Handbook Series
November 2020

NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

insights

IMPACT INVESTING

NordSIP Handbooks are published by
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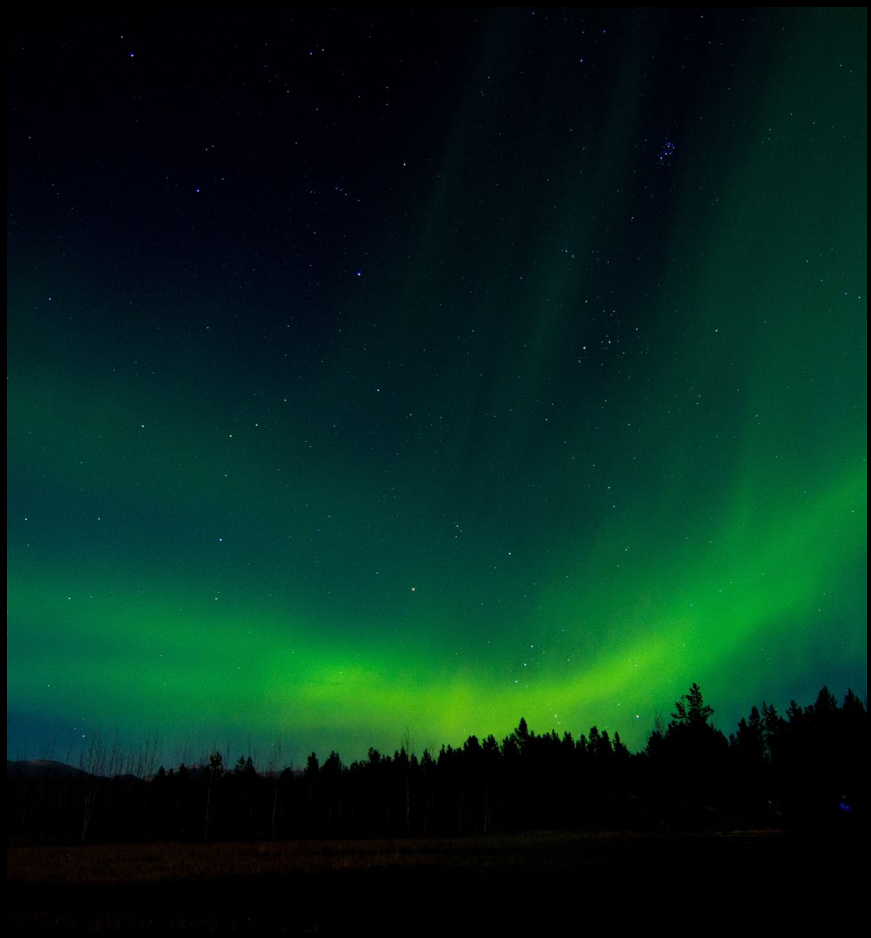

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the editor's word

Aurora borealis no more

When it comes to aurora borealis, most people are usually rather disappointed. First of all, you may have to either travel quite far north and away from civilisation and then perhaps even wait quite a long time until you can witness one. But once it's happening, many realize that it looks better in picture than in reality.

The early impact investors, those pioneers who have been beating the drum about the importance of moving capital towards solving global issues for a couple of decades at least, have recently been joined by a crowd of newbies. Their collective cries are now loud enough that they can't be ignored by the mainstream institutional investor.

The major tenant of the impact investor is that one can do well, while doing good. But can you really have it all? Beyond discussing whether the impact thesis belongs to the realm of wishful thinking, we want to know how and what evidence there is, if any, that it really works.

In this edition of NordSIP Insights, we talked to ten experts, from asset owner to asset manager, from Sweden, Denmark, Finland and beyond to understand what impact in practice means.

For those in need of inspiration, we have on offer a new vision of capitalism, a journey into impact, a call to reshaping the future and the elevation of "S" in ESG.

Digging into the fundamentals, we propose an overview of impact measurement, the practical implementation of impact by an asset owner and Social Investments for dummies. Last but not least, we explore three particular strategies: MDB bonds, microfinance and the opportunities behind sustainable food in Asia.

In 2020, impact opportunities are easier to find and more accessible than ever for asset owners. The definitions are clearer, the goals are tangible and the financial performance delivers on target. Impact has earned its space in institutional allocations. Aurora borealis no more.

Aline Reichenberg Gustafsson, CFA

Editor-in-Chief

NordSIP

A Defining Moment for a Big Reset

by Hans Stegeman

Millions of citizens around the world are feeling the impact of the corona crisis. Some have lost loved ones or struggle with their health; many have abruptly lost their jobs. Numerous measures have been taken to help people and support the economy.

Yet, it has become increasingly clear that there is no quick fix, neither for the pandemic nor for the unfolding deep economic recession.

The corona crisis and the resulting Great Lockdown are unique. What started as a health crisis quickly turned into an economic and social emergency. But this crisis has to be placed in context. In essence, we are witnessing a failure of our economic and social system: it is systemic.

The question now arises: what next?

So far, the focus has primarily been on overcoming the health crisis, and rightfully so. But Triodos Investment Management believes we also need to address the severe shortcomings in our present-day economies and societies. We need to prevent a future pandemic from holding the world in such a vice-like grip, we must intensify our efforts to combat the climate emergency and we must work on a more socially inclusive society. And the emergency measures from governments and central banks will determine economic developments in the years to come.

Triodos Investment Management calls for a reset of the 'old' economy and for a global and collaborative effort to rebuild a more resilient, sustainable and inclusive one.

Root causes

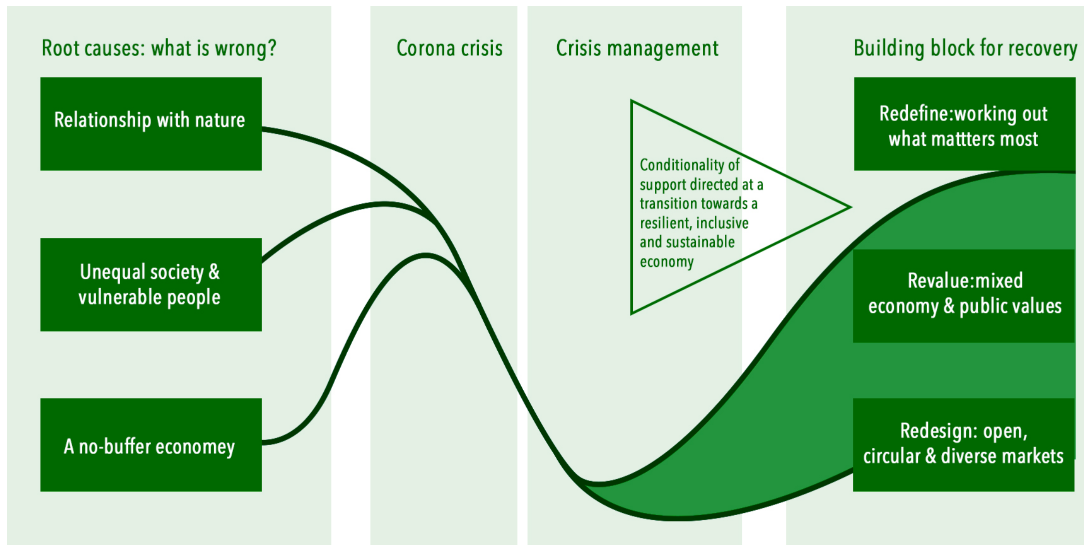
If we are to take the right steps to rebuild the economy, we need to understand the root causes of the systemic corona crisis.

First, our relationship with nature is broken. Zoonoses, like corona, are far more likely now to transfer from animals to humans than they used to be. Rampant deforestation, uncontrolled expansion of agriculture, intensive farming, mining and infrastructure development, as well as the exploitation of wild species have created a perfect storm for the spillover of diseases from wildlife to people. Part of the solution is to completely redesign our food and agricultural systems.

Secondly, the Covid-19 disease and the crisis it triggered have exposed societal inequality and weaknesses in healthcare. Not everybody has access to affordable healthcare; not everybody can afford to stay at home. There is also inequality between countries: the economic effects of the crisis are likely to be more severe for lower income countries.We can and should use this moment to create a more inclusive society.

Thirdly, the pandemic has laid bare fundamental flaws in the way we have organised our economy in our unrelenting efforts to strive for economic growth. The speed and severity of the economic impact on (global) enterprises and value chains are significant. The supply side restrictions and the fallout of demand demonstrate the absence of buffers and a lack of resilience in big parts of our economy. We have encouraged gigantic, highly leveraged firms to operate on a delicate balance of high debt and ultra-efficient, just-in-time performance. They are simply not equipped to adapt to the current conditions. The same goes for significant parts of the workforce. Many self-employed and casual workers are out of business and out of work. Without buffers they face instant difficulties. This needs to change.

Figure 1. From root causes to crisis management and building blocks for recovery



“If we make the right choices, our economy can become more resilient, we can create better prospects for a lot of people around the globe and in the end build an economy that is also sustainable in the long term.”

Figure 2. Overview of building blocks for a resilient and inclusive recovery

	Public Policies	Business agenda	Role of finance
Redefine	Greening (tax) regulation integrated reporting	True price Integrated reporting	Report & commit on impact Regulatory incentives on impact & resilence
Revalue	Green deal investment plan Strenghening public institutions Equity & fair share Open markets Different stakeholder models & the commons	Open markets Different stakeholder models & the commons	Facilitate sustainable private equity Increase social equity Gift money for transitions Debt cancellation for hopeless situations
Redesign	From transaction-based to use-based European coooperation Diversity and globelisation	From hyperglobalisation to globalisation Sustainable bisiness models	Global sustainable finance agenda

Plotting a path to the future

The recovery from the corona crisis is not simply a question of putting the ‘old’ economy back on its feet. The reset we call for addresses the root causes and is a thorough overhaul of the economic system.

Crisis management

The transition to a more resilient, sustainable and inclusive economy starts with the crisis management of many governments and central banks as a response to the immanent impact of the corona crisis. Fortunately, many governments and central banks have launched comprehensive packages of measures to support liquidity. It is vital that these interventions are effective for the people most in need. Communities, business organisations and financial institutions should also do their utmost to mitigate the direct impact of the crisis.

We need to revive and revitalise every corner of our economies.

However, more is needed to support the transition. More global solidarity is needed. Gifts and aid packages should be made available on a larger scale and the IMF needs enough firepower to provide emergency credit lines, especially for countries with relatively low debt affordability. We need better cooperation in the European Union on many pandemic-related issues, including possible financial support in the form of a conditionalised mutualisation of corona-linked debt in the eurozone.

