HSBC Private Banking

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Impact investing and the road to recovery

Impact investment is now recognised as a powerful vehicle through which UHNWIs can support the transition to a sustainable economy and aid recovery from the effects of the pandemic.

WRITTEN BY The Economist Intelligence Unit

Introduction

Impact investing and sustainable finance have reached a potentially transformational moment. As the world gets to grips with the wide-ranging effects of the coronavirus pandemic, a vital role is emerging for the growing number of ultra-high net worth individuals (UHNWIs, those with US$30m or more to invest) seeking to invest constructively and with purpose.

Using their wealth to make a positive impact on the world has long been important to UHNWIs. In recent years the investment landscape has evolved to provide frameworks to enable the wealthy to act effectively on those good intentions, with asset managers, banks, wealth offices, consultancies and other firms allocating greater resources to understanding and serving a growing market. Impact and responsible investing are also benefiting from a greater recognition among private and institutional investors that sustainability has a direct impact on investment returns. Evidence of this can be found in the prominence of environmental, social and governance (ESG) factors as risk metrics, as well as the increased issuance of products including green and social bonds.

As the market continues to grow it will be shaped to some extent by its role in the rebuilding and remaking of the global economy in the wake of the coronavirus crisis. Urgency has been injected into the need to identify and finance solutions across a range of areas, from access to affordable housing and healthcare to the development of vaccines and sustainable food supply chains. The pandemic is also a prompt for UHNWIs to evaluate their investment priorities. Over the coming months and years there will be opportunities for wealthy investors to make a significant, measurable impact with their capital and help to drive a sustainable recovery.

In this report we explore the current state of the sustainable finance and impact investment market and look at how this asset class will become increasingly relevant for UHNWIs in the post-covid environment.

The state of play

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THE PANDEMIC HAS REALLY EXPOSED THE INEQUITIES OF OUR SOCIETY, THE INCREDIBLE VULNERABILITY OF MANY WORKING PEOPLE.

Amit Bouri
Co-founder and chief executive,
Global Impact Investing Network (GIIN)

The rapidly evolving impact investment market forms a part of a global and diverse responsible investing ecosystem. Impact investing—a term coined in 2007, a year after the UN Principles for Responsible Investment (UN PRI) were published—shares some common features with related labels including ESG, socially responsible investing (SRI) and ethical investing.

All take distinctly different approaches, however. For example, ESG factors are usually employed as risk metrics in investment analysis, with the focus mainly on publicly listed companies. By contrast, impact investment seeks to make a direct and quantifiable environmental and/or social impact through investments primarily in private (non-listed) businesses whose main purpose is to address a particular problem or issue.

Although impact investing sits under the broad sustainable investment umbrella, it exists in its own wide-ranging investment ecosystem, across which the level of impact and the expected financial returns can vary significantly. Possibilities range from commercially oriented private equity funds or fixed-income products, which offer risk-adjusted market rates, to microfinance or the funding of projects (in areas such as reforestation, affordable housing and access to healthcare, for example), where the impact is prioritised and returns can be "concessionary"—that is, lower than the market rate. Impact investors are expected to publish a yearly impact report that discloses, measures and assesses the actual impact being achieved, often based on progress towards the 17 UN Sustainable Development Goals (SDGs).

$500bn

were held in impact investing assets worldwide in 2019

46%

of wealthy investors plan to invest in companies pursuing ESG policies over the following year

