



Impact investment in the LGPS

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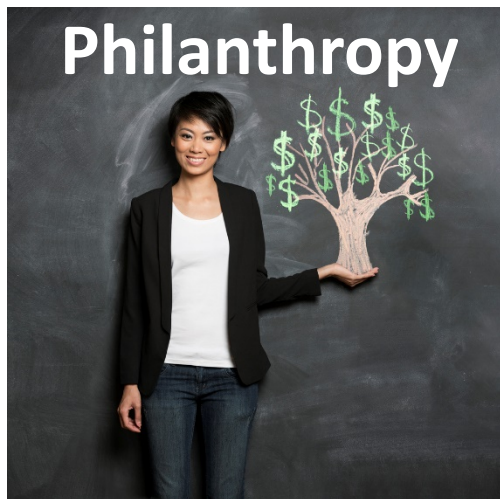
17th January 2019

Discussion points in this session

- What is impact investment (and what is it not)?
- Pension fund allocations to impact investments - trends around the world
- Case studies (interspersed throughout)
- What stops pension funds from investing and what are members concerned about?
- How to implement an impact investment approach
- The challenges of measuring social or environmental impact
- The benefits of pooling and impact investment

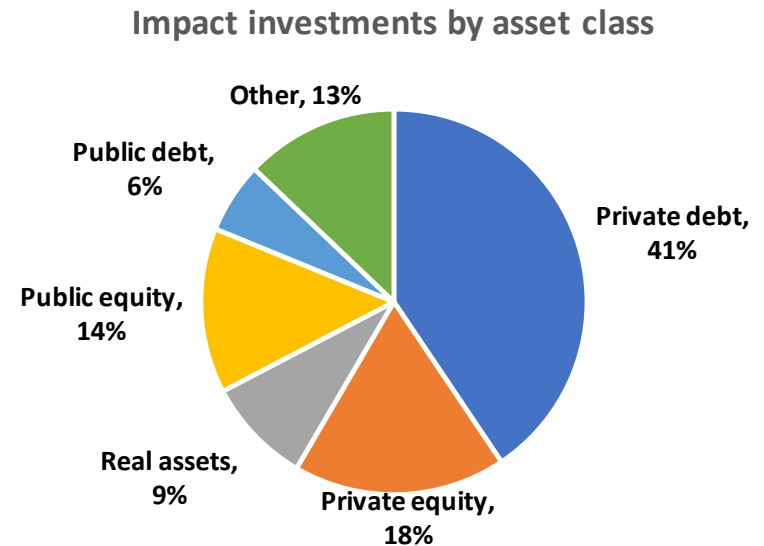
Mythbusters

Impact investment does not mean...



Impact investment – what is it?

- Offers a financial return
- Intentionally generates a positive impact (social or environmental)
- Measures both the financial return and the social/environmental impact
- Covers the full range of different asset classes
- Already forms part of the investment strategy for many pension funds
- Constitutes at least £150bn of assets *(Source: FT)*



Source: GIIN 2018 Annual Impact Investor Survey

Impact investment trends around the world

Australia:

- 2016 Impact Investing Australia survey (impactinvestingaustralia.com)
 - 56% of institutional investors had impact investments
 - A third allocated over 10%
 - Clean energy, health and housing/homelessness key impact concerns
 - First State Super, HESTA and Christian Super are trailblazers in impact investment



Case study: Christian Super

- **Pension fund:** 25,000 members AUM of around £900m
- Invest in impact investments globally
- Dedicated impact allocation of 10%, rose to 12% in 2018
- First investment was in renewable energy
- Also invest in sustainable agriculture, community infrastructure, venture capital and social benefit bonds (environmental ➡ social impact)
- Performance benchmark of inflation +4% per annum
- Impact portfolio returned 6.5% p.a. after fees - six years ending 31 December 2016

“We are often challenged with questions as to whether it’s actually possible as a fiduciary to build a viable impact portfolio, but I think that our track record is sufficient to dispel that myth.”



