For professional investors/qualified investors only

Capital with purpose

Impact investing in listed equities

Setting out our approach and framework

COLUMBIA THREADNEEDLE INVESTMENTS

This is an opportunity for our industry to champion positive change, and respond to a growing desire **from clients that want to make a real difference alongside attractive long term returns.**

Contents

Key risks

Past performance should not be seen as an indication of future performance.

The value of investments and any income derived from them can go down as well as up and investors may not get back the original amount invested.

The information, opinions estimates or forecasts contained in this document were obtained from sources reasonably believed to be reliable and are subject to change at any time.

Get to know the author

Sacha joined the firm in 2009, following an extensive education. She graduated with an MSc in Finance (with distinction) in 2009 from Bayes Business School, formerly known as Cass Business School, City University. Sacha also has a BA in Economics with a minor in Business Administration from the American University of Beirut, and is a CFA charterholder.

Sacha is lead portfolio manager of the CT Sustainable Global Equity Income Strategy and is the alternate portfolio manager of the CT (Lux) SDG Engagement Global Equity Fund, and the CT Sustainable Opportunities Global Equity Fund. Sacha's role is entirely focused on running and feeding into strategies with explicit Responsible, Sustainable and Impact mandates, and she places particular emphasis on driving and evidencing impact in the team's processes and investments.

Sacha is passionate about using her role as an investor to influence and effect positive change in the real world.

Sacha El Khoury, CFA
Director, Portfolio Manager, Global Equities

The views and approach outlined in this document apply only to funds and strategies with an explicit mandate to deliver ESG impact as well as positive investment performance which are managed by our Global ESG Equities Team operating through Columbia Threadneedle Management Limited. The team are now part of Columbia Threadneedle Investments which is the asset management business of Ameriprise Financial, Inc.

Harnessing capital

to make a positive impact

The purpose of this white paper is to introduce our approach to impact investing in listed equities.

We provide context for the relatively nascent concept and argue that, given the urgent need, the application of impact should evolve beyond its historical bounds to include listed equity investments as a key asset class to drive real world impact. We distinguish between the different types of impact and lay out the different key components of impact, and how they're applied in practice in our framework. Our impact framework builds on existing definitions and standards to set out an ambitious, multi-dimensional structure for delivering impact transparently. It has 4 key building blocks (Additionality, Intentionality, Materiality and Measurability) upon which impact can be sought, evidenced, and tracked. Given the lack of standardised industry approach and definition, our framework is intended to be holistic but transparent and provides a robust basis for our impact investing activities.

Executive summary

Impact investing originated in philanthropy and started from a need to close a funding gap in private markets. This to a certain extent explains why the traditional purist definition of impact investing remains constrained to certain asset classes. The landscape has changed materially however, and mobilising capital beyond private markets to advance the UN Sustainable Development Goals has become an imperative.

Why?

- **Because** the world is facing an existential crisis, and environmental and social challenges are threatening our collective future.
- **Because** the magnitude of challenges is currently not being met by capital of similar magnitude; and to begin addressing those sustainability challenges, capital needs to start mobilising en masse.
- **Because** beyond private markets, mobilising capital in publicly listed equities brings something unique to the impact table: scale and reach. Very few asset classes match the scale of capital needed to plug the $2.5 trillion funding gap required to achieve the UN SDGs[1]. But listed equity investments do.

- **Because** capital with purpose can be harnessed to deliver intentional positive impact through thoughtful investments and intentional engagement; and has the potential to deliver a much-needed boost to progress on the SDGs.
- **Because** investors are now more than ever aligning their investments to their values, and the appetite for impact is growing rapidly.
- **Because** impact will soon become a key determinant of future investment returns, and we believe positive impact and attractive investment performance go hand in hand.

> “We strongly believe that with clear intent and a robust and holistic framework, **impact can be driven in public equities.**”

As a result, the definition and approach to impact need to evolve beyond traditional impact asset classes if we are to progress towards a more sustainable future, to include one of the most scalable asset classes – public equities.

As active shareholders of public equities, we recognise the limited nature of our ownership: we are after all minority stakeholders in businesses, and we do not over-state our influence, or in impact parlance, additionality. However, we do not believe we are too small to make a difference. To quote the Dalai Lama (himself drawing upon an old African proverb): “If you think you are too small to make a difference, you haven’t spent the night with a mosquito”. The renowned activist Greta Thunberg embodies this sentiment too in the aptly titled book “No one is too small to make a difference”.

