GLOBAL IMPACT INVESTING NETWORK

GIIN INITIATIVE FOR INSTITUTIONAL IMPACT INVESTMENT
CASE STUDY: *MN*

The GIIN Initiative for Institutional Impact Investment supports institutional asset owners seeking to enter or deepen their engagement with the impact investing market, by providing educational resources, performance research, and a community of practice. The Initiative is made possible by the generous support of JPMorgan Chase & Co., a founding member and longtime partner to the GIIN.

This series of case studies represents one of the GIIN's educational resources offered to the growing institutional community. Each case study profiles one institutional asset owner that has started to make impact investments, providing a snapshot of what they did to make it work thus far. The case study series provides a useful tool for institutional investors seeking to understand how to make the case for, and then establish, an impact investment strategy, based on examples from peers. If you are interested in contributing to this resource, please contact the GIIN's Network Membership team.

MN

MN is a fiduciary pension fund asset manager that works to ensure the financial future of almost two million people in The Netherlands. MN has 114 billion euro assets under management and aims for both financial and social return and long-term value creation for its stakeholders. MN sees the integration of climate-related opportunities and risks in investment decisions and processes as its fiduciary duty. MN has engaged in impact investing since 2016. The current impact investments total 1.9 billion euro at the end of 2018. For more information, see www.mn.nl .

We interviewed Mr. Arjan van Wieren, Head of Private Equity, Infrastructure, Real Estate & Equities, about MN's impact investing strategy and activity.

What have you done to start making impact investments?

Like many institutional investors, MN had already integrated ESG considerations across its entire investment portfolio, with its main instruments for responsible investment including: exclusions, proxy voting, and company engagement. MN is also actively supporting responsible investment practices. For instance, MN contributed to the Task Force on Climate-related Financial Disclosure and, together with many other institutional investors around the globe, endorsed the principles of Fiduciary Duty in the 21ste Century', the initiative of former Vice President of the U.S. Al Gore. Van Wieren explains: "At a certain point we decided that it was time for a next step. The integration of ESG tends to be focused on excluding or improving the *negative* aspects of investments. With our impact investments, we are seeking to actively channel capital to *positive* solutions. We see impact investments as investments that address specific social and/or environmental challenges, or investments that help *prevent* social and environmental problems. It means that we have a clear intention to positively contribute to environmental and social challenges with that investment. "

How the discussion with the pension fund boards started.

"Our responsible investment team is in continuous dialogue with the boards of our pension fund clients," says Van Wieren. "They help the pension funds boards with understanding long-term ESG trends. The team looks far ahead and constantly works on innovation of the ESG policies and their implementation in investment processes. The responsible investment team helps the board members to set ambitions for the future. This is an evolutionary process. Ten years ago, we just had an exclusion list. If you now look at the current policies and implementations, it has become a completely different game, much more advanced. Practically, being a responsible investor means narrowing your investment universe down to the point that it matches your ESG principles and policies, and reflects the kind of things you believe are important for a sustainable future and that will drive future investment performance."

In that dialogue, the boards concluded that there was one thing missing. "Impact investing goes a step further. You are actively looking for ways to solve problems. You do that by channeling capital towards solutions. It is a new approach that complements the other ESG instruments that are more focused on the negative ESG impact. Also important, but different."

Paris Climate Agreement gave momentum
"The [Paris Climate Agreement from 2016] accelerated the movement we were already in," Van Wieren says. "MN and its clients have publicly endorsed the agreement and this brings an obligation to act upon it. This led to one of the larger themes that we have within MN for impact investing: Energy Transition. We want to prevent global warming beyond two degrees Celsius. This means that we are actively looking for investments that positive contribute to the energy transition and Co2 reduction."

How do you define impact at MN?

Van Wieren explains how MN defines impact: "With 'impact investments' we mean: investments that have a clear intention to contribute positively to social or environmental issues, and whereby we could also measure this positive contribution. We have four themes for our investments: Energy Transition, Circular Economy, Access to Finance, and Affordable Housing. These were selected by the boards of our pension fund clients PME and PMT, working in tandem with their stakeholders, who are beneficiaries from the Dutch metal and engineering sectors.

As impact investing is about channeling capital to solutions, private markets play a key role. We have chosen for an implementation where MN's impact investments are primarily overseen by the investment teams that manage the *private markets* asset classes. These are: Infrastructure, Private Equity and Real Estate and fixed income/credit. The product mandates of these asset classes define what criteria an investment should match, in other words: which investment opportunities are in and out of scope. These restrictions are the same for impact investments and 'mainstream' investments. The current [2018] product mandates of the three asset classes literally define that all investments are restricted to OECD countries, which in practice means: Europe and North America.

"These impact investments fit regular criteria such as financial risk and return criteria, and we are making an extra effort to make capital flow towards impact investments. If we cannot find existing funds or projects that match our impact themes, we might even *build* investment products ourselves, in co-creation with external partners. For example in the case of affordable housing, we invest directly in residential projects in the Netherlands."

Why did your approach work?

Setting clear ambitions together with clients and stakeholders
"Key to our approach was that we first had in-depth conversations with the Boards of our clients to set clear objectives and expectations. Surveys among members of one of our largest clients have shown that more than half of them believe that the investment policy of their fund must be geared not only to restricting damage to society, but also to making a positive social contribution. In other words: do no harm, do good. It's important to have this clarity. One of our clients has set a target to contribute with 10% of its assets under management to the Sustainable Development Goals, and invest 250 million euro a year in impact investments. That is not a hard obligation, but a target towards which we can work. It's a general guideline that sets things in motion. The direction and level of ambition is clear."

