Pension Funds and Impact Investing 2022

Time to move the needle

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Preface

Yvonne Bakkum - Embrace long term value, invest for impact

In 2016, VBDOs first research on impact investing pointed to a Dutch market size of EUR 24 billion[1]. Six years later, the Netherlands Advisory Board on Impact Investing (NAB) estimated a size of 150-180 billion[2]. Apart from this substantial growth, the relative proportion of impact assets reflects the leading position of the Netherlands, with an average 4-6% of AuM versus 1-2% on a global level.

Despite this leading position, the NAB titled its report: 'Are we punching below our weight?' Why, you may wonder. Because we have what it takes to do more! Over the last 10 years, impact investing in and from the Netherlands has developed from primarily microfinance driven into a credible investment approach across asset classes, with different impact-risk-return profiles to suit all investors' needs. Investors pledged their commitment to the Sustainable Development Goals[3]. Aggregated vehicles deliver scale, blended structures reduce risk. Impact measurement practices have evolved, Dutch institutions co-operate on harmonising their SDG investing approach, international best practices and standards are unfolding. And last but not least, the intentionality of outcomes-based responsible investment practices signals a convergence between 'traditional' SRI and impact investing.

The urgency to step up our game is real. Since 2016, the funding gap to realise the SDGs by 2030 has increased to over USD 4 trillion per year. The convergence of various global crises requires large-scale and ongoing investment in mitigating and adapting to climate change, reversing the loss of biodiversity and reducing inequalities. In the Netherlands and especially in developing countries.

The long-term adverse effect of these crises on portfolio values will be much worse than any trade-off investors might face now on risk or return. Impact has value and embracing long-term value requires a long-term vision accompanied with bold ambitions.

In that spirit I call upon institutional investors to double their impact investment allocations over the next 3 years, and allocate at least 40% thereof in emerging markets. Besides that, I urge all stakeholders to collaborate for systemic change. Organisations such as VBDO and the NAB are committed to drive and facilitate such collaboration. You can count on us, can the world count on you?

Yvonne Bakkum
Chair, Netherlands Advisory Board on Impact Investing

[1] Impact Investing: from niche to mainstream (2016) – www.vbdo.nl/wp-content/uploads/2016/02/ImpactInvestment_Final.pdf
[2] Are we punching below our weight (2022) – www.nabimpactinvesting.nl/post/mapping
[3] Building highways to SDG Investing (2016) – www.sdgi-nl.org/report

1. Introduction

This study focuses on impact investing in illiquid markets with regard to Dutch pension funds. At the heart of the study are two overarching questions, 'What is the current state of play of impact investing in illiquid markets and what opportunities are there for development and growth?'

In 2016, a study by VBDO reported that EURO 24 billion, 1.7% of Dutch institutional investments, could be classified as impact investments.[4] Back then, impact investing was still very much in development. There was an even distribution between public and illiquid private markets, and investments were made across various asset classes. Since then, responsible and sustainable investments have increased rapidly. Impact investing is one of the most difficult investment strategies, but arguably it is also the most important given the real world impacts that need to happen if society is to overcome the significant challenges that it is currently facing.

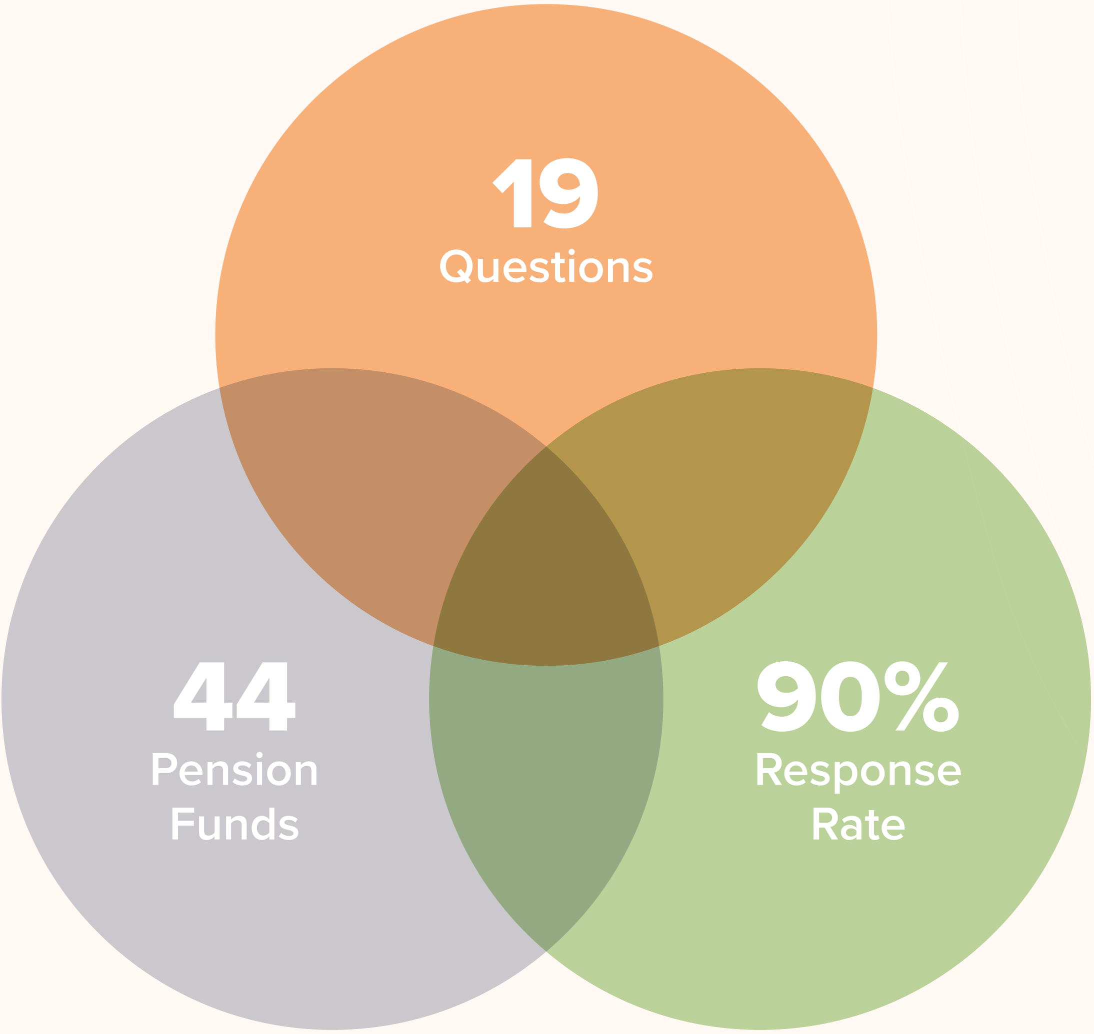
These are all reasons enough to analyse the current state of play on impact investing. In this study we provide an overview of the current activities, ambitions and considerations of Dutch pension funds in their transition to incorporating impact investing in their investment strategies, along with the challenges that they are facing in making that transition. We look into the different themes and asset classes for impact investing, the different instruments for measuring impact and the various approaches taken by pension funds. In our analysis, we also consider the size (in terms of AuM) of the pension funds.

[4] Impact Investing from Niche to Mainstream, VBDO, 2016

1.1 Scope and methodology

The research focuses on Dutch pension funds. A total of 44 funds participated – a response rate of 90%.

Figure 1.1 | **Scope study**



We used various research methods, which we will reflect on later 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.
- Questionnaire: A questionnaire about impact investing in illiquid markets was sent to 49 pension funds. The results have been used for the quantitative analysis of the impact investing market and informed several best practices.
- Interviews: A total of two interviews were held to obtain a better understanding of the current impact investing developments, practices and dilemmas. The interviews can be found throughout the study.

1.2 Outline

Chapter 2 provides some background and goes into the definition and characteristics of impact investing. In chapter 3, we have provided an analysis of the results from the questionnaire. Chapter 4 highlights VBDO's concluding remarks.

