PENSIONS AND LIFETIME SAVINGS ASSOCIATION

March 2018

IMPACT INVESTING

MADE SIMPLE GUIDE

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INVESTMENT MANAGEMENT

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INTRODUCTION

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) INVESTMENT HAS BECOME AN INCREASINGLY IMPORTANT PART OF GOOD INVESTMENT MANAGEMENT IN RECENT YEARS. MANY UK PENSION FUNDS ALREADY INTEGRATE ESG FACTORS INTO THEIR INVESTMENT DECISION-MAKING FRAMEWORK. THERE ARE TWO REASONS WHY: THEY WISH TO INCREASE THE PROSPECT OF STABLE LONG-TERM VALUE FOR THEIR MEMBERS, AND THEY BELIEVE THAT SUSTAINABILITY FACTORS MATERIALLY INFLUENCE THE RISK-RETURN PROFILE OF THEIR INVESTMENTS.[1]

The concept of social impact investing is not a recent phenomenon. Its origins can be traced back to the 1800s when religious groups, such as Quakers and Methodists, established socially responsible investing guidelines for their followers.

More recently, changes in terminology and practice have resulted in the evolution of SRI into ESG investing, and we are now seeing an increasing interest in impact investing, which aims for positive social and environmental impacts from investments alongside financial return. The amount of assets in responsible investment strategies continues to grow globally: it stood at $22.9 trillion at the beginning of 2016, up 25.2% from 2014.[2]

In 2006, the United Nations launched a set of six investment principles encouraging the incorporation of ESG matters into investment practice. The UN Principles for Responsible Investment (UNPRI) were developed by investors for investors, and major institutions have since become signatories.

Impact investing is now the fastest-growing area of responsible investment. The World Economic Forum estimates that $1 trillion of assets will be committed to impact investing by 2020, which means the sector is forecasted to grow by $250 billion annually.[3]

So, there is clearly an opportunity to make a positive impact on people and the planet through investment, while also generating healthy returns for pension savers. In this guide we will look at the growing importance of ESG investment. We will look at UK regulations and the UN Sustainable Development Goals (SDGs), and outline why impact investing will drive future growth.

1 PLSA Made Simple Guide: Environmental, Social and Corporate Governance (ESG), 2016
2 Source – 2016 Global Sustainable Review, published by the Global Sustainable Investment Alliance.
3 UN Sustainable Development Goals, published by UN PRI as at November 2017. Source: "UN Sustainable SDGs," published by the United Nations Principles for Responsible Investment (UNPRI)

1
ESG STRATEGIES

Differences between the various types of ESG approaches can be confusing. The table below explains some of the related terminology, which covers strategies from exclusionary screening to active ownership.

EXCLUSIONARY SCREENING ›

DEFINITION: Excluding entire sectors, companies or countries from a fund or portfolio based on ESG criteria, moral or ethical views, or religious beliefs.

OBJECTIVES: Align investors' money with their perception of ESG risk or broader beliefs, and to mitigate ESG risks as investors exit 'sin' stocks, such as tobacco or gambling companies.

POSITIVE SCREENING ›

DEFINITION: Investing in companies demonstrating positive ESG performance relative to peers.

OBJECTIVES: Achieve superior capital appreciation by mitigating ESG risks and acting on opportunities provided by companies demonstrating good ESG behaviours.

ESG INTEGRATION ›

DEFINITION: The inclusion of ESG factors alongside financial analysis of assets by investment managers.

OBJECTIVES: Improve long-term risk-adjusted returns, mitigate ESG risks and identify investment opportunities created or supported by positive ESG change.

IMPACT INVESTING ›

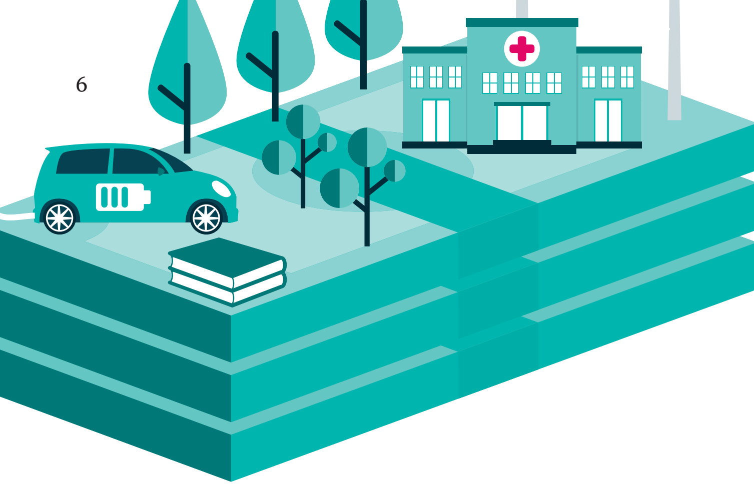
DEFINITION: Investing in companies, organisations and funds which have the commercial purpose of solving social or environmental problems.

