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Making an impact

By Tim Ford

For many people 'impact investing' is a relatively new turn of phrase, however the term is gathering significant prominence as media coverage of climate change, excessive use of plastics and biodiversity loss increases significantly. As a consequence we can begin to feel our moral compass shifting as the very real threat of irreversible damage to the earth increases and the need for action grows greater. The natural desire to accumulate wealth, whilst being ever more mindful of the broader issues facing society, investors and wealth providers alike, is refocusing the need to invest with a greater degree of responsibility and target a positive impact from investments.

Jersey has a growing presence in such investment with a clear ability to meet socially responsible investment (SRI) needs. A recent report noted in excess of 30 SRI funds administered in Jersey currently valued at c£7.4 billion. This should be no surprise given Jersey's well respected, flexible and responsive regulator, political stability and strong fund administration and private wealth management capabilities.

THE GROWING TREND IN IMPACT INVESTING

Sustainable and socially responsible investment strategies have gathered considerable momentum in recent years. At the start of 2018, SRI assets across the world's five biggest regional markets stood at $30.7 trillion – a 34% increase in just two years. Increasing awareness of climate change and environmental, social and governance (ESG) issues has generated wider interest in the field of impact investing. Increasingly, investors are demanding measurable social and environmental impacts, greater corporate transparency and a wider range of investment opportunities that better reflect their values. Whilst undoubtedly having an impact on corporate behaviour, there is mounting evidence in the commercial world that sustainable business solutions are ultimately more cost effective for providers, more commercially attractive to consumers and strong drivers of policy change – therefore financially sound.

The world is facing diverse and complex social and environmental emergencies. Climate change, biodiversity loss, modern slavery and the threat of antimicrobial resistance, are among a growing number of sustainability challenges seeking innovative solutions and the investment to help finance them. While companies and the private sector have often shouldered the blame for targeting short-term profits despite the long-term costs, the private sector is crucial to the delivery of positive impacts on social wellbeing and environmental stewardship. For companies and investors alike, investing for positive impact has become a business imperative as well as a moral duty. Investors in Jersey can source investment managers who understand this approach and have the expertise to advise them on strategies and products to reflect their values.

WHAT IS IMPACT INVESTING?

Impact investing looks to generate measurable social and environmental benefits alongside a financial return. These returns can range from below-market to market rate. While ESG factors have a role in impact investing, investment decisions are based on a different set of parameters. While both ESG and impact investing consider business operations (e.g. board composition, workers' wellbeing and supply chain transparency) and company outputs, impact investing places greater emphasis on intentionality and additionality. Is there a clear intention to address the world's sustainability challenges? Do the company's products or services reflect that intention? A company may rank highly in terms of its own operational ESG performance – displaying strong workplace policies, board-level gender equality and good resource management for example, yet if the underlying business or product is environmentally damaging or a risk to public health, it may be difficult to define it as having a positive impact.

However, 'intention' can be measured by impact investors in other ways. Companies not demonstrating a clear link to sustainability in their core operations may nevertheless support sustainable development in a different capacity. For example, this could be reflected in the way they incorporate circular economy principles into their design and manufacturing processes, limiting waste, preserving the value of production resources through recovery and reuse and changing consumer habits. It could also be reflected in a company's 'best-in-class' approach to workforce management, regarding employees as assets to be invested in, not costs to be minimised. This kind of culture promotes good, secure work, reduces inequalities and ultimately demonstrates impact by helping to transform social wellbeing. New technologies also play a prominent role in impact investment decisions, the remote delivery and management of data and energy solutions via the internet of things (IoT) being a recent example.