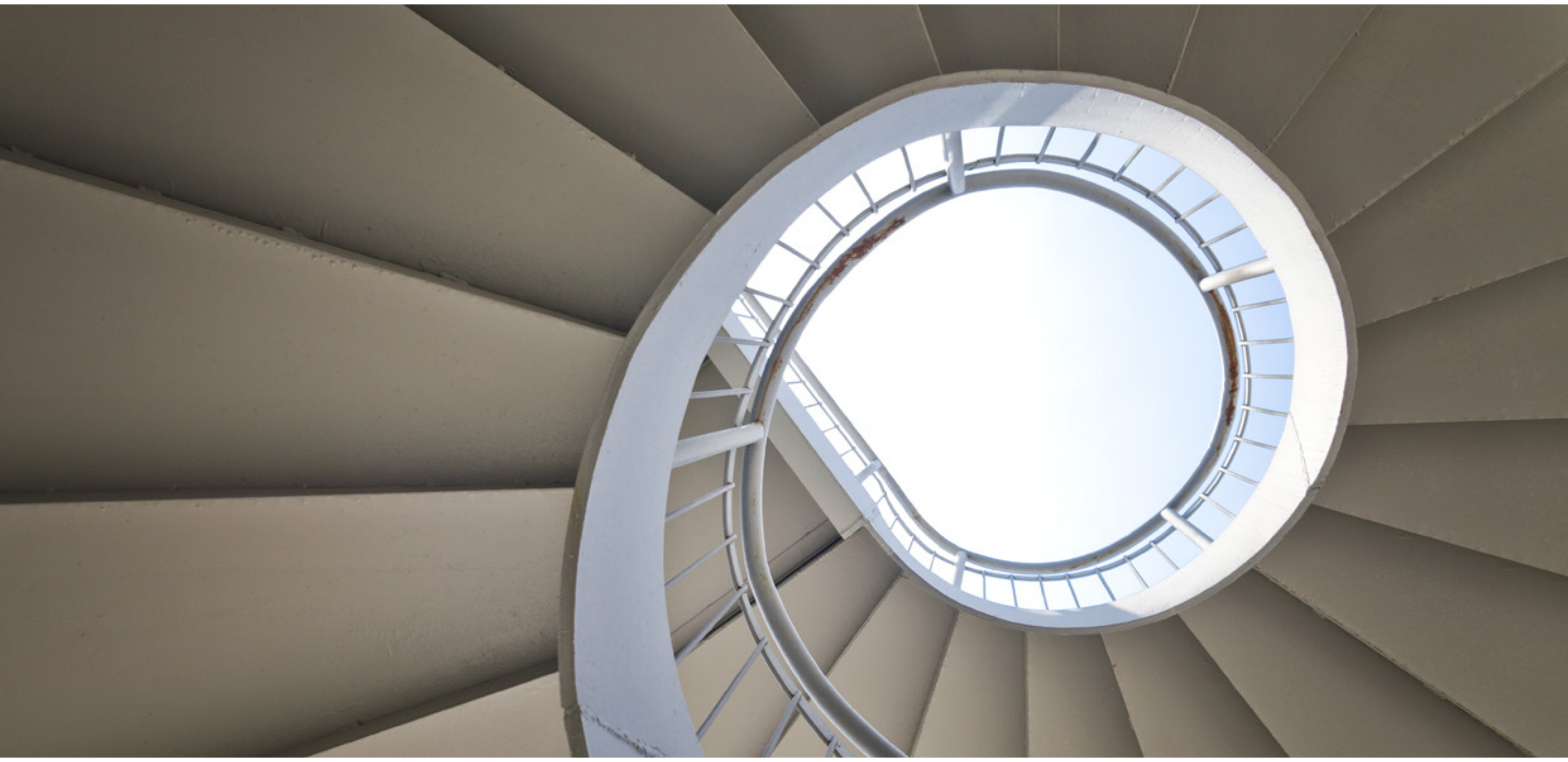
There is currently no regulatory definition of impact investing. It is defined by the Global Impact Investing Network (GIIN) as "investments made with the intention of generating positive, measurable social and environmental impacts alongside a financial return". A 2019 GIIN report, Sizing the Impact Investing Market, estimated that more than US$500bn was held in impact investing assets worldwide, with the sector having doubled in size in just two years.[1] Almost seven in ten respondents to the GIIN 2020 Impact Investor Survey said that the impact investing market was "growing steadily" with 21% describing the market as "about to take off".