2. Impact investing

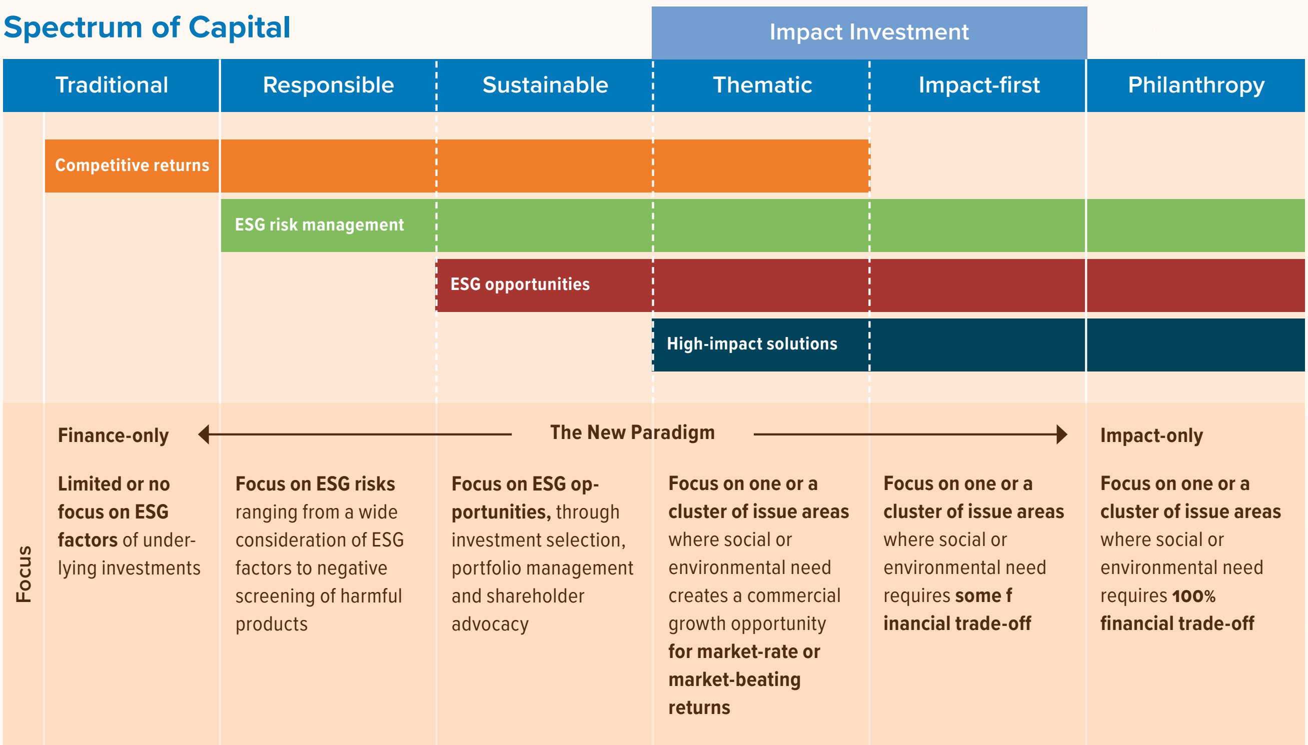
This chapter covers the definition and main characteristics of impact investing. We will then move onto illiquid investments and discuss some important themes associated with impact investing.

2.1 The foundation of impact investing

In 2007, the Rockefeller Foundation officially introduced the term impact investing. In its early days, impact investing was mainly related to social project investments, community projects, development finance and microfinance. In 2009, the Global Impact Investing Network (GIIN) was launched, with a mission to increase the scale and effectiveness of impact investing.

The years after saw an increase in attention from investors and policymakers. From its roots in social impact investing, philanthropy and development finance, impact investing diversified to different types of investors, themes and countries. The yearly GIIN surveys show an increasing impact investing market, from US$114 billion of impact investments in 2017 to US$715 billion in 2020.[5]

Figure 2.1 | **Position of impact investing in broader spectrum**



[5] https://thegiin.org/impact-investing/need-to-know/

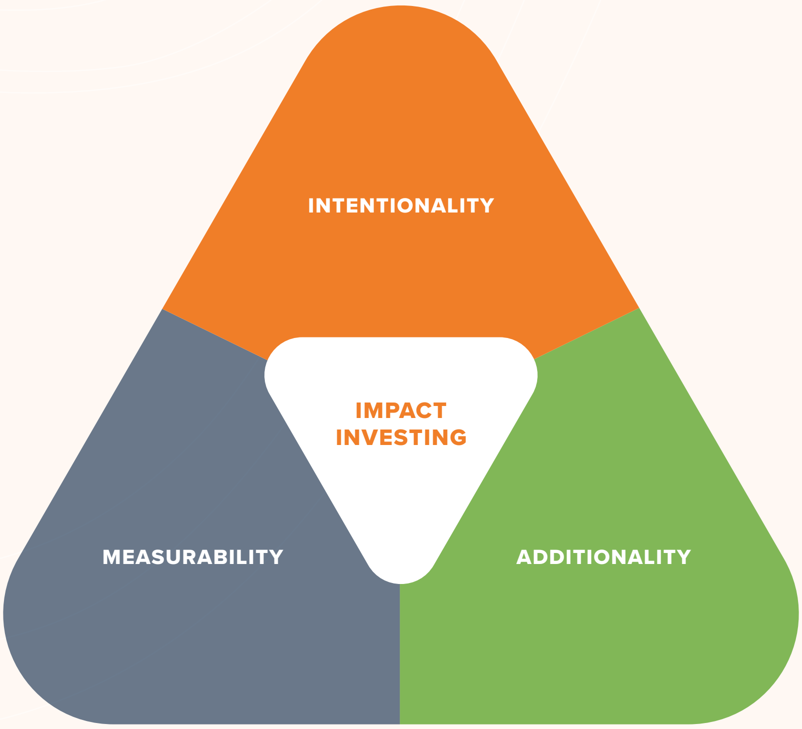
Impact investing is part of the field of responsible investing (RI). Figure 2.1 illustrates how impact investing can be seen to fit within the broader investing context. Impact investments actively seek to have a positive impact on society.

To date, the investment community still deploys a variety of definitions and approaches on what exactly impact investing is. The definition provided by the GIIN is very much in line with how VBDO perceives impact investing. For VBDO, impact investing refers to active investments whereby the investor has a specific intention of improving sustainability or clearly offering added value for sustainable development. It is also crucial to measure and evaluate the actual environmental and social impacts of impact investments.

While there may be different definitions of impact investing, the majority of studies on the matter agree on three key characteristics:

- **Intentionality** – the drive to identify specific themes or development areas to contribute to and actively searching for investee companies or projects that contribute to the chosen themes.
- **Additionality** – the additional effect produced by an investment, consisting of a three-part combination of financial additionality (private-sector investment that otherwise would not have happened), value additionality (non-financial assistance or resources) and development additionality (exceeding initial chosen targets).
- **Measurability** – measuring the added value (i.e. impact) and adjusting, altering or developing the impact strategy based on the results of this measurement.

Figure 2.2 | **The three characteristics of impact investing**



2.2 Measuring impact

Impact measurement refers to the commitment of investors to measure the social and environmental performance and progress of their investments. In 2016, VBDO's study of impact investing found that 59% of institutional investors that engaged in impact investing also measured the impact of their investments. It was noted that the quality of measurement varied greatly, and most investors stated that they struggled with impact measurement.

Now, six years later, the impact investing market has evolved. Many tools, frameworks, standards and methodologies to attain a better grip on impact measurement have been developed by and for the financial sector and within the academic world.
A few of the many impact measurement tools are described below.