We therefore strongly believe that with clear intent and a robust and holistic framework, impact can be driven in public equities. How? By harnessing the power of capital to catalyse and accelerate the pace of change, drive systemic transformation, and inform positive social and environmental developments at unprecedented scale and reach.

1 Business and Sustainable Development Commission (2017)

Why impact – now?

Change is the only constant

Our economic system, whilst an engine for enormous prosperity, can prioritise short-term, material gains at the expense of longer-term collective goals, and this can have significant, severe ramifications for the health of our planet, the environment and society. We now find ourselves at a critical juncture to halt and reverse some of the harm caused; and the urgency to evolve the system from one that exploits to one that enables and nurtures is clear. Ensuring a safer and more sustainable future will be challenging and the global financial system needs to evolve.

Just as risk metrics became a ubiquitous financial tool and a key determinant in the efficient allocation of capital in the second half of the twentieth century when the measurement of risk became standardised, so must impact considerations be factored into investment decision making to optimise return profiles.

As the seriousness of issues like climate change are increasingly well understood, stakeholders are mobilising everywhere. The likes of governments, corporates, individuals, consumers, and investors now recognise that the actions we take today and over the next decade are key. As a result, change is about to become our only constant. The world needs to transition to a more sustainable footing, and we believe that how we allocate capital will be key to unlocking that future.

What is impact investing?

A brief history of impact

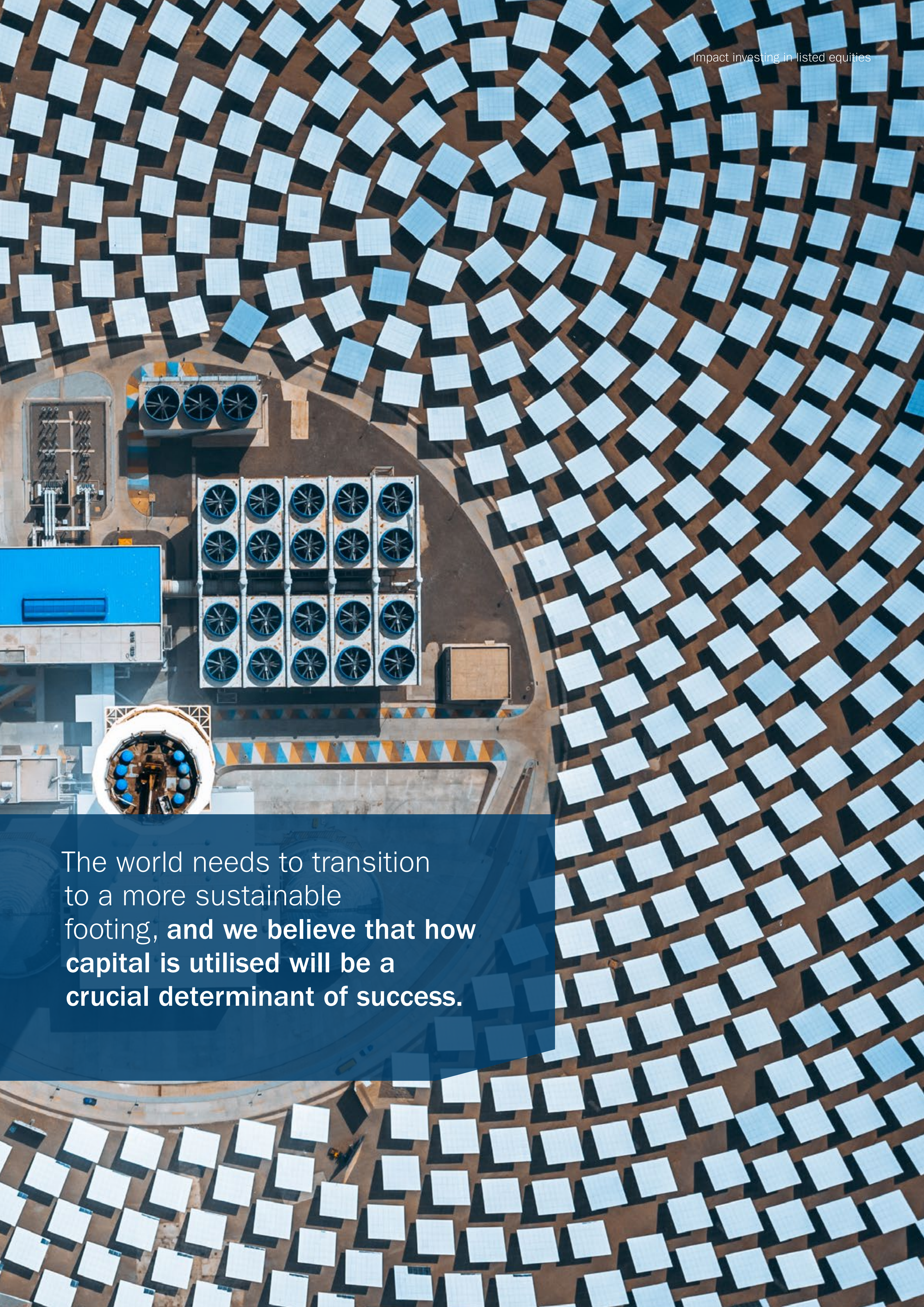
It is important to look back if we are to make progress. Whilst the concept of impact originated in philanthropy, the concept of targeting non-financial as well as financial returns has a few precursors: from exclusionary approaches rooted in religion, to the bottom-line approach which saw a continuous evolution in the 1990s.

