

LEVEL EEI

Towards an impact assessment framework
for environmental financial products

Webinar – October 11th, 2022
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AGENDA

- I. Description of the project
- II. Presentation of existing frameworks for product categories
- III. Presentation of existing frameworks for specific products
- IV. Proposing a two-step methodology

I. Overview of the project

Description of the project

Developing, pilot-testing and promoting a methodological framework for rating environmental products and related marketing claims in relation with the advancement of Sustainable Energy and Energy Efficiency investments

The present step: Developing a rating system of sustainable financial products based on their environmental impact

The following step: Developing a (connected) rating system of marketing impact claims of financial products

Ongoing questions

- Ex ante impact estimation vs ex post evaluation ?
- A rating system based on a two-step process ?
- Which Integration of the rating systems for products and for environmental claims ?
- Which technical criteria ?

Presentation of existing frameworks

- **Frameworks for product categories (ex ante)**
 - Framework #1: Caldecott et al. (2022)
 - Framework #2: Swiss Asset Management Association
 - Framework #3: 2DII's Product Category Climate Impact Factsheet

- **Frameworks for specific products (ex post)**
 - Framework #4: IMP's guide to classifying the impact of an investment
 - Framework #5: Busch et al. / Eurosif (2022)
 - Framework #6: Sustainable Transition Contribution Potential Measurement Grid" by Finance for Tomorrow (France)

Your questions and comments

II. Presentation of existing frameworks for product categories

Framework #1: Ben Caldecott et al. (2022)

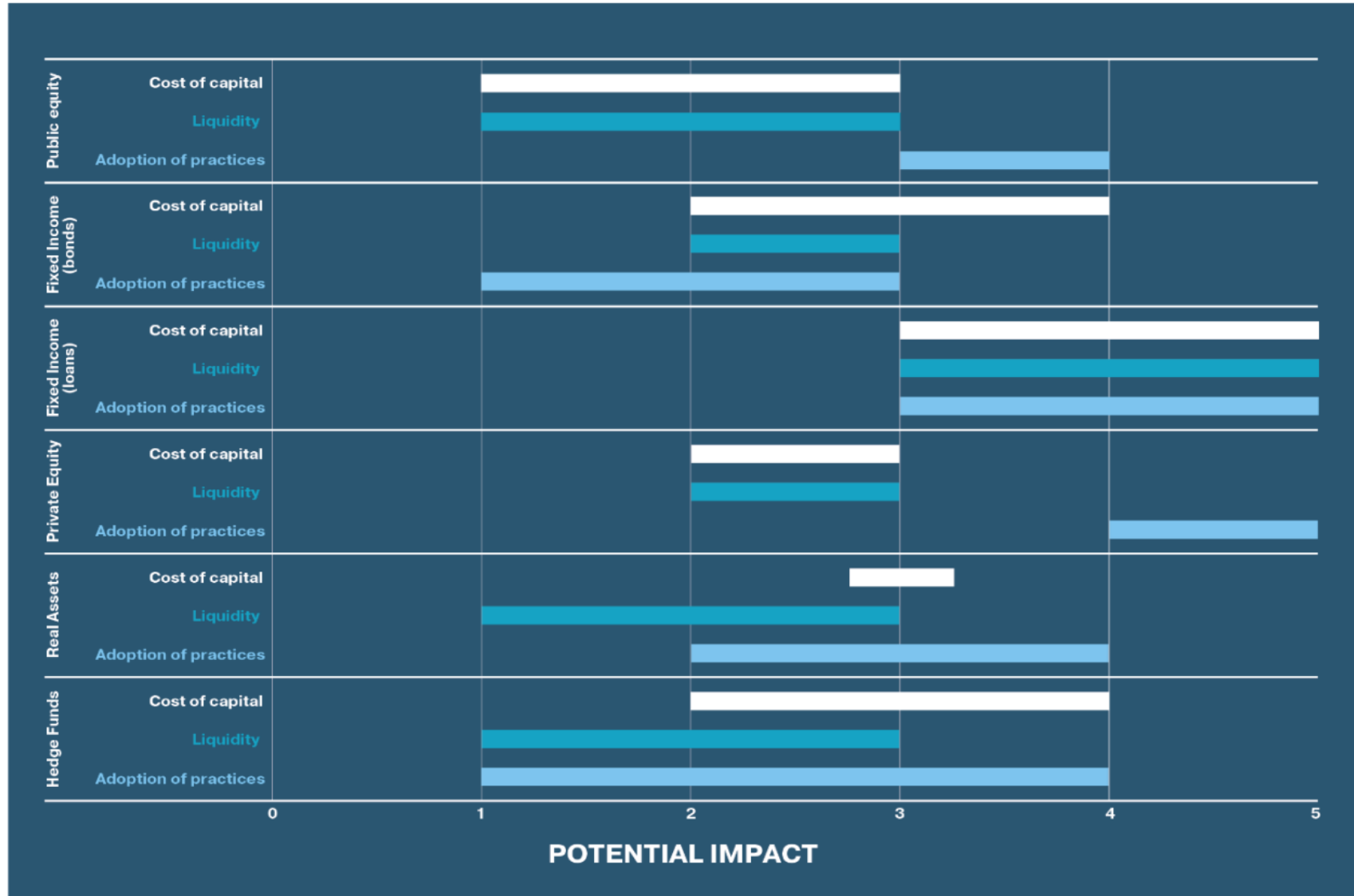
- “Sustainable Finance and Transmission Mechanisms to the Real Economy”
- They argue that, in order to have a positive environmental impact, financial institutions must make a clear and measurable difference in one or more of the following ways:
 - reducing (increasing) the cost of capital for (un)sustainable activities;
 - increasing (reducing) access to capital for (un)sustainable activities;
 - encouraging or enabling sustainable practices by counterparties, such as companies, sovereigns, and individuals
- They assess the availability of impact across key **asset classes**, hypothesizing a maximum potential for impact for each.