Carbon Risk Real Estate Monitor (CRREM)

CRREM is a tool developed by a consortium of five knowledge institutions specifically for monitoring carbon risks within the real estate sector[6]. The tool allows both investors and property owners to assess the exposition of their assets to stranding risks based on energy and emission data on the analysis of regulatory requirements. By setting science-based carbon reduction pathways, CRREM helps the real-estate sector to address the challenges of estimating the risk and uncertainty associated with commercial real estate de-carbonisation, building a methodological body, and empirically quantifying the different scenarios and their impact on the investor portfolios.[7] Whilst focusing on potential risks related to the real-estate sector, CRREM can be used to measure several impacts related to such investments.

[6] www.crrem.eu/
[7] www.crrem.eu/about-crrem/

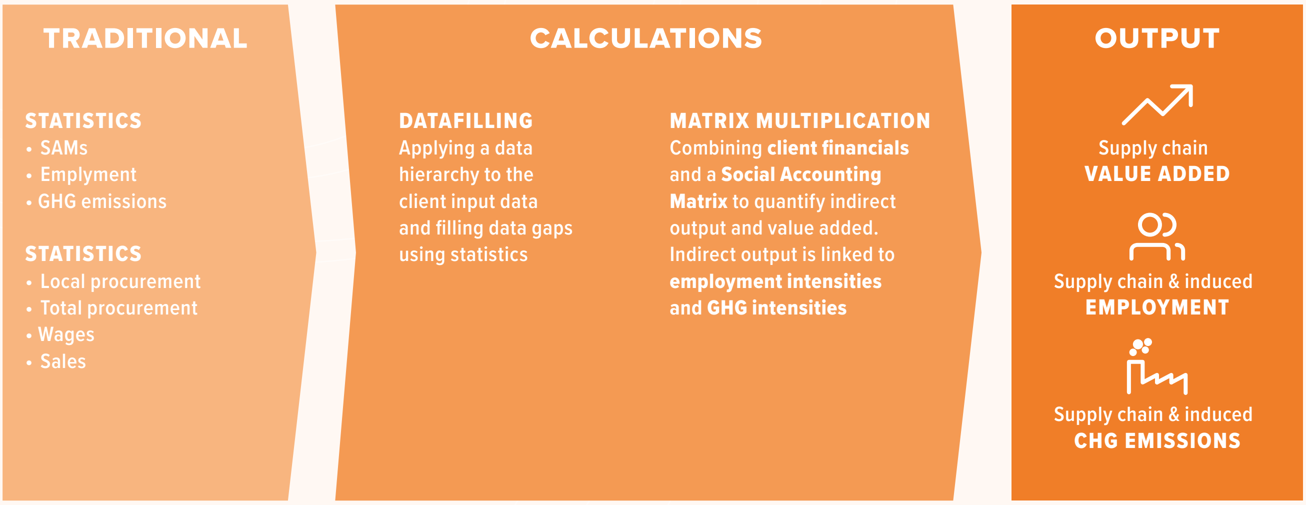
The Joint Impact Model (JIM)

The JIM is a global model developed by Steward Redqueen.[8] The model incorporates greenhouse gas (GHG) emission analysis related to investments. As can be read on the JIM's website, the model 'enables the quantification of indirect jobs, value-added and GHG-emissions related to investments of financial institutions.' It also aims to bring 'comparability, accountability and transparency'.

The methodology (see figure 2.3) of the JIM consists of twin inputs: statistics provided in three categories by several global datasets, and client/investment-specific data provided by the investor. The data inputs are sequentially calculated through a matrix system that generates three outcomes: value added, employment and GHG emissions.

The model has an academic basis which constantly updates calculations and its methodology. The model makes use of available international data based on economic structures. The results depend on a range of factors, such as where the value and output (i.e. greenhouse gas emissions) is created and which sectors the company operates in. By using the model, it is possible to better understand the impact of investment projects in certain sectors, even though the JIM measures collective instead of individual impact per sector.

Figure 2.3 | **Joint Impact Model Methodology**



IRIS+

IRIS+ was created by the GIIN to provide investors with a consistent basis from which to efficiently measure and manage their impacts.[9] It consists of a catalogue of metrics (both numerical and qualitative) to help investors decide what and how to measure, depending on their impact goal or investment theme. IRIS+ Core Metrics Sets are available by impact theme or Sustainable Development Goal. Data must be collectable, decision-relevant and aggregable at portfolio level. IRIS+ metrics provide support for users in mapping their impacts across the five dimensions of impact of the Impact Management Project.

[8] www.jointimpactmodel.org/
[9] https://iris.thegiin.org/
[10] https://s3.amazonaws.com/giin-web-assets/iris/assets/files/guidance/IRIS-five-dimensions_June-2020

Impact-Weighted Accounts Framework (IWAF)

The Impact-Weighted Accounts Framework was created to address the challenges investors face in measuring impact (e.g. reliability of data, and the comparison of values) and managing sustainable value creation (e.g. how to engage stakeholders and ensure organisations take action). The framework offers a way for organisations to quantify their impacts. Impact-weighted accounts (IWAs) have been developed to supplement traditional financial accounts.[11] The framework provides information on the impacts of investments through quantitative and valued accounts, and shows the value creation or reduction for all stakeholders of an organisation, such as employees, customers and wider society. The IWAs are segmented into types of capital: financial, manufactured, intellectual, natural, social and human.

Other frameworks

There are a great deal of other methodologies, frameworks, standards and tools for measuring impact. These may focus on detailed impact metrics for different themes or specific asset classes, but they can often be used in different ways and for different purposes.

[11] https://impacteconomyfoundation.org/impactweightedaccountsframework/

Interview with Karen Maas

As earlier discussed, impact investing is not solely about measuring impact, it is also about intentionality and additionality. Because of this, an impact investment strategy is not something that can be created once and then fixed in stone for ever more. Instead, it needs to be refined regularly to ensure that the greatest impact can be made. We discussed this, as well as the difficulty of correctly measuring impact, and crucial steps for impact investing, with impact expert Karen Maas.

"Learn, innovate and adapt," is the mandate Karen Maas offers when asked how to approach impact investing. She is Endowed Professor of Accounting and Sustainability at the Open University and Academic Director of Impact Centre Erasmus. She conducts research in the field of impact measurement, sustainability, social enterprises and impact investing.

One of the topics that arose from the VBDO's questionnaire is the difficulty that pension funds experience when measuring impact. In this interview, Karen Maas sheds light on her ideas about measuring impact and impact policies as a whole. She offers advice on implementing impact investing in a robust strategy, amongst other subjects.

Starting with the basics, one issue raised by pension funds was 'Impact is unclearly defined.' How do you define 'impact'?

Impact is the effect of an activity, in this case an investment, on a social-economic and environmental dimension. It can be positive or negative, intended or unintended, and also direct or indirect. Individual investments interact with other drivers to create a greater impact. However, it is important to correctly measure the individual impact of the investment. In other words, what has been achieved compared to what would have been achieved without the investment. This is called "additionality": the additional effect you have produced by your investment.

This is where impact gets especially tricky, measuring what sort of impact you have actually created. How do you measure impact?

This is indeed where it gets difficult. But how difficult it is depends on how seriously you consider impact. If your focus is mainly financial, I doubt that measuring impact is taken seriously enough. It depends on your ambition: how willing you are to lead on the subject of impact. I believe it comes down to whether you want to prove what you've done or to improve your impact. To prove impact for accountability is not very difficult; all you need is a couple of numbers. We see this happening everywhere, and it's basically greenwashing. There are a lot of reports published just to show impact. Such information is often selective, mainly focusing on intended and positive impact and does not show the complete picture.

Similarly, there is a huge difference between promise and practice. What you promise and what you practise are often disconnected, as are what you do and what you achieve. If there is a disconnect between what you promise and what you practise, that is always intentional. However, a disconnect between what you aim to do and what you achieve could be unintentional or due to poor planning. In order to prevent that disconnection, you need to measure your impact to understand how to align the three aspects of promise, practice and achievements.

