All In

Examining a 100% Impact Portfolio

Jointly created by members of the Responsible Investment Association

What is a 100% impact portfolio?

A 100% impact portfolio is an approach to investing that activates the total portfolio for positive social and environmental impact. In a 100% impact portfolio, performance metrics are designed to measure not only the financial performance of an investment but also their social and environmental impact. Often the identified social and environmental impact metrics are tailored to the unique objectives of the investor. Increasingly, however, investors and various industry bodies are establishing common, quantifiable social and environmental targets based on guidelines such as the United Nations Sustainable Development Goals (SDGs). See the Resources section at the end of this document for examples of impact measurement tools, including the SDGs as an impact measurement framework.

A 100% impact portfolio is an investment strategy that can be applied across all asset classes, with the goal of creating positive social and environmental impact through its investments. It is an investment approach that is able to engage various mechanisms for investing in both the public and private markets. Although not always the case, a 100% impact portfolio is typically structured across asset classes, geographies, and currencies.

At this point, a 100% impact portfolio remains to be a relatively aspirational approach to investing. There are, however, some progressive early adopters. For example, the 100% Impact Network at Toniic – a group of more than 130 foundations and high net worth individual investors, with assets totaling approximately $4.5 billion, who are committed to 100% impact portfolios.

How does an organization transition to a 100% impact portfolio?

It starts with building on what one knows and deepening one's impact from there. Some investors place a parameter around impact activities and restrict them to a specific portion of their portfolio, be that by a specified percentage of a portfolio (i.e. 10% for impact) or by asset class. Others have a "light" impact approach across the entire portfolio, such as Environmental/Social/Governance screens (ESG). A 100% impact portfolio typically integrates intentional positive impact across all asset classes in a portfolio, using many mechanisms for investing in impact (e.g. positive & negative screening, ESG risk analysis, thematic investing, shareholder engagement, proxy voting, divestment, etc.).

The decision to adopt a 100% impact portfolio is a long-term commitment. It is not a transition that can happen overnight, both due to practical and prudent considerations. Common challenges that confront pioneering practitioners typically center around three issues: (a) impact data availability in the public markets, (b) product availability in the private markets, and (c) impact measurement standards. Investors are also often limited by a lack of relevant expertise and the willingness of their advisers and investment managers to adopt the investment approach. As financial institutions deepen their understanding of the topic, they will be better positioned to respond to investor and market demand.

Ask the Experts

What is the motivation for foundations and endowments to transition towards a 100% impact portfolio?

It is important for foundations and endowments to understand the impact of their investments. The issue of ethical integrity is an important one for many foundations and endowments. It would be ironic if their commitments to creating a healthier society, community, and environment are funded by the proceeds of harmful investments. We must therefore ensure that their investment decisions reflect the values of their organizations and meet the expectations of those who support them.

The journey towards a 100% impact portfolio typically begins as an effort to "do no harm". This often means adopting socially responsible investment practices such as shareholder engagement and proxy voting, which can eventually lead to ESG integration in all investment decision making. In this evolution, there is often the appreciation that adopting a values-based approach to investing can lead to stronger, more stable financial performance. Better managed companies that have a positive impact on their communities can be more profitable; taking into account the strategic value and risks (e.g. cleantech vs. fossil fuels) associated with an investment opportunity can also yield better financial results than simply sticking with status quo.

Advancing the missions of foundations and endowments, being consistent with organizational values, and strengthening overall returns are solid motivations for transitioning to a 100% impact portfolio.

Desmond Wilson,
Catherine Donnelly Foundation

How can the largest institutional investors include impact across 100% of their portfolio?

How one invests assets can help shift markets towards social, environmental, and economic sustainability. Organizations, communities, and the global economy are interdependent and interconnected with our environment. The capacity of the planet to continue to provide resources and supports is threatened by the degradation of natural and social systems. Through investments made, partnerships forged, and actions taken, important issues are addressed to better prepare for current and future challenges.