INVESTING FOR IMPACT

Impact investors can use a spectrum of approaches to satisfy their investment mandates, ranging from applying positive and negative screening strategies, where the intention is to produce market comparable returns, to 'impact first', where investors accept that there may be a trade-off between financial and social returns. Important to any approach is the understanding that accurate calculations of positive net impact require the measurement of both positive and negative factors. Investors may act to avoid social and environmental harm by assessing these impacts to gauge the overall contribution to positive outcomes. They can direct investments to organisations working to benefit people and the planet without necessarily being transformational and they can target others contributing directly to transformational change. >>

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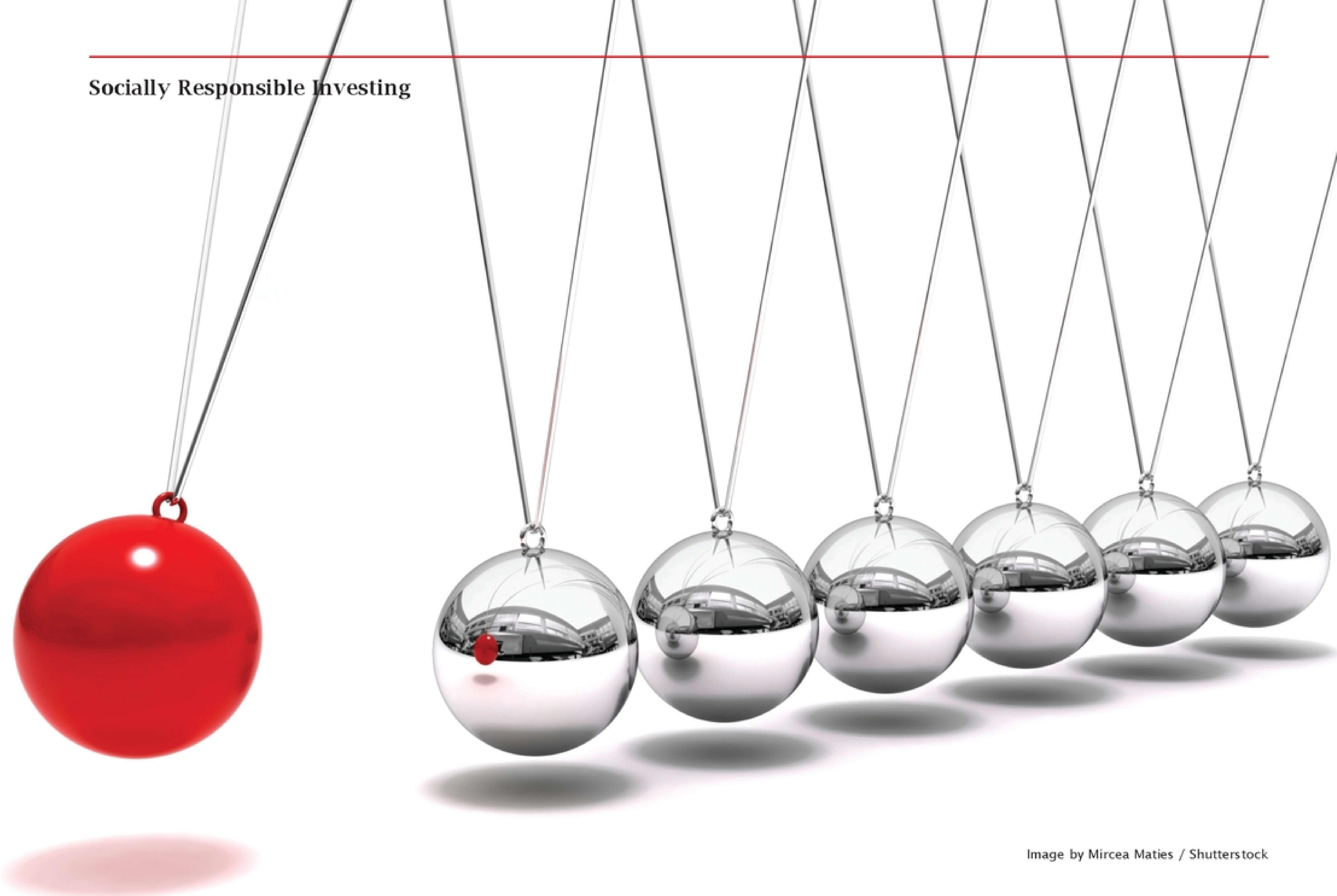