It sounds like a linear progression, is that how you would describe it?
Theoretically, yes. Basically it means translating your vision and mission into strategy and policy, which then translates to activity and outputs. Measuring impact comes later. To stay in control of your organisation, you need to ask yourself four key questions:

- *"Is what we do and achieve in line with our ambitions?"*
- *"Is what we do in line with what is happening in the world?" (In other words, "What is the competition doing? Are we complying with regulations and laws? What new developments are coming up?" and so on.)*
- *"Is it in line with our future vision?" (In other words, "Do we need to adapt or improve based on our experiences?")*
- *"How are we performing?" It's important to note that 95% of investors' attention tends to be focused on performance when it comes to measuring impact, but performance is only relevant and interesting when it is interconnected with the other three points. Otherwise, you're measuring impact solely to be accountable.*

Perhaps the standard you use for measuring impact is less important than the reason why you use that specific standard?
Yes, I agree but both are important. It is very important what sort of standard you use. Different standards aid you in translating your output to impact. For example, you might say "We have built this number of windmills; the capacity of each windmill is such and such, therefore our CO_2 -emissions are this number, which is a reduction compared to the prediction." To me, this is not measuring impact, because you do not know how the windmills have actually performed and what amount of energy has been delivered to the energy system. Instead of impact realised, you've provided your intended impact or, in other words, the impact you expected to generate. Only organisations that take impact goals seriously will take the next step of validating whether that intended impact has been realised. One important step in that direction is explaining the assumptions on which your data and impact is based. Set clear indicators, which reflect real impact goals, and make sure these are context specific.

Reading through the lines, is it correct to state that we should approach measuring impact the other way around? Instead of collecting lots of data to know your impact, it is vital to create a clear vision, to start with 'impact thinking', figuring out what impact you want to achieve with your "impact strategy" and measure impact for 'impact management'.
Exactly, otherwise you will end up with data that does not lead to anything. To gain this insight, it is important that we change our approach to the impact process. Start by reflecting on your own ambition regarding impact, but also be proud of your ambition. If you really believe in it, you will want to realise it. So, take that ambition very seriously when aiming to make an impact. You are much too important to greenwash.

> "Construct a clear vision on impact; apply this vision to the whole of your policy, including measurement, and use feedback and lessons learned to adjust or adapt your policy."

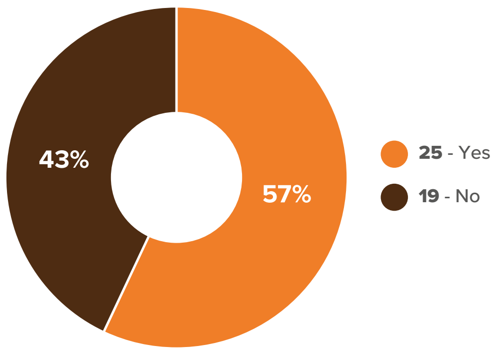
3. Analysis and results

This chapter presents the analysis and results of the study. We start with a general analysis and look into pension funds' preferences on geography, asset class and themes, taking both current activities and future ambitions into account. We also look into the considerations and challenges related to impact investing, especially when it comes to measurement. Finally, we categorise the results according to the size of the pension funds and provide insights into possible size-related differences between the pension funds.

3.1 Breaking down impact investing

Of the 44 participating pension funds, 25 (57%) engage in impact investing in illiquid markets.

Graph 3.1 | **Pension funds with illiquid impact investments**



Geography

Dutch pension funds primarily hold impact investments in Europe and North America as can be seen in graph 3.2. Other regions, such as Africa or Oceania, are less often part of the impact investment strategy.

When asked in which regions the pension funds are considering future impact investments, moderate shifts become apparent: China (+5 funds), Oceania (+9 funds) and Africa (+6 funds). There is no expected decrease in investment for any of the regions.

Asset classes and investment themes

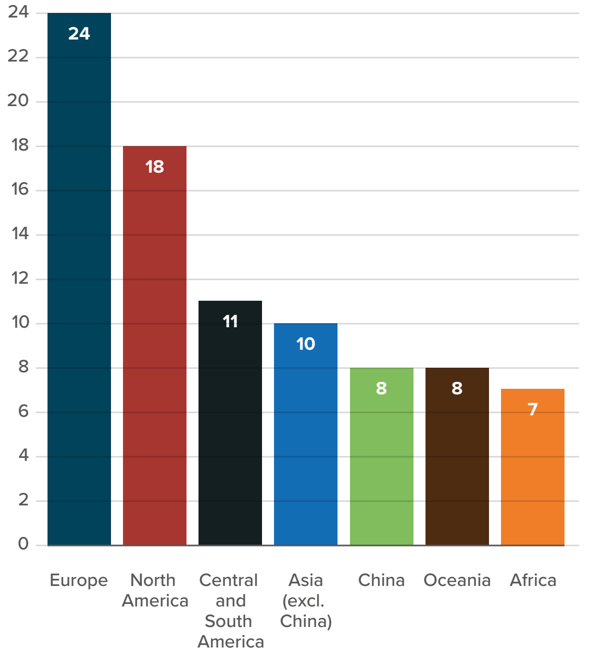
Graph 3.3 shows the division of impact investments by asset class.

Infrastructure (15 funds) and real estate (15 funds) are favoured most by Dutch pension funds, closely followed by private equity (12 funds) and private debt (9 funds). Therefore, infrastructure and real estate currently stand out as key areas of interest.

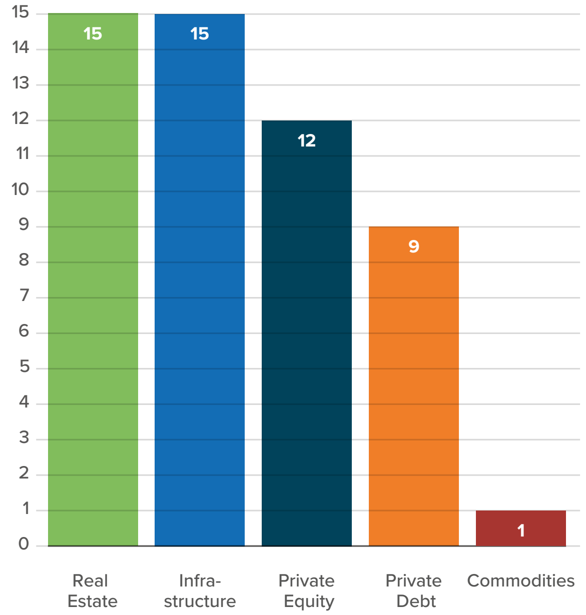
Pension funds were also asked which asset classes they are considering for impact investing. Interestingly, an additional 4 funds are considering investing in private equity. Real estate, infrastructure, private debt and commodities are all expected to keep a similar interest by the pension funds.

When it comes to impact themes, pension funds acknowledge a variety of themes as important. This is illustrated in graph 3.4

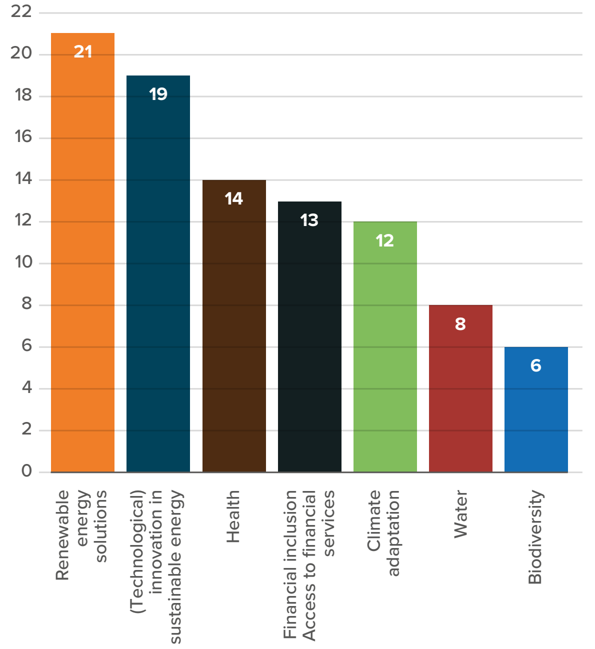
Graph 3.2 | **Europe and North America being favoured.**



Graph 3.3 | **Segmentation of asset classes**



Graph 3.4 | **Innovation, Technology and Renewable Energy most important**



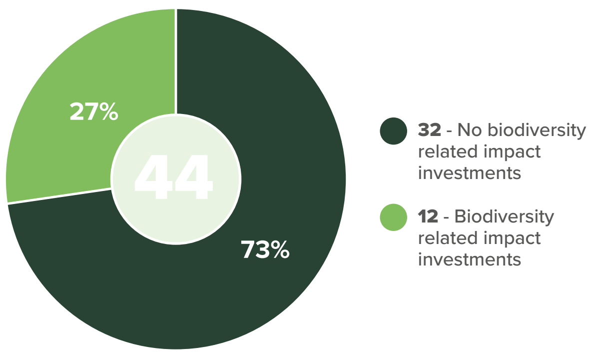
Innovative technology relating to sustainable and renewable energy solutions is a very popular theme. Other key themes are climate adaptation, health and access to finance. Twelve of the pension funds hold climate-related impact investments. Less dominant themes are water and biodiversity.

