CREATING IMPACT

The Promise of Impact Investing

ANNEXES

Creating Markets, Creating Opportunities

ANNEXES

Annex A. Definitions of Impact Investment That Have Been Used in the Industry

TABLE A.1 Definitions of Impact Investment

No.	ORGANIZATION	Impact investment ...is made with the intent...	...to contribute to...	...measurable...	...positive social and environmental impact
1.	Cambridge Associates LLC	is "made in an enterprise that offers"			"a market-based solution to a social or environmental challenge"
2.	Global Impact Investing Network (GIIN)	has "intention"	"to generate"	"measurable"	"positive social and environmental impact"
3.	Global Steering Group for Impact Investment (GSG)	"optimizes risk, return and impact to people and the planet"	by "setting"	"and measuring their achievement" of	"specific social and environmental objectives"
4.	Mission Investors Exchange	is "intended"	"to generate"		"social and/or environmental impact"
5.	Monitor Institute	is "actively placing capital in businesses"	"that generate"		"social and/or environmental good"
6.	Omidyar Network	"seeks"	"to generate"		"social change"
7.	Organisation for Economic Co-operation and Development (OECD)	has the "expectation of"		"measurable"	"social return"
8.	Overseas Private Investment Corporation (OPIC)		"deliver[s]"		"social and environmental benefits to emerging markets"
9.	Social Impact Investment Taskforce	"intentionally"	"targets"	"and measure[s]" the "achievement" of	"specific social objectives"
10.	The Rockefeller Foundation	has the "intention"	"of generating"		"social and/or environmental impact"
11.	U.K. National Advisory Board on Impact Investing	has the "deliberate intention"	"to make a"		"positive social or environmental impact"
12.	UN Global Compact	has the "intent"	"to create"		"benefits beyond financial return"
13.	World Economic Forum (WEF)	"intentionally seeks"	"to create"	"that is actively measured"	"positive social or environmental impact"

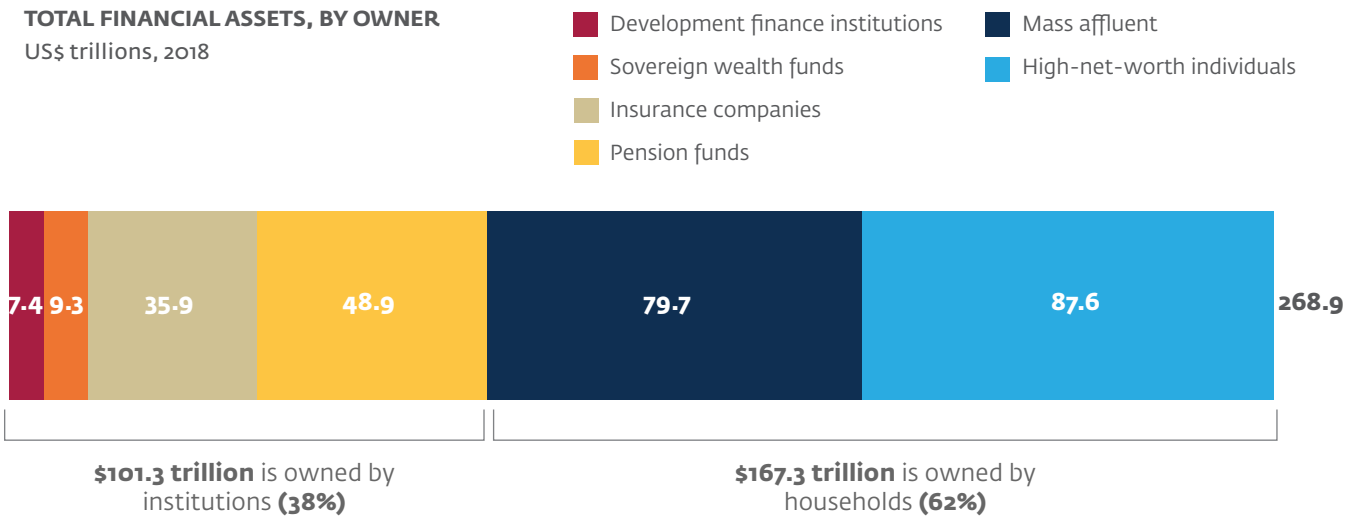
Sources: Organizations' websites and publications.
Note: Definitions of impact assessment used in the industry include three components, in addition to a focus on social or environmental impact. A notion about a causal contribution is shared by 12 of 13 organizations; intent is shared by 8; and measurement is shared by 5.

Annex B: An Estimate of Investor Appetite for Impact Investment

In 2018, the private and public sectors owned an estimated $268.9 trillion in financial assets (Figure B.1).[1] PwC forecasts that as institutional investors seek diversification, assets under management in private equity will rise faster than managed products in public securities.[2] They will invest these over the short, medium, and long term. Of this total, $101.6 trillion is owned by public and private institutions: pension funds, insurance companies, sovereign wealth funds, and development finance institutions.[3] The remainder, $167.3 trillion, is owned by households, with $87.6 trillion held by high-net-worth individuals, who have financial assets of over $1 million, and the rest are held by what are called the "mass affluent" segment, or individuals with assets of less than $1 million.

Mass affluent households, or those with less than $1 million in financial assets, have insufficient wealth to participate in most private markets. Therefore, even though they comprise a substantial share of total assets, the extent to which their assets may be invested for impact is limited. Such households are likely saving for retirement or education for children, which requires safer and more liquid investments, such as stocks and bonds. There are also regulatory barriers. The United States Securities and Exchange Commission, for instance, only gives "accredited investor" status, allowing investment in private equity or hedge funds to investors with assets greater than $1 million, or income of more than $200,000 in the two prior years, and a plan to do so in the next.[4] This is justified by an imperative to protect smaller investors from taking excessive risk.

FIGURE B.1 In 2018, $268.9 Trillion in Financial Assets were Available for Investment



Sources: Credit Suisse, PwC and DFI annual reports.
Note: Financial assets do not include land, housing or, in some jurisdictions, equity in small businesses held by households. Assets of private banks are reflected in the graph in the total financial assets, as the asset owner's financial assets include claims on their equity, debt, and deposits.

[1] Estimate for 2018, based on forecasts from PwC. The daily value of financial assets may vary substantially, day-to-day, due to volatility in market prices.

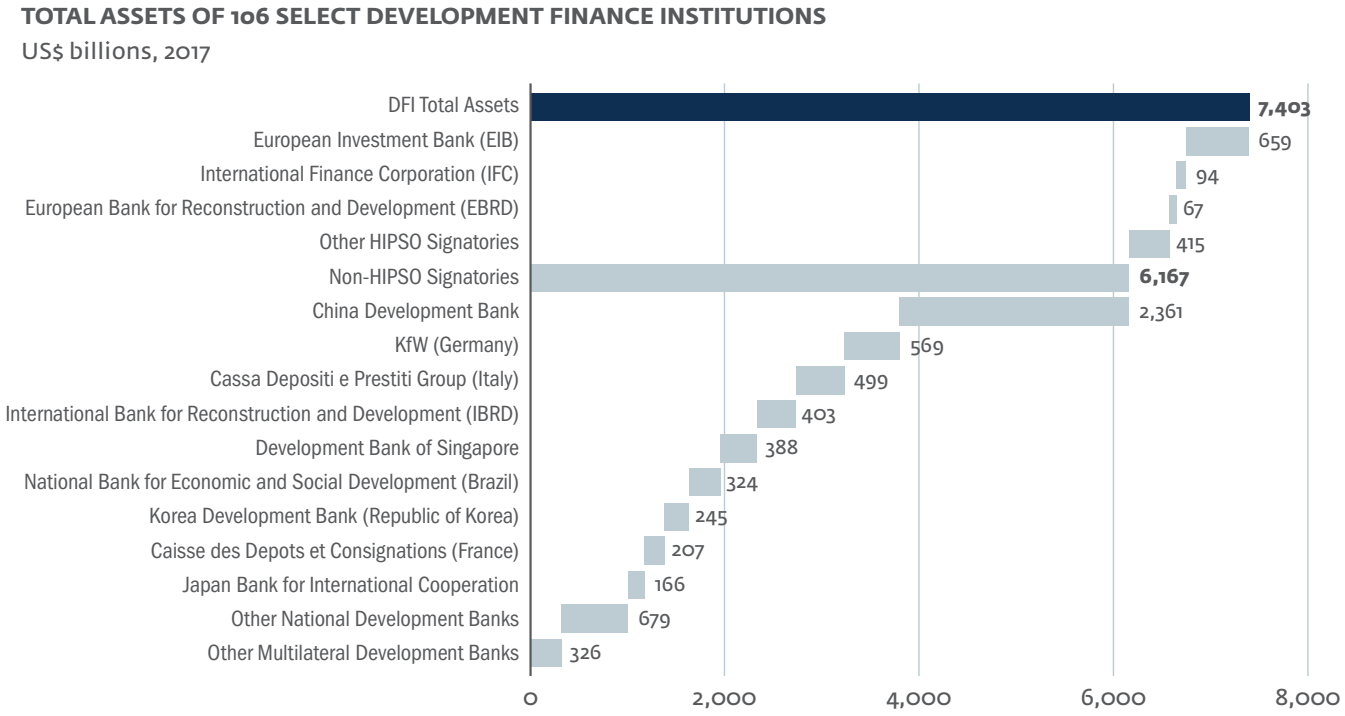
[2] See https://www.pwc.com/gx/en/asset-management/asset-management-insights/assets/awm-revolution-full-report-final.pdf.

