IMPACT INVESTING
FROM NICHE TO MAINSTREAM

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From Niche to Mainstream

A report by VBDO
(Dutch Association of Investors for Sustainable Development)
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Dutch Association of Investors for Sustainable Development (VBDO)
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PREFACE

In a recent study by Deloitte, on new generations (e.g. millennials), respondents ranked "to improve society" as the number one priority of business. However, this does not imply that the next generation of investors will not be seeking market returns. As a consequence, the concept of "Mainstreaming" is important to ensure there is investment supply to meet investor demand. As an asset manager we are creating products to address this generational shift. We strongly believe in steering the power of capital towards 'greater utility'.

AXA IM innovates by supporting Impact investments reaching the mainstream while creating new solutions to investors' specific needs and objectives. The breadth of AXA IM's business and institutional framework enables us to leverage on broad resources and expertise. Ultimately we want to demonstrate that the impact investment market is ready for more than wealthy investors and foundations. AXA IM team's active involvement has already led to the improvement of several underlying funds' structure, processes, governance and positioning thanks to a very open exchange with impact fund managers during our due diligence and selection process.

We are active practitioners, having already deployed a EUR 200M portfolio of impact investments on behalf of the AXA Group and are expanding our impact platform and product offering in this area to meet client demand. We believe that the involvement of institutional investors, such as AXA, will help in accelerating the growth of the industry, attracting more capital and hence ultimately increasing opportunities for investment in the social impact space.

Currently, the market size is estimated to be worth about U$50bn and is expected, according to different surveys,[1] to reach assets of U$500bn to U$1trn by 2020. This strong growth is accompanied by an increasing variety of available instruments, themes & sectors and geographies. We are still far from the 1 trillion USD market however, the market has grown considerably over the last 4 years already. When sourcing investments for our portfolio we are seeing increasingly more fund managers and companies seeking "impact" capital to fund their investments. We see this encouraging practical evidence to support these growth projections.
The industry is approaching an inflection point by rapidly moving from niche to mainstream.

Matt Christensen
Global Head of Responsible Investment

[1] World Economic Forum Industry Agenda, Impact Investing (09/13)

PREFACE

FMO Investment Management

The importance of mainstreaming impact investing stems from the magnitude of global challenges. The year 2015 confronted us with the consequences of climate change and mass migration. With over 2 billion people still living in poverty, 1.2 billion people lacking access to electricity and more than 800 million people severely undernourished, the world needs solutions at large scale. So, we face huge financing needs to develop and implement these solutions. Three major international conferences this year reported similar findings: private sector involvement is key to meet these financing needs and to ensure a disciplined execution.

FMO Investment Management aims to scale up impact investing by providing (institutional) investors access to FMO's deal flow in sustainable emerging markets investments. Translating this mission into specific fund propositions is our contribution to mainstreaming impact investing. And so is sharing our stories about how FMO empowers entrepreneurs to build a better world. And how FMO has consistently been profitable throughout the financial crisis and under current volatility in emerging markets. These stories are essential to inspire and convince investors that impact investing is serious business.

In 10 years, I expect we will see a much more mature market for impact investing. More sophisticated and large scale suppliers, including FMO Investment Management, offering products that are properly rated not only on financial strength and risk profile, but also on impact. In 2025, 10 years from now, this recognition of impact as a serious investment goal and consideration will have been embraced by all long term investors. Investors will evaluate impact alongside financial return and combine a realistic return requirement with specific impact objectives. The major shift versus today will be that 'just some form of impact' will no longer be sufficient for serious investors.

I am looking forward to that future. Together we can build a better world!

Yvonne Bakkum
Managing Director,
FMO Investment
Management

PREFACE

NN

Institutional investors are becoming increasingly concerned with the question of how they can realise financial performance while addressing the world's sustainability challenges. This positive development has brought the investment industry to a turning point as it recognises its role in meeting these challenges. As more assets are allocated to investment strategies and approaches with positive social and/or environmental impact, the chances for meaningful change increase.

As a pioneer in responsible investing since the turn of the millennium, NN Group aims to help guide the transformation process. Our participation in this study is part of realising that objective.

We launched our first socially responsible investment funds in 2000. Since then, environmental, social and governance factors have become an integral part of our mainstream investment processes at our asset manager, NN Investment Partners. Our recent activities in impact investing include a new sustainable emerging markets loans fund in collaboration with FMO. We are also increasing our presence in the green bond market and participating in research and initiatives that are helping to develop this market further.

The impact investment market will no doubt look very different in 10 years. We foresee a more diverse range of asset characteristics and impact targets. As the market matures, barriers to impact investing will become less imposing. Track records will be built, the number of scalable investment opportunities will increase, and previous risk-return perceptions will have been challenged. We seek to continue playing a role in shaping this new investment environment.

NN Group looks forward to using the insights gained from this study to further explore the potential of impact investments for our clients as well as our own assets. We would like to thank the VBDO for conducting this research and organising the inspiring 'joint learning sessions'. We express our thanks also on behalf of our colleagues at NN Investment Partners, Hendrik-Jan Boer and Caroline Muste, who participated in these sessions as well.

Nathalie van Toren, CFA
Sr Advisor Sustainability
NN Group N.V.

PREFACE

Financial institutions create immense positive impact for our society by organizing risk and capital allocation. However, in many cases, most financial institutions are failing to optimally invest in maximising society's wellbeing. Impact investing has arisen to optimise or supplement traditional financial institutions in order to more effectively maximise society's wellbeing. Whereas impact investing is currently a niche activity, Impact Centre Erasmus (ICE) believes that mainstreaming impact investing (doing more impact investments and improving their quality) would be extremely beneficial to society. ICE conducts research into the barriers and opportunities to mainstream impact investing using rigorous methods such as behavioural experiments. Moreover, ICE aids organisations in the development of impact assessment and impact evaluation frameworks to improve the basis on which investment decision can be made. In order for impact investments to be of higher quality (and thus contribute more to society's well-being), investors need to use evidence of impact more actively when assessing impact in their due diligence which in turn also requires them to evaluate actual results of impact of past investments to grow this evidence base.

Karen Maas
Program director CSR and Societal Impact.
Erasmus Centre for Valorisation

PREFACE

VBDO is very pleased to present this report on impact investing. Impact investing is the most ambitious responsible investment strategy and is therefore of particular interest to the VBDO, with our mission to make the capital markets more sustainable.

As it can unlock substantial capital to develop a more sustainable global economy, impact investing can offer solutions to a wide range of social and environmental challenges that cannot be solved by aid and governments alone.

This research confirms that impact investing is no longer the exclusive domain of philanthropic organisations, but is also gaining ground within the institutional investment community.

The scale of impact investing in the Netherlands is still limited, but growing. Mainstreaming impact investing would bring the highly needed closer alignment of the investment community with societal needs.
Mainstreaming impact investing poses many challenges, but the stakes and the returns are high. We are convinced that many of these challenges will be overcome during the next ten years. In our vision of the future, impact investing will not exist anymore, as all investments will be impact investments.

We hope this research contributes to gaining insight on what is happening in this exciting field. VBDO would like to warmly thank the sponsors and partners who made this research possible and thanks all partners who contributed to this inspiring learning journey.

Jacqueline Duiker
Senior Manager Responsible Investment VBDO

EXECUTIVE SUMMARY

Aiming for social impact is no longer the exclusive domain of public authorities and philanthropic investors, as the interest from institutional investors for impact investing is growing rapidly. This report reveals the extent of impact investment amongst Dutch institutional investors, and addresses some of the actions that will need to be taken if the market is to reach its potential.

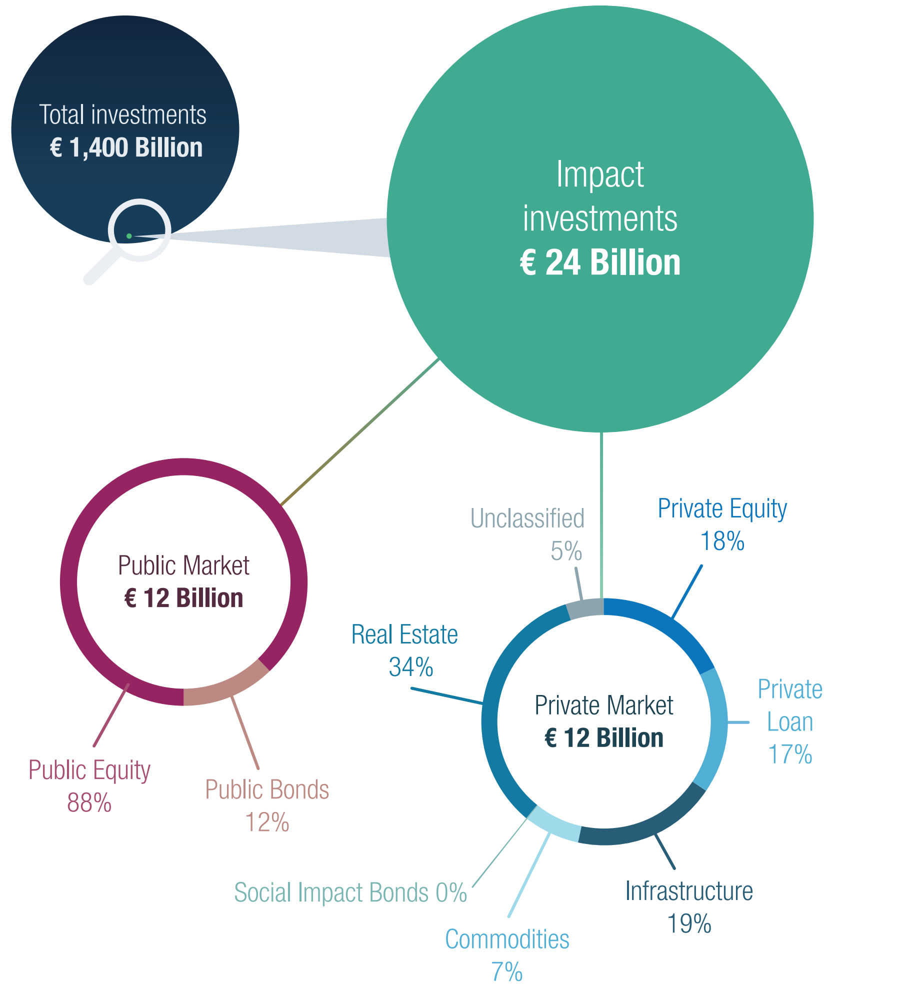
Impact investing is an investment strategy that aims to generate both financial and social or environmental return. The Dutch impact investment market is fragmented, comprising several sub-markets. Some of these markets are just emerging (e.g. the market for social impact bonds), while others are more mature (e.g. micro-finance). This variety means that it is unlikely a single definition could meaningfully capture all types of impact investments.

Based on questionnaires and additional research with pension funds and insurance companies, four key characteristics are identified for impact investing.

1. Intention to achieve a positive societal impact
2. Competitive financial return
3. Impact measurement
4. Long-term horizon

THE DUTCH IMPACT INVESTMENT MARKET

Fifty five percent of the institutional investors that were looked at are engaged in impact investing. Based on their self reported data, impact investments currently amount to 1,7% of the Dutch institutional investment market. The impact investments are made across various asset classes and are evenly divided over the public and the private markets.



Overall results from the analysis of the Dutch market.

The Dutch institutional impact investment market is dominated by a few players. Together, the three largest pension funds and the three largest insurance companies represent 54% of the total investment market and 87% of the impact investments. Most investors allocate less than 1% of their assets to impact investments, although some allocate as much as 8%.

The majority of these investments do not take all four characteristics into account. Our impression is that just over half of impact investments by Dutch institutional investors can be typified as ‘light impact investments’.

ENHANCING THE MARKET

There is great potential for the growth and development of the impact investing market, but this depends on certain drivers being addressed

ORGANISATIONAL

Engaging in impact investing challenges investors to reconsider commonly accepted investment beliefs. Where social issues pose long-term financial risks, investors should take these into account, by adjusting their horizon and the benchmarks for evaluating results. For this to happen, strong and innovative leaders are needed at all levels of the organisation.

MARKET

The market needs to become more efficient, as currently there are difficulties matching supply and demand for impact capital. A significant impediment is a lack of expertise and know-how on standardized impact data for defining, measuring, managing and ultimately monetising the social impact.

INDIVIDUAL

Cognitive biases are likely to play a role in the investment selection process. As the expected social impact is generally more complex to evaluate than the expected financial returns, an evaluability bias may occur where investors only focus on the financial information decreasing the likelihood they make impact investments. Preliminary findings of a research experiment with Dutch investors into this question points to no such evaluability bias. However, it does show that investors from development finance institutions are significantly more likely to opt for impact investments versus investors from commercial organisations.

REGULATION

Public authorities could have a major influence on impact investing, by helping to create a stable and reliable market environment for investments. While regulation is important, market interference can also have the opposite effect to the one desired, and create an unpredictable market that is not attractive to investors.

MAIN RECOMMENDATIONS

Different actors can play an important role in the growth and development of impact investing by taking various actions.

ALL ACTORS

Actors in the impact investment market should join forces and collaborate by forming partnerships and supporting future research.

ASSET OWNERS

Institutional investors should take into account their role in society and take the lead by directing their asset managers to invest responsibly.

ASSET MANAGERS

As the implementers of investment policy, asset managers should be open to adopting “impact-proof” investment beliefs and allowing more flexibility in their investment processes.

INVESTEES

Investees can help to grow the market by increasing the deal size of investment propositions to make them more attractive to institutional investors and by providing data on the social and environmental impact of investments.

INTERMEDIARIES

Intermediaries may prove to be invaluable when it comes to standardizing of the impact investing market and developing investment platforms.

PUBLIC AUTHORITIES

Regulators and governments should use their authority to create an accommodating and stable climate for impact investments.

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INTRODUCTION

MOTIVATION

Impact investing is an increasingly popular investment strategy[2] that aims to generate both financial, social and environmental return; also referred to as societal return. The societal return can address one or more of a wide range of social and environmental issues, such as climate change or poverty. Although impact investing is becoming more common in the investment industry, there is a huge potential ahead.

The purpose of this research is to support the further development of impact investing and to examine what needs to be done in order to mainstream this type of investing.

With these goals in mind, this report aims to:
1. Provide different approaches to impact investing.
2. Provide insight into market developments.
3. Identify opportunities to support the further development of impact investing.

SCOPE OF THE RESEARCH

The research focuses on those institutional investment organisations that are active in the Dutch market.

METHODOLOGY

Different research methods have been used, which is reflected in this report. All data obtained from field research has been anonymised.

- Desk research: A review of existing data has provided the foundation for further study. An overview of the sources can be found in appendix 1.
- Questionnaires:
  - A responsible investing questionnaire (a) was sent to 50 pension funds (response rate 98%) and 30 insurance companies (response rate 63%). The results have been used for the quantitative analysis of the impact investing market and illustrated several best practices.
  - A specific impact investing questionnaire (b) (appendix 2) was sent to the same group. A combined total of 29 pension funds and insurance companies responded. This questionnaire was, amongst other research, used to identify the key characteristics of impact investing.
- Interviews: a total of 19 interviews were held with various people operating in the field, such as policy advisors; board members; and analysts from asset management companies, pension funds and insurance companies. The information gathered from these interviews is incorporated throughout the report and quotes are included. The list of interviewees can be found in appendix 3.
- Roundtable meetings: three 'joint-learning sessions' were held with the sponsors of the report in order to discuss practical challenges and opportunities for impact investing.
- Behavioural experiment: a behavioural experiment was conducted in cooperation with the Erasmus University. This took the form of an online survey (appendix 4) that was sent to various asset managers. Currently the analyses are based on 80 respondents. The purpose of this experiment was to better understand the decision making processes of investment managers and their cognitive biases with regards to mainstreaming impact investment.

OUTLINE OF THE REPORT

Chapter 1 starts with describing the different approaches to impact investing and the relation with other responsible investment strategies. Subsequently four key characteristics important for impact investments are elaborated. Chapter 2 provides an analysis of the impact investment market in the Netherlands. The impact investing market is segmented by asset class, geographical location and theme. Chapter 3 highlights organisational, individual, market and governmental and regulatory developments that are drivers for enhancing the impact investing market. In the final chapters the conclusions and recommendations are presented.