Interestingly, when asked which themes the pension funds would like to expand their investments in, the leading answers were biodiversity (+3 funds) and climate adaptation (+3 funds). Four funds are considering reducing their health-related investments.

Biodiversity

Biodiversity is likely to become an increasingly important theme for impact investing. At the moment, 27% of the Dutch pension funds have impact investments related to biodiversity. While the remaining 73% do not hold such investments, 7 funds stated that they plan to research and/or explore the possibilities surrounding investments in biodiversity. Of the pension funds that already hold impact investments relating to biodiversity, the majority do so through private equity (6 funds) and private debt (5 funds). A smaller, yet significant, number of funds hold investments in venture capital (3 funds). Several pension funds expressed an interest in learning more about biodiversity-related impact investing.

Graph 3.5 | **Biodiversity related impact investments**



Interview with Diane Griffioen and Gert-Jan Sikking of PGGM

Diane Griffioen
Head of Private Equity

Gert-Jan Sikking
Senior Advisor
Responsible Investment

PGGM is a leading company with regard to impact investing in illiquid markets, how did it start and can you tell us a bit about the journey so far?
We started in 2015, at a time when we were still focused on exclusion and managing ESG risks. In that period we were asking ourselves in what way we could generate more positive impact with our investments. We already had some impact investments in our portfolio but when we started mapping them, it added up to five billion euros. Our client PFZW then said: "let's quadruple these in the next five years". We decided on four focus themes: climate, water, healthcare, and food. Still quite general but it left us with the ability to invest through all asset classes. We called it "investing in solutions", rather than impact investing.

And the spirit of it was to "just start and see how far we can get". We began to report every quarter, set out a pathway and asked teams to think along for the coming years and look out for possibilities and opportunities. When we developed our strategy for 2020-2025, we chose a set of SDGs to aim for. Importantly, from the start in 2015, we wanted the impact to be measured with regard to the four themes and the SDGs that we focused on later.

"Just start and see how far we can get" - it seems a spirited start, how did PGGM gain knowledge regarding the difficulty of measuring impact and how interactive has this been?
From the beginning, we decided to gather data on the four themes we had chosen. We knew it would be difficult to measure impact but we thought it better to start right away and develop it by doing instead of waiting till we would have figured it out completely after a long time. We studied how companies reported, we developed impact models with the academic world to discover which impact we have with existing investments.

And we started to collaborate with APG which developed into the founding of the Sustainable Development Investments Asset Owner Platform, together with APG, Australian Super and British Columbia Investment Management Corporation. One of the fundamentals is that other parties can learn from us and vice versa. We see it as a natural aspect of impact investing to seek cooperation. If more like-minded parties can join in this journey, it will be more impactful.

Could you elaborate more specifically on how you embed impact investing in the private markets?
For example, for our private equity (PE) portfolio we execute a mandate, focused on the relevant SDGs, with a total value of one billion euros. Half of that is already invested or committed, mainly in food, climate and healthcare. SDGs played no role in our PE investments and to boost impact in this asset category we needed a tailored mandate. So far, that is working really well. We have set up a separate, dedicated team which builds up know how on impact and the whole PE team benefits from that.

Where did the realisation come from to create a specific private equity impact team?
Obviously, we had been doing PE for a long time and we were invested in all sorts of PE funds. Deciding whether a fund is ideally for investing is always a challenge. Looking at the size of the funds that appear on our

“Impact investing is evolving and growing. The way to do it is just to start. Get going and learn in the process, and also seek out collaborations for further development.”

“radar”, for a few allocations we usually have to analyse 30 to 40 funds. From an impact point of view, with the SDGs we had chosen, we realised that there are great PE impact funds with good returns that did not appear on our radar due to their size. Usually, we invest in funds that pool between 500 million to 1 billion euros. By contrast, the smaller impact funds generally pool 100 to 300 million each. To be able to select these funds, we needed a dedicated team. And although we do manager selection ourselves, it may increase costs but we thought it would be worthwhile if we would be able to generate more impact. Each of these investments has at least to be aligned with chosen SDGs and the impact needs to be measured. We hope this model inspires others as well and in a few years it will become the “new normal”.

One challenge when it comes to impact, especially measuring impact, is the lack of available data, and the access to good data. How does PGGM tackle this challenge?
For private equity we make use of the EDCI standard[12], with data all general partners have access to. The asset managers involved supply comparable data, enabling collective data collection. PGGM is one of the initiators of this platform, which is specifically designed for private equity. Investee companies have to deliver their collected data to the fund manager who then shares it with EDCI. The EDCI, which started only a year ago and already has over 200 participants, is not only a database, but it also sets KPIs through a steering committee in which PGGM is represented. So, we use this as a tool for gathering data required to steer our PE teams. Based on this we can also steer on impact and set KPIs.

[12] www.esgdc.org/

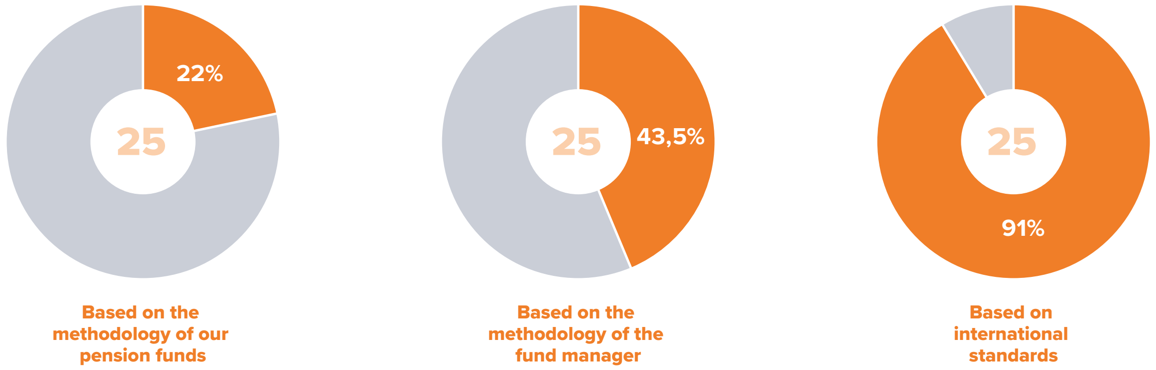
3.2 Measuring impact and other challenges

One of the key characteristics of impact investing, the measuring of impact, can be done in multiple ways. This is reflected in our results, which show that Dutch pension funds have different approaches to measurement. Graph 3.6 shows that almost all funds (91%) opt for incorporating international standards. Examples of these standards include the OECD Guidelines, SDGs and UNPRI. A significantly smaller group would also rely on the methodology used by the investment fund to measure impact (43.5%); fewer funds indicate to use their own methodology (22%).

Figure 3.7 demonstrates the various standards and methods that pensions funds currently make use of. The SDGs and SDI Taxonomy are clear favourites. Others, such as the Greenhouse Gas Protocol and the earlier discussed CRREM tool, are less commonly used.

