Jake Moeller *Fund Buyer*

'Articulate a theory of change'

There are many manifestations of responsible investment, something which has led to some confusion surrounding what investors should expect when considering these kinds of strategies. However, the various approaches can be broken down into four broad categories which should resonate with most investors. These are 'ethical exclusions' where businesses and industries that harm the planet are excluded; 'responsible practices' which considers the operational practices of companies and supports 'best practice'; 'sustainable solutions' which invests in companies that provide solutions to social and environmental challenges to realise long-term financial benefits; and 'impact investing'.

A fund manager that focuses on impact investing will seek to invest almost exclusively in companies that provide a meaningful and measurable solution to a social or environmental challenge. This objective is just as important as gaining a financial return and investors will expect to see detailed and targeted evidence of the positive social and environmental impact a fund is having.

Typically, this approach to responsible investment is the most comprehensive because by virtue of its desire to be a force for good, an impact fund will likely have an element of exclusion as it will seek to avoid sectors that damage the environment or society such as mining or gambling. It seeks to 'do good' by not only investing in companies whose products or services help to directly solve a social or environmental problem or help in the mitigation of one, but by actively engaging to encourage companies to become more responsible corporate citizens, thereby leading change.

60.5%

Average percentage invested in environmental solutions within gold rated funds

30.4%

Average percentage invested in social solutions within gold rated funds

For example, an impact fund may invest in companies addressing healthcare needs, generating renewable energy, directly improving energy efficiency or facilitating positive farming practices. It would report on its impacts in terms of the number of patients cared for, the kilowatts of clean energy generated, or the tonnes of natural resources saved or acres of trees planted.

Also, an impact fund manager should be able to articulate a "theory of change" for a specific security. This should explain how a company is going to achieve its social or environmental impact, how it will deliver this impact and importantly, how it will be measured.

An impact fund will frequently have high-level themes that drive stock selection, for example, low-carbon generation or social housing. Where this is not the case, a high-impact fund should be able to map a portfolio and ideally all of its holdings to an impact-related objective such as one of the United Nations' Sustainable Development Goals. Some funds in this space might have very specific impact criteria; one fund we have assessed considers its holdings in relation to the nine planetary boundaries as articulated by the Stockholm Resilience Centre. Alternatively, others might closely follow the UN Global Compact.

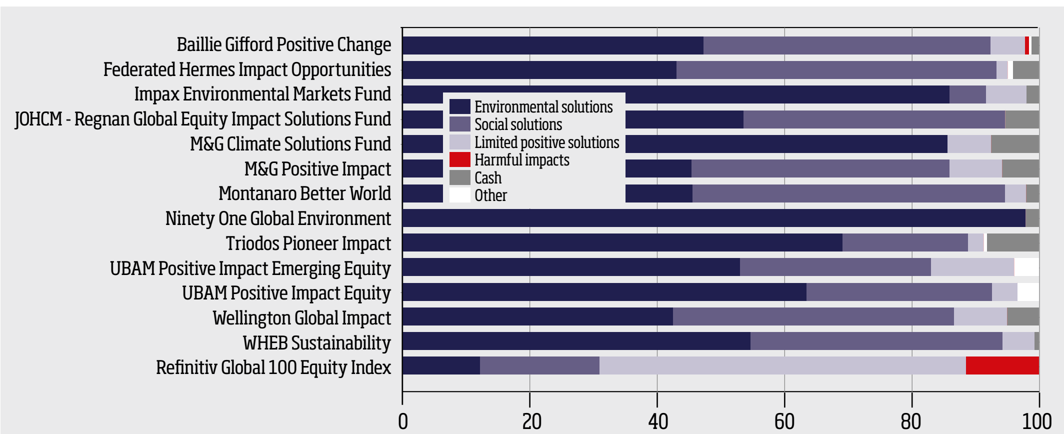
> Measuring impact can be challenging and demands a defined framework

Measuring impact can be challenging and demands a defined framework. Our method is to map a portfolio based on 13 investing classifications which sit in the broad categories of environmental solutions (stocks involved in renewable energy, circular economy, or low carbon transport), and social solutions (companies involved in education, social infrastructure or sustainable food production). These in turn are mapped back to a number of the UN Sustainable Development Goals. We also identify stocks with a harmful impact, such as weapons, or limited positive solutions, for example banks with little exposure to microfinance.

Using this framework, one would expect an impact fund to have a very high exposure to companies offering environmental and social solutions, very little exposure to those we would classify as limited positive solutions and no exposure to stocks with a harmful impact.

Indeed, looking at the Responsible Investment funds reviewed under this methodology with the highest 'gold' rating, there is a very clear differentiation between them and the composition of a standard broad based index analysed through the same lens.

Breakdown of impact funds' impacts



SQUARE MILE RESEARCH/REFINITIV

Jake Moeller is senior investment consultant at Square Mile Investment Consulting and Research

Nick Parsons *Economist*

'A considered blend'

Measuring impact is neither an art, nor a science, and requires a carefully considered blend of qualitative and quantitative metrics to judge the 'additionality' of an investment; the extent to which it has brought about change – both positive and negative – which would not otherwise have occurred. In line with SFDR, an investment must equally demonstrate that it has a positive impact, and that it does no harm.

