A growing awareness around issues of sustainability has led to a concerted movement towards the field of impact investing. This paper examines the increasing prominence of the impact investment sector generally, the high-profile financial institutions moving into the space and how investors can now seek a social return along with financial gains.

Introduction

Despite human advancements – political, economic, social and technological – extreme poverty remains a huge global blight. World Bank data states 10.7% of the world’s population or 767 million people live on less than $1.90/day, with around half residing in Sub-Saharan Africa. Meanwhile, environmental degradation is occurring at unheard of levels, with net emissions of greenhouse gases from human activities increasing by 35% between 1990 and 2010.

It is abundantly clear that traditional methods of philanthropy on their own are not sufficient to solve these societal challenges. The growth in impact investing by asset managers and the financial centres that support them is another way by which serious global issues and risks such as climate change, poverty, inequality, hunger and preventable diseases can be managed, mitigated and one day potentially eliminated.

Impact investing has the support of global governments. Initiatives like the United Nations’ Sustainable Development Goals (UN SDG) are encouraging institutional investors and their asset managers to reshape their strategies, and increasingly to prioritise impact goals and objectives. It is clear that a market response to these long-term problems will help breed success going forward.

This paper provides an overview of the growth of impact investing. It identifies how asset managers are building up impact investment positions using real-life examples, and reviews the motivating factors behind this trend such as client demand and regulation. It outlines briefly some of the challenges facing impact investing, before examining how strong financial centres will be able to support managers pursuing such strategies.
Defining impact investing

Impact investing is the term now better understood by financial institutions, having long been confused with other concepts such as socially responsible investing (SRI) and environmental, social and governance (ESG) criteria. There is a clear overlap between all of these ideas, but financial institutions have recognised the divergences.

Impact investment is often understood on a spectrum of value-based investments. Sonen Capital, a fund management company with a bias towards social and environmental investing, believes impact investing falls somewhere in between traditional investing to generate maximum returns, with no attention paid to ESG issues, and full-scale philanthropy, where returns are sacrificed to deliver a social or environmental impact.

“Impact investing is the investment into a company, fund or organisation with the intention of generating a measurable environmental and/or social impact alongside financial return. Alongside – not instead of,” reads a briefing by Gitterman Wealth Management, a US-based wealth management firm.

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Drivers for impact

The move towards impact investing is accelerating through regulation and intergovernmental initiatives. International programmes and landmark agreements around climate change such as COP 21 in Paris, and the UN SDG have imbued a sense of collective responsibility to address a number of global challenges, and the asset management industry is playing its own unique role. The involvement of financial institutions in addressing these monumental issues is more important than ever, given the US withdrawal from the Paris Agreement.

The UK has been particularly active since the establishment in 2013 of the Social Impact Investment Taskforce, later superseded by the Global Social Impact Investment Steering Group, comprised of 13 countries plus the EU. The organisation seeks to promote discourse and policy changes around impact investing. Other countries such as France go further and have introduced legislation demanding institutional investors file reports detailing their carbon footprints.

All of these government reforms and positions are driving more investors to take greater note of impact investing.

“Impact investing used to be the preserve of HNWIs, private wealth or family offices but we are seeing a broadening of the base. This has happened due to greater awareness about the subject matter, and recognition that investors can make risk adjusted returns through a wider range of products. As such, we are seeing private banks, insurance companies and pension funds move into impact investing. The concept has become more mainstream,” said Justin Sykes, Managing Director at Innovest Advisory, a boutique consultancy focusing on social impact and innovation.

The direction of travel

Impact investing is a growing business in financial services. AuM growth in impact investments has been strong with the Global Impact Investing Network (GIIN) 2017 Annual Impact Investor Survey of 208 market participants indicating AuM stood at $114 billion.

Analysis of 205 respondents in the GIIN’s survey found that $22.1 billion was allocated into nearly 8,000 impact investments in 2016. This is a significant increase from the $15 billion that was committed to 7,751 deals in 2015. Stakeholders told the latest survey they would invest 17% more over the course of 2017, which would bring impact investment capital allocations up to $25.9 billion.

Tom Carey, Partner at law firm Carey Olsen, said impact investment was becoming increasingly popular, and highlighted that projections indicated AuM could hit $2 trillion, or 1% of globally invested assets by 2025. He added AuM at managers pursuing impact investment strategies was growing at 20% year on year.