As will be further highlighted in the best practice, pension funds look for clear impact indicators to measure and manage impact. Pension funds appear to use a multitude of indicators.

Graph 3.6 | **Pension funds opt for international standards**

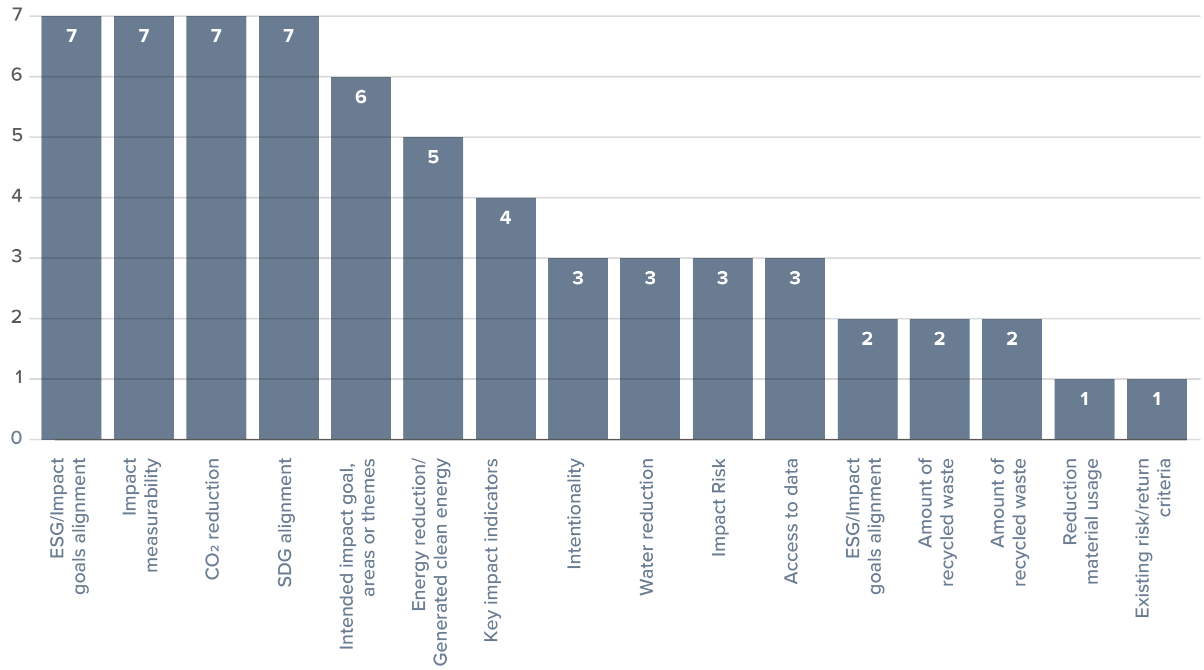


Graph 3.7 | **SDGs and SDI Taxonomy clear favourites**

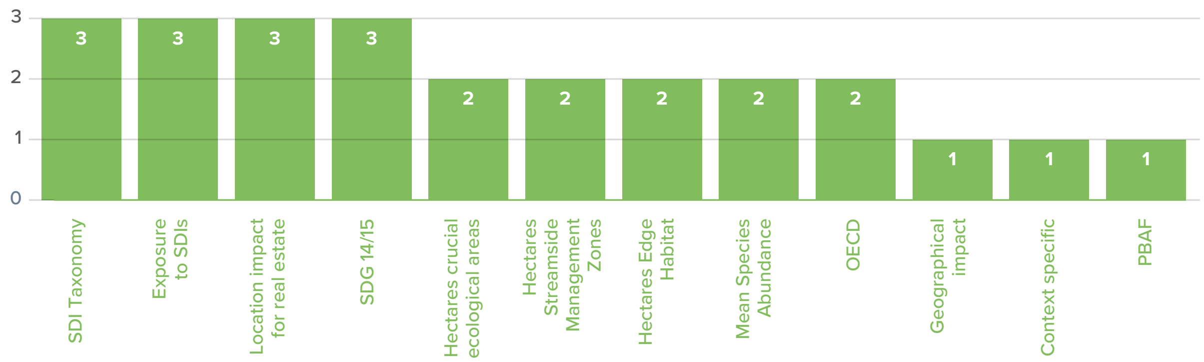
Often these indicators share similarities (see figure 3.8). However, with 25 pension funds involved in impact investing, the list of indicators is extensive. The most common indicators are related to CO2 reduction and the SDGs. The indicators vary in their approach; some are mainly focused on alignment (either with external strategies/policies or an internal policy), while others are more focused on providing definite impact numbers (such as CO2 reduction, water reduction, recycled waste etc.).

This variety of indicators is also true for measuring biodiversity-related impact investments (see figure 3.9). However, indicators for biodiversity can be very specific, for example the measuring of hectares of crucial ecological areas, streamside management zones, and edge habitat.

Graph 3.8 | **Impact measurement methods and indicators**



Graph 3.9 | **Impact indicators for biodiversity related impact investments**



Best practice - Moving the needle

Impact investments remain a small fraction of the total Dutch institutional investment arena. With only 57% of Dutch pension funds having illiquid impact investments and most pension funds facing numerous challenges and barriers to increasing allocations, it becomes imperative to understand how to develop this market so it can grow. An in-depth interview with a medium-sized Dutch pension fund revealed how impact investing can be dynamically approached if pension funds 'dare to change'.

Like many other funds, this medium-sized pension fund has its impact investment roots in microfinance and the development of emerging markets. In order to increase its impact (which was the pension fund's goal), it needed to move beyond solely focusing on these areas. However, limited scalability and the relatively small sizes of impact funds made this challenging. This led it to expand its approach to the market, which meant that recently formed impact funds appeared on its radar. The pension fund has also explored co-finance structures, which resolve issues of scale and mean the pension fund has a higher number of possible projects to choose from, many of which result in real-world impacts. It focuses on projects that are aligned to one or more of the SDGs. Measuring performance is a key part of the monitoring process.

The pension fund is also actively looking for impact investments that increase sustainable energy provision (e.g. windmill parks, solar parks, etc.). Traditionally, these types of infrastructure investments have private equity-style cost structures, with high performance fees. Often, the cost related to these fee structures is a barrier to investment. However, the market is showing some development here. Unlike a few years ago, fee structures are now available that are more in line with the beliefs of pension funds, making it easier to invest in infrastructure.

Barriers to impact investing do not only concern the scalability or availability of good impact funds, it can also be challenging for institutional investors to adapt their investment beliefs and policies. This particular pension fund has created its own impact investment framework, which comprises five impact principles. Potential investments have to be approved on the basis of these five impact principles (among other assessments) by the board. During the investment period, the achieved impact is monitored. Interestingly, each single investment is uniquely measured using a tailored approach.

A final lesson learned by the pension fund is of vital importance for the sector as a whole. You do not have to wait until something has a completely proven track record before investing in it. When it comes to more traditional investing, one of the first things that happens when selecting a new fund manager is filtering on track record. Ideally, you would look at five years or longer. If the pension fund had stuck to that approach, many of the investments it has recently made would not have happened. Yes, there is greater risk involved when you invest in something new, but the pension fund decided that their goal of creating a bigger impact meant that the risk was worth taking.

