"Principle 4 – Manage and review your impact"

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Discussion topics from Pensions for Purpose's fourth Impact Investing Adopter Forum (IIAF) event, run in partnership with the Impact Investing Institute and hosted by DWS.

Introduction

So, you (as an investor) have set your impact objectives, appointed third-party advisers and managers that align with those objectives, and formulated engagement and stewardship guidelines. Brilliant, good governance so far, but how do you know what social and environmental impact you are really having?

This is where managing and reviewing your impact (Principle 4) comes in. How are your managers measuring impact alongside financial return? How is progress being measured? What is the additionality?

These questions were all unpacked in the presentation and Q&A discussion with DWS.

So, how does DWS embed impact?

We heard from Andy Pidden, Head of Sustainable Investments Group at DWS, and Yoshiko Saito, Senior ESG Product Specialist at DWS, on their use of the triple bottom line, theory of change and use of the Operating Principles for Impact Management. Bear with us, I realise there is a lot of investment jargon there. So, let's unpack it.

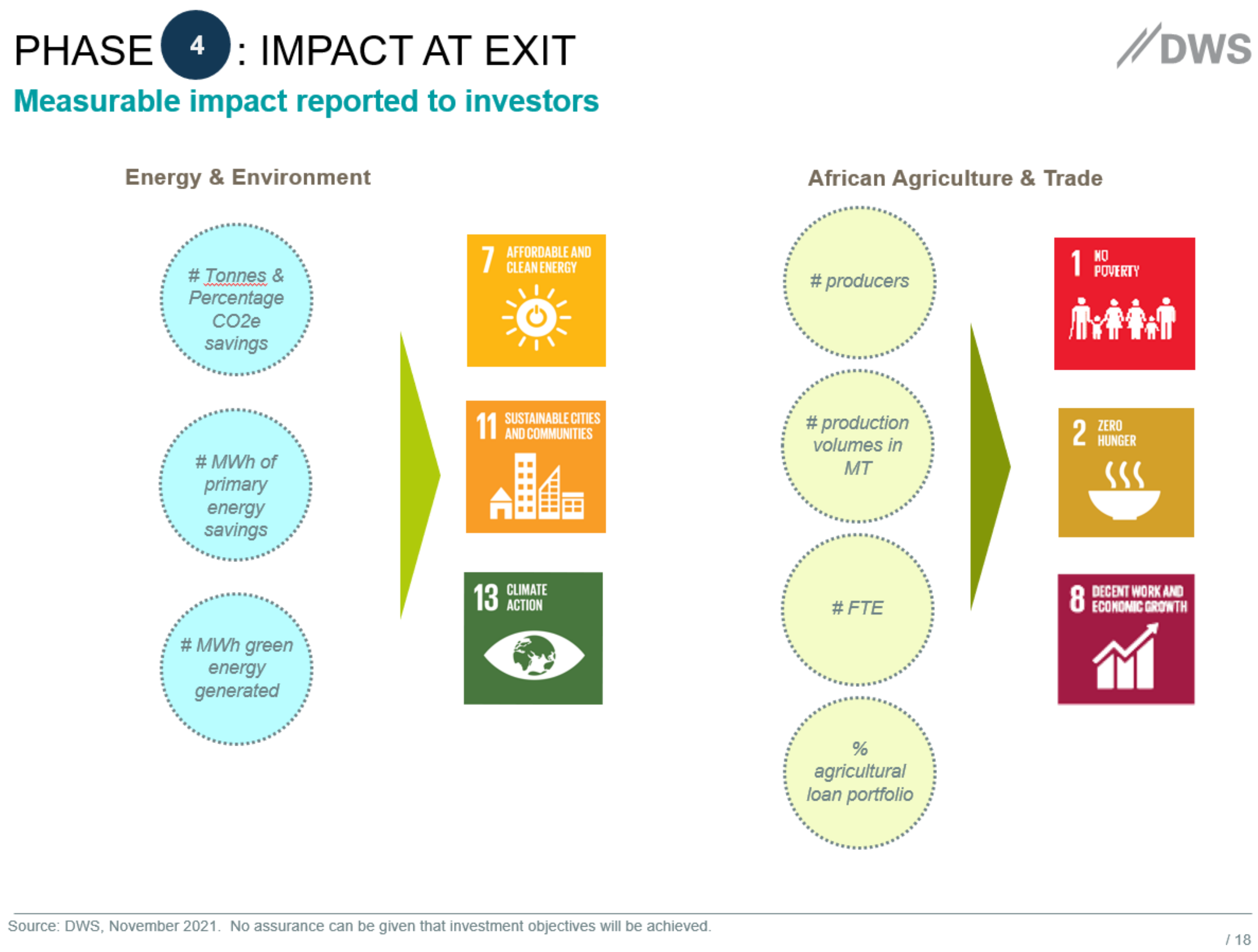
Phase one of DWS' process to invest for impact is about strategic intent and integrates the triple bottom line, which is a consideration of not just financial return but also the impact on people and planet. These are equally weighted decisions when considering potential investment opportunities. The impact on people and planet is derived by looking at the UN Sustainable Development Goals and understanding the underserved need.

