TAKING ADVANTAGE OF SUSTAINABLE AND IMPACT FINANCE

NOT QUITE BUSINESS AS USUAL

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THE LANDSCAPE OF PRACTICE

Triple Bottom Line Investing
Impact Investing
PRI
ESG
SRI
From “Global perceptions of environmental, social, and Governance (ESG) investing, 2017” by CFA Institute
ESG EXAMPLES

There is no one exhaustive list of ESG issues. ESG issues are often interlinked, and it can be challenging to classify an ESG issue as only an environmental, social, or governance issue.

ESG issues can often be measured (e.g., what is the employee turnover for a company?), but it can be difficult to assign them a monetary value (e.g., what is the cost of employee turnover for a company?).

Environmental

- Climate change and carbon emissions
- Air and water pollution
- Biodiversity
- Deforestation
- Energy efficiency
- Waste management
- Water scarcity

Social

- Customer satisfaction
- Data protection and privacy
- Gender and diversity
- Employee engagement
- Community relations
- Human rights
- Labor standards

Governance

- Board composition
- Audit committee structure
- Bribery and corruption
- Executive compensation
- Lobbying
- Political contributions
- Whistleblower schemes
THE DIFFERENCE

ESG Investment/PRI based strategy

- Can be pursued for financial profit only
- ESG awareness as long term risk mitigation strategy
- Primarily about bringing additional data and analysis into existing approaches

Impact/Ethical/Green Investment

- Financial and non-financial returns explicitly targeted
- Non-financial returns not monetized but reported to conscious investors
# Full Range of Possibilities

<table>
<thead>
<tr>
<th>Focus</th>
<th>Traditional</th>
<th>Responsible</th>
<th>Sustainable</th>
<th>Impact Investment</th>
<th>Philanthropy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance Only</td>
<td>Limited or no focus on ESG factors of underlying investments</td>
<td>Focus on ESG risks ranging from a wide consideration of ESG factors to negative screening of harmful products</td>
<td>Focus on ESG opportunities, through investment selection, portfolio management and shareholder</td>
<td>Focus on one or a cluster of issue areas where social or environmental need creates a commercial growth opportunity for market-rate or market-beating returns</td>
<td>Focus on one or a cluster of issue areas where social or environmental need requires some financial trade-off</td>
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<table>
<thead>
<tr>
<th>Examples</th>
<th>PE firm integrating ESG risks into investment analysis</th>
<th>&quot;Best-in-class&quot; SRI fund using deep integration of ESG to create additional value</th>
<th>Clean energy mutual fund</th>
<th>Fund providing debt or equity to social enterprises and/or trading charities</th>
</tr>
</thead>
</table>

(Source: European SRI Study, 2012)
# THEMED FUNDS, GREEN BONDS, IBs

Tailored products whose remit overlaps with areas responsible investment

Can be part of a responsible investment strategy.

<table>
<thead>
<tr>
<th>Environmentally- or socially-themed funds</th>
<th>Green bonds</th>
<th>Impact bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Standard management compensation ~ 2%</td>
<td>• Finance for projects consistent with Green Bond Principles</td>
<td></td>
</tr>
<tr>
<td>• Lower hurdle rate of less than 10%</td>
<td>• Top credit quality eg. by WB and IFC</td>
<td></td>
</tr>
<tr>
<td>• Obligation to report on impact indicators</td>
<td>• Fixed income returns</td>
<td></td>
</tr>
<tr>
<td>• Frequently, specific theme for investment, e.g. African Agriculture, SMEs, EcoEnterprises, Agroforestry</td>
<td>• Commitment to transparency and reporting in the use of proceeds</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>• Transfers the risk of subsidized projects to investors</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Makes social results directly tradeable</td>
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<tr>
<td></td>
<td></td>
<td>• Returns unconnected with financial markets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Costly verification – directly material</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• COMPLEX MULTI-PARTY LEGAL STRUCTURE</td>
</tr>
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IMPACT INVESTING GROWTH

• ESG considerations are not new and increasingly recognized to be a positive factor in asset valuations
• UN’s PRI and SDG create publicity and demand for Impact Investments – most major financial players have impact funds
• AUM $114bn (GIIN, 2016) growth 45% yoy
• “The industry is constrained by lack of instruments” (the Economist, 5 Jan 2017)
CHALLENGES: DEALS