1. The discrepancy in numbers, according to GIIN, is attributable to the exclusion of two major outliers and two respondents who did not report on their investment activity.
Impact investing is primarily adopted by fund management companies. The same GIIN study found 67% of respondents comprised fund managers, with foundations the next biggest category at 11%. Other financial institutions involved in impact investing include banks (4%), development finance institutions, family offices, pension funds and insurance companies (each 3%).

Private equity, private debt, venture capital (VC) or firms transacting in real assets tend to account for the majority of fund managers participating in the impact investing space. “Impact investing is generally a long-term investment play, as firms need to assess and measure non-financial returns and this can only be identifiable after the medium to long-term,” said Greg Brown, Partner at Allen & Overy in London.

Other industry experts agreed that patient, long-term capital was critical for impact investing to thrive. “Private equity, thematic debt funds and VC are driving impact investing, whether it is through supporting microfinance, or expanding the provision of social housing or private education targeting low-income groups. In the VC space, we are starting to see more and more fund managers supporting start-up social enterprises looking to address a clear social or environmental challenge,” said Sykes.

A number of high-profile financial institutions have expanded into the impact investment world.

These include BlackRock Impact, a sustainable investment platform with around $200 billion in assets. The platform has a fund range which specialises in ESG, impact investing and screened portfolios. Meanwhile, TPG’s Rise Fund is looking to raise $2 billion to invest across a number of sectors including education, energy, food and agriculture, financial services, healthcare, information and communication technology, industrials and infrastructure. Early deals include a $190 million financing of EverFi, a US-based educational technology start-up.

Other firms have made notable investments too. Bain Capital’s Double Impact Fund is a $390 million vehicle and it has just finalised investments into two mission-based companies – Living Earwth and Impact Fitness. Living Earth is a Texas-based commercial recycler of organic landscaping materials while Impact Fitness is a fitness franchise that promotes healthy lifestyles in underserved communities. Goldman Sachs Asset Management (GSAM) in 2015 acquired Imprint Capital, an institutional impact investment firm as it sought to expand its product range to incorporate ESG, while UBS invested $5 billion to meet the 2030 Sustainable Development Goals, and this includes an allocation to the TPG Rise Fund.
Returns through innovation

Empirical studies show that returns are not being forfeited for the sake of positive impact. Ninety-one per-cent of respondents to the GIIN study said financial performance was superior or in line with expectations, while 98% added impact performance was better or on par with expectations. This roughly correlates with 2016’s findings. “Investors would not allocate into these products if the returns were disappointing,” said Sykes.

Many of the impact initiatives are highly innovative, and are enjoying widespread success.

This financial innovation has been a major factor behind the growing appeal of impact investing. A paper – Doing Well by Doing Good – published by UBS identified a number of financial innovations that have emerged to facilitate impact investing. These include blended finance structures, which combine ‘private, finance return-orientated sources of capital with either public sector or philanthropic funds, whereby the latter often assume a more junior, loss absorbing or credit enhancing position in the capital structure to entice more participation of the former’.

Social impact bonds are also gaining market share, and these utilise private capital to help solve societal problems. Investors are only rewarded once those societal objectives have been achieved. For such bonds to pay out, the investments must make a measurable or quantifiable impact.

One prominent example is the ThinkForward’s social impact bond, which was designed to help improve the lives of young people across 14 schools in the London Boroughs of Tower Hamlets, Islington and Hackney. Returns were directly correlated to ‘securing positive social outcomes, including improving behaviour, attainment at school and progression into further education or employment’.

The social impact bond funded ThinkForward’s programme whereby it intervened to help vulnerable young people succeed at school and find employment. It did this by providing highly qualified progression coaches in schools to give five years of one-on-one support for children aged 13 and over. Through this initiative, 90% of subjects aged 18 progressed into further education, employment or training.

Social impact bonds are highly diverse in terms of the problems they seek to alleviate.

“One social impact bond sought to reduce the reoffending rates among prisoners. Reoffending ultimately costs governments money as they have to use taxpayer funds to house inmates and otherwise deal with the consequences of that reoffending. The proceeds of this bond were used to invest in prisoner education and employment in order to reduce reoffending rates. If rates fell below a certain level, the government promised to pay a return on the bond. The government is happy as it is spending less money homing prisoners, while the bond investors makes a return,” said Brown.

Charity bonds have also grown in popularity. Such products allow charities to borrow to fund their impact goals, and the concept has gone down well as investors increasingly seek out returns that accentuate a social good or positive cause.

