects.

The scope of eligible projects and issuers is a source of **recurring debates among investors**, such as the bond issued by the oil company Repsol, in 2017 to finance energy efficiency projects linked to its production of fossil fuels. Likewise, the **measurement of social and environmental impacts remains a major challenge**. In a survey that canvassed a panel of 17 major investors among the most committed to green finance and holding €7.7bn in green bonds, Novethic showed in 2016 that one-half of them made measuring the CO2 emissions of funded projects a top priority, but that they ran into a problem of inadequate reporting. One-quarter of the panel sought to measure the emissions avoided thanks to the projects and one-fifth were waiting for more mature impact measurement methodologies to integrate these indicators into the control and monitoring of their investments.

Impact measurement thus remains limited. This is why Novethic does not categorize green and social bonds as impact investments. Instead, they are regarded **as thematic investments, a category that targets assets linked to sustainable development in a more flexible manner compared to impact investing**. In particular, this category covers listed equity funds investing in companies deriving all or part of their revenue from themes regarded as sustainable (clean energy, water management, agriculture, healthcare, sustainable buildings, etc.). In the absence of consensual taxonomies, the choice of sectors relies on each investor's convictions.

Thematic investments allow investors **to capitalise on opportunities related to sustainable development** and to communicate about their green and social strategies. Thematic investments reached **$331bn in 2016** according to the GSIA (+140% since 2014). Thematic approaches create highly differentiated portfolios and this is the reason why Novethic classifies them as sustainable investment strategies.

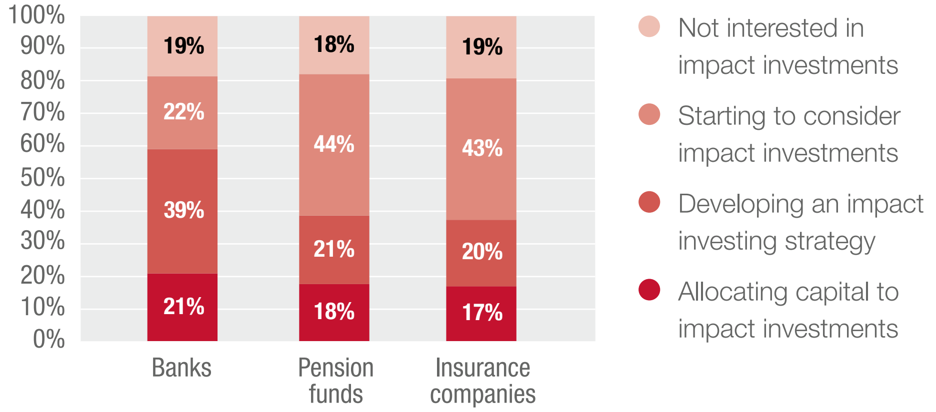
The impact investing market grows out of its niche

The Global Impact Investing Network (GIIN) defines impact investing as "investments made into companies, organisations, and funds with the **intention to generate social and environmental impact alongside a financial return"**. Its core characteristics include **investors' explicit intention to have a positive social or environmental impact and the commitment of investors to measure and report this impact**. Therefore, best practices consist of establishing social and environmental objectives specific to the companies, measuring these objectives over time and reporting on performance. Some investors also measure **additionality**, that is, the social or environmental impact that would not have occurred without their investment. For some investors, additionality is a fundamental criterion of impact investing while for others it is too difficult to implement. The GIIN does not include additionality in its defininition of impact investing.

Applicable to any asset class, impact investing in fact places strong emphasis on **private markets**, particularly private debt, private equity and real assets. In fact, the organisations funded are primarily companies of limited size in sectors such as housing, energy, micro-finance, financial services, food, healthcare or education.

The 208 investors that responded to the GIIN in its 2017 Annual Impact Investor Survey reported that they manage **$114bn in impact assets**. The survey shows that the impact investing market is characterised by a high number of individual investors, especially through family offices, as well as **ethical investors and development finance institutions**. Nonetheless, the figures of the GIIN survey show that at least one-quarter of impact investments are made by **pension funds and insurers** either directly or through their asset managers. Two-thirds of surveyed impact investors target risk-adjusted, market rates of return and one-third target lower returns to achieve social and environmental impacts. Among the obstacles frequently cited as standing in the way of developing the sector is the lack of products meeting investor expectations, especially in terms return/risk profiles.