Impact investment trends around the world

USA:

- Global Steering Group on impact investment:
 - \$8.7 trillion of assets in the US that “feature impact investing considerations”
- US Sustainable, Responsible and Impact Investing Trends 2016
 - Gender lens investing gaining popularity (\$397bn in assets)
 - Community investing popular (\$122bn in assets)



Impact investment trends around the world

Europe

- A number of leading pension funds are moving allocations towards impact investment.
 - Unilever intending to move 5% over two years
 - Already allocated 1% to green bonds and carbon-optimised listed equities
 - PGGM has invested \$11.7 billion - four SDG* themes: climate, food security, water scarcity and health
 - Targeting \$23bn by 2020
 - Involved in Impact Management Project to discuss measurement and management of impact



* SDG = Sustainable Development Goals (explained later)

Impact investment trends around the world

UK

- Local authority pension funds have begun allocating to impact investments
 - E.g. Greater Manchester, Merseyside, EAPF, West Yorkshire
- Corporate defined benefit pension fund take-up is still slow
 - Only 7.5% had allocated to impact in a survey by MJ Hudson Allenbridge
- Defined contribution funds beginning to offer impact funds as optional investments
 - yet to embed in their default funds despite member interest...but...
 - 87% were in favour of an allocation of up to 3% in their default fund (MJ Hudson survey)
- Government and agency interest in promoting social impact investment. “Growing a culture of social impact investment in the UK”

Case study: Merseyside Pension Fund

- **Pension fund:** 131,000 members and assets under management of around £8.3bn
- Dedicated impact allocation of £50m, across seven investments (still only 0.6%)
- Mainly private equity, property and special opportunities, with an interest in local issues
- E.g. investment in a social impact bond preventing 14-19 year-olds in the Merseyside region from becoming NEET (not in education, employment or training)
- Impact investments have offered reasonable risk-adjusted returns to other holdings with good diversification

“Social impact or thematic investing may provide access to diverse opportunities, uncorrelated to other assets, and can deliver acceptable risk-adjusted returns.”



What stops pension funds from impact investing?

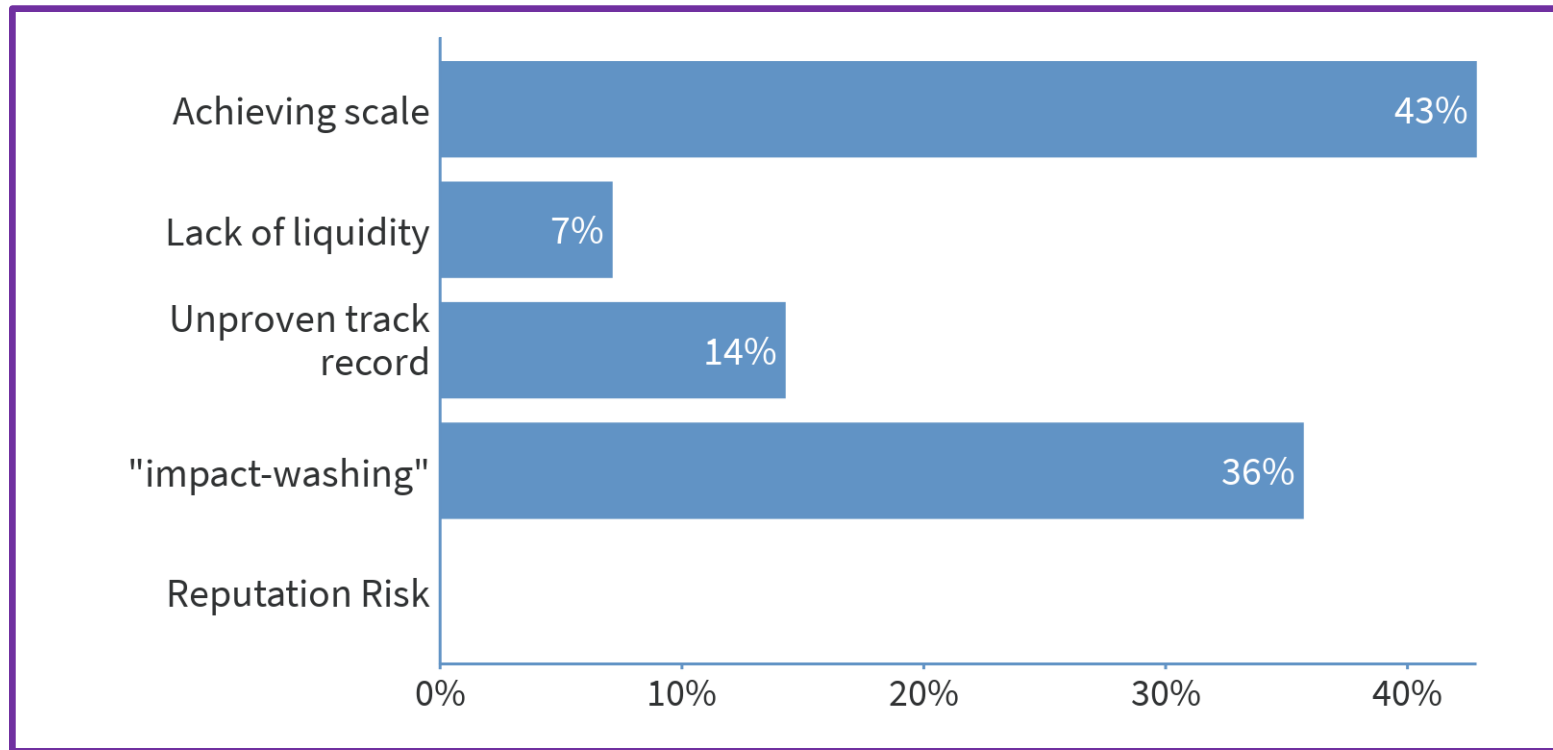
MJ Hudson Allenbridge Market research for DCMS