[3] This includes the assets of 106 development banks that satisfy three criteria: (a) their mission statement and reference documents suggest a mission that relates to social and economic development, as opposed to just financial return, and (b) they have some government ownership or were originally formed by an act of government (multiple banks are identified in some countries), and (c) recent balance sheets were available. Export credit agencies are excluded from the analysis.

[4] U.S Securities and Exchange Commission 2019.

In our analysis, we do not separately distinguish between households and the foundations and endowments they donate money to, due to variance across countries in how these organizations are defined by the tax code, which creates differential incentives for financial disclosure.[5] Overall, though some foundations and endowments have been leaders in the practice of impact investment over the past decade, their contribution to total asset value is likely less than 1 percent of total assets. Foundations notable for their size include the Bill and Melinda Gates Foundation ($51.8 billion)[6], the Wellcome trust ($33.1 billion)[7], a publicly traded British charity which funds biomedical research, and the Azim Premji Trust ($12.0 billion)[8], named for the founder of the Indian software company Wipro Ltd.The world's largest university endowments include Harvard University ($39.2 billion in assets)[9] and Cambridge University and its colleges ($15.1 billion).[10] Their assets may be illiquid, however, as in the case of artwork or real estate given by bequest.

FIGURE B.2 Assets of Development Finance Institutions



Sources: DFI Annual Reports. Assets of IFC and IBRD refer to fiscal years 2018. Dollar values may differ slightly from official figures, as they were calculated using exchange rates current at the time of publication.

5 In the United States, for instance, where the greatest value of individual foundations by assets appears to rest, foundations are subsidized through tax exemptions on investment income and property tax. The value of these subsidies increases with household income. Reich 2018.

6 2017 audited financial statements. See https://www.gatesfoundation.org/Who-We-Are/General-Information/Financials.

7 Converted from £11.8 at 1.28 $ per £. As of September 2018. See https://wellcome.ac.uk/news/value-wellcome-investments-passes-25-billion-pounds.

8 Mishra, Pankaj 2018. "Azim Premji quietly gives away more to charity.,Äù Livemint, March 7. https://www.livemint.com/Companies/6fd1boxRbPYAuRoeNk852L/Azim-Premji-quietly-gives-away-more-to-charity.html.

9 Fiscal Year 2018. See https://finance.harvard.edu/files/fad/files/harvard_annual_report_2018_final.pdf.

10 Converted from £11.8 at 1.28 $ per £. See https://www.theguardian.com/education/2018/may/28/oxford-and-cambridge-university-colleges-hold-21bn-in-riches.

Asset Owners' Preferences

FOR IMPACT ACROSS THE RETURNS SPECTRUM:

Understanding demand for impact investment is difficult, given uncertainty over the return it delivers. Investor surveys provide a starting point, with the caveat that given the concentration of the dollar value of wealth in a small number of households and institutions, one should exercise caution in extrapolating from a survey to preferences over aggregate asset allocations. When investors are offered a specific definition of impact, interest varies. Morgan Stanley asked whether investors were interested in "making investments [...] to achieve market rate financial returns while pursuing positive social and/or environmental impact?" Seventy-five percent were interested, though only 23 percent were "very" interested, suggesting, perhaps, bridled enthusiasm.[11] Of those that express interest, fewer may identify as impact investors. A survey by The Economist found that only 39 percent of women investors under 35 agree that "I align my investments with my giving goals (for example, through impact investing)." The share is lower for men, at 26 percent, and for older women, at 24 percent.[12] Of course, the survey's use of the word "giving" may have prompted respondents to think of charitable returns, lowering response rates.[13]

There are two returns scenarios for the pool of capital among investors who might intend to invest for impact (Table B.1). These are based on the revealed preference of asset owners for managed investment products. Private institutions and households are assumed to invest 29 percent, which corresponds to the share of professionally managed assets under socially responsible investing (SRI) strategies, which can be understood to reflect taking into account social or environmental considerations, alongside financial return.[14] Under the scenario of sub-commercial returns, we assume that households invest only 19 percent of assets for impact, or the share of managed assets under negative screening strategies, which arguably indicates a willingness of asset owners to sacrifice returns.[15] Institutional investors are assumed only to operate on commercial terms. This is apparent from the fact that they are often careful to emphasize the upsides as well as the downsides of negative screening and ESG integration strategies, suggesting discomfort with stating they have intentionally sacrificed return. For instance, a recent report by Norway's $1 trillion Government Pension Fund Global, which is funded by surplus oil income, found that, with regard to the funds' sustainable and responsible investment strategies, "both the exclusion of tobacco companies and certain weapons manufacturers have reduced returns. This effect has, to some extent, been mitigated by the positive contribution of [...] environmentally based exclusions of mining companies."[16]

[11] Morgan Stanley Institute for Sustainable Investing 2017.

[12] EIU 2018.

[13] The growth of impact investment, so far, may have been hindered by expectations of sub-commercial returns. In a UBS survey, of the 61 percent of respondents who had not engaged in sustainable or impact investing, 63 percent said that it was because they were worried about lower returns. Further, 67 percent said they would prefer to maximize returns on investment and focus on charitable donations for their giving, suggesting that many investors think in binary terms about the return of their portfolio.

[14] This percentage is calculated as assets allocated to any SRI strategy, as reported by the Global Sustainable Investment Alliance (2016), divided by an estimate of total managed assets for the same year, based on data provided by PwC.

[15] GSIA 2017.

[16] Katz 2017.

TABLE B.1 Assumptions behind estimate of investor appetite for impact investment

SHARE OF INVESTIBLE ASSETS ALLOCATED TO IMPACT INVESTMENT		Commercial Return	Sub-Commercial Return
INSTITUTIONS	Insurers, Pensions, and Sovereign Wealth Funds	29%	0%
	Development Finance Institutions	100%	0%
HOUSEHOLDS	High-net-worth Individuals	29%	19%
	Mass Affluent	29%	19%

Source: Global Sustainable Investment Alliance. PwC.
Notes: 29 percent corresponds to the share of assets professionally managed under any type of SRI strategy; 19 percent corresponds to the share under negative screening strategies—both are for year-end 2015. This assumes that asset owners invest for impact on their own account in equivalent proportion to asset managers, and that impact is possible in public markets, at all liquidities

FOR PUBLIC AND PRIVATE MARKETS:

An investor's asset allocation is typically immutable, due to liquidity needs. It is unlikely, for instance, that an asset owner would take assets allocated to cash or short-term bonds, and invest them in private equity, which is typically illiquid for 5–7 years. Households hold a substantial amount of assets in liquid assets, namely cash (24 percent of total household financial assets).[17] They may hold liquid assets as buffers against expected shocks, or because investment opportunities are not available. There is substantial variation across countries in the preference for cash, too: In the United States, just 13 percent of household assets are held in liquid assets, whereas in Germany, the figure is 39 percent, and in China, 53 percent.