This growth reflects a surge of interest among investors, particularly those with the most assets to deploy. More than a quarter of HNWIs and 40% of UNHWIs were interested in sustainable products as at January 2020, according to the Capgemini 2020 World Wealth Report.[2] The report found that wealthy investors planned to invest 41% of their portfolios in companies pursuing ESG policies by the end of 2020, rising to 46% over the following 12 months.

"Before the pandemic we were seeing great interest around the world from high net worths who wanted to put their capital to work to address social and environmental problems at home and globally," says Amit Bouri, co-founder and chief executive of the GIIN. "They increasingly recognise that impact investing is an appropriate and attractive strategy to use for this."

More than half of those polled by the GIIN said that the coronavirus crisis was unlikely to influence the level of funding that they would commit to impact investments in 2020. Another 20% said that they would reduce their commitment, while 15% said that they would add to their investments in impact themes. Some of those not planning to change their commitment explained that the impact themes in which they were already invested had been exacerbated by the effects of the pandemic, making them less likely to commit to other themes in addition.

But the pandemic will inevitably inform investor impact goals and how they are acted upon, Mr Bouri predicts. "It has really exposed the inequities of our society, the incredible vulnerability of many working people, and of course there are the added dimensions of disparity around race and gender."



How UNHWIs use impact investing to achieve outcomes

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THERE IS A NEW GENERATION OF INVESTORS THAT ARE VERY INTERESTED IN SOLUTIONS-BASED AND IMPACT INVESTMENT.

Lisa Beauvilain
Head of sustainability and ESG, Impax Asset Management

Studies show that a majority of UHNW investors around the world want sustainable and impact opportunities for their assets. Their interest reflects both a desire for measurable outcomes and a recognition that it can drive long-term returns. There is an appreciation too for the transparency that impact investing offers. With both the impact and the financial outcomes reported on, UHNWIs can see what their wealth is contributing to, as well as the returns that they are getting on their investments.

Almost four in ten (39%) respondents to Capgemini's World Wealth Report 2020 cited higher returns as their biggest single motivation for investing sustainably (39%), followed by an improving understanding of ESG products (29%) and a wish to "give back to society" (26%).

Environmental risks and climate change were the preferred ESG-related areas of focus for

55%

of investors.

Issuance of social bonds in Q2 2020 jumped to

$33bn

up from $17bn for FY 2019.

Where to go

Asked by the GIIN about their primary motivations for impact investing, 87% of respondents cited both "impact being central to their mission" and their "commitment as responsible investors". "There is a new generation of wealthy clients that are very interested in solutions-based and impact investment, especially younger generations," notes Lisa Beauvilain, head of sustainability and ESG at Impax Asset Management.

Against the backdrop of big issues like rising inequality and the climate crisis, there is also a deepening awareness among investors that if better systems are to develop, they need to be invested in. UHNWIs who place a premium on making a social and/or environmental impact are those interested in (or attracted by) the concept of "additionality"—the positive outcomes that would not happen but for the new capital that they are providing and intentionality. Additionality is key to understanding why direct investments in private markets are viewed by impact investors as a more effective solution than buying shares in listed companies.

The range of desired outcomes and favoured themes is accordingly broad. Environmental risks and climate change were the preferred areas of focus for 55% of respondents to the Capgemini survey, just ahead of ethical governance systems (54%) and socially conscious business practices (52%).

How to get there

Impact can be achieved through various strategies in addition to the firmly established listed investment routes. These include social bonds, where the proceeds are directed to social projects in areas such as education, health and affordable housing. Issuance of social bonds in the second quarter of 2020 jumped to US$33bn, up from US$17bn in full-year 2019, according to Moody's, and it will continue to increase as institutions seek to address social issues highlighted by the crisis.[3]

The HSBC Private Banking view

In the first half of 2020, social bond issuance was up by 399% and issuance of sustainability bonds up by 81%, according to HSBC Global Research. Social bonds are ideally suited to responding to the covid-19 pandemic.

