IMPACT INVESTING WHOLESALE VEHICLE

LEARNING BRIEF

Good Practice to Support Pension Funds in Integrating Impact Considerations into Investment Processes

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Learning Brief

Good Practice for Integrating Impact Considerations into Investment Processes

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Contents

Table of figures

Foreword

The international sustainable investing industry has evolved rapidly in recent years with total assets under management (AUM) recording remarkable growth of 34.3% from $22.8 trillion in 2016 to $30.7 trillion in 2018. The market is projected to grow further to $37.8 trillion by the end of 2021 and $53 trillion by 2025, which would represent a third of total global assets. While the growth in AUM has been driven primarily by developed markets, emerging market economies have also seen rising interest in not only sustainable investing, but more specifically in impact investing. In 2017, there were $399.45bn in AUM in Southern Africa that were subject to an investing for impact strategy, up 22.6% from $325.9bn in 2016.

Sustainable investing aims to fulfil present needs without compromising the future generation's ability to fulfil their own, and it is generally accepted that there are three pillars of consideration for sustainability, including people, planet, and profit. Impact investing takes the theme of sustainable investing one step further and is defined by the Global Impact Investing Network (GIIN) as investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.

The appropriate investment strategy for any pension fund will be determined by its mandate, which in turn is developed in the context of the market within which the fund is domiciled.

South Africa's triple challenge of poverty, inequality and unemployment is well-documented and are arguably the most pressing issues to address from a sustainability and impact point of view. Failure to address these issues risk destabilising the very market within which South African pension funds operate. At the same time, the country is one of the largest carbon emitters globally and the need to transition its footprint to net zero over the next few decades must be prioritised.

South Africa therefore faces an enormous challenge of not only addressing the process of transitioning to a greener economy but also ensuring that it does so in a just and equitable way to avoid further compounding the triple challenge.

The onus of driving developmental mandates have typically rested with the government, yet various factors contribute to inefficiencies in the interventions deployed by the government. The domestic market requires support from the private sector to aid in providing innovative solutions to assist in addressing market failures and engineering a more robust and sustainable economic environment.

South Africa's pension funds have oversight of approximately R4.3 trillion in AUM (or the equivalent of 86% of the country's nominal GDP in 2020) and there is a unique opportunity for the industry to rethink its strategic allocation of capital to ensure that it not only avoids compounding existing challenges, but potentially help resolve environmental, social and governance issues by targeting positive impact.

It is imperative that the pension fund industry recognises that positive impact and risk-adjusted financial returns do not have to be mutually exclusive and there are ample opportunities in the domestic market for pension funds to integrate impact considerations into existing investment mandates.

Regulation 28 of the Pension Funds Act provides the regulatory framework within which pension funds operate. The Act explicitly outlines requirements related to sustainability, both in the preamble as well as paragraph (2)(c)(ix) which requires the following as one of the principles that a fund's board must apply (own emphasis):

> *Before making an investment in and while invested in an asset consider any factor which may materially affect **the sustainable long term performance** of the asset including, but not limited to, those of an **environmental, social and governance character.***

In addition, the Financial Sector Conduct Authority (FSCA) issued Guidance Notice 1 of 2019 of the Pension Funds Act in June 2019 which provided further guidance on the sustainability of investments and assets related specifically to a retirement fund's investment policy statement, as well as expectations regarding disclosure and reporting on issues of sustainability.

Regulatory reforms are meanwhile underway in terms of asset allocation allowances under Regulation 28 into both private markets and infrastructure, which has the potential to provide additional opportunities for pension funds to integrate impact into their investment strategies.

Where sustainable investing was arguably viewed as a discretionary value add offered by pension funds in the past, it is fast becoming an integral part of the investment strategies developed by retirement funds. Specifically, 80% of South Africa's retirement funds[1] declare how its investment philosophy and objectives seek to ensure the ESG sustainability of its assets in their investment policy statement.

Pension funds have a fiduciary duty to act in the best interests of their members and there is mounting evidence[2] to suggest that efficient ESG management of investment portfolios enhance financial returns over the long-term. There is value to be found in rethinking how ESG and impact considerations can be integrated to not only help maximise long-term, risk-adjusted returns but to also achieve measurable positive impact.

The purpose of this Learning Brief is to provide South African pension funds with a practical guide on incorporating impact objectives into their investment strategies. While it aims to deliver a comprehensive view of impact investing, it is not an exhaustive guide and additional resources should be utilised where appropriate.

Executive summary

The spectrum of capital, developed by the G8 Social Impact Investment Taskforce back in 2014, illustrates a broad range of risk/return strategies associated with sustainable and impact investing and how financial goals for different strategies may align with set intensions around ESG and Impact.

