Innpact is a Luxembourg-based fund management company, whose mission is to foster sustainable impact finance initiatives by providing innovative advisory, consulting and management services.

In this interview, zeb and ALFI sat together with Adriana Balducci, Associate Director — Head of Advisory Services at Innpact, on how recent regulatory and market trends have shaped the impact investment industry and what major developments can be expected in the short-medium term.

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Regulatory and market trends impacting investment

Interview with Adriana Balducci, Associate Director — Head of Advisory Services, Innpact

Which major trends in impact investing do you see? What are the current most significant investment themes in your opinion (e.g., climate change, etc.) and what is the outlook for the future?

Financial inclusion has historically been an important investment theme, with particular focus on microfinance projects aimed at supporting SMEs lending in Africa and other developing countries. In addition, fostering education and, more generally, social themes have also been recently gaining momentum. For the future, we expect focus to increase on environmental-related themes, in particular on projects and investments supporting biodiversity and natural capital deployment. The availability of liquidity will certainly contribute to drive the success of impact investing themes as certain products have in the past proven to be non-viable investments due to the lack of solutions to liquidate the investments. In addition, the approach towards exit strategies is evolving. If in the past priority was given to find a financially attractive exit from an investment, nowadays, fund managers are also looking at the sustainability of their exit strategy. In other words, they tend to consider more whether their exit would potentially tarnish the positive impact achieved so far by the underlying investment.

How have impact funds adapted to SFDR on 10 March 2021? Is it fair to say that impact funds would be categorized as Article 9 products under SFDR?

Impact funds are indeed categorized as Article 9 funds. SFDR is expected to bring a positive impact on the market as it provides a structured framework, including clear indicators and paradigms how financial institutions should define sustainability investments.

Certain challenges are nevertheless expected to be considered at least initially, even by more "pure" and advanced impact investors. As organizations have so far mostly focused on measuring positive impact, it is often questionable how far should the negative or adverse impact of an investment be considered (e.g., opportunity cost of implementing specific impact initiatives). We expect regulatory interventions will further help to clarify the required approach as well as more common practices will be established ("learning by doing") once SFDR implementation will bring its first effects.

Would you like to read on?

Please find the complete study to be downloaded at: bit.ly/zebSustainableFundsStudy

What do you think about the hypothesis that small asset managers/funds cannot really make a difference due to their limited market power? Or, put it in another way: Do only large asset managers make a difference in terms of impact investing?

It is indeed true that large asset managers can "make a difference" as they typically attract more significant volumes of investments and liquidity. Nevertheless, all financial institutions, regardless of size and background (private or public institutions), can play an important role in impact investing. By actively engaging in impact investing, financial institutions can in fact "signal" to the market that the underlying impact initiatives matter, thus bringing more public attention on the particular investment themes.

On the other hand, smaller management companies engaging in impact fund solutions may develop special know-how in specific instruments or markets, thus also contributing to the overall development of impact investing.

Is impact investing relevant for all client groups or only for a certain group (such as development institutions, religious institutions, governmental bodies, foundations, family offices) thus limiting the future market size in relation to less ambitious ESG strategies?

The answer is twofold. On one hand, we can see that in certain markets, or for certain investments, barriers like the lack of liquidity or the specific know-how required presume that the investor should have an institutional background or that only a specialized development organization (e.g., development banks, etc.), willing to take higher risk for a potentially lower financial return (than other traditional investments) may engage with the investment project.

However, the appetite and demand for impact investing has significantly increased in the past years also for private retail investors. As proven by the success of crowd-funding platforms, retail investors also want to see their investments making a positive impact, albeit obviously with an eye on financial returns.

In addition, with the emergence of blended finance, we also observe a stricter collaboration of public and private funding on the success of specific impact initiatives, resulting in positive results for both investors and communities.

Is impact investing only for impact-driven investors?

Not really. As the definition of impact investing says, these investment solutions should combine positive social and environmental impact with financial returns. Hence, these investment solutions are suitable for "financial returns first" type of investors as well. In addition to that, in certain situations, we also observe how pure financially driven investors enter impact investing after considering the adverse implications (or even higher costs) faced by not engaging in impact investing.

How significantly does the impact investment focus narrow the relevant investment universe, with (negative) consequences on performance and risk?

Given how quickly the impact investing landscape has evolved, there are now several investment opportunities across different markets and products types. Therefore, we can say that the impact investment focus does not narrow the investment universe to a critical extent.

For what concerns performance of impact investing solutions, several studies and research have shown that impact investing may have the same or higher financial performance as other investment solutions. As the topic whether impact investing has positive or negative correlation with financial returns is arguably debatable, what we can say is that, when measuring both financial and "impact" returns, the track record of an investment solution should be carefully monitored.

Do you think impact investment fund providers must follow ESG criteria themselves rather than only on product level for their credibility? Would you make a difference to providers that only offer "basic" ESG-compliant funds?

It is important for institutions engaging in impact investing to also comply with ESG criteria as per their day-do-day operating and business framework. That is true both from a regulatory and a public credibility perspective. On one side, SFDR prescribes that when preparing relevant disclosures, organizations assess sustainability criteria not only at product level but also at overall entity level, i.e., how the organization integrates sustainability criteria in their operations. At the same time, organizations engaging in impact investing products but not following ESG criteria directly, may face the risk of negative publicity, as we have seen recently for example in the case of fund houses offering impact investment solutions, but not complying with sustainable governance criteria such as gender diversity, gender pay gaps, etc.

When it comes to assessing the level of impact or the level of ESG-compliance of a product, we also observe that the market and public sentiment now ponder more carefully the degree of impact made by an investment solution.

Even though the full spectrum of sustainable solutions is still relevant, we see a difference in how the market perceives impact investing versus for instance more basic negative screening investment solutions.

Can you think of new pricing models that not only refer to the AUM or performance but also to meeting set KPIs related to impact objectives?

We see the first examples of fund pricing models linked to the impact returns of the underlying investments. However, we don't yet have a framework already commonly replicated across the market as it is the case for other sustainable products, like green bonds.

The challenge of developing fund pricing models linked to impact objectives lies in finding a consistent approach to measuring impact returns, both for organizations to make a first quantification and for auditors to monitor the correctness of impact values.

How has the pandemic influenced impact investing, and what is the outlook for the next years?

Pandemic has, in general, contributed to a more widespread attention on ESG criteria and on sustainability-related issues. With the Covid-19 pandemic, we see more interest in social themes like for example sustainable public health and safety issues. For impact investing, the time horizon is usually longer as it takes more time for investment fund solutions to be designed, assessed and implemented. We then expect to see the results of ideas being developed today only in the next few years.

The outlook for impact investing is anyhow positive: SFDR will play an important role in shaping impact investing by providing clearer definitions on impact objectives and performance indicators, thus reducing green-washing effects. This will hopefully help to spread the image of impact investing not only as a niche offering for institutional investors but also an attractive solution for private capitals.