Summary
- Impact investing is rising up schemes' agendas, with institutional investors increasingly seeking to make impact allocations.
- COP conferences and the rise of ESG have spurred trustees to consider societal impacts alongside financial returns.
- The investment industry is adapting to offer more expertise and impact investment products.
- Data is seen as the major hurdle preventing a broader uptake of impact strategies.
- Frameworks such as the UN's SDGs can be used as stepping stones for schemes to establish their own impact agenda.

Why pension schemes are making a noise about impact

Schemes are increasingly turning to impact investment strategies to deliver outcomes for members and society as a whole

In the age of ESG, tapping into key financial markets megatrends while addressing some of our most important sustainability challenges, such as climate change, biodiversity loss and social inequalities is rising in importance for pension schemes.

Impact investing, or the strategy to generate targeted social or environmental outcomes in addition to financial gains, has evolved from a niche segment of the sustainable investment sector to a market worth £58 billion in the UK alone, with a further £53 billion of impact-aligned investments, according to the Impact Investing Institute.

On a global scale, impact investing has snowballed to hold $2.1 trillion (£1.74 trillion) in assets under management, International Finance Corporation research shows – a bellwether for the growing institutional interest in the space.

In the UK, more than 50 per cent of pension schemes hold some form of impact investment, as of March this year. The research, conducted by Pensions for Purpose and sponsored by Big Society Capital, found that UK pension funds are increasingly taking impact investing into consideration, with 90 per cent of respondents looking to make such investments in the UK.

Making the first impact

"The interest of pension funds in impact investing is being driven by the greater interest in ESG, sustainability, social impact and climate change, which we have seen in recent years," says Independent Trustee Services director, Graeme Griffiths. He believes there has been a step-change in how pension schemes view the opportunities presented by impact investing in the wake of the pandemic and successive COP conferences.

"Greater concern about climate change, particularly since the Paris Climate Agreement, signed by 196 parties at the COP 21 conference in 2015, has driven a rapidly rising interest in sustainability and ESG from both investors and pension scheme members. The increased demand from firms and individuals has led to a proliferation of ESG and impact strategies and solutions," he adds.

In particular, the attraction to the space comes in the duality of outcomes, he says – "attractive financial return, and positive societal or environmental benefits".

There are other tangential appeals too. Around three-quarters of pension schemes have either net-zero plans in place or will soon have them, research from the Pensions and Lifetime Savings Association shows. As schemes increasingly look towards net-zero targets, impact investing is offering opportunities to engage with investment opportunities that can aid in achieving either specific goals or broader portfolio-wide objectives.

Meanwhile, the investment industry is pooling expertise, capabilities and opportunities to cater for the burgeoning institutional demand for impact investment.

AXA Investment Managers senior equity investment specialist, Sian Long, points to a "rapidly growing roster of listed companies" that are now "providing products and services that can deliver positive and demonstrable impacts for people and the planet".

Yet for many schemes seeking to make an impact, quantifying, measuring and legitimising the outcomes of such investments is proving to be a hurdle.

Measuring change

The integrity of impact investing is dependent on being able to verify outcomes through accessible data, and while there is an inherent "sense of alignment in the longer-term outlook of

pensions, the timeframe for ESG risks biting and environmental and social impact being realised", according to Insig AI head of ESG research, Diana Rose, it is hard for trustees to monitor and assess impact-related data, owing to several factors.

Primarily, there is no "easy, universal method" for measuring impact, so it falls to the pension fund to "go beyond screening to define its own impact targets, and to assess portfolios against them", she says.

The issue is catalysed by the scope of impact investing, with industry efforts to overcome ESG data challenges overlooking more niche areas such as biodiversity.

There is not yet a universally agreed definition of what constitutes biodiversity or an agreed method to price natural capital, and the same is true for countless other factors. But industry forces are driving change that is giving investors enough assurance to act now.

New biodiversity-focused solutions are being developed today that offer some hope in addressing biodiversity metrics gaps. Innovators such as Iceberg Data Lab, CDC Biodiversité and ENCORE are seeking to drive a potential future consensus on biodiversity metrics by developing and testing approaches suitable for global corporate and portfolio biodiversity assessment. Global ESG data providers are also expected to develop biodiversity solutions that could eventually be scaled up.

Seizing the moment

In light of the numerous hurdles facing prospective impact investors, there is a need to partner with the right specialist to obtain "meaningful oversight", Rose says.

"There are hundreds of data points flying around in an alphabet soup at the moment and still an education piece is needed at the highest levels. Trustees have arguably the greatest agency to move the needle in sustainable investment, but increasingly they will need access to relevant, robust and meaningful information, wrapped up in context, to make decisions," she adds.

Similarly, there is a need for trustees to establish an impact investment strategy that not only aligns with their fiduciary duties and members' interest, but also facilitates meaningful change.

"The decision will inevitably mean facing financial risks and returns, including related costs and liquidity," notes Griffiths, adding that a crucial element of investment success for pension schemes is having "clear impact targets available" to regularly compare performance.

"In general, it's best to observe for a little while, and when ready, to start small," he says.

For many schemes, and impact investors more broadly, the need to have a supporting framework in place leads them to invest along the lines of the UN's Sustainable Development Goals (SDGs). The 17 goals span environmental, social and economic factors and can act as a basis for a scheme's impact investment approach.

"What we are seeing from pension schemes is increasing demand for mandates and pooled solutions that seek to address all the SDGs and to deliver positive outcomes for people and planet,and we are seeing this in both equities and fixed income," Long says.

For AXA, this approach is realised in their five-step impact framework, which covers intentionality, materiality, additionality, negative externalities, and measurability.

Long says: "In putting our five-step listed equity impact framework to work, we seek to deploy capital with impact leaders in a way that sends clear price signals to the market while using engagement to encourage SDG-aligned corporate behaviour."

Similarly, Griffiths points to Bridges Fund Management's four categories that relate to impact. The distinction between the four, in essence, is the financial return each one is expected to deliver.

Impact Version 1 refers to investments that address societal challenges and delivers a competitive financial return. Impact Version 4 addresses societal challenges that cannot generate a financial return. The other two groups lie between the two.

"Pension funds are likely to be comfortable in investing in the first category, and possibly even the second depending on scale, but are less likely to consider the latter two categories at any meaningful level. These are more the domain of development finance institutions, impact-focused foundations and endowments, and philanthropists or private investors," says Griffiths.

Imperatively, schemes must consider how their members fit into any kind of impact framework. From fully considering the fiduciary implications, engaging with place-based impact investing to engaging with members to understand what matters to them.

"Initiatives like Make My Money Matter are raising public awareness around how people can start to ask questions of their pension providers about how their money is invested," Rose says.

There's a generational shift happening but still a long way to go to give people the sense they can influence outcomes using their pensions. Research shows that goodwill is there for ethical investing, but it's more daunting than everyday decisions such as recycling or buying locally.

For schemes looking to embark on an impact journey, the lessons are clear – determine a robust framework, develop expertise and partnerships and be prepared to navigate a tricky data environment.

Written by Tom Higgins, a freelance journalist

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