High Level Expert Forum for Sustainable Finance

Co-creating the Future of Sustainable Finance.

13 & 14 December 2022

#HLEF2022

Lecture & Q&A – Measuring and proving environmental impact, an impossible task - really?

Mickaël Mangot, Chief Scientific Officer
“Retail and Impact Investing”, 2Dii

13 December, 14h00-15h00

GA n°894345

levelEEI

The “impact paradox”

Measurement is commonly accepted as a key dimension of impact investing

but…

measurement of investor impact is so far widely neglected by product manufacturers of “impact products”

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Why is evaluating (investor) impact important ?

If done well, it would…

1. Provide useful information to impact-motivated investors
2. Limit impact-washing
3. Comply with consumer protection law (and upcoming financial regulation?)
4. Contribute to manage impact risk

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Why is evaluating (investor) impact important ?

Example: FCA’s consultation paper on Sustainability Disclosure Requirements (SDR) and investment labels (October 2022)

A qualifying criterion for “sustainable impact” products: “***a robust method to measure and demonstrate that its investment activities have had a positive environmental and/or social sustainability impact***”

Figure 4 – Sustainable investment labels

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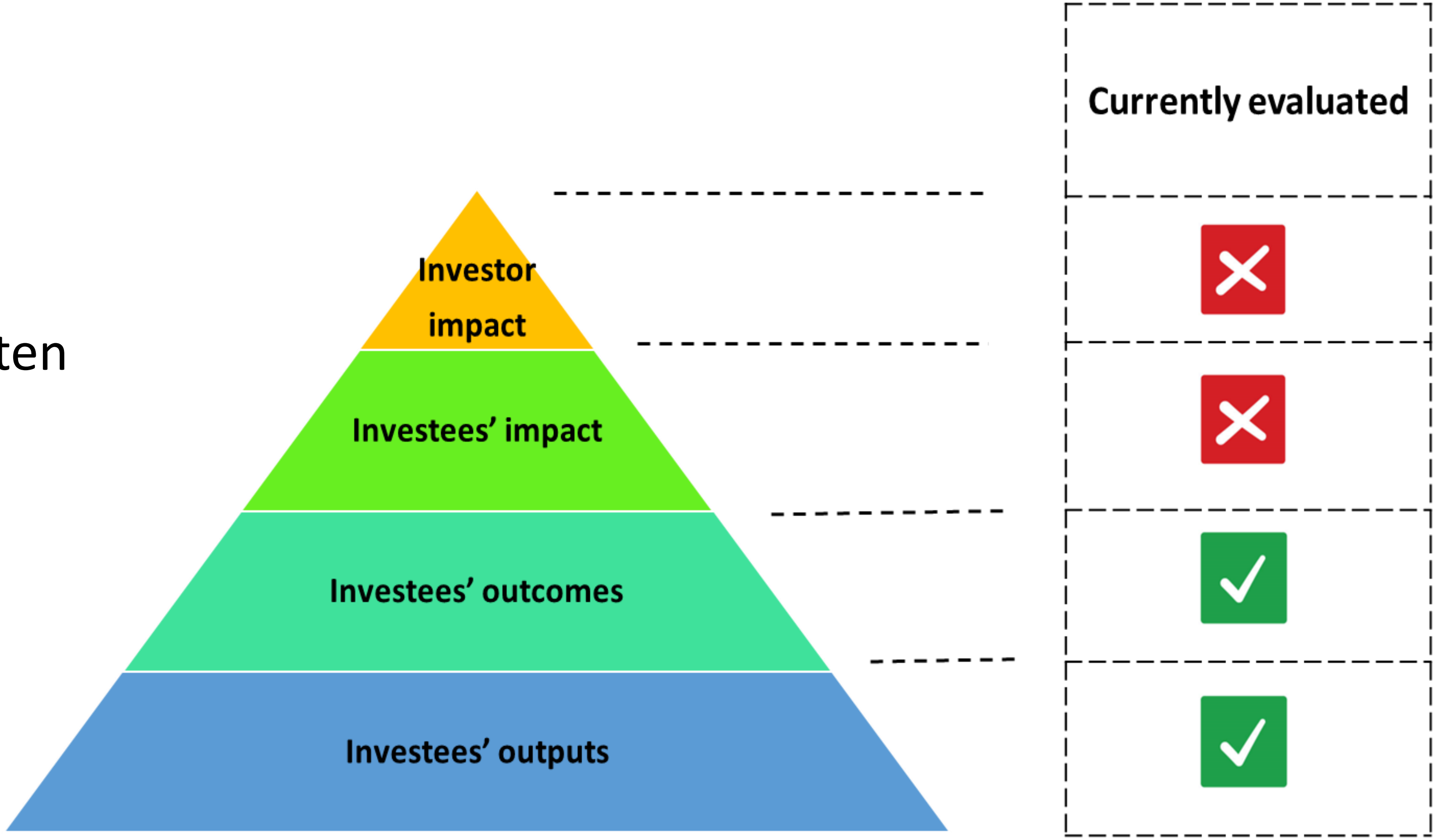
The missing “investor impact” measurement