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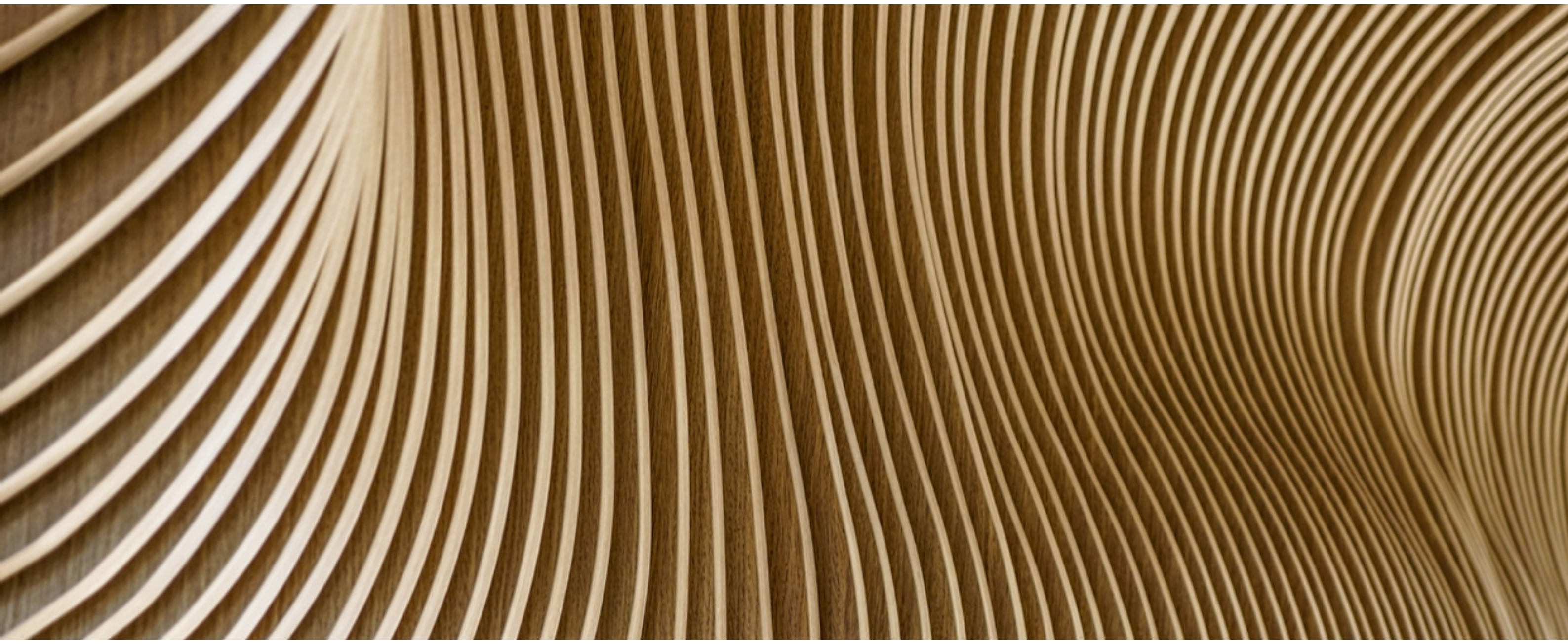
IMPACT INVESTING CAN DEMONSTRATE THAT SOCIALLY AND ENVIRONMENTALLY POSITIVE INVESTMENT APPROACHES CAN ALSO DELIVER SUPERIOR RETURNS IN EMERGING COMMERCIAL SECTORS THAT NEED TO BE SCALED.

Richard Burrett
Chief sustainability officer,
Earth Capital

There was initially a marked decline in the issuance of green bonds (which fund projects that have positive environmental or climate benefits) over the same period as lockdowns left green infrastructure projects stuck on hold. But a record September—including a US$7.7 sovereign green bond from the German federal government—took the level of green bonds issued up to US$200bn for the first nine months of 2020, 12% up on the same period a year earlier, BloombergNEF reported.[4]

But although bonds offer scalability advantages and strong additionality—providing benefits beyond investment returns—it can sometimes be difficult for investors to assess the intentionality of impact and to earmark capital for particular projects.