Principles of asset and liability management also requires institutions to hold more liquid and less risky instruments, such as bonds and cash. In 2016, 67 percent of U.S. insurer assets were held in bonds, and just 12 percent in common stocks.[18] Insurance companies have disproportionate demand for bonds because of regulatory requirements. Although there is substantial variation across countries, a pension typically holds approximately 50 percent in bonds and liquid assets, with the remainder in public equities.[19] Investment by pensions is concentrated in the United States, where pensions invested $28.2 trillion in 2017, or 64.8 percent of the value invested by all OECD countries. Development finance institutions also hold between 40 and 60 percent of assets in treasury, typically in bonds.

17 Credit Suisse 2018.
18 National Association of Insurance Commissioners and the Center for Insurance Policy and Research 2017.
19 OECD 2018.

Annex C: Financial Performance of Realized IFC Investment Projects

TABLE C.1 Financial Performance of Realized IFC Investment Projects By Vintage Year

A) EQUITY		SIZE WEIGHTED				F-test of equality between time periods	EQUAL WEIGHTED				F-test of equality between time periods
		Full Sample	1961-1987	1988-2007	2008-2016		Full Sample	1961-1987	1988-2007	2008-2016	
Public Market Equivalent (vs. MSCI EM)	median	1.14	Index does not exist	1.20	1.04		0.94	Index does not exist	0.94	0.90	
	mean	1.36		1.47	1.13	***	2.03		2.22	1.16	**
	std. dev.	(1.64)		(1.86)	(0.98)		(7.02)		(7.69)	(1.48)	
	[p25; p75]	[0.62;1.62]		[0.66;1.68]	[0.39;1.46]		[0.46;1.53]		[0.50;1.57]	[0.33;1.37]	
	n	1,266		1,042	224		1,266		1,042	224	
Internal Rate of Return	median	7.94	13.57	10.22	1.85		5.05	6.35	5.66	0.00	
	mean	27.06	13.57	33.58	16.06		60.40	11.12	74.13	53.30	*
	std. dev.	(251.85)	(54.38)	(266.2)	(247.46)		(442.6)	(106.24)	(491.61)	(432.44)	
	[p25; p75]	[-2.9;21.1]	[1.78;25.0]	[-0.4;22.6]	[-23.2;16.5]		[-6.5;16.6]	[-0.3;14.6]	[-6.4;18.5]	[-27.;13.3]	
	n	1,622	344	1,052	224		1,622	344	1,052	224	

B) DEBT		SIZE WEIGHTED				F-test of equality between time periods	EQUAL WEIGHTED				F-test of equality between time periods
		Full Sample	1991-2001	2002-2007	2008-2015		Full Sample	1991-2001	2002-2007	2008-2015	
Public Market Equivalent (vs. JPM CEMBI Broad Diversified)	median	0.97	Index does not exist	1.01	0.94		1.00	Index does not exist	1.03	0.96	
	mean	0.96		1.01	0.91	***	0.98		1.03	0.94	***
	std. dev.	(0.14)		(0.13)	(0.13)		(0.14)		(0.13)	(0.13)	
	[p25; p75]	[0.89;1.04]		[0.93;1.08]	[0.84;0.99]		[0.91;1.06]		[0.96;1.09]	[0.86;1.02]	
	n	1,109		562	547		1,109		562	547	
Internal Rate of Return	median	6.38	8.30	7.10	4.10		7.50	8.48	7.61	5.04	
	mean	5.70	7.66	7.03	3.29	***	6.25	6.16	7.81	4.75	***
	std. dev.	(6.05)	(5.49)	(4.44)	(6.8)		(7.86)	(10.22)	(4.33)	(6.05)	
	[p25; p75]	[4.06;8.54]	[7.07;9.70]	[5.48;8.83]	[2.41;5.92]		[4.91;9.42]	[6.56;10.5]	[6.06;9.20]	[3.15;7.18]	
	n	1,962	841	574	547		1,962	841	574	547	

Source: IFC equity investments that have been fully sold (or written off) and senior loans that have been fully paid down (or written off). Projects are grouped by vintage year, so that a project in the data dated 2008 may have been closed as recently as June 2018.

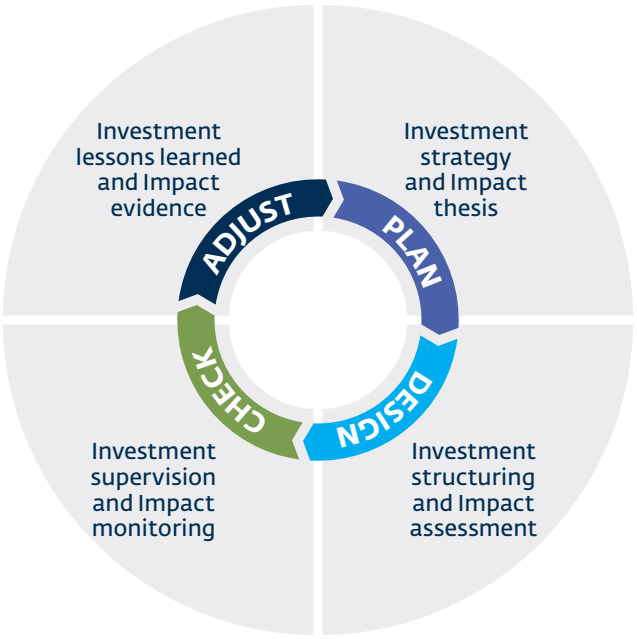
*Note: PME is calculated following Kaplan and Schoar (2005), and may be understood as a market-adjusted multiple of invested capital, greater than 1.0 if the investment delivers return greater than an equivalently timed investment in the market index. A PME of 1.20, for example, implies that, at the end of the investment, an investor ended up with 20 percent more than they would have if they had invested in the public market. In this example, if $100 invested in public markets would have yielded $200 after seven years, the private investment yielded $240 over the same time. Asterisks indicate that one should reject the null hypothesis that average returns are constant across time periods, and the statistical significance level of the F-test: *p<0.1, **p<0.05, ***p<0.01*

Annex D: Impact Measurement

Within a result-oriented effective management system

Impact measurement is a core component of an effective results-oriented management system and the foundation for management that seeks to continuously optimize outcomes. It is not a one-time documenting or accountability-focused activity conducted at the beginning or end of an investment. Just as financial considerations are integrated throughout the investment process, impact and measurement considerations should be embedded within an impact investor's strategy, structuring, supervision, and, wherever possible, within investment exits. Throughout the investment cycle, both financial and impact considerations can be thought of as part of an iterative, four-step, continual improvement, management process (Figure D.1).[20]

FIGURE D.1 Financial and Impact Management Lifecycle



An investor's impact measurement system may be designed to support this continual improvement process. The table below illustrates the overarching core questions any impact investor should be asking themselves in managing for both financial returns and impact (Table D.1).

The answers to these questions will differ among investors, and their impact measurement systems should reflect this. For example, what is suitable for a large institutional investor investing across asset classes, impact mandates, industries, and geographies would look very different from what is suitable for a small foundation looking to invest in a single country. Just as each investor has his or her own investment strategy, a rationale for that strategy, and ways for assessing performance of that strategy, each impact investor should look at impact considerations through the lenses of their specific answers to the questions above. The framework applied to address these key questions constitutes the investor's *impact measurement framework*.

The impact measurement framework thus forms the basis of an overall impact management system. Just as investors have a system to manage and measure financial performance throughout the investment process, impact investors should have a system to measure and manage impact performance as part of an end-to-end process. The analytical model to understand the impact measurement is defined through the core dimensions within an impact measurement framework, as shown in Table D.1:

- **Impact thesis**
- **Impact assessment and monitoring**
- **Impact evidence**

[20] Based on the Deming PDCA (Plan, Do, Check, Act) cycle for continuous quality improvement. Ishikawa 1985.

