

# **Responsible Investment (ESG) Sustainable Investment and Impact Investment**

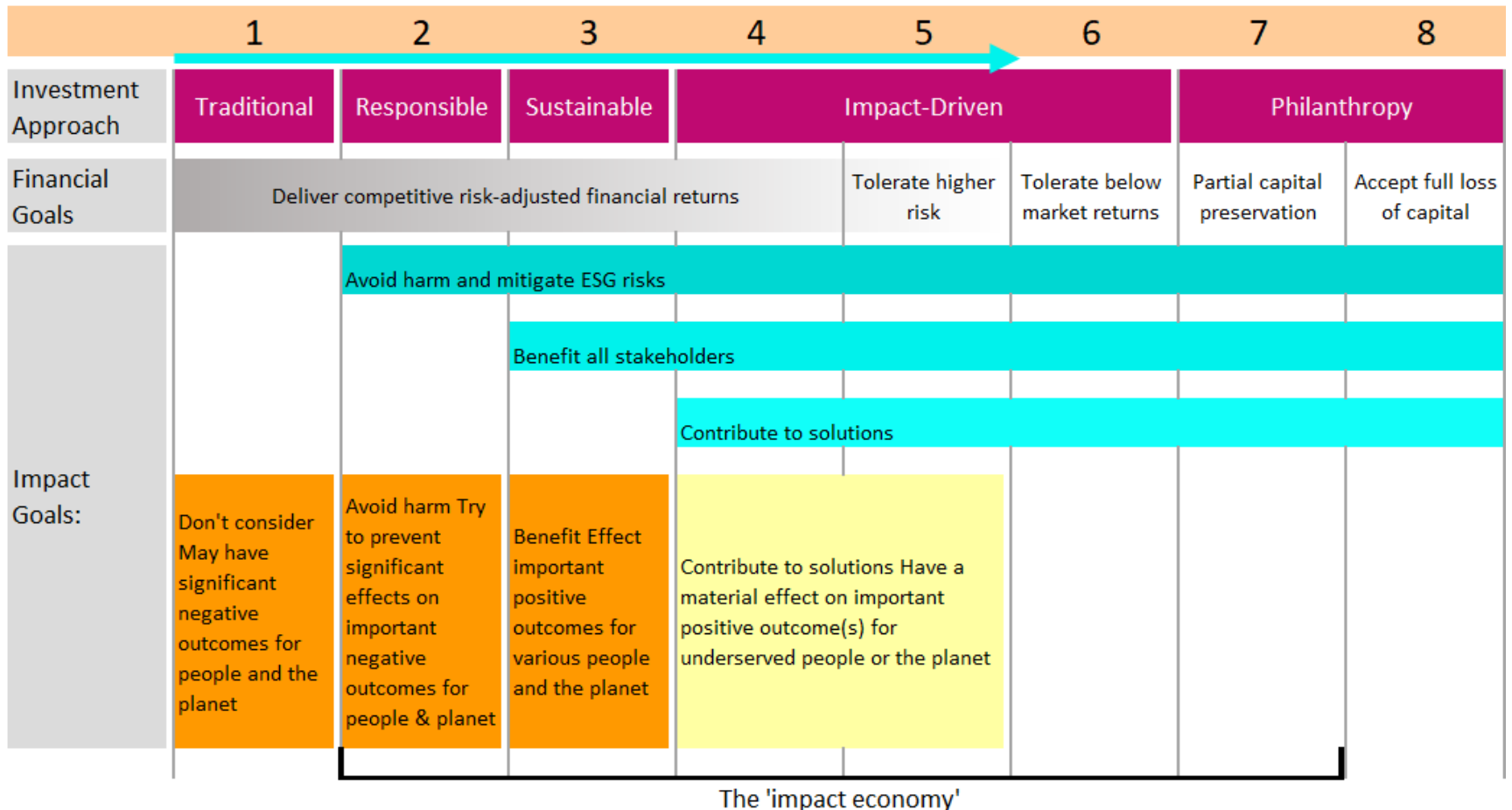
**Karen Shackleton**  
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**20<sup>th</sup> June 2019**

# Discussion points in this session

- Understanding the spectrum of capital
- Responsible investment within traditional portfolios (ESG)
- Moving to values-based investment – sustainable investment
- What is impact investment (and what is it not)?
- Listed vs unlisted impact investments
- Case studies
- The challenges of measuring social or environmental impact