[2] Eurosif (2014). European SRI study 2014.

1. APPROACHES TO IMPACT INVESTMENT

This chapter addresses the historical development of impact investing and its position in the broader field of responsible investment. Since impact investing takes many different forms, a relatively broad view is adopted that fits with prevailing developments in the institutional investment market. This chapter details four key characteristics of impact investing.

1.1 EVOLUTION OF IMPACT INVESTING

The Rockefeller Foundation introduced the term impact investing in 2007. The impact investment industry originally comprised of a core group of proponents that included family offices (private wealth management advisory firms), high-net worth individuals, foundations and development finance institutions. Family offices and high-net worth individuals were particularly well suited to leading the way, as they typically have greater flexibility in their investment mandates, and are less bound by strict legal interpretations of fiduciary duty.[3] Initial impact investments were mainly related to community development finance and microfinance. In 2009 the Global Impact Investing Network (GINN) was launched, which is dedicated to increasing the scale and effectiveness of impact investing.

In recent years impact investing has been gaining broader attention from investors and policymakers. Impact investing has diversified to different types of investors, themes and countries and is growing rapidly on a global scale[4]. In addition to traditional investments in microfinance, institutional investors are now allocating capital to impact investments in various asset classes, as well as to innovative investment products.[5] Chapter 2 will further elaborate on these market developments.

Relation of impact investing to other responsible investment strategies

Impact investing is part of the field of responsible investment (RI). Figure 1.1 illustrates how impact investing fits within the broader investment context.

[3] Balandina, J,J. (2011). Guide to impact investing
[4] Impactbase and the GIIN. (2015). An analysis of 300+ impact investing funds.
[5] World Economic Forum. (2013b). From ideas to practice, pilots to strategy.

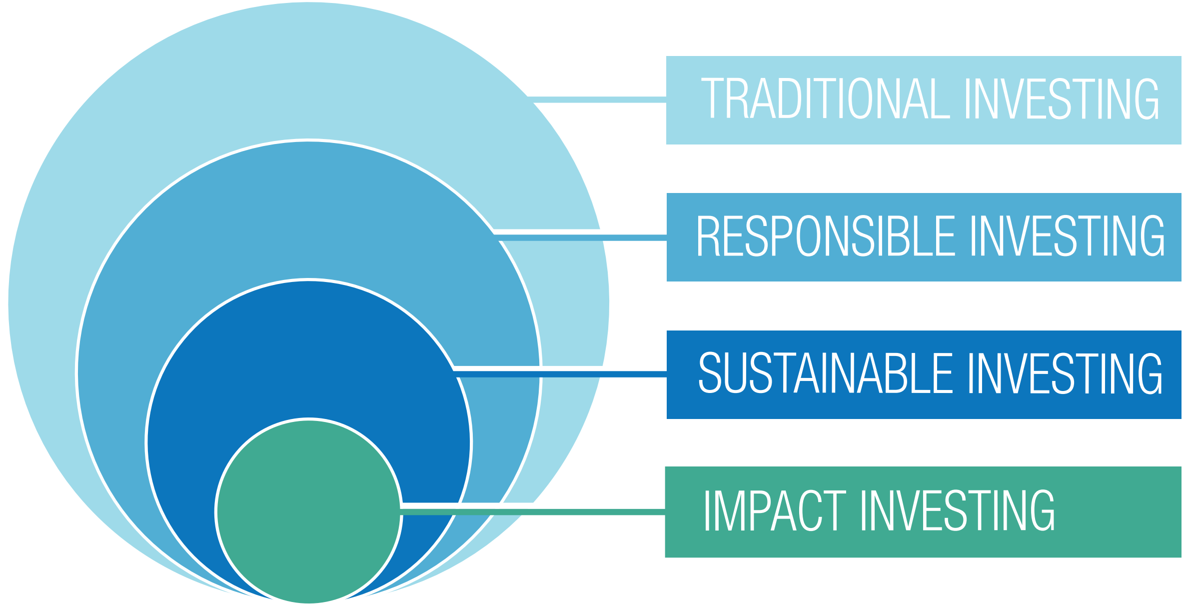


Figure 1.1: Impact investing in the broader investment context.

> *"Impact investing is simply taking responsible investment a step further; it is a natural evolvement in our approach." (Development Finance Institution)*

Figure 1.2 provides a further explanation of each investment strategy. Impact investments actively seek to have a positive impact on society or the environment. Other RI strategies work in different ways. For example, 'exclusion' focuses on minimising the negative impacts of an investment, or addressing environmental, social and governance (ESG) risks. Sustainable investing takes this further by integrating social and environmental factors more thoroughly, and actively selecting investments based on these ESG factors. Investors active in impact investing go even further, by aiming to have a direct positive impact on specific social and environmental issues.

TRADITIONAL INVESTING	RESPONSIBLE INVESTING	SUSTAINABLE INVESTING	IMPACT INVESTING	PHILANTROPHY
Limited or no regard for environmental, social or governance practices, with the sole focus being financial return	Mitigation of risky environmental, social and governance practices, in order to protect financial return	Adoption of progressive environmental, social and governance practices that may enhance financial return	Addressing of social and environmental challenges to generate both financial and social return	Addressing of social and environmental challenges, with the sole focus being social return

Figure 1.2[6] : Impact investing compared to other investment strategies.

[6] Based on G8 and Bridges. (2014). Allocating for impact

1.2 IMPACT INVESTING: FOUR KEY CHARACTERISTICS

There are many different definitions and descriptions of impact investing. When examining the main characteristics of these definitions and the results from the impact investment questionnaire (b), four key characteristics are identified. These are represented in figure 1.3, and will be explained in more detail below.

Figure 1.3: Impact investing key characteristics. (source: questionnaire (b))

1 Intention to achieve a positive societal impact

The intention to achieve a positive social impact is an important characteristic of impact investing and often mentioned in current literature.[7] The results of the questionnaire (b) support this, with 55% of institutional investors naming explicit intention as one of the core characteristics of impact investing.

It is, of course, possible to generate a positive impact as a side effect of generating financial returns. However, for an investment to qualify as an impact investment, a positive impact needs to be intentional.[8] Intention can originate from the investor or from the investee.

2 Competitive financial return

The notion of an investment is based on the idea that the assets purchased will produce some future income or will appreciate in the future. Therefore, any investment strategy has to target a certain financial return. This characteristic distinguishes investments in general, and impact investing more specifically, from philanthropy. The financial return can range from below market to above market financial returns.

The majority (67%) of the institutional investors surveyed agreed the expectation of a competitive financial return on capital as a key characteristic of an impact investment. This is illustrated by figure 1.4. However, 41% of those surveyed believe that impact investing may generate a below market financial return. The investors that expect a below market return often only allocate a small percentage of their portfolio to impact investments in an alternative asset class. >>

[7] Eurosif (2014). European SRI study 2014.
[8] World Economic Forum. (2013a). From margins to mainstream.

Interviewed investors cited below market returns as a considerable impediment to mainstreaming impact investing. These investors are concerned about breaching their fiduciary duty and therefore require the anticipated financial return to be competitive if they are to allocate larger portions of their portfolio to impact investing. For impact investing to become more mainstreamed, investments need to offer financial returns that are at least market rate.

DUTCH MARKET INSTITUTIONAL INVESTORS' EXPECTATIONS FOR FINANCIAL RETURN REGARDING IMPACT INVESTING

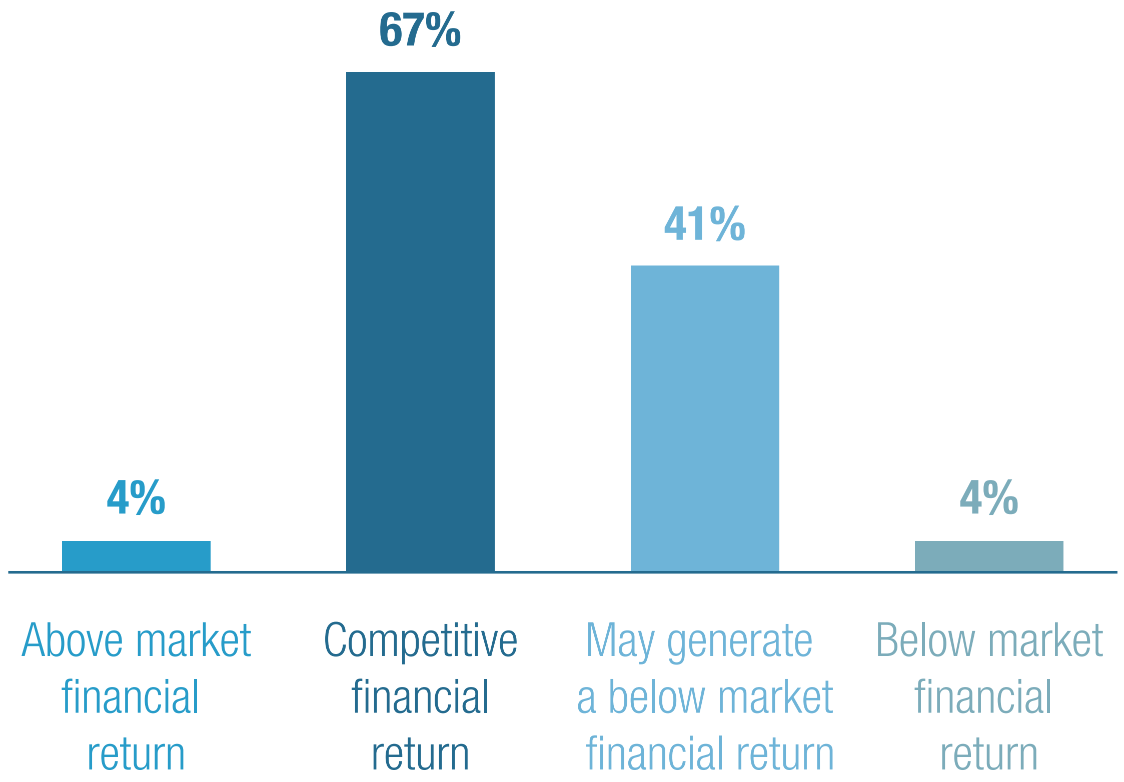


Figure 1.4: Dutch institutional investors' expectations for financial return. (source: questionnaire (b))
* Investors were allowed to provide more than one option. For example, some investors indicated that they expect both a 'competitive financial return' and 'may generate a below market financial return'.

3 Impact measurement

Impact measurement refers to the commitment of investors to measure the social and environmental performance and progress of their investments.[9] The results of the questionnaire (b) indicate that a slim majority (59%) of the institutional investors engaging in impact investing do measure the impact of their investments. However, it is likely that the quality of these measurements varies greatly, as it is widely recognised that most investors currently struggle to assess and evaluate the impact of their investments.

Opinions differed as to the extent to which impact measurement should go beyond desk-based assessment of the impact expected. There appears to be a lack of clarity as to who is responsible for undertaking impact assessments and evaluations. Some investors argued that concrete impact expectations and objectives should be formulated prior to investing. This would then allow for the comparison of results against expectations[10], which may help to improve the likelihood of subsequently selecting investments with a greater impact.

4 Long-term horizon

Roughly half of the institutional investors surveyed (55%) identified a long-term horizon as a key characteristic of impact investing. Impact investments focus on addressing social and environmental challenges and creating long-term value in these areas. Achieving these social or environmental goals therefore often benefits from a long-term commitment from investors.

In practice, mainly driven by the use of short-term remuneration structures and short-term benchmarks, the focus of institutional investors has shifted more and more to short-term results.[11]

However, while a long-term horizon is prefered, long-term investing is not necessarily a prerequisite for impact investing. More opportunities for short-term investing will develop when liquidity in the market increases. An example of already existing liquid and short-term investments are green bonds that are commonly traded on the stock exchange market.

> *"For an impact investment, the investment horizon does not have to be long (some impact investments can have a short investment structure), but the societal horizon will probably be very long, so we need to make that distinction."* (Investor)

1.3 CONCLUDING REMARKS

By examining the results of the questionnaires and interviews, and reviewing existing literature four key characteristics for impact investing are identified. However, it is evident that all four key characteristics need more research and development in order to serve as criteria for the identification or classification of impact investments.

It is unlikely that a single definition could provide a full representation of impact investments across all asset classes. Instead, considering and further defining these key characteristics is a more useful approach to take in order to improve our understanding - and the practice - of impact investing.

The following chapter will further describe the Dutch impact investment market.

9 The GIIN. (n.d.) Core characteristics of impact investing. Retrieved from: https://thegiin.org/impact-investing/need-to-know/#s2
10 Grabenwerter, U and H. Liechtenstein. (2011). In search of Gamma: an unconventional perspective on impact investing. IESE business school, University of Navarra.
11 Andringa et al. (2015). Korte termijn winst of lange termijn waarde creatie?. VBA, nummer 123

2. DUTCH MARKET ANALYSIS

The previous chapter explored the concept of impact investing and outlined its four key characteristics. This chapter gives an illustration of the public and the private markets and the different asset classes in which impact investments can be made. It also analyses the impact investments of Dutch insurance companies and pension funds. The analysis is based on aggregated quantitative and qualitative responses from questionnaires send out to the 50 largest Dutch pension funds and 30 Dutch insurance companies relating to the year 2014. The presented market figures are based on self-reported data on impact investments.

Figure 2.1 The impact investment market for Dutch institutional investors. (source: questionnaire (a))

Figure 2.2 provides an overview of the main findings regarding the Dutch impact investment market. This market will be further explored in this chapter.

2.1 DUTCH IMPACT INVESTMENT MARKET

The institutional investment organisations that responded to the questionnaires manage approximately €1,400 billion between them. For the purpose of this study, this figure is taken to be the total Dutch institutional investment market.[12] In 2014, 30 pension funds and 14 insurance companies were active in impact investing, with approximately €24 billion allocated to the impact investing market. Therefore, impact investing accounts for 1.7% of the wider investment market.

Total impact investing market: the split between pension funds and insurance companies

The pension funds surveyed manage a total of approximately €1,000 billion, of which some €18 billion (1.8%) are allocated to impact investments. The insurance companies manage approximately €400 billion, €6 billion (1.6%) of which is allocated to impact investments.