TABLE D.1 Core Questions That an Investor's Management Systems Should Address

PHASES	Overarching question	Financial view	Impact view
PLAN	*What* is the investor's mandate and strategy?	What is the **financial thesis** including risk/return profile and target returns? **How will the investor's strategy deliver these returns?**	What is the **impact thesis** including the intended social and environmental outcome?[21] **How is the investor's strategy linked to expected outcomes?**
DESIGN	*Who* to invest in, allocation of capital?	What is the approach to **origination and structuring** of the investments and what is the expected financial return and risks?	What is the approach to ex-ante **impact assessment**, including risks and how it may affect decision making and approach to strengthen impact potential?
CHECK	*How* will success and progress be continuously measured?	What type of **financial data** should be used during supervision to monitor performance against goals?	What type of data and indicators should be used for **impact monitoring** against goals?
ADJUST	*Where* are improvements possible?	What are the **corrective actions** needed to secure best possible returns? What are the lessons learned to improve **returns** and lower **risk** within future investments?	What are the **corrective actions** needed to secure best possible outcomes? What are the lessons learned and **impact evidence** created that will enable improved ex-ante assessments and outcomes in future investments?

FIGURE D.2 Impact Measurement's Role in Shaping and Scaling the Impact Investment Market[22]

Measurement's role in growing the market

In any market, limited use of standards is a formidable barrier to the effective and efficient allocation of resources. An agreed-upon set of principles, frameworks, and metrics can allow financial markets to scale. What distinguishes impact investing from traditional investing are data and information on social or environmental outcomes, alongside financial returns. For impact investing to truly scale, impact measurement systems need to secure the following three elements (3Cs): Clarity, Credibility, and Comparability, around this "impact" information.

- **Clarity.** There is significant confusion on how to measure impact in the impact investment market, which is a critical barrier to scaling the market.[23,24] Transparency on concepts and approaches to impact measurement will help increase the efficiency of markets, reduce information asymmetries, support evidence-based decision making, and build trust in the industry among asset owners and asset allocators. Clarity also means recognizing uncertainties and risks.

[21] Outcomes are the short-term and medium-term effects of an investment's outputs, while the outputs are the products, capital goods, and services resulting from the investment. Adapted from OECD-DAC.

[22] IFC staff, International Finance Corporation, 2019.

[23] Hupp and Silva 2013.

[24] OECD 2015.

- **Credibility.** Impact investors, particularly in mainstream financial markets, need to show stakeholders that they are managing (and delivering) for positive impact. Robust impact measurement practices (and resulting data) can help establish the credibility of investors and avoid accusations of "impact-washing,"[25,26] where the investor uses impact jargon or marketing to raise money or burnish reputations without delivering real positive impact. Beyond clarifying approaches to impact, the use of rigorous impact measurement based on evidence and performed free of undue political influence,[27] can help to generate trust.
- **Comparability.** Finally, comparing impact performance results, both internally and externally, allows asset owners, allocators, and managers to make informed decisions on the best allocation of funds. Making results comparable requires that impact measurement practices are based on shared fundamentals, principles, standardized indicators, and industry benchmarks. Comparability is perhaps the greatest challenge, given the inherent subjectivity in assessing impact.

[25] Ethical Corporation 2018.

[26] Rust 2018.

[27] To ensure credibility and safeguard against undue political influence, responsibility for the design of impact measurement should be independent from operations.

Annex E: Designing a Measurement Framework Around An Impact Thesis

The impact thesis articulates the overall intention of the investors, and their contribution to achieving that intention. Designing an impact measurement framework around an impact thesis ensures that investors collect relevant information that will allow them to manage for the intended impact, as well as document, assess, and communicate about impact performance success. This thesis is thus crucial for deciding which data to collect and the level of rigor of evidence needed, as well as how to go about actually collecting this information.[28] Explicitly stating an impact thesis enables investors (and other stakeholders) to define the scope of the potential impacts of their investments, and better understand and strengthen the processes to maximize their results, as well as to test the extent to which results align with the expected theory of the intervention.[29]

Notably, an impact thesis is based on the ultimate impacts the investor seeks, and not necessarily what the recipients of this "impact" want and need. For example, an investor may be focused on providing access to clean water for rural underserved populations in Uganda, but these individuals may prioritize access to employment and education above access to clean water. Incorporating the voice of the beneficiary is increasingly a key aspect of many investor's approaches to impact measurement, but is not specifically a focus here.

In developing (and updating) the impact thesis, evidence should be used as the basis, as much as possible, to ensure a high level of credibility that the outcome may be achieved, and that it is aligned with the investment strategy. The evidence applied should represent a balanced perspective on the topic addressed with a focus on the rigor, as well as the relevance. Sources of evidence can include: internally produced evidence derived from monitoring of previous investments, different forms of feedback from end-beneficiaries or stakeholders, and/or evaluations.

An impact thesis can take many forms and is often referred to as a "theory of change," "results chain," or "logic model." This terminology has its roots in the evaluation of international development programs and projects;[30] the components of these approaches include inputs, activities, outputs, outcomes, and impacts. Extensive literature exists on what falls under these different components and how impact investors can apply this thinking to their frameworks. Investors can also approach their impact thesis though the use of a "line-of-sight". Rather than distinguishing between outputs and outcomes (which can often be tricky), a line-of-sight[31] articulates the linear connection and linkages between an investor's strategy and the ultimate impact outcomes sought.

Depending on the number and complexity within the sector targeted, the investors may utilize a single, overarching, impact thesis for their portfolio, while others may operate across several impact theses.[32] For example, an investor that invests in one sector in similar types of companies, and in similar geographies, may be able to use one overarching thesis for all investments. However, an investor who invests in sectors such as health, education, and energy could have a high-level overarching thesis for the entire portfolio, but would need more specific theses to establish the basis for what to measure and why.

Finally, some impact theses focus solely on achieving project outcomes, while others may include the ambition to contribute to systemic effects. Systemic effects are impacts beyond the direct/indirect investment stakeholders, such as broader impacts on markets or regulation. Increasingly, contributing to systemic changes is considered critical to the achievement of the SDGs and the Climate Goals. Investors that target these types of impacts as part of their investment mandate, including many MDBs and DFIs, should include them in their impact thesis, and therefore what they measure and monitor. See Box E.1 below with a case that is an example of a shorter impact thesis from IFC.

[28] Kazimirski and Pritchard 2014.

[29] Jackson 2013.

[30] Ebrahim and Rangan 2014.

[31] See https://www.changefactory.com.au/our-thinking/articles/implementing-transformational-change-through-a-line-of-sight/.

[32] Saltuk and Idrissi 2015.

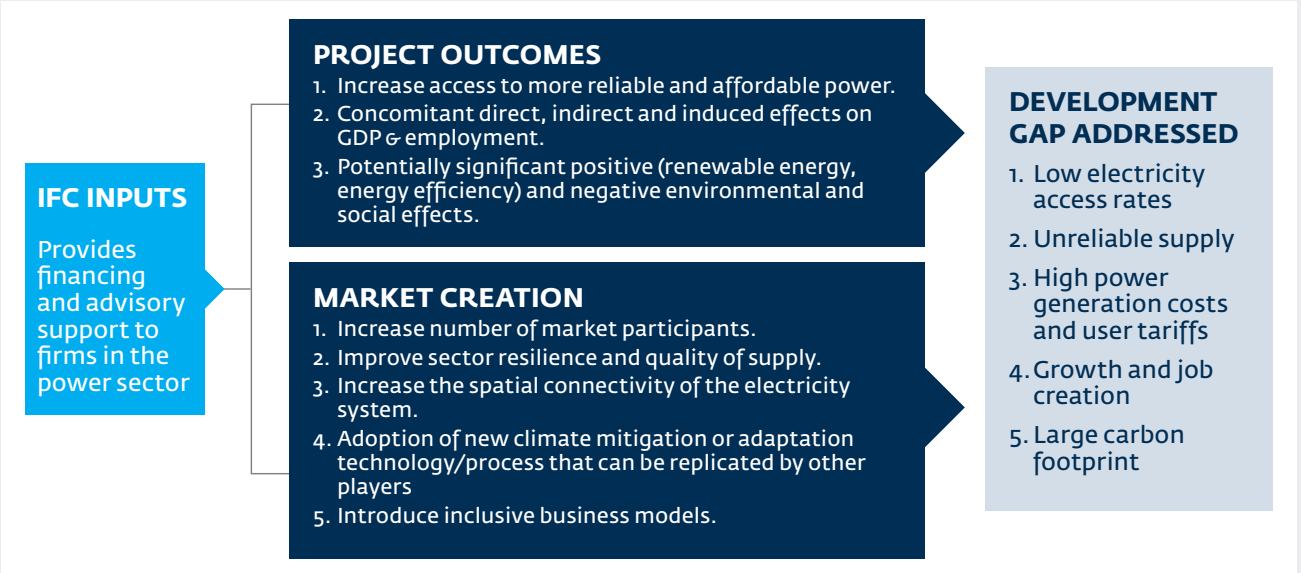
BOX E.1 Case Example—IFC Power Sector Impact Thesis

Enhancing access to power is a key priority for IFC and the World Bank Group. A significant number of developing countries face large power deficits, with important implications for economic growth and human development. An estimated 1.2 billion people, globally, live without electricity, almost all in developing countries and about half in Africa. Quality of electricity services is also the most frequently cited obstacle to doing business in developing countries where firms also rely on expensive back-up options to stabilize supply. Electricity access, quality, and costs have limited firms' contribution to growth and job creation, through negative effects on firms' productivity, cost-competitiveness, and investment decisions.

