

# 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

## HOW ESG INFLUENCES THE INVESTMENT PROCESS:

Client demand is the primary driver in ESG investing with most respondents saying they would consider ESG if there was sufficient demand. Although those considering ESG remains the same overall, there has been growth in the use of each component.



There has been growth in the use of each E, S, and G.

2017	54%	ENVIRONMENTAL
2015	50%	
2017	54%	SOCIAL
2015	49%	
2017	67%	GOVERNANCE
2015	64%	
2017	27%	I DO NOT TAKE ESG FACTORS INTO CONSIDERATION
2015	27%	

Risk analysis and client demand were the main reasons to take ESG integration into consideration.

2017	65%	TO HELP MANAGE INVESTMENT RISKS
2015	63%	
2017	45%	CLIENTS/INVESTORS DEMAND IT
2015	44%	

Of those that practice ESG integration, it is more commonly done with equities versus fixed income.

LISTED EQUITY	76%
FIXED INCOME	45%

While the most common use of ESG in the investment process is still integrating it into the whole investment analysis and decision-making process, there was an uptick in exclusionary screening that was offset by a slight decrease in best-in-class investing since 2015.

2017	59%	COMPLETE ESG INTEGRATION
2015	57%	
2017	38%	EXCLUSIONARY SCREENING
2015	38%	
2017	33%	BEST-IN-CLASS INVESTING/ POSITIVE ALIGNMENT
2015	38%	

When examining ESG investing practices, the most impactful issues are:



## HOW DIFFERENT TYPES OF INVESTMENT PROFESSIONALS VIEW ESG INVESTING:

While institutional investors are more likely than private investors to take ESG into consideration, the difference between portfolio managers and analysts is less pronounced.

Considers ESG in investment decisions:

INSTITUTIONAL INVESTORS	79%
PRIVATE INVESTORS	63%
PORTFOLIO MANAGERS	71%
ANALYSTS	78%

## GENERATIONAL DIFFERENCES:

Younger generations are more likely to consider ESG:

Millennials	78%
Gen-X	74%
Baby Boomers	68%

## GENDER DIFFERENCES:

Women are more likely than men to include ESG data in their investment process.

**62% of women and 49% of men** systematically consider ESG issues in their investment analysis.

**46% men vs. 18% women** say ESG issues are immaterial or add no value to investment analysis or decisions.



Those who consider ESG in investing put different emphasis on the components.

# 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

		Impact Investment					
		Traditional	Responsible	Sustainable	Thematic	Impact-first	Philanthropy
		Competitive returns					
		ESG risk management					
		ESG opportunities					
		High-impact solutions					
Focus	Finance Only	←	The New Paradigm			→	Impact only
	Limited or no focus on ESG factors of underlying investments	Focus on ESG risks ranging from a wide consideration of ESG factors to negative screening of harmful products	Focus on ESG opportunities, through investment selection, portfolio management and shareholder	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	Focus on one or a cluster of issue areas where social or environmental need requires some financial trade-off	Focus on one or a cluster of issue areas where social or environmental need requires 100% financial trade-off	
Examples		<ul style="list-style-type: none"> <li>• PE firm integrating ESG risks into investment analysis</li> <li>• Ethically screened investment fund</li> </ul>	<ul style="list-style-type: none"> <li>• "Best-in-class" SRI fund</li> <li>• Long-only public equity fund using deep integration of ESG to create additional value</li> </ul>	<ul style="list-style-type: none"> <li>• Clean energy mutual fund</li> <li>• Emerging markets healthcare fund</li> <li>• Microfinance structured debt fund</li> </ul>	<ul style="list-style-type: none"> <li>• Fund providing debt or equity to social enterprises and/or trading charities</li> </ul>		

# THEMED FUNDS, GREEN BONDS, IBs

Tailored products whose remit overlaps with areas responsible investment

Can be part of a responsible investment strategy.