Table 3: Potential Impact Rating Scorecard

	Public equity	Fixed Income (bonds)	Fixed Income (loans)	Private Equity	Real Assets	Hedge Funds
Cost of capital	1 / 3	2 / 4	3 / 5	2 / 3	2 / 3	2 / 4
Access to liquidity	1 / 3	2 / 3	3 / 5	2 / 4	1 / 3	1 / 4
Adoption of practices	2 / 4	1 / 3	3 / 5	3 / 5	2 / 4	1 / 4

Source: Caldecott (2022)

Figure 2: Potential Impact by Asset Class and Transmission Mechanism



Source: Caldecott et al. (2022)





Framework #2: Swiss Asset Management Association (2021)

- “How to Avoid the Greenwashing Trap: RECOMMENDATIONS ON TRANSPARENCY AND MINIMUM REQUIREMENTS FOR SUSTAINABLE INVESTMENT APPROACHES AND PRODUCTS”
- Three main goals of the paper:
 1. Define the various sustainable investment approaches and instruments in more detail and set minimum criteria for the implementation of each of them
 2. Specify minimum requirements for investor information on the different investment approaches and instruments.
 3. Identify which of these **sustainable investment approaches** satisfy the three main sustainable investor goals (**Financial performance, Values alignment, Positive change**) most effectively

Table 3. Matrix illustrating suitability of different sustainability approaches for different investors' sustainability goals

		Sustainability approaches					
		Exclusion	Best-In-Class	ESG Integration	Thematic Investments	Impact Investing	Stewardship
Investors' sustainability goals	Financial Performance	Contributes to a certain extent	Contributes to a medium extent	Contributes to a great extent	Contributes to a certain extent	Contributes to a certain extent	Contributes to a certain extent
	Values Alignment	Contributes to a great extent	Contributes to a medium extent	Not applicable	Contributes to a medium extent	Contributes to a medium extent	Not applicable
	Positive Change	Contributes to a certain extent	Contributes to a certain extent	Not applicable	Contributes to a certain extent *	Contributes to a great extent	Contributes to a certain extent **

* Refers to Chapter 4.4
** Refers to Chapter 4.6

-  Not applicable
-  Contributes to a certain extent to respective sustainability goal
-  Contributes to a medium extent to respective sustainability goal
-  Contributes to a great extent to respective sustainability goal

Framework #3: 2DII's Product Category Climate Impact Factsheet

- A traffic light rating based on three criteria:
 1. The activation of impact mechanisms
 2. The level of academic evidence on product effectiveness on climate
 3. The level of academic evidence on the additionality of outcomes