OBJECTIVES: Generate strong investment returns by allocating to companies creating tangible benefits for society and the environment that will endure over time.

ACTIVE OWNERSHIP ›

DEFINITION: Engaging with companies on ESG concerns that affect their long-term growth, and using shareholder power to influence corporate behaviour.

OBJECTIVES: Promote positive change within companies that strengthens their financial performance, and provide a forward-looking view of ESG performance than can reveal opportunities.



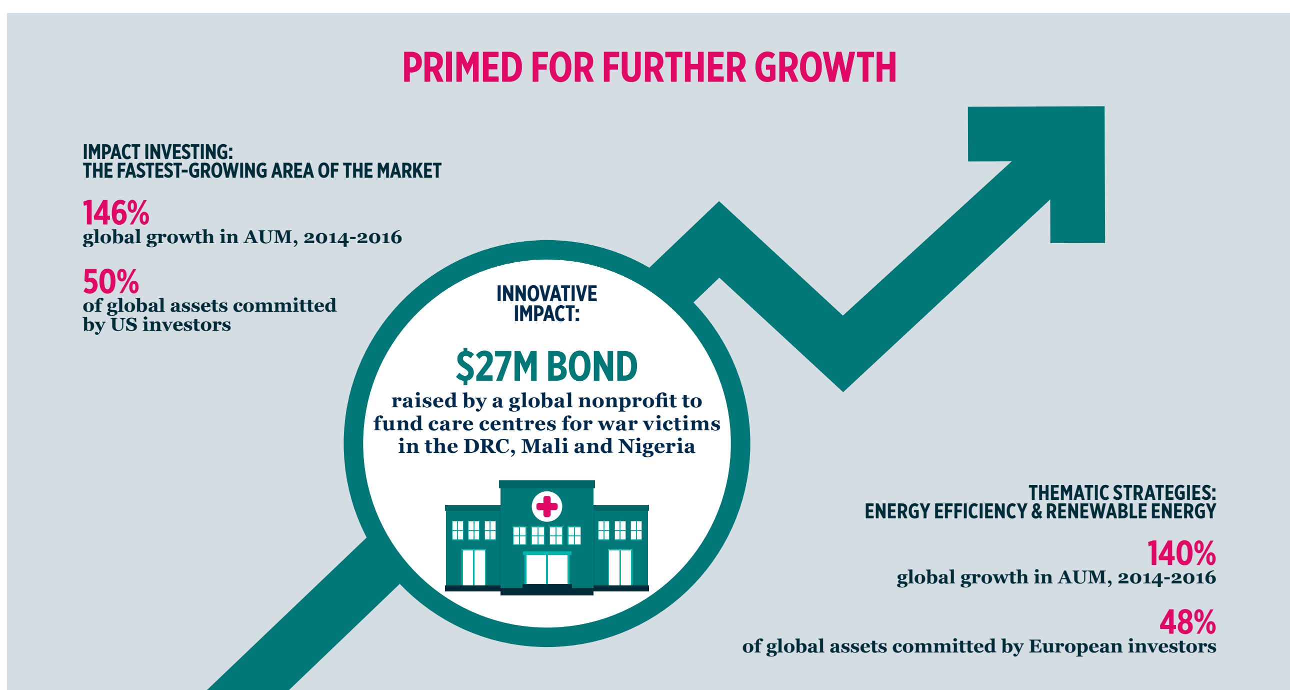
THE DIFFERENCE BETWEEN ESG AND IMPACT INVESTING

ESG investing includes environmental, social and corporate-governance information in order to gain a more expansive view of the risks faced by companies and their potential returns. It aims to improve portfolio risk-reward characteristics and therefore the prospects for long-term outperformance. By taking ESG factors into account when making an investment, this approach has a positive effect on society and the environment.

Impact investing goes a step further by investing in companies, organisations and funds with the express purpose of creating a positive social or environmental impact. While ESG investing analyses sustainability factors in order to understand their effect on investment returns, impact investing strategies prioritise positive social and investment impact as a specific objective of the investment alongside investment returns. Impact investing is forward-looking; it aims to identify businesses and organisations pursuing purpose-led activities with the intention of delivering products and services which tackle the underserved needs of the global economy.

As the concept of responsible investing is becoming more universally understood, the investment industry is now taking a step further by beginning to embrace impact investing. The approach is well established in the philanthropic, family office, non-governmental organisation (NGO) and social enterprise world, but less understood in the mainstream. It is long-term in nature and focuses on developing new capabilities that address the needs of society in a mission-led manner. It requires investors to identify investment opportunities involving businesses, organisations and investment funds which exhibit a clearly-defined approach to delivering additional and measurable societal benefits that will endure over time.