The contribution strategy most strongly associated with UHNWIs—philanthropy—offers the ability to fill gaps, respond quickly and act as a potentially transformative factor. "Venture philanthropy may play an important role in donor aid or the development of novel business models and approaches in areas where the economics are yet unproven," says Richard Burrett, chief sustainability officer at Earth Capital. "But impact investing can demonstrate clearly that socially and environmentally positive investment approaches can also deliver superior returns in emerging commercial sectors that need to be scaled."



The pandemic and the future of impact investing

As additional needs become clearer there is likely to be more investment focus on issues including sustainable food supply and access to affordable healthcare and housing. UHNWIs may seek to support initiatives such as the Access to Medicines Index and to engage with the pharmaceutical industry in making sure that essential treatments and medical devices are both accessible and affordable. Prevention is expected to be a prominent theme in healthcare impacts, with efforts directed towards work including the development of vaccines and the analytics of testing and diagnostics.

Investment opportunities may also arise around the technological and digital infrastructure that increasingly underpins the global economy, Ms Beauvilain points out, accelerating an existing trend. "There will be parts of the economy that will now be much more dependent on e-commerce, so investors might want to consider what are the opportunities around digital infrastructure."

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NATURE-BASED INVESTMENT OPPORTUNITIES WILL EMERGE AS THE REVERSAL OF BIODIVERSITY LOSS IS LINKED MORE CLEARLY AS A PREREQUISITE COMPONENT TO ADDRESSING CLIMATE CHANGE.

Pablo Berutti
Senior investment specialist, Stewart Investors

Climate change

The experience of a global crisis on the scale of the pandemic may force policymakers and individuals to consider more urgently the potentially disruptive impact of climate change on day-to-day life. "There will be a deep soul-searching once the clear crisis mode has passed," Ms Beauvilain predicts. "This is one of the first serious events stemming from our encroachment on our natural habitats and ecosystem and what that means for our health."

This increased focus on environmental issues will involve greater investment in solutions in mitigating the effects of climate change and considering how to adapt economies and livelihoods to a changing climate. Impact investors could increase their focus on green recovery strategies that support job creation, such as energy efficiency, greening residential property and real estate, according to Pablo Berrutti, senior investment specialist at Stewart Investors. "Nature-based investment opportunities will also emerge as the reversal of biodiversity loss is linked more clearly as a prerequisite component to addressing climate change," he says. "These might include forestry and land-use-based restoration investments alongside sustainable agriculture approaches."

Goals and guidance

Many investors putting their capital to work in the post-pandemic rebuilding effort will be guided by the SDGs. According to a policy brief published in June by the UN Department of Economic and Social Affairs (UN DESA), the overarching concern of the SDGs—"to leave no one behind"—should be at the heart of covid-19 recovery efforts. UN DESA used the example of SDG 6—access to clean water—as essential in enabling people to wash their hands regularly (and so reduce infection risk), and SDG 3, which concerns the need to deal with pre-existing health conditions that have been a factor in infection risk. However, there are limitations in the extent to which the SDGs can guide impact decisions. Although they "help to paint a picture of the longer-term unmet needs in society globally and highlight the need for investing in solutions", according to Ms Beauvilain, many of

SDG 6

access to clean water and

SDG 3

dealing with pre-existing health conditions should be at the heart of Covid-19 recovery efforts.

the sub-goals—including SDG 13, which concerns the need for urgent action to combat climate change and its impacts—are directed at governments. "The challenge with the SDGs is that it becomes hard in that framework to distinguish what the role of government is and what the role of the private sector exactly is," she points out.