The massive interventions of governments and the impact of the Great Lockdown on national budgets, will deteriorate fiscal balances and lead to a steep increase in public debt. Similarly, the debt burden might become a problem for companies, which historically have had highly leveraged balance sheets. In our opinion, central banks’ acquisitions of significant quantities of government and subsovereign bonds are unavoidable. Intervening in financial markets mainly serves those markets: it leads to higher prices of assets and does not serve the real economy. So to serve the real economy, Triodos Investment Management believes central banks such as the ECB should engage directly in financing public debt. And government support for businesses should be conditional: jobs need to be maintained and ‘fossil’ companies must submit ambitious greening plans to receive support.

Long-term building blocks

In addition to short-term crisis management, we should start to focus on the long-term recovery.

Triodos Investment Management has identified three key building blocks: redefine what matters most; revalue the way we live, cooperate and communicate; and redesign our economy.

Redefine

We have known for a long time that human progress cannot be reduced to annual GDP growth. Declining ecosystems are a threat to our wealth.

And as we have seen in the past decades, economic growth without adequate levels of equality ends up excluding people from basic needs, human dignity and resilience.

People, planet and prosperity should therefore be the central values upon which government policy rests and business investment decisions are judged. Economic growth must make way for wellbeing.

An important precondition is adopting the ‘true’ value or cost of production. This should be calculated and used as a metric for transactions. Governments can and should adopt this approach in tax policy (green taxation) and companies need to look beyond shareholder value and become more embedded in society.

Revalue

Public policy and the economic activities of companies should reflect the common shared values in each society. Standard neoclassical economics works from the premise that market prices, for instance for products and services, reflect our values. However, this is not how it works in practice and there is no guarantee that market forces deliver outcomes in line with what we want to achieve.

So markets should be directed through cooperation, public investment, and more activist industrial policies. Such an approach helps to steer economies in the right, more sustainable direction and to create effective demand. Government has an important role to play here through fairer taxes and anti-trust policies.

Redesign

The notions of wellbeing, a values-based economy and public institutions and investments are building blocks for a redesign of the economic framework. The corona crisis is a clear indication many (global) enterprises operate on business models that are resilient nor sustainable and that more should be done to improve the diversity of economic and finance activity

A concrete agenda

The general framework of redefine, revalue and redesign provides the right context for concrete measures that work towards a resilient, sustainable and inclusive economy. This is truly a collaborative effort by governments, businesses and communities.

We see a special role for the financial sector. After all, money and the way we use it have a material impact. The leadership of financial institutions will determine whether they will be part of the solution.

Given the important role of private investments in the long-term recovery, it matters a lot how money will be allocated and how finance will be used in the transition.

This is a defining moment for a reset. If we make the right choices, our economy can become more resilient, we can create better prospects for a lot of people around the globe and in the end build an economy that is also sustainable in the long term.

The direction we choose over the coming ten years will define our future. If we make the right choices, future generations will also enjoy their lives.

Donwload the full paper here.

Impact Management, Measurement and Reporting

by Johanna Raynal

Johanna Raynal
Director of ESG & Impact
Swedfund

picture credit: mihacreative via Twenty20

Impact Management, Measurement and Reporting

Development Finance Institutions (DFIs) are at the core of impact investment. Indeed, they are arguably the first impact investors mandated to create positive societal impact alongside financial returns. According to GIIN (Global Impact Investor Network) "impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return"[1].

As the development finance arm of the Swedish state, Swedfund has been impact investing for more than 40 years by making sustainable investments in developing countries to reduce poverty. Our business model is based on the three equally important pillars: impact on society, sustainability and financial viability. The following lines highlight some key concepts, experiences, and frameworks that Swedfund uses to manage, measure and report on its impact.

Intentionality

Impact investing starts with a strategic intent. The first step into impact investing is to develop impact targets that are aligned with the investment strategy. There are two key questions to answer at this stage. First, what is the intended impact? What kind of measurable social and environmental effects are to be created? Can the intended impact be aligned with the Sustainable Development Goals or any other widely accepted targets? The second question is credibility. Is it possible to deliver the impact though the investment strategy? Is the scale and depth of the intended impact proportionate to the size of the investment portfolio?

A useful tool when developing the strategic intent of impact investing is a Theory of Change. The Theory of Change explains an organisation's intended path to impact by outlining causal linkages. It helps to map backwards from the intended impact via desired outcomes and outputs to activities and inputs that are required to deliver the impact. Swedfund has formulated Theories of Change for its overall mission, as well as for its focus sectors (renewable energy, healthcare and financial inclusion) and key themes (gender equality, climate change and digitalisation). These Theories of Change frame the impact rationale for all investments and are used as a starting point when defining Swedfund's strategy.

To make the impact measurable and to be able to monitor and report on progress, Swedfund has portfolio level objectives regarding the environmental, climate and social sustainability of investments in the owner's directives. On climate change, the goal is for Swedfund's investment portfolio to be climate-neutral by 2045, meaning the portfolio shall have a net zero release of greenhouse gases. Moreover, the total release of greenhouse gases per invested Swedish krona shall accordingly decline over time with 2020 as the base year.

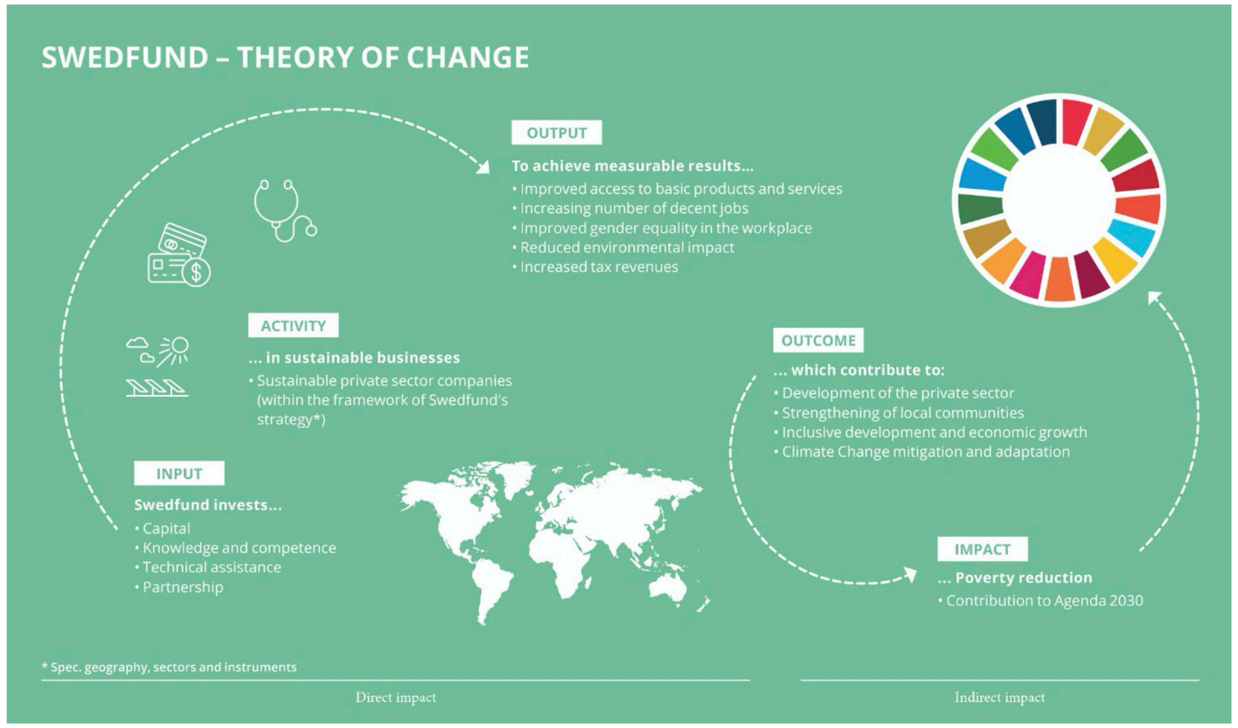
Swedfund is also focused on increased gender equality in the investment portfolio. This entails the fulfilment of the 2x-Challenge criteria or equivalent in at least 60% of the investments of the total portfolio, not later than three years from the date of investment.

Finally, on the issue of decent work, Swedfund expects to achieve compliance by 100% of the investment portfolio with decent working conditions in accordance with the ILO Declaration on Fundamental Principles and Rights at Work not later than three years from the date of investment.

Impact Management

Impact does not just happen. It requires hard work. Impact should be embedded into the investment process and managed as any other business activity. Swedfund is a signatory to IFC's Operating Principles on Impact Management[2] and embeds the impact management into the investment process aligned by these principles. When planning how to achieve impact goals in practise, Swedfund focuses on three points. First, it is necessary to consider if we are additional and what our contribution to the desired impact is. How can we describe in a credible way how we contribute to the impact? Is it possible to support this argument with evidence? Next, Swedfund is concerned with how the impact potential can be assessed. How can we articulate and calculate the impact potential of investments? What is the likelihood that impact occurs? What could risk the impact and how can the risks be mitigated?

Finally, it's necessary to determine how potential negative impacts can be mitigated. We need to establish what the potential negative impacts might be and how they can be avoided, mitigated and managed.



One framework that is useful when conducting these assessments is the Impact Management Project's five dimensions of impact[3]. Swedfund assesses the impact potential of all investment opportunities, and the results from impact due diligence are presented to the Investment Committee. The assessment needs to show how the characteristics of the investment are aligned with Swedfund's applicable Theory of Change and key Sustainable Development Goals (SDGs). Further, the assessment of the investment opportunity need to tell a story, an impact narrative. The assessment needs to be validated on five dimensions. First, Swedfund needs to clarify what outcomes people and the planet will experience and how important those outcomes are to those experiencing them. Then, who experiences the outcomes and how underserved they were before the intervention, also needs to be made explicit. Third, the assessment needs to clarify how much of the outcomes actually occurs in terms of how many stakeholders experience the outcome, what degree of change they experience, and how long they experience the outcome for.

Relatedly, the assessment must go the extra mile and understand the contribution of the investment – how the investors and companies involved contribute to the outcomes relative to what would likely occur otherwise. Finally, Swedfund assess the risk that the actual impact may be different than expected.

The impact due diligence culminates in an agreement on the value creation activities necessary to enhance expected impact, which are then included in the contract with the client. The impact due diligence is conducted by an impact expert that is included in every investment team.

Negative impact is managed through Swedfund's ESG Management System, which categorises all potential investments in four risk categories to reflect the potential ESG risks and impact related to the business activities of the investment. The risk categorisation guides Swedfund's due diligence procedure. The main frameworks and guidelines used during the ESG due diligence are the European Development Finance Institutions (EDFI) Harmonised Environmental and Social Standards[4], the International Finance Corporation (IFC) Performance Standards and the United Nations Guiding Principles on Business and Human Rights (UNGP)[5]. In addition, Swedfund apply specific lenses to assess for example gender and climate issues.