Measurement too often stops at investee outcomes…



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Avoiding confusion about investor impact

- In an investment context, it is relevant to assess impact at various levels (investor, product and investee)
- Investor impact is **NOT a mechanical proportion** of the invested companies’ impact
- Investing in positive impact companies (e.g., providing green solutions) or in positive impact financial products does not mechanically lead to having a positive investor impact
- In many cases, it leads to a **zero-sum portfolio reallocation** across investors and impact reattribution
- **Several verification checks are necessary** to claim investor impact

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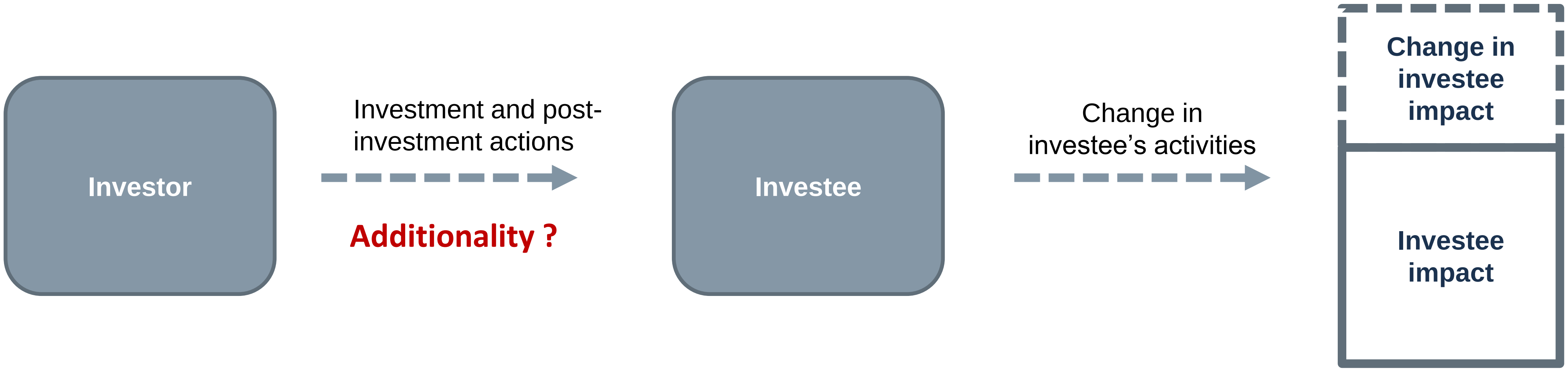
Investor impact: case of direct investments



Investor impact = change in invested company's impact due to a change in the company activities that can be attributed to the investor's actions