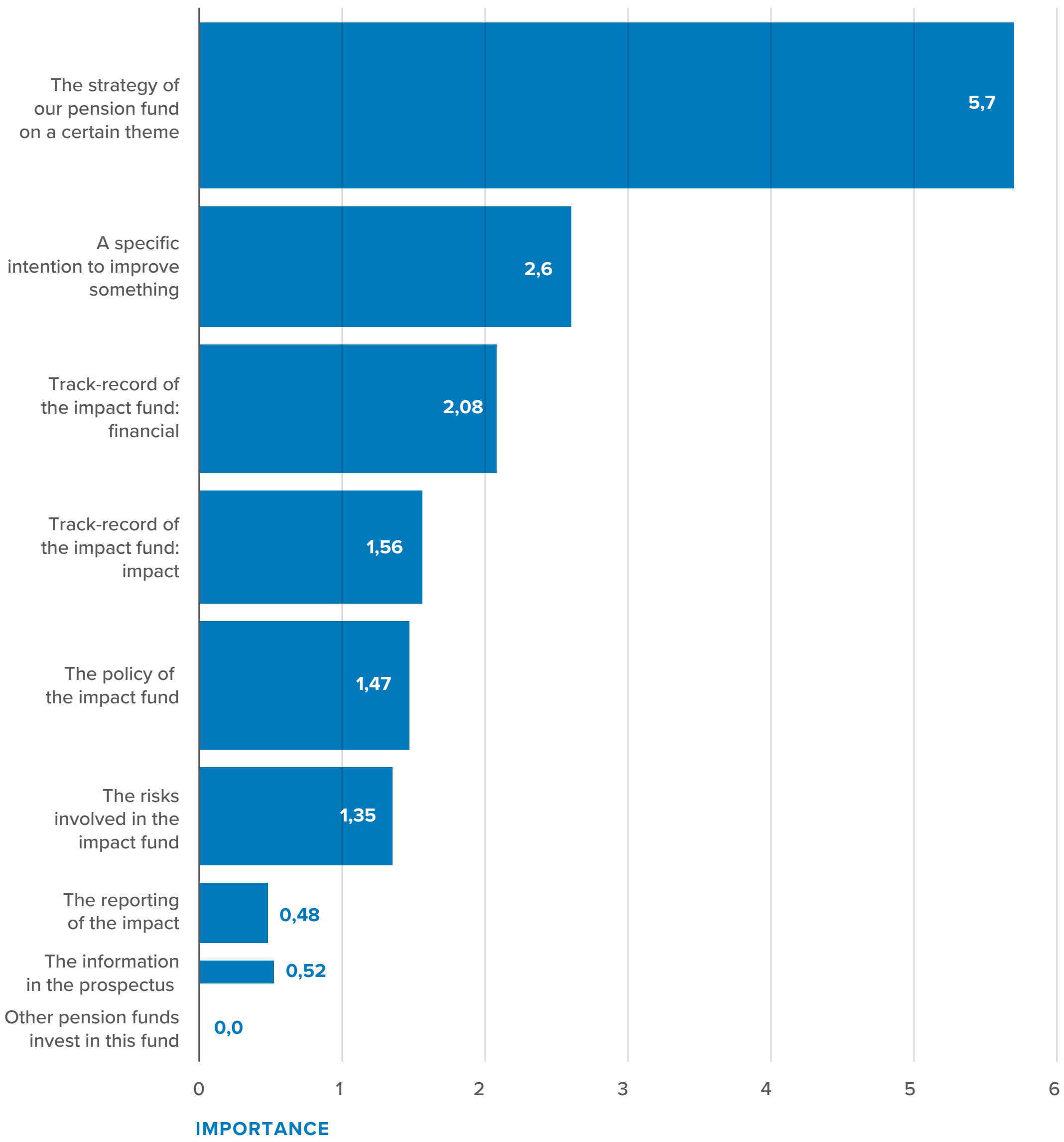
There are many barriers and challenges regarding impact investing, but pension funds need to be daring and push through those barriers. Such an approach, where you decide to pursue impact and accept taking on a bit more risk, is rethinking the act of investing. Maybe it is not (yet) an approach that everyone will be willing.

Other considerations and challenges

Whilst 57% of the participating Dutch pension funds engage in impact investments in illiquid markets, the remaining 19 pension funds (43%) do not, or at least, not yet. A majority (6 funds) state that impact investing will be part of their future strategy. However, a significant number of pension funds do not have an ambition for impact investing (13 funds). Reasons mentioned are that impact investment does not fit their strategy, that impact as such is unclearly defined, or that the pension fund is not familiar with the possibilities.

Graph 3.10 shows what criteria are important for pension funds in decisions on impact investing. Most important is the pension fund's thematic policy. Having "a specific intention to improve" is the second most important consideration. Other important criteria are the financial and impact track records of the impact investment fund. Our findings show that although the impact investing sector is gaining in popularity and the process of measuring and managing impact is developing, the main focus for each investment is ultimately financial.

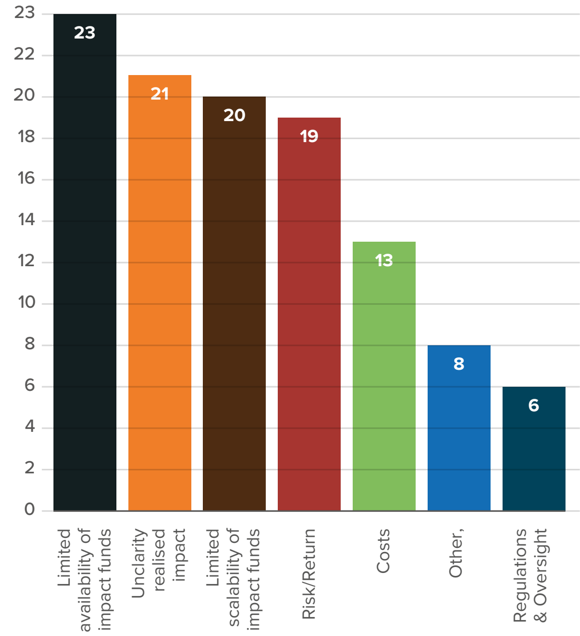
Graph 3.10 | **Finance and strategy remain important criteria**



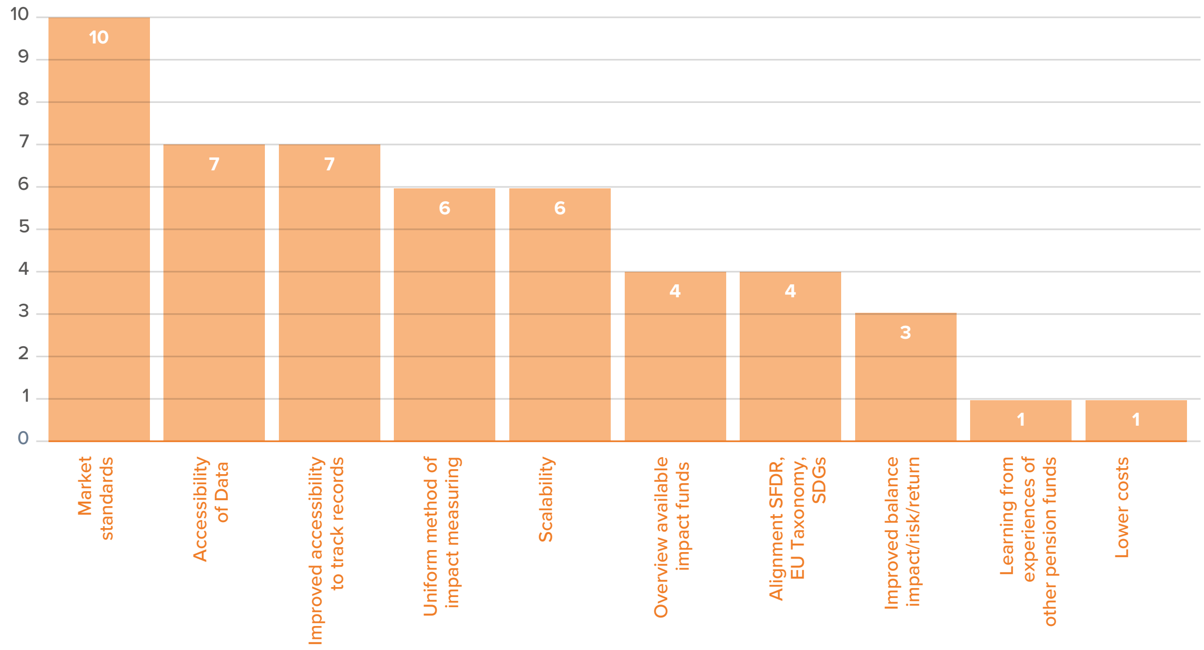
Pension funds mention a number of barriers to further developing and increasing their impact investments. As illustrated in graph 3.11, a lack of clarity around realised impact is one of the major barriers. However, the most frequently mentioned barrier is the limited availability of impact funds. Other barriers are the balance of risk/return and impact, as well as high costs and a lack of scalability.