Impact Monitoring and Measurement

The old wisdom that "what gets measured gets done" applies also for impact investing, or rather "what gets measured and monitored gets done". Monitoring and measurement of the actual impact in comparison with the originally expected impact is essential to deliver on the goals. Reporting on the impact performance keeps impact investors accountable to their stakeholders. That monitoring exercise is crucial to allow Swedfund to take corrective actions when needed, and to be credible.

When designing impact monitoring, measurement and reporting system, Swedfund reflects on five points, which I think can be a good guide to other potential impact investors. First, it is necessary to establish the information requirements for monitoring. What information must be collected to monitor progress towards impact goals at portfolio and investment levels? How does this link to the Theory of Change? What kind of indicators would be most descriptive?

Monitoring is inextricably linked to data, so the next pertinent consideration is about data collection. Impact investors should establish the most suitable method for data collection. What are the available data sources? How often the data will be collected? Who is responsible for the data collection? Following data collection, reporting needs to be organised. Who is interested in the reporting? How often and in which form?

The relevance of the data to decision making cannot be ignored. Investors need to establish how the impact information can serve decision making. The final factor is data reliability and whether this assessment requires external assurances by an independent and specialised third party. The GIIN's IRIS+ catalogue is widely used system to measure impact and serves as a good starting point when defining portfolio and investment level impact indicators.

Impact Reporting

Swedfund's performance and result management requires both quantitative and qualitative impact data. As part of its investment agreements with clients, Swedfund outlines data collection, methodologies, and responsibilities prior to the beginning of monitoring activities and requires clients to report on key indicators each year. Both qualitative and quantitative data is gathered through annual sustainability surveys via our online data collection system, at both portfolio level and sector level. Other reporting from portfolio companies' reports, such as fund reports and annual reports, are used as well. The ESG & Impact Team is responsible for collecting and verifying the data. The data is aggregated and analysed at the portfolio level and the results are published in Swedfund's annual integrated report[6].

Swedfund's impact and sustainability data needs to be as authoritative as its purely financial counterpart. Impact and sustainability data reported in Swedfund's annual integrated report is audited by an external auditor. Portfolio level metrics are assessed vis-à-vis Swedfund's mission goals. Furthermore, Swedfund reports quarterly to the Board of Directors on the portfolio progress including impact information. We conduct quarterly internal business reviews to discuss performance regarding our strategy and business plan.

Swedfund has also started to conduct demand-driven impact studies to better understand the development effects from different investments and to be able to identify the assumption and conditions that can enhance the desired impact. These studies are generally delivered by a third party. Impact studies also enable us to build empirical support for our Theories of Change while also identifying additional relevant pathways to deliver development impact.

Intermediate Impact Steps for Starters

All investments create impact, be they positive or negative, intended or unintended. However, no one likes surprises, so it's important to take steps to actively manage and mitigate unpleasant effects. Even though the development of a full scale Impact Management and Measurement System may not be immediately feasible, that does not mean that nothing can be done in the meantime.

There are steps that investors and asset managers embarking on their impact investment journey can take to signal that impact matters to them. They can start by implementing a responsible investment code that recognises social and environmental return alongside financial returns. The establishment of processes that factor in expected social and environmental return – both positive and negative – into investment decisions and the assignment of responsibilities and resources is also important.

Another early step that prospective impact investors can take is to engage actively and show curiosity. Asking questions on what the expected impact is, how much it is expected to be and the risks that could undermine it when discussing with investees shows a commitment to impact investing. Joining impact industry initiatives to learn more and develop the common practices also projects this signal, as does the inclusion of impact in company presentations and communication and reporting on impact performance.

Finally, thinking outside the box allows potential impact investors to consider opportunities that have previously been overlooked. Finding out whether the perceived risk is higher than the actual risk and considering whether the expansion of your investment universe towards measurable social and environmental impact can open new opportunities for good financial return. All these steps could create momentum towards the subsequent adoption of a more formal Impact Management and Measurement System.

[1] https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing
[2] https://www.impactprinciples.org/
[3] https://impactmanagementproject.com/impact-management/how-investors-manage-impact/
[4] https://www.swedfund.se/media/1123/edfi_principles_responsible_financing-signed_copy_09-05-07.pdf
[5] https://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/Sustainability-At-IFC/Policies-Standards/Performance-Standards
[6] https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf

The Elevation of the Social Dimension of ESG

by Guillaume Mascotto

It is clear COVID-19 has altered global economies, but it has also affected investment theory. Investors assume what is good for the long-term viability of our economic system and society will also lead to positive investment outcomes. It's no longer about what makes a good stock, but what makes a good company.

Guillaume Mascotto
Head of ESG and Investment Stewardship
American Century Investments

The virus's escalation to a global pandemic has hastened the shift in mindset toward sustainable investing. While public health is a key ESG issue, the effects of COVID-19 are being felt in areas beyond individuals' health and well-being. We believe investors will increasingly focus on the Social (or "S") pillar of ESG in the aftermath of the global pandemic. Investors will also measure the impact of an effective and transparent diversity, equity and inclusion (DE&I) strategy, business ethics and strong corporate governance on company performance.

The "S" Pillar Will Gain Traction

While social issues have always been central to ESG analysis, especially for exposed sectors such as health care, technology and consumer, one of the pandemic's tangible consequences is the elevation of the social dimension of ESG.

For ESG analysts to consider public health negative externalities idiosyncratic, they would need to determine if the issue is triggered by misconduct or failure of companies' process quality or asset integrity (i.e., "ESG fundamentals"). In the case of COVID19, available evidence does not establish a link between the cause of the pandemic and companies' ESG risk management practices (as was the case in 2008).

However, the pandemic's societal reverberations are having an impact on these ESG fundamentals, especially under the social pillar. Institutional investors are likely to increase focus on companies' emergency response mechanisms (e.g., telecommuting and distributed management) and employee benefits (e.g., paid sick leave and telemedicine) as a gauge of long-term competitiveness (human capital) and operational integrity (business continuity). While companies could adapt to the "working from home" era, they will also likely face heightened data privacy and security risk.

Pre-pandemic, these factors were difficult to quantify. Investors now understand they can have material implications for the companies they invest in and therefore need to be quantified and accounted for. Subsequently, and considering the growing issue of "green washing," the post-COVID-19 investment space is likely to result in increased investor ESG due diligence. Investors will likely ask for verifiable evidence that ESG considerations, including those flowing from COVID-19, are formally integrated into a manager's investment process and for support of such claims by stock selection, reporting and portfolio construction.

“We believe companies lacking transparency in this area or trailing their peers’ Diversity, Equity and Inclusion efforts may see negative impacts to their long-term competitiveness, brand reputation or financial condition.”

DE&I and the effect on the Bottom Line

From an investment perspective, research increasingly shows the financial benefits to companies that emphasize DE&I in their organizational and business strategies. For example, the Pipeline’s “Women Count 2020” report found FTSE 350 companies with executive committees comprised of at least 33% women had a net profit margin over 10 times greater than companies with no women on their committees.

Investors place growing importance on this topic and are the main drivers of momentum in the ESG space. DE&I is also playing a larger role in manager selection as asset owners and large investment consultants include more questions and criteria during the due diligence process. A survey by the CFA Institute found that 83% of institutional investors value gender diversity specifically, with 55% believing that it drives better performance in investment teams. Even so, governments are passing new regulations to establish quotas for female participation and revamping older regulations with stricter requirements. Examples include Germany , France and California (the first and only U.S. legislation).

We believe companies lacking transparency in this area or trailing their peers’ DE&I efforts may see negative impacts to their long-term competitiveness, brand reputation or financial condition.

Governance as Part of DE&I Analysis

When evaluating companies for our portfolios, we use a proprietary framework to assess each company’s risks related to environmental, social and governance (ESG) issues. Within this framework, we consider DE&I to be sector agnostic and include it under both the Social and Governance pillars of the ESG equation. We specifically look for strong evidence of DE&I as part of a company’s human capital strategy. We believe DE&I to be a material factor for workforce acquisition, and by extension, long-term competitiveness. Gender diversity in the boardroom and in senior and middle management is another of the factors to consider when analyzing a company’s Governance practices. We immediately flag companies with no women on their boards of directors. We also use the Hampton-Alexander Review’s annual “FTSE Women Leaders” report to help evaluate corporate board membership. As part of our proxy voting guidelines, we also support resolutions pertaining to DE&I, including gender and racial pay gap and board parity.

Malene Bason
Partner
ATRIUM Kapitalförvaltning

The Call of Impact

by Aline Reichenberg Gustafsson, CFA

The line between ESG or sustainable investments and what constitutes ‘impact’ investing is still often the subject of a passionate debate. While the early proponents of impact strategies, which were mostly project-based or at least private, continue to defend their right to claim the term exclusively, public market managers have started actively claiming the right to the space as well. To get some perspective on the matter, NordSIP discussed these and other matters with Malene Bason, Partner focusing on sustainable investments at ATRIUM Kapitalforvaltning.

"I acknowledge that in order to fill the current funding gap to resolve global issues, we need to allocate capital in new directions."

"Within the investor segment of families and foundations, I see an increasing focus on liquid impact strategies."

The start of a journey

"Investments have been the focal point of my whole career, first working for a small pension fund getting to fill out all the different roles in an investment team, over time, including creating the investment strategy, executing on the strategy and developing the risk management system," Bason starts, as she recalls the time she worked as an analyst and an investment advisor for Danish Telecom company TDC Group, and its pension fund.

"In 2010, I joined Danske Bank where I headed up the Manager Selection team for seven years," she continues. "We started as a team of three people selecting and monitoring all the external investment strategies and grew to a team of eight people monitoring all the internally and externally managed strategies at the bank."

In 2018, Bason left the Danish bank to found Future Impact with the goal of providing investment advisory services on impact investing. "I left Danske Bank early 2018, to focus more on sustainable and impact investments, among other reasons. Since I couldn't find an organization who shared the same ambitions as I had, I ended up creating my own advisory firm, Future Impact," Bason explains. "For almost 2 years, I gave strategic advice to families and foundations about sustainable investments in general, but with a strong focus on impact investments."

"The advice spanned across several areas. One was educating investors, another was developing new impact strategies. I also spent time finding relevant investment strategies that fit the purpose of the individual organizations I advised. It has been a very exciting and meaningful experience for me. I have enjoyed the close contact with the clients being able to help them on their journey to create a bigger impact with their assets."