But the term impact investing was only coined in 2007 by the Rockefeller Foundation, which saw an opportunity to plug a massive funding gap with private capital. This was a disruptive ethos that purposefully differentiated from both philanthropy which typically does not pursues a financial return, and ESG investing which at that time typically focused on exclusions.

> “Governments, corporates, individuals, consumers, and investors now recognise **that the actions we take over the next decade are key.**”

Because of its association with specific asset classes, definitions and frameworks for impact investing are far from being standardized. This becomes apparent when looking at market statistics which result in wildly different estimates depending on the source:

- More than 450 investors allocated **$1.3 trillion** to impact investments worldwide in 2016 (PRI)
- Impact Investment is expected to reach **$307 billion** by 2020 (GSG)
- The Global impact Investing Network (GIIN) estimates that the impact investment sector stood at **$502 billion** AUM at the end of 2018, and now it is heading for the first **$1 trillion**.
- Investor demand amounts to no less than **$26 trillion** (50x the size of the 2018 market) (International Finance Corporation – a subsidiary of the World Bank)



The world needs to transition to a more sustainable footing, **and we believe that how capital is utilised will be a crucial determinant of success.**

The many definitions of impact

Whilst there isn't a single approach to impact, there are several widely accepted definitions and principles that have been recognised and adopted by the investment community. One is that of the Global Impact Investing Network (GIIN), which states that 'impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return'.

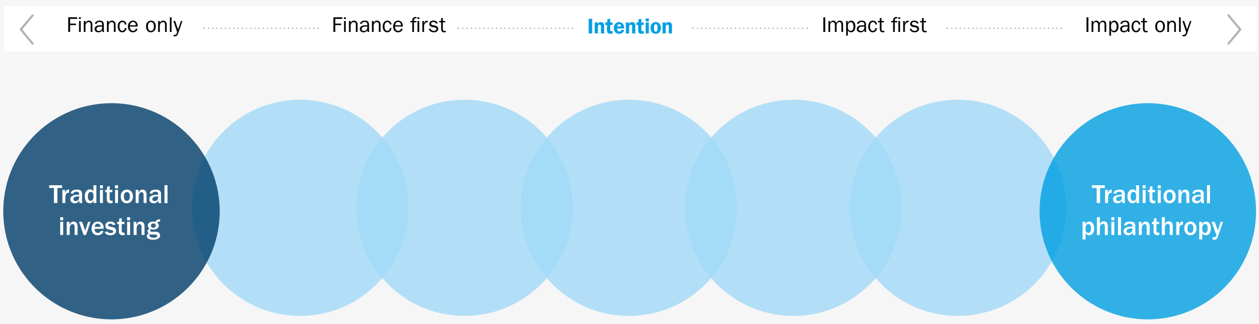
There is a recognition amongst industry participants that the approach to impact investment is still up for debate however, and that there isn't a single accepted standard or framework. This is especially true in listed equities where the concept is still in its infancy.

We observe three elements as being common to most industry definitions and approaches:

Intentionality is key – the intentional desire to contribute to social and/or environmental benefit is probably the single most important characteristic of impact investing.