Integrate impact investing into the teams
"When we started this journey internally, we integrated impact investments into the teams," Van Wieren says. "I head a multidisciplinary team, with diverse expertise. Impact investing is a very flexible model. It can be applied to equity, debt, or something in between, in both liquid, and illiquid strategies. Because it is so heterogeneous, we think it should be approached in a heterogeneous manner, involving various areas of expertise. Also, in our view going forward, we find it important that impact investments are integrated in regular products. We believe that in the future, positive impact will become mainstream. Portfolio managers that build portfolios that positively contribute to the society will be more profitable in the long term. We are here for the long term too. We want to invest in companies that contribute positively, not negatively. Not only because of our values, but also from a financial perspective. Look at the consumer market: consumers no longer want to buy products that negatively affect society or the environment. Those companies will go out of business. That's why I think you have to look at impact investments as an integral part of your portfolio. The trend is unstoppable: consumers, customers, beneficiaries: they want their money to not only do no harm, but also do good."

Internal coordination
"We have been active in impact investing for three years. When we started, we had four themes and a policy document from our responsible investment department. We then created an internal taskforce to share knowledge, brainstorm together and get things moving internally. We are receiving investment proposals from all directions: of course via the investments teams, but also via our clients and the responsible investment team. We centrally log all these impact investing proposals for our own knowledge sharing and to coordinate whether the proposal fits within our impact portfolio. In the process of selecting external managers we have continuous interaction with our clients. This goes from creating the long list all the way to deciding on the short list, to final selection." Impact investments follow exactly the same process as other investments, Van Wieren explains. "The only difference is that a special Responsible Investment steering committee looks at the investment proposal and decides if it deserves the label 'impact investment', based on the policy guidelines that MN has defined."

Enthusiasm of employees
"What certainly helps in our journey is that MN's employees are very motivated to contribute their ideas, and work together to move the frontier. ESG is integrated within all our products, from the investment strategy to product mandates, manager selection processes, monitoring, etcetera. This means our team is already used to thinking about environmental, social and governance aspects of investments. It's already part of the DNA of our 'mainstream products'. The step to positive impact is then a small one."

…but there are certainly still challenges to scaling up
Van Wieren is clear that impact investing at scale is not always easy: "Scalability is still an issue for us. As an institutional investor of our scale, we typically don't do deals under 100 million euro. The current supply in the market is limited for large investors like us. In the Infrastructure asset class, there is more supply, but we need even more, to scale up. Within real estate sector, product is limited via indirect investing, however when investing directly in real estate there is sufficient product available."

Track record and experience of external fund managers is also in short supply for newer impact investment themes, Van Wieren explains. It takes time for smaller initiatives to build sufficient scale and track record, which are both needed to make them investable for MN. But it is not always limited scale and track record that makes the match difficult. "There certainly exist larger funds from more established fund managers. Sometimes these funds cover broader impact themes, which can make it difficult to make the match to the four impact themes we focus on, and given our own policy priorities." This is why Van Wieren believes in co-creation with suppliers, to be involved earlier in the process of product development, so that some customization is still possible. "We do that more often at MN: find a partner and build a product together that is specified according to the wishes of MN's clients, instead of trying to find an existing product 'off the shelf'."

What advice do you have for institutional investors interested in impact investing?

Prepare well
"It is very important that you first think about what you want to achieve, in terms of financial return as well as in terms of impact. Ask: What impact would I like to have and what do my stakeholders find important? Also, think about questions like: What is my ambition level? How fast do I want to implement my strategy? How difficult or easy will it be to implement the strategy?"

Allow for some flexibility around impact themes
"We were quite specific about the impact we wanted to see. Maybe one of our lessons learned is that if you define your impact themes very narrowly, you make the implementation of your strategy harder. You have to find external managers that operate in the areas that you have defined." Defining impact themes too narrowly might leave you with too few investment opportunities that meet the other criteria of your mandate.

Invest in your own expertise
Van Wieren believes that among asset managers worldwide, there is still a relatively low level of knowledge of impact investing. "Especially in the impact theme Energy Transition, there is so much innovation! You have to be able to assess the financial aspects of these technical innovations. You need people who are able to understand these new techniques, that know about project finance structures and are able to assess the financial risks and opportunities. Even as an asset owner, you need quite a good understanding of these products to be able to select the right external managers. This means that the preparation period to make impact investments in these innovative fields is much longer than in conventional

investment. It is important to work with good external advisors, and invest time to learn about these new fields of investment. You also need people that understand the ESG aspects really well."

Don't wait for others to start

MN's CIO, Gerald Cartigny, has stated: "Investors and companies should not wait for government policy, and take the lead in energy transition related investments. They should not only focus on climate risks, but also on climate opportunities. Investments in new markets and products are necessary for the energy transition. They can offer attractive financial returns."

Start simple

As a last piece of advice, Van Wieren advises to start simple. "For instance, when it's about measuring and reporting impact, start simple and build upon that over time. Don't try to be perfect and complete at the start."

Van Wieren points to the collaborative spirit that the explorations in impact investing can bring: "Everyone enjoys it and is enthusiastic. It gives an additional meaning to your work. You see sustainability everywhere, in your circle of family and friends, in the supermarket: sustainability is top of mind, and a great driver of innovation. Sustainable development is here to stay as driver of innovation and economic growth."