"Last year, while working on an idea for an impact investment seminar, I was introduced to ATRIUM Kapitalforvaltning," Bason continues. "The three founding partners and I quickly clicked, and the seminar was successfully held in January this year. Throughout the planning of the seminar, we realized that we were a perfect match through my competences within sustainable investments and their ambitions in this field as well as their strong client base. So late March 2020, in the middle of the Covid-19 lockdown, I joined ATRIUM Kapitalforvaltning, as a partner responsible for our sustainable investment offering."

ATRIUM Kapitalforvaltning, is a Danish independent wealth management company serving foundations, charities and wealthy families who want to invest sustainably. Founded in 2009, ATRIUM proposes both investment solutions and advisory services. Part of the firm's aim is to provide pro-bono investment advice to NGOs and impact start-ups.

The 'right' approach to impact investing

One of the main issues among impact specialists is the definition of what constitutes impact investing and the criteria necessary to establish that the capital allocation is truly making a difference. "When discussing the right approach to investing in impact, I believe it's important to be open to a relatively pragmatic approach," says Bason.

"Many impact investors argue that the only true impact investment is done through direct investments due to the need for 'additionality'. Additionality, in this context, means that the company I invest in, should not be able to do the project that creates impact if I hadn't invested my capital. This is obviously not the case when investing in listed companies where the ownership of the company is just changing hands and no new capital is allocated," Bason explains.

"I acknowledge that in order to fill the current funding gap to resolve global issues, we need to allocate capital in new directions (meaning it should be additional)," she continues. "However, direct investments are normally a small part of the investor's portfolio due to the high level of risk and illiquidity associated with these types of investments. We also need to focus on making the liquid, and often biggest, part of our clients' portfolio more sustainable. These days, there are several strong impact strategies within listed equity where the investor allocates capital to companies actually coming up with new solutions to societal challenges."

The Case for Listed Impact

Given these considerations, it is not surprising to find that Bason takes a more encompassing view of impact investing. "In order to move as much capital as possible in a sustainable direction, we as investors should have a broad focus on impact investments across asset classes."

However, it doesn't mean that investors should lower their guard. "Just be aware of green washing – do a thorough due diligence before investing," warns Bason.

"At the moment, ATRIUM Kapitalforvaltning is mostly focusing on finding impact investment opportunities within the equity space – both liquid and illiquid structures," she explains. "We have just launched a long-only global equity strategy consisting of around 70% impact companies and 30% ESG companies. We see a strong interest in this type of product, both due to the high focus on impact companies who actually bring new solutions to the world, the robustness and diversification that the ESG companies bring to the portfolio and finally the liquid structure, which makes the strategy a good and secure first step for the clients."

The Case for Impact Venture

"We are also looking into opportunities within the impact venture space, where we see many strong investment cases, both in terms of expected return as well as impact," Bason says. "Looking more broadly at the investment trends in Denmark, there is an increasing focus on impact venture."

"Most investors in this space are currently business angels," she adds. "Lately, however, more of the traditional venture funds are now also starting to focus on this space and a few impact venture funds are coming to market. The institutional investors are still reluctant to invest due to the limited deal size and lack of track record."

"Within the investor segment of families and foundations, I see an increasing focus on liquid impact strategies. For many investors, the liquid impact space is a comfortable first step into the world of impact investing and a manageable way to become more familiar with this approach. Most importantly, it is a chance to gain experience with the different approaches to measuring the impact," Bason concludes.

Easy Impact for Asset Owners

by Aline Reichenberg Gustafsson, CFA

"There are huge investments in the listed bonds space, and we are seeing a trend that real assets will become the next area of focus."

Peter Lööw
Head of Responsible Investments
Alecta

As one of the top pension funds in Sweden and known for having an appetite for innovative sustainable investment opportunities, Alecta is able to shed some light on Nordic institutional investors' perspective of impact investing.

"During the year [of 2019], Alecta delivered the best return for 20 years and in parallel raised defined benefit pensions and reduced risk premiums for health insurance," Magnus Billing, Alecta's CEO, said in the company's 2019 Annual and Sustainability Report. "We have further enhanced our expertise in the analysis of sustainability factors and clarified our sustainability goals while also continuing to make sustainable investments," he adds.

NordSIP talked with Peter Lööw, Head of Responsible Investment at Alecta since 2015, to discuss the pension fund's take on impact investments, risks, opportunities, preferences and ongoing trends.

Impact Investing at Alecta

"We define impact investment as any investment which has a measurable social and environmental impact alongside a financial return. For us, this has mainly been achieved with investments in different sorts of debt instruments," Lööw starts.

"Alecta has around SEK50 billion in green bonds and another SEK13 billion in other sustainable investments, from SEK40 billion and SEK11 billion at the end of 2019. In this bucket there is a mix of social bonds but also investments in a microfinance fund and a private debt fund managed by the Dutch development bank FMO," he explains. Green bonds correspond to 11.1% of the approximately SEK450 billion worth of fixed income investments held by Alecta out of its SEK1,000 billion balance sheet.

"For Alecta, the Agenda 2030 and the SDG's serve as a broader framework for characterizing such investments", Lööw adds. "We have identified some of the SDGs – on gender equality, climate, decent work and economic development, sustainable cities – as more specifically linked to our assignment and investment strategy but reiterating, the entire set of SDGs can be reflected in our impact investments to different degrees."

Misconceptions and Concerns

For Lööw, the nature of risk in impact investments is one the most pervasive misconceptions about this type of strategies. "Potential investors need to understand that impact investments do not imply that you will have to reduce your expected risk adjusted returns. In fact, there is a good chance that you will add to your diversification with assets that can be less correlated with your conventional holdings."

However, investors with pressing cash needs may not be best suited for impact strategies, which often involve investments with limited to no secondary market trading. "The obvious constraint is still a lack of supply. For large institutions it is also a scale problem as we typically look for large ticket sizes. Normally, and this is the case for us at Alecta, a long investment time horizon and low liquidity should not be a problem for pensions funds as long as you are compensated for that risk," he explains.

The Right Approach for the Right Investor

That being said, once investors have decided to begin their impact journey, Lööw explains, the spectrum of investment opportunities is quite vast. "With respect to the different actors in the investment chain there is a range of channels to match the different impact investment opportunities, spanning from seed and venture capital to more mature financial instruments," he says.

"Institutional investors have an important role to signal appetite for impact investments while being clear about expectations and formal criteria's," Lööw continues. "In our experience impact investments through different kinds of use-of-proceed bonds is a good way to start. They are more or less standardized and fit in any fixed income strategy. The innovation is not as much in the financial instrument as in the combination of partners or collaborators, e.g. DFIs and asset managers, the use of proceeds and the reporting back to investors on impact indicators."

The Ideal Product

Discussing the features he looks for when considering impact investments, Lööw highlights the accessibility of off-the-shelf reputable and established products. He also emphasises partnerships as ways to facilitate risk-sharing among impact investors.

"We hope for a high degree of standardization which can minimize due diligence costs and make it easier for an investor to make its investment analyses," he says. "We like set-ups that do not differ from conventional investments. Bond format is obviously most feasible but closed-ended fund is also manageable."

"Given the often-unchartered territory for investors, we think that different methods to de-risk an investment is key to grow the market," he adds. "Here we have seen a variety of set-ups, including first-loss guarantees from states or supranationals to CLO structures where the risk is divided through different tranches. We also encourage co-investing as it clearly aligns our interest with the asset manager's interest."

"As long as an investment can meet out risk-adjusted return requirements we can at least take a look at a prospectus. In this space we are seeing a new ecosystem of managers which we have no prior relation to, hence collaborations with known partners can help get the opportunity to pitch for institutional investors like us."

Ongoing Impact Trends

Looking more broadly at the investment trends in Sweden or even in the Nordics, Lööw highlights the ongoing interest in more standard asset classes and in impact reporting. "There are huge investments in the listed bonds space, and we are seeing a trend that real assets will become the next area of focus. There is an increasing appetite and expectations to be able to measure and disclose impact, hence parallel to the actual investments there is a growing interest in more standardised ways to measure impact," he concludes.

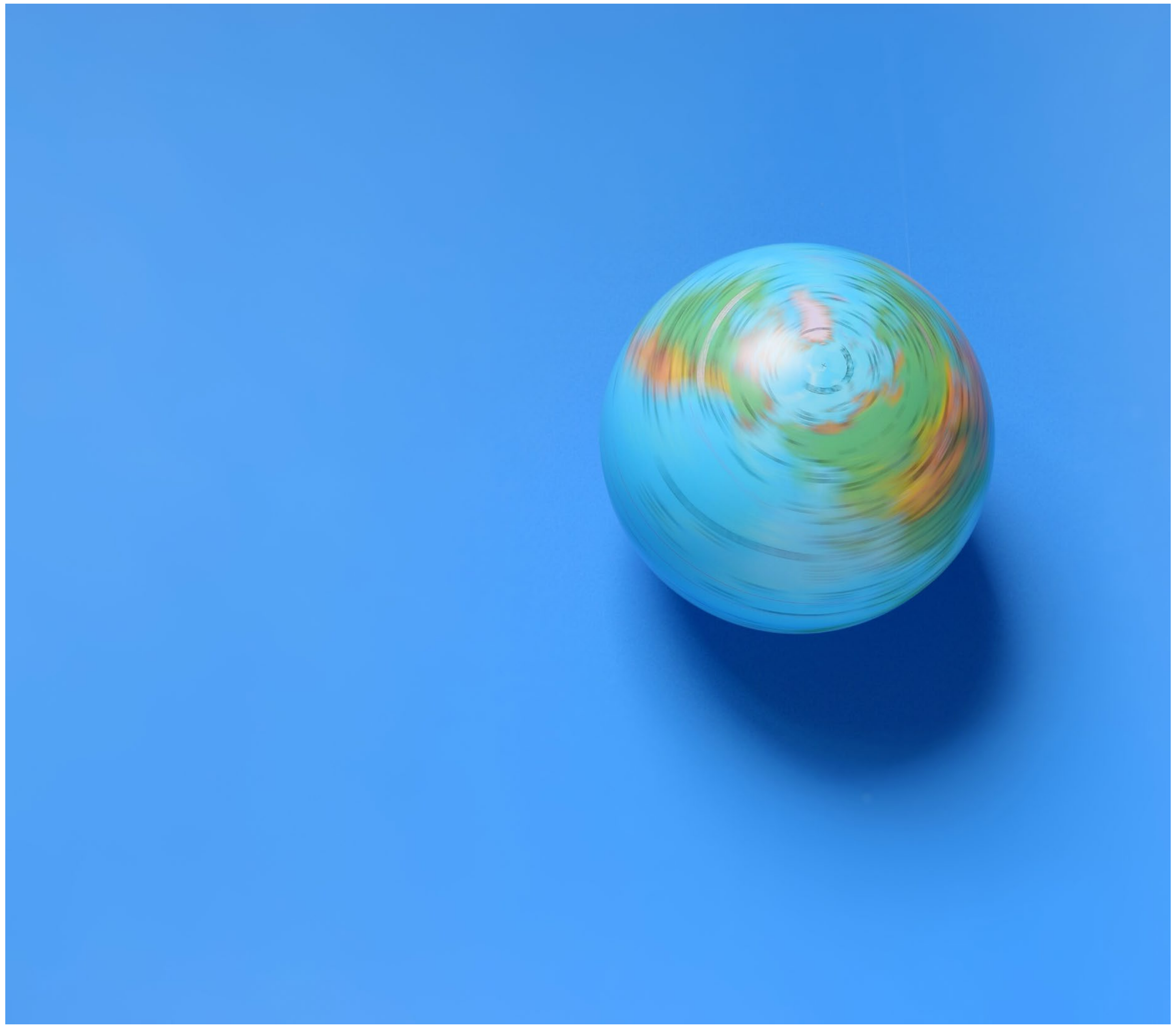
Impact Investing: a key role to play in reshaping the future

by Ingrid Kukuljan

Today, the world is confronting the global coronavirus pandemic, which has put a severe strain on health systems and economies worldwide.