[12] According to Statistics Netherlands (CBS), the total invested assets from insurance companies and pension funds in 2014 amounted to 1620 billion. Our dataset thus covers 86% of the overall Dutch institutional market.*
*CBS. (2015). Total invested capital. Retrieved from:
http://www.cbs.nl/en-GB/menu/themas/financiele-zakelijke-diensten/cijfers/extra/beleggingen-soorten.htm?Languageswitch=on

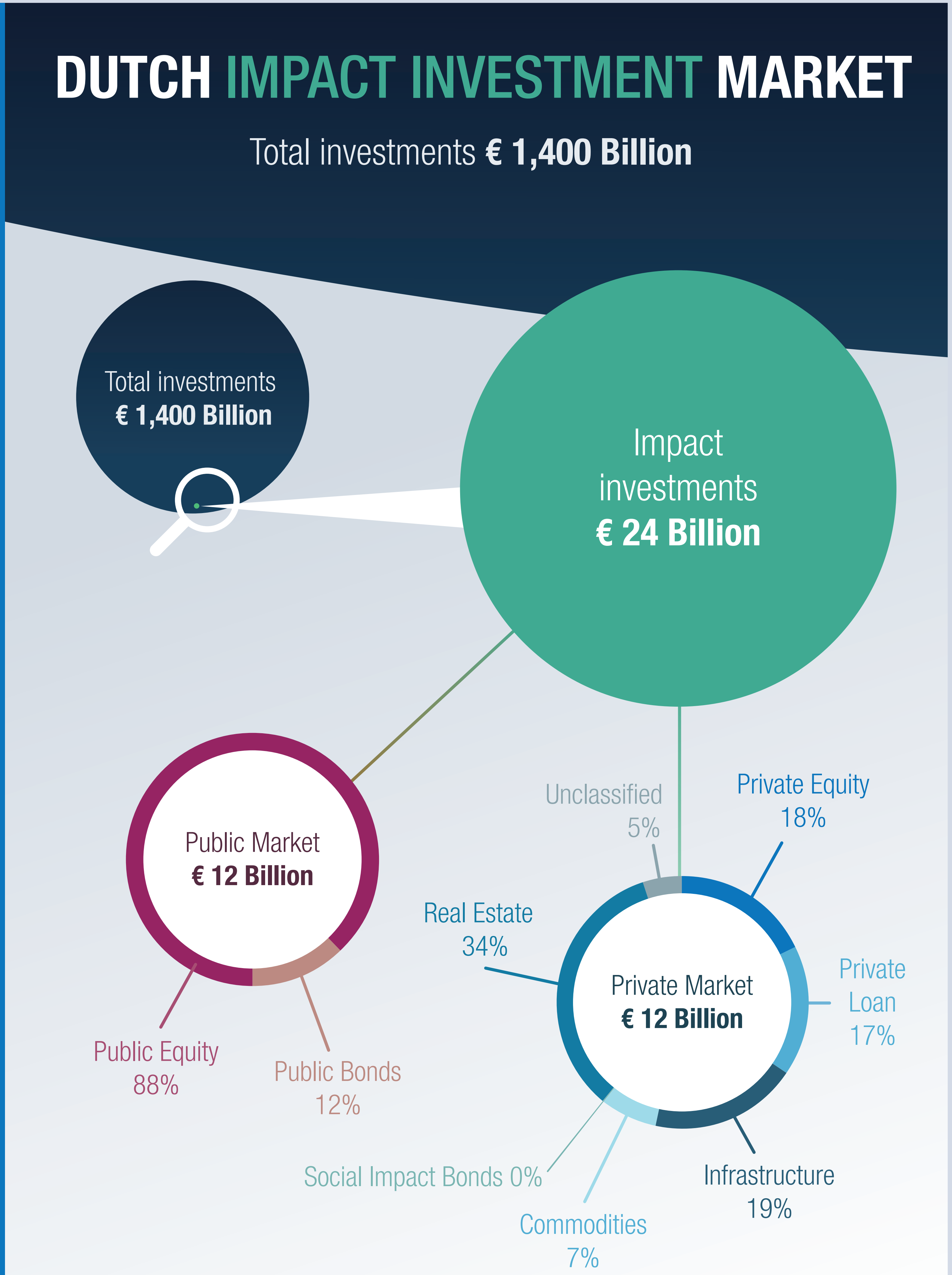


Figure 2.2: Dutch impact investment market.

2.2 COMPARING LARGE AND SMALL INVESTORS

The Dutch institutional impact investment market is dominated by a handful of very large players. The largest three pension funds together with the largest three insurance companies represent approximately 54% of the total investment market, with €757 billion in assets under management (AuM). For impact investments, these six investors represent 87% of the total impact investments, amounting to €21 billion. These figures seem to suggest that there are very few small sized investors active in impact investing. Indeed, as can be seen in table 2.1 below, there appears to be a partial relationship between the size of the investor and the percentage of assets allocated for impact investments. The size of assets under management cannot be said to be the sole determinant for the allocation to impact investments, however. Those small and medium sized investors that do allocate a percentage of their assets to impact investments do sometimes allocate a relatively large proportion. Data analysis shows that some of the smaller investors actually had major impact allocations of around 8 to 9%.

IMPACT INVESTMENT STRUCTURES

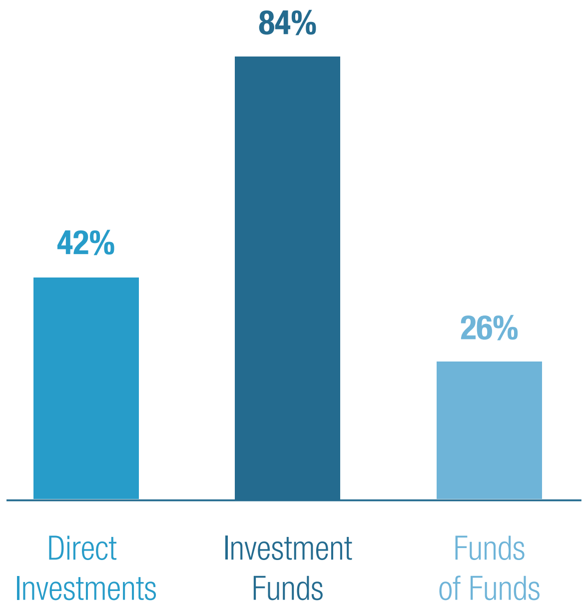


Figure 2.3: Investment structure used by institutional investors for impact investing. (source: questionnaire (b)) *The investment structures are measured by number of investments

2.3 IMPACT INVESTMENTS SEGMENTED BY INVESTMENT STRUCTURE

Three types of investment structures can be distinguished: direct investments, investment funds and 'fund of funds'. As can be seen in figure 2.3, investment funds are the most common structure used by the surveyed investors.

Impact allocation compared to assets under management of investor	Impact allocation (0% - 1%)	Impact allocation (1% - 2%)	Impact allocation (>2%)*	
Small (<5b assets under management)	71%	24%	6%	100%
Medium (5b - 20b assets under management)	77%	8%	15%	100%
Large (>20b assets under management)	50%	29%	21%	100%

Table 2.1: categories of investor size related to allocation to impact investments. These numbers correspond to those investors that at least had some impact investments (>0% allocation). (source: questionnaire (a)) * The highest found percentages are around 8 to 9% of total assets under management.

[9] The GIIN. Core characteristics of impact investing. Retrieved from: https://thegiin.org/impact-investing/need-to-know/#s2

Control versus risk mitigation and deal size: fund preference

Less than half (42%) of the institutional investors reported that they make direct impact investments. Several investors indicated in interviews that they prefer direct investments over investment funds as they can exert more control over direct investments. However, most prefer investment funds, because deal size can be increased significantly and risk is mitigated through diversification.

2.4 IMPACT INVESTING IN DIFFERENT ASSET CLASSES

Impact investments are allocated across all asset classes, and in both public and private markets. Impact investments do vary considerably between the different asset classes, however. In particular, differences exist in the availability, size and liquidity of investments. Below the Dutch impact investing market, its sub-markets and different asset classes are described and analysed.

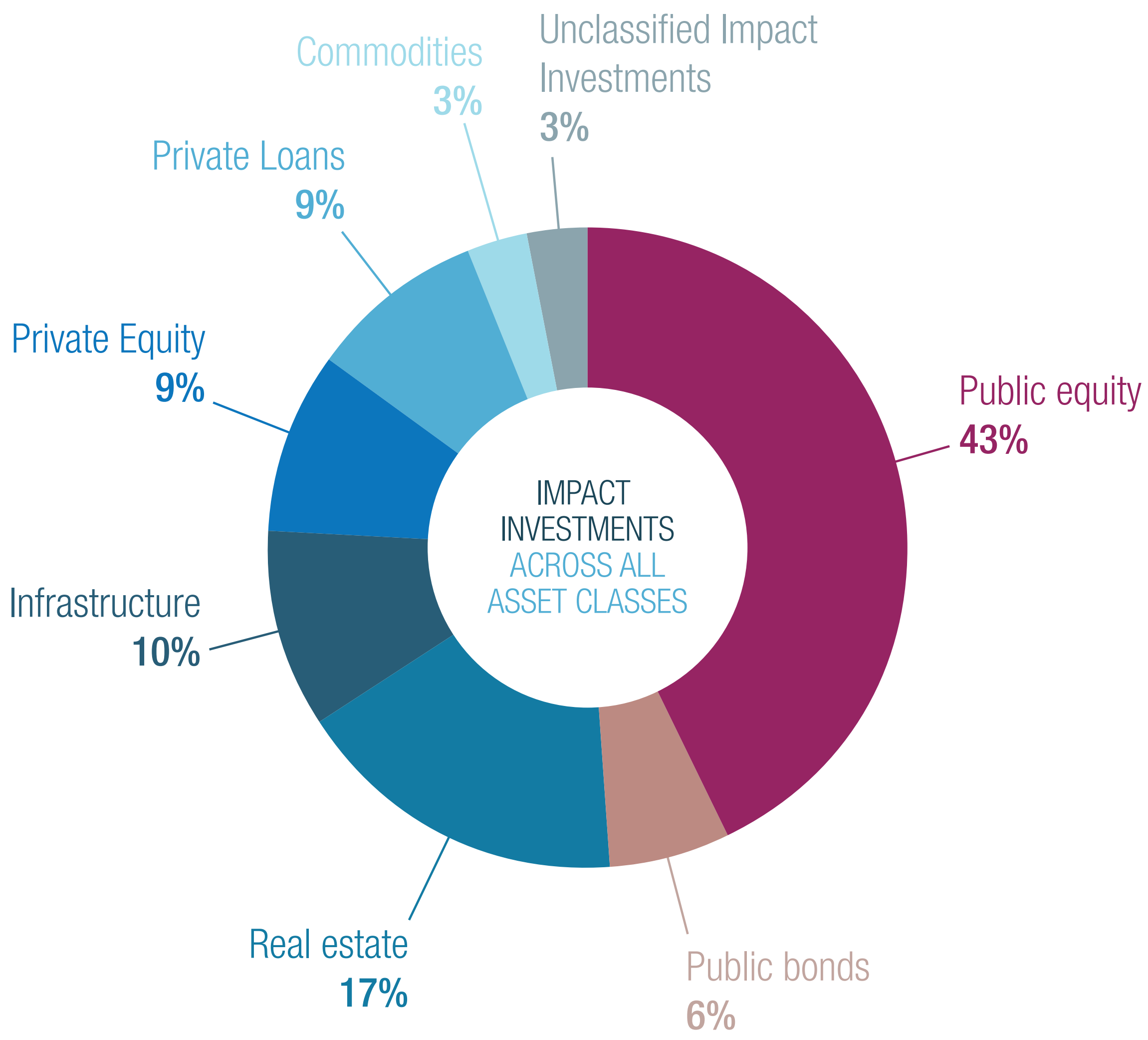


Figure 2.4: Division of impact investments by asset classes on assets under management (AuM = €24 billion). (source: questionnaire (a))

Impact investing across asset classes

Figure 2.4 demonstrates that, according to the institutional investors surveyed, public equity is the largest asset class for impact investments. Real estate is the next largest, comprising 17% of the total impact investment market. None of the institutional investors surveyed held impact investments in social impact bonds (SIBs) in 2014. Impact investments appear to be equally divided over the public (49%) and the private markets (51%).

Impact investing across asset classes: insurance companies and pension funds

Figures 2.5a&b provide separate overviews of the division of impact investments across the asset classes for the pension funds and insurance companies surveyed. Real estate is the largest asset class amongst the insurance companies, with public bonds following. Public equity is the largest asset class amongst the pension funds.

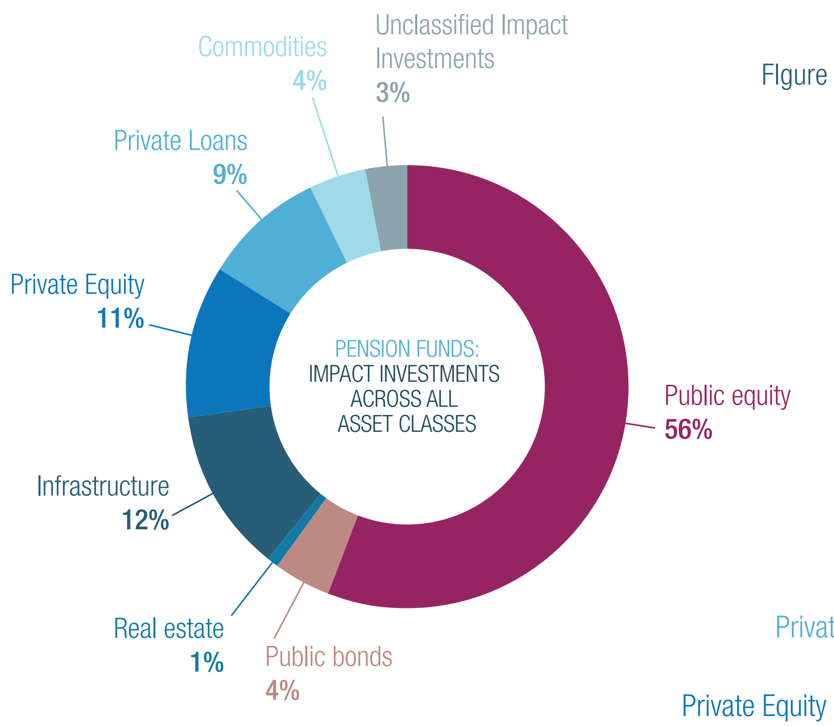


FIgure 2.5a: Impact investments made by pension funds split into asset classes (AuM = €18 billion). (source: questionnaire (a))

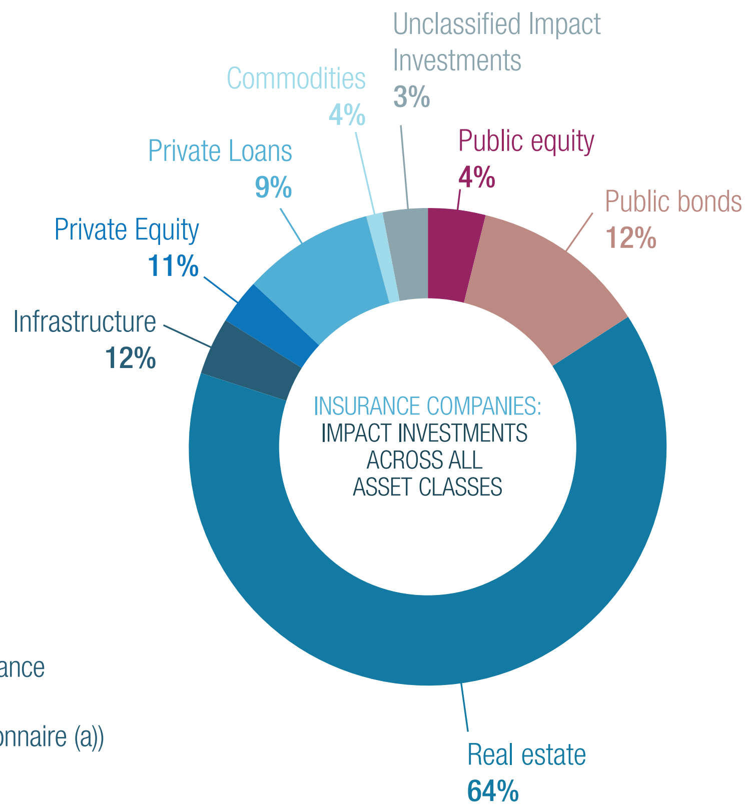


Figure 2.5b: Impact investments made by insurance companies split into asset classes (AuM = €6 billion). (source: questionnaire (a))

2.4.1 Impact investments in the public market

The public market for impact investments comprises publicly traded equity and bonds.

Public equity

For impact investments in public equity a distinction can be made between investments in public companies with a relatively small market capitalisation (known as 'small caps') and companies with a market capitalisation of more than €1 billion (known as 'large caps').

Small cap impact investments usually involve less money, and are often illiquid. Initiatives such as social stock exchanges (SSEs) provide liquid trading opportunities. SSEs are trading platforms that only list social businesses. Similar to regular stock exchanges, they help to connect supply and demand. SSEs facilitate the listing, trading and settlements of shares, bonds and other financial instruments.[13]

"We can help the market develop by attracting more companies and then assisting them with raising money so they can grow. Hopefully in two years' time or five years' time we can have a different conversation, because we will see impact businesses with a market cap of 500 million." (Social Stock Exchange)

LONDON SOCIAL STOCK EXCHANGE

The London Social Stock Exchange (LSSE) selects and lists designated impact enterprises that meet specific criteria with regard to the intention of their business and measurement of the societal results. The LSSE currently lists 34 companies with an individual market capitalisation of less than 1 billion Euros. The LLSE provides the opportunity to invest in an index of companies of impact enterprises. This platform is currently solely focused on small caps.
Several other countries have introduced their own social stock exchanges including Canada (Social Venture Connexion), Singapore (Impact Exchange) and South Africa (SASIX).[14]

Large caps are generally more liquid and commonly traded on the traditional stock exchanges. In addition, several major asset managers launched impact oriented investment funds for large cap public equities in 2015.[15]

13 World Economic Forum. (2013a). From the margins to the mainstream.
14 Chhichhia, B. (2015). The rise of social stock exchanges.
15 Case, J. (2015). A new inning for impact investing. Forbes. Retrieved from: http://www.forbes.com/sites/jeancase/2015/08/11/new-inning-impact-investing/#2715e4857a0b48ff84683bdc

IMPACT FUND FOR LARGE CAPS

A large multinational asset manager introduced an impact fund for large caps in 2015. The fund "aims to achieve exposure to equity securities with a measureable positive societal impact". The focus is on investing in companies that make a measurable positive difference to society in at least one of three specific areas: health, welfare and the environment.