# The Spectrum of Capital



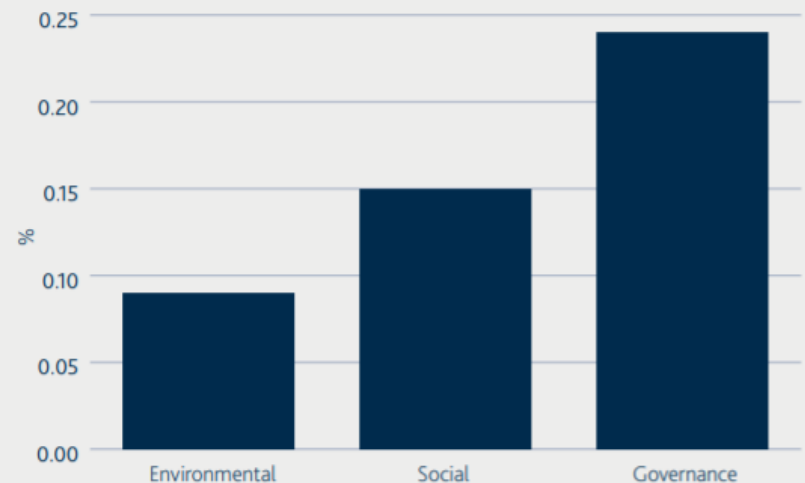
Source: *The rise of impact: five steps towards an inclusive and sustainable economy*  
 UK National Advisory Board on impact investing 2017 & Impact Management Project 2017

# Moving from traditional to responsible (1 to 2 on the spectrum of capital)

- Historically, very little consideration of ESG factors (Environmental, Social, Governance)  
Position 1 on the spectrum of capital
- In the past 3-5 years, more and more managers are taking this into account  
Position 2 on the spectrum of capital
- There is evidence that this adds value.  
[See Hermes: ESG investing: a social uprising on Pensions for Purpose website](#) (reproduced here with their permission)

Figure 2. ESG value is driven by corporate governance and social characteristics

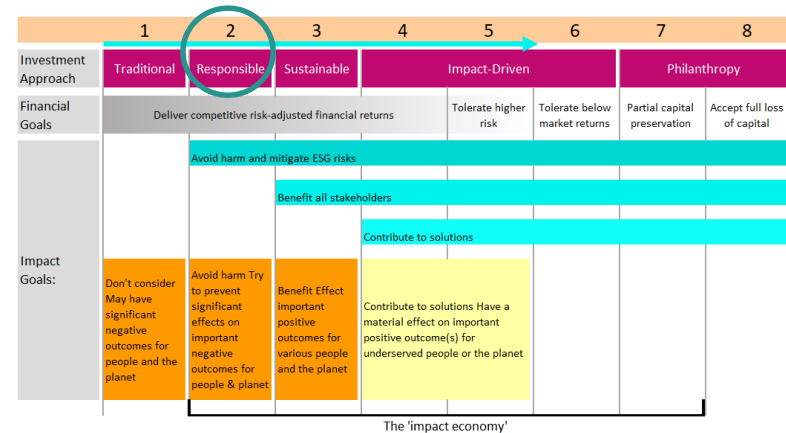
Average monthly dispersion in total returns between companies in top decile and lowest decile on environmental, social and governance scores from 31 December 2008 to 30 June 2018.



Source: Hermes Investment Management as at 30 June 2018.

# How do managers take ESG into account?

- Analysis e.g. carbon footprint, gender diversity statistics, living wages – used to value a company
- Engagement with management
- Voting
- **Purpose: to get the maximum risk adjusted return on the portfolio.**
- No values expressed on whether ESG issues are morally right or wrong
- **How many of you would describe yourselves as responsible investors?**  
(position 2 on the spectrum of capital)



# From value investing to *values* investing

	1	2	3	4	5	6	7	8
Investment Approach	Traditional	Responsible	Sustainable	Impact-Driven			Philanthropy	
Financial Goals	Deliver competitive risk-adjusted financial returns				Tolerate higher risk	Tolerate below market returns	Partial capital preservation	Accept full loss of capital
Impact Goals:	Avoid harm and mitigate ESG risks							
	Benefit all stakeholders							
	Contribute to solutions							
	Don't consider May have significant negative outcomes for people and the planet	Avoid harm Try to prevent significant effects on important negative outcomes for people & planet	Benefit Effect important positive outcomes for various people and the planet	Contribute to solutions Have a material effect on important positive outcome(s) for underserved people or the planet				
The 'impact economy'								

