Impact investing: a win-win alternative?

More insurers are discovering how to achieve market rate financial returns alongside intentional as well as measurable environmental and social outcomes, says Jonathan Dean, Head of Impact Investing at AXA IM.

"Around the year 2030, 10 years 252 days and 10 hours away from now, we will be in a position where we set off an irreversible chain reaction beyond human control that will most likely lead to the end of our civilisation as we know it. That is *unless* in that time, permanent and unprecedented changes in all aspects of society have taken place, including a reduction of CO_2 emissions by at least 50%."

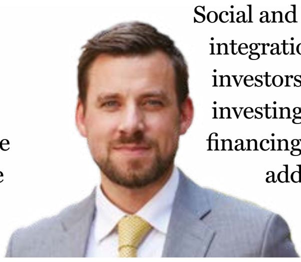
That was 16-year-old Swedish climate activist Greta Thunberg, speaking to the UK parliament last month in just one of a series of powerful speeches aimed at inspiring collective action around the world. And now it's impossible for financial institutions to ignore the increasingly urgent calls to action surrounding climate change.

At the same time as Thunberg's address for instance, central banks and supervisors were calling for collective action. The governors of the Bank of England and the Banque de France, together with the chair of the Network for Greening the Financial System (NGFS), warned in an open letter that, "the catastrophic effects of climate change are already visible around the world... These events damage infrastructure and private property, negatively affect health, decrease productivity and destroy wealth."

They pointed out that apart from the human costs, weather events are costly from a financial perspective.

Rising to the challenge

While the world at large is coming to realise that climate change is a challenge that cannot be solved by one country, one region, or one economic sector alone, substantial progress is being made in some areas.



Leading insurers, like AXA, are rising to address the climate challenge and reframing it as an opportunity worthy of their best efforts and resources. Jonathan Dean, Head of Impact Investing at AXA IM explains: "The insurance industry is uniquely well placed to influence and give momentum to sustainability efforts. And that applies to participants across all lines of business. It should include all key functions in an insurance company, from risk management and underwriting, through sales and marketing to investing.

"We are seeing globally organised collective initiatives, substantial commitments to investing in green assets, the establishment of robust climate policies and the exclusion of the most CO_2-intensive sources of energy from investments or underwriting – just to name a few areas where progress is being made," Dean says.

Impact investing a focus

Dean's area of expertise, private market impact investing, is proving to be a particular focus among forward looking insurance companies that want to do more with their investment portfolios.

Impact investing is a natural extension of the trend for responsible investing that is already seeing the mainstreaming of Environmental, Social and Governance (ESG) integration into institutional investors' portfolios. Impact investing takes a step further by financing solutions that directly address environmental or social challenges, thereby creating positive impact for the planet or benefitting the welfare of a community, Dean explains.

In the context of the environment, impact investing could mean funding activities that reduce CO_2 emissions or investing in solutions that improve climate change resilience and foster adaptation for vulnerable communities.

Fast growing market

"Impact investing is about investing for market rate financial returns alongside intentional and measurable social and environmental outcomes," Dean says. "The market has grown ten-fold in the last five years. When AXA IM entered it was a $50bn market and now it's a $500bn* market."

This momentum is being driven by clients – both institutional and individual investors – demanding tangible returns from their investments beyond only financial outcomes, Dean says.

"That simply wasn't happening a decade ago. A typical investor today has ESG risk concerns that they want to mitigate in their portfolio. But more are also looking to produce positive financial outcomes, as well as social and environmental results, in addition to mitigating risk."

This drive for impact outcomes can be pursued across the investment spectrum, from private markets to listed assets. While investing for impact via listed securities can offer relative benefits of scale and liquidity, private market programmes deliver the strongest "intentionality" around linking capital to impact outcomes, Dean stresses.

AXA IM is ahead of the curve.

"We launched our impact programme in 2012 and year-on-year we've built on our expertise, leveraging the rapidly developing market opportunity to meet increasing demand from sophisticated investors, like insurers," Dean says.