Measuring impact is a key tenet of impact investing – despite this, there is no generally accepted impact measurement standard. The SDGs remain a good framework for goal-setting and reporting, but standardised principles are still at a relatively early stage. It is worth noting that initiatives like SASB, GRI, and WDI all help to improve transparency, giving investors enough data to identify meaningful areas where change may be required.

Positive financial returns are necessary – they are what differentiate impact investing from philanthropy.



Source: Rockefeller foundation

The many asset classes of impact

Because of the philanthropic roots of impact investing, the traditional 'impact' asset classes never included public markets, which were not seen as relevant for a very long time as they didn't attract impact-oriented capital, and most importantly, were perceived as failing to meet one of the key criteria for impact investing: that of additionality – or the degree to which the impact created could be attributed to the dollar capital being invested. Simply put, additionality means that the social or environmental outcomes would not have occurred if the investment were not made – and investments in listed equities were perceived to have failed this hurdle because this type of causality is hard to evidence in public markets.

In contrast to ringfenced asset classes like debt, or private markets where capital can be allocated towards specific projects with measurable IRRs, secondary capital in public markets just changes hands from one shareholder to another – without really affecting the company's access to capital, as it does not involve new capital, and with no direct link to specific projects. This has been one of the main pushbacks to impact investing in public equities.

As the importance of intentional active ownership grows however, this view is slowly but perceptively shifting, and the GIIN amongst other bodies now recognises that impact investments can be made across a range of asset classes. We would argue that this must be the case, especially in public equity markets, where purchases on the secondary market are a source of demand, and demand vs. supply is simply one of the drivers of the share price. Lowering the cost of capital for impactful companies looking to raise additional capital (e.g. through rights issue, secondary offering, etc…) is tangible evidence to the importance of impact investors in public markets.

Why impact in listed equities?

Public equities, the next frontier – capital with purpose

It is estimated that $5 – 7 trillion of capital will be needed annually until 2030 to achieve the UN Sustainable Development Goals (SDGs)[2] objectives, a number that is significantly higher than the estimated $3 trillion a year that is currently talked about. If we really are serious about progressing the SDGs, then public equity investments must be central to the conversation. They can play an important role in plugging this funding gap because they bring a dimension that has so far escaped traditional impact asset classes: reach and scale.

This argument, made by a Former Managing Director at the Rockefeller Foundation, is even more powerful when we think about the intent behind the investment. Active equity investors motivated to generate positive social and environmental change bring an altogether different kind of capital to the table: capital with intentional engagement focused and aimed at progressing the SDGs.

Activating capital by purposeful engagement is one of the most powerful tools in listed equity investors' arsenal. When looking at how to address sustainability challenges, this is without a doubt one of the most significant levers to pull to achieve impact.

> "Purposeful engagement **is one of the most powerful tools in listed equity investors' arsenal.**"

[2] Source: https://www.weforum.org/agenda/2021/01/the-sustainable-development-goals-can-get-back-on-track/

Types of impact

Before we move on to our framework, it is important to make the distinction between the different types of impact:

- The first is the impact generated and delivered **by the underlying investment**, i.e. by an investee company's activities – as defined by the products and/or services it sells, as well as its conduct, i.e. its footprint and operations. This is often referred to as '**Enterprise impact**'. We believe there is a lot of confusion in the industry when it comes to this first type of impact, and very few investors disaggregate 'Enterprise impact' into its two components: products/services and conduct. We believe it is important to distinguish between the two, as they serve to drive and deliver impact in different, albeit meaningful ways.
- The second is the impact generated and delivered **by the investor**. This is often referred to as '**Investor impact**'. This represents the investor's intention to deliver positive impact through:
  – Pro-active engagement, tailored and intentionally pursuing pre-determined outcomes – this is also called 'investor contribution'. The aim of this activity is either to precipitate or accelerate Enterprise impact.
  – Influencing the cost of capital, enabling the investee company to deliver more positive Enterprise impact.

Both investor impact and enterprise impact are of course intimately linked, as the former can play a role in shaping and steering the latter.

In general, we have found that the distinction between the various types of impact is not often made and the various components and drivers of impact are not commonly split out. We believe it is an important exercise however as it helps in establishing the drivers of impact, in engineering a well-thought-out engagement agenda, and in measuring and tracking outcomes.

Our approach to impact investing

Whilst our approach builds on the work of industry peers, we aim to go beyond that, being ambitious and holistic in the way we pursue and deliver impact.