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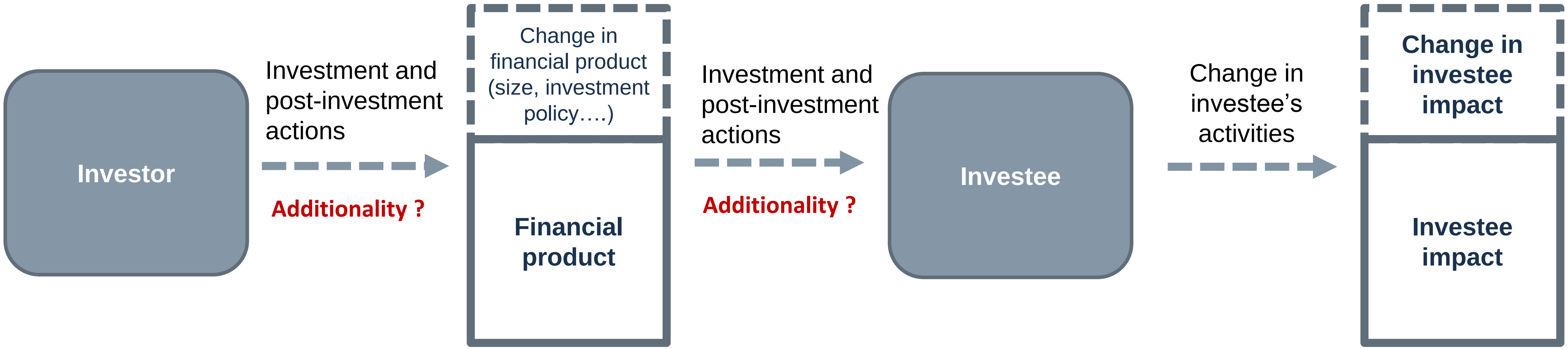
Level the playing field for Energy Efficiency Investment products

Investor impact: case of intermediated investments



Product impact = change in invested companies' impact due to a change in the companies' activities that can be attributed to the financial product's actions

Investor impact = change in invested companies' impact due to a change in the companies' activities that can be attributed to the change in the financial product's actions in connection with the investor's own actions

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Why is impact measurement desperately missing?

Typical arguments:

- Argument #1: investor impact measurement is not feasible
- Argument #2: even if feasible, investor impact measurement is useless anyway. Investors want impact, not the evidence for impact.
- Argument #3: even if feasible and useful, investor impact measurement would be too costly

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What to respond?

Argument #1: investor impact measurement is not feasible

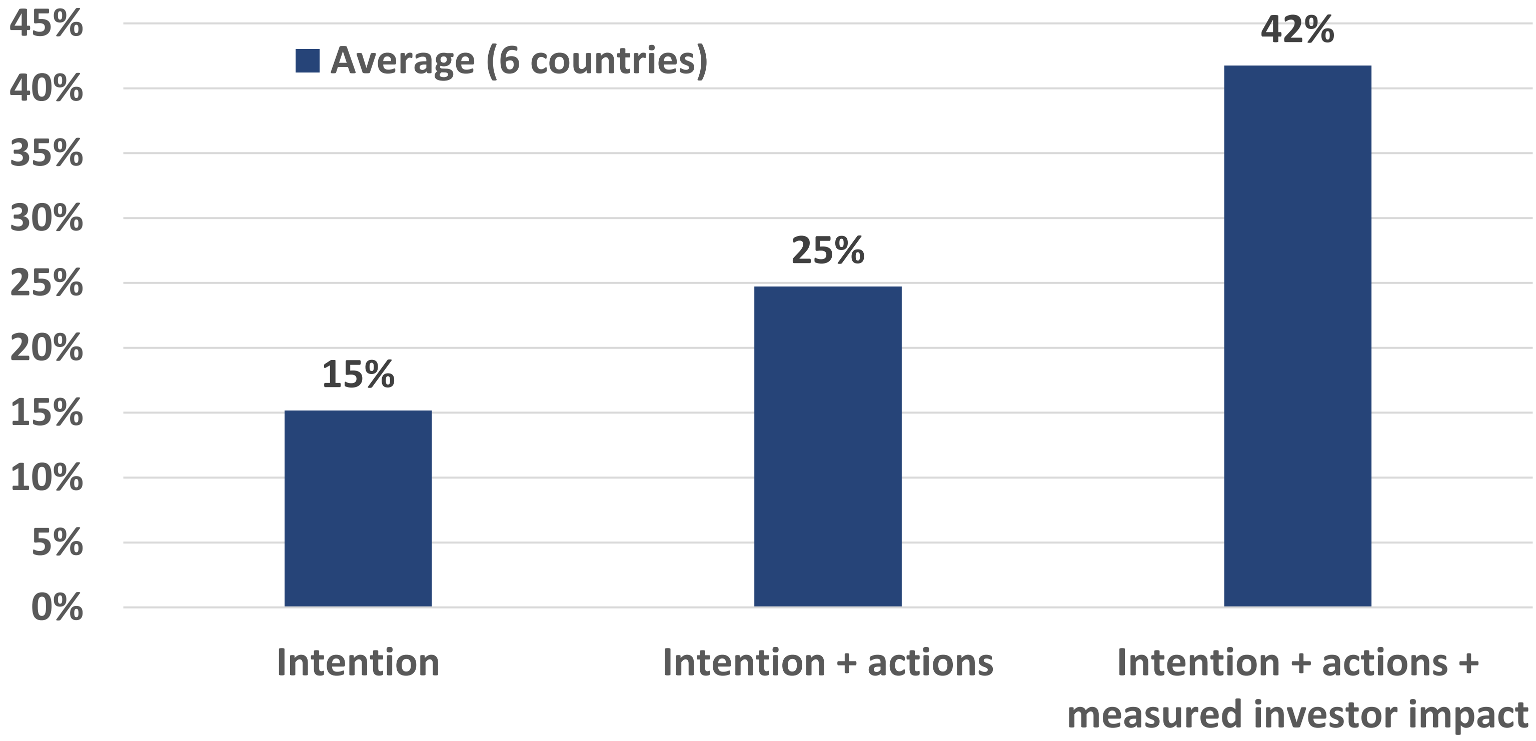
- It is true that there are practical limitations to impact evaluation in finance (non available data, small sample size, impact timeline, etc.)
- But…
- Multiple impact evaluation techniques do exist and have been massively used in philanthropy, social business and public policy for at least 20 years
- Among all of them, some are for sure applicable to financial investments
- Evaluation experts and scientific societies are here to help

