

# Influence Change with Greater Impact



A GUIDE TO SUSTAINABLE INVESTING



INVESTMENTS

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# Growth and evolution of sustainable investing

*Impact investing is the most proactive sustainable investment approach in that investors explicitly use capital to attempt to influence the world in a positive way.*

In recent years, “sustainable investing”—meaning investment strategies that incorporate non-financial environmental, social, and governance (“ESG”) factors alongside traditional financial analysis—has grown considerably in attention and assets under management (AUM). According to a 2018 study, more than \$30 trillion of assets around the globe were managed following a sustainable process, with \$12 trillion of that in the United States.<sup>1</sup> As a subset of that \$30 trillion global total, “impact investing” accounted for \$502 billion in 2018.<sup>2</sup>

What is impact investing and how does it fit into the broader sustainable investing universe? The Global Impact Investing Network (GIIN) defines the approach as investments “made with the intention to generate positive, measurable social and environmental impact alongside a financial return.”<sup>3</sup> Compared with other sustainable investing approaches, impact investing is the most proactive in that investors explicitly use capital to attempt to influence the world in a positive way. That said, impact investments are still investments. Unlike purely philanthropic approaches, impact investments seek a financial return, though that objective can range from above-market rate to below-market rate returns, depending on the investor’s goals.

1. Source: Global Sustainable Investment Alliance, “2018 Global Sustainable Investment Review.”

2. Source: Global Impact Investing Network, “Sizing the Impact Investing Market,” 2019.

3. Source: Global Impact Investing Network, “What You Need to Know About Impact Investing,” 2019.

# Impact investing’s place along the sustainable investment spectrum

Before diving further into impact investing, it may be helpful to outline where this approach fits into the broader sustainable investment universe. **Figure 1** summarizes the various approaches using a “spectrum” framework. As a reminder, all sustainable investment approaches include the belief that non-financial factors play a key role in the investment process. On one end of the spectrum stands a “negative” approach—often called “socially responsible investing.” This generally means excluding the stocks and bonds of companies or industries from an investor’s portfolio based on their values and/or beliefs. For instance, a religious institution may bar the inclusion of “sin stocks”—such as companies in the alcohol, tobacco, or gambling industries—from its portfolio. Negative approaches generally don’t look to ESG factors as a way to enhance investment performance. Instead, this approach aims to ensure that an organization’s investments align with its broader mission.

In contrast, other sustainable investors use a “positive” approach that directly incorporates ESG factors into the investment process to help generate alpha. This approach is often called “ESG integration.” Investors following this approach generally seek to purchase stocks or bonds of “best-in-class” ESG companies and avoid the “worst” ESG companies with poor or problematic ESG profiles. In short, they believe companies with strong ESG profiles will outperform. There’s evidence to support that belief, including a 2015 academic report that analyzed more than 2,000 other studies, determining that companies with good ESG ratings do indeed outperform over time.<sup>4</sup> While ESG integration indirectly rewards companies with good ESG practices by providing them capital, this approach does not directly intend to effect social or environmental change. The main goal is to generate positive investment performance and to outperform a benchmark or other investment target.

**Figure 1: The Spectrum of Capital<sup>5</sup>**

	Financial-only	Responsible	ESG	Impact		Impact-only	
		Delivering competitive financial returns					
		Mitigating Environmental, Social, and Governance risks					
		Pursuing Environmental, Social, and Governance opportunities					
			Focusing on measurable high-impact solutions				
			Competitive financial returns				
			Below market financial returns				
Investment profile	Limited or no regard for environmental, social, or governance practices	Mitigate risky environmental, social, and governance practices in order to protect value	Adopt progressive environmental, social, and governance practices that may enhance value	Address societal challenges that generate competitive financial returns for investors	Address societal challenges(s) which may generate a below market financial return for investors, if required by purpose	Address societal challenges that require a below market financial return for investors	Address societal challenge(s) that cannot generate financial returns for investors

4. Source: Gunnar Friede, Timo Busch & Alexander Bassen (2015) ESG and financial performance: aggregated evidence from more than 2000 empirical studies, *Journal of Sustainable Finance & Investment*, 5:4, 210-233.

5. Source: The World Economic Forum, “Building Impact-Driven Investment Portfolios,” 2019.

# Going a step further: Explicitly aiming to doing good

Impact investing takes “positive” ESG investing a step further, as investors explicitly seek to use capital to effect positive change in the world. Impact investments can be made in developed, emerging, or frontier markets, and use capital to address areas such as sustainable agriculture, renewable energy, and other environmental goals. Impact investments

can also help underserved populations gain access to affordable and accessible basic services, such as housing, healthcare, and education. **Figure 2** shows the range of impact investment areas across both broad investment objectives (listed across the top), and specific environmental/social initiatives (listed down the left).