Our definition

Our definition encompasses 5 key observable attributes that can distinguish impact investing from other types of investing:

1. Intentionality as a key starting point
2. Engageability as a prerequisite for investing
3. Contribution as a key driver to pursue impact
4. Measurability of impact
5. Positive Impact Principle, or our twin ambition to deliver attractive financial returns and positive non-financial outcomes

Intentionality

The intent to invest with purpose is central to the idea of impact, as it ultimately shapes the outcomes and lends a robust structure to what it is we are intending to achieve – accelerating and ushering the change towards a more sustainable world, that promotes a fairer society, and a healthier planet.

> “The SDGs provide a good framework for goalsetting, measuring and reporting **as it is the most common language spoken by the investor community, the corporate world and clients.**”

Identifying and addressing a clearly articulated environmental or social problem that the investment would help to solve is our starting point.

Engageability

Engaging is a powerful tool to effect positive change. Investee companies need be amenable to change, and be engageable, as a prerequisite for investing. Here, we conduct pre-investment assessments of a company’s engageability based on our own track record of engaging with the company, as well as governance metrics.

Contribution

Investor contribution can be defined as the action of the impact investor that will help achieve the goal. Our capital bears weight, and it is in the manner we wield it that our contribution is felt:

- either through the cumulative power of allocating capital to influence the cost of capital,
- or through using the weight of our capital to influence positive change: engagement alongside voting. As active investors, engagement is one of the most powerful tools in our arsenal.

Contribution is an area of contention amongst traditional impact investors and relates to the idea of additionality explained briefly earlier. Whilst we accept that the causal link is harder to establish in listed equities, there are numerous examples of successful engagement stories in the market. Simply because something can be challenging to attribute with precision, does not mean it is any less real or impactful.

Given our extended engagement track record, we strongly believe in the power of harnessing active capital, especially if it is intentional by design, for the purpose of catalysing or accelerating change in publicly listed companies.

Measurability

Measuring impact is a key tenet of impact investing, that comes up repeatedly in the literature. Despite its importance, there is no common language or standardised framework, which is perhaps unsurprising given the sheer nature of the remit. A number of initiatives have emerged however, making an attempt at providing a common reporting framework[3].

While we encourage disclosure, reporting against various sets of standards and frameworks that are impossible to compare or make sense of can be confusing and potentially counter-productive. It is only a matter of time before the industry lands on a generally accepted impact measurement framework, but in the meantime, we believe the SDGs provide a good framework for goal-setting, measuring and reporting as it is the most common language spoken by the investor community, the corporate world and clients.

Further to using the SDGs, our approach is to reframe the question: What is the purpose of measuring impact?

We identify two key reasons: 1) what gets measured gets acted upon, and 2) accountability.

This is why we believe only meaningful outcomes should be measured, tracked and reported through time. We aim to focus on outcomes that are SMART (Specific, Measurable, Achievable, Realistic and Time-bound).

Positive Impact principle

Our approach is underpinned by our Positive Impact Principle. We aim not just to avoid negative impact, but to create a positive one in both:

- Financial returns: we believe impact investing should deliver attractive returns over and above the wider market over the long term.
- Positive impact of investee companies (‘Enterprise Impact’)

3 The list of most prominent initiatives can be found in the appendix

Our definition can **be summarised as follows:**

Intent to address a clearly articulated environmental and/or social problem or need that the investment helps to solve

Quality business models

Strong/improving ESG credentials

Defensible moat

Engageable stewards of capital

Intentional pursuit of positive impact that is additional, either through companies’ activities, or through investor contribution

Intentional pursuit of positive impact that is measurable

Twin ambition to deliver attractive investment performance and positive non-financial outcomes

Impact investing

We need to look beyond the impact definitions of old and progress our own understanding of how capital can be wielded and harnessed to deliver real world impact.

Our framework

We have developed a robust framework that puts our definition of impact investing into practice. We use this as a systematic, structured approach to applying our principles to impact investments. Our proposed framework is called AIMM (Additionality – Intentionality – Materiality – Measurability).

Additionality	Intentionality	Materiality	Measurability
'Enterprise impact' 'Investor impact'	Engageable enterprises Intentional allocation of investment capital	Revenue materiality[4] Scale of materiality	Assess, measure and track impact

Each of these 4 pillars represents a fundamental building block to our approach which ensures transparency and provides a robust framework for our impact investing activities:

Additionality: we assess both enterprise impact, and investor impact, aiming to disaggregate and clearly identify the type of impact. We recognise the limitations of the nature of our ownership, yet believe that as long-term active investors, we will drive additionality through our engagement activities.