- A methodology applied to ten **categories** of environmental financial products

Impact mechanisms




	Description of the mechanism	Deployment by products from the category
Price signaling	Do investments in the product send clear price signals that may positively influence the behavior of economic agents (i.e., issuers or investors) regarding their climate policy?	YES (green bonds currently trade at a “greenium”, i.e. a decreased yield compared to conventional bonds from the same issuer)
Underserved markets	Do investments in the product finance holders of green projects with difficult access to financing?	NO (they de facto target large companies with no difficulty to access funding)
Flexible capital	Do investments in the product provide capital to holders of green projects at flexible conditions (e.g., at lower cost or with a risk transfer compared to market terms)?	UNCLEAR (there is currently a “greenium” in bond markets at the issuance but it seems too small to influence issuers)
Commitment to a B2DS	Do investments in the product create a strong incentive for project holders to align with a scenario well below 2°C?	CONDITIONAL (to the standards the purchased bonds follow)

Example: Green bonds

Observed effects on climate

Number of research papers investigating the effect of the product category on climate metrics (as of 2021/12/31)	8
% analyses that obtain a positive effect (at climate KPI level)	68%

2DII's product Category Climate Impact Factsheet

<p>High impact potential</p>		<ul style="list-style-type: none"> • Green equity crowdfunding • Green peer-to-peer lending • Green private equity funds • Green private debt funds • Green infrastructure funds
<p>Medium impact potential</p>		<ul style="list-style-type: none"> • Green bond funds • Green deposits
<p>Low impact potential</p>		<ul style="list-style-type: none"> • Green thematic equity funds • Green low-carbon equity funds

Your questions and comments

III. Presentation of existing frameworks for specific products

Framework #4: IMP's guide to classifying the impact of an investment

- the Impact Management Project (IMP) has collaborated with over 2,000 investors and enterprises to develop “impact classes”, which group investments with similar impact characteristics based on their impact performance data (or, in the case of new investments, their impact goals).
- An **impact class** combines the impact of an investment's underlying asset(s) with the contribution the investor makes to this impact
- The IMP has so far identified **13 impact classes**

Figure 1 | The Impact Classes available

		IMPACT OF UNDERLYING ASSETS / ENTERPRISES		
		A	B	C
		Act to avoid harm	Benefit stakeholders	Contribute to solutions
1	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital	E.g. Ethical bond fund	E.g. Positively-screened / best-in-class ESG fund	E.g. Sovereign-backed bonds (secondary market) funding vaccine delivery to understand people or renewable energy projects
2	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital	E.g. Shareholder activist fund	E.g. Positively-screened / best-in-class ESG fund using deep shareholder engagement to improve performance	E.g. Public or private equity fund selecting and engaging with businesses that have a significant effect on education and health for underserved people
3	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital	E.g. Anchor investment in a negatively-screened real estate fund in a frontier market	E.g. Positively-screened infrastructure fund in a frontier market	E.g. Bond fund anchoring primary issuances by businesses that have a significant effect on environmental sustainability, access to clean water and sanitation
4	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital	<i>Investment archetypes not yet defined</i>	E.g. Positively-screened private equity fund making anchor investments in frontier markets	E.g. Private equity fund making anchor investments in businesses that have a significant effect on income and employment for underserved people
5	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital	<i>Investment archetypes not yet defined</i>	<i>Investment archetypes not yet defined</i>	E.g. Below-market charity bonds, or an unsecured debt fund focused on businesses that have a significant effect on employment for underserved people
6	Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital	<i>Investment archetypes not yet defined</i>	<i>Investment archetypes not yet defined</i>	E.g. Patient VC fund providing anchor investment and active engagement to businesses that have a significant effect on energy access for underserved people

Framework #5: Busch et al. / Eurosif (2022)

- Classification Scheme for Sustainable Investments
- 5 categories of sustainable investments:
 - Exclusion-focused
 - Basic ESG
 - Advanced ESG
 - Impact-aligned
 - Impact generating
- **Impact generating investments** have specific features:
 - Pre-investment strategy: selection process of investees based on investor impact potential
 - Post-investment strategy: active engagement and voting
 - Measurement of company impact **and investor impact**

Table 1: Classification scheme for sustainable investments.