IFC's engagement in the power sector is designed to help client countries secure the affordable, reliable, and sustainable energy supply needed to end extreme poverty and promote shared prosperity. This strategy mirrors the objectives of the Sustainable Energy for All Initiative, and SDG7: achieving universal access, accelerating improvements in energy efficiency, and doubling the global share of renewable energy by 2030. Meeting these goals requires a concerted push toward sustainable options for energy access, including on-grid and off-grid, as well as other viable, low-carbon solutions that reflect every country's unique endowments. Because energy-related activities are the largest emitters of greenhouse gases, accounting for more than a third of global CO_2 emissions, there is strong overlap between SDG-7 and the climate change agenda embedded in SDG-13: take urgent action to combat climate change and its impacts.

IFC's power sector investments seek to catalyze changes in the market that are beyond the project's direct and indirect effects. For example, IFC projects may support the power sector's competitiveness through enabling improvements in the market structure and regulation, as well as via catalytical effects on the market through the introduction of innovative technologies and processes. IFC projects may support energy resilience through targeting systemic effects on diversification of the electricity generation mix, and improving resilience of electricity infrastructure to enhance the sector's adaptability to potential shocks, including climate risks.

FIGURE E.1 The Power Sector's Project and Market Impact Channels



Annex F: Measurement Frameworks Applied to a Hypothetical Investment: Water Drip

To provide a tangible example of how each framework archetype can be applied, we have outlined a simplified hypothetical investment example, described in Box F.1 below. Through this case we will illustrate an example of how each of the three impact measurement frameworks could be applied to assess the impact of an investment ex-ante, and monitor impact as part of investment management.

IMPACT TARGET FRAMEWORK

Using a target framework approach, an investor might assess the impact ex-ante and set targets focused on the number of drip irrigation systems expected to be sold to smallholder farmers. Targets may or may not be set based additional indicators (for example, average increase in income for smallholder farmers). Targets may also be set for the multiple aspects of positive and negative impacts stemming from this investment.

- The number of expected smallholder farmer clients during the investment period:
  - » Reach: **500,000**
- The average amount of the increase in income generated from the expected increase in yields:
  - » Depth: **$100/year**

Monitoring would focus on collecting data based on these (and other relevant) indicators and monitored against targets.

IMPACT RATING FRAMEWORK

Using a rating framework approach to this investment, an investor could combine multiple aspects of positive and negative impacts stemming from this investment. This could include: (a) the potentially positive impact on smallholder farmers, (b) negative impacts through increased water usage, (c) the ripple effects on jobs and incomes throughout the supply chain, and other factors. The material outlined below focuses on the potentially positive impacts on farmers:

- The number of expected smallholder farmer clients during the investment period—assessed against a scale defined though similar types of investment:
  - » Reach: 500,000 = **medium rating**
- The amount of potential increase in income generated from the expected increase in yields—benchmarked against the current level of smallholder farmer income within the investors targeted geographies:
  - » Depth (people): **$100/year = medium rating**

BOX F.1 Hypothetical Investment Example

Investment description: An investor is looking to make a $25 million equity investment in Water Drip and expects to hold this investment for five years. Water Drip, a drip irrigation company, produces drip irrigation equipment that can increase the yields of smallholder farmers. The company sells to a variety of types of famers, but sees an opportunity to expand into a new geography.

Impact thesis: Smallholder farmers within the new geography do not get optimal yields due, in part, to the negative impact of inconsistent rainfall. The investment in Water Drip will allow the company to expand its sales. As a result, smallholder farmers will be able to affordably access equipment that can lead to increased yields and increased incomes.

Evidence: Macro studies have shown a significant relationship between increases in yields and overall farmer income. Micro evaluative evidence related to this product has documented increases in yields of up to 30 percent for a number of crops, with an ROI of less than two years for farmers that own more than a minimum number of hectares. Feedback collected from customers has been overall positive.

- The demonstration effect within the market—considered against a market maturity typology:
  - » How much or how likely the investment is likely to spur competition = **high rating**
- This can be combined into an overall score at the investment level = **high rating**

Building on the target framework, impact monitoring can be based on collecting data related to one or more of the aspects highlighted above. For example, some investors may choose only to collect data as part of ongoing monitoring based on "reach" data, while others may choose to collect data on all aspects that feed into the overall rating. Performance can be assessed relative to what was expected.

IMPACT MONETIZATION FRAMEWORK

Using a monetization framework approach to this investment, an investor would look at multiple aspects of positive and negative externalities stemming from this investment. This could include the potentially positive impact on smallholder farmers, negative impacts through increased water usage, the spillover effects on jobs and incomes throughout the supply chain, as well as other factors. What is outlined below is only focused on the potentially positive impacts on farmers:

- The number of expected smallholder farmer clients during the investment period:
  - » 500,000
- The amount of potential increase in income generated from the expected increase in yields (benchmarked against the current level of smallholder farmers' income within the investors' targeted geographies):
  - » $100/year (for five years)
- This may then be discounted for various factors (such as the rigor of evidence, risk of famers being unable to sell increased yields, and so forth):
  - » Likelihood of realizing the potential impact = 75 percent
- Some investors may also account for their percentage stake in the investment:
  - » Investment stake = 50 percent
- Investors may also account for the size of the investment:
  - » Investment size = $25 million

Final calculation: 500,000 farmers X $100/increase in income per year X 5 years = $250 million in potential impact generated. Discounted for the likelihood of impact (75 percent) and the investment stake (50 percent) = $93.7 million. Divided by the investment size = **$3.75 of social return on investment** for every $1 investment.

Annex G: Standardized Indicators Used in the Impact Investment Industry

B Impact Assessment (BIA)

The BIA assesses a company's overall social and environmental performance by measuring its impact on stakeholders, and therefore can be a useful tool to capture aspects of impact strategies within impact investing. The BIA is a set of questions (based on underlying indicators) that differ based on the sector and market in which the company operates. The BIA is the basis for the Global Impact Investing Rating System (GIIRS), a tool that can be used to assesses companies and funds based on their social and environmental performance. The BIA and GIIRS are managed by B-Lab.

See https://bimpactassessment.net.

Global Reporting Initiative (GRI) Standards

The GRI Standards provide guidelines to help businesses, government, and other organizations understand and communicate publicly on a range of economic, environmental, and social impacts. The GRI Standards provide lists of indicators/disclosures through the universal standards that can be used by every organization as part of its sustainability reporting, as well as sector-specific standards based on material topics. The GRI Standards are managed by the Global Reporting Initiative.

See https://www.globalreporting.org.

GRESB

Launched in 2009, the GRESB assesses the sustainability performance of real estate and infrastructure portfolios and assets, worldwide. We offer ESG data, Scorecards, Benchmark Reports, and portfolio analysis tools. The assessments are guided by what investors and the industry consider to be material issues in the sustainability performance of real asset investments and are aligned with international reporting frameworks such as the GRI and PRI. Assessment participants receive comparative business intelligence on where they stand against their peers, a roadmap with the actions they can take to improve their ESG performance, and a communication platform to engage with investors. Investors use the ESG data and the GRESB's analytical tools to improve the sustainability performance of their investment portfolios, engage with managers, and prepare for increasingly rigorous ESG obligations.

See https://gresb.com.