But amid this crisis, we have a chance to build a better future. For responsible investment strategies, Covid-19 has resulted in a paradigm shift: it has put a focus on the critical need to build resilience in healthcare, food and water security, and across supply chains. It has also put climate change and worker rights under the spotlight.

Ingrid Kukuljan
Head of Impact Investing
Lead Portfolio Manager
Federated Hermes



picture credit: Zenzetar via Twenty20

Impact investing is forward-looking: it aims to identify businesses and organisations pursuing purpose-led activities whose products and services tackle the pressing needs of the global economy and environment. Indeed, our thematic approach to impact investing seeks to identify opportunities created by megatrends – and as a result, we have been investing in pandemics long before the outbreak of Covid-19.

Here we dive into the details of two megatrends, exploring their sub trends and how they are shaping our investment thinking. We also identify companies that can tackle these challenges and opportunities.

Megatrend: climate change

Climate change is the defining issue of our time: it threatens the lives and livelihoods of billions of people. Since 1998, extreme weather events have resulted in 16,000 deaths and economic losses of $142bn every year. To respond to a changing climate, we must build resilience to these threats.

Sustainable technologies can be particularly impactful when it comes to addressing the climate crisis. We see renewable energy, electric vehicles and energy efficient housing as some of the main pillars in the fight against climate change. For example, Kingspan helps create energy efficient housing. The company is a global leader in insulation and its products not only reduce carbon emissions, but some of them are made from recyclable materials. We believe products like these, which can help reduce emissions from buildings, are critical to tackling the climate emergency as buildings account for about 40% of all global carbon emissions .

We continue to see a huge opportunity in renewable energy across the globe. Production costs have fallen

"We believe the pandemic will serve as a catalyst to accelerate existing trends, thereby increasing the awareness of risks facing economies, the environment and society alike."

precipitously: renewable wind can now compete with fossil fuels on an un-subsidised basis. As such, we anticipate strong growth in the industry for many years to come.

Megatrend: water

For six consecutive years, water crises have been listed in the World Economic Forum's top five global risks .

One of our impact themes is water and it is aligned to SDG 6 (clean water and sanitation) and SDG 13 (climate action). We believe that improving access to quality water supply and preservation of the resource are critical to the environment. After all, water is essential for agriculture and food security, and it is the lifeblood of our ecosystems. For example, Ecolab is a global leader in water and sanitation solutions across food service, food processing, hospitality, healthcare, industrial and oil and gas markets. Through its cleaning and sanitation products and analytics capabilities, it helps deliver clean water and safe food to its customers, while reducing their water use, carbon footprint and waste. This demonstrates how sustainable technologies can be used to produce a better long-term environment.

As one of our most precious natural resources, efficient and sustainable management of water is critical, particularly as climate change is expected to exacerbate water scarcity.

Investing in pandemics

There has been much debate about how the global coronavirus pandemic has changed the way people live around the world. For many, the lockdown has provided time for reflection – an opportunity to consider what is truly important. For us, we believe the pandemic will serve as a catalyst to accelerate existing trends, thereby increasing the awareness of risks facing economies, the environment and society alike.

One of our theses is that we will increasingly see a transfer of funds from governments to the private sector to help address pressing environmental and societal challenges worldwide – issues which governments do not have the capacity or expertise to tackle or have failed in their attempts to do so previously. As governments worldwide look to fiscal stimulus to support the re-opening of economies, we believe that companies addressing the SDGs are best placed to benefit – and in doing so, they can help shape a sustainable future for all.

Read our full Federated Hermes Impact Opportunities Fund H1 2020 report, to find out more about our recent activity and performance, our engagement progress, and how we have been investing in pandemics through our impact themes.

[1].“Brown to green: The G20 transition towards a net-zero emissions economy, 2019,” published by Climate Transparency in 2019.

[2].Source: World Green Building Council, as at September 2019.

[3].“The Global Risks Report,” published by the World Economic Forum in January 2020.

Social Investing for Dummies

by Aline Reichenberg Gustafsson, CFA

"I find impact and social investing exciting and intellectually stimulating. It isn't simply about avoiding harmful investments but 'putting your money where your mouth is'," says Irene Mastelli, who recently started collaborating with two prominent foundations that focus on social issues, to identify investments that align with their philanthropic goals.

Irene Mastelli
Independent Consultant
Maloja Advisory

Prior to founding Maloja Advisory, Irene held positions as Director for Advisory at Phenix Capital and Senior Investment Strategist at Nordea, as well as Senior Investment Director at Cambridge Associates.

"In a time when much of the public discourse is focused on climate, I went a little against the current and engaged in two projects on social investing," Mastelli says. "I say this with a smile, as the two dimensions – social and environmental – are obviously intrinsically related. An environmental disaster such as the rise in sea levels has tragic consequences as it displaces coastal populations. Similarly, activities such mining can affect human health negatively. Clearly the social and environmental dimensions are closely interlinked."

What is social investing?

"At its core, a social investment aims to affect people, communities or societies, and to promote social innovation by developing new ideas, services, models. For example, consider investment managers operating in deprived areas, say the French banlieues, or the area of Watts in Los Angeles. Using the theory of change, which is strongly embedded in the language of impact investors, allows us to clearly see the path from problem to solution," Mastelli explains.

"The issue we have to deal with is the social and economic exclusion created by a lack of investment and opportunity even in areas adjacent to wealthy regions. The solution is to encourage private enterprises by providing access to capital for business ideas that can generate opportunities," she adds. "The output is employment creation for previously excluded persons, with positive effects on the vicinity. This leads to improved access to products and services, such as the opening of a grocery store where previously there was none, which means access to fresh vegetables."

"The actual impact of this process is the economic development and improved health outcomes it generates which change the perception and self-image of these areas, bringing in other investors' money. This type of outcome is systemic," Mastelli explains.

"Hopefully other asset managers see this investment opportunity and copy the project," she adds. "In fact, one of the conundrums of impact investing is that of leadership. Returning to the example of job-creating investments in deprived areas, once the model is proven commercial operators will follow. In a way, impact managers succeed when they attract the capital of others, making themselves somewhat redundant."

"Inevitably, some managers are coming into impact investing because it is fashionable," she admits. However, despite question marks around the genuine nature of their commitment, such an approach can still yield positive results. "At the same time, while they explore and launch products, these managers learn about their own impact as investors, consider their negative impacts as well as the positive, and they are forced to consider social issues at the same time," Mastelli explains. "Ultimately, it's hard to gauge whether a manager is taking on impact investments because they feel guilty or because someone on the board is nagging them. What I see is a generation of younger portfolio managers and investors eager to make a difference and they are not going anywhere. So I remain fairly optimistic."

Private and public tools for social change

There is no shortage of instruments to tackle social issues, including blended credit, microfinance, equity, social and social impact bonds, according to Mastelli. "The oldest tool is debt, in the form of secured and unsecured loans to small and medium-size companies, charities, cooperatives, social enterprises, at market rate or below, with guarantees or "blended", where a government entity or foundation provides a first loss (partial insurance). Microfinance is other example, including microloans worth US$100 to US$25,000, checking accounts, micro-insurance products, start-up capital, and even financial and business education with a goal to expand the reach of financial services for unemployed or low-income individuals, most often in developing markets."

"At its core, a social investment aims to affect people, communities or societies, and to promote social innovation by developing new ideas, services, models."

"Equity investments have historically played a role: angel investing, venture capital, or even private equity provided by individuals, say via crowdfunding, or institutional investment in enterprises aiming to provide a solution to social issues," Mastelli says. "Affordable and social housing is another one – lower or more affordable housing provided to specified eligible households whose needs are not met by the market.

"More recently we have seen a rise in social bonds – 'use of proceeds' bonds that raise funds for new and existing projects with positive social outcomes. They are similar to green bonds, which finance projects with positive environmental impact," she explains. However, this is not the only form of social fixed income. "The latest kid on the block is social impact bonds. These are contracts on social outcomes, where generally the public sector pays for better social outcomes in certain areas and passes on part of the savings achieved to investors. Social investors pay for the project at the start and if the organization delivers the expected outcomes, the local or national government pays back the investors with interest. They are not fixed income instruments but private contracts."

There are also more specific and targeted tools. "To this list I would also add investments made with a 'lens', a gender lens, a migrant lens," Mastelli says. These are instruments (bonds, loans, equity investments) investing in entities and businesses targeting a specific underprivileged group and for example women, immigrants, refugees, or minorities."

However not all social issues can be solved with private capital. "Some issues need government intervention and changing mindsets via advocacy," she explains. "Private capital plays a role when a market solution can be found, which makes the project inherently more sustainable. Good impact investors engage with those already on the ground and working on the issue: charities, NGOs, the local or central government. That investors can come in, make a buck, and help solve a problem is only a piece of the puzzle. I admit however that it makes me feel warm and fuzzy that capital helps good causes and generates a return, or at least that so many attempting to do this."

No silver bullet

Despite the comprehensive list of approaches to tackling social problems, Mastelli argues that there is no one-size-fits-all solution to every issue. "All instruments have pros and cons. Credit is by nature time-limited and can be a good way of 'testing' the ability of private capital to make a difference. At the same time customers might have to accept forbidding rates. Equity is longer term but exits can be an issue."

"There is evidence that affordable housing brings social benefits, particularly when mixes in commercial tenants, but some projects created greater disenfranchising. Social bonds seem straightforward, but investors demand reporting on the positive impact generated, and liquidity is lower than expected. Social impact bonds are complicated and can be construed as 'a solution looking for a problem'," Mastelli says.