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There are various frameworks available to assess impact outcomes. One prominent example is the UN's 17 Sustainable Development Goals (SDG), which target key areas of global economic, social and environmental concern. The goals between them contain 169 targets, each with between one and three indicators for measuring progress. The SDGs have become a useful metric for impact investors to determine how closely their investments might be aligned to a global sustainable development framework with broad support. The IRIS+ framework, developed by the Global Impact Investing Network (GIIN) is another comprehensive reference point for identifying impacts outcomes to be measured and tracked. Alongside traditional financial performance indicators, investors can obtain a much broader picture of the impact of their holdings through non-financial indicators: is production waste being minimised? How much clean energy has been generated? How have workplace inequalities been addressed? Good or bad, non-financial indicators can help investors assess risk and make a material difference to future financial performance.

Establishing proof of positive impact is a cornerstone of impact investment, yet there is often a scarcity of available and comparable data, plus with reporting requirements falling short of what they could be, a concern that impacts are being assessed on incomplete or unreliable corporate disclosures. There is also the problem of 'impact washing' where organisations align with sustainability trends to enhance their public profiles but do little to incorporate them into their operations.

INVESTOR CONTRIBUTION

When looking at the overall impact of a portfolio, it is also important to consider the impact of the investor alongside that of the underlying holdings. In addition to signalling the importance of social and environmental factors to the wider market, investors can generate substantial positive impact via their engagement activities. Engagement can range from informal dialogue, through to formal measures such as meetings with company boards and filing or voting on AGM resolutions – all aiming to address issues of concern or encourage best practice. >>

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One example is a growing body of investors committed to the Climate Action 100+ initiative, which has brought together over 320 global investors to engage with the world's largest greenhouse gas emitters, encouraging action on climate change, increased board awareness of climate-related risks and enhanced disclosure on these factors. A key achievement of the initiative was Royal Dutch Shell becoming the first international oil and gas company to announce targets for reducing operational emissions along with the net carbon footprint of its energy products. Though causation is difficult to prove definitively, continuous dialogue between the company and a dedicated group of investors undoubtedly had some bearing on Shell's commitment.

A GROWING MARKET

The GIIN estimated the size of the global impact investment market to be $502 billion at the end of 2018. This is collectively managed by 1,340 active impact investing organisations worldwide. While seeming relatively small in comparison to the overall investment market – or the capital flows needed to address global sustainability challenges – it is nevertheless suggestive of a rapidly growing market. As recently as 2015, the Global Steering Group for Impact Investment (GSG) published a market size and forecasting report, estimating that a global investment market of around $138 billion in 2015 would grow to $307 billion by 2020.

With a significant percentage of global assets under management considering sustainability principles and a growing investor base wanting their money to achieve more than purely financial returns, the future looks set for further expansion in impact investment. Jersey's strategy is to integrate the best of the jurisdiction and offer access to our tax-neutral environment, wide range of structures, expert workforce and cross border investment. Add a flexible and enabling environment, international connections, knowledge and expertise, plus innovation in service, product and instrument and Jersey offers a leading jurisdiction for impact, environmental, social and governance solutions to private clients and institutional investors as they explore global impact opportunities.

Increasing awareness of climate change and environmental, social and governance (ESG) issues has generated wider interest in the field of impact investing

STILL FURTHER TO GO

The financial services industry has made significant inroads in being able to offer investors a greater array of services that augment the work being done by companies to lessen their impact on the environment and enhance the world we live in, whilst being able to offer attractive investment returns. Some investment companies have been providing investors with such opportunities for a significant period of time and have a high degree of experience in this area, however as coverage of the issues being faced gathers momentum, it is acknowledged there is more to do and a greater impact still to be made. The good news is the bow wave of support and awareness continues to build and the multiplier effects of our collective efforts are turning the tide.

Tim Ford

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Tim is responsible for managing private client, trust and charity investment portfolios. He forms part of the Jersey investment committee and also sits on the Rathbone Group Fixed Income and the Managed Funds Selection Committees and is responsible for the selection of Japanese funds for the Group.

Tim is a Chartered Member of the Chartered Institute for Securities and Investment.