Fund manager perceptions of interest in impact investments from potential investors



Source: GIIN

More and more major investors are expressing interest in impact investing (See opposite). The investors surveyed by the GIIN forecast growth of the market together with expectations of higher returns. This could ultimately transform the market by professionalising it, but it also raises concerns over impact dilution.

Impact measurement at the heart of impact investing

Measuring social and environmental impacts is a core component of impact investing. Investors have therefore developed a number of approaches and indicators. These may relate to processes, outputs and outcomes. Relative to responsible investment, impact investing is characterised by a greater emphasis on output and outcome indicators, which are designed to measure the real world impacts of companies and projects financed.

The GIIN identifies "generally accepted performance metrics" in an online free public catalogue called IRIS, which also includes references the main approaches and guides. The Sustainable Development Goals are becoming the main framework to which investors refer: 60% of the respondents to the GIIN's Annual Impact Investor Survey use or plan to use them in the near future.

Asset owners striving to boost social enterprises

Investing in the social economy is still often regarded as incompatible with investors' constraints. However, new products are allowing them to enter into this high-impact market. Focus on France, where the market is growing quickly.

A new range of **investment products**

In France, impact investing may involve the financing companies in the "social and solidarity" field as defined by the law (associations, cooperative and mutual companies, or businesses pursuing social goals) or other companies with high social impact. Historically, the **social finance** movement developed through employee and individual savings around the **Finansol label**, awarded to investment products used to finance activities regarded as useful from a social or environmental standpoint, such as access to employment and to housing, organic agriculture or renewable energy. Finansol calculates that in 2016 social finance led to the creation or consolidation of 49,000 jobs, the rehousing of 5,500 persons, the supply of renewable energy to 20,000 households and the financing of 100 institutions in developing countries.

More recently, private equity impact funds have been developed and marketed to asset owners. In May 2017, the AFIC Impact Club reported that its members managed €1.26bn in investments seeking a double bottom line of financial return and social impact, while committing to measure this impact and to **engage actively** with entrepreneurs. Among the subscribers for this fund were the Caisse des Dépôts, Bpifrance, Crédit Mutuel Arkea, CNP Assurances, l'Erafp, AG2R La Mondiale, Mirova, Crédit Coopératif or Natixis.

The companies financed operate in the areas of social inclusion, microfinance, social housing, renewable energy or recycling, or are located in underserved areas. Examples of **impact indicators published by asset managers** include: the number of of back-to-work jobs created, the number of hectares of forest preserved, the number of tons of waste, water or CO2 avoided, the quantity of renewable energy generated, the number of micro-entrepreneurs supported, the minimum wage at companies or the number of visits to financed clinics, the number of businesses operated by women, or the number of people provided with new access to financial services.

Members of Club Afic Impact Club				
Alter Equity	Comptoir de l'innovation	Financités	Investisseurs & Partenaires	Nef Capital Ethique
Arkea Capital	Engie Rassembleurs d'Energies	Impact Partenaires	Mandarine Gestion	Phitrust
Citizen Capital	Esfin Gestion	Investir&+	Mirova	XAnge Impact

Some asset owners are also launching their own investment funds dedicated to social impact. In 2013, AXA created a €150M fund of funds, while Aviva France invests €30M in the **social economy** through the Impact Investing France Fund. This trend is part of a broader European movement. Large insurers such as Prudential, Zurich Insurance Group and Legal & General have made substantial commitments in the area of impact investing.

In 2016, the Caisse des Dépôts Group, in collaboration with several investors, launched the NovESS fund, which, with a first closing of €60M and a target of €100M, attracted investors such as BNP Paribas, BNP Paribas Cardif, CNP, Crédit Coopératif, ERAFP, IRCANTEC, Union des mutuelles régionales (UMR) and Mutuelle Nationale Territoriale. The fund targets sectors where investors have identified a substantial leverage effect, allowing change in scale and the structuring of new industries: healthcare and social services, energy transition, short supply chains or the circular economy. The first investments will be made in September 2017.

The NovESS fund seeks large scale impact

The viewpoint of Géraldine Lacroix, Caisse des Dépôts

Géraldine Lacroix, Head of the Economics and Social Cohesion Department at the Directorate of Investments and Regional Development of the Caisse des Dépôts answers our questions.

What type of company is eligible for financing by NovESS?

“The fund operates in the existing financing ecosystem. In 90% of its operations, provides equity or quasi-equity to finance social economy organisations: associations, cooperatives, mutual societies, foundations and commercial companies. NovESS mainly targets organisations that are scaling up and are involved in large projects, with investments ranging from €1M to €5M. It also seeks to develop innovative projects, start-ups in the acceleration phase for with investments ranging from €100,000 to €500,000.