As mentioned in the introduction, impact investing is the fastest-growing area of the 'ESG market' – the graphic below highlights how it is set for future growth.

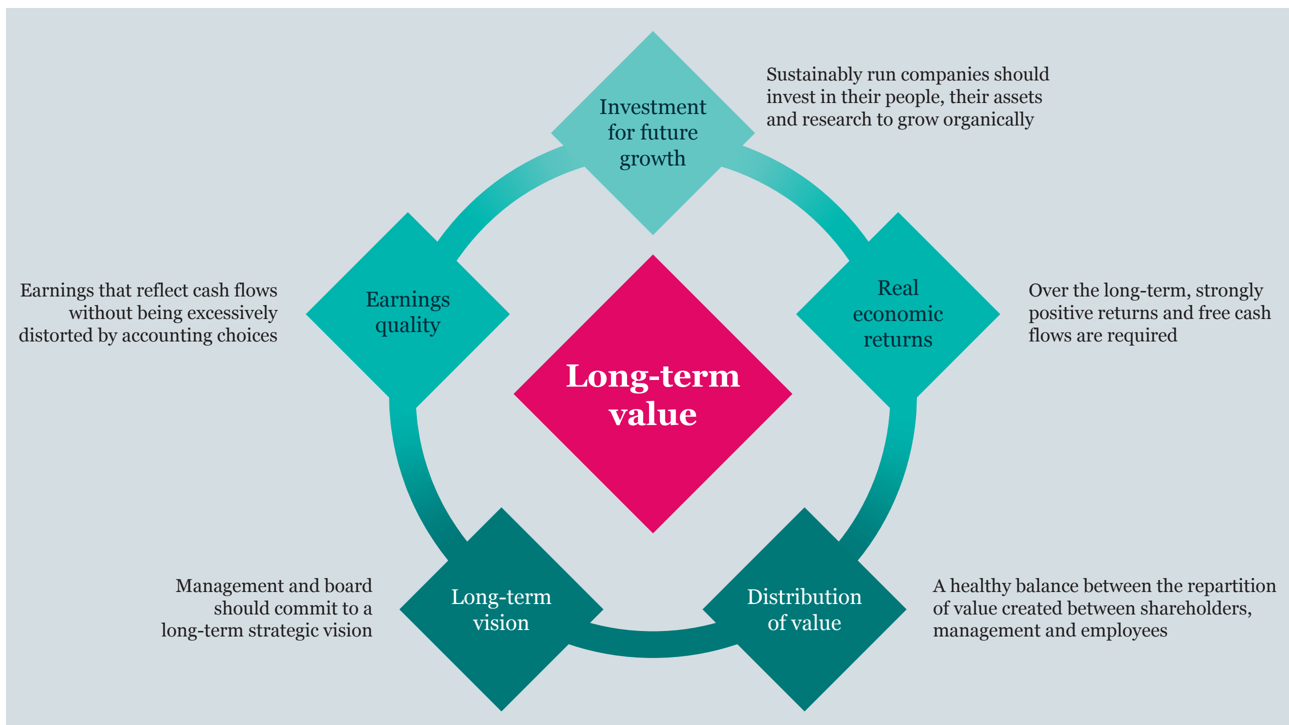


2016 Global Sustainable Investment Review," published by the Global Sustainable Investment Alliance

2 IN IT FOR THE LONG TERM

THERE IS EVIDENCE OF A REMARKABLE TRANSFORMATION UNDERWAY, REFLECTED IN AN INCREASING AWARENESS AMONG BUSINESSES AND SHAREHOLDERS OF THE NEED TO CREATE A SUSTAINABLE AND RESILIENT WORLD, COMBINED WITH A RECOGNITION THAT INVESTING TOWARDS THIS GOAL CAN ENHANCE, NOT DETRACT FROM, LONG-TERM PORTFOLIO RETURNS. THIS IS A SIGNIFICANT OPPORTUNITY FOR CHANGE, IRRESPECTIVE OF THE POLITICAL FORCES THAT OFTEN SEEM TO WORK IN OPPOSITION TO THESE INTERESTS.

Impact investing encourages a forward-looking view of where the world is heading, with investors essentially buying tomorrow's leading companies today. It is truly long-term investing, and this long-term value creation is perfectly aligned with the time horizons of pension funds.



Focusing on long-term value creation requires sustainable business models. Forward-looking companies are inevitably aiming to reduce their environmental footprint, decrease their fuel, energy and water consumption and produce less waste. Similarly, a workforce that is treated well improves long-term profitability, while badly-governed companies on the contrary systematically destroy value.

Today's consumers increasingly demand that companies act to preserve the environment and combat social problems. Firms must therefore work harder than ever before. The UN SDGs, which are linked to the most important sustainability challenges that humanity faces, illustrate the significance of these pressures on businesses. In an increasingly challenging world, the way companies manage their impacts must be integral to how they manage risk and stakeholder relationships and, ultimately, how they make strategic decisions.

