MARKET INSIGHT

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IMPACT INVESTING: MAKING GOOD WITH YOUR INVESTMENTS

Socially responsible investments (SRI) or ethical investment consists of any investment strategy which seeks to consider both financial returns and social good. While some investors simply avoid businesses involved in alcohol, tobacco, fast food, gambling, pornography, weapons or fossil fuel production, others integrate more complex data analysis on ESG (Environment, Social justice, and corporate Governance) criteria in their investment process. On top of that, an innovative form of investment is emerging: impact investing. These are investments made into companies or through mutual funds with the intention of generating a social or environmental impact alongside financial returns. This can be done using various assets classes such as listed equities, fixed income, microfinance and private equity. Impact investing differs from ESG investing which tends to focus on analyzing internal company processes, while impact investing is concerned with companies' external environmental and social impacts for our planet. Thus, some companies could have a very good ESG rating without having a positive impact. Investors should be cognizant of the impact that their investments have, which may be positive or negative and will have long-term effects on addressing some of the world's greatest challenges. Therefore, investors should consider building portfolios which are aligned with their own core values and objectives.

The United Nations Sustainable Development Goals (SDG) are now used within the financial industry as a framework for impact investing and to evaluate social impacts. On 25 September 2015, 193 countries of the UN General Assembly adopted the 2030 Development Agenda titled "Transforming our world: the 2030 Agenda for Sustainable Development". The 17 Sustainable Development Goals target basic needs (no poverty, zero hunger, good health and well-being, clean water and sanitation), climate change (affordable and clean energy, climate action), natural resources (responsible consumption and production, life on land and below water), human life quality (education, gender equality, inequality reduction, decent work and economic growth, industry innovation and infrastructure, sustainable cities and communities) and better governance (peace, justice and strong institutions, partnerships for these goals).

The SDGs also target the world's poorest people. According to the United Nations, 1.2 billion people, 15% of the world population, are living with earnings of less than $1 a day, and 4 billion people, 61% of the world population, with earnings between $365 and $3,000 per year. By serving the "bottom of the pyramid", companies can operate a change to improve the quality of life of the poorest people, while opening opportunities for investments of their own.

Alongside poverty, the world faces many other challenges. With a huge demographic growth in some countries and climate change coupled with increasing natural disasters, water supply is becoming a major issue in many areas of the globe, which will have consequences in the coming decades such as conflicts and migrations linked to safe drinking water access.

Plastic pollution is also a key challenge, with the accumulation of plastic objects such as bottles in the Earth's environment adversely affecting wildlife and humans alike. Moreover, the chemical structure of most plastics renders them resistant to many natural processes of degradation and as a result they are slow to decompose. Wildlife, particularly marine animals, are harmed by its mechanical effects, such as entanglement in plastic objects or problems related to ingestion of plastic waste. Humans are also affected by plastic pollution, like disruption of various hormonal mechanisms often caused by contaminated water or food. In some areas there have been significant efforts to reduce the prominence of plastic pollution, through reducing its consumption and by promoting recycling. For example, Danone announced in 2018 the change all its packaging to recyclable plastic by 2025.

Governments, development aid agencies, NGOs (non-governmental organizations) and philanthropic endeavors are contributing to the SDGs with their remarkable work. Financing needs are huge, the United Nations estimates the gap in financing to achieve the Sustainable Development Goals at billions per year in developing countries alone. This is why both the private sector and the financial industry should take the impetus to take their share of responsibility and bring innovative solutions to achieve these goals. As shareholders of many companies across the globe, this is the duty of financial market actors such as pension funds, insurers, high-net-worth individuals and wealth managers. More and more asset owners are now aware of this duty and responsibility. For example, BlackRock, one of the biggest world asset managers is actively promoting a more sustainable approach. This is the vision of BlackRock CEO Larry Fink who wrote in his 2018 annual letter to CEOs entitled "A Sense of Purpose," that "to prosper over time, every company must not only deliver financial performance, but also show

how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."

The challenge of impact investing is in simultaneously delivering financial and social returns. Some impact investors are "impact-first"; they are willing to accept a lower financial return (compared to a conventional financial product) for a greater impact. For "finance-first" impact investors, the return on investment is higher priority. Accordingly, impact investors are focusing their investments toward companies with business models that provide sustainable technologies, healthcare services to the poorest, sustainable agriculture and manufacturing, responsible consumption and production, education or clean energy. As an example, Ørsted, a Danish state-owned power company, has transformed itself from using fossil fuels to a green energy provider to become the largest offshore wind farm company in the world with a market share of 16%.

Investors also want to evaluate businesses' impact on society, but measuring a firm's wider societal impacts is not easy. Accounting standards for measuring impact do not exist and the metrics currently in use are still evolving. Greater clarity on measurement is slowly emerging as academic researchers are studying impact assessment, and organizations such as the Global Impact Investing Network (GIIN) with the IRIS methodology, B Lab with Global Impact Investment Rating System (GIIRs) and the United Nations with the Principles for Responsible Investment (PRI) seek to develop standards for the industry.

Businesses shape our world, that's a fact. Their actions are profound, global and lasting. They impact our Earth, our oceans, our climate, our cities and our lives. We can all participate in changing the world for the better by inciting businesses to become a driving force for good. Capital markets will be profoundly transformed by global sustainability challenges, including climate change, pollution and essential investments in human rights and human dignity, infrastructure and resource efficiency. Therefore, impact investments based on analysis which incorporates long term objectives such as United Nations Sustainable Development Goals, including environmental, social and governance (ESG) factors, will become significant in the coming years. They are also enhancing investment decisions and improving portfolio diversification. Impact investing can "restore" the purpose of financial markets which are not doing their basic job: connecting those who have capital to those who need capital, in order to help the economy and society grow well.

Switzerland is the heart of a large socially responsible investment community and Geneva is one of the leading cities in impact investing, hosting the United Nations European headquarters, specialized international organizations, NGOs, foundations, microfinance institutions, impact investing actors, private banks, asset managers and institutional investors. As a result, Switzerland will therefore become a driving force and leader for impact investing in the coming years.

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