"Not only there is no silver bullet; sometimes the actual evidence of positive impact is itself thin. Unlike with medical trials, practical and ethical concerns complicate the conduct of randomized control trials that would allow us to see what would have happened in absence of these interventions".

Social investment program

According to Mastelli, the vision of a project is at the core of the construction of a social investment program. "We need to start with a vision. For example, I am conducting work with a foundation aiming to positively affect the lives of migrants and refugees. To be helpful, it's necessary to understand the lives of these people: what works, what does not, what actions you believe make a difference."

"For migrant populations, it is important to consider that displacement and transitions take longer than most believe," she explains. "The Refugee Investment Network performed pioneering work in the space. In short, forcibly displaced people do not go from one place and settle into another, they are in transit for years, and while in this precarious situation, they need to work, and gain access to services and capital. This broader picture informs which investments are suitable."

"The foundation spent a lot of time thinking investigating topic, testing solutions with philanthropic money, collecting evidence, and publishing results. Impact investors should always remember that for most issues there is a non-profit that dug into the problem and has good ideas. That's why impact investing demands collaboration – it should not operate in a vacuum," Mastelli concludes.

Picture credit: 9_fingers_ for Twenty20

MDB Bonds

Impact and Safety During the Pandemic

by Filipe Albuquerque

Since the creation of the World Bank's International Bank for Reconstruction and Development (IBRD) at the end of World War II, Multilateral Development Banks (MDBs) have spent the last 76 years testing and fine tuning the impact investing tools necessary to help the world grow out of poverty.

The creation of the UN Sustainable Development Goals (SDGs) in 2015 and the recent needs emerging out of the COVID-19 crisis have ensured MDBs remain relevant to tackle the world's most pressing needs. For private investors, such relevance has translated into continued liquidity and has facilitated the partnerships necessary to allow the private sector to contribute to development goals while sheltering themselves under the credit worthiness of these institutions. This is patent in the continued popularity of indices and ETFs allowing investors to tap into these impact opportunities.

Multilateral Development Banks

MDBs, also known as multilateral lending institutions (MLIs), are supranational financial organisations specialised in the provision of financial support and know-how for economic and social development projects. MDB bonds can be classified as a form of impact investment because the capital acquired from the issuance of these bonds is channelled to social as well as physical infrastructure such as roads, railways, bridges, telecommunication, water management facilities, solar and wind farms, schools and hospitals.

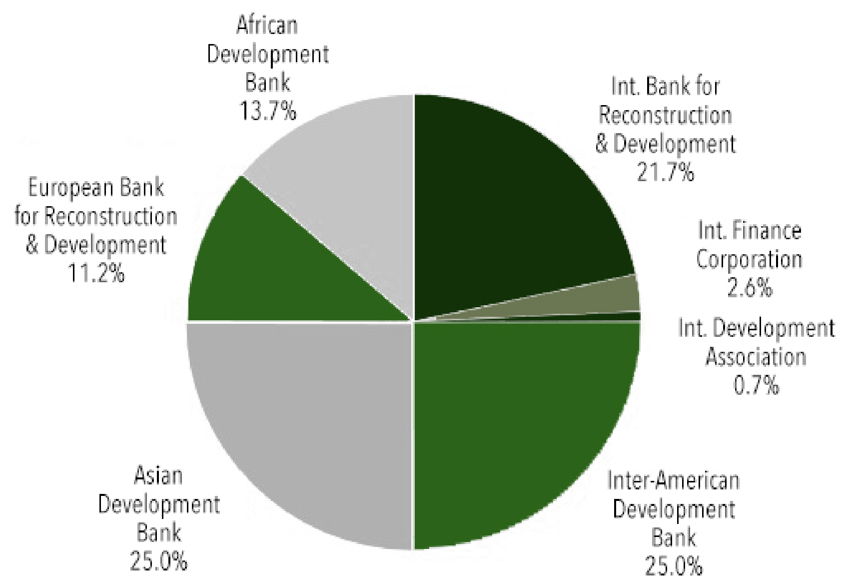
Structurally, the ownership of these institutions is shared between multiple member states, whose stakes are represented by a share of votes and a share of callable capital, often proportionate to GDP. Although some MDBs provide outright grants, the main focus of these institutions is to ensure the long-term development of the countries they intervene in. While they are not purely profit-driven, MDBs see profit as a signal of the competitiveness and long term viability of the projects they invest in.

Although lending criteria are determined prudently, the nature of conditions on the ground in the markets where MDBs operate is such that these projects are not risk-free. Therefore, an important aspect of MDBs is their status as "preferred creditor", which gives them priority over all other creditors. Additionally, they enjoy strong guarantees by G7 countries and other highly-rated sovereigns. Although MDB bonds generally offer slightly higher yields compared to US Treasuries, member states' assurances guarantee that they are extremely reliable creditors, which are often perceived as safe-havens. As such, they can be seen as a "sustainable alternative" to high-grade government debt.

Investing in MDBs

For investors interested in contributing to the impact investments of MDBs, ETFs offer a simple and accessible path to tap into the work and returns of MDBs, through bond benchmarks such as the "Solactive UBS Global Multilateral Development Bank Bond" index family, introduced in 2018. The Solactive UBS Global Multilateral Development Bank Bond USD 25% Issuer Capped Index, for example, focuses on MDB fixed rate bullet or callable international bonds, rated no less than AA- (S&P) or AA3 (Moody's). The index is denominated in US Dollars and invests in bonds with a minimum of US$500 million outstanding and more than 12 months to maturity. Each issuer is weighted by market capitalisation and capped at 25% of the index.

Figure 1
Weightings per MDB institutions within the Solactive UBS Global Multilateral Development Bank Bond USD 25% Issuer Capped

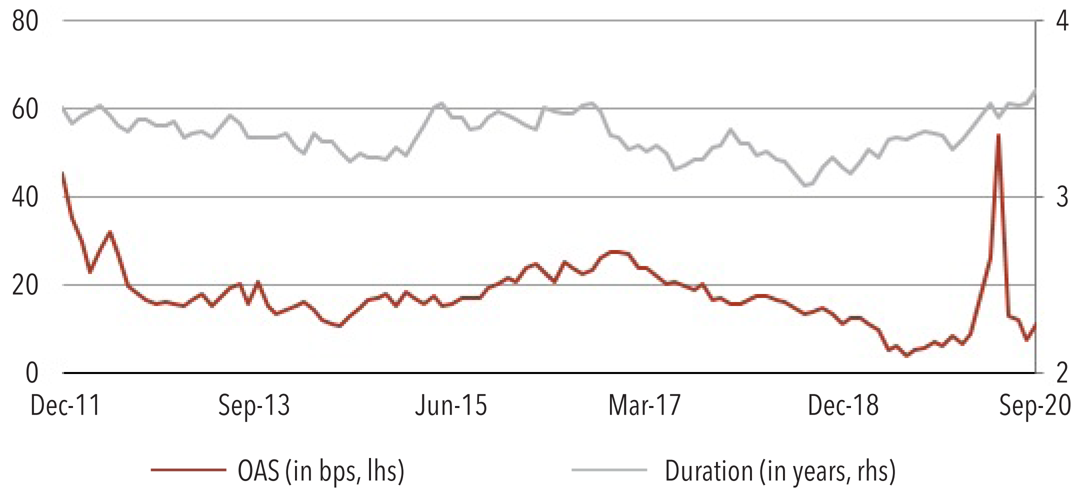


Source: Solactive, UBS Asset Management, data as of 30 September 2020

“For investors interested in contributing to the impact investments of MDBs, ETFs offer a simple and accessible path to tap into the work and returns of MDBs.”

Figure 2

Option-adjusted spread and duration of MDB index



Source: Solactive, UBS Asset Management, data as of 30 September 2020

For impact-minded investors, UBS has created the “UBS ETF (LU) Sustainable Development Bank Bonds UCITS ETF”, which replicates the above mentioned benchmark and provides a diversified exposure to sustainable bonds issued by IBRD, International Finance Corporation (IFC), Inter-American Development Bank (IADB), the International Development Agency (IDA), the European Bank for Reconstruction and Development (EBRD), the African Development Bank and Asian Development Bank (ADB).

MDBs and COVID-19 Impact

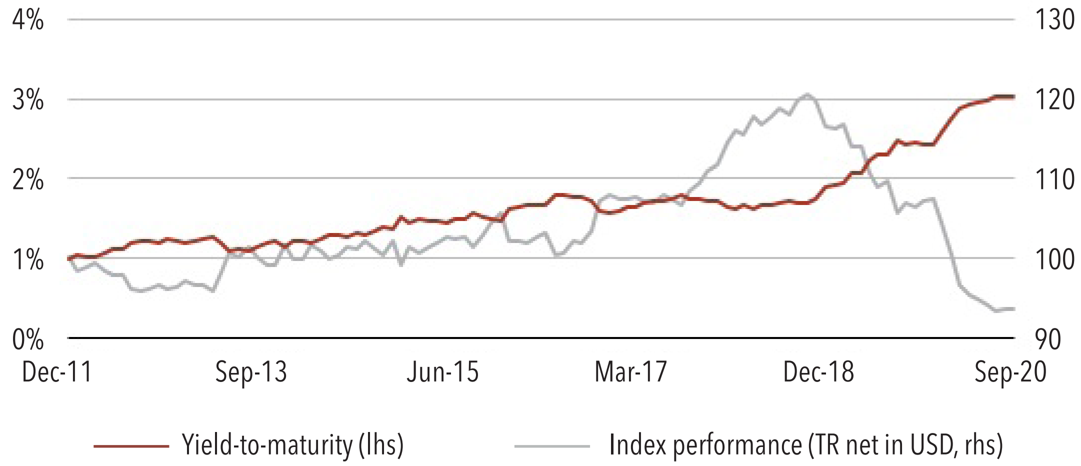
2020 has provided a test of the relevance and strength of MDBs. In the face of the pandemic, global MDBs were some of the first to react to the crisis. As early as March, institutions such as the World Bank’s IFC were coming to the market to issue social bonds, the proceeds of which were to be channelled to dedicated programs designed to assist the most exposed developing countries. Other organisations followed suit, including the AfDB, the IADB, the European Investment Bank (EIB), the EBRD and the IBRD.

Not only do MDB bonds offer investors a possibility to achieve positive social and economic impact they also provide a way for them to diversify their portfolios. During the March sell-off this year, high grade bonds (such as US Treasuries) lost all their previously accumulated returns of the year. As a result, their performance contribution to a diversified port-

“The positive impact of MDB bonds is not limited to the social and economic development projects they fund but extends into the diversification of portfolios.”