Source: *The rise of impact: five steps towards an inclusive and sustainable economy*  
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# Moving from 'responsible' to 'sustainable'

## (2 to 3 on the spectrum of capital)

- Many pension funds are now wanting to introduce a set of **investor beliefs** to their investment strategies
- This is values-based investing –
  - **There may be a performance implication from doing this... Could be positive or negative**
- Climate change is a common consideration
- Some pension funds set goals for the pension fund to achieve
- Example: London Borough of Islington pension fund's goals:
  - Reduce future CO2 emissions
  - Reduce exposure to carbon intensive companies across asset classes and industry sectors in the public equity allocation by 40%
  - Invest 15% of the Fund in sustainability-themed investment



# What do sustainable portfolios look like?

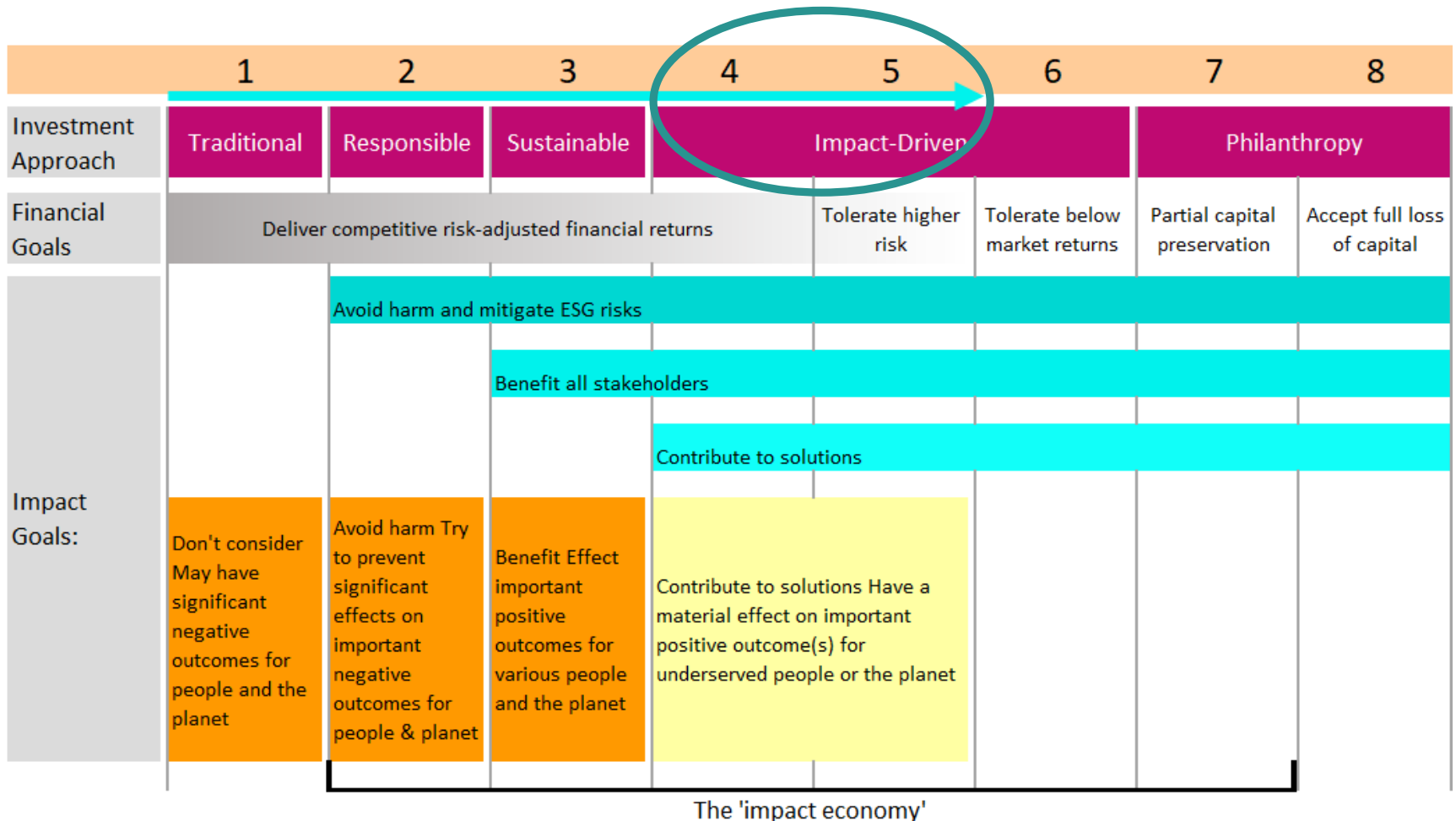
- **Passive equities**
  - Low carbon index funds
  - Still track the market index
  - Aim to have a lower carbon footprint than the index
- **Active equities**
  - Still aim to outperform the MSCI World Index
  - Aim to have a lower carbon footprint than the index
  - Proactively engage on climate issues
- Other asset classes are less developed in this space