SCHEMES NEED THE BEST POSSIBLE RISK-ADJUSTED RETURNS AND SHOULD BALANCE REWARD WITH RISK OVER THE LONG TERM

LISTENING TO THE REGULATOR

Pension trustees have a fiduciary duty to invest pension trust assets in the best interests of scheme beneficiaries. This is usually taken to mean the best financial interests, but should not in fact be equated solely with maximising financial returns.

In July 2016 the UK Pensions Regulator highlighted the fact that many pension schemes were failing to take material ESG issues like climate change into account in their investment decisions, due to a mistaken belief that their duty was to focus on short-term returns. It recommended that trustees seek information on their members' preferences regarding non-financial factors and socially responsible investment.

As a result, the Pensions Regulator updated its guidance for trustee boards of both defined benefit and defined contribution schemes. In a section headed 'Sustainability' the DC guidance states: "Where you think environmental, social and governance (ESG) factors or ethical issues are financially material, you should take these into account."[4]

Schemes need the best possible risk-adjusted returns and should balance reward with risk over the long term. Wider factors, including ESG issues, can legitimately be taken into account from a financial perspective.

Overview of recent ESG regulation in the UK

JULY 2012	*The Kay Review of UK equity markets and long-term decision making* identifies significant uncertainty concerning the legal concept of fiduciary duties, with some intermediaries interpreting this as a duty to maximise short-term financial returns over potential longer-term performance. The government subsequently tasks the Law Commission with investigating the issue and deciding to what extent fiduciaries, including pension scheme trustees, should consider: ▸ Longer-term factors including sustainability or environmental and social impact; ▸ Interests beyond the maximisation of financial return; and ▸ Generally prevailing ethical standards and/or their beneficiaries' ethical views, even where not in beneficiaries' immediate financial interest.
JULY 2014	The Law Commission report *Fiduciary Duties of Investment Intermediaries* recommends amending pension investment regulations, in order to clarify trustees' responsibility to take into account all financially material factors over both the short and longer term, including ESG issues where relevant.
FEBRUARY 2015	The Department for Work and Pensions (DWP) launches a consultation paper pushing pension trustees to focus on longer-term investment performance, including questions of sustainability or environmental and social impact.

4 The Pensions Regulator, Guide to Investment Governance (to be read alongside DC Code of Practice No. 13), Page 8.

SEPTEMBER 2016	The UK Pensions Regulator publishes a new code of practice to strengthen guidance on the consideration of ESG risks in pension fund investments. The code has implications for more than 30,000 schemes covering nearly 6 million beneficiaries, and confirms the Law Commissions view that: - Trustees should take into account factors which are financially material to the performance of an investment; - This should include ESG factors where relevant; and - While the pursuit of a financial return should be trustees' main concern, the law allows the flexibility to take other, non-financial factors into account if they have good reason to think that scheme members share their view and there is no risk of significant financial detriment to the fund.
NOVEMBER 2017	The Advisory Group on Growing a Culture of Social Impact Investing, convened by the Department of Culture, Media and Sport in Summer 2016, produces its report. The formation of the group demonstrates the government's intention to encourage impact investing in the UK. The report's recommendations include: - An increase in co-investment opportunities offered by government and the financial services industry, meaning more investors have the opportunity to engage in impact investing; - Consistent standards for measuring non-financial impact, meaning that investors are better able to understand the impact of their investment; and - New professional development opportunities in impact investing, meaning stakeholder organisations can build their capacity for impact investing. If implemented, these measures will add further momentum to the growing interest in impact investing.
DECEMBER 2017	The DWP issues its interim response to the Law Commission's report on Pension Funds and Social Investment, stating that it is minded to make the changes proposed by the Law Commission. These would require trustees to: - State their policies in relation to ESG risks to their investment; and - Respond to scheme members' ethical concerns. If implemented, these changes would add further regulatory impetus to impact investing by requiring greater transparency regarding environmental and social impact, and by creating pressure to respond to members who want to see their pensions investments have a positive impact.

3
MEETING THE UN'S SUSTAINABLE DEVELOPMENT GOALS (SDGS)

THE UN'S SUSTAINABLE DEVELOPMENT GOALS (SDGS) ARE A UNIVERSAL SET OF GOALS, TARGETS AND INDICATORS FOR GLOBAL DEVELOPMENT WHICH CAN BE USED AS IMPORTANT GUIDELINES FOR IMPACT INVESTING. THEY EFFECTIVELY SERVE AS A BLUEPRINT FOR POSITIVELY TRANSFORMING THE WORLD IN WHICH WE LIVE, BY ENDING POVERTY, SAFEGUARDING THE PLANET AND ENSURING PROSPERITY FOR ALL BY 2030.