The impact needs to be positive, showing material and measurable incremental change over and above regulatory and market drivers. These can be derived from KPI measurements such as energy/waste/water savings, via sustainability certification and/or other industry recognised measurement on SDG impact.

Phase two of the process is around origination and structuring. This is where the potential investment opportunities are reviewed from an impact and financial returns perspective during due diligence and screening, according to the theory of change, which is about setting long-term goals and mapping backwards to identify necessary preconditions. An example would be reducing CO_2 emissions in relation to SDG 13 on Climate Action and then mapping all the investment activity to reach that goal with interim steps.

Phase three of the investment process is portfolio management. This follows an investment agreement put in place that has outlined the social and environmental impact management and allows DWS to monitor and verify ESG and impact progress of the underlying assets.

The last phase is the impact at exit. It takes into account the lifecycle of assets beyond the investment period and creates a measurement tool to review impact according to a number of dimensions in relation to the overall target, eg. value chain integration, employment and local production as an example for DWS's sustainable agriculture fund. Measurable impact according to the set SDGs is provided to investors, as shown below.



Following the investment process through from objective setting to implementation and reporting demonstrates why the steps need to be interwoven to achieve the intended outcome, as well as to understand an investor's additionality in relation to specific social and environmental impacts.

Environmental and social targets - and initiatives such as net zero, the UN SDGs and build back better - are about a fundamental, systemic shift to a sustainable global economy. These represent significant risks if not followed through, but also opportunities that are particularly important for pension funds with long liability and diverse member profiles. The embedding of impact is therefore a powerful de-risking tool for such a long-term investor.

For DWS' interactive presentation, please view the recording here.

Q&A discussion with attendees

How do we address the still thorny issue of a perceived incompatibility between fiduciary duty and impact, for example the use of green gilts? We [an investment consultant firm] still have pension funds that are legally advised not to pursue an investment because the return case is put first.

There have been many arguments for the compatibility of impact investing with fiduciary duty, including the Impact Investing Institute's 'Impact investing by pension funds. Fiduciary duty – the legal context' paper by a legal panel, which was also reviewed by the Association of Pension Lawyers. Despite this, there is still a perceived barrier that we need to address. Investing in new sustainable and impact investments is likely to have a cost compared with traditional investments; however, that cost is offset by risk. What do we mean by this?

The use of sustainability and impact measures, in particular, creates a level of transparency that mitigates systemic risks; as Donald Rumsfeld would have put it, the 'known unknowns' and the 'unknown knowns'. What is interesting is why impact is so specifically targeted in relation to fiduciary duty, even though the risk, return and cost implications of other investment decisions – eg. whether to go active versus passive, delegated versus in-house, private versus public - are more readily accepted.

This demonstrates a clear need to clarify and educate around this issue, and is an area we will look to tackle at future Impact Investing Adopter Forum events.

How do you deal with the issue of carbon offsetting, and should investors/pension funds be considering this?
DWS' view is that carbon offsets should not be the goal, unless necessary. It is far better to invest in solutions such as renewable energy and energy efficiency, carbon capture technology and nature-based solutions. Some myths also abound on issues such as afforestation. The effort and energy expended to plant and maintain new timberland, for it to mature and sequester carbon creates its own inefficiencies. Working to maintain the forested land we have is of paramount importance but we need to ensure we are investing appropriately in the right areas from a scalability perspective.

One of the pension fund participants opined that they are not looking to use carbon offsets for the reasons mentioned above.

Shouldn't impact just be considered for all investments, particularly if it presents a systemic risk and opportunity?
Yes, essentially all investments should be viewed through a risk/return/impact lens to understand potential risks and opportunities. Impact is a de-risking tool for a pension fund. However, it is important to understand the distinction between measuring negative and positive impacts across your investment portfolio and intentionally pursuing a positive social and environmental impact, which might only be achieved in a portion of your investments.

Thank you to DWS for this fascinating presentation and to our participants for a very interactive session. We will be looking to address the issues and topics brought up in this and previous sessions as part of our events programme for the Impact Investing Adopters Forum in 2022.

Next steps

If you would be interested in joining the Impact Investing Adopters Forum, signing up to the Impact Investing Principles for Pensions or participating in one of our events, please contact Charlotte O'Leary.