The measurement of the societal impact is split into sub-themes, which have either a positive or negative outcome. Examples of themes with a positive outcome are High Impact Disease Research, Corporate Culture and Green Innovations. Themes with a negative outcome are Controversies and Lawsuit & Litigations. Indicators are used to estimate the outcome of the different themes for companies. This firm uses innovative ways to collect relevant data for their estimations. The final score on the themes are used to determine the extent of (positive) societal impact.

Green and social bonds

A key characteristic of green and social bonds is that each bond should be raising capital for a project that is clearly focused on addressing a key environmental or social challenge.[16]

Generally two types of green bonds exist: governmental green bonds and corporate green bonds. The first type is issued by governments in order to fund schemes such as energy efficiency improvements to public buildings, and the restoration of habitats to reduce pressure on biodiversity. Governmental green bonds also include those that are issued by inter- or supranational organisations, such as the European Investment Bank and the World Bank. Corporate green bonds are issued by a range of private companies, including energy and utility companies, consumer goods producers, and companies in the real estate sector. Corporate green bond issuing is quickly gaining market share in the total bond issues.[17]

Institutional investors are interested in green and social bonds as they provide the opportunity to make large size investments in the public market (due to the relatively large deal size) as well as having a positive social impact.

Public market impact investments: public equity and green bonds

Twenty-nine of the institutional investors surveyed reported public market impact investments (see figure 2.6b). The division between these public asset classes, based on volume invested, can be seen in figure 2.6.a.

The majority of capital for impact investments in the public market is allocated to public equity (88%). However, this dominance of equity is due to a few investors having major equity holdings.

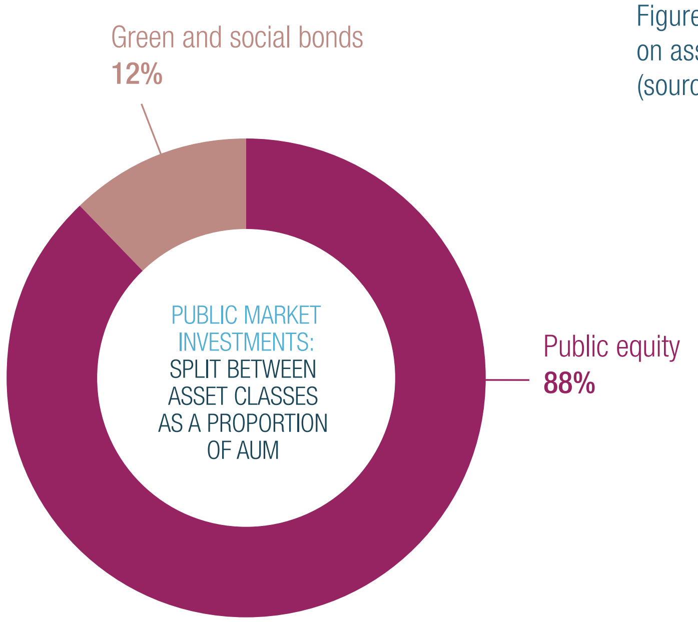


Figure 2.6.a Public market: split between asset classes on assets under management (AuM = €12 billion). (source: questionnaire (a))

Figure 2.6.b, below, shows each individual investor's public asset mix between equity and bonds. This figure demonstrates that many investors solely invest in green and social bonds (pink area). Due to the large equity investments by a few investors, this widespread bond preference is not immediately apparent when just looking at the split between asset classes based on assets under management.

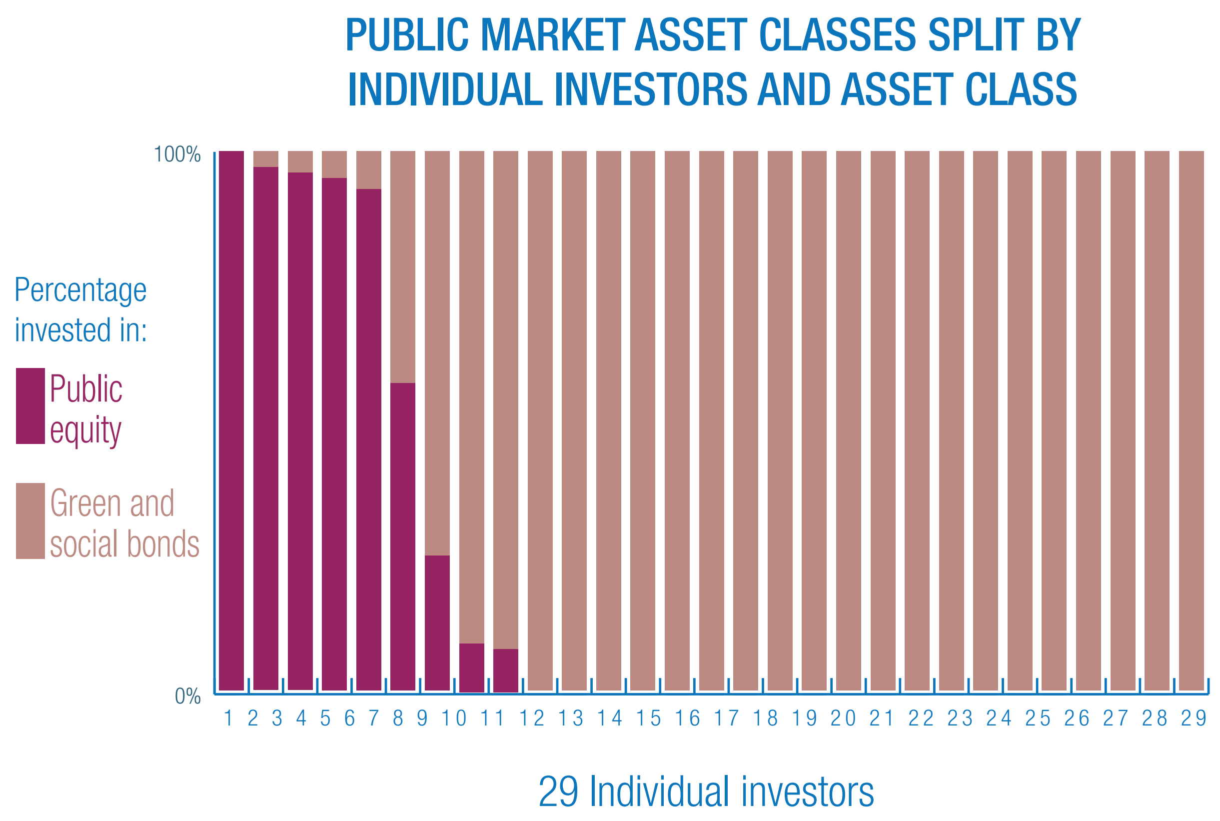


Figure 2.6b Public market: split between asset classes per investor (AuM = € 12 billion). (source: questionnaire (a))

16 KPMG International. (2015). Gearing up for green bonds.
17 See note 16

Pension funds and insurance companies in the public market

Pension funds are responsible for 92% of the volume of impact investments in assets under management in public markets, with insurance companies responsible for the other 8%.

2.4.2 Impact investments in the private market

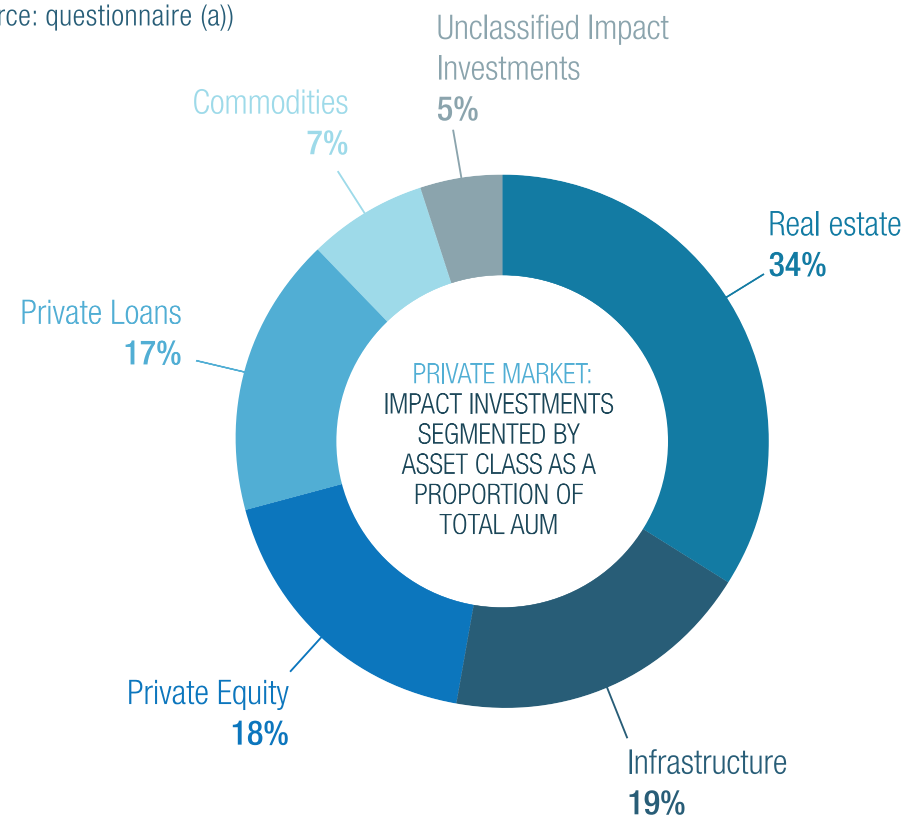
In the private market the following asset classes are recognised: private equity, private loans, infrastructure, commodities, social impact bonds and real estate. As was shown in figure 2.4, 51% of impact investments are made in the private market. Further analysis of the data shows that 57% of private impact investments are made by pension funds and 43% by insurance companies.

Private equity

Up until now, a relatively large share of impact investments has been allocated to private equity and private debt.[18] Private equity is well suited for early stage venture capital impact investments. Promising and innovative sustainable business concepts, not able to go public yet due to size and a short track record, can be fostered by so-called patient capital.[19] Due to the small size of some of these opportunities, investments are often made via investment funds.

Out of the total impact investments in the private market, 18% are private equity. Further analysis of the data shows that, especially amongst the pension funds, private equity is a popular asset class for impact investments. Despite its popularity, some asset owners feel that it is difficult to find good fund managers with relevant experience in the market.

Figure 2.7: allocation of impact investment along the different asset classes in the private market (AuM = €12 billion). (source: questionnaire (a))



18 J.P.Morgan and GIIN. (2015). Eyes on the horizon: the impact investor survey.
19 World Economic Forum. (2013b). From ideas to practice, pilots to strategy
Bugg-Levine, A. & J. Emerson. (2011). Impact Investing; Transforming how we make money while making a difference.
Pena, M., Pena, M.A. & T Newmark. (2011). Portfolio for the planet.

Private loans

Within the private loan asset class, microfinance has gained popularity over the last decade. Microfinance is 'the provision of access to capital and financial services in low income countries'.[20] Similar to private equity, the deal size of impact investment in private loans is often small and the costs of due diligence relatively higher.

> *"Microfinance is a relative small category but portfolios for microfinance are often more complex. It requires additional effort."* (Asset owner)

Impact investments in private loans comprise 17% of the total private market. Pension funds are responsible for 73% of these investments.

Infrastructure [21]

Impact investments in infrastructure are classed as investments in facilities and structures required for the effective operation of an economy and society.[22] Examples include investments in wind, hydro and solar power. The impact of these investments can be measured in a variety of ways, such as the amount of carbon dioxide averted, or the number of people who have been provided with clean drinking water. This asset class is particularly interesting as the investment size is often relatively large, allowing institutional investors to scale their investments. However, lack of liquidity can be an issue for infrastructure.

Nineteen percent of impact investments (by assets under management) in the private market are in infrastructure. Further analysis of the data shows that this relatively large percentage can be attributed to a few large investments held by both pension funds and insurance companies. This results in a large share in the total private market, although the quantity of investments is relatively limited.

Commodities

Impact investments in commodities comprise investments made into basic resources that are used in the production of other goods and services'. An investment in sustainably produced timber can be seen as an example of an impact investment in a commodity. Commodities is not yet a common asset class for impact investing.[23]

Seven percent of impact investments in the private market are allocated to commodities. Further analysis of the data shows that this comprises a few large impact investments that are mostly related to the production of sustainable timber.

20 Dominice, R. (2011). Microfinance investments. Symbiotics.
21 Infrastructure and real estate are sometimes overlapping asset classes. In this research all investments related to energy generation via wind and solar are allocated to infrastructure. It can be expected that this asset class is bigger than the data suggests: some investors did indicate that they made impact investments in infrastructure but did not quantify or specify the investment. Therefore, those investments could not be attributed to the asset class infrastructure but have been included in the market figures as 'unclassified'.
22 World Economic Forum. (2013a). From margins to mainstream.
23 See footnote 22

Social Impact Bonds

Social impact bonds (SIBs) are highly structured, innovative investment products. This type of impact investing is not yet common practice and only a few examples exist. A SIB is an absolute return, pay-for-performance contract between a problem owner (generally the government), an executer and a private investor. The investor provides capital to fund an intervention that addresses a social challenge and is subsequently paid according to the extent of the success of the social intervention. Thus the investor carries the risk if the project is not reaching the social goals . If the social goals[24] are not reached, the investor may not be paid.[25] This is different from previously mentioned green and social bonds, where the risk of the social performance of the project lies with the issuer. In addition to the risks related to investment products, SIBs are currently difficult to scale. They also have high transaction costs due a lack of a track record and established methods for these public-private contracts.[26]

"SIBs do not have track records and there are so many risks involved that as an institutional investor you do not have the courage to, or do not want to invest." (Asset owner)

In our research population no investors were found that invest via social impact bonds.

Real Estate [27]

Impact investing in real estate can focus on social or environmental impact. For example, investments can be made in properties that have a specific social theme, such as elderly housing or empty office spaces that are being repurposed into affordable housing. Investments can also focus on sustainably constructed and managed properties.

Thirty four percent of impact investments in the private market are allocated to real estate. This relatively high percentage is mainly due to large investments in affordable housing projects. Further analysis of the data shows that one single investor is responsible for the majority of these investments.

[24] ABN AMRO, 2014. Social impact bonds.
[25] Social Impact Finance. (n.d.). Social Impact Bonds. Retrieved from: http://www.socialimpactfinance.nl/qa/
[26] See footnote 24.
[27] Data shows that in 2014 about 15 billion Euros investments are made in real estate funds with a high GRESB score, so called "Green Stars". This comprises of a small group of investors that are making large volume investments. These "GRESB investments" are additional to the impact investment market. The reason for this is that GRESB only considers the relative sustainability score compared to other real estate funds.