The SDGs were born at the UN Conference on Sustainable Development in Rio de Janeiro in 2012 (they replaced the Millennium Development Goals, which were established in 2000 as a global effort to tackle extreme poverty).[5] The SDGs have been adopted by 193 governments.

The 17 SDGs balance three primary dimensions of sustainable development: economic, social and environmental. Achieving these goals will require an estimated annual investment of $5-7 trillion until 2030. Approximately $1 trillion will come from public funds from the UN and member countries, while private capital must fund the remaining $6 trillion[6] on an annual basis.

5 Source: The United Nations Development Programme. http://www.undp.org/content/undp/en/home/sustainable-development-goals/background.html
6 "UN Sustainable Development Goals," published by UN PRI as at November 2017. Source: "UN Sustainable SDGs," published by UNPRI; "What do the UN Sustainable Development Goals mean for investors?" published by the PRI, UNEP Finance Initiative and UN Global Impact as at December 2016; and "Within investor reach? The UN Sustainable Development Goals," published by Hermes Investment Management April 2017

THE SDGS COULD BE DESCRIBED AS THE BETA OF FUTURE GROWTH; COMPANIES NEED TO FIND SOLUTIONS TO ADDRESS UNDER-MET NEEDS OF THE ECONOMY IN ORDER TO GROW

WHY DO SDGS MATTER TO INVESTORS?

Creating investment themes linked to the detailed sub-goals of the SDGs, of which there are 169, illustrates the breadth of opportunity that impact investing offers. Addressing issues including access to clean water, sanitation and pollution management, food and energy security, urbanisation, climate change, preservation of biodiversity, improvement of healthcare and education, financial inclusion, promotion of a living wage and quality jobs, and cyber security represent enormous opportunities, as well as challenges.

The SDGs could be described as the beta of future growth; companies need to find solutions to address under-met needs of the economy in order to grow. Impact investing can therefore be seen not only as an effective means of ensuring financial returns, but also as a lens through which to focus on wider responsibilities as part of overall returns. For impact investing, the SDGs provide a useful framework against which to measure the impact an investment may have in relation to the achievement of the 17 goals.

At the same time, governments across the world are introducing regulations and incentives to promote the SDGs, and companies are adopting more sustainable business practices and seeking to innovate to deliver sustainable products and services.

For example, French law requires asset owners to disclose how they are assessing carbon risk, while the updated UK Corporate Governance Code, published in September 2016 by the Financial Reporting Council, asks company boards to consider strategy beyond a minimum of 12 months.[7] This demonstrates an interest in wider long-term benefits over the narrow aim of short-term financial reward, an approach perfectly suited to long-term investment vehicles such as pension funds. With regulators increasingly determined to align business/investment practices with the interests of society and investors, investors with a long-term outlook should be giving serious consideration to joining governments and businesses on this journey.

POTENTIAL BENEFITS OF THE SDGS FOR INVESTORS INCLUDE:

- **Serving as a list of important factors** investors should consider as part of their fiduciary duty;
- **Offering the opportunity to help improve the lives of people across the world** in areas such as clean water, waste management and renewable energy;
- **Creating long-term value** by aligning investors with the broader needs and objectives of society and the environment;
- **Providing a clear risk framework** to help investors avoid businesses with exposure to unsustainable risks that could compromise their long-term revenues; and
- **Helping investors integrate ESG** by identifying companies with a material revenue exposure to products and services that assist in overcoming challenges in society, thereby managing risk and improving return.

7 The UK Corporate Governance Code 2016. https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf

4
THE PILLARS OF IMPACT INVESTING

INTEREST IN THE LONG-TERM SUSTAINABILITY OF BOTH BUSINESSES AND THE PLANET IS INDICATIVE OF A SEA CHANGE IN OPINION. NO LONGER IS IT A CASE OF PORTFOLIO MANAGERS ARGUING WHY THEY FOCUS ON RESPONSIBLE ESG ISSUES: THEY MUST NOW JUSTIFY WHY THEY DO NOT.