Intentionality: in addition to the over-arching intentionality behind the investment in question, we look for companies that are open to constructive dialogue, and amenable to change. Engageability is a prerequisite for investing.

Materiality: we seek to assess the scale of the impact that companies can make. We make a clear distinction on whether the real world impact is driven by companies' products/services or whether it is driven by their footprint (i.e. conduct). We believe both fall within the scope of impact investing; but the distinction is necessary to evidence and assess the scale of impact.

Measurability: assessing, measuring and tracking outcomes that are meaningful and contribute to making a real-world impact. We endeavour to report total impact – both positive and negative.

Our framework is underpinned by our Positive impact Principle which underlies our twin ambition to deliver attractive investment performance and positive non-financial outcomes.

[4] Companies' products/services (i.e. revenues) must be >50% linked to an impact theme (or SDG) or be on a pathway to doing so in 2-3 years

Conclusion

The world is in danger of missing its mark: time is running out to halt and reverse the damage that has been inflicted on our environment and societies, and by extension our future economy, and potential investment returns. One very effective and powerful way to effect positive change is to mobilise capital with intent and purpose. There is an urgent need for our economic model to evolve and embrace impact as a key input into capital allocation decisions and ultimately, as a key determinant of future investment returns.

This is why we need to look beyond the impact definitions of old and progress our own understanding of how capital can be wielded and harnessed to deliver real world impact. Given their reach and scale, and the levers at investors' disposal to effect real world change, publicly listed equities as an asset class must be included in mainstream impact investing.

With the right framework, investments in listed equities can generate real world impact. With this in mind, we have developed an impact framework around sound principles, which provides a robust and transparent structure to pursue, deliver and evidence real world impact[5].

We believe listed equity investors can mobilise their capital to enable the most impactful companies, and can activate their capital by using powerful tools at their disposal such as voting or engagement to precipitate and accelerate enterprise impact. Harnessing the power of capital in this intentional way only amplifies impact when like-minded investors join up with the same intention, through partnerships or collaborations.

Looking forward to the next decade, there is a plethora of challenges that require immediate mobilisation of capital: from the need for a fairer, more equitable and inclusive society, to environmental challenges on land and sea. This is an opportunity for our industry to champion positive change, and respond to a growing desire from clients that want their capital to make a real difference in the world, whilst delivering attractive financial returns that outperform the market over the long term.

> “This is an opportunity for our industry to champion positive change, **and respond to a growing desire from clients that want to make a real difference alongside returns.**”

[5] Whilst the framework developed in this paper focuses on listed equities, we believe that many of the principles set out are equally applicable to other asset classes that have perhaps been overlooked so far.

Appendix

GIIN[6] definition:

Impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending on investors' strategic goals.

The growing impact investment market provides capital to address the world's most pressing challenges in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services including housing, healthcare, and education.