What to respond?

Argument #2: even if feasible, investor impact measurement is useless anyway

- There is some evidence showing that retail investors are requesting impact measurement
- 2DII (2022): N=6000 in Spain, Sweden, Poland, Netherlands, Belgium, Italy

According to you. what should be an Impact Fund in order not to mislead investors?



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What to respond?

Argument #3: even if feasible and useful, investor impact measurement would be too costly

- Other sectors, with less financial resources, are currently doing it. Why not finance?
- Evidence suggests that some investors would accept to pay more for financial products with clear, measured impact
- There are ways to decrease the costs associated to impact evaluation
- The more common impact evaluation in finance, the cheaper it will be

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The challenges of impact evaluation

Proving causality and additionality
- An outcome that would not have happened otherwise?
- An outcome that is caused by the investor actions?

The fundamental evaluation problem
- There is no planet B
- Need to rely on second-best options

Finding an appropriate counterfactual
- Need to control for many confounding factors (selection bias, spillovers, secular trend, interfering events, etc.)
- Different ways to create a counterfactual (most perfect match, comparison group, synthetic clone, artificial cutoff, etc.)

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An introduction to impact evaluation methods

Quantitative methods > observe difference vs a baseline

- Counterfactual methods: RCTs and quasi-experimental methods
- Non-counterfactual methods: before/after designs, casual comparisons, etc.

Qualitative methods > get evidence that achieved outcomes are in line with expectations / may reasonably be attributed to investor contribution

- Surveys, interviews and focus groups
- Structured interviews (ex: QuIP)
- Targets, ratings and scorecards