Although many pension funds in South Africa have mandates which incorporate social impact considerations (i.e. transformation, infrastructure, jobs and economic growth, etc.), the main focus for these funds has historically been in the "Traditional Investing" column, with a core focus on generating competitive risk-adjusted returns, with little to no regard for ESG or impact considerations when taking a decision to invest (refer to Figure 1).

While ensuring competitive financial returns remains a priority for pension funds and their shareholders, there is growing consensus on the importance that ESG factors play in sustaining long term risk-adjusted returns, with funds shifting their approaches towards the right-hand side of the spectrum to include more systematic consideration of the management of ESG risks and negative impacts, as well as positive impacts (alongside financial returns). This includes pension funds setting up specific policies or commitments around responsible and sustainable investing and embedding these into their investment policy statement, as prescribed in Regulation 28.

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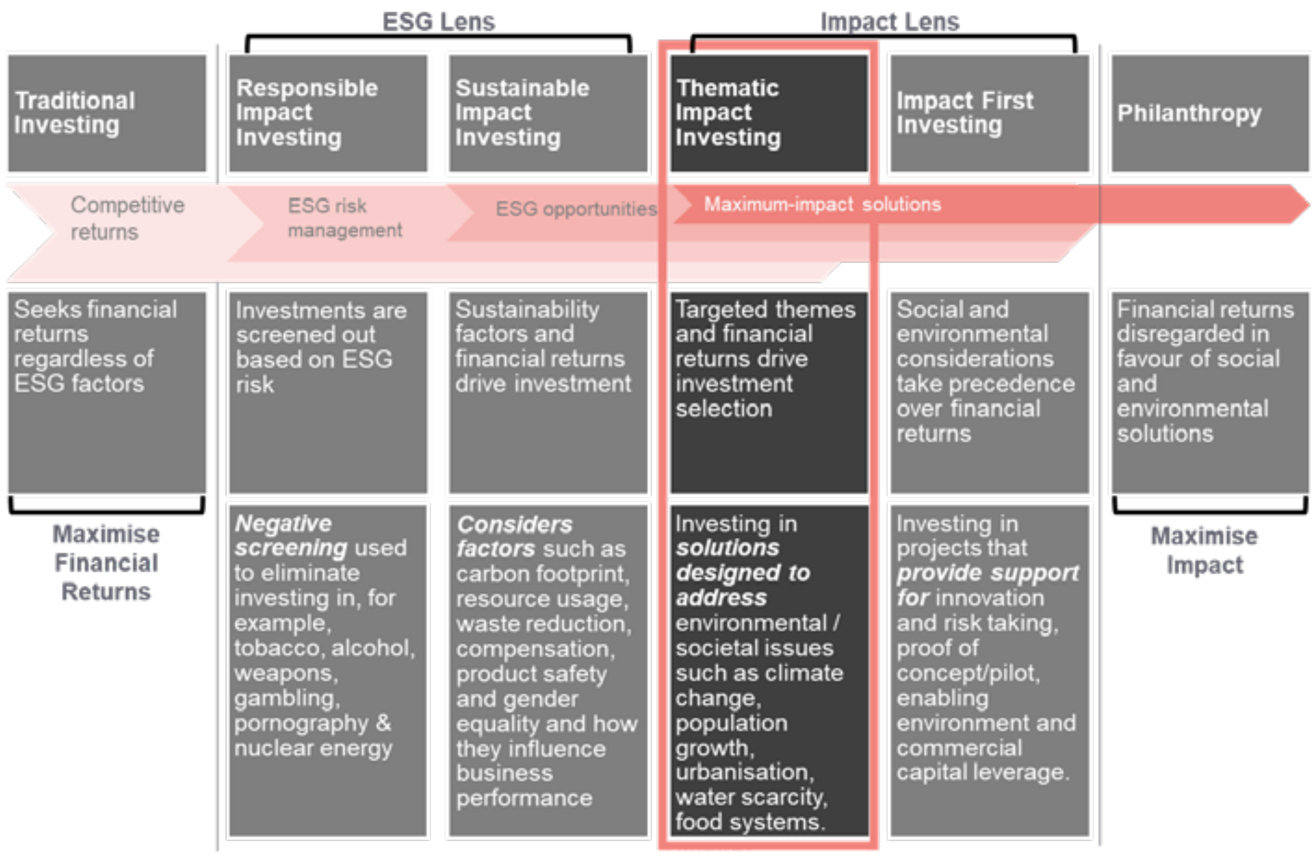
[1] International Finance Corporation. (2020). *Sustainable Finance Practices In South African Retirement Funds: Opportunities to unlock investment in green and climate finance and support a resilient economy. https://www.ifc.org/wps/wcm/connect/93d586c6-fe64-439e-907a-d067e640e8ec/South+AfricaRetirementFunds-SustainableFinance040221.pdf?MOD=AJPERES&CVID=nu3gl6v*

