Institute for Sustainable Finance

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SUSTAINABLE FINANCE PRIMER SERIES:

Impact Investing

WHAT IS IMPACT INVESTING?

The Global Impact Investing Network (GIIN) defines impact investing as:[1] "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return."

The specific social and environmental objectives desired will vary from investor to investor, and from investment to investment, but the majority are aligned (to varying degrees) with one or more of the UN's Sustainable Development Goals (SDGs).

GIIN identifies the following four key elements of impact investing:[2]

1. **Intentionality:** intentionally contribute to social and environmental solutions, which differentiates it from other responsible investing strategies such as ESG integration, screening, etc.
2. **Financial Returns:** seek a financial return on capital even though this return can range from well below market rate to market rate or above, which distinguishes impact investing from philanthropy.
3. **Range of Asset Classes:** can be made across asset classes and markets.
4. **Impact Measurement:** includes the commitment to measure and report the social and environmental performance of underlying investments, in addition to overall financial performance.

Impact investments may occur in public or private debt or equity markets around the globe. Given the elements noted above, one can visualize a spectrum of impact investing that includes grant support at one end, to focused investments with market rate return (or higher) expectations at the other end.

MARKET CHARACTERISTICS

In April 2020, GIIN estimated the size of the global impact investing market at US $715 billion based on data provided by 1720 investors.[3] The study surveyed 294 of these firms, representing US $404 billion, with the surveyed firms being comprised 65% asset managers (51% profit; 14% not-for-profit), 14% foundations, 5% development financial institutions (DFIs), and another 16% consisting of family offices, diversified financial institutions, pensions, insurance companies, and "other".

RIA Canada estimated the size of the Canadian impact investing market at $14.75 billion at the end of 2017, close to double the 2015 estimate of $8.15 billion and well over three times the 2013 estimate of $4.13 billion.[4] Similar to the GIIN breakdown, the RIA Canada survey indicated 54% of the AUM was with impact fund managers, with another 31% with credit unions and another 8% with Quebec Solidarity Finance.

While the GIIN definition of impact investing provided above is consistent with most commonly used definitions, there is not universal consensus as to what qualifies as impact investing, and what does not. For example, the UN Principles for Responsible Investing (PRI) note that while impact investing clearly extends beyond "ESG-related compliance and investing," the concept has evolved through time leading to an industry that "has expanded and become increasingly complex."[5]

PRI notes that impact investing is now increasingly being integrated into mainstream investing. For example, PRI estimated impact investments of US $228 billion in 2016, based on similar estimates to those used by GIIN above, including grants, blended finance and traditional impact investing. However, when mainstream impact investing assets are also included, PRI estimated US $1.3 trillion in AUM in impact related investments. This is consistent with a recent survey of large institutional asset owners conducted by Morgan Stanley Institute for Sustainable Investing, which found that close to half (48 of 110) of the asset owners surveyed employed thematic or impact investment approaches.[6]

PRI notes that the current impact investing landscape is broad and fragmented, stating: "It is broad because organisations define impact differently..." and, it is "fragmented because there are no basic methodologies, certifications or standards to identify and assess impact investing funds, or to distinguish ESG investing from impact investing."[7]

In order to provide some clarity to the market, PRI developed the Impact Investing Market Map to provide a common definition of thematic investment, some basic criteria to identify thematic investments, as well as some key performance indicators. The PRI Market Map was developed along the following 10 themes: energy efficiency; green buildings; renewable energy; sustainable agriculture; sustainable forestry; water; affordable housing; education; health; and inclusive finance.

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MEASUREMENT AND IMPACT

As discussed above, impact investors have objectives with respect to both impact objectives and financial returns, which may vary considerably from investor to investor. A 2020 GIIN study shows that about two thirds of impact investors pursue risk-adjusted market rate returns, with 18% pursuing below but close to market-rate returns, and 15% pursuing capital preservation.[8]

Virtually all impact investors measure and evaluate their impact. GIIN's survey indicated that over 70% of the surveyed investors reference the SDGs in performance tracking, with the average number of SDGs being pursued being eight. The most commonly referenced SDGs being: decent work and economic growth (71%), no poverty (62%), good health and well-being (59%), and reduced inequalities (58%). Measuring and assessing progress on achieving impact objectives requires identifying specific impact outcomes, determining thresholds in terms of scale and depth that indicate success, evaluating outcomes versus such thresholds, and identifying and addressing relevant risks to achieving these objectives. An important part of the impact measurement process requires reporting of progress to key stakeholders, along with identifying opportunities for improvement.

CURRENT STATE OF THE MARKET

The impact investing market continues to grow at solid rates, and impact investing is making significant inroads into the mainstream responsible investing market. This growth has been driven by client demand, a desire to contribute to local and global communities, an interest in sustainable development, and a desire to align investments with personal values. These motivating factors will only strengthen as millennial investors place greater emphasis on these objectives and values.

As the market has grown there have been improvements in key areas such as relevant market research and common understanding of key market information, improvements in impact measurement and assessment, investment opportunity sets, and government support. However, all of these areas still require significant development, and impact investing remains small in comparison to the total market of investable assets. Remaining obstacles include a shortage of quality deals, a lack of capital, inadequate regulatory clarity, and a general lack of incentives for investment advisors to recommend impact investments.

1 What is impact investing?
2 Ibid
3 Sizing the Impact Investing
4 2018 Canadian Impact Investment Trends Report
5 "Impact Investing Market Map," 2018, PRI
6 Morgan Stanley Sustainable Signals
7 "Impact Investing Market Map," 2018, PRI
8 What is impact investing?

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