Theory-based methods > validate different steps of a theory of change

Mixed methods > combine various methods to triangulate investor impact

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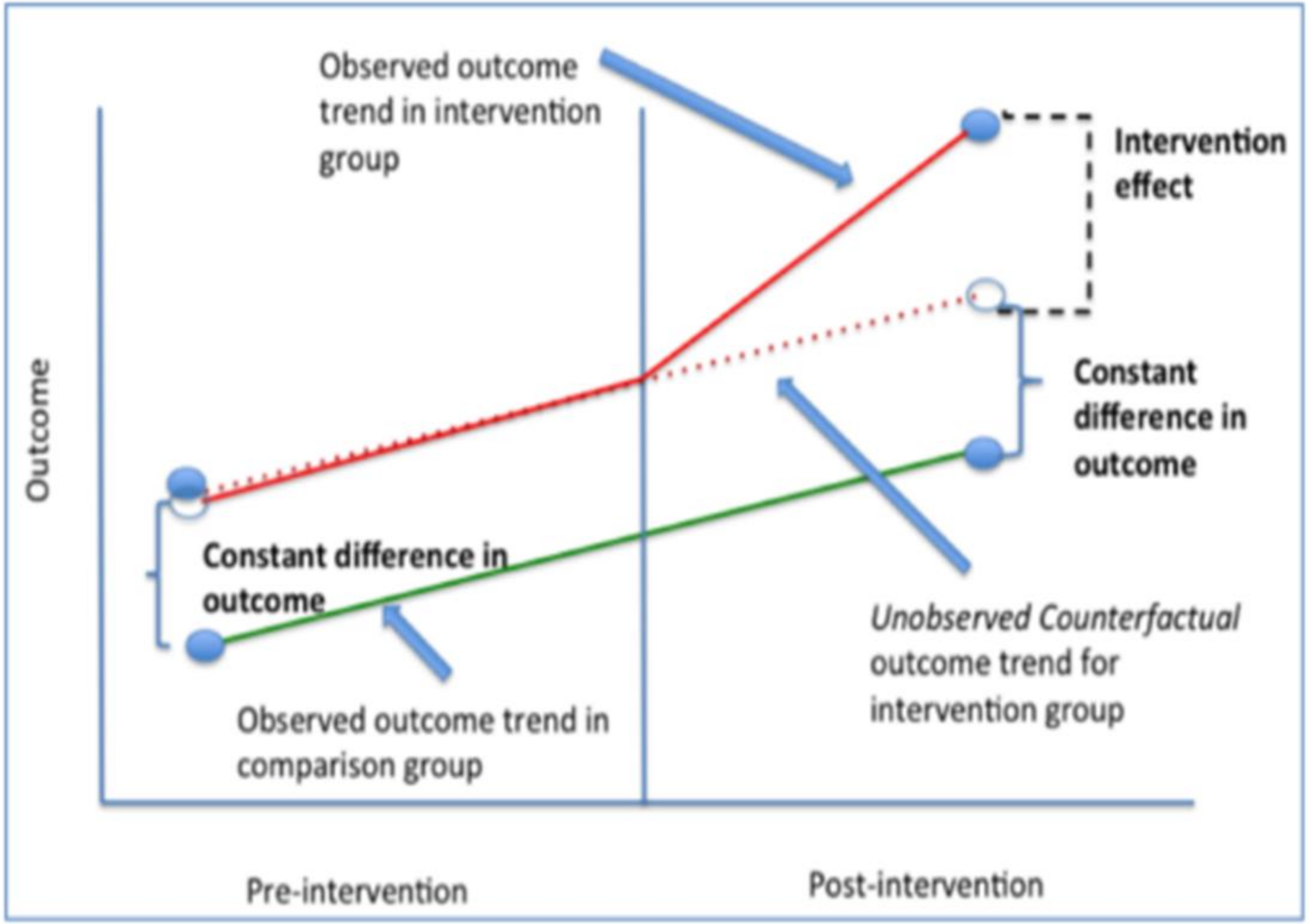
Quasi-experimental methods

They include:

- (Propensity Score) Matching > the most perfect match
- **Difference-in-Difference > a comparison group with a similar past trend**
- The Synthetic Control Method > a synthetic clone
- Instrumental Variables > an adequate comparison group after removing selection bias
- Regression Discontinuity Designs > a comparison group based on an artificial cutoff



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Stronger ability to demonstrate causality and additionality ⟷ Weaker ability to demonstrate causality and additionality

Counterfactual methods

Experimental methods

- Randomized Controlled Trials

Quasi-experimental methods

- (Propensity Score) Matching
- Difference in difference
- Regression Discontinuity Design
- Synthetic Control Method
- Instrumental variables

Non-counterfactual methods

Comparative methods

- Before/after designs
- Casual comparisons

Qualitative and mixed methods

- Surveys, interviews and focus groups
- QuIP
- Targets, ratings and scorecards
- Theory-based methods

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How to choose the right evaluation method?