GEOGRAPHICAL FOCUS OF INSTITUTIONAL INVESTORS

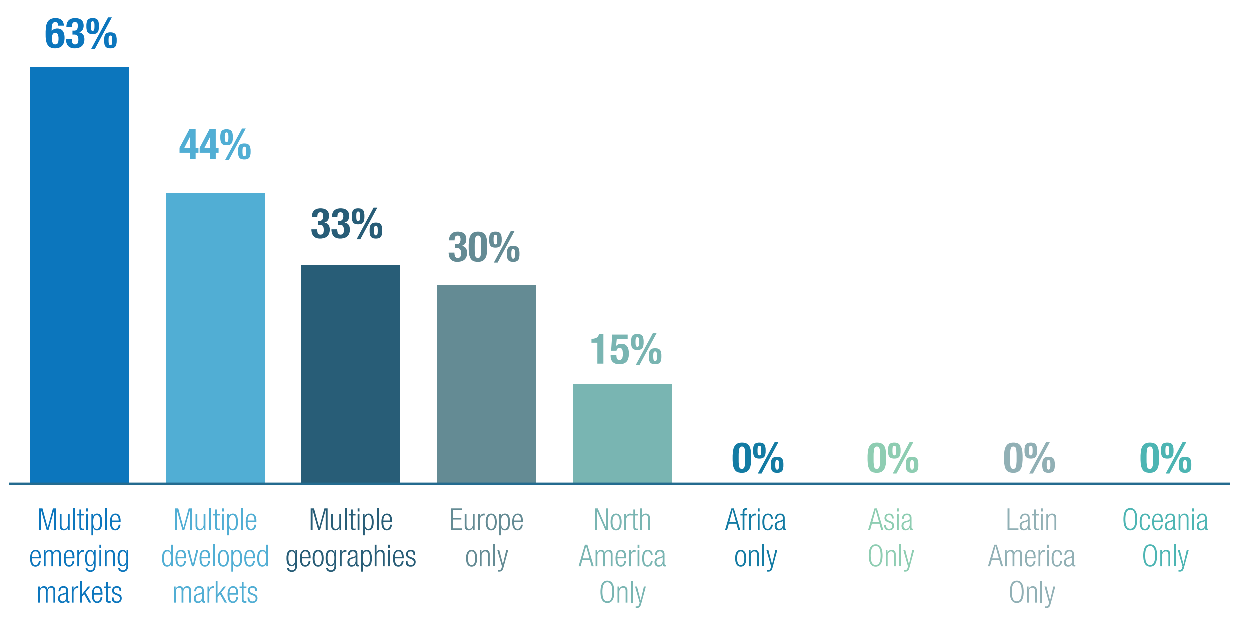


Figure 2.8: Institutional investors' focus segmented by geographical location. (source: questionnaire (b))
*The geographical focus of investors is measured by number of investments

2.5 GEOGRAPHICAL SPREAD

Figure 2.8 provides an overview of the geographical focus of impact investments. Respondents indicate that there is no specific, dedicated continental focus for Africa, Asia, Latin America or Oceania, only for Europe and North America. Geographically diversified investment strategies are most common, in many cases with a focus on emerging markets.

Mission related geographical focus

From the interviews it emerged that the geographical focus is sometimes related to the mission of the investor. Health insurance companies, for example, indicated access to medicine in emerging markets a chosen investment theme. Some pension funds are shifting their focus to impact investments with closer proximity, investing, for example, in microfinance in the fund's home country. This is partly due to investors aiming to invest in social or environmental challenges of interest to their clients.

2.6 DUTCH IMPACT INVESTMENT MARKET SEGMENTED BY THEME

Impact investments can be divided into various social and environmental themes. Impactbase, an online database of impact investment funds, distinguishes four general themes (figure 2.9) with a total of 20 sub-themes. [28]

In figure 2.10 this categorisation is used for the investments in the Dutch market, based on quantitative data obtained from questionnaire (a).

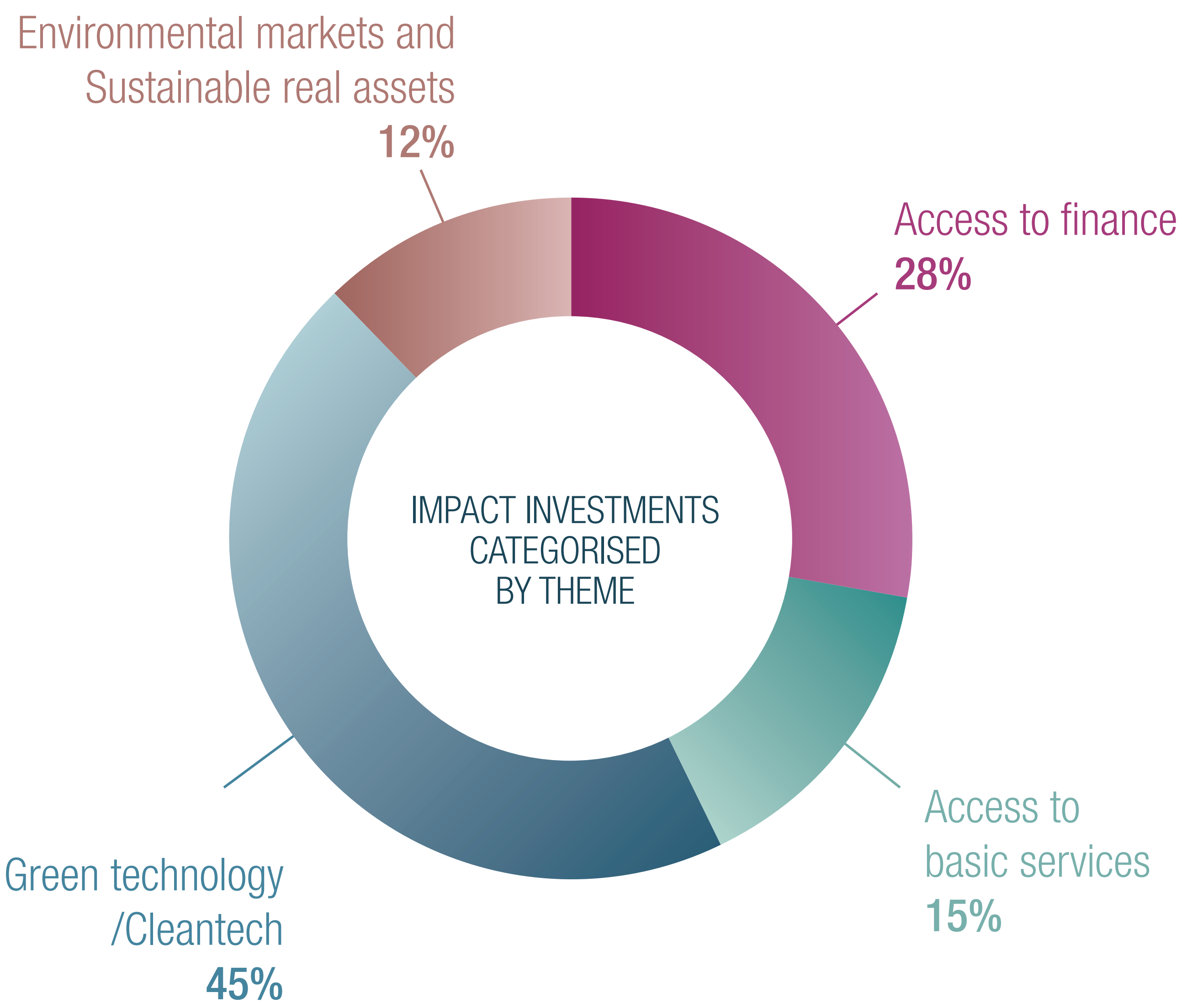


Figure 2.9: division of impact investments segmented by theme (source: questionnaire (a))
*Themes are categorised by number of investments.

[28] Impactbase and the GIIN. (2015). An analysis of 300+ impact investing funds.

Figure 2.10 illustrates that most impact investments are made in the field of green technology or 'Cleantech'. These investments are predominately in energy, fuel, energy generation and energy efficiency. From the interviews it is derived that there is a strong demand for more 'green technology' and 'Cleantech' investment opportunities. Microfinance and finance for small and medium enterprises are major sub-themes within 'access to finance'. Based on interviews limited growth is expected in these areas, as the market is perceived to be quite mature and investment size is relatively small.

'Access to basic services' mainly comprises health-related investments. The 'environmental markets & sustainable real assets' is the smallest theme, subdivided into several relatively small sub-themes.

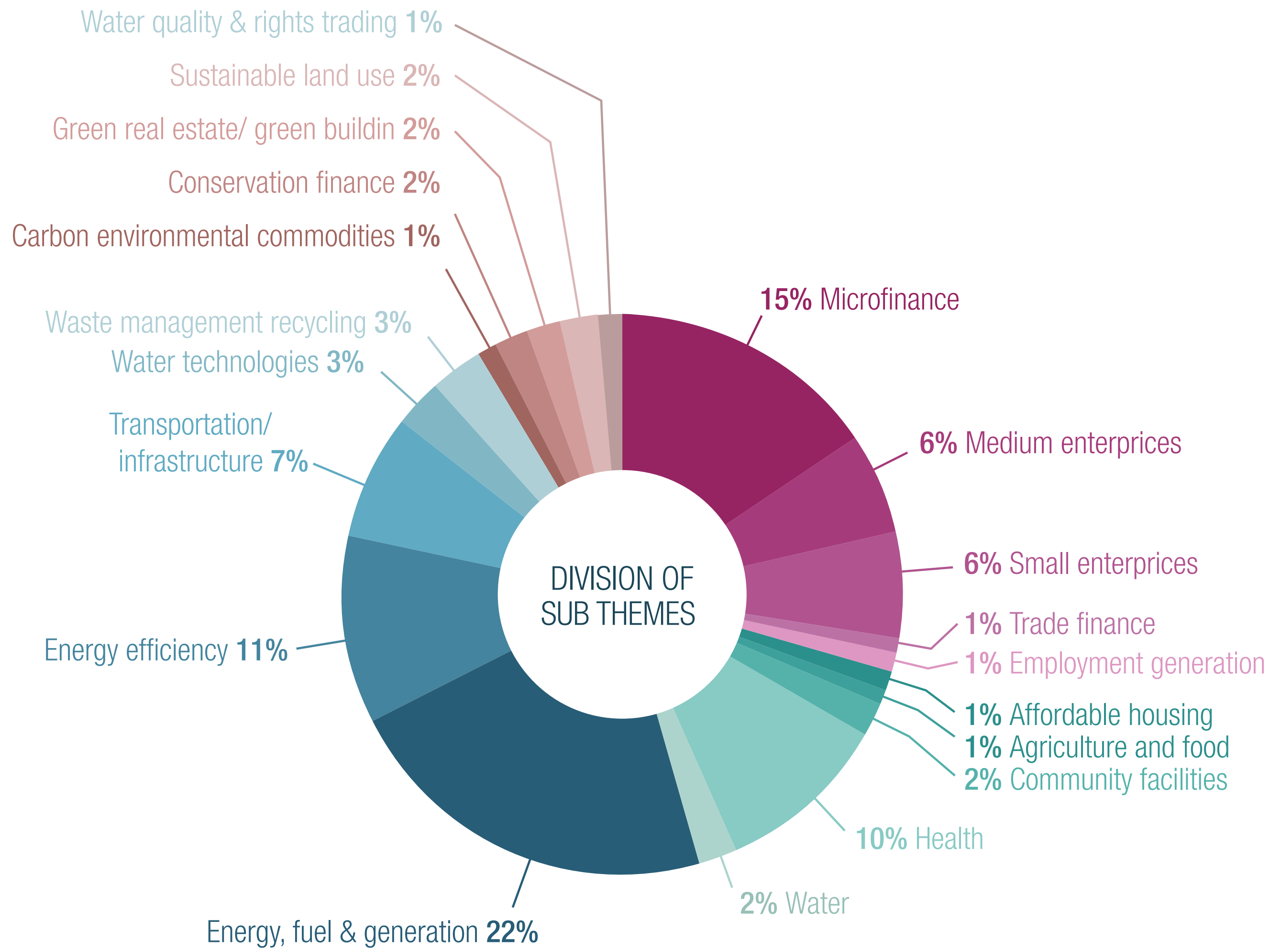


Figure 2.10: division of impact investments segmented by sub-theme. (source: questionnaire (a))
*Sub-themes are categorised by number of investments.

2.7 FUTURE AMBITIONS

Dutch institutional investors claim to allocate a total of some €24 billion to impact investments. These investors have also indicated four building blocks that typify impact investments. More research needs to be done into these building blocks in order to comprehensively analyse individual impact investments.

Based on the received data from the questionnaires, the preliminary impression is that the reported impact investments show varying levels of ambition to address social and environmental challenges.

Although it is not within the scope of this research to make such an analysis, it appears that the majority of these impact investments could be typified as 'light impact investments' or even be better categorised as part of a different responsible investment strategy (e.g. ESG-integration or best-in class).

Figure 2.11 represents the potential development of the impact investment market regarding both the total market size and the quality of impact investments. 'Mainstreaming' impact investing will entail the growth of impact investments as a share of total invested capital and an improvement of the quality of the investments. The quality growth relates to the improvement of standards.

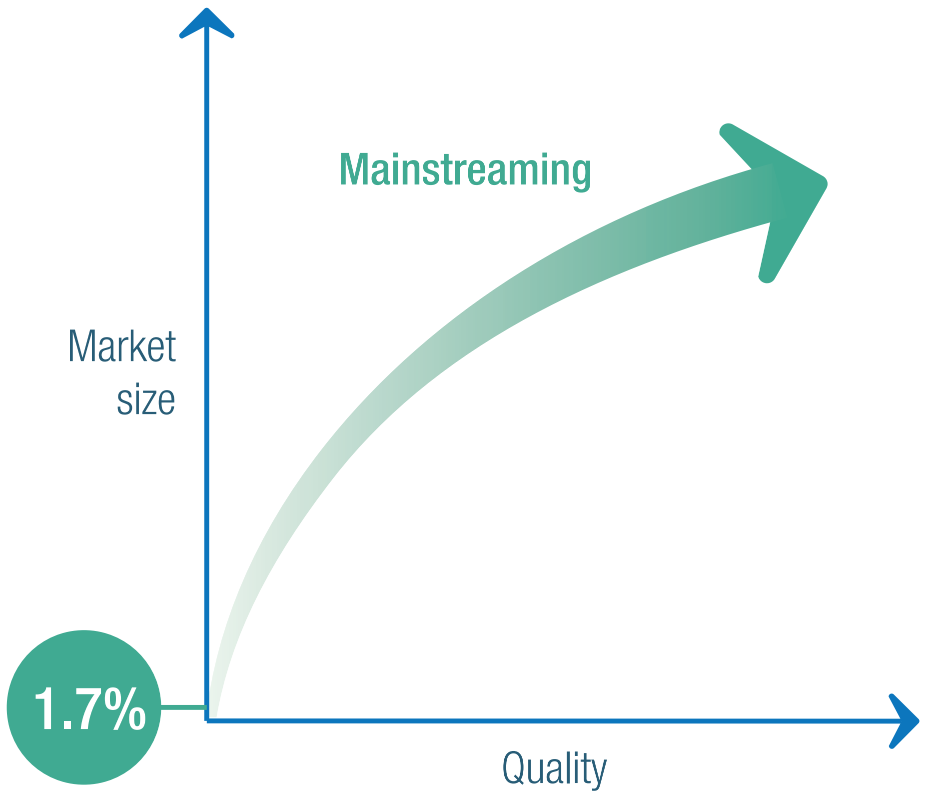


Figure 2.11: Dutch impact investing market potential.

2.8 CONCLUDING REMARKS

Impact investments are made across all asset classes, but vary considerably both in the share of market and level of impact. Therefore, the individual asset classes require a tailored approach.

In the public market the majority of impact investments are in public equity, in terms of assets under management. However, many more individual investors with relative smaller investments are active in green and social bonds.

In the private market, infrastructure and real estate are the largest asset classes in terms of asset under management. Private equity and private loans are relatively small asset classes. However, further analysis of the data shows that these smaller asset classes comprise a large number of investors making relatively small investments. It is found that differences in characteristics and market development exist between the asset classes. Due to this fragmentation, it would be necessary to approach the asset classes as individual sub-markets and carry out a tailored assessment of each in order to provide a clear picture of the impact investment market.

3. ENHANCING IMPACT INVESTMENT

This chapter addresses several elements that need addressing in order to enhance, and therefore mainstream, impact investment. Interviews and the joint learning sessions have seen a wide range of drivers discussed, which are detailed in the different sections in this chapter. The first section addresses the organisational drivers; the second looks individual behaviour within an organisation; the third looks at market drivers and the fourth examines the role of government policy and regulation.

3.1 ORGANISATIONAL DRIVERS

The organisational drivers for mainstreaming impact investing are divided into leadership, investment beliefs, and the investment decision-making process.