Greensleeves Care, a charitable care home provider, issued a London Stock Exchange-listed charity bond yielding 4.25% to fund elderly care home expansion in March 2017. The bond, which was made available to both retail and institutional investors, will enable the charity to increase the number of elderly people it supports through the development of new homes. The bond raised £33 million in less than one week.
The challenges

Impact investing is a diverse concept, but positive efforts are being made to create better understanding and reporting around it. Fund managers which purposely adopt an impact investment-driven approach must be conscious of their clients’ beliefs. For example, an impact investment into a project supporting local farmers which encourages GM crop growth may upset an environmental endowment. Put simply, impact investing is highly subjective and is determined by the managers’ and their clients’ fundamental beliefs and ideologies.

This ultimately makes it difficult to subjectively measure impact investment versus a blue chip security.

“Quantifying or articulating the non-financial impact on a person, community or market is very hard and subjective, versus the measurement of a traditional monetary return. Whilst there are standards on how to quantify or benchmark impact investments, there is not yet a clear, established ‘go-to’ set of global standards. This makes comparing one impact investment to another very challenging. The key is to be transparent with investors about how ‘impact’ is measured and reporting in a way that is understood and comparable so they can assess the success of their investment based on their own criteria,” said Tony Corbin, Director at PricewaterhouseCoopers (PwC) in Guernsey.

However, there have been efforts to better measure impact performance through initiatives led by the GIIN, which has developed its own customisable metrics covering social, environment and financial performance. Others, including GIIRS help managers quantify their portfolio impact on workers, customers, communities and the environment. These initiatives clearly recognise that impact investment is not subject to a standardised measurement, but they are very useful for end investors in qualifying and quantifying their social impact goals and objectives. Schemes like this are a positive step towards creating metrics by which impact goals can be adequately benchmarked against.
The opportunity for international financial centres

For a jurisdiction to become an impact investing hub, it needs six fundamental prerequisites according to a paper by PwC and the City of London Corporation. These are knowledge and expertise; innovation in products and instruments; mature and attractive financial markets; a favourable legal and regulatory environment; social impact standards and reporting; and international connections.

Financial centres that engage regularly with industry professionals, and which have widespread service provider and regulatory expertise covering a broad range of asset classes – whether it is private equity, VC, reinsurance or captive insurance – will be in a solid position to develop the infrastructure to support impact investing.

Impact investing is continually changing with new players entering the market, adopting unique and different structures. Any international financial centre looking to build a track record in this space has to be forward-thinking and flexible in its approach. This must be underpinned by strong but amenable regulatory oversight, which permits innovation to take hold but displays robust consumer protection and follows best practices and standards.

A number of jurisdictions and markets are retreating behind a rising tide of protectionism and illiberalism, which go contrary to the globalist nature of impact investing.

Any jurisdiction looking to develop into an impact investment hub needs to adopt an internationalist, outward-looking worldview. It must also have proven experience as a jurisdiction which can support innovative financial products.

Guernsey has expertise in servicing such products and this should give it excellent bearing in catering to those pursuing an impact investment agenda. The island’s experience as a leader in cleantech and fintech financial innovation, for example, cannot be faulted. Through its strong regulation, regulatory engagement, tax neutrality, service provider depth, robust listing capabilities, thoughtful IP laws, knowledge of captive insurance and investment funds, Guernsey was able to create an industry-leading framework to support managers running these strategies.

As an international financial centre, Guernsey is home to a number of leading service providers including law firms, accountants and administrators, who have a holistic view and knowledge of a wide range of bespoke asset management products. The market adopts Common Law, is highly regulated and has a long history of supporting asset management. Guernsey is internationalist in its business approach, and has strong links in particular to many emerging markets. As such, it is a leading jurisdiction to support this new breed of investing.

Guernsey pedigree

Guernsey is already home to a growing number of impact investment related structures and vehicles. For example, Partners Group created PG Impact Investments in 2015, which is a closed-ended collective investment scheme, investing via impact fund managers as well as directly into social enterprises. Obtala Limited, established in Guernsey with a view to listing on the London Stock Exchange (LSE), is an AIM and Social Stock Exchange listed agriculture and forestry company, with a mission to become one of East Africa’s largest sustainable food and timber producers. This is a well-known path to listing and indeed there are more listings on the LSE from Guernsey than from any other jurisdiction outside the UK. Guernsey is also home to a variety of cleantech funds such as Catalyst Investment Management, targeting investments in clean energy in the MENA region.

* This white paper was produced in conjunction with financial services journalist Charles Gubert of GTL Associates.