Figure 3

Performance and yield-to-maturity of the MDB index



Source: Solactive, UBS Asset Management, data as of 30 September 2020

folio was close to zero. In contrast, the MDB bond index currently offers higher returns compared to duration-matched US Treasuries with an option adjusted spread of 11.4 bps (September 2020). The option adjusted spread spiked to new historical highs of almost 60bps at the end of the first quarter 2020, as the COVID-19 shock rocked financial markets leading investors to sell en-masse.

The strong credit rating allowed investors to maintain their confidence on MDBs as a suitable investment during market turmoil. The safe haven status of MDBs is patent in the consistent downwards path of the MDB index’ yields-to-maturity as well as the strongly positive index performance since the beginning of 2020.

While MDB bonds have a direct impact in supporting developing countries to cope with the pandemic their positive total returns also helped investors cushion against the losses from risky assets. The high credit rating makes multilateral development bank bonds a liquid and low-risk form of impact investing while offering true global diversification through the unique reach and variety of MDB activities across most of developing countries.

A Path to Impact for Conscientious Investors

by Filipe Albuquerque

"The Church Pension Fund is a long-term investor and impact investments have been and will continue to be a part of our investment strategy."

The history of sustainable investments was originally paved by ethical investors who objected to certain practices or products on moral grounds. Religious organisations have always had an important role to play in this context and the modern financial arms of religious institutions in the Nordics are no exception. To hear more about the view of the Evangelical Lutheran Church of Finland and its history with impact investing, we reached out to Magdalena Lönnroth, Portfolio Manager and Head of Responsible Investment at The Church Pension Fund.

A serendipitous start

"I started working as a Fund Analyst at the Central Church Fund in June 2006," Lönnroth says. "I had just finished my finance studies and decided to apply for this new position at the Central Church Fund. I had written my master's thesis on the profitability of responsible companies and was attracted by the ethical investment profile of the Central Church Fund."

The timing of her start at the Fund was extremely fortuitous, Lönnroth explains. "Upon starting in my new position, I was immediately invited to the working group founded to update the responsible investment policy of the Central Church Fund. 2006 was a great year to update the policy, as it coincided with the foundation of the UN PRI. Suddenly there was a new framework and a vocabulary to build the new responsible investment policy upon."

"After this policy project I have worked on many other policies and RI projects at the Central Church Fund, such as a special three-year project for developing responsible investment practices at the parishes and promoting responsible investment in the Finnish market. One practical outcome from this project was the foundation of Finsif, Finland's Sustainable Investment Forum back in 2010. The Church Pension Fund was separated from the Central Church Fund to become an independent public law legal person on 1 January 2016. Today I am employed by the Church Pension Fund."

The Church Pension Fund's impact investment approach

"The Church Pension Fund's Responsible Investment Guidelines and the Climate Change policy steer the responsible investment work at the Pension Fund," Lönnroth explains. "Impact investing is defined as one responsible investment approach (the others being Responsibility analysis and Active ownership/engagement) in the Responsible Investment Guidelines."

According to the Guidelines, intentionality plays an important role in the pension fund's approach to impact investing. Not only do the relevant investments need to generate a financial income, the purpose of the relevant investee companies, organisations or funds needs to involve the achievement of "significant social or environmental impact". The Guidelines refer to micro loans and green bonds as examples of the sort of impact investments it is interested in.

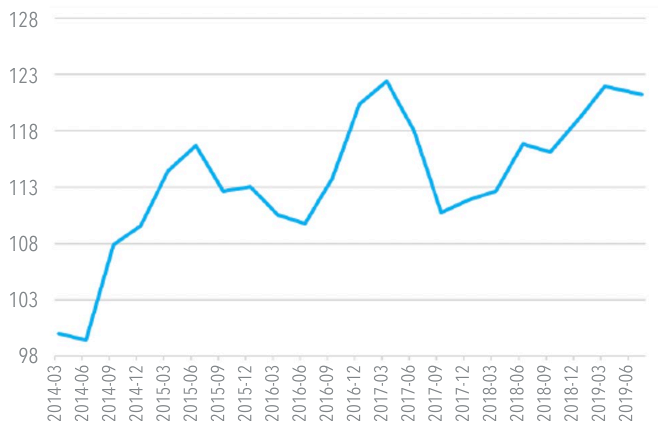
Making impact investing easy

Whilst the Church Pension Fund had been involved in sustainable investments for some time, the first impact investment was made in 2014 in the SEB Microfinance Fund II. "SEB approached the Pension Fund with the second Microfinance Fund, as the first fund had been promoted primarily to Swedish institutional investors. The Church Pension Fund was the first Finnish investor to participate."

"The Church Pension Fund had taken an interest in

Figure 1
NAV SEB Microfinance Fund II EUR (A/D share class)

* performance up until June 2019 when 97% of the capital was paid off. Due to work-out positions, the fund was formally closed in January 2020



microfinance for many year," Lönnroth adds. However, the clarity of the benefits of impact investing and the ease with which the Church Pension Fund could contribute to them via SEB's fund appear to have tipped the scales. "In 2014, finally, a lot of pieces found their place in this collaboration with SEB. First, the bank presented us with a familiar, well-resourced asset manager with whom we felt comfortable partnering. We were also encouraged by the fact that SEB consulted with Symbiotics, a microfinance advisor, in the search and monitoring of investments. The sector had also reached maturity and we felt that its return/risk-profile was reasonable and that the fund was tolerably priced. Overall, we felt that the resources and processes were in place to ensure responsible lending practices by the local microfinance institutions (MFIs). Satisfied with all these details, CFO Ira van der Pals and I prepared the investment proposal following SEB's initial proposal."

Lönnroth was keen to emphasise the complementarity of microfinance investments. Climate action, for example, and poverty relief do not have to compete with one another. "It is not a choice between one or the other. Some of the MFIs finance the purchase and installation of fixed and portable eco-efficient stoves, biodigesters and solar dryers, for example (SDG 13 Climate Action)," she says. "A broad range of the SDGs are covered in this fund, as you can read in the attached SEB Final Report. The most recent SEB Impact Opportunities Fund focusses, in addition to microloans, also on projects in education, housing, energy, and agriculture. The impact investment sector is evolving over time and will grow into new segments."

Good performance in volatile times

The Church Pension Fund's was invested in the SEB Microfinance Fund II for five years until the investment period came to an end in 2019.

The fund lent directly to financial intermediaries or microfinance institutions, in emerging and frontier markets. Thus the fund enabled institutional investors to channel capital to markets where it otherwise doesn't flow to provide credit to micro, small and medium enterprises, and low and middle-income households. The strategy was to capture financial and social value creation from financial intermediaries active at the base of the pyramid in emerging and frontier markets.

"The fund financed 67 microfinance institutions in 32 emerging and frontier markets, investing US€129 million in the projects of 6.6 million entrepreneurs," Lönnroth explains. "For our part, the Church Pension Fund invested €5 million in the fund," she added. Performance wise, the fund was relatively well balanced. Its 4.8% annualised return outperformed JPMorgan's Emerging Markets Local Currency Debt Fund and the MSCI Emerging Markets Currency Index and barely missed the MSCI Frontier Emerging Markets Index. Moreover, this relatively good performance was accompanied by lower levels of risk than any of those benchmarks, leading to a superior Sharpe ratio.

"There were some ups and downs during the period we were invested in the fund. According to SEB's final report, the fund "operated in various market environments over the five-year period. Growth was strong

Figure 2
Returns, volatility & sharpe ratio compared to other asset classes (EUR)

Index name	SEB Microfinance Fund 2 - EUR (A/D Share Class)	JPMorgan Emerging Markets Local Currency Debt Fund	MSCI Frontier Emerging Markets Index	MSCI Emerging Markets Currency Index
Asset class	Microfinance fully unhedged	Emerging markets local currency debt	Frontier/Emerging stocks	Emerging currencies
Index currency	EUR	USD converted to EUR	USD converted to EUR	USD converted to EUR
Annualized return	4.8%	3.1%	4.9%	3.8%
Annualized volatility	6.7%	9.2%	12.8%	7.6%
Sharpe ratio	0.73	0.35	0.39	0.51

Source: SEB Microfinance Fund II Financial Report, December 2019

and emerging markets attracted significant portfolio inflows over much of the period. However, a sharp decline in oil and commodity prices in 2014- 15 was particularly challenging, causing large devaluations in several currencies against the USD. In addition, national-level policies as well as natural disasters negatively affected some microfinance markets."

"After making this first microfinance investment with SEB, I have had the opportunity to meet directly with some local MFIs and their end-clients. This insight has been very valuable to understand the underlying need for financing in these regions (and the opportunities for real impact!), as well as understanding responsible lending practises in a market where competition is growing fiercer."

These interactions and the general experience of the Church Pension Fund with impact investment and SEB were successful enough that the Pension fund was happy to invest €10 million in the SEB Impact Opportunities Fund and in the SEB Microfinance Fund IV.

Microfinance and COVID-19

"Looking at the year-to-date performance of the SEB Microfinance Fund IV, second quarter returns have recovered nicely," Lönnroth says. "The pandemic has affected all countries to various degrees. Emerging and frontier economies generally do not have the same capacity to support their population as higher income countries which makes the population more exposed."

"MFIs have extended payment moratoriums to their clients and while it is too early to know the final effects, the fact that the funds are highly diversified in terms of countries and sectors is important." She adds. "The rural economy, where half of end-clients live and operate, has for example not been affected to the same degree as some businesses in the large cities."

"Evidence from previous crisis shows that micro-entrepreneurs are quick to restart their businesses due to the sheet need to generate an income to feed the family. We should also take into consideration that the institutions that the fund has invested in are generally well-capitalised with a strong set of owners so there is a buffer to sustain more challenging times," Lönnroth explains.

Looking ahead to new opportunities

The success of the first impact investment and of those that followed, including during the pandemic, appear to have convinced the Church Pension Fund of the merits and ease of impact investing. "The Church Pension Fund is a long-term investor and impact investments have been and will continue to be a part of our investment strategy. Covid-19 has not changed the fundamental properties of this asset class," Lönnroth explains. "We will continue to update our impact investment strategy to reflect the market developments".

"This year we have made a new commitment in OP Finnfund Global Impact I GP. The fund will make debt and equity investments in EM projects related to renewable energy (20-30 %), agriculture (20-30 %), infrastructure (10-20%), manufacturing and services (10-20 %)– in addition to finance institutions (20-30 %)," she concludes.

Picture byakbaranif on Twenty20

Tackling Sustainable Food Investments in Asia

Financial Return and Impact Potential

by Filipe Albuquerque

Impact investing in emerging markets can sometimes seem distant, complicated and challenging from the outside. There is also the lingering myth that it exposes investors to too much risk at the expense of not enough return.

But that does not have to be the case. According to Rik Vyverman, Head of Sustainable Food Equity at responsAbility, clarity in impact investing, the attractiveness of business opportunities available and the significantly high returns on offer are at the core of quality impact investment.