**Figure 2: The Broad Range of Impact Investments<sup>6</sup>**  
Mapping Impact Investments by Theme/Sector and Asset Class

	Liquidity	Income & Wealth Preservation			Capital Appreciation & Wealth Growth			Inflation Protection	
	Cash/Cash Alternatives	Notes/ Other Debt Obligations	Bonds	Absolute Return/ Low Equity Correlated	Public Equity	Equity Long/Short	Private Equity	Real Estate	Commodities & Other Real Assets
Climate Change	Green Deposit Bank		Tax- Exempt Green Bonds	Carbon Trading	Positive & Negative Screening		Clean Tech Venture Capital	Green REITs	
Energy			Screen Corporate Bonds	Alternative Energy Project Finance	Exchange Traded Funds	Renewable Energy	Energy Efficient Venture Capital		Sustainable Feedstocks
Water			Corporate Infrastructure Bonds	Water Treatment Project Finance	Unit Investment Trust, Closed End Funds	Water Funds	Water Technology Venture Capital		
Community Development	Community Bank CDs	Foreclosure Repair		Microfinance Institutions Debt	Shareholder Proxy Voting		Community Dev. Venture Capital	Transportation Smart Dev. Funds	
Social Enterprises		Social Enterprise Credit			Micro-Cap Listed Social Companies		Small & Medium Enterprise	Conservation/ Ecotourism	
Health & Wellness		Bridge Financing		Structured Public Note			Consumer Product Venture Capital	Organic Farming	
Sustainable Development	Trade Finance Guarantee/ Deposit		Smart Growth Municipal Boards	Blended Debt Equity Hybrid Structures	Thematic Screening			Ranch Land, Agriculture	Sustainable Timber
Education	Linked Deposit/ Guarantee		Charter School Bonds				Education Private Equity	University Green Building	

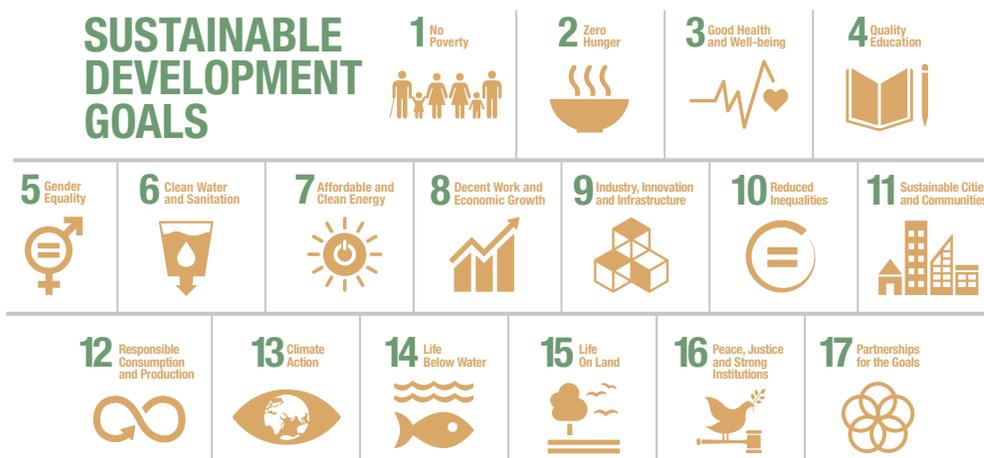
6. Sources: Arabella Advisors, Exponent Philanthropy and Mission Investors Exchange, “Essentials of Impact Investing: A Guide for Small Staffed Foundations,” 2015. Rockefeller Philanthropy Advisors, “Solutions for Impact Investors: From Strategy to Implementation,” 2009.

## Sustainable development goals (SDGs)

Impact investments often aim to address the SDGs established by the United Nations (UN) in 2015.<sup>7</sup> SDGs represent 17 global goals to be met by 2030 and include a range of social and environmental initiatives. **Figure 3** shows these goals in a graphical format. The UN estimates it will require \$5-\$7 trillion annually to meet these goals by 2030. Since the funding cannot all come from governments or contributions by nonprofits, it's expected that impact investments will help fill the gap—likely leading to significant growth in the asset class over the next decade.

*The Sustainable Development Goals are the blueprint to achieve a better and more sustainable future for all. They are interconnected and address the global challenges we face so no one gets left behind.*

Figure 3: The Blueprint to Achieving a Better and More Sustainable Future for All<sup>7</sup>