How do you attract asset owners to social financing?

Attracting asset owners to invest in social innovation requires the development of legal and financial innovations. Because of its leadership, NovESS sends a strong message to asset owners by building trust, broadening the scope of financing activities and setting up participatory governance with both public and private investors in the Fund. The MESIS tool, which measures and monitors the social impact of the projects, built in partnership with BNP Paribas and the Comptoir de l'Innovation, plays an active role in this process and is designed to become a tool of the financial marketplace. Finally, NovESS provides support to enterprises to help them build successful business models and maximise their impacts. This contributes to an aspect of social investing that often goes unnoticed: the corporate default rate is not as high as in the traditional economy. As a result, we contribute to showing that social companies should not be categorised as high-risk investments.”

The MESIS impact measurement tool is used to measure the evolution of the social impact of projects over time, based on cross-sector and sector-specific indicators linked to their relevance, consistency, effectiveness, value added, the quality of HR practices and governance, or their innovative character and job creation.

Impact management process of the NovESS fund

Pre-investment	Investment	Post-investment
Project analysis via a catalogue of criteria linking: • impact, • and responsible practices (ESG-type criteria). **Establishing impact targets based on a few key performance indicators:** • specific to the projects based on their sector, • and cross-sector.	**Review of the initial analysis criteria** to monitor changes and compliance with expectations. **Annual monitoring of targets and key performance indicators:** • reporting of data by the organisation, • verification of data quality, • sharing and interpretation of the outcomes with the organisation. **Annual aggregation of data at the fund level for cross-sector indicators.**	**Overall assessment of the performance** of the fund via the performance of investments and an impact analysis of the investment itself for the projects.

Focus on **social impact contracts**

Social impact contracts (CIS) are gaining interest in France. Inspired by social impact bonds in the English-speaking world, they are designed to provide private funding to social programmes, focusing on prevention. Where they achieve their objectives, the benefit of the projects to public finances justifies the interest paid to investors by the governement. French CIS are contracts between a social operator, an investor and a third-party payer and are **not designed for trading on a market**. Given fears that they might substitute state subsidies by private financing by investors less dedicated to the public interest, the Impact Invest Lab has developed a code of ethics, which stipulates that CIS are designed to finance innovative programmes that are not covered by existing schemes and meet the criteria of measurable outcomes and **limited interest payments** to investors. In May 2017, **the largest CIS so far** was signed (€100m). It relates to a fund from Ampere Gestion that will finance 10,000 emergency shelter beds collected from hotels undergoing renovation. Payments to investors (Aviva France, BNP Paribas Cardif, the Caisse des Dépôts Group, CNP Assurances, MAIF and Pro BTP) will hinge on the achievement of social objectives evaluated by an independent expert (% of children enrolled in school, % of residents referred to permanent housing, etc.).

Listed equities: a challenge for impact investing

Investors and service providers are developing impact strategies for equity markets. These emerging approaches, which face methodological challenges, have yet to prove their actual impact.

Many investors who responded to the annual GIIN annual survey don't believe it is possible to generate impacts on public equity markets, at least without owning a sufficiently large share of the companies' capital to influence them. No consensus exists to date on how to adapt the concept of impact investing to public equity markets, particularly with respect to its main characteristics: the investors' explicit intention to generate a positive impact, their commitment to measuring that impact, or their investments' additionality.

Outcome measurement remains limited

Many funds and products that claim to have impacts or to contribute to the SDGs **do not actually measure their impacts**. They often confine themselves to **calculating the revenue exposure of the companies in the portfolio to «sustainable» or «impact» themes** related to the SDGs: nutrition, health, education, energy efficiency, renewable energy, water treatment, etc. This is for example the case of the MSCI ACWI Sustainable Impact index, which is linked to an ETF from BlackRock, and the Solactive Sustainable Development Goals World Index, based on Vigeo Eiris' Equitics methodology. Different «impact» or «SDG aligned» funds offered by asset managers take the same approach, and are actually multi-thematic investment funds. Some methodologies, like the one developed by the sustainability rating agency Oekom, **balance positive and negative impacts** within an SDG-based methodology, on both the company and portfolio level.