Large institutional investors have a role to play alongside foundations and endowments when it comes to investing for positive impact. For example, the investment approach for larger institutions can integrate the consideration of ESG matters into investment and stewardship activities with the goal of enhancing long-term investment performance. Investors can strive to have a positive impact on portfolio companies through stewardship activities and active engagement with companies on material ESG issues.

In addition to integrating of ESG factors in an investment approach, larger institutions can invest a growing portion of portfolios into investments that intentionally seek to create both competitive investment returns and positive social and/or environmental impact that is actively measured and reported. Invested assets can help meet financial targets while making communities more sustainable and resilient for future generations.

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What role does a theory of change play in a 100% impact portfolio?

It is important for an organization to define what a "theory of change" means to them – one should place as much emphasis on the impact outcomes one hopes to achieve in a portfolio as the decision-making process that goes into balancing financial returns within a portfolio. A theory of change is different from a screening tool, which would be employed in a socially responsible portfolio: it is clear about the intention of the impact change that it hopes to bring about, as well as ways to effectively measure those associated outcomes.

At a conceptual level, the theory of change should identify the impact outcomes that one hopes to achieve; for example, the eighth UN Sustainable Development Goal around inclusive economic growth. A theory of change would outline what inclusive growth means, such as equal pay and employment opportunities for women and youth workers. A theory of change can be made up of cascading cause and effect relationships which can in turn lead to a greater understanding of the key criteria that need to be identified when making investment decisions.

Post investment, one should be able to rely on values that have been identified during the investment process as yardsticks to measure the performance of the investment. The said portfolio is then built around a theory of change that is able to have an aggregate measure of the quantifiable impact generated by the relevant investments. Importantly, the impact measurement, along with the risk/return criteria, can be used to build a portfolio's efficient impact frontier. This can help one identify the different levels of impact against one's corresponding risk/return profiles. At this point, it may be possible to understand how various portfolios with different theory of changes begin to relate to each other.

World Vision

Josh Folkema,
World Vision Canada

How can public equities contribute to the success of a 100% impact portfolio?

Generating impact in investing is not limited to a specific asset class or sector – it is more about total portfolio management. That said, given public equities are a core component of the total investment portfolio, addressing impact in public equities is crucial to the success of a 100% impact portfolio. Publicly traded companies can have a positive social and environmental impact but they can also perpetuate the very problems that investors' grant-making or private impact investments are trying to solve.

Investors can achieve 100% impact portfolios through allocation of capital towards companies that generate positive impact and offer direct engagement with the management team of individual firms. Public companies can deliver positive impact through their products, services, or business strategies as many companies have embarked on the journey to providing solutions for the world's problems rather than compounding them. Investors can actively seek to invest in companies that have the potential to create positive economic, environmental, and social impact. Shareholders can drive positive change through equity ownership, which can be a useful tool to influence companies. Through active engagement with company management, equity investors have the ability to influence and shape corporate strategy on material environmental, social, and governance issues, nudging them towards implementing better sustainable policies and practices.

The starting point for building a public equity portfolio should be setting specific targets around financial, environmental, and social impact to meet investors' long term goals rather than relying on conventional benchmarks as arbitrators of what is reasonable from a risk/return perspective. The construction of a 100% impact portfolio should be managed in a manner that aligns with the financial and impact returns of a portfolio's objectives.

AGF™

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AGF Management

How can fixed income contribute to the success of a 100% impact portfolio?

Fixed income can play a pivotal role in a 100% impact portfolio. From a financial perspective, when used appropriately, debt investments can provide diversification and stability to a 100% impact portfolio in times of economic crisis. In fact, impact fixed income can have a lower correlation to other asset classes than traditional fixed income. Furthermore, the bond market's size, liquidity, track record, and existing infrastructure can make it a favourable market for achieving immediate and large-scale impact with few barriers to entry for investors.

Fixed income instruments are often connected to specific underlying projects, making the process of impact measurement relatively straightforward. For example, investors who provide debt financing to a renewable energy project can measure the impact of that project using metrics such as renewable energy generated in Megawatt hours (MWh). Many green bond issuers provide legally binding, science-based eligibility criteria to ensure proceeds from the sale will be used to make environmentally beneficial investments. These criteria are often validated by an independent third party with relevant experience, providing investors with assurance that their capital will be directly tied to the expected impact outcomes.