Leadership

Several participants in the joint learning sessions pointed out that making impact investing more conventional in an organisation requires embedding the investment strategy throughout an organisation and the buy-in from the executive level. An organisation's leaders need to express a clear intention to invest in areas that have a positive social or environmental impact. Subsequently, they need to create the conditions that will enable this to be implemented. The ambition to achieve a positive social impact needs to be accompanied with appropriate targets in order to be realised. Furthermore, not only the management is responsible, leadership is also required of other individuals throughout the organisation. These are people who are willing to make an extra effort to achieve a positive social impact. Efforts to embed impact investing can get stuck in 'the middle layer of clay' of an organisation. Even with the intention from the top and motivation from individuals, embedding impact investing throughout all layers of the organisation is not going to be easy.

> *"Of course it is a matter of leadership. It starts with leadership, however it doesn't stop there. It has to drill down and create the environment that does it. It should not always be leadership at the top but also throughout the organisation."*
> *(Development Finance Institution).*

Organisational culture

The culture of an organisation can be an important driver of impact investing. According to different participants in the joint learning sessions, enhancing impact investing requires an organisational culture that is open to learning and innovation. In a sector where investment decisions tend to be made within strictly defined constraints and are based on historical data, this can be quite a challenge.

Investment beliefs

Investment beliefs signify how an organisation will meet the interests of their key stakeholders and clients. The investment beliefs also include capital market assumptions to assess the viability

ORGANISATIONAL DRIVERS | INDIVIDUAL BEHAVIOUR
MARKET DRIVERS | GOVERNMENTAL AND REGULATORY DRIVERS

and results of investments. Ideally, the asset owner and the fiduciary manager together formulate the overarching investment beliefs, and these beliefs then act as a foundation for the investment strategy.

Different interviewed persons indicated that impact investing is usually not included in the investment beliefs. A vision regarding sustainability and, specifically, the role of impact investing needs to be included in the investment beliefs and the capital market assumptions. The main assumptions in relation to impact investing are discussed in more detail in the following sections.

Long-term focus

In recent years, the time period for demonstrating positive results for publicly listed companies and for institutional investors has become increasingly shorter. This 'short-termism' does not adequately consider the long-term interests of stakeholders nor the long-term social impact of investments. Some impact investments are intrinsically focused on long-term results; investments in affordable housing can have an investment cycle of more than 10 years and funds can have 'lock-up' periods of several years.

A group of Chief Investment Officers from Dutch asset management companies are advocating the return to a long-term focus, which "would lead to better risk-adjusted returns and lessen pro cyclical investment behaviour".[29]

Considering risk, financial return and societal return

Financial return expectations for impact investing vary between investors. Some institutional investors may be willing to accept below market returns if the investment has a positive social or environmental impact. However, most institutional investors only accept impact investments with a competitive risk/return-profile.

[29] Andringa et al. (2015). Korte termijn winst of lange termijn waarde creatie?. VBA, nummer 123

It is also important to address the social return. Respondents indicated that it is difficult to quantify the positive and negative social impacts of impact investments. However, assessing the social return well can help to better manage impact investments. Assuming that environmental and social issues are ultimately long-term risks, it makes sense that taking them into account contributes to an improved risk/return profile.

> *"The positive societal impact of investments is not taken into account in the financial return of the portfolio. The challenge lies in trying to measure this. This could be the 'icing on the cake': that impact investing generates at least the same return and in addition has a societal benefit." (Asset owner)*

Diversification: potential that can be used

Impact investments' revenue streams may prove to have a lower correlation to traditional business cycle investments. A respondent indicated that investors could choose to categorise impact investments according to their diversification contribution to the overall portfolio.

Dealing with liquidity constraints

The lack of liquidity is often a major constraint for impact investments in the private markets. On a portfolio level this limited liquidity could be offset by increasing diversification, or by taking into account a longer investment horizon. When impact investments become more mainstream, such as seen in the green bond market, liquidity is likely to improve automatically.

Selecting benchmarks

Several interviewed persons mentioned that it is important to determine what benchmarks should be used to measure the results of impact investments. For example, comparing a long-term investment policy with a short-term benchmark will not produce relevant information. Benchmarks should be consistent with the investment beliefs. It was argued that ideally benchmarks should include long-term risk indicators and conditions for long-term value creation.

> *"All our benchmarks are short-term; reports are delivered each month. If we want to start thinking long-term something has to change principally." (Asset owner)*

Investment processes

Investment processes differ greatly between types of investors and types of investments. Embedding impact investing within an organisation poses several challenges.

Structuring expertise within the organisation

It is important to determine how the people responsible for impact investing will be structured within the organisation structure. There are several possibilities:

- Some investors consider impact investments as a separate asset class and have dedicated teams with a specific skill set and budget for impact investing.
- Some investors consider impact investment as an investment strategy across various asset classes. In this case one person or department is dedicated to impact investment, or responsible investment in general, and serves as a knowledge centre for all portfolio-managers.
- In other cases knowledge on impact investing is embedded throughout the organisation, with each department responsible for making impact investments within their own context.

It depends on the strategy, ambitions and resources of the investor how expertise on impact investment should be effectively structured.

> *"We certainly do not want to separate impact investing; we want to keep it integrated. We want all managers to know what they can invest in. If they do not choose an impact investment, I want to know why." (Asset manager)*

It can also be important for the organisation to consider specific specialisation with regards to impact investment. Since impact investments can span a wide range of social and environmental themes and asset classes, a strategic option could be to focus on certain themes and asset classes. This enables the organisation to build specific expertise on these themes and co-operate with specialised data-providers.

Measurement of the impact

Impact measurement is often mentioned as a crucial element in impact investment. It is important to make a distinction between impact assessments – ex ante analyses of the expected impact one hopes to achieve with an investment – and impact evaluations – ex post evaluation of the actual results. When measurement is mentioned in the impact investing industry it is often concerns impact assessments, not impact evaluation.

In one of the joint learning sessions the participants drafted a loop that connects expected impact (measured with an impact assessment) with achieved impact (measured with an impact evaluation), back to future investments and their assessments (See figure 3.1). Closing this loop as depicted seems to be one of the greatest challenges that lies ahead for investors, but it is crucial if they are to move from 'hoping to have an impact' investments towards 'actually achieving an impact' investments.

However, as mentioned previously, impact assessment and evaluation requires expertise and resources. These can drive up transaction costs for investors and therefore make impact investments less attractive. The emergence of intermediates can be promising in this regard. They could help investors to determine which investments have a strong likelihood of making a considerable impact, based on previous results, or a competent evaluation.

Figure 3.1: The impact measurement cycle.

3.2 INDIVIDUAL BEHAVIOUR

Although the individual level often receives the least attention, it is crucial to also address barriers at the individual level, as this is where actual investments take place. Choices of individual investors regarding impact investing are shaped by various factors such as organisational culture, incentive structures, availability of information, and human psychology. In this research the focus is on the role that human psychology has on decisions related to impact investing. In particular, we look at the effect of the so-called "cognitive biases": systematic and deeply rooted thought patterns that can lead to irrational and inconsistent decision-making.

Cognitive biases

Cognitive biases often occur when information is limited or choices have to be made under time pressure. They help the brain to ease the burden of information processing. The fact that we use cognitive biases to relieve some pressure placed on our brains does not mean we cannot change them.[30] Most cognitive biases can be mitigated by being aware of them and by being willing to change them . Even if there is no awareness or willingness at the individual level, the choice architecture that one is under can also influence the extent to which cognitive biases are likely to play a role. [31]

Cognitive biases have been extensively studied in psychology and economics in the past decades[32], and numerous different biases have been identified. Many of these are relevant to decision-making in the field of finance. Several behavioural experiments have been done with investors to test the presence of different cognitive biases in decisions related to regular investments. Some examples of the cognitive biases are illustrated in the textbox.

THE REPRESENTATIVENESS BIAS

This bias implies that once people, things, or situations are categorised, they share all the characteristics of other members in the same category. This can result in investors labelling investments as either good or bad based on a category's recent performance.[33]

THE CONFIRMATION BIAS

The confirmation bias. This bias occurs when people seek and give more authority to information that confirms their existing beliefs above information that may prove their assumptions wrong. For example, when analysing a stock, investors may intentionally look for information that endorses their opinions. As not all investors are familiar with impact investments, they are relatively vulnerable to this bias.[34]

30 Kahneman, D. (2003). Maps of bounded rationality: Psychology for behavioural economics
31 Thaler, R.H. & Sunstein C,R. (2008). Nudge
32 Kahneman, D.(2003). Maps of bounded rationality: Psychology for behavioural economics
33 Baker, H. K. & Ricciardi, V. (2014). How Biases Affect Investor Behavior
34 Parker, T. Behavioral Bias- Cognitive Vs. Emotional Bias In Investing

THE OPTIMISM BIAS

This bias refers to the situation in which one's confidence in his/her judgements is greater than the actual accuracy of these judgements.[35] In finance, this can result in overtrading and underperformance.[36]

THE STATUS-QUO BIAS

This bias occurs when people firmly stick to their habits instead of seeking new practices. As a result, investors may place capital in the same market segment over and over again, which may limit profit potential.[37]

While extensive research has been done to investigate cognitive biases associated with regular investing, little is known about mental processes related to impact investing. We have tested a bias that we hypothesise to play a role in preventing investors from making more/higher quality impact investments. Moreover, we selected this specific bias because if it plays a role in preventing investors to engage in impact investing, it can be quite easily overcome by organisations changing the choice architecture of investors.

Evaluability Bias

The evaluability bias suggests that when people evaluate things with multiple attributes they tend to focus on the 'easy-to-evaluate' attributes in situations in which a single option is considered; and focus relatively more on the "harder-to-evaluate" attributes in situations in which multiple options are compared. The underlying psychological mechanism for this bias is that in joint evaluations people 'receive' a reference point for the attribute that they find hard to evaluate in the separate condition. This reference point subsequently eases the evaluation of the originally complicated attribute.

The evaluability bias has been found to apply to a range of domains, including the evaluation of charities. When people evaluate a single charity they tend to focus on the overhead of the charity (i.e. they have a strong dislike for charities with high overhead). However, when people compare charities they focus more on the cost-effectiveness, i.e. how much "good" (e.g. lives saved) the charity achieves per euro donated.[38]

Since data on companies' social impact is very limited or simply non-existent, investors may well lack knowledge about the expected social returns of investments in different sectors. Thus, when available, the impact of an investment has to be evaluated in an isolated manner without any reference point. The problem with this absolute evaluation is magnified by the fact that impact data is often presented as an open-ended scale (e.g., 200 lives saved or 100kg of CO_2 emissions reduced per 1 million euros invested) rather than as a ratio. Ratios have an inherent reference point (e.g. 200 out of a possible 1000 lives saved per 1 million dollars invested), which makes them easier to assess in isolation.

The limited knowledge about expected social returns and the open-ended scales make the interpretation of social impact

35 Seawright, B. (2012), Investors' 10 Most Common Behavioral Biases
36 Baker, H. K. & Ricciardi, V. (2014). How Biases Affect Investor Behavior
37 Parker, T. Behavioral Bias- Cognitive Vs. Emotional Bias In Investing
38 Caviola, L. et al. (2014). The evaluability bias in charitable giving: Saving administration costs or saving lives?

data very challenging for investors to use in their decision-making. Therefore, it is possible that investors may decide to focus their attention solely on the financial and ESG criteria, which are easier to assess. The ease of evaluation results from the wide-spread use of both types of factors and the plethora of pertinent benchmarks that have been developed.

If the evaluability bias is indeed at play in investors interpreting impact related information, there would be a number of things that organisations can do to relieve this bias (and thus stimulate their investors to invest in impact investments):

1) When creating financial reports on potential investees, research analysts should be encouraged to disclose data on company/ fund social impact, if available.
2) When such data is disclosed, research analysts should try to include information on social impact of similar firms/ funds/ projects as the company/fund/ project in question.
3) When information on social impact of potential investees is not available, attempts should be made to encourage these investees to measure and disclose this information.
4) To gather more information on company/ fund/ project expected impact, relevant experts or specialised agencies can be contacted to help with estimates.
5) Company incentive structure should include rewards for investing in companies/ funds/ projects with high positive social impact.
6) Company culture, as well as its mission, vision, and strategy, should encourage impact investing among individual investment managers.

Findings

In order to evaluate to what extent evaluability bias plays a role in preventing investors with engaging in impact investing, the Impact Centre Erasmus (ICE) is conducting a behavioural experiment with investors. This behavioural experiment tests whether investors place more importance on social impact information in joint or separate evaluations:

- Joint (relative) evaluations mean that it is possible to compare the social impact of an investment to a reference point.
- Separate (absolute) evaluations do not provide a reference point.

It is conducted as a randomised experiment with investors, using an online survey sent to a large range of organisations in the financial sector. An explanation of the methodology of the research and the complete survey that was sent out can be found in the appendix.

While it is important to acknowledge the limited size of this sample, it does allow us to identify a trend. The final results, based on a larger sample, will be published at the end of January on www.impactmeten.nl.

RESPONSES

We expect to gain more than 200 responses. However, as the survey has been sent out by contacts in various investment companies, it is difficult to predict the exact response rate. For this report, we were able to analyse the 80 responses received prior to the 15th of January 2016, although the survey will be open until the first week of February. Of the respondents so far:

- ± 80% are male
- ± 50% are aged 35-45 years, with another 40% falling in the 25-35 or 45-55 years brackets
- ± 40% are portfolio managers; 25% research analysts; & the remaining 35% are engaged in different functions
- ± 45% work for development finance organisations & 55% for commercial organizations which include insurers, pension funds or banks
- ± 60% receive a bonus for financial performance, and 15% receive a bonus for social impact

The preliminary results indicate that evaluability bias may play a role in investor decision-making. However, the role of this bias seems to be suppressed by much stronger decision making factors related to the organisation that an investor works for.

Because the survey has to guarantee respondents complete anonymity, we do not ask the names of organisations that investors work for. We only ask for the type of the organisation. This allows us to split our preliminary results into two groups: development finance institutions and commercially oriented organisations (insurers, banks and pension funds).

Unsurprisingly, investors from development finance institutions seem to attach greater importance to social impact information in their investment decision-making process in both separate and joint evaluations. In contrast, investors from commercially oriented organisations consistently place more weight on financial returns.