Recovery and resilience

The coronavirus crisis has drawn attention to broad global sustainability challenges in addition to climate change. Among them are structural changes disrupting business models, according to a report published in August by Impax, such as the exposure of supply chain vulnerabilities, the effect of social distancing measures on behaviour and acceleration towards a digital economy.[5]

Impact investment is a critical offering in delivering the positive sustainability outcomes that wealthy investors are increasingly engaged in achieving. But achieving such long-term outcomes is also the responsibility of the wider investment universe beyond impact and sustainability strategies, says Mr Berrutti. "If investors allocate capital to old economy assets, thinking they are safe, they actually risk sinking capital into stranded assets that will not only lose money but also sow the seeds of the next crisis," he warns. "Rather than backsliding on their sustainability efforts to address the impacts from covid-19, investors need to work even harder to achieve returns that also benefit society and the environment."

Conclusion and key takeaways

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ONE THING OF GREAT INTEREST IS MORE ROBUST DATA WHEN IT COMES TO IMPACT PERFORMANCE.

Amit Bouri
Co-founder and chief executive,
Global Impact Investing Network (GIIN)

It is now widely accepted that investing successfully and effectively over the longer term requires a holistic perspective that goes well beyond financial accounts. Although ESG factors are now increasingly integrated into mainstream investment risk frameworks, the past few years have also seen much greater demand for sustainable and solution-based investments.

Impact investment is now recognised as a credible and powerful vehicle through which UHNWIs can support the transition to a sustainable, low-carbon economy and aid the recovery from the effects of the covid-19 pandemic.

Key takeaways

» UHNWIs are looking to make an impact

There are clear demand and supply factors at work when it comes to UHNWIs and sustainable and impact investing. External forces driving demand for impact investing include the growing recognition of the need to tackle problems such as climate change and rising inequality. There is an emerging sophistication in terms of products, strategies, and performance and measurement data.

» What does success look like?

There is now greater urgency for the sustainable and impact investing sector to get to grips with some of the obstacles to its wider adoption. Data, disclosure and measurement have all been problematic, not only for impact but for all aspects of responsible and ESG investing. As the OECD noted in 2019, social impact investment "could be more effective if it were more clearly defined internationally with more measurable outcomes".[6]

The GIIN last year launched its IRIS+ system, a free online resource that gives investors the tools to translate their intentions into real results, including metric sets, guidance and alignment with the SDGs and other frameworks. "The focal point now is sector by sector, which helps drive more convergence in the market around a core set of measures," Mr Bouri says. "In terms of what's needed, one thing of great interest is more robust data when it comes to impact performance."

» Overcoming a short-term culture

There is a compelling case to argue that sustainable investment should be the default option for anyone deploying capital for the long term. But misconceptions that investing responsibly comes at the cost of returns continue to linger. "In an industry obsessed with short-term benchmark-relative returns, you end up with a perverse view that preferring companies who do well by doing good is riskier than staying invested in harmful companies," says Mr Berrutti. "The evidence shows that over the long-term this clearly isn't the case." This may become clearer in the wake of the covid-19 pandemic, he adds. "If there is a lesson to be learned by investors, it is that business resilience not only wins out financially over short-term efforts to juice returns with debt, but can better support employees and communities through crisis."

» Stepping into the breach

The pandemic has exacerbated longstanding inequities in society and exposed the vulnerability of vast numbers of people to social, economic and environmental problems. It has also underscored the scale and urgency of the climate and biodiversity crisis. As with action on climate change, the immediate policy and investment response to the crisis was led by governments. Meeting the needs of a world rebuilding from the widespread effects of the pandemic will now fall to institutional and private investors too.

UHNWIs investing for impact have the intentions and the means to address the most pressing challenges across sectors including sustainable agriculture, energy, conservation, and affordable and accessible basic services such as housing, healthcare, and education. "Philanthropy and governments alone are not sufficient to address the world's problems," says Mr Bouri. "There is a recognition that impact investing is essential if you want a more sustainable, inclusive and just world."