Impact bond issuance in Canada has increased steadily over the last several years and is expected to continue to grow to meet increasing demand from investors. In our view, the prevalence and variety of impact opportunities in this space, combined with the financial benefits of diversification, makes fixed income an essential component of any 100% impact portfolio.

ADDENDA
CAPITAL

Karolina Kosciolek,
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How can alternatives contribute to the success of a 100% impact portfolio?

Many investors first initiated their impact portfolios with investments in alternatives and these investments remain an important part of impact portfolios today. From an impact perspective, these instruments – including private equity, venture capital, private debt, and real estate – can be quite attractive. Many of the entities issuing private securities are devoted to creating intentional impact, offer stories of impact, and are able to provide more impact transparency due to less complex business models compared to a public entity. The management teams of these private companies or entities can often be more accessible to investors as well.

Investing in alternatives can also lead to greater diversification in a 100% impact portfolio. Alternatives typically have risk/return characteristics that are different to other asset classes, making them attractive for a well-balanced portfolio. Private equity and venture capital can yield higher returns than other asset classes. However, these returns often come with additional risks, such as illiquidity risk and startup risk.

It is not uncommon for investors to find themselves confronting some obstacles when they first venture into alternatives. Investors will often need to do the groundwork and source opportunities. At the same time, they will find that many ventures will offer only limited information and more often than not, additional due diligence is needed. In other words, investors often cannot adopt the passive role, as they might have when investing in other asset classes. However, as funds, services, and marketplaces emerge, impact investing through alternatives will become more accessible.

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What role can data providers play in a 100% impact portfolio?

ESG research providers have played a pioneering role in developing metrics and frameworks to measure the preparedness and performance of companies on a wide-range of social and environmental issues. Their core area of focus is mid-large cap listed companies which are: a) heavily represented in investment portfolios; and b) have significant social and environmental footprints.

Despite the obvious challenge of needing to drill down to the project level (in the manner applied to smaller companies), by focusing assessments on the most relevant ESG issues per sector, research providers can offer insights on whether – and crucially, how – companies are creating positive impact. Impact is assessed by evaluating the degree to which companies are managing and mitigating the negative social and environmental impacts of their operations and/or offer products and services that inherently contribute to a more sustainable society.

As ESG becomes increasingly mainstream, resulting in a heavy emphasis on risk and materiality, there is corresponding demand among institutional and retail investors for more impact-oriented metrics, ratings, and products. The Sustainable Development Goals (SDGs) are quickly becoming the leading framework for embedding impact more prominently into ESG. Research providers can play an important role in helping investors allocate capital towards the SDGs by assessing company alignment with the SDGs, considering company impacts across the entire value chain, and by identifying companies that are providing products and services that align with the achievement of the SDGs.

Some ESG research providers are also helping shape the market for sustainable fixed income instruments, most notably green and social (sustainable) bonds. By acting as external reviewers for sustainable bond issuances, research providers are offering investors the necessary assurance that proceeds from the bond sale are being effectively directed towards projects which meet the sustainability criteria as prescribed by leading global standards and best practices.

SUSTAINALYTICS

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Conclusions

Committing to a 100% impact portfolio is the beginning of a journey to understand all the impacts of a portfolio – financial, social and environmental. It is a commitment to examine, improve and iterate on current investment allocations. It is not a drastic idealogical change; instead it is about being active, comprehensive, and managing risk. Simply put, it is a commitment to do better.

Resources:

Heron Foundation's Investment Policy Statement - formally commits the foundation to a 100% impact portfolio

Impact Measurement – a list of impact measurement tools curated by the MaRS Centre for Impact Investing

KL Felicitas Foundation's Evolution of an Impact Portfolio - the process of how the foundation committed and implemented a 100% impact portfolio

Toniic's 100% Impact Network - a group of investors committed to 100% impact portfolios

United Nations Sustainable Development Goals – a framework for embedding impact into investments

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