Harmonized Indicators for Private Sector Operations (HIPSO)

HIPSO is a list of 38 reporting indicators, across 15 different sectors and industries, which have been agreed by 25 different development finance institutions (DFIs). Fifteen of the HIPSO indicators are aligned to the Impact Reporting and Investment Standards (IRIS) metrics. The indicators have been developed by a working group whose goal is to reduce the reporting burden of shared clients, aggregate and share data among international financial institutions (IFIs), and facilitate learning. While designed by DFIs, many of the indicators are applicable and useful for impact investors, although they do not cover the full range of possible effects sought by impact investment strategies.

See https://indicators.ifipartnership.org/.

Impact Reporting and Investment Standards (IRIS)

IRIS is a catalog of over 400 generally accepted metrics that can be used to measure social, environmental, and financial performance. IRIS serves as the taxonomy, or set of terms with standardized definitions, which investors can use to pick metrics that align with their objectives. IRIS metrics are aligned with the various aspects of impact investing, as outlined in this report, and can provide many investors with a comprehensive basis for indicator selection. The IRIS database is currently being re-designed to align with the shared fundamentals of the SDGs and the Impact Management

Project (IMP), which will further increase the database's accessibility and utility. In total, 59 percent of the GIIN survey respondents are using metrics aligned with IRIS. IRIS is managed by the GIIN.

See https://iris.thegiin.org/.

Sustainable Development Goal (SDG) indicators

The SDG indicators, which have been defined for each SDG, comprise a total of 230 agreed-upon indicators. The target audience for reporting on these indicators is government, not impact investors. However, a number of initiatives have translated/aligned these indicators to existing enterprise indicators, which can be useful for investors. Once such initiative is the SDG Compass.

See https://sdgcompass.org/business-indicators/.

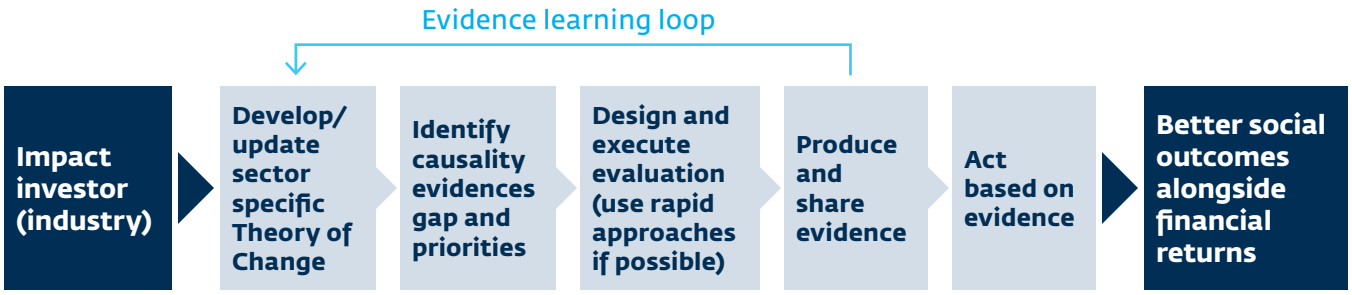
Sustainable Accounting Standard Board (SASB) Standards

These standards are focused on a small set of industry-specific disclosures (on average, five topics and 13 associated metrics per industry) that are deemed to be financially material (as defined by the U.S. Supreme Court). The target audience is thus more limited than the impact investing industry, but still useful, where applicable. The SASB aims to integrate its standards into the requirements for filing 10-Ks with the U.S. Securities and Exchange Commission and other financial regulatory bodies. The SASB Standards are managed by the Sustainability Accounting Standards Board (SASB).

See https://www.sasb.org/.

Annex H: Process for Strengthening the Impact Evaluation Evidence Base

FIGURE H.1 Process for Strengthening the Evaluation Evidence Base[33]



Over the last decade, evaluations focusing on the impact achieved from private sector engagements have been produced;[34] however, this is still a relatively immature field, with room for improvement in terms of better dissemination and application of robust knowledge, as well as identifying and closing knowledge gaps. Below is a simple evaluation evidence process (Theory of Change), which can guide both the individual impact investor, but more importantly, guide the impact investing community.

Box H.1 below is an example case about completed evaluations that illustrates the last part of the change pathway. Box H.2 provides an example of a Theory of Change that shows how evidence is mapped to illustrate the first half of the change pathway.

Within the proposed evidence evaluation process illustrated in the figure above, we want to highlight four key considerations important for impact investing industry participants as they build the needed evaluative evidence base:

1. **Acknowledging the role of both evidence users and producers.** Producing (and using) rigorous impact evidence must not become a market entry barrier. Most private impact investors may find it easiest to use existing evaluation evidence when developing their impact thesis/framework. For example, an investor in girls' education would not need to conduct their own rigorous evaluation to establish the relationship between education and improved economic opportunities for women. Rather, within their thesis, they could reference and link to external evidence, already conducted, which establishes the basis for this linkage. By helping to anchor the impact thesis, it can also influence the types of investments made (doing), the types of impact data collected (checking), and feed this back into what has been learned (adjusting).

   There are multiple resources available that impact investors can tap into for existing evidence including: the MDRC, a non-profit, social-policy research organization; the Abdul Latif Jameel Poverty Action Lab (J-PAL); and Innovations for Poverty Action (IPA). Additionally, initiatives like the GIIN's Navigating Impact[35] project, are pulling together examples of rigorous evidence, and connecting these to the common impact objectives of impact investors.

   Larger, established impact investors are playing a critical role as evidence users, but also as producers. The MDBs and DFIs, given their current majority share of impact investing in emerging markets, their long track record of investing for impact, and their public ownership structures, are in a unique position to collectively take the lead in developing and sharing evaluation evidence to ensure the credibility and effectiveness of capital allocations, and also to help scale the market. Beyond the evidence

[33] IFC, with inspiration from Shah et al. 2015.

[34] IFC's internal database for demand-driven self-evaluation contains more than 300 completed evaluations from the last 10 years.

[35] GIIN. https://navigatingimpact.thegiin.org.

produced within the impact investment industry, public institutions, philanthropy foundations, and academia can also play a role in the producing and sharing of evidence as a public good, which will facilitate private impact investors achieving greater positive outcomes.

2. **Causality is key, and investors should focus on partial,[36] rather than sole, attribution.** Impact was defined as causality in Section 1, and contribution was established as a key attribute of impact investing and should thus be a clear focus point in creating the evidence base at a micro level. Improved understanding of how changes occur, and what role the investor plays, are critical to increase effectiveness within impact investing. Applying a sole versus partial attribution[37] criterion to determine the value of the evidence is, for most impact investors, of little practical value and thus not in demand,[38] and for good reasons. Most impact investors do not work in solitude with the investee enterprise, and many key influencers are engaged within an open complex dynamic context, making attribution analysis challenging, time consuming, and often costly. It is excellent if sole attribution can be established,

BOX H.1 Case Example: Increasing Women-owned Business Banking in Pakistan

In Pakistan, in 2011, only 3 percent of the female population had access to a bank account, and women-owned businesses faced a credit gap of $179 million. Pakistan was ranked 135 in the Global Gender Gap report of 2013, the lowest in the region, and second-lowest among all ranked countries (136). Since 2006, IFC has partnered with Habib Bank Limited (HBL), the largest commercial bank in Pakistan. The relationship with HBL has been growing through several IFC investment and advisory engagements—the latest being an equity investment and a senior loan (both in 2015). This was the first investment IFC made with the explicit impact thesis to support finance for women-owned businesses. IFC's additionality included, for example, the provision of long-term U.S. dollar loan funding, as well as capacity building and knowledge transfer through an advisory services program. To date, the financial returns have been very satisfactory, and the equity share was successfully reduced in 2017.

Since then, HBL has launched a sub-brand called "HBL Nisa" to target women. At the same time, HBL has set up a women's business unit, increased key performance indicators (KPIs) for women's deposits, appointed a diversity manager, and trained HBL staff on gender intelligence.

Using quasi-experimental methods, IFC conducted a rapid evaluation to gauge the cause and effect of the gender intelligence program. The evaluation examined the differences between employees who have undergone training compared to untrained employees. Over 13,000 HBL employees were surveyed, with branch level data analyzed for the years 2014–16. This study showed that branches whose managers have been trained in gender intelligence demonstrated a 10 percent increase in the volume of deposits from women-owned accounts when compared to branches with untrained branch managers. This supports IFC's decision to continue strengthening its initiative within HBL.