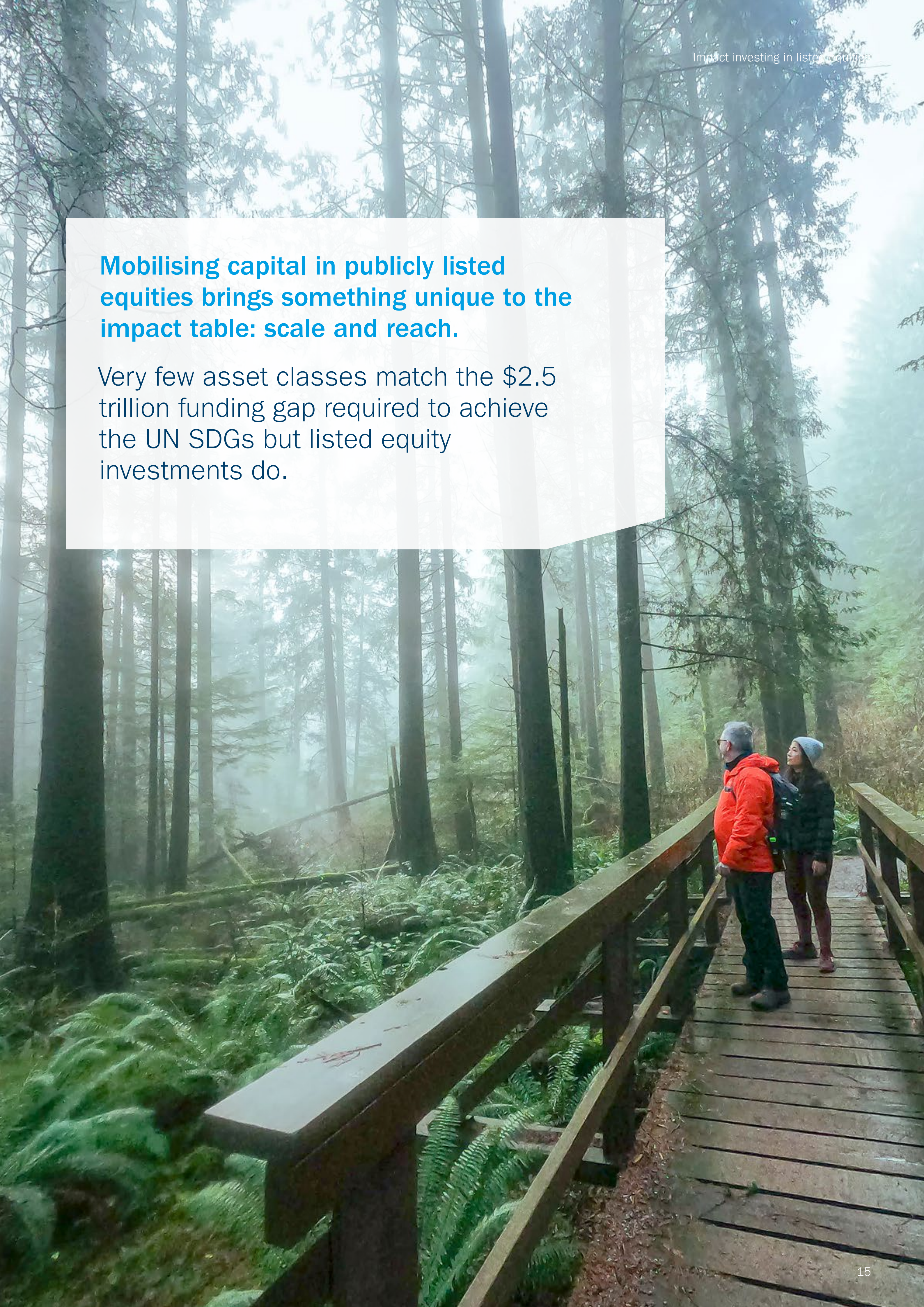
The Bottom-line approach for instance, saw a continuous evolution over time:

- Double bottom line approach: financial returns + social impact
- Triple bottom line approach (developed in 1994 by the celebrated corporate sustainability activist John Elkington): took social and environmental sustainability into account in addition to the profit quotient.
- Quadruple bottom line adds a 4th component – the purpose the company serves

Impact Measurement Initiatives

- IFC has developed over 2 dozen sector frameworks to assess projects across 4 industries[7]
- Impact Weighted Accounts (developed by Harvard Business School): an ambitious accounting project developed by Harvard Business School with a mission to create financial accounts that reflect a company's financial, social and environmental performance, and would include total enterprise impact (both products/services and conduct). The accounts would transparently capture external impacts in a way that drives investor and managerial decision making.
- IRIS+[8] (managed by the GIIN) is a system that has been developed for measuring, managing and optimising impact.
- Other newer disclosure initiatives include the IFRS ISSB[9], the EFRAG[10] and the UK government's sustainability reporting standards[11].

[6] Global Impact Investing Network
[7] https://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/Development+Impact/aimm/measuring-impact/
[8] https://iris.thegiin.org/
[9] https://www.ifrs.org/groups/international-sustainability-standards-board/
[10] https://www.efrag.org/Activities/2010051123028442/Sustainability-reporting-standards-roadmap?AspxAutoDetectCookieSupport=1
[11] https://www.gov.uk/government/publications/public-sector-annual-reports-sustainability-reporting-guidance-2021-to-2022



Mobilising capital in publicly listed equities brings something unique to the impact table: scale and reach.

Very few asset classes match the $2.5 trillion funding gap required to achieve the UN SDGs but listed equity investments do.

To find out more visit **columbiathreadneedle.com**