IMPORTANCE OF SOCIAL IMPACT INFORMATION IN JOINT AND SEPARATE EVALUATIONS

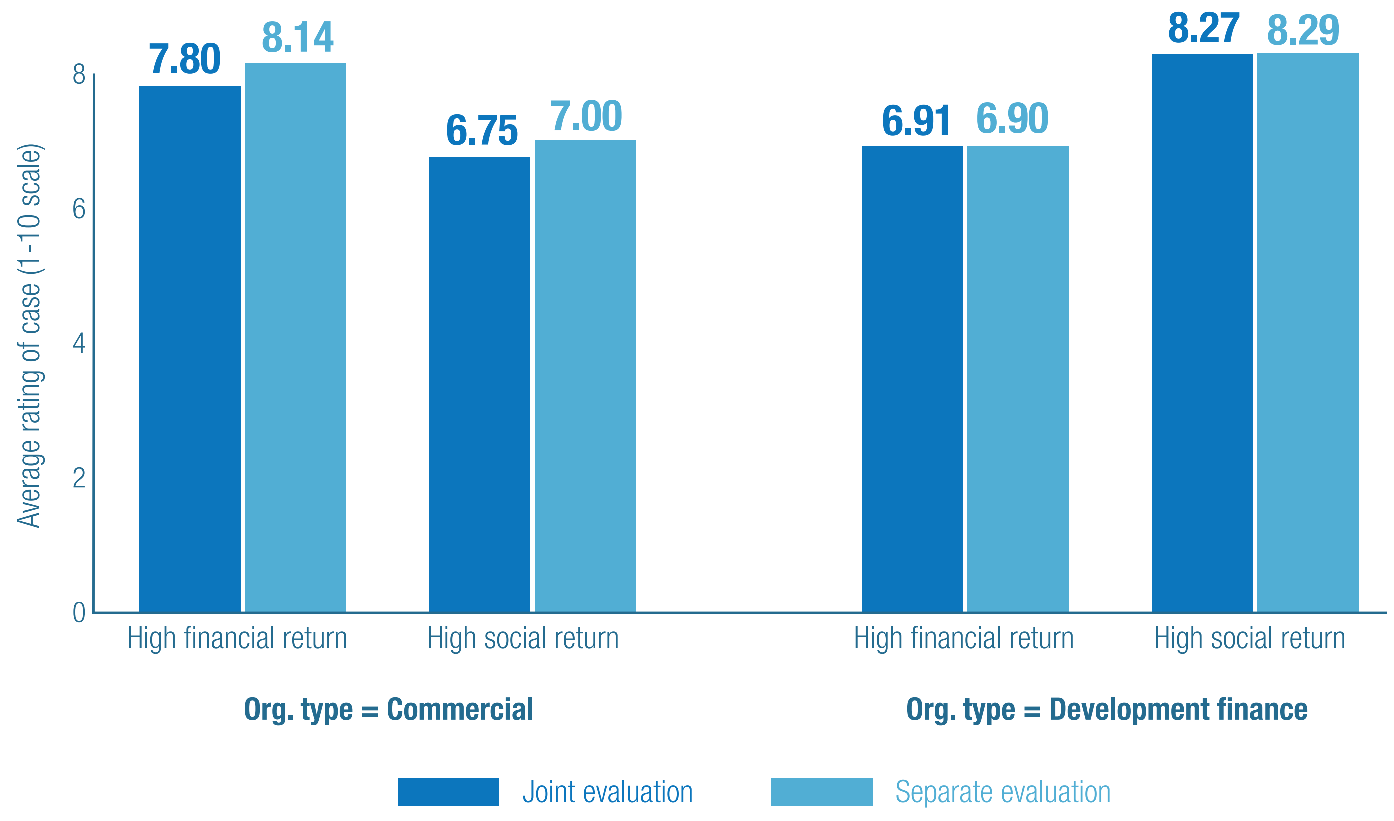


Figure 3.2: Joint vs. separate evaluation, commercial vs. development finance organizations.

The trends these preliminary results detect could be caused by a range of factors, such as the incentive structure in the organisation, the organisational culture, the type of investors the organisation attracts, the information investors in the organisation are given, and the training that they undergo. If the analysis with the entire sample confirms these initial results, further research should be done to determine which of the above factors plays a role in stimulating attention for social impact information and how significant that role is. Moreover, it should study whether evaluability bias has an effect in a setting where these factors are controlled for.

3.3 MARKET DRIVERS

In this section the drivers of the market and the possibilities for development are addressed.

Perception of the market

It appears from interviews that impact investing is often still associated with charity and donations. This can discourage institutional investors with a 'finance-first' investment approach. As pointed out in figure 1.4, the majority of the surveyed institutional investors (67%) seek to generate competitive financial returns.

Some institutional investors indicate that the market for impact investing will benefit if a clear distinction is made between donations and investments that aim to generate an at market return in combination with social impact. A hybrid approach, that accepts below market returns, could have the effect of impact investing continuing to be regarded as 'nice play-money' for a limited percentage of the portfolio, for which less attention needs to be paid. This can hamper the development of expertise and appropriate processes.

> *"Many investors still think impact investments are not real investments."* (Asset Manager)

Organising capacity of the market

On the supply side of the market approximately half of the institutions (55%) surveyed are actively engaged in impact investing. The impact investment market is dominated by a few large investors. Institutional investors typically make large-sized investments in mainstream capital markets. Often the (small) deal-size of impact investments does not coincide with the investment universe of institutional investors.

The demand for capital often originates from widely dispersed projects and organisations. Typically, they lack the resources and expertise to express their investment proposition according to the required formats. Green and social bonds are notable exceptions. Ideally intermediaries are able to connect the different worlds, but this is not always the case.

Standardisation of impact measurement

The screening, management and evaluation of an impact investment often requires highly specialised information. This is especially the case when considering social impact, but accurate information on social impact effects is often missing. The information that is available often lacks accuracy, as too little evidence of actual results achieved with investments seems to be used by investors to base their impact assessment of future investments on. Instead, assessments are based on gut feeling. Similar to financial expectations, the accuracy of impact assessments is likely to improve in the future when results from past investments are taken into account. Sometimes evidence is not considered because it is not available; there are not enough sufficiently rigorous evaluations of results for SME investments, for example. In other cases the evidence is available but is not yet used in investors' impact assessment processes (e.g., microcredit).

An increasing number of organisations and initiatives provide data on track records, rating, process guidelines, certification and benchmarks. Data-providers all have their own definitions of impact themes such as

CO2 emissions. In the case of environmental impacts, in particular, comprehensive evaluations of results are being used to feed into assessments of the expected impact of new investments. For social impact effects, similar efforts are slowly developing, but for now the emphasis is very much on processes (e.g., no child labour) rather than results (e.g., improved wellbeing of cwhildren).

3.4 GOVERNMENTAL AND REGULATORY DRIVERS

This section addresses how the regulatory framework and government policies can influence and enhance impact investing.

Regulatory framework by the Dutch Central Bank

Pension funds and insurance companies act under different regulatory frameworks, but both are supervised by the Dutch Central Bank (DNB).[39] DNB supervision distinguishes between mainstream investments and alternative investments. The supervision has an increased focus on risks relating to innovative financial products and illiquid investments. Alternative investments with less liquidity and less transparency include private equity funds, hedge funds, infrastructure and micro-credits. Impact investments are often located in the alternatives portfolio and governed by a special policy measure.

From the interviews it emerged that impact investments often do not yet have a proven track record. For these investments, asset owners are required to have detailed knowledge and provide extra reporting in regard. These requirements can be an impediment for individual asset owners who have little experience in regard to impact investing.

> *"Understanding your investments up to board level is very complicated for, for example, a small impact fund of 10 million. If the board is questioned by the Dutch Central Bank it is challenging for the board to explain this."*
> *(Asset Manager)*

REGULATION: PENSION FUNDS AND INSURANCE COMPANIES

In reaction to the crisis of 2008 new and more tightened regulations have been developed for pension funds and insurance companies.
Insurance companies operate under European Solvency regulations and, as of 2016, the new Solvency 2 framework will apply. These solvency requirements are intended to increase the capital buffers and professionalise risk management. Insurance companies are directed to invest a large portion of their portfolio in highly rated public bonds.

Pension funds operate under national regulation. The supervisory framework, Financial Assessment Framework (FTK), was adjusted in 2015. The FTK is directed at achieving a good balance between risks and buffers. For pension funds the monthly reporting of the asset mix and of the coverage ratio intend to encourage risk reduction.

[39] De Nederlandsche Bank. (2014). Visie DNB Toezicht 2014 – 2018

Transparency on sustainable investing and impact investing

According to the 'prudent-person' principle in Article 135 of the Pensionlaw,[40] pension funds are required to invest their funds in the interest of the participants of the pension fund. The law does not specify what these interests are and how this should be done. The Pensionlaw does require that a pension fund's annual report states how ESG-factors are embedded in the investment policy. This may generate some transparency and awareness on RI in general, and impact investment in particular, and stimulate pension funds to step up their efforts. For the future development of the regulatory framework, lessons can be learned from other countries where examples exist of favourable regulations for impact investing.

INTERNATIONAL BEST PRACTICE

French national strategy for transition
France has adopted regulatory measures to further integrate sustainability factors into its financial system. The Grenelle 2 requirements adopted in 2010 were further developed in 2013. This was down to the Ministry of Ecology and the Ministry of Treasury, which jointly developed the White Paper on Financing the Ecological Transition. In a follow-up to the White Paper it was agreed that investors will be required to disclose information on their management of sustainability factors and on their contributions to the international goal of limiting climate change.

INTERNATIONAL BEST PRACTICE

UK Focus on Strengthening Transparency & Risk Management
In the 2000 Pensions Act a requirement has been added requiring funds to disclose information on whether they incorporate social, environmental, and ethical factors into their investment processes. In 2014 the UK' s Law Commission Strategy published a review of fiduciary duties, which states that pension fund trustees can choose to consider any financial factor that relates to investment performance and should consider all financially material risks, including those related to the organisation's long-term sustainability.

The disclosure of climate risks has also been considered. Initially, disclosing information on a company's performance in terms of greenhouse gas emissions was voluntary. However, since 2013 this practice has become mandatory for corporations. Furthermore, the Prudential Regulatory Authority of the Bank of England recently performed an assessment of 'the implications of climate change for the safety and soundness of insurance companies and the protection of policyholders.'[41]

[40] Pensioenwet, artikel 135
[41] UNEP. (2015). The Financial System We Need: Aligning Financial System with Sustainable Development.

Governmental policies

Public authorities can play an important role in mainstreaming impact investments, by establishing the legal infrastructure and a predictable business environment, as well as ensuring long-term incentives for impact investments. One way of providing incentives is by reducing risks or de-risking. Broadly speaking, investment risk can be reduced by the public sector in three ways: [42]

- By mitigating risk, i.e. taking steps to reduce adverse effects.
- By transferring risk, for example by providing guarantees for investments that have a positive social impact and/or contribute to policy goals.
- By compensating for risk. These compensations can take a number of different forms, including price premiums, tax breaks (such as production tax credits), and proceeds from carbon offsets.

Some impact investments, for example in renewable energy, are highly influenced by compensating risk measures. The Dutch government has developed a wide range of measures that have been subject to changes.[43] These interferences may cause a lack of the predictability which is often crucial to investors, so can make investors reluctant to invest in these sectors. In fact, from various interviews it was derived that some investors actively seek projects in sectors with minimal government exposure.

"Governments are often not consistent in their policy. For example they withdraw subsidies, which leads to the failure of projects. We look explicitly for projects in which the government is least involved." (Asset Owner)

A strong incentive for impact investments is that some governments provide guarantees for the tail risk of the investment or for the lifetime of the investment, or act as co-investor. The resulting stability is crucial for investors. The European Investment Bank provides these types of guarantees for a pool of investments. Besides stability, the pool also contributes to risk diversification and liquidity. Guarantees can be given for innovative investments with social impacts and can be very effective in contributing to overall government policy targets.

3.5 CONCLUDING REMARKS

On the organisational level leadership plays a key role in embedding impact investing in the organisation. Impact investing also challenges investors to reconsider traditional investment beliefs. At the individual level, preliminary findings show that investors do not have an evaluabilitiy bias (ignore social impact information and only look at expected financial returns because social information is hard to interpret). There does appear to be a significant difference between the weights attached to social impact information between investors working for development finance institutions who place more weight on social impact information than investors from commercial institutions.
The market is influenced by a lack of clarity about impact investing. In addition, the required investment formats of institutional investors (the supply side of the market) do not fully match the investment propositions from the investees (demand side). Deal-size and lack of standardised data are important factors in this respect.

Governments and regulators play a role in the growth of the market. While first steps in the area of transparency on responsible investment have been made, the specific features of impact investing are not taken into account in the supervisory structure in the same way as with more regular investing. Investors also identified that the government currently does not create an investment environment in which impact investments are stimulated. In particular, some policies and incentives create an unpredictable and unstable environment for impact investment.

[42] UNIT. (n.d). Working group on Sustainable Development Financing.
[43] WRR report.

4. CONCLUSIONS

1. THE IMPACT INVESTMENT MARKET IS SMALL AND HIGHLY FRAGMENTED

Impact investment is growing and moving forward, but it is still a nascent market. Based on self-reported data, impact investments currently amount to 1.7% of the total Dutch institutional investment market. Impact investments are made across all asset classes.

In the public markets, the largest share of impact investments are made in public equity and most institutional investors are active in green and social bonds. In the private market, infrastructure and real estate are the largest asset classes.

Differences in market characteristics exist between the asset classes, for example in terms of market maturity and measurability. Also, the number of institutional investors active in the different asset classes and the volume of investments vary greatly. The impact investment market is fragmented and should not be seen as one single market.

2. POTENTIAL FOR DOING MORE AND BETTER

With a market size of 1.7%, impact investing is a niche market with a great potential for growth. Almost half of the investors (45%) are not engaging in impact investments at all yet, while others allocate as much as 8% of their assets under management to impact investments.

Four key characteristics of impact investments have been identified:
- Intention to achieve social or environmental impact
- Competitive financial return
- Impact measurement
- Long-term horizon

At least half of the assessed impact investments had only limited evidence of the four characteristics. We would describe these impact investments as ‘light impact investments’.

3. IMPACT INVESTMENT MARKET IS CURRENTLY INEFFICIENT

Matching demand and supply of capital for impact investments is challenging. In several sub-markets, price forming and liquidity are sub-optimal. The transaction cost of impact investments are often increased by the small deal size and complexity.

Impact investing is an innovative investment strategy. Innovation is intrinsically at odds with institutional investment processes, which rely on mainstreaming and standardisation. Increasing the use of evidence-based impact assessments is crucial if investors are to be able to select quality impact investments and fully evaluate their impact. Intermediaries can play an important role in the delivery of data to avoid driving up transaction costs for investors.

In due time, standardisation and monetisation of impact data will contribute to redirecting more assets towards impact investment opportunities. In the future, impact data, such as the environmental footprint, could also be valued and included in the balance sheet, similar to the valuation of goodwill and brands. Ultimately, the market mechanism will need to integrate impact data.

4. ORGANISATIONS STRUGGLE TO FULLY EMBED IMPACT INVESTING

At the individual level many cognitive biases may be at play preventing investors from opting for more or higher quality impact investments. In the report we present preliminary findings from an experiment with investors that finds that a specific bias - the evaluability bias that pushes people to focus on things that are easy to evaluate and ignore things that are not - is not present in the larger group of investors. However, investors from development finance institutions opt for impact investments over regular investments significantly more than investors from commercial organisations.

Relative to this specific bias of individuals, other aspects at the organisational level, such as organisational culture, seem to play a more important role. In some organisations, impact investing is still associated with charity and donations, or with a specific and risky asset class. Such organisations are often unaware that impact investing can achieve competitive financial returns, as well as making a positive social impact.

Investors that do embrace impact investing usually find it difficult to embed it in the core of their organisation. Embedding is partly dependent on the leadership demonstrated by key individuals who dare to challenge deeply-routed investment beliefs and assumptions. Complexity and lack of knowledge are significant barriers to embedding impact investing within an organisation.

5. THE IMPORTANT BUT INDISTINCT ROLE OF PUBLIC AUTHORITIES

Current Dutch Central Bank regulation does not specifically impede investing. However, some investors do mention Central Bank regulation as an impediment, citing various reasons. Some of these reasons relate to the complexity of the regulatory burden, and others are linked to the principles of the underlying policies. In addition, the supervisory framework mainly focuses on the short-term, while impact investments often require a long-term horizon.

Furthermore, governments have a primary task to address social issues. However, investors sometimes consider their interference of the market unpredictable, and not beneficial in the creation of a stable impact investment environment.

5. RECOMMENDATIONS

Different stakeholders all need to play a role in order to move forward. This starts by generating awareness that impact investing is a viable investment strategy, offering opportunities for generating both financial and social return. Leadership is an important factor and can help to embed impact investing within the core structure and processes of an organisation. All actors in the impact investment market should join forces and collaborate by forming partnerships and supporting future research.

ASSET OWNERS: TAKE THE LEAD

Asset owners are primarily responsible for how their entrusted assets are being invested.

Develop a policy on impact investing

When formulating policies, investors need to actively consider their role in society. Policies should be reflected in investment beliefs, and should:

- Make a clear distinction between charitable donations and investments that aim to generate a competitive return in combination with societal impact. A hybrid approach is confusing and can lead to impact investing continuing to be seen as 'nice play money'.
- Clarify which theme(s) the asset owner seeks to impact, e.g., climate change and human rights. Ideally themes should be selected because they align with the preferences of employees, clients or other key stakeholders.
- Include the following:
  - o The intended social impact and financial risk/return, including targets
  - o The evaluation process that will be used to decide the impact results

Select and encourage appropriate asset managers

Select asset managers with expertise and experience in the field of impact investment, including impact investment markets, due diligence and impact measurement methods. It is vital that the fiduciary managers or at least one of the asset management companies have specific expertise in these areas in order to effectively start or progress with impact investment. Furthermore, as a principal, asset owners can actively encourage asset managers to develop impact investment products.