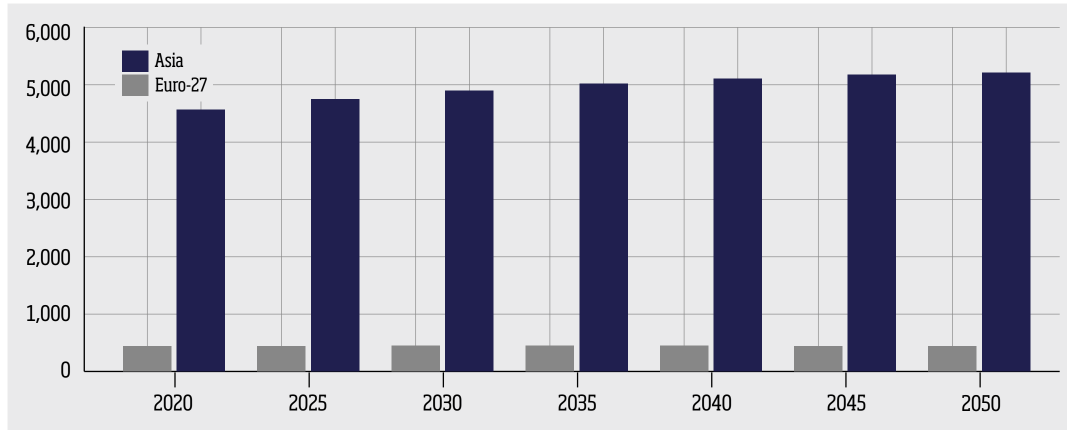
By its very definition therefore, impact must necessarily involve the injection of new money into the economy. In this important respect, the development of real assets is crucially different to the trading of financial assets. The former provides new funds, creates real jobs, and builds new infrastructure. The latter merely changes the ownership of a share certificate, with no new money for investment and no effect on employment, economic growth, or wider social and environmental outcomes.

The key to delivering impact is creating jobs. Employment brings income, security, responsibility and dignity. It brings family stability and fosters respect for institutions and justice. The development of infrastructure is both capital and labour-intensive. It requires a lot of money and creates a lot of jobs, multiplied well beyond the initial project investment.

These are not the dirty, polluting jobs of yesterday: mining coal or burning precious natural resources in heavy industry. They are jobs in the new, green economy: producing sustainable, renewable energy to bring clean, locally-generated electricity to power business, light schools and transform life at home.

The availability of reliable, clean electricity is changing lives in the fastest growing countries of Asia, where our efforts at serious climate-change mitigation must now be focused. We have seen the growth of new industries such as Business Process Outsourcing (BPO) which creates safe places of work for women; helping reduce traditional gender imbalance and bringing equality of opportunity to millions.

EU27 and Asia population projections 2020-2050 (m)



SOURCE: EUROSTAT AND UN WORLD POPULATION DIVISION

650m

Predicted increase of Asia's population over the next 30 years

Asia's population is set to increase by 650 million people over the next 30 years. That is equivalent to adding eight Germanys or ten Frances. Indeed, it is 50% bigger than all the countries which today make up the EU27. It is here that the dial on climate change can most effectively be moved.

Take, for example, a biomass plant in the Philippines, which burns trash left after the sugar cane harvest. There are specific, measurable impacts which result directly from that investment:

- Increase in farm incomes as we pay cash for trash
- Waste removal from the fields, reducing rodent infestation
- Improved soil quality through mechanised collection
- Better air quality as field burning is avoided
- Generation of locally-produced green, sustainable electricity
- Self-sufficiency and economic security which come from reduced dependence on imported fuel

Investors risk being seriously misled by the aggregators and promoters of purely financial assets who sell so-called sustainable investment products based on questionable claims about their social and environmental effects.

Impact investing is different to investing through an environmental, social and governance (ESG) lens, which has recently become so fashionable and attracted substantial net inflows from investors. ESG merely codifies a set of behaviours every responsible individual or company should already be living by. It may provide increasingly elaborate checklists to demonstrate commitment or compliance, but it will be neither the catalyst for fundamental change nor the standard against which that change can be measured.

Responsible investment does not mean removing paper towels from the company washroom while buying shares in automobile manufacturers or fossil fuel producers.

If we are going to have the biggest positive impact on the environment, climate and poverty, then we must lift our heads above the horizon. Be bold and ambitious. For sure, we can play a part with small changes in our everyday European lives. But the big opportunity and the greatest rewards for all will come from investing where our money makes a difference to tens or hundreds of millions of people – Impact investing that focuses on sustainable infrastructure, real assets and importantly, the creation of jobs and employment.

That is what we call impact.

Nick Parsons is head of ESG at Thomas Lloyd Group