Rik Vyverman
Head of Sustainable Food Equity
responsAbility

A Path to Sustainability

After becoming a young multimedia entrepreneur in the 1990s, Vyverman only entered the world of impact investment in the early 2000s after travelling the world. "While I don't criticise any projects nor their intentions, I believe that the traditional model of intergovernmental development cooperation has made little difference. People progress if they have a job and are paid a decent salary, which requires a robust private sector."

"With the arrival of a new government in my home country of Belgium, I spontaneously wrote the minister for cooperation a letter, as a private citizen, explaining what I thought Belgium needed and pointed at the relevant instruments for private sector development in emerging markets. To my surprise he invited me to become his advisor and to help implement some of the ideas I had advocated. This led to the creation of the Belgian Investment Company for Developing Countries (BIO-Invest) in 2001, which I ran for four years."

"I left BIO to set up a private equity fund in Vietnam in 2005 – the SEAF Blue Waters Growth Fund. Vietnam was the final frontier market in Asia at the time. They had just created the legal framework for people to incorporate companies as private businesses. Prior to that reform, the country's communist system meant that every business was either informal or a state owned enterprise."

"I subsequently moved to Switzerland for family reasons and worked as a consultant in private equity investments in emerging markets, for institutional investors, family offices or non-profits until I joined responsAbility in 2013 as portfolio manager and Head of Ventures, before creating the Agricultural equity fund 2017."

The Food Equity Fund

According to Vyverman, responsAbility has two asset classes, private debt and private equity, and three sectors: financial inclusion, sustainable food and climate finance. "I manage the 'responsAbility Agriculture Fund I', which fits in the private equity sustainable food box. Our strategy is to deploy growth capital, focusing on delivering market based returns, ESG implementation and impact linked to the UN SDGs."

"The fund has US$67.5 million in committed capital and has been fully invested since November last year, 2 years after it was launched. We are currently raising the responsAbility Agriculture Fund II, which is focused on Asia. Our focus is on the part of food production once crops leave the fields. Agriculture at that stage become more of an industrial or consumer goods activity."

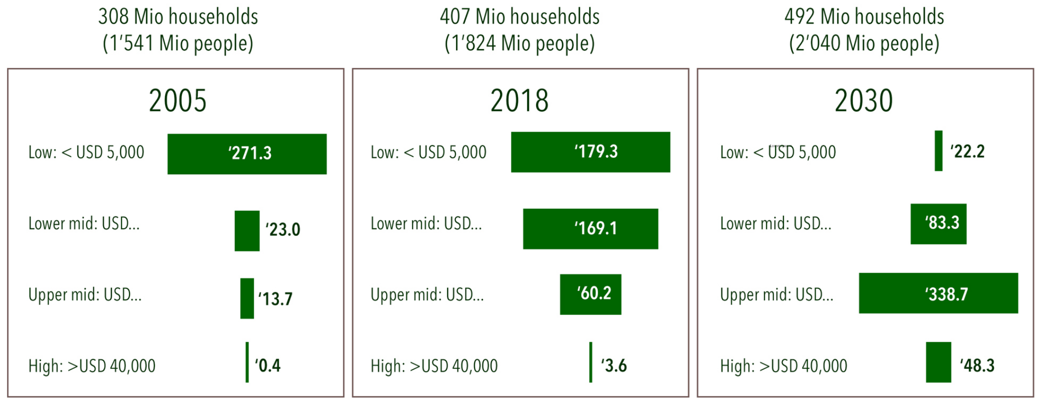
Asia – The Biggest Opportunity in the History of Capitalism

"Asia's growth opportunity is driven by the rise of Asian consumer and middle class, which according to McKinsey is the biggest investment opportunity in the history of capitalism," Vyverman says. "According to the 2005 data, 88% of households in Asia's (ex-China) four most populous countries - India, Indonesia, Vietnam and the Philippines - had an income below US$5,000, the threshold for low income according to the World Bank. By 2018, the share of low income households had declined to 42%, with lower and upper middle income growing to 56%."

"According to projections, by 2030 the share of lower or upper middle income class will reach 95%. The upper middle class, with incomes above US€10,000, will represent 78% of the population. In ten years' time, the region will have an extremely large middle income population."

INCOME GROWTH TRANSFORMS ASIA (*) INTO MIDDLE CLASS LED ECONOMIES

Rising demand – Asian consumers will be wealthier than ever before



Source: World Bank Group: World Development Indicators, Global Insight, Bain

- Today : ~1 out of 6 (15%) households in the high income and upper middle income segment
- 2030 : ~1 out of 1.25 households (+300 million households) in the high income and upper middle income segment

(*) Asia = India + Indonesia + Philippines + Vietnam

Source: responsAbility

This population growth, together with urbanisation and demographic trends will create important demand pressure on the food industry. "This will lead to a tremendous increase in food consumption. The population will become more urbanised too, not only in large metropolitan areas of 10 million people or more, but also of in smaller cities with 500 thousand and 200 thousand inhabitants. The demographics will also change. In 2030 the median age in this region will be 30 years old. Working age people will be the dominant group. Asian millennials are already better educated and have higher incomes, leading them to have more sophisticated and diverse eating habits, focusing on food safety, health and sustainability, trends which are likely to endure."

Supply-Side Opportunities

While economic development, urbanisation and population growth are likely to increase demand for agricultural goods, Vyverman is keen to point at the present structure of the region's agricultural industry to highlight impact investment opportunities. "The supply-side in Asia is a story of small-holder farmers, on average above the age of 55, with typically less than two hectares of cultivated land, uneducated and low use of technology."

The post-production, service part of the agricultural industry in the region is also plagued by inefficiency, Vyverman says. "While in Europe and in the USA most of the food wastage occurs at the point of consumption, with much food being thrown out by retailers and consumers, wastage in Asia occurs predominantly along the supply chain and processing, as products move from the farms to the consumers." Vyverman singles out two main problems.

Structurally, markets have been historically disorganized and inefficient, and characterised by layers of intermediaries that don't add any value to the product but mark-up prices significantly. "

Logistically, the inappropriate transportation of food products leads to waste. "On their way to the market, products are often just thrown into a truck without any form of support. Produce will just pile up. Some perishable goods, like fruit will be damaged. In the case of soft fruits, such as bananas, about 15% of the produce would almost automatically be spoiled due to the absence of crates to cushion their transportation," Vyverman explains. Cold storage is also a problem. "In India, the price of apples drops significantly at the time of the harvests because there are so few refrigerated storage facilities to hold the produce and what doesn't get sold goes to waste. In Europe, we are able to spread the annual supply of apples because they can be stored in controlled atmospheres and progressively taken to the market for a period of up to 12 months."

"The company works directly with the farmers and owns local processing facilities. This closer relationship also allows Suminter to share with the farmers a fraction of the premium paid for its goods by consumers."

Case Study - Suminter Agrex

"As an investor, this scenario is fertile ground for the introduction of efficient supply chains, methods and technologies that can improve efficiency and transparency," Vyverman explains. "The consumer benefits from fresh products at lower prices without necessarily hurting the producer. Poverty decreases and tax revenues increase. It's the definition of a win-win situation."

As an example, Vyverman cites the investment that the responsAbility Agriculture Fund I made in Suminter Agrex, an agriculture supply chain management company. "The company sells 100% certified-organic, all natural, non-GMO organic products. They work with over from 60,000 farmers cultivating over 100,000 hectares, without use of harmful chemicals, delivering high quality foodproducts . The company has operations in South Asia, Africa and South-East Asia.

The crux of their product is quality assurance and certification, according to Vyverman. "Their products are certified as organic. To ensure this level of quality, the company sends agronomists to visit farmers and teach them how to grow these products. The organic certification process is complicated and involves sampling and testing of every delivery to customers. The company uses a German laboratory to provide these tests in order to use the organic certification of its products."

"This sort of quality control requires very careful and transparent sourcing and a much closer relationship with primary producers," he explains. "The company works directly with the farmers and owns local processing facilities. This closer relationship also allows Suminter to share with the farmers a fraction of the premium paid for its goods by consumers."

The company has been a tremendous success and has seen incredible growth, according to Vyverman. "Suminter has been performing well, in line with the rest of the entire portfolio. The financial return of fund I is outperforming the upper quartile of European and US PEs and VCs as well as public markets. And even during the COVID-19 pandemic, all our portfolio companies continue to grow by at least 50%, proving the resilience of the companies and more broadly the sector."

Making an Impact –Simplicity, Performance, Conditionality, and Transparency

When discussing impact, Vyverman is keen to do away with complex terminology. "Clarity and simplicity are paramount. The performance of our investments has to be understandable to clients of a pension fund. It needs to be clear. If we want to continue to see money come into impact investing, be it from institutional or private investors, we should not be making things more difficult."

On a macro level, the focus of impact investing is to address poverty (SDG1 and 2), climate (SDG12 and SDG13) and economic development (SDG1, SDG6 and SDG11). "Poverty is linked to rural small holder farmers. Climate action is linked to the better use of resources in agriculture. Economic development is linked to job creation, value creation, taxes paid. Impact measurement focuses on certain specific KPIs, such as the number of farmers reached, hectares of farmland under cultivation by sustainable farming, factory output, etc," Vyverman adds. "We measure these KPIs at the time of investment and project them forwards into the future as we would by the end of the holding period. Throughout the holding period we will report on those KPIs. At the ESG level, we want our companies to operate at the level of international best practices, based on World Bank definitions. At the time of investing we give the companies a rating regarding their operational policy alignment around these ESG issues and throughout the holding period we work with them to improve this score."

On the topic of governance risks, Vyverman was optimistic. "It's important to recognize the existence of corruption in any country, and historically its prevalence has been higher in developing countries. However, these countries' performance in terms of the ease of doing business and corruption has improved a lot over the years." Moreover, this is not a rubber stamping exercise. Transparency matters. "For us, the ethics of the entrepreneur we are investing in is key and requires a very thorough due diligence process, including a forensic due diligence on the owners and key management. There is no tolerance for corruption in the companies in the fund. The people that run these companies need to share our values."

about our partners

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Founded in 1958, American Century Investments' 1,400 employees serve financial professionals, institutions, corporations and individual investors from offices in New York; London; Hong Kong; Frankfurt; Sydney; Mountain View, Calif.; and Kansas City,

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responsAbility is headquartered in Zurich, Switzerland, and has local offices in Bangkok, Lima, Mumbai, Nairobi, Oslo, Paris and Tbilisi. Owned by various reputable Swiss and international financial institutions, private investors and its own employees, responsAbility is registered with the Swiss Financial Market Supervisory Authority FINMA.

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November 2020

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