# Investing with impact

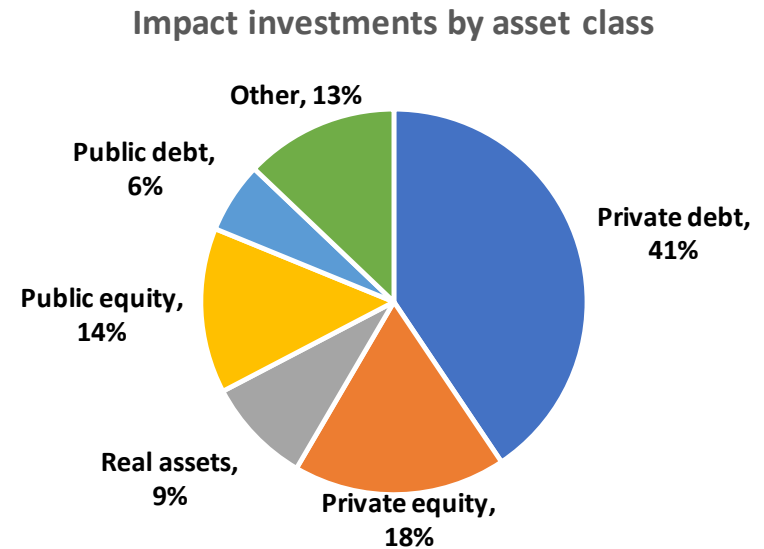
## (3 to 4 on the spectrum of capital)



Source: *The rise of impact: five steps towards an inclusive and sustainable economy*  
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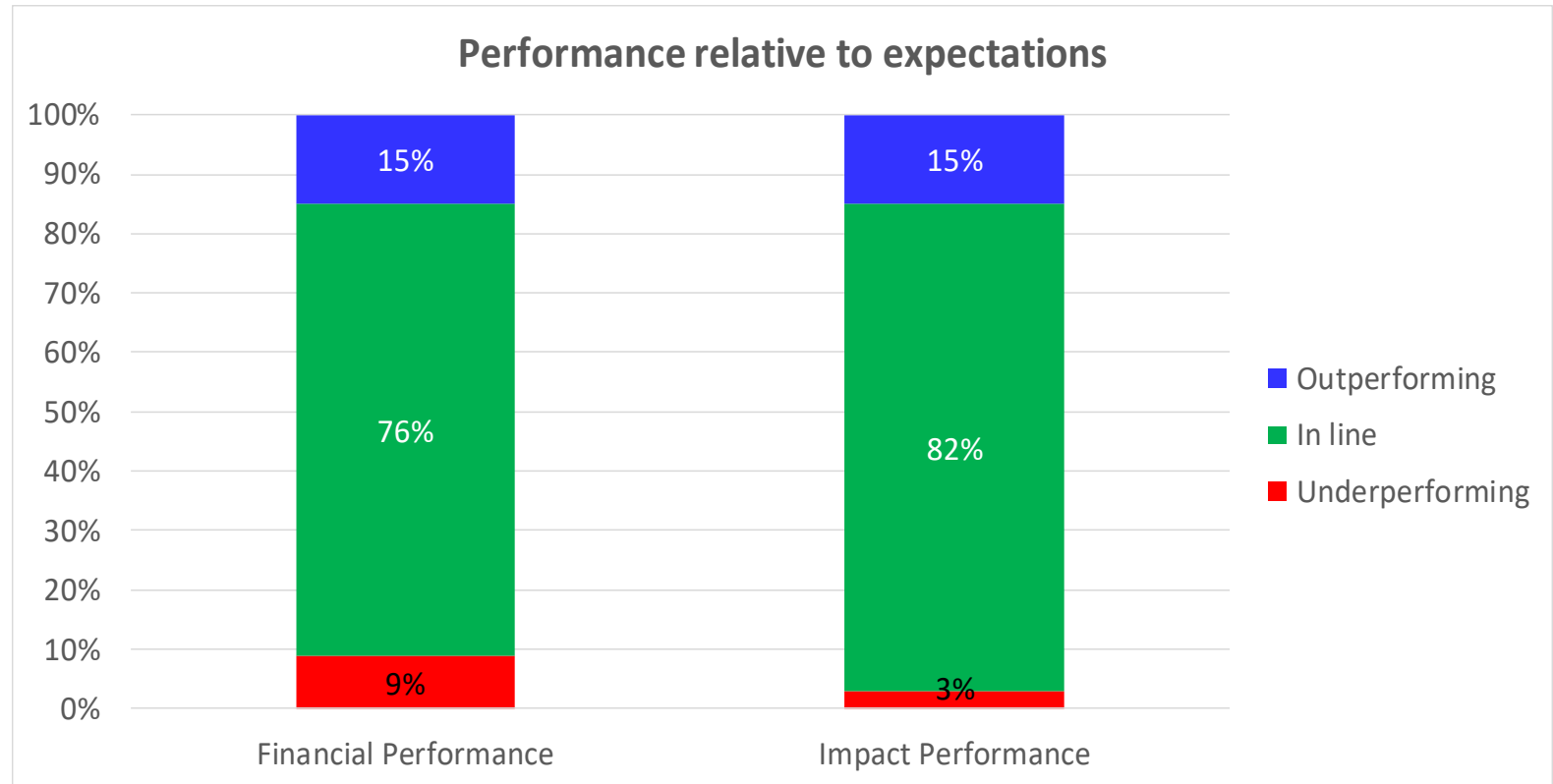
# Impact investment – what is it?