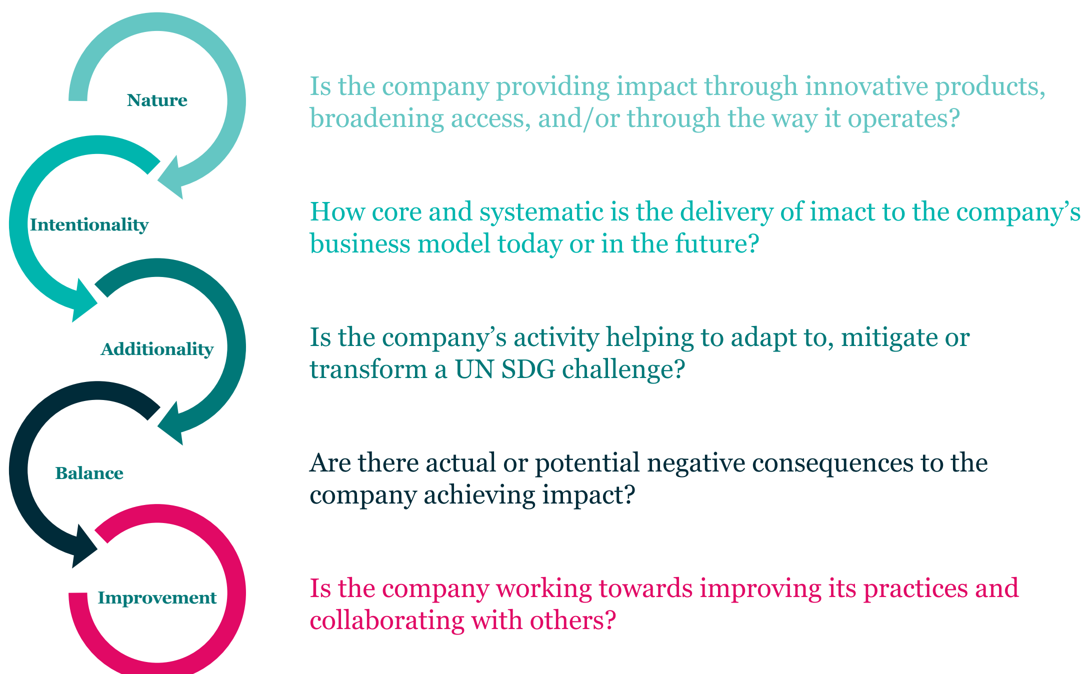
As previously mentioned, the concept of ESG-aware investing is now well understood, although it is delivered in varying forms. The investment industry, however, is now taking this one step further and embracing impact investing, an approach that is well established in the world of philanthropy, family offices, non-governmental organisations and social enterprises, but is less well understood in the mainstream.

Existing social investors understand this concept well, but they also operate in a world in which social returns generally rank higher in importance than financial ones. So, how readily can the philosophy of impact investing be applied more broadly?

The three key concepts which distinguish impact investing from conventional investing are:

1. **INTENTIONALITY:** the intention of an investor to exert a positive social or environmental impact;
2. **ADDITIONALITY:** fulfilling a good cause beyond the provision of private capital; and
3. **MEASUREMENT:** being accountable and transparent in reporting on the financial, social and environmental performance of investments.

Identification validation



These ideas can bring significant benefits compared to the way traditional investors approach investing. Analytical thinking, along with a proactive approach to understanding and measuring the impacts (both positive and negative) that all businesses have on society and the environment, is fundamental to long-term investment success. This reflects the complex, interrelated nature of the ecosystem in which we operate as investors and our responsibility for sustaining that system for future generations.

ENCOURAGING PROSPERITY ACROSS SOCIETY

The concept of additionality, often seen as too idealistic for mainstream investors, is worth exploring as it can be argued that it forms the very purpose of capital markets. The accusations of short-termism and over-intermediation levelled at the investment industry reflect the loss of a connection between capital and its commercial and societal purpose. Through additionality, impact investing can help restore that bond.

Investors can encourage companies to invest capital, funded by shareholders if required, in long-term, sustainable opportunities that address unmet societal needs in innovative ways. Doing so has the potential to deliver attractive returns for all stakeholders. This is a lofty ambition which takes impact investing in public markets beyond ESG investing, with the aim of constructing a concentrated portfolio of companies which demonstrate a commitment to long-term sustainable returns that bring real societal benefits.

Such companies will not only have a clear mission but should also embody strong cultural values, embracing diversity, employee development and environmental awareness, and ensuring that their mission is enforced throughout their supply chains. These are features that are increasingly recognised as hallmarks of successful and resilient businesses. As such, additionality should underwrite behaviours which establish a holistic and long-term perspective that perceives short-term maximisation of profits to the detriment of longer-term sustainability as failure. The true goal of additionality is to encourage prosperity across society rather than to create pockets of isolated wealth.

THE CASE FOR IMPACT INVESTING

1) Investors have to live in the societies shaped by their investments, therefore environmentally/socially positive investing is inherently in their interests. This is particularly important to ordinary pension savers, most of whom will not have the very high levels of wealth necessary to insulate themselves from the problems of wider society.

2) In the long term, businesses can only thrive if the wider economy/society does as well, so investors should prioritise investments that enable a more resilient economy, environment and society.

Therefore, there is a strong argument that impact investment delivers the best holistic outcomes for beneficiaries and is the most sustainable approach to long-term investing
However, impact investing is not just about 'doing good', it is about doing a good job. First and foremost, you have to be a good investor. You still have to think about valuations and the quality of business – a problem in the short term is that everyone wants to invest in a sustainable way and there are not enough credible options that meet the criteria.