Dimension	Criteria	Exclusions-focused	Basic ESG	Sustainable investments			
				Advanced ESG	Impact Aligned	Impact Generating	
General characteristics	Ambition level	No	Marginal	Low	Medium	High	
	Main objective	Values driven	Mitigation of ESG risks	Managing ESG risks & opportunities	Address E/S challenges	Active contribution to solving RWC (i.e., transition of investees)	
	Materiality	-	Financial materiality	Financial materiality	Double materiality	Double materiality	
Pre-Investment strategies	Negative screening	Exclusions	Based on ethical values	Based on ESG risks	Based on ESG risks	Based on negative impacts	
		Norms based screening	OR	AND	AND	AND	Based on non-transformable activities
	AND						
	Positive screening	ESG integration	-	Low commitment	High commitment		Focus on positive investor impact through capital allocation
		Best-in-class / Best-in-universe/ Best-in-progress	OR	OR	OR	Focus on positive company impact through positive screening	
			-	Low sophistication	High sophistication		
Sustainability themed		OR	OR	OR	Financial opportunities		
AND						OR	
Post-investment strategies	Engagement & voting	-	-	Transparency ESG risks and opportunities	Transparency company impact	Transition objective investor impact	
AND							
Performance measurement	Performance measurement	-	ESG Risks	ESG risks and opportunities	Measurement of company impact	Measurement of expected and generated company & investor impact	
AND							
Documentation	Objective Pre-investment	✓	✓	✓	✓	✓	
	Post-investment	-	Short description	Detailed description	Detailed description	Detailed description	
	Performance measurement	-	-	Formal and regular reports	Formal and regular reports (company impact)	Formal and regular reports (investor impact)	
	External verification	-	At least one KPI	> one KPI on ESG matters	> one KPI on company impact + impact monitoring	> one KPI on company & investor impact + impact monitoring	
		-	-	(✓)	✓	✓	

Framework #6: “Sustainable Transition Contribution Potential Measurement Grid” by Finance for Tomorrow (France)

- A grid to assess the potential of investment funds to actively contribute to the sustainable transition (beyond the energy transition)
- Developed under the umbrella of Finance For Tomorrow, an initiative by Paris Europlace to support and grow sustainable finance in France
- Co-constructed with more than 40 associations and financial institutions under the patronage of two pilots since S2 2021 (including 2DII)
- Currently in the finalization round

- The grid serves different purposes:
 - 1) Self-assessment by funds
 - 2) Pedagogy about impact concepts and best practices
 - 3) Information for investors (need for external audit)
 - 4) Identification of “impact funds” (need for external audit) > **minimum score + validation of 12 “pass-or-fail” questions**
 - 5) Starting point for an “impact label” in France within or outside “Label ISR”

- Important challenges:
 - Find a set of questions relevant for all funds (listed vs non-listed, equity vs debt)
 - Define (demanding but realistic) requirement levels
 - Select a short list of qualification questions

- Methodological choices:
 - Contribution instead of impact
 - Additionality at input AND outcome levels
 - IMP impact mechanisms and beyond
 - Includes the two impact pathways (grow the positive or fight the negative)
 - Full score after two years since inception

		Number of questions		Number of points	
A	THEORY OF CHANGE	13		30	
A.1	<i>Definition of general objectives</i>		6		12
A.2	<i>Description of planned actions</i>		7		18
B	IMPLEMENTATION	5		30	
C	OUTCOME MONITORING	10		30	
C.1	<i>Outcome monitoring process</i>		6		15
C.2	<i>Achieved outcomes</i>		4		15
D	COMMUNICATION AND CREDIBILITY	4		10	
	TOTAL	32		100	
E	BONUS	1		3	

Your questions and comments



IV. Proposing a two-step methodology

Description of the two-step methodology

- 1) Attributing an average impact potential rating to each product category

Ex: high, medium, low


- 2) Attributing an impact exploitation score for specific products within a category

Ex: Each product receives a rating (**0, +, ++ or +++**) based on its ability to exploit the full impact potential of its product category

Consequently, each product will receive a double score: one for its product category (in the form of a traffic light) and one for its own capability to exploit the full potential of its product category