The right evaluation method is highly **context-dependent** !

It depends on several criteria, especially:
- The availability of data
- The sample size of portfolios
- The expected confounding factors (selection bias, spillovers, secular trend, interfering events, etc.)

And don't forget that you can mix methods !

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The specific case of “collective impact”

1) How do we evaluate a collective impact?

    Ex: impact of clean energy thematic funds

A problem: there is no counterfactual since all similar companies are treated > evaluation will be prone to many confounding factors (ex: a change in perception by conventional investors)

2) How do we evaluate individual impact within a collective action? Should we use proportional attribution?

    Ex: market signaling through screening strategies

    Ex: coordinated engagement

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Where to go next? Potential ways forward…

For product manufacturers:

- Engage with your investees about their impact evaluation
- Evaluate your own (investor) impact
- Choose adapted and credible evaluation strategies
- Set your evaluation strategy <u>before</u> investing
- Hire evaluation experts
- Always substantiate your impact claims

For regulators:

- Add an “impact product” category in the regulation to satisfy the sustainability preference of some retail investors
- Make explicit if investor impact evaluation is compulsory for all impact products / all impact-related marketing claims
- Provide clear guidelines about which evaluation methods to use
- Provide minimum requirements regarding achieved outcomes (and disclaimer)

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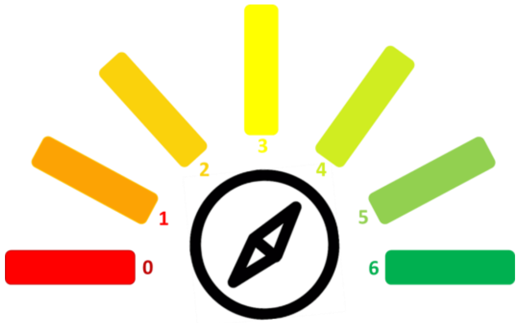
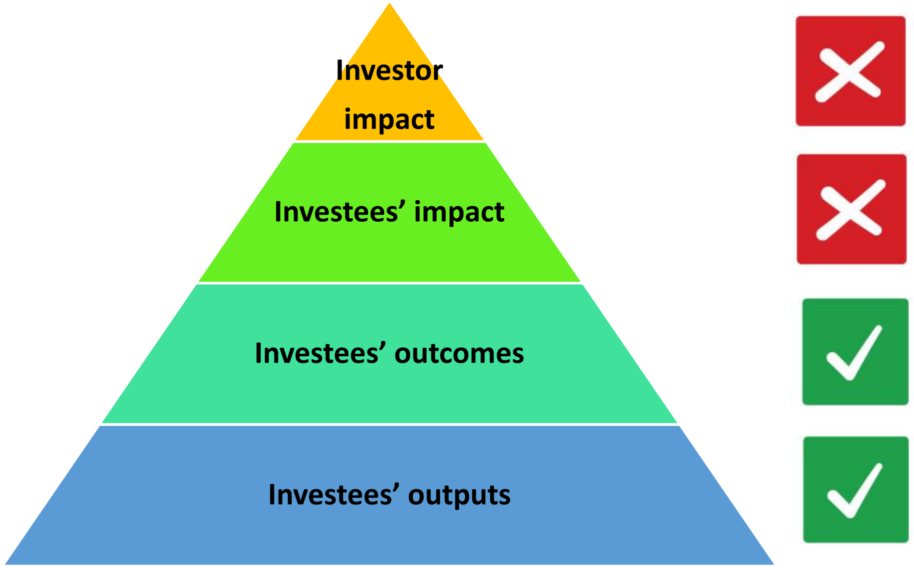
	Category impact potential	Potential exploitation (of the product)	Impact evaluation (by the product)
Product XXX	*How high is the impact potential of the product category? From 0 to 6*	*How much does the product exploit the impact potential of its category? From 0 to +++*	*Which effects on the real economy does the product carefully evaluate (quantitatively or qualitatively)?*
		++	

Product's Climate Impact Potential Synthetic Rating

(based on category impact potential and potential exploitation scores)

Highest impact potential

Lowest impact potential

Still a long way to go…

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