Subsequently, pension funds have two main requirements if they are to increase their impact investments (figure 3.12). Firstly, there is a clear call for uniformity: uniformity of methodologies to measure impact, databases to increase the accessibility of impact data, and standards and impact indicators to increase accountability and transparency. As well as uniformity, pension funds would like to have an overview of available impact funds, preferably funds with the size and track record they usually look for.

Graph 3.11 | **Barriers to increase impact related investments**



Graph 3.12 | **What do pension funds require to increase impact investments?**



3.3 Does size matter?

Impact investing is often said to be a relatively heavy burden on the resources of investors. Relatively small private market impact investments can be more time consuming than other types of investments. This is why we have taken a specific interest in differences in impact investing between different sizes of pension funds. For this analysis, we have defined 3 categories: small, medium and large.

SMALL

Geography

When it comes to regions, the smaller pension funds tend to invest relatively often (compared to the total group of pension funds) in emerging markets, such as Africa, Asia, Central America and South America. However, these smaller funds have a relatively lower interest in North America and Oceania.

Asset classes

Infrastructure is currently the favourite asset class for the smaller pension funds (87.5% of the small funds). This is striking, as infrastructure investments can be quite large and require specific know how. That said, when it comes to impact, investments in windmills and solar energy are popular in this asset class. Real estate and private equity (both 62.5%) follow infrastructure as the next most common asset classes for smaller pension funds. In the future, real estate is expected to become more popular than infrastructure when it comes to impact investing. Private equity is expected to decline, whilst private debt will continue to be rarely used.

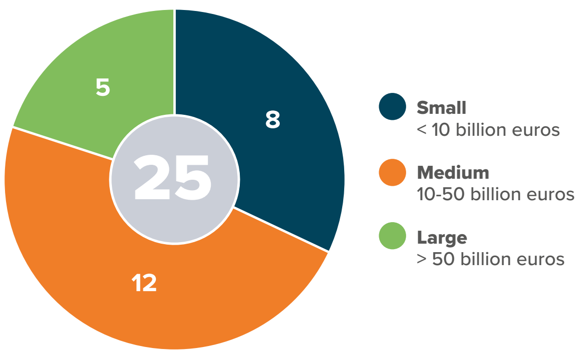
Themes

The theme of renewable energy solutions was chosen by almost all smaller funds (87.5%) as an important current impact theme. Biodiversity was chosen the least times (12.5% of the funds). Looking ahead, several of the smaller pension funds share an increasing interest in climate adaptation (+3 funds). This is relatively more than the interest of the overall group. The lack of interest for biodiversity is contradicting to the overall group (see graph 3.5) regarding investments in biodiversity).

Other considerations

With regard to barriers to increase allocations towards impact investing, the hurdles most often mentioned by smaller pension funds are: not enough active impact funds, difficulty of balancing return and impact, lack of clarity around created impact, scalability and high costs. The need for standardisation was mentioned by just 25% of the smaller funds.

Graph 3.13 | **Three categories of pension funds**



MEDIUM

Geography

Medium-sized funds mainly invest in Europe (82%), North America (54.4%) and Oceania (27.3%). Global South regions attract less interest, although we expect this interest to increase in the future.

Asset classes

Medium-sized pension funds seem to be less interested in private equity than the smaller funds (18.2% of the medium funds) and instead favour infrastructure (36.4%), real estate (27.3%) and private debt (27.3%). However, their interest in private equity is expected to increase in the future (+4 funds).

Themes

There is a relatively large amount of interest in climate adaptation (54.4%), biodiversity and water (both 27.3%). The interest for other themes is similar as for the total group, except when it comes to health, which attracts slightly less interest. The predicted future interest is remarkably balanced across the seven themes. This is different to the overall analysis, which shows a more uneven distribution.

Other considerations

The criteria used for investments is very similar to that used by the overall group. The exception is track records (36.2% compared to 28% of the overall group). Medium-sized pension funds also seem to more strongly desire the standardisation of data and of the methods used to analyse this data.

LARGE

Geography

Similar to the medium-sized pension funds, the large pension funds focus on investments in Europe and Northern America (both 100%) and expect that to stay the same. Africa, in particular, receives less interest from large pension funds than the other sizes of funds.

Asset classes

The larger pension funds are represented in all classes. There is a slightly higher representation in private equity (80% of the funds) and real estate (80%). Comparing this to the overall group, private equity and private debt are relatively more popular.

Themes

The larger funds also focus on a wide variety of impact investment themes. Noticeably, while smaller and medium-sized pension funds show less interest in access to finance, healthcare, and water, these themes are almost equally as important as renewable energy solutions and technological innovation for the larger pension funds. Looking ahead, there seems to be no change in interest in themes. Noticeably, just 2 funds hold or expect to hold investments relating to biodiversity.

Other considerations

The criteria used by the larger pension funds for making impact investments is very similar to those used by the overall group. There is, however, one factor that stands out: the intention to improve. Barriers for the largest pension funds are: scalability, difficulty of balancing return and impact, the lack of impact funds, the lack of clarity around created impact and the lack of standardised frameworks and data. It is the only category to not mention costs as a barrier or limitation.

4. Concluding remarks

Impact investing in illiquid markets has not yet taken off

This is underscored by the number of Dutch pension funds that currently engage in impact investing through illiquid markets. Of the 44 participating funds, only 25 do so, although 6 funds do expect to enter this arena in the future. Looking at the total amount of invested assets, impact investments still only make up a small fraction.

Climate change is the core investment theme

Infrastructure, investments in renewable energy technologies and, to a lesser extent, climate adaptation are the most common themes for impact investing. The smaller and medium-sized pension funds have a particular focus on climate change. The larger pension funds, which in some cases have been active in impact investment for a longer period, also focus on other themes.

There is a growing interest for other themes and asset classes

Over the past few years, investments in infrastructure and private equity have gained in popularity. Areas that have traditionally attracted impact investments, such as technological innovations, renewable energy, health and access to finance, all attract a similar level of interest. We also see a cautious growing interest for biodiversity and new asset classes, such as deforestation and nature-based solutions.

Bigger is not always better

In some cases, small pension funds seem to be more ambitious than medium-sized pension funds. As an example, 8 small pension funds invest in a total of 19 asset classes, while the 12 medium-sized funds only cover 12 asset classes. The smaller funds also take an interest in emerging markets in the Global South, unlike the medium and larger funds. The large funds focus on the most themes but have relatively little interest in climate adaptation, biodiversity and water.

Pension funds struggle to embed impact in mainstream investment decision making

In spite of increasing interest in impact investing and the growing availability of standards and instruments, pension funds struggle to embed impact investing in mainstream investment decision making. This is particularly the case for pension funds that stick to traditional requirements on risk/return, size and track record, as the market cannot always meet these. Pension funds are, however, eager to find more impact funds to invest in.

Measuring impact remains a (paradoxical) challenge

Almost all pension funds express the need for a clear definition of impact investing, as well as better measurement methods and impact indicators. At the same time, there appear to be too many standards and measurement methods. Often these standards are used in a static approach to measure in hindsight and align with the standards. Far less often they are used more dynamically, with pension funds using these standards to aid intention, additionality and measurability.

Frontrunners do try to move the needle

Frontrunners put in extra effort and dare to stretch traditional financial conventions to create the space and possibilities to include impact investments in the portfolio. In some cases, specialist impact teams have been created. These frontrunners are also taking advantage of opportunities for innovative financing structures, such as co-financing and debt-finance. These pension funds also sometimes adjust their risk/return and track record beliefs to match the reality of the impact investment market.