Source: Hamm, Kathrin; Joseph, Roshin Mathai; Veit, Sebastian; Singh, Sandeep. 2017. Gender Intelligence for Banks—Moving the Needle on Gender Equality. International Finance Corporation Washington, DC.

[36] To avoid confusion between investor contribution, as discussed earlier in this flagship report, partial attribution is used here in the same manner as evaluation contribution terminology.

[37] Pritchett 2017.

[38] Vosmer and de Bruijn 2017.

but it should not be a requirement within building the evidence base for impact investing. In applying partial attribution, the investor should ensure not to overstate claims of impact by making their small or large contribution clear.

A range of approaches[39] can be used to robustly address the question of causality from (quasi) experimental approaches involving in-depth data collection, through to more qualitative theory-based studies.[40]

3. **Investors should design fit-for-purpose approaches to evidence, combining direct, decision-focused, and more knowledge-focused evidence methods.** There are fundamental differences between engagement in public sector reform and private sector investments, with implications for the design of impact evidence approaches. Within impact investing, the relatively shorter management decision timeframe, the investment time horizon, and the often smaller investment value, limit the value of often-costly, multi-annual, larger (quasi) experimental impact evaluations. These statistically compare a "treatment" group to a control group with similar characteristics, based on baseline (at entry) and end line data (ex-post) for both groups, and they have risen to prominence as part of a global learning agenda.[41] Beyond the high cost of these evaluations, there is the risk that the business and market have moved on before evidence is produced, and its lessons are no longer relevant.[42]

   To be fit for purpose, more rapid decision-focused, cost-effective evaluations need to be prioritized and undertaken. These evaluations can be based on structured rigorous analysis using, for example, a process tracing approach;[43] a qualitative comparative approach;[44] end-beneficiary direct feed-back/experiences; consumer preference/behavioral insights; or econometric in-output statistical analysis, focusing on jobs and GPD growth.[45] The traditional multi-annual impact evaluations should still be conducted, where appropriate, and fit for purpose, based on the objectives and resources of the investor. These are of particular value when performed within larger strategic, selected, and global knowledge-producing and sharing programs.[46]

4. **Evidence from evaluations should prioritize a learning focus.** Evaluations have traditionally had the dual purpose of accountability and learning.[47] Within private impact investing, accountability to the end beneficiaries and society is clearly an important aspect, but it is inherently different from public sector accountability.[48] In private impact investing, it should largely be addressed by the clarity and credibility of the operational impact management systems and the processes adopted by the impact investor. At this early stage of exploring the impact investment market, risk taking and innovation are important, and the choice of evidence, study design, as well as the finding formulations and dissemination, should prioritize delivering on this critical market learning imperative.

39 Picciotto 2017.

40 Jackson 2013.

41 Shah et al. 2015.

42 However the impact investor and business also has to balance the need for rapid evidence and the time it takes to achieve long-term sustainable impact.

43 Bennett 2010.

44 Ragin 1987.

45 In/output modelling analysis focusing on jobs and GDP growth have gained momentum across DFIs in recent years.

46 Examples of programs: Mastercard Foundation/IFC: Financial Inclusion Africa; and GAFSP (Global Agriculture and Food Security Program) a multilateral financial intermediary fund.

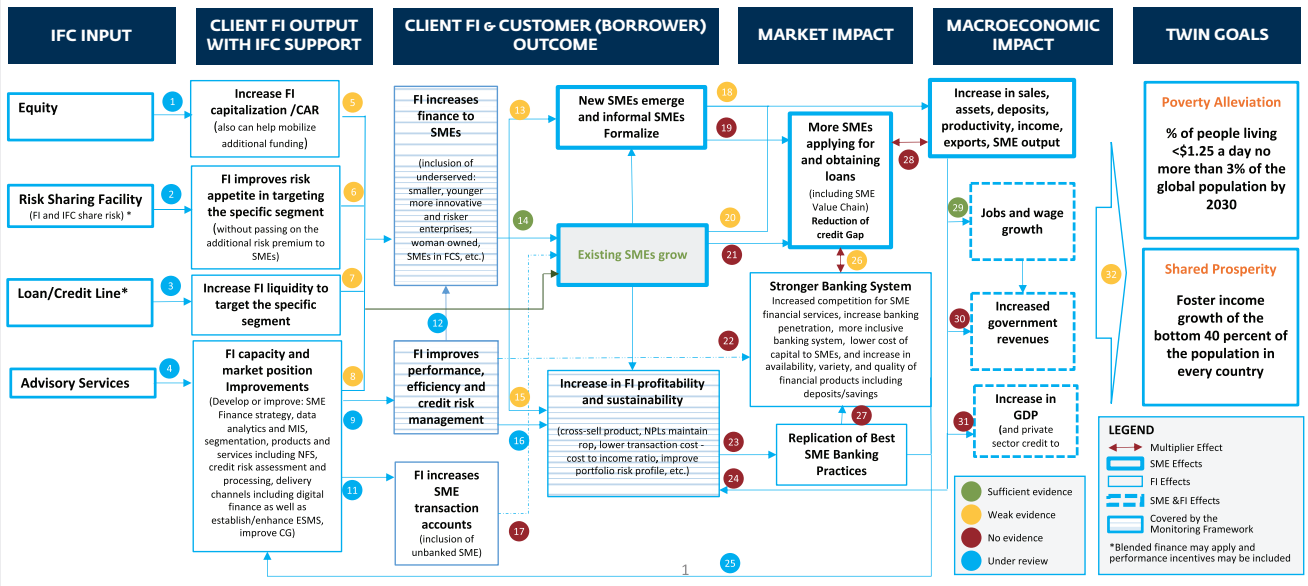
47 See World Bank Group Evaluation Principles. Forthcoming April 2019.

48 Simon 2014.

BOX H.2 Case Example: Theory of Change with Evidence Mapped—Linking SME Banking to Poverty Reduction and Shared Prosperity

This Theory of Change (ToC) with evidence mapped for SME banking was undertaken through collaboration between IFC's Sector Economics & Development Impact Unit and an external consulting firm; and the Financial Institutions Group (FIG), an industry association. The two main objectives were to: (a) strengthen the ex-ante impact potential assessment, and (b) guide the IFC evaluation agenda in SME Banking.

FIGURE H.2 The Power Sector's Project and Market Impact Channels



The development of the above ToC was based on: (a) a review of key IFC FIG strategy documents and board papers; (b) consultation with FIG industry specialists, investment officers, and advisory experts engaged with SME banking interventions; and (c) a scan of the existing literature. This included IFC Rapid Evidence Mapping (REM), which is based on an adapted guideline from the U.K. Government Social Research Unit's Rapid Evidence Assessment Toolkit. This research aimed to map, assess, and communicate the evidence about what works and what is required for it to work.

The evidence mapping suggests that many studies show supportive evidence for the impact that SME lending has on SME growth and wider macro-economic outcomes; however, the evidence base is not, by and large, comprised of studies with credible approaches to identifying causal relationships. Furthermore, the hypothesis that SME lending improves client outcomes would benefit from better definition and more testing across multiple contexts.

Source: IFC 2019. Unpublished material.

Annex I: Legal Disclosure Relevant to Section 2.3

The following notice pertains to the disclosure of the Partners Group PG Life impact measurement framework.

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Annex J: Regulatory Environment for Impact Investing in Select Jurisdictions

This annex reviews the regulatory environment in select jurisdictions as it pertains to allowing fiduciaries to pursue additional objectives, such as social and environmental impact, alongside financial return. These regulations are typically related to the consideration of ESG risk factors in the investment decision. Such regulations are relevant to the extent that impact investors use ESG criteria to select investments.