- Offers a financial return
- Intentionally generates a positive impact (social or environmental)
- Measures both the financial return and the social/environmental impact
- Covers the full range of different asset classes
- Already forms part of the investment strategy for many pension funds
- Constitutes at least £150bn of assets (Source: FT)



Source: GIIN 2018 Annual Impact Investor Survey

# The financials of impact investment



Source: GIIN 2018 Investor Survey

64% targeted market-rate risk adjusted returns



# What do listed impact investments look like?

- **Listed equities** – invest in companies that have a positive social or environmental impact, for example:
  - A biotech company -> selling drugs that improve third world health
  - An automobile company -> selling electric cars
  - An elderly care home operator -> helping residents with mental health issues
- **Listed bonds:**
  - Green bonds that fund projects with positive environmental/climate benefits
  - Social bonds where payments depend on specific social outcomes being achieved
- Often target the SDGs (Sustainable Development Goals)
- Scalable and liquid investments
- Investing **WITH** impact, not investing **FOR** impact (position 4 on the spectrum of capital)



# What do unlisted impact investments look like?

- **Property investments**

- A social housing property fund
- A homelessness property fund
- A disabled living property fund

- **Infrastructure investments:**

- A renewable energy fund
- A fund investing in deprived areas

- **Private debt investments:**

- Micro finance to third world countries
- Loans to small businesses

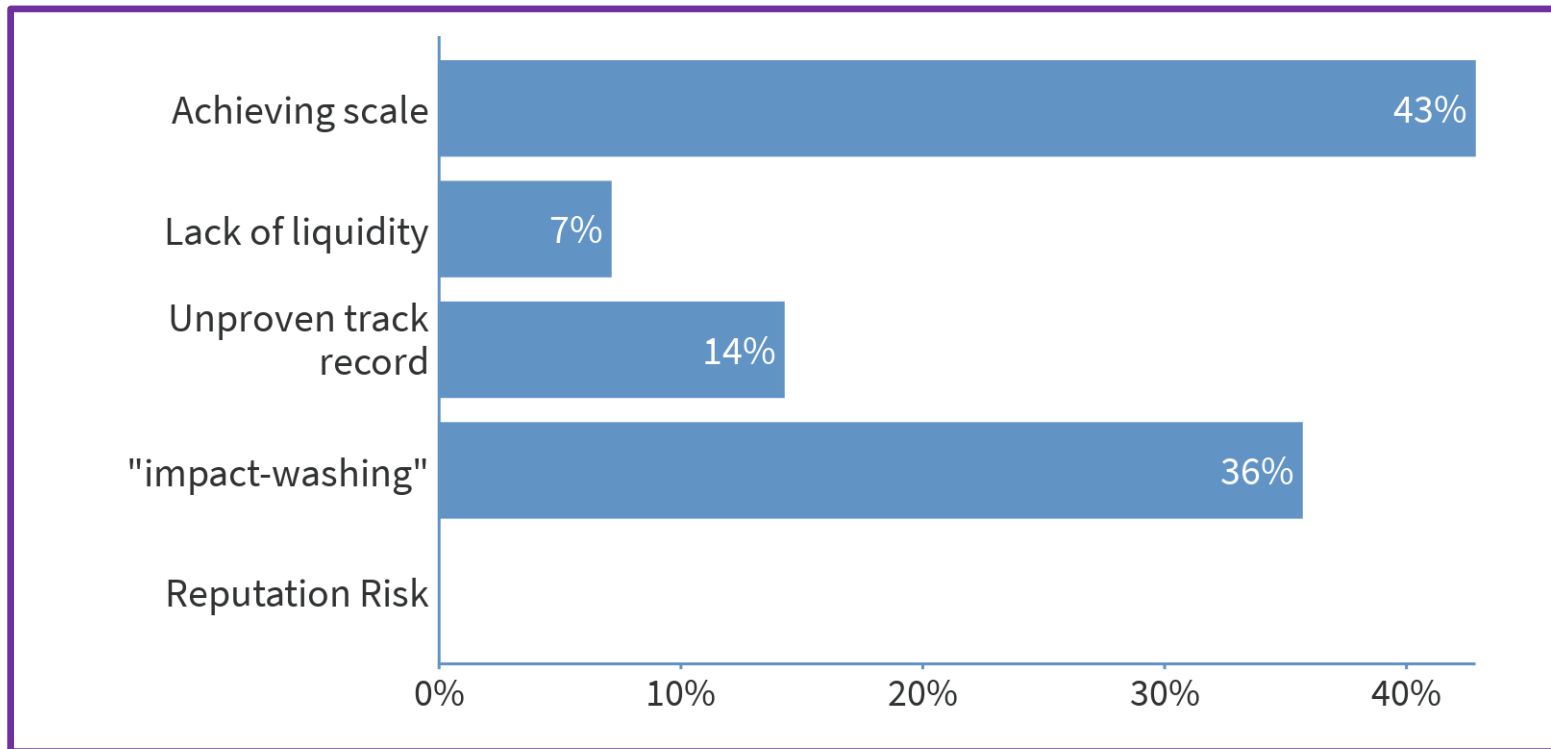
- Investing **FOR** impact, not investing **WITH** impact – more direct and measurable impact ... “Additionality”...

- BUT... less scalable and less liquid (more likely to be position 5 on the spectrum of capital)