In summary, the benefits to investors are:

- The potential to access superior long-term returns; and
- Investors are playing their part to ensure the overall system is sustainable to support pension fund liabilities for decades to come.

THROUGH ENGAGEMENT AND ACTIVE OWNERSHIP INVESTORS CAN ENCOURAGE COMPANIES TO MEASURE THEIR IMPACTS AND REPORT MEANINGFUL DATA

MEASURABLE IMPACT

For investors, focusing on impact offers a good opportunity to reflect on how the sustainability performance of a business can be measured. The fast-growing availability of ESG data has enabled investors to make more holistic assessments of how companies create value.

However, for all its benefits, ESG data is sometimes criticised for not capturing on-the-ground sustainability performance. For example, some companies can be awarded high ESG scores, while their actual, real-world impacts are net-negative.

Part of the issue is that ESG data is still relatively new and not entirely standardised – a common criticism is that scores are based on data which lacks sufficient detail or fails to analyse particular aspects of a business.

Furthermore, certain sectors and industries are inherently more 'ESG-negative' – avoiding these businesses altogether does not address the problem; instead, active engagement is needed to identify where improvements can be made.

Investors should therefore be wary of repurposing high ESG scores as direct evidence of impact. Instead, they should recognise that much existing ESG data is at best an imprecise tool for accurately capturing the impacts of companies, and therefore be prepared to take a more proactive and qualitative approach.

Through engagement and active ownership investors can encourage companies to measure their impacts and report meaningful data. Over a longer period, this could spur a move away from a tick-box approach to ESG integration and result in more holistic company valuations, which better capture companies' social and environmental performance.

The SDGs provide a universal framework through which investors and companies can start thinking about their impacts. Several initiatives have been launched, including the SDG Compass,[8] which helps corporates align their activities with and measure their contributions to the overall goals. However, impact measurement should not be practised through a one-size-fits-all approach. Companies need to focus on their most material net impacts, positive and negative.

As a result, different asset managers will adopt different investment approaches when it comes to both selecting, and then investing in, what they consider an impact company to be. What one manager sees as an impact company, another may disagree with. Pension funds need to be mindful of this and look for those impact strategies with the appropriate measurement tools.

CORPORATE ENGAGEMENT ENABLES IMPACT INVESTING

Efforts by all participants in the financial and business worlds – including companies, funds and investors – need to be better aligned to increase the understanding, measurement and management of impacts.

Measuring and reporting on impacts achieved is essential to help foster strong relationships between companies and their investors. Active and collaborative corporate engagement is therefore necesssary and results in better alignment between all stakeholders in a business. It also encourages investors to take a truly long-term perspective. When considering impact investment approaches, pension funds should make sure they have a good understanding of their manager's engagement policy, as engagement is integral to impact investing.

Passive investors can also embrace this approach: through engagement and intelligent voting across their portfolios, they can help reduce negative behaviours and reward positive actions for the long-term benefit of society. Indeed, it can be argued that constructive corporate engagement that is aligned with the UN SDGs enables all investors to be impact investors.

8 https://sdgcompass.org/

Impact engagement requires time, resources and focus. It is primarily driven by face-to-face executive- and board-level interactions with a company and an ability to shape the engagement strategy to suit the circumstances, local regulatory framework and specific issues.

Through engagements with companies, the aim is to create a positive feedback loop that strengthens and sustains the changes they are creating. The aim is to generate long-term value for clients, not seek media headlines.

The success of any engagement is heavily dependent upon the willingness and readiness of a company to change. Some engagements can involve just one or two meetings, while others are more complex and will require multiple meetings with management and board members over several years. A long-term perspective makes it possible to persist with these difficult and more time-consuming engagements.

ENGAGEMENT CASE STUDY

SEEKING POSITIVE IMPACT AT A DIAMOND MINING COMPANY

This diamond mining company has the scope to fundamentally transform lives and communities – changes that will further improve its business. The company's mines are the primary economic contributors to the isolated rural communities in which it functions, and it operates in a particularly water-scarce region.

The engagement plan focuses on the following targets:

- Provision of decent jobs and the miner's contribution to local economic growth, which relate to SDGs of 'no poverty' and 'decent work and economic growth';
- Efforts to support the SDG of 'Good health and well-being' through reducing accidents and fatalities, and supporting greater treatment of prevalent communicable diseases among the workforce, their families and within the wider community; and
- A long-term water-use plan that serves the local community equitably, which is aligned with the SDG of 'clean water and sanitation'.

The Company's on-the-ground impacts will be measured by assessing enhanced company disclosures, external data sources and using proprietary analytical tools.

5
WHY SUSTAINABILITY MATTERS: A WORLD IN TRANSITION

TO UNDERLINE WHY A SUSTAINABLE APPROACH IS IMPORTANT FOR PENSION FUNDS, IT IS WORTH TAKING A MOMENT TO CONSIDER THE CURRENT STATE OF THE WORLD AND THE IMPLICATIONS THIS HAS FOR THE FUTURE.