Rating	Total score (as % of maximum score for the product category)
0	0
"+"	$0 < x < 33\%$
"++"	$33\% < x < 66\%$
"+++"	$x > 66\%$

	Impact potential (category)	Potential exploitation (product)
Product XXX		"++"

Ex: Swiss Project

Impact potential	Impact mechanisms	Eligible product categories
<p style="text-align: center;">High impact potential</p>	<p style="text-align: center;">Signalling + undersupplied markets / flexible capital</p>	<p>Microfinance / solidarity funds Thematic PE/Private debt/ VC funds Thematic Infrastructure funds Impact investing funds Social Impact Bond funds Sustainability loan funds Sustainability-linked loan funds</p>
		<p>Thematic equity crowdfunding Thematic peer-to-peer lending</p>
		<p>Sustainable saving accounts</p>
<p style="text-align: center;">Medium impact potential</p>	<p style="text-align: center;">Signalling + active stewardship</p>	<p>SDG engagement funds ESG engagement funds</p>
<p style="text-align: center;">Low impact potential</p>	<p style="text-align: center;">Signalling</p>	<p>Best-in-class equity funds Exclusion equity funds Thematic equity funds Low-carbon equity funds</p>
		<p>Sustainability bonds Sustainability-linked bonds</p>

Eligible product categories	Important moderators	Criteria	No evidence	General statement or sector-level evidence	Portfolio-level evidence	Investment-level evidence
			0	1	2	3
Microfinance / solidarity funds	Selection process of the investees (impact, needs...)	Does the fund select investees based on their impact potential?	No	Yes, the fund provides evidence of an investment policy targeting sectors with high impact potential	Yes, the fund documents a general selection process incorporating investees' impact potential	Yes, the fund provides evidence on how investees' impact potential was taken into account for each investment
Thematic PE/Private debt/ VC funds	Documented funding gap for the investees	Does the fund document funding difficulties of investees?	No	Yes, the fund provides evidence at sector level	Yes, the fund provides evidence at portfolio level (e.g., metrics on the average difficulty of investees to get funding)	Yes, the fund provides evidence for every investee
Thematic Infrastructure funds	Tailored or concessional terms (rate, risk transfer, duration)	Does the fund provide evidence it offers flexible funding conditions (rate, risk transfer, duration, etc.) compared with market conditions?	No	Yes, the fund mentions it sometimes offers provide flexible financing	Yes, the fund mentions it often provides flexible financing and brings evidence at portfolio level	Yes, the fund provides evidence of the flexible conditions offered to each investee
Impact investing funds	Public signalling	Does the fund display a clear intention to deliver impact?	No	Yes, the fund discloses a general intention to deliver impact	Yes, the fund discloses an intention to achieve a specific, quantified impact at portfolio-level (e.g., an average reduction of carbon emissions by investees of X% in 2025)	Yes, the fund discloses an intention to achieve a specific, quantified impact at investee level
Social Impact Bond funds						
Sustainability loan funds						
Sustainability-linked loan funds						

Ongoing questions:

- A rating system based on a two-step process
 - How to evaluate categories ? Based on activation of impact mechanisms only ? Or on observed outcomes too ? (**limited research**)
 - Provide categories with a single rating or a range ? Based on an average impact / maximum possible impact / on current best practices ?
- Ex ante impact estimation (**intended actions, processes, expected outcomes**) vs ex post evaluation (**deployed actions, processes and realized outcomes**)
 - Relevance to assess products based on their (investor) impact measurement ?
 - Relevance to assess products based on their achieved (investor) impact ?

Presentation of existing frameworks

- Frameworks for product categories (**ex ante**)
 - Framework #1: Caldecott et al. (2022) > ex ante
 - Framework #2: Swiss Asset Management Association > ex ante
 - Framework #3: 2DII's Product Category Climate Impact Factsheet > ex ante (**incl. outcome measurement for the category**)
- Frameworks for specific products (**ex post**)
 - Framework #4: IMP's guide to classifying the impact of an investment > ex post
 - Framework #5: Busch et al. / Eurosif (2022) > ex post (**incl. outcome measurement**)
 - Framework #6: Sustainable Transition Contribution Potential Measurement Grid" by Finance for Tomorrow (France) > ex post (**incl. outcome measurement**)

Your questions and comments

THANK YOU !