Ensure internal know-how on impact investing

It is not just asset managers who need to have an understanding of the subject. In order to be a professional principal and an equal negotiating partner with asset managers and regulators, asset owners need to have at least a basic understanding of impact investing.

ASSET MANAGERS: DEMONSTRATE LEADERSHIP

As experts in investing, asset managers should take the lead in developing impact investing.

Embed impact investing in the organisation

Impact investment is often the responsibility of a separate department or individual. It should be integrated into the entire organisation, both in terms of structures and processes. Responsible investment and impact investing should be embedded at the core of asset management. This should include ensuring that investment managers fully understand the relevance of impact investing. In-house expertise can be built through the provision of training on the selection, monitoring, management and measurement of impact investments.

Develop products that can be integrated into an institutional investment portfolio

Current impact investment propositions and funds do not always fit well with the existing portfolios of institutional investors. Product developers should ensure that that majority of investments could fit within investors' portfolios and take into account criteria on size, due diligence, track record, fund documentation and cost.

Provide support to asset owners

Asset managers could provide expertise and guidance to asset owners. For example, they can ensure that appropriate financial and impact data is available and provide reports that meet the formats required by regulators.

Learn by doing

Impact investing is also a practical challenge that requires asset managers to go beyond theory in order to fully appreciate the complexities. Asset managers can start this process by allocating a small portion of assets for experimentation and learning. Sharing experiences, insights and knowledge could accelerate the process. It is not necessary (nor possible or desirable) for individual investors to each reinvent the wheel.

Monitor social return

After selecting investments based on evidence-based assessments of expected impact, investors should monitor (or outsource the monitoring of) the social return. This ensures that necessary milestones are reached (e.g., the number of elderly people who are provided housing) in order to achieve the overall goal.

Act on insight

As with any investment, monitoring and measurement provide useful information about investment returns. Information on the performance of investments can also help to improve the selection of new investments.

PUBLIC AUTHORITIES: CREATE ENABLING CONDITIONS

Public authorities (Government and Dutch Central Bank) play an important role. Their role should preferably be in line with the working of the market.

Link impact investing to societal and policy goals

Public authorities need to appreciate what is needed for investors to be attracted to those investments which have a positive societal impact. This should be integrated into overall long-term, stable policies (beyond four years) and used to stimulate cooperation between government and investors.
The Dutch Central Bank should develop a policy on impact investing. This should be a multi-annual plan, allowing for a long-term focus by investors. The Dutch Central Bank should also develop the knowledge and instruments needed to take the financial risk of societal issues into account in the regulatory framework.
Governments could also develop and apply various instruments to reduce investment risk and thereby make the investments more attractive for other investors.

Require accountability of social footprint

Both governments and the Dutch Central Bank should develop regulations that require investors and other organisations to report on their social footprint, similar to the required transparency on their carbon footprint.

Encourage knowledge building and education

The Dutch Central Bank could also encourage asset owners to improve their understanding of responsible investing, and impact investing in particular. Practical guidance about how impact investing can be integrated in an investment policy would be helpful, for example. This is particularly relevant for pension fund boards, where knowledge about responsible investment is vital.

INVESTEES: PROFESSIONALISE AND SCALE UP

On the demand side, impact investees could take several actions to help grow the market.

Make it institutionally investable

Investors often prefer to make larger sized investments. Combining investment propositions can generate an increased deal size and lower transaction cost for investors.

Provide impact data

Investees can also contribute by reporting on the social and environmental impact of the investment. This will improve the credibility of the investment and improve accountability of the sector as a whole.

INTERMEDIARIES: CONNECT THE DOTS

Different types of intermediaries play a role in developing the impact investment sector and making the market more efficient.

Standardise the market

Examples of intermediaries include data providers, and rating and certification agencies. They could contribute to the standardisation of the impact investing market by cooperating more fully with each other and, where possible, aggregating data on impact investments.

Set up platforms for impact investments

Impact investment platforms support knowledge building and connect different stakeholders. Marketplaces offer opportunities for connecting investors and investees. An example is the London Social Stock Exchange. Developing separate market places for impact investments eases the trading of these types of investments.

Support future research

The further development and professionalisation of impact investing requires extensive research that should cover many different areas. These include the classification of impact investments, methods for measuring impact and ways of developing the market.

APPENDIX 1:
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APPENDIX 2:
Impact Investing, Questionnaire (b)

Defining Impact Investing

1) **How do you define impact investment?** Open Answer:
2) **What are, in your opinion, the fundamental characteristics of impact investing? Select from the choices below:**
   - Achieving societal impact
   - Intention to achieve positive societal impact
   - Measurement of societal impact
   - Active management of the investment
   - Expectation to generate a financial return on capital
   - Long-term investment horizon
   - Separate asset class
   - Responsible investment strategy applicable to all asset classes

   Impact investing in your own portfolio

3 **Do you engage in impact investing? If yes, what drives you to engage in impact investing? If no, please explain why not?** Open Answer:

4) **How would you qualify your investment beliefs regarding impact investing? Select one from the choices below:**
   - Impact investments are mainly based on the motivation to generate above market financial returns
   - Impact investments are mainly based on the motivation to generate competitive financial returns
   - Impact investments are based on the motivation to address societal challenges and may require the investor to accept a below market financial return.
   - Impact investments are mainly based on the motivation to address societal challenges and require a below market financial return.

5) **What % of your total investment portfolio do you qualify as impact investing?**
   Open Answer: Scope of your impact investments

6) **Please indicate the percentage of impact investments focused on:**
   - Envrionmental themes
   - Social themes
   - Both environmental and social themes

7) **Within these categories more specific sub-themes can be identified (e.g. microfinance, waste management, sustainable land use). Which sub-themes are your impact-investments focused on?** If possible, please specify the impact investments.
   Open Answer:

8) **Please check the boxes (regions and asset classes) that correspond with your impact investments: Investment process and monitoring**

	Public equity	Fixed income	Real Estate	Private equity/ Venture capital	Alterna-tives	Total
Africa only						
Asia only						
Latin America only						
Europe only						
North America only						
Oceania only						
Multiple emerging markets						
Multiple developed markets						
Multiple geographies						
Total						

9) **What vehicle do you use for impact investments? Select from the choices below:**
   - Direct investments
   - Funds
   - Funds of funds

10) **Do you monitor your impact investments? And if so, what is your monitoring and evaluation process for the impact of your investments?** Open answer:

11) **What do you need to successfully monitor and evaluate your impact investments?**
    Open answer:

12) **Do you know if your impact investment have actual positive impact? If so, how do you know?** Open answer:

13) **Do you also take possible negative impact into account?If applicable, select from the choices below:**
    In the selection of impact investments
    In the evaluation of impact investments
    The Impact Investment Market

14) **What are the main impediments and opportunities for mainstreaming impact investment? Open answer:**

15) **Are there any best practices regarding impact investing would you like to mention?**
    Open answer:

APPENDIX 3:

List of interviewees

Name	Function	Organization
Brouwers, Theo	Director Actiam Impact Investing	ACTIAM
Carruthers, Tomas	Chief Executive	London Social Stock Exchange
Criado, (de) Raquel	Senior Portfolio Manager	a.s.r
Donne, Hendrick	Accountmanager	Blackrock
Fransen, Nadja	Portfolio Manager Socially Responsible Investments	SPF Beheer
Gijsbers, Jos	Senior Portfolio Manager	a.s.r.
Goor van, Linda	Director	Regulatory Communication
Heuvel, (van den) Harry	Investment Manager	Achmea
Klop, Piet	Senior Advisor Responsible Investment	PGGM
Lancee, Karianne	Senior Pension Investment and Sustainability Manager	Univest Company BV – Unilever
Langerak, Johan	Investment Director Benelux	Standard Life Investments
Nieukerke, Laurina	General Director	Social Impact Finance
Oostveen, (van) Jan Willem	Manager Investment and Financial Affairs	PFZW
Putten, (van der) Dennis	Head ESG-research	ACTIAM
Roest, Gerard	Board member Pensions FNV	FNV
Schellen, Ad	Investment Manager	Delta Lloyd
Walkate, Harald	Head of Responsible Investment	AEGON Asset Management
Werger, Charlotte	Product Strategist Scientific Equity	Blackrock
Wildeboer Schut, Roger	Manager Responsible Investment	AEGON Asset Management

Joint Learning Session

Name	Function	Organization
Bakkum, Yvonne	Director of FMO Investment Management	FMO
Boer, Hendrik-Jan	Senior Portfolio Manager Responsible Investing	NN Investment Partners
Leeuwen, (van) Menso	Marketing & Communications	AXA
Maanen, (van) Beatrijs	Evaluation Officer	FMO
Muste, Caroline	Head of Fixed Income Insurance	NN Investment Partners
Toren, (van) Nathalie	Senior Advisor Sustainability	NN Group
Veringa, Hanneke	Head of AXA IM	AXA

APPENDIX 4:

Online survey Erasmus University

Methodology of the Experimental Research

To measure preferences for the two key attributes of impact investments - financial return & social impact - we constructed two hypothetical cases about opportunities to make loans to similar companies, with varying levels of expected financial returns & social impact.

- Case type A: higher expected financial return, lower expected social impact
- Case type B: lower expected financial return, higher expected social impact

To identify the causal effect that the evaluation method (separate vs. joint) is assumed to have on the evaluation of financial returns and social impact, subjects are randomly assigned to one of three groups: in two groups the subjects evaluate either of the two single cases (A or B), and in the third group they jointly evaluate the two cases (A and B):

- Group 1: evaluate hypothetical case, type A
- Group 2: evaluate hypothetical case, type B
- Group 3: evaluate two hypothetical cases, types A & B

Subjects are asked to indicate on a 1-10 scale their perceived quality of the investment option(s). In addition, subjects are asked to indicate a few basic characteristics (age, sex, organization type, and whether they receive a bonus for financial returns and social impact created). Altogether, the online survey takes around 5 minutes to complete.

Survey

Dear participant,

Thank you very much for participating in this survey; it is much appreciated! Please be assured that your participation is completely anonymous and all your answers will be treated with the strictest confidentiality, **so please answer all questions truthfully.** The survey should take about 5-10 minutes to complete. Enjoy.

Q1 What is your gender?

○ Male (1)
○ Female (2)

Q2 What is your age?

○ 18 to 24 (1)
○ 25 to 34 (2)
○ 35 to 44 (3)
○ 45 to 54 (4)
○ 55 to 64 (5)
○ 65 and more (6)

Q3 What is your function in the company?

○ Portfolio manager/fund manager (1)
○ Research analyst (2)
○ Other (please specify) (3)

Q4 How many years have you been with your current company?

○ 0 to 2 (1)
○ 3 to 4 (2)
○ 5 to 6 (3)
○ 7 to 8 (4)
○ 9 to 10 (5)
○ 10 and more (6)

Q5 Decision-task

Randomization: participants randomly receive one of the following three cases to answer

CASE 1

Imagine that you work for a large financial institution. The organization has to make an average return of at least 10% (benchmark). If for the funds you manage the average return is above 12% (target) you earn a bonus. In addition, the institution aims to maximize positive social impact.

The financial institution is considering a loan, of €5 million, to a pharmaceutical company that is in the final stages of developing & bringing to market a new and highly effective asthma treatment for the Indian market, where asthma is common, particularly among low-income groups. This new medicine can significantly improve the quality of life for the patient as it makes it easier to breathe. Current asthma medicines in India are unaffordable for most low-income consumers. The loan has a very low default risk as the company has sufficient collateral to fully guarantee the entire sum.

The pharmaceutical company will market this medicine to the high-end of the market. With this strategy the will reach approximately 1.7 million high-income asthma patients in India and make a profit of 2.50€/unit (consumer price=2.75€/unit).

Given this market size & profit margin, the pharmaceutical company is willing to pay 15% interest on the €5 million loan (i.e. earnings of €750.000)

Please use the slider to indicate how good on a scale from 1- 10 would you rank the possibility of making a €5 million loan to this company? (1= Very bad; 10 = Very good)

__________ Rating of Loan

CASE 2

Imagine that you work for a large financial institution. The organization has to make an average return of at least 10% (benchmark). If for the funds you manage the average return is above 12% (target) you earn a bonus. In addition, the institution aims to maximize positive social impact.

The financial institution is considering a loan, of €5 million, to a pharmaceutical company that is in the final stages of developing & bringing to market a new and highly effective asthma treatment for the Indian market, where asthma is common, particularly among low-income groups. This new medicine can significantly improve the quality of life for the patient as it makes it easier to breathe. Current asthma medicines in India are unaffordable for most low-income consumers. The loan has a very low default risk as the company has sufficient collateral to fully guarantee the entire sum.

The pharmaceutical company will market this medicine to the low-end of the market. With this strategy the will reach approximately 8.5 million low-income asthma patients in India and make a profit of 0.25€/unit (consumer price=0.50€/unit).

Given this market size & profit margin, the pharmaceutical company is willing to pay 11% interest on the €5 million loan (i.e. earnings of €550.000).

Please use the slider to indicate how good on a scale from 1- 10 would you rank the possibility of making a €5 million loan to this company? (1= Very bad; 10 = Very good)

__________ Rating of Loan

CASE 3

Imagine that you work for a large financial institution. The organization has to make an average return of at least 10% (benchmark). If for the funds you manage the average return is above 12% (target) you earn a bonus. In addition, the institution aims to maximize positive social impact.

The financial institution is considering 2 loans, of €5 million each, to pharmaceutical companies (A & B) that are both in the final stages of developing & bringing to market a new and highly effective asthma treatment for the Indian market, where asthma is common, particularly among low-income groups. The two pharmaceutical companies target different market-segments, but will sell exactly the same medicine. This new medicine can significantly improve the quality of life for the patient as it makes it easier to breathe. Current asthma medicines in India are unaffordable for most low-income consumers. The loans both have very low default risks as the companies have sufficient collateral to fully guarantee the entire sum.

- Pharmaceutical company A will market this medicine to the low-end of the market. With this strategy they will reach approximately 8.5 million low-income asthma patients in India and make a profit of 0.25€/unit (consumer price=0.5€/unit). Given this market size & profit margin, pharmaceutical company A is willing to pay 11% interest on the €5 million loan (i.e. earnings of €550.000)
- Pharmaceutical company B will market this medicine to the high-end of the market. With this strategy the will reach approximately 1.7 million high-income asthma patients in India and make a profit of 2.50€/unit (consumer price=2.75€/unit). Given this market size & profit margin, pharmaceutical company B is willing to pay 15% interest on the €5 million loan (i.e. earnings of €750.000)

Please use the slider to indicate how good on a scale from 1-10 would you rank the possibility of making a €5 million loan to company A? (1 = Very bad; 10 = Very good)

________ Rating of Loan A (1)

Please use the slider to indicate how good on a scale from 1-10 would you rank the possibility of making a €5 million loan to company B? (1 = Very bad; 10 = Very good)

________ Rating of Loan B (2)

Q6 Do you receive a bonus depending on:

- ○ Financial performance of your fund / company? (yes/no)
- ○ Social/environmental impact of your fund / company? (yes/no)

Q7 What share of your bonus is based on social/environmental impact

- ○ Less than 25%
- ○ Between 25-50%
- ○ Around 50%
- ○ Between 50-75%
- ○ More than 75%

Q8 When you evaluate an investment, do you compare its expected social/ environmental impacts to the expected social/environmental impacts of other (historical and/or future) investments?

- ○ Never
- ○ Sometimes
- ○ Always

Q9 What type of an organization do you work for?

- ○ Insurer (1)
- ○ Pension Fund (2)
- ○ Development finance organization (3)
- ○ Other (please specify) (4)

Q10 What do you think the survey tested?

- ○ Whether bonus partially based on social impact stimulates more impact investing as opposed to a bonus based solely on financial returns (1)
- ○ The ease of evaluating social impact compared to financial returns (2)
- ○ The link between gender and the weight attached to social impact (3)
- ○ The link between age, years of expertise, and the weight attached to social impact (4)
- ○ Importance of social impact in investor decision making process (5)

This is the end of the survey. Thank you very much for your valuable input.

Yours faithfully,

The research team of the Erasmus University