Asia

Responsible investment in Asia is addressed by various Stewardship Codes, which introduce principles of responsible investment, and also specific initiatives of regional stock exchanges. Over the past four years, six Asian economies—Hong Kong SAR (China), India, Malaysia, Singapore, South Korea and Taiwan (China)—revised or introduced Stewardship Codes regarding responsible investment by institutional investors, including recommendations on voting policy, engagement, and reporting requirements.[49]

National stock exchanges have also recently clarified reporting requirements regarding material ESG factors. The Singapore Stock Exchange (SGX), the Hong Kong Stock Exchange (HKEX, Located in Hong Kong SAR, China) and the Taiwan Stock Exchange (Located in Taiwan, China) have published disclosure and reporting requirements on ESG factors for all listed companies. The Financial Services Authority of Indonesia (OJK) is requiring all financial institutions, issuers, and public companies to prepare an annual sustainability report starting in 2019. The Securities and Exchange Board of India (SEBI) recently extended its mandatory reporting requirements on ethics, human rights, and environmental protection, to the top 500 largest listed companies by market capitalization (up from 100 companies, previously). By 2020, the China Securities Regulatory Commission (CSRC) will require all listed companies to disclose the environmental risks associated with their operations.[50]

European Union

The European Union has embarked on a comprehensive program to integrate ESG considerations into pension fund investment policy and reporting requirements for all member states. These policies are addressed in the 2016 update to the Institutions for Occupational Retirement Provision Directive (IORP II). IORP II requires member states to allow IORPs to (a) consider ESG factors and invest for the long term; (b) consider ESG factors in their governance and risk management; and (c) disclose in the statement of investment principles how ESG factors are considered and reported to beneficiaries. Note, however, that according to IORP II, member states do not have to require pension funds to consider ESG factors.[51]

The 2017 proposal on Pan-European Personal Pensions Products (PEPP), a plan to create unified standards for member states' smaller pension plans, encourages PEPP providers to consider ESG factors in investment decisions and risk management systems, but does not require that they do so.[52] However, regulators are considering taking this additional step: a report issued by the EU High Level Expert Group in January 2018, recommended that regulators clarify "that fiduciary duties of asset owners *should include* integrating environmental, social, and governance (ESG) considerations into decision-making" and that EU directives "*should link* investor duties to the investment horizon of the individuals they serve and to their ethical preferences."[53]

[49] See "Singapore Stewardship Principles for Responsible Investors," November 2016; "Stewardship Principles for Responsible Investors," Taiwan (China), July 2016; "South Korea Stewardship Code: Principles on the Stewardship Responsibilities of Institutional Investors," December 2016; "Hong Kong Stewardship Code: Principles of Responsible Ownership," March 2016; "Insurance Regulatory & Development Authority (IRDA) Stewardship Code for Insurers," March 2017; Malaysia Code for Institutional Investors, March 2014.

[50] Sustainable Stock Exchanges Initiative 2018.

[51] E.U. 2016.

[52] Eatock 2018.

[53] EU High-Level Expert Group on Sustainable Finance 2018.

The EU also requires companies to report on ESG factors material to their businesses, which may aide asset managers and pensions in measuring the impact performance in their funds. In 2017, the European Commission released non-binding guidelines on "methodologies for reporting non-financial information" for companies with 500 employees or more.[54] In principle, such regulation will make it easier for impact investors to select investments in large companies.

Japan

Japan issued a number of new regulations relevant to responsible investment in 2017. The Stewardship Code was revised and published in May 2017, promoting engagement between institutional investors and portfolio companies to "enhance medium- to long-term returns and improve investee companies' sustainable growth prospects." Material ESG factors are considered an essential part of this engagement process. The Stewardship Code further clarifies the relationship between asset owners and asset managers regarding responsible investing, noting that "asset owners have a duty to make clear their intentions and to assess asset manager performance without placing undue emphasis on short-term performance." Asset managers are required to "provide services as expected," and report in clear and concise terms to their clients.[55]

In addition, the Ministry of Economy, Trade and Industry released the "Ito Review 2.0" in May 2017, including recommendations on environmental and social issues.[56] Finally, a significant development occurred in July 2017, when Japan's Government Pension Investment Fund (GPIF), the world's largest pension fund with assets of $1.6 trillion, executed its first ESG-compliant investment with a $10 billion allocation to three passive ESG indices in Japanese equities.

Netherlands

Regulations on pension funds in the Netherlands include a duty to report on responsible investing practices, and to collaborate with beneficiaries in shaping investment policy. The "Code of the Dutch Pension Funds" includes three standards, numbers 27, 28, and 29, aimed specifically at outlining the role of fiduciaries on responsible investing. The provisions state that pension funds must consider long-term liabilities, acceptable levels of risk, and mission characteristics when seeking to optimize returns; must document and report to stakeholders their considerations with respect to responsible investing; and must engage with stakeholders to ensure input and support for responsible investment policies.[57]

The Pension Act also contains a provision on reporting requirements for responsible investing, stating "pension funds must explain in their annual report how their investment policy takes account of issues relating to the environment, climate, human rights and social relations." In addition, Dutch law prohibits pension funds from investing in businesses that produce cluster munitions, use child labor, or violate human rights, and the government has empowered the Dutch Pension Fund association to produce guidelines for implementing, monitoring, reporting, and evaluating responsible investing policies.[58]

Some Dutch pension and sovereign funds have been leaders in responsible investment. For example, in December 2018, 70 Dutch pension funds, with assets of $1.2 trillion, signed a covenant with non-governmental organizations (NGOs), trade unions, and the Dutch government, pledging worldwide co-operation on sustainable investment, specifically to exert worldwide influence on policies and outcomes related to human rights, labor conditions, and the environment.[59]

54 European Commission 2017.
55 Financial Services Agency and Tokyo Stock Exchange 2017.
56 Ministry of Economy, Trade and Industry 2017.
57 Federation of the Dutch Pension Funds and the Labour Foundation 2014.
58 De Nederlandsche Bank N.V. 2016.
59 Preesman and Van Alphen 2018.

United Kingdom

The United Kingdom has introduced new regulation regarding responsible investment over the last few years. In June 2018, the U.K. government issued a report responding to recommendations from the Law Commission regarding pension funds and social investing. The report codified into law several concepts, including a requirement to consider long-term returns and risks, rather than short-term performance; clarification that material ESG factors should be considered as financial, rather than non-financial risks; requirements that social concerns of beneficiaries be incorporated into investment policy; and an edict that trustees make a statement and report on social investing policy.[60]

The government also agreed to support pension providers, academics, government agencies, and industry participants to work toward a common terminology for social investments in order to develop examples of good practice for impact reporting.[61]

United States

Guidance from US regulators on responsible investment permits fiduciaries to consider material ESG risks, but cautions them against the sacrifice of return in the pursuit of social or environmental goals. While this guidance does not, as a consequence, prohibit impact investment, which may seek to achieve commercial returns commensurate with traditional investment strategies, such guidance does make the pursuit of impact investment strategies seeking sub-commercial return more challenging.

In October 2015, the key regulatory body for U.S. public pension funds, the U.S. Department of Labor, issued a bulletin clearing a path for pension funds to consider ESG risk factors, stating that "environmental, social and governance issues may have a direct relationship to the economic value of the plan's investment" and in such instances are "proper components of the fiduciaries primary analysis of the economic merits of compelling investment choices."[62]

An April 2018 bulletin also reiterated a longstanding view that, "because every investment necessarily causes a plan to forego other investment opportunities, plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk as a means of using plan investments to promote collateral social policy goals." By cautioning against investments that might "sacrifice" returns or that may promote "collateral social policy goals," the guidance appears to prohibit fiduciaries from pursuing impact investment strategies that seek anything less than commercial return.

The 2018 bulletin also recognizes a key finding in the literature, that many ESG factors may not be predictive of financial return, suggesting that "fiduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision…. Rather, […] fiduciaries must always put first the economic interests of the plan." Another provision of the 2018 bulletin, regarding publishing a statement on responsible investing practices, says that "investment policy statements are permitted, but not required, to include such guidelines," and if the investment policy does include such guidelines "it does not imply that fiduciaries managing plan assets always have to adhere to them." Finally, the 2018 bulletin notes that shareholder action (which may be used to pursue impact goals) may be costly, and "warrants a documented analysis of the cost of the shareholder activity compared to the expected economic benefit (gain) over an appropriate investment horizon."[63]

[60] The Law Commission 2017.

[61] Department for Digital, Culture, Media & Sport and Department for Work and Pensions 2018.

[62] Department of Labor, Employee Benefits Security Administration 2015.

[63] U.S. Department of Labor, Employee Benefits Security Administration 2018.