# Why are pension funds hesitant to allocate to impact investment?

## Concerns expressed:



Source: DG/Pensions for Purpose Investing with Impact Summit November 2018

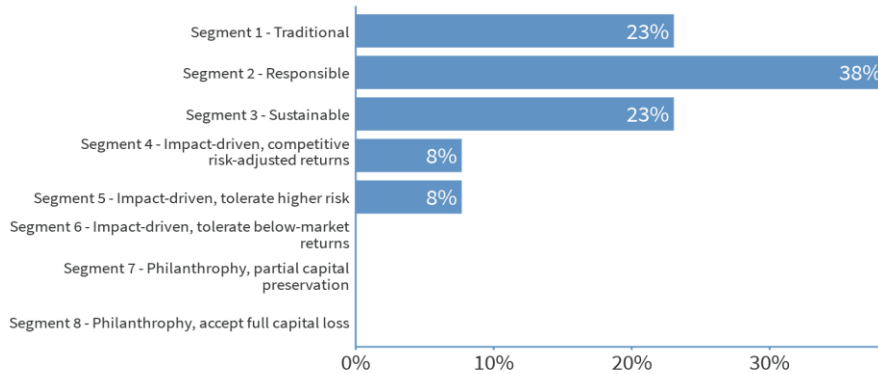


# The direction of travel for pension funds

## A shift along the spectrum of capital

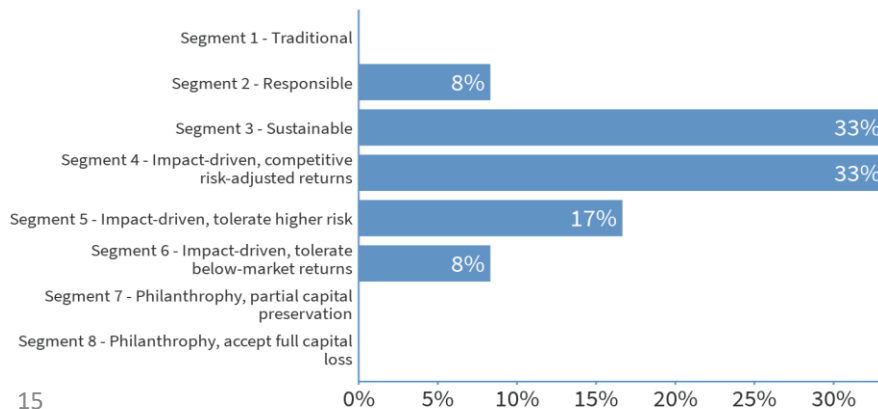
### 3. Where on the spectrum of capital do you think your pension fund currently sits (1 to 8 scale on the slide displayed)?

**🔒 Poll locked.** Responses not accepted.



### 4. Where on the spectrum of capital would you like to sit in three years time?

**🔒 Poll locked.** Responses not accepted.



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- Voting by delegates at the DG Publishing/Pensions for Purpose “Investing with Impact” summit 2018
- In three years time there is a significant shift along the spectrum of capital
- 58% said they would like to be invested in impact funds, compared with 16% in 2018



# A typical pension fund's journey along the spectrum of capital

- Begin with a review of investor beliefs



Source: Christian Super 2018 Annual Report

- Review how ESG is being embedded (responsible investment) – moving to 2 on the spectrum
- Discuss sustainable investment – moving to 3 on the spectrum
  - Divest?
  - Lower carbon footprint?
- Consider impactful investment approach – moving to 4+ on the spectrum
  - Global or domestic impact?
  - Environmental or social or local impact?
  - Embedded in all asset classes or a focused sleeve?
- Implement and monitor
  - Measure both financial and impact returns



# Case study: Christian Super

- **Pension fund:** 25,000 members AUM of around £900m
- Invest in impact investments globally
- Dedicated impact allocation of 10%, rose to 12% in 2018
- First investment was in renewable energy
- Also invest in sustainable agriculture, community infrastructure, venture capital and social benefit bonds (environmental → social impact)
- Performance benchmark of inflation +4% per annum
- Impact portfolio returned 6.5% p.a. after fees - six years ending 31 December 2016