- **Knowledge:** 64% lacked knowledge
- **Data:** 82% lacked risk/return data
- **Consultants:** 68% relied on consultants... who had not mentioned impact investing
- **Regulatory change:** nervous about moving goal posts
- **Reputation risk:** e.g. social housing
- **Strategy uncertainty:** how to treat it?

The trustees (or members) feel nervous if they don't understand what they are investing in.

The blame can often fall on the investor rather than the manager in this sphere.

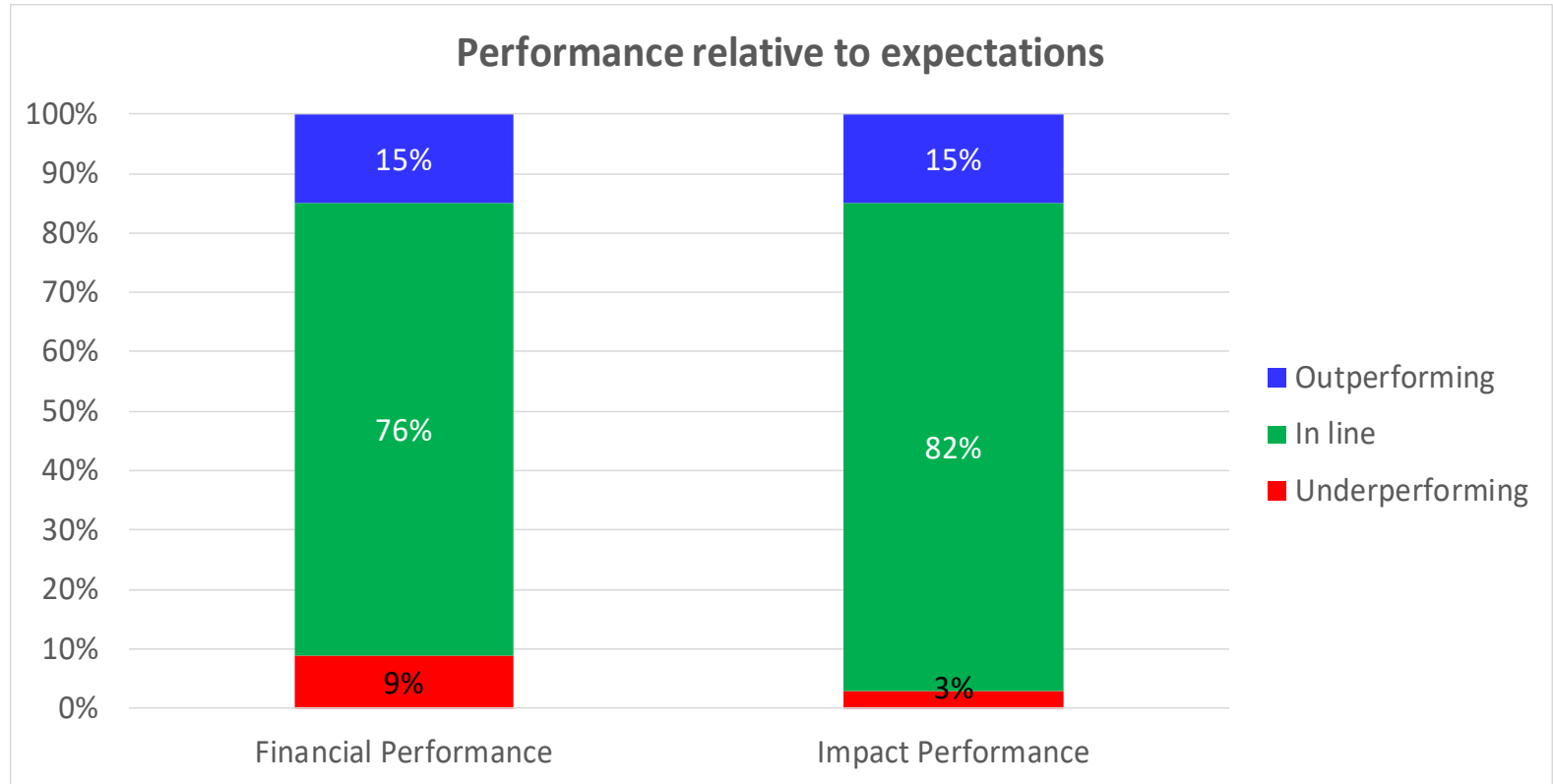
What is your main concern about implementing impact investment?