7. Source: United Nations, "Sustainable Development Goals," 2019.

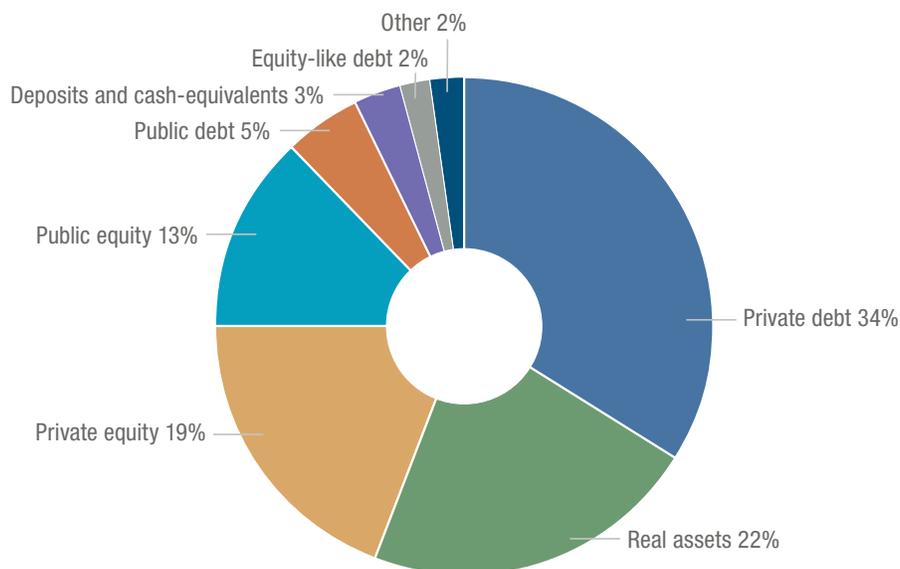


# Impact investments in more detail

As impact investments are still investments, we can analyze them in a similar way to traditional strategies. A significant percentage of impact investments are private instruments—with private equity and debt serving as two of the largest categories. **Figure 4** shows the asset allocation of impact investments as of 2017, highlighting the prevalence of private and real assets, which accounted for 75% of the entire universe.<sup>8</sup> While the “public debt” total only represents 5% in the chart, the growth of “green bonds”—which

directly fund projects to combat climate change and other environmental initiatives—have grown significantly. According to Bloomberg, \$580 billion of green bonds were sold through 2018, with another \$170-\$180 billion likely to be sold in 2019.<sup>9</sup> While green bonds are not explicitly considered impact investments, they are similar in spirit and show the demand for investments that combine returns and positive environmental results.

**Figure 4: Asset Allocation of Impact Investments (2017)<sup>8</sup>**



A key aspect of impact investing is clearly measuring both the financial and impact dimensions of these investments. Are impact investments meeting these dual objectives? The short answer is yes, though it's a bit more complicated because the expected financial returns required by impact investors can vary. According to a 2017 survey, 66% of impact investors sought risk-adjusted, market-rate returns, 19% sought returns close to or just below market-rate returns, and 15% sought below market-rate returns or to preserve

their capital.<sup>10</sup> The “impact” dimension obviously varies depending on the investment, so that's a bit harder to define. However, survey results suggest that both dimensions are being achieved. According to the Global Impact Investing Network, 98% of survey respondents stated that their investments had met or exceeded their impact goals, while 91% stated that their investments had met or exceeded their financial return expectations.<sup>10</sup> By these measurements, impact investing has been a clear success.

8. Source: Global Impact Investing Network, “GIIN Perspectives: Evidence on the Financial Performance of Impact Investments,” 2017.

9. Source: Lyubov Pronina, “What Are Green Bonds and How ‘Green’ Is Green?” Bloomberg, 3/24/19.

10. Source: Global Impact Investing Network, “GIIN Perspectives: Evidence on the Financial Performance of Impact Investments,” 2017.

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# Room for growth in terms of assets and investment options

*In a 2019 New York Life Investments study, we found that **53% of the general population surveyed represented what we have defined as a “Values-Driven” investor**—one whose portfolio is highly diversified and has taken action against a brand (e.g. boycotting), divested their portfolio of a company that no longer aligned with their beliefs, or changed the types of products purchased (e.g. stopped using plastic straws or now owns an electric vehicle).<sup>11</sup>*

Impact investing is still only a relatively small part of the sustainable investing universe. At just over \$500 billion in assets in 2018, impact investments represented less than 2% of the overall \$30 trillion of global assets managed following a sustainable process. However, this area is likely to grow significantly, driven by the trillions of dollars needed to meet the UN’s sustainable development goals over the next decade. Demand by investors should also contribute to growth. Impact investments could be very appealing to clients seeking to make a positive environmental or social contribution, but who would like a return on their investment rather than only writing a check to a charity or other nonprofit organization. Younger generations of investors should also fuel demand for impact investments, along with their broader interest in sustainable investments.

For impact investing to emerge as a mainstream option for individual investors, there will need to be more investment strategies accessible to non-accredited investors. At this point, there are not many impact investing vehicles (like mutual funds) available for individuals, though that is likely to change as the demand for impact investing grows. It’s still early in the story for impact investing, but the demand for strong investments and the need for solutions to large global problems like climate change are not going away. Impact investments can address each of these goals and allow investors to feel good that their investments are making a difference in the world.

11. Source: New York Life Investments and RTi Research, September 2019. Results based on survey questions asked of 594 investors, both men and women, with investable assets over \$250k, ranging in age from 25-39; 40-54; and 55+.



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## ABOUT RISK

All investments are subject to market risk, including possible loss of principal. Diversification cannot assure a profit or protect against a loss in a declining market.

## DEFINITIONS

**Alpha** is a term used in investing to describe a strategy's ability to beat the market or provide excess return.



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