“We are often challenged with questions as to whether it’s actually possible as a fiduciary to build a viable impact portfolio, but I think that our track record is sufficient to dispel that myth.”



# Case study: Environment Agency Pension Fund

- **Pension fund:** 40,000 members and assets under management of £3.3bn (March 2017)
- As at March 2017, 34% invested in clean technology and sustainable investments
- A separate impact portfolio (“Targeted Opportunities Portfolio”) where £131m has been committed
- 11.6% annualised over 5 years to March 2017. EAPF attributes this to its long-term, responsible investment approach to investment
- Climate goal: decarbonise the equity portfolio, reducing exposure to future emissions by 90% for coal and 50% for oil and gas by 2020 (compared to exposure in 2015)

“The EAPF believes that climate change presents a systemic risk to the stability of every country.”

# Impact measurement

- Measuring impact remains a challenge for investors – lack of standardisation
- UN Sustainable Development Goals allow some comparability
- Easier for listed assets, harder for private impact investments
- Managers should be able to map their investment themes onto the SDGs
- Ask for impact measures e.g. tonnes of CO2 avoided, litres of water cleaned, number of homeless people helped
- Compare managers' ESG and impact reports
- Still an evolving space

## SUSTAINABLE DEVELOPMENT GOALS



# For more information about ESG, sustainable and impact investment...



A collaborative initiative between impact managers, pension funds, social enterprises and others involved or interested in impact investment



# Risk warning

Pensions for Purpose ([www.pensionsforpurpose.com](http://www.pensionsforpurpose.com)) provides an online platform for our Influencer Members, who are professionals within the pensions sector, to upload features, case studies, blogs, research papers and other information relating to impact investment for use by the general public and Affiliates (asset owners, government bodies, independent advisers and journalists).

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