In a recent article, UBS warned against the reductionist, potentially misleading nature of these approaches, which are based only on revenue derived from product categories. The Swiss bank explains that social impact should instead be measured **in «units of human well-being»** and indicates that it is working with academics and PGGM to develop a **quantitative framework for measuring companies' impact**. PGGM warns against the risk of «impact-washing» or «SDG-washing» if investors interpret the SDGs loosely or oversimplify their impact measurement practice.

VBDO, the Dutch responsible investment forum, published a study in 2016 analysing impact investments reported by its members (€24bn, including €10bn invested in listed equities). According to VBDO, a majority could be considered **«light impact investments»**, or would be better categorised under other strategies given their **varying degrees of ambition** in addressing social and environmental challenges and measuring impacts.

In a 2016 report, MSCI shows how far is left to go before we can measure portfolio impacts. At present, it would be premature to assume that funds or products which confine themselves to step two of the process are true impact strategies. They should instead be considered thematic investments.

Steps to Measuring Sustainable Impact at the Portfolio Level

1 Anecdotal	2 Exposure to impact theme	3 Define sector specific metrics	4 Define outcome	5 Estimate outcomes
Provide case studies and qualitative example of impact generated at the company level	*Measure exposure to companies which provide solutions to some of the world's largest environmental and social challenges in a consistent manner accross sectors*	*Define metrics that are specific to each sector. For example: - Healthcare: R&D pipeline, differential pricing strategies - Consumer: availability, accessibility, quality*	*Define outcome based metrics for each theme. For example: - Climate change: avoided emissions - Finance: number of SME financed*	*Develop estimation model based on specific region and sectors if possible. For example: - Education: number of students sent to college in emerging markets - Healthcare: number of HIV treatments developed per year*
Current approach		Potential future approach		

Source: MSCI ESG Research

Lack of data and complexity of impact assessment

Several investors go further than only measuring companies' exposure to specific themes, and **are developing impact indicators**. In its 2016 impact report, WHEB AM, an asset manager focusing on sustainable development, has calculated several environmental impacts for every £1M pounds invested in its FP WHEB Sustainability Fund: 1,200 MWh of renewable energy generated; 1,600 tonnes of CO2 avoided; 1.6 million litres of waste water treated; 30 million litres of drinking water provided; and 140 tonnes of waste recycled. WHEB admits that these indicators are imperfect due to **data availability and quality issues**, and that it is unable to report **quantitative indicators relating to social issues**.

Social issues raise especially difficult questions with respect to defining and measuring what counts as positive impacts. For example, determining which services should be considered as public and which should be assumed by the private sector is under debate in sectors like health, education or water management, which are often targeted by thematic investment funds. The methodology developed by the Investment Leaders Group proposes an interesting indicator for assessing corporate contributions to well-being: their tax burden, which contributes to government financing of public goods (see p.10).

The Dutch asset manager PGGM, which is a pioneer in structuring its impact approach, illustrates this issue. PGGM has already committed €11bn to **«investments in solutions»** in four fields: environment, water, food, and health. For each subject, PGGM invests in companies whose activities are assessed as providing sustainable solutions, and measures their performance in light of several key indicators. These companies include, among others, providers of energy efficiency solutions, companies that specialise in water treatment, pharmaceutical groups (Sanofi, Novartis, etc.), fertiliser and pesticide manufacturers (BASF, Monsanto, Dow Chemical, Phosagro), and food businesses (Wilmar, Unilever, etc.).

PGGM, « Investing in solutions »

Area of Focus	Euros Invested (millions)	Impact in 2015
Climate and Environment	€3,860 (**€820** in 2016)	**3.8 million MWh** of renewable energy produced; **4.0** million tonnes of CO_2 avoided
Water	€867 (**€451** in 2016)	**38 million m³** of water saved; **65 millions m³** of wastewater treated
Health	€2,800 (**€629** in 2016)	**111,000 tonnes/hectare** improvement in return; **640 million litres** of milk produced in developing countries
Other	€3,690 (**€893** in 2016)	**530,000** people provided with access to good healthcare

This kind of portfolio reflects **convictions that can be diametrically opposed to those of traditional impact investors**. For instance, PGGM considers that chemical pesticides and fertilisers help improve crop yields, and therefore food security. The more natural approach for social impact investment would be to fund organic and local food systems, in order to foster alternative models to large monocultures dependent on chemical inputs. The rating agency Oekom Research, meanwhile, believes that the large-scale use of chemical pesticides goes against SDG 15 (protect and promote a sustainable use of terrestrial ecosystems) and SDG 2 (end hunger, achieve food security and improved nutrition and promote sustainable agriculture).