• Appropriate capital across the risk–return spectrum
• Common understanding of definition and segmentation of impact investing market
• Suitable exit options
• High-quality investment opportunities (fund or direct) with track record
• Innovative deal or fund structures to accommodate investors’ or investees’ needs
• Government support for the market
• Professionals with relevant skill sets
CHALLENGES: IMPACT WASHING

• Greater transparency from impact investors on impact strategy and results
• Third-party certification of what qualifies as an impact investment
• A (voluntary) set of principles governing impact investor behavior
• A code of conduct that impact investors need to commit to
• The market mechanism will address the risk of impact washing
**WHAT IMPACT INVESTORS EXPECT**

<table>
<thead>
<tr>
<th>Number of respondents that selected each answer shown beside each bar; optional question.</th>
<th>Percent of respondents</th>
<th>n =</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is central to our mission to intentionally pursue impact through our investments.</td>
<td>91% 7% 2%</td>
<td>216</td>
</tr>
<tr>
<td>They are part of our commitment as a responsible investor.</td>
<td>89% 9% 2%</td>
<td>204</td>
</tr>
<tr>
<td>They are an efficient way to meet our impact goals.</td>
<td>73% 24% 4%</td>
<td>200</td>
</tr>
<tr>
<td>We are responding to client demand.</td>
<td>46% 40% 14%</td>
<td>170</td>
</tr>
<tr>
<td>They provide an opportunity to gain exposure to growing sectors and geographies.</td>
<td>34% 40% 26%</td>
<td>186</td>
</tr>
<tr>
<td>They are financially attractive relative to other investment opportunities.</td>
<td>31% 43% 26%</td>
<td>181</td>
</tr>
<tr>
<td>They offer diversification to our broader portfolio.</td>
<td>22% 33% 46%</td>
<td>129</td>
</tr>
<tr>
<td>We do so to meet regulatory demands.</td>
<td>9% 12% 79%</td>
<td>102</td>
</tr>
</tbody>
</table>

Note: Some respondents chose ‘not sure/not applicable’ and their responses are not included.

Source: GIIN
PRACTICING SUSTAINABLE DEVELOPMENT GOALS

The SDGs provide a communications framework regarding impact:

• Mapping impact metrics to the SDGs and underlying targets

• Market impact to investors, clear impact expectations for investee companies, contribute to global image of a stronger impact investing industry

Communication about ESG impact of financial investments brings more capital into impact investing
Material Significance of Reported ESG Indicators
SDG 1: NO POVERTY – END POVERTY IN ALL ITS FORMS EVERYWHERE

- Eradicate absolute poverty (1.1)
- Reduce by half relative poverty (1.2)
- Social protection (1.3), access to economic resources (1.4)
- Build resilience, reduce exposure and vulnerability to disasters and shocks (1.5)
- Mobilization of resources (for education, health and social protection)
- Pro-poor policy framework
SDG 2: ZERO HUNGER, SUSTAINABLE AGRICULTURE

• End hunger (2.1), end malnutrition (2.2)
• Double productivity and income (2.3)
• Sustainable food production systems (2.4)
• Genetic diversity (2.5)

Investment in Rural infrastructure, research
Correct trade distortions
Proper functioning of food commodity markets and their derivatives and facilitate timely access to market information, including on food reserves
SDG 8: DECENT WORK AND ECONOMIC GROWTH

• Per capita growth (8.1)
• Higher productivity (8.2)
• Policies for job creation, entrepreneurship (8.3)
• Decouple growth from environmental degradation
• Full employment, equal pay (8.5, 8.6), Labour rights (8.8), eradicate forced labour (8.7)
• Local financial institutions (8.10)

Aid for trade, trade related TA
Youth employment strategy
SDG 10: REDUCED INEQUALITIES

• Income growth for the poorest (10.1)
• Economic inclusion (10.2)
• Eliminate discrimination (10.3)
• Fiscal, wage, and social protection policies (10.4)
• Financial market regulation (10.5)
• Voice for developing countries (10.6)
• Orderly migration (10.7)

Special treatment for LDCs
ODA to LDCs, LLDCs, SIDS,
Reduce cost of migrant remittances
Indicators for all SDGs have gender equality dimension. Time for programs on gender equality in commodities.
THANK YOU! FOR MORE INFORMATION

• CFA Institute: Environmental, Social and Governance Issues in Investing, a guide for investment professionals
• Global Impact Investing Network (GIIN)
• Toniic Institute
• Global Reporting Initiative (GRI)
• Global Impact Investing Rating Standards (GIIRS)
• Omidyar Network
• KIT’s SDG House

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