## Environmentally- or socially-themed funds

- Standard management compensation ~ 2%
- Lower hurdle rate of less than 10%
- Obligation to report on impact indicators
- Frequently, specific theme for investment, e.g. African Agriculture, SMEs, EcoEnterprises, Agroforestry

## Green bonds

- Finance for projects consistent with Green Bond Principles
- Top credit quality eg. by WB and IFC
- Fixed income returns
- Commitment to transparency and reporting in the use of proceeds

## Impact bonds

- Transfers the risk of subsidized projects to investors
- Makes social results directly tradeable
- Returns unconnected with financial markets
- Costly verification – directly material
- COMPLEX MULTI-PARTY LEGAL STRUCTURE

# 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

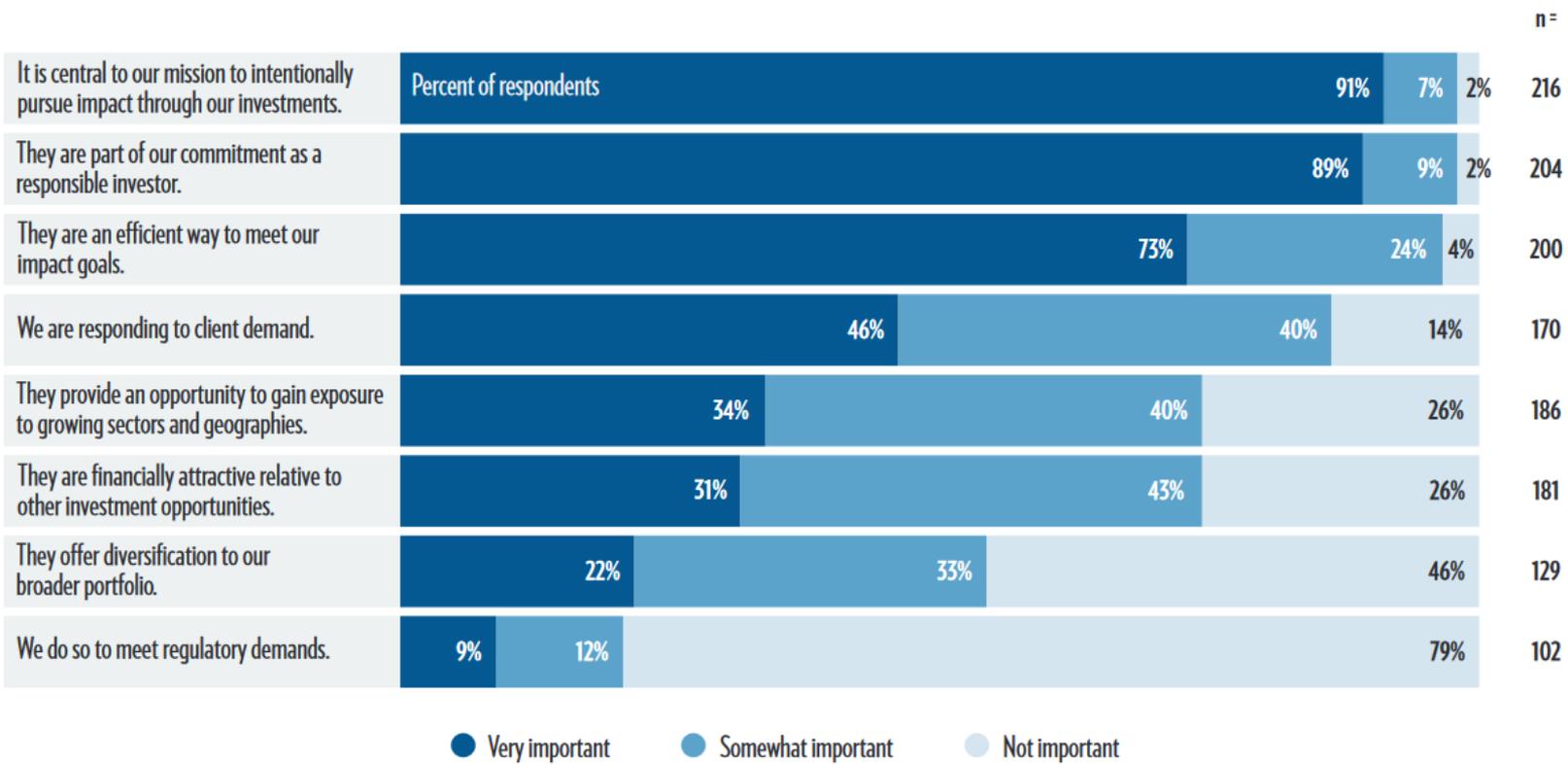
- Appropriate capital across the risk–return spectrum
- Common understanding of definition and segmentation of impact investing market
- Suitable exit options
- High-quality investment opportunities (fund or direct) with track record
- Innovative deal or fund structures to accommodate investors' or investees' 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

Number of respondents that selected each answer shown beside each bar; optional question.



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

2 ZERO  
HUNGER



# 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



# GENDER LENS



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