Defining and credibly measuring impacts, both positive and negative, therefore remain **crucial challenges to avoid the risks of impact washing**. This is the theme of one of the workgroups of the **Positive Impact initiative** by the UNEP FI, and of **the Impact Management Project**, sponsored by Blackrock, PGGM, and Pimco. One of the seminal works comes from the **Investment Leaders Group (ILG)** facilitated by the **Cambridge Institute for Sustainability Leadership**. In a report published in 2016, the ILG proposes six impact themes related to the SDGs and metrics to measure corporate impacts, as well as possible refinements them once data is available – the overall quality of the data is currently quite poor. The ILG also proposes portfolio-level impact aggregation and disclosure methodologies.

Investment Leaders Group Proposed Metrics

Theme	Metric	Rationale	Refinements
Basic needs	Revenue from products serving low-income groups ($)	Proxy for addressing needs of low-income groups	• Purchasing power • Restriction to 'basic needs' products • Fair dealing • Product ethics
Wellbeing	Total tax burden ($)	Proxy for public value contribution	• Corruption record of government • Negative externalities (alcohol, air pollution, tobacco, sugar) • Revenue from health, care, education, justice and environmental protection
Decent work	Number of jobs	Proxy for livelihoods supported in operations + supply chain	• National level of unemployed and vulnerable workers • Living wage • Stable (open-ended) contracts • Labour conditions • Indirect job creation
Resource security	Consumption of virgin material (tonnes)	Proxy for resource burden and waste of operations + supply chain	• Scarcity of hard commodity • Regeneration of soft commodity • Toxicity
Healthy ecosystems	Land footprint (hectares)	Proxy for ecosystem burden of operations + supply chain	• Level and trend of national ecological deficit • Full ecological footprint • Restoration of ecosystem services
Climate stability	Scope 1–3 GHG emissions ($tC0_2e$)	Proxy for climate burden of operations + supply chain + product use	• Avoided emissions from product use • Sector-specific targets and contributions • Alignment with 2°C scenario

Shareholder engagement as a key element of impact strategies

On public markets, impact approaches to date have mainly sought to invest in companies whose products and operations contribute to sustainable development. However, given the nature of these markets and companies, the investors' actual impact remains hard to evaluate. As a result, some investors consider **shareholder engagement to be an essential part of their impact strategies**. The Swedish pension fund AP7, which wishes to contribute to SDG 6 (ensure availability and sustainable management of water and sanitation for all), therefore combines two approaches: investing in projects that provide solutions, and engaging with companies to improve their water management. In 2016, AP7 **engaged with the mining, garment, and food & beverage sectors** on this goal. The many collaborative engagements carried out by investors on issues like climate, tax evasion, and working conditions could also be integrated into impact strategies.

Prerequisites of an impact strategy

Among the most engaged investors, Hermes Investment Management also believes that shareholder engagement is key to seeking impact. In a speech at the Impact Investing World Forum published by Investment & Pensions Europe, Andrew Parry, Head of Equities at Hermes IM, proposes **five tests for determining what counts as an impact investments in public markets**:

1. **Long-term approach** to companies, value creation, and portfolio management;
2. **High conviction positions in concentrated portfolios**, which move away from benchmarks, given the limited number of truly impactful businesses;
3. **Active ownership** that focuses on **constructive dialogue with companies**;
4. A **clear measurement framework** identifying, in advance, clear goals for companies and portfolios;
5. A **recognition that this is meant to be hard work**, not superficial, and should be integrated through the investment process, and ideally across all products.

Developing new models to meet financing needs

Existing financial instruments are ill-suited to meeting SDG funding needs. New research and initiatives are seeking to overcome this deficit.

The viewpoint of Elisa Vacherand, UNEP FI

Elisa Vacherand, Positive Impact Finance Program manager at the UN Environment Finance Initiative.

What are the main challenges to address in order to fund the SDGs?

“Achieving the SDGs requires that companies and financial institutions that accompany them consider their impacts on the environment, the economy and society as strategic issues. To achieve this goal, the Positive Impact Initiative, launched in 2015 by UNEP FI and its members, has identified two main challenges. First, the need to establish a common language shared by all actors in order to define what counts as positive impact activities and encourage their development. This is the goal of the Principles for Positive Impact Finance, launched in Paris in January. Additionally, developing engagement policies between private and public actors to jointly consider new financing models based on the notion of impact. This is the subject of a report that we will be publishing this year, and of a working group set up as part of the Positive Impact Initiative.”