The dual-returns objective – achieving financial returns while making a real and measurable impact – requires a unique set of skills and a highly calibrated investment process. For a successful impact portfolio, asset managers will need to have the resources and expertise to manage a raft of components – including access to innovative investment projects, ESG factors, impact measurement, financial analysis, strategy, and operational considerations. "It's a layer of complexity that raises the bar for asset managers," Dean notes.

Impact label integrity

"Intentionality"and impact labelling are a sensitive issue in this fast-growing segment of responsible investing. "As demand grows there's a risk that the impact investment label is applied too easily and the purpose of what we want to achieve as a sector is diluted," Dean observes.

Last month, AXA IM became a founding signatory of the new Operating Principles for Impact Management announced at the World Bank/IMF Spring meetings. The 60 asset managers and institutions that adopted the International Finance Corporation's impact investing principles have collectively committed to manage over $350bn in assets in line with the new impact principles.

The IFC framework, which should bring greater transparency, credibility, and discipline to the impact investing market, follows on from the UN's Sustainable Development Goals (SDGs). The 17 SDGs are part of the 2030 Agenda for Sustainable Development that was agreed by world leaders to mobilise efforts to end poverty, fight inequality and to protect and preserve the natural environment.

The SDGs can be used as a framework to help investors allocate capital to impact investments. While there are 17 SDGs to target, some present deeper and more tangible opportunities than others, with greater potential for concrete, measurable outcomes.

Healthcare and well-being, climate change and financial inclusion are examples of scalable investable themes for insurers who are committed to an investment agenda focused on achieving the SDGs, Dean says.

"The SDGs are also important to impacting investing because they highlight a funding gap – $5-7trn per year – that needs the infusion of additional capital to fund innovation and solutions," Dean emphasises. "If we simply relabel products we have already got we're not helping to close that funding gap. There's a lot of work to do and it requires the whole industry to adhere to consistent definitions and standards."

Get off the fence

While the impact investing market may be relatively nascent compared to more traditional investment approaches, private market solutions align well with the corporate strategies of insurance companies.

"It's why so many insurance companies are developing impact investment programmes. They want to be good corporate citizens, and impact investing can also be aligned to the strategic objectives of their business. At the same time, it's a justifiable, standalone part of their balance sheet," Dean says. Still, some insurers are sitting on the fence.

"I suggest to insurers that are starting to look at impact investing as part of their asset allocation strategy that they first need to identify their most important corporate values, objectives, and business risks. Plot those criteria back into investable areas in the impact segment and there will be solutions available that can be tailored to those specific priorities," Dean suggests.

"The solutions are out there today that deliver market rate financial returns and target outcomes on environmental and social themes – now it's up to investors to seize the opportunities. Together we can help transform tomorrow."

**At end 2018 – GIIN: Sizing the Impact Investing Market*

Case study

Protecting natural capital and emphasising conservation through impact investing

Peru's Amazon rainforest is an important climate resource because it absorbs and stores carbon from the atmosphere and is a key habitat supporting biodiversity. But it is threatened by deforestation.

Recognising the importance of forest conservation and sustainability, AXA IM is working with a range of partners and stakeholders to help restore degraded lands and prevent deforestation in the region, while helping smallholder farmers to develop sustainable agroforestry livelihoods.

This is done by investing in infrastructure that helps farmers to plant the cash crop cacao in the shade of canopy trees whilst creating demand for product that meets the highest standards of sustainable organic production. By doing so, the farmers effectively extend their product range into the 'fair trade' and organic premium bracket and increase yields through a funded technical assistance and support programme.

The intended positive impacts of the investment are clear – protection of high value ecosystems, significant carbon emissions savings through natural sequestration, measurably improved biodiversity and improved income generation for communities. In terms of the financial returns, investors look to share in the upside generated by the revenues from a premium product. Additionally, the carbon emissions savings can be converted to tradable units with a monetary value.

It's a true impact investment approach because it aims to meet the double objective of achieving a social and environmental outcome as well as targeting a market rate financial return.

Source: AXA IM. For illustrative purposes only. Past performance is not a guide to future returns. The example is intended for purposes of discussion of this particular impact investing strategy and no representation is made that the example is a past or current recommendation, or that it should be bought or sold, nor whether it was successful or not.