Source: DG/Pensions for Purpose Investing with Impact Summit November 2018

“Lack of evidence”

The financials of impact investment



Source: GIIN 2018 Investor Survey

64% targeted market-rate risk adjusted returns



A typical pension fund's journey to impact investment

- Begin with a review of investor beliefs



Source: Christian Super 2018 Annual Report

- Review how ESG is already being embedded
- Discuss socially responsible investment
 - Divest?
 - Lower carbon footprint?
- Consider impactful investment approach
 - Global or domestic impact?
 - Environmental or social or local impact?
 - Embedded in all asset classes or a focused sleeve?
- Implement and monitor
 - Measure both financial and impact returns

What do listed impact investments look like?

- **Listed equities** – invest in companies that have a positive social or environmental impact, for example:
 - A biotech company -> selling drugs that improve third world health
 - An automobile company -> selling electric cars
 - An elderly care home operator -> helping residents with mental health issues
- **Listed bonds:**
 - Green bonds that fund projects with positive environmental/climate benefits
 - Social bonds where payments depend on specific social outcomes being achieved
- Often target the SDGs (Sustainable Development Goals)
- Scalable and liquid investments
- Investing **WITH** impact, not investing **FOR** impact



What do unlisted impact investments look like?

- **Property investments**
 - A social housing property fund
 - A homelessness property fund
 - A disabled living property fund
- **Infrastructure investments:**
 - A renewable energy fund
 - A fund investing in deprived areas
- **Private debt investments:**
 - Micro finance to third world countries
 - Loans to small businesses
- Investing **FOR** impact, not investing **WITH** impact – more direct and measurable impact
- BUT... less scalable and less liquid



Impact measurement

- Measuring impact remains a challenge for investors – lack of standardisation
- UN Sustainable Development Goals allow some comparability
- Easier for listed assets, harder for private impact investments
- Managers should be able to map their investment themes onto the SDGs
- Ask for impact measures e.g. tonnes of CO2 avoided, litres of water cleaned, number of homeless people helped
- Remains an evolving space



Case study: Environment Agency Pension Fund

- **Pension fund:** 40,000 members and assets under management of £3.3bn (March 2017)
- As at March 2017, 34% invested in clean technology and sustainable investments
- A separate impact portfolio ("Targeted Opportunities Portfolio") where £131m has been committed
- 11.6% annualised over 5 years to March 2017. EAPF attributes this to its long-term, responsible investment approach to investment
- Climate goal: decarbonise the equity portfolio, reducing exposure to future emissions by 90% for coal and 50% for oil and gas by 2020 (compared to exposure in 2015)

"The EAPF believes that climate change presents a systemic risk to the stability of every country."

Why investing via a pool could be advantageous - an idea that might work...

- Local investment – usually causes a sharp intake of breath from a consultant!
- With a pool, each member fund's capital can still get invested in its own county/borough
- However, each member's allocations are aggregated for investment purposes
- The return paid to member funds is diversified across all the investments
- Yet the underlying impact can be measured at a local level
- Addresses fiduciary responsibility but still achieves local impact

A call to action

What should LGPS committees be doing?

- Become informed – learn about impact investment across different asset classes (join Pensions for Purpose!)
- Discuss your investor beliefs – what matters to you and your members?
- Decide whether you are happy with your approach to ESG – are improvements needed?
- Consider socially responsible investment
- Consider a small allocation to impact investment to learn more about this approach
- Don't dismiss the smaller managers in this space – many have decades of experience in impact investment

For more information about impact investment...



A collaborative initiative between impact
managers, pension funds, social enterprises
and others involved or interested
in impact investment



Risk warning

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