The **Dutch pension funds**’ taxonomy

The Dutch asset managers APG and PGGM, which manage the assets of the pension funds ABP and PFZW, are currently working on a taxonomy for SDGs investing, which will «serve as the basis for an in-depth conversation between asset owners and their asset managers on how we can go further in integrating SDGs into asset management,» according to Claudia Kruse, managing director of responsible investment and governance at APG AM. A more detailed publication is envisaged.

Prospects and challenges of emerging solutions

Developing impact investments requires overcoming various financial and regulatory obstacles, particularly those related to portfolio risk profiles. Explored solutions include **blended finance**, which combines **public, private, and philanthropic funds** with the intention to help improve projects’ risk and return profiles. The World Economic Forum and the OECD are for instance supporting the Sustainable Development Investment Partnership, which totals €100bn in blended finance commitments. The Canada-based organisation Convergence has also launched a platform that connects investors around blended finance deals. In France, the Presidents of the pension scheme Ircantec and of the RAIR, a network of pension schemes administrators committed to responsible investment, recently called for 1% of assets and reserves of pension funds, mutual companies, and insurers to be invested into the social economy, which would involve **addressing some regulatory obstacles**.

Meeting investors’ needs should not come at the **expense of seeking impact**. This is the reminder that the anti-poverty organization Oxfam issued in two reports published in 2017. The first one noted that high return requirements are often contrary to the **needs of social enterprises**, and calls for the development of new financial tools with «low and slow returns». The second warns of the riks of **competition between blended finance and public services**, development strategies, and local financial systems. In both cases, Oxfam is calling for improved transparency regarding investors’ impacts.

Useful references

A framework: the Principles for Positive Impact Finance, 2017

UNEP FI, *Principles for Positive Impact Finance*, 2017, unepfi.org, 2017

Spearheaded by the United Nations Environment Programme – Finance Initiative (UNEP FI: unepfi.org), the Principles for Positive Impact Finance establish a framework for the development of positive impact strategies by financial institutions. The Principles are set to become a market benchmark for assessing the contribution of investments to meeting the UN's Sustainable Development Goals. The members of the Positive Impact initiative have set up working groups to expand and apply these principles.

A report encouraging investment in Sustainable Development Goals

Sustainable Development Goals Investing Initiative, *Building Highways to SDG investing*, 2016, sdgi-nl.org

This report, signed by major financial institutions in the Netherlands, explores ways to develop investment in support of the Sustainable Development Goals, both in the Netherlands and abroad. The report is structured around four key pillars: blending private and public capital, mobilising retail-oriented impact capital, stimulating data standardisation and ensuring a supportive regulatory environment (barriers and incentives). The report makes recommendations to financial institutions, public authorities and regulators.

The Global Impact Investing Network's market survey

GIIN, *Annual Impact Investor Survey*, 2017, thegiin.org

The GIIN's market survey portrays a market undergoing rapid development. It analyses the practices and opinions of impact investors and offers keys to understanding the market: market players, investment themes, impact measurement, target returns, asset classes and ongoing changes. The GIIN also provides investors with a database of over 400 impact funds (impactbase.org) as well as a catalogue of impact metrics (iris.thegiin.org).

A methodology for measuring impact

Investment Leaders Group, Cambridge Institute for Sustainability Leadership, *In search of impact. Measuring the full value of capital*, 2016, cisl.cam.ac.uk

This report offers a framework and methodology for measuring the impact of investment portfolios. It translates the Sustainable Development Goals into impact themes, which are assigned metrics (meant to be further developed) methodologies for portfolio-level impact aggregation and disclosure. This framework has begun to be applied by the members of the Investment Leaders Group, who plan to enhance it over the coming years.

A critical analysis of impact investing

Oxfam, *Impact investing : Who are we serving ?*, 2017, oxfamamerica.org

This report by Oxfam analyses and questions some of the recently popularised assumptions about impact investing, particularly the notion that social and environmental impacts can be systematically combined with competitive financial returns. Oxfam recommends establishing a code of practice that makes generating and measuring impacts the key concern. In another report published in 2017 (oxfam.org.uk), Oxfam analyses the growth in blended finance and issues recommendations to make the practice more transparent and to ensure that it contributes to sustainable development.

Investors in search of impact

Strategies, innovations and challenges

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