Few would disagree that we are experiencing unprecedented levels of change and uncertainty, with the world going through four major transitions:

- **Technology**
- **Climate**
- **Geopolitics**
- **Demographics**

These factors all interact to generate significant and sometimes unpredictable market shifts, which could lead to businesses which fail to plan for the longer term becoming stranded and obsolete. An investment strategy which does not take the impact of such trends into account runs the risk of underperforming in the long term.

This is not just happening in areas you might expect, such as fossil fuels: it can also be seen across sectors from retail and healthcare to automotive and industrials.

Take the healthcare sector as an example. The traditional world of small molecule pharmaceuticals has already given ground to biological drugs, but rapid technological advances are now seeing a transition to immunology that threatens to maroon some of the major drug providers with obsolete products. With soaring healthcare costs, technology and demographics all colliding, a great deal of uncertainty is being generated in the broader healthcare space which represents a huge opportunity for alpha.

Furthermore, historical precedent evidences the fact that the market is inefficient at discounting change at turning points: the demise of Blackberry and Nokia as preeminent mobile brands illustrates the danger of misreading an ebbing technological tide.

6 CONCLUSION

IMPACT AND SUSTAINABLE INVESTING ENCOURAGE A FORWARD-LOOKING VIEW OF WHERE THE WORLD IS HEADING AND PROVIDE A RICH OPPORTUNITY FOR FUTURE RETURNS. AS SUCH THEY EFFECTIVELY DEFINE REAL LONG-TERM INVESTING.

Sustainability is an imperative, not an option: pension funds cannot isolate themselves from the societies and environments in which they are based – instead of factors such as the SDGs being seen as worthy goals with limited financial reward, they should be seen as a source of growth opportunities for genuine long-term investors.

Impact investing is also not about philanthropy and giving up returns. Resilience and sustainability are important factors in building long-term investment portfolios that not only preserve wealth but are also resistant to shocks in the system, through tackling issues such as poverty and climate change. A failure to create a resilient system and a more sustainable future will almost inevitably result in debilitating episodes of heightened financial market volatility and a reduction in the net present value of future assets. For example, a rise in global temperatures of 2°C above pre-industrial levels would result in a significant drop in the net present value of all pension funds.

In an ideal future, investors will no longer be talking about impact investing as a separate issue because it will have been fully integrated into their thinking. This will represent a realisation that investing is part of our overall responsibility to act in the best interests of society as a whole.

As we look at the choices that lie ahead of us, we should ponder on the consequences of each and focus on the long-term sustainability of society. Making the wrong turn now might not only increase volatility and impair profits, but also undermine the viability of the ecosystem in which we live.

QUESTIONS TRUSTEES SHOULD CONSIDER

- **Is the rationale for pursuing impact investing clearly expressed and understood by stakeholders, and does it take into account the needs and wishes of beneficiaries?**
- **Does the manager have a defined impact investment strategy?**
- **How is the impact of investments and the effectiveness of the impact investing approach measured?**
- **How does the manager and/or the funds they are invested in engage with companies regarding their impact?**
- **How does the manager communicate impact investing activity to beneficiaries?**

7
GLOSSARY

Active ownership: Engaging with companies on ESG concerns that affect their long-term growth, and using shareholder power to influence corporate behaviour.

Engagement: A process that allows the fund manager to meet the companies in which they invest. This is crucial to the ongoing management of a fund as it allows regular discourse with a company or regulator in order to seek long-term positive outcomes.

ESG (environmental, social and governance): An investment approach that incorporates environmental, social and governance factors into the investment process.

ESG integration: The inclusion of ESG factors alongside financial analysis of assets by investment managers.

Exclusionary screening: Excluding entire sectors, companies or countries from a fund or portfolio based on ESG criteria, moral or ethical views, or religious beliefs.

Global Impact Investing Network (GIIN): A not-for-profit organisation devoted to increasing the effectiveness of impact investing, which was launched in 2009.

Impact investing: Investing in companies, organisations and funds which have the commercial purpose of solving social or environmental problems.

Positive screening: Investing in companies demonstrating positive ESG performance relative to peers.

Principles for Responsible Investment (UNPRI): The United Nations-backed Principles for Responsible Investment initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. It works to understand the implications of sustainability for investors, and support signatories to incorporate these issues into their investment decision-making and ownership practices.

Socially Responsible Investment (SRI): Socially responsible investing is the incorporation of ESG factors into investments. It covers a range of strategies including ESG integration, thematic investing, ethical investing, socially responsible investing, sustainable investing, green investing and impact investing, among others.

UN SDGs: The United Nations Sustainable Development Goals. These are a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity. They can provide a useful lens through which to view impact investing.

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