Endnotes

1 https://thegiin.org/assets/Sizing%20the%20Impact%20Investing%20Market_webfile.pdf

2 https://worldwealthreport.com/resources/world-wealth-report-2020/

3 https://www.moodys.com/research/Moodys-Sustainable-bond-issuance-hits-record-high-in-Q2-as--PBC_1241741

4 https://www.edie.net/news/7/BNEF--Green-bond-issuance-broke-monthly-record-in-September-2020/

5 https://impaxam.com/news-and-views/thought-leadership/covid-19-implications-for-the-transition-to-a-more-sustainable-economy/

6 https://www.oecd.org/newsroom/impact-investment-needs-global-standards-and-better-measurement.htm

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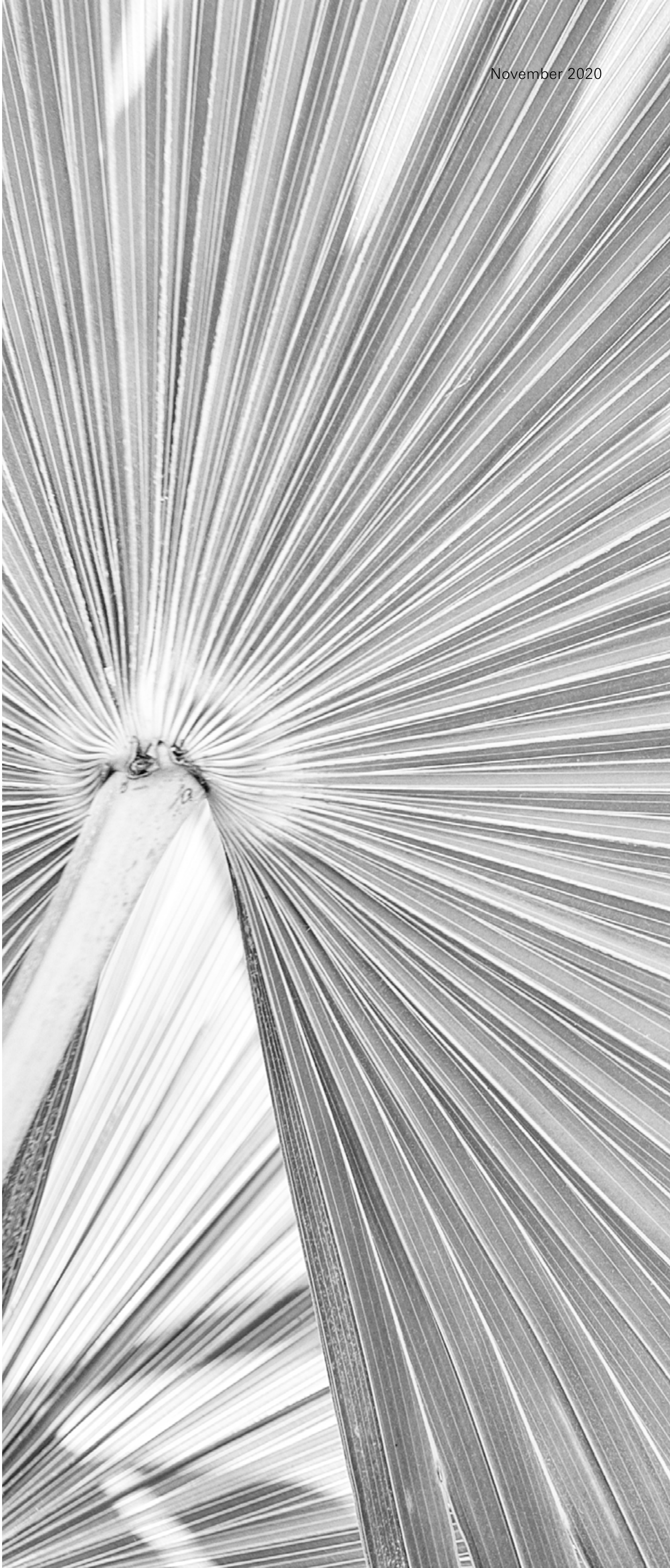

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