[2] Riding, S. (13 June 2020). *"Majority of ESG funds outperform wider market over 10 years" Study of sustainable funds counters claims that ESG investment comes at the expense of performance.* Financial Times. https://www.ft.com/content/733ee6ff-446e-4f8b-86b2-19ef42da3824

Figure 1: Spectrum of investing



Source: Adapted from Sonen Capital's investing spectrum

In the South African market, there has been a growing trend towards mainstreaming investing with an ESG lens. Specifically, some 47% of local pension funds surveyed in 2020 indicated that they include details on how the fund intends to monitor, evaluate, and make strategic decisions about the ongoing ESG sustainability of the assets it owns or intends to acquire in their IPS[4]. At the same time, while impact considerations have been inherently entrenched in many South African pension funds' mandates, the adoption of impact investing strategies is still in its infancy stages.

As impact considerations are more widely adopted and integrated into investment processes, there is growing consensus around how and through what tools impact can be most effectively applied in practice.

Against this backdrop, this Learning Brief aims to serve as a guide to support pension funds in understanding emerging good practice linked to Impact Measurement and Management (IMM)[5] and how best to integrate such considerations into investment processes and decision making. Where possible, guiding resources and examples have been provided to support practical application of the content provided.

[3] National Treasury. (2011). Pension Funds Act, 1956: Amendment of Regulation 28 of the regulations made under section 36. http://www.treasury.gov.za/publications/other/Reg28/Reg%20 28%20-%20for%20Budget%202011.pdf.

[4] FSCA & IFC. (2020). Sustainable finance practices in South African retirement funds. https://www.ifc.org/wps/wcm/connect/93d586c6-fe64-439e-907a-d067e640e8ec/ South+AfricaRetirementFunds-SustainableFinance040221.pdf?MOD=AJPERES&CVID=nu3gl6v

[5] Impact measurement and management includes identifying and considering the positive and negative effects that one's business actions have on people and the planet, and then figuring out ways to mitigate the negative and maximise the positive in alignment with one's goals (The Global Impact Investing Network, 2021)

The Learning Brief is structured according to seven key elements that investors should be considering when developing / updating their approach to IMM. These comprise the following:

1. Intentionality (setting Impact objectives) →
2. Contribution (what impact can be attributed to our investment) →
3. Pre-investment IMM Integration →
4. Measurement and Management →
5. Impact Reporting →
6. Governance of IMM Practices →
7. Managing ESG Risks and Negative Impact

Each of the seven key elements are discussed in depth in this Learning Brief and some of the key recommended actions for pension funds are outlined in the schematic below.

Figure 2: Key Recommendations for Pension Funds

Recommendation 1

Consider developing impact objectives which align to local and national development priorities, in addition to any international development frameworks that might apply (i.e. alignment with Sustainable Development Goals).

Recommendation 2

Theory of change (ToC) is a useful tool for pension funds to use when starting to consider potential impacts it will achieve through the investments it makes and in developing robust impact goals and objectives.

Recommendation 3

Formalising the fund's impact intentions and commitments in the form of an Impact Policy plays a key role in signalling the fund's intention to different stakeholders and the market. Therefore it is important that fund impact goals and objectives are clearly articulated.

Recommendation 4

Third party manager selection plays an important role in the type of impact a fund will have - therefore it is important to ensure that third party manager mandates are aligned with the pension fund's own Impact objectives (as well as their competence, commitment and capacity to deliver on such elements).

Recommendation 5

When measruing impact, selected impact indicators / metrics must be clearly defined to ensure relevance for chosen impact objectives and to avoid gathering unnecessary data for impact performance areas which the pension fund has limited influence over.

Recommendation 6

To support the impact measurement process, it is important to manage the expectations of third party managers or direct investments upfront and to engage with them at an early starge in the process to determine what data can feasibly be gathered, the quality of this data and at what frequency.

Recommendation 7

Robust impact reporting must be prioritised to clearly communicate and evidence the pension fund's intentions on driving impact. This should include details on the fund's impact objectives, its theory of change and approach to IMM, and the extent to which defined impact objectives are being achieved.

Recommendation 8

Adequate organisational structures, capacity and competencies are critical in supporting the effective implementation of meaningful IMM practices.

Recommendation 9

Funds should not only focus on measuring and managing positive impacts. ESG risks and potential negative impacts are still important and have the potential to expose funds to signficant financial and reputation liabilities, which may erode their credibility and the good work being done around impact.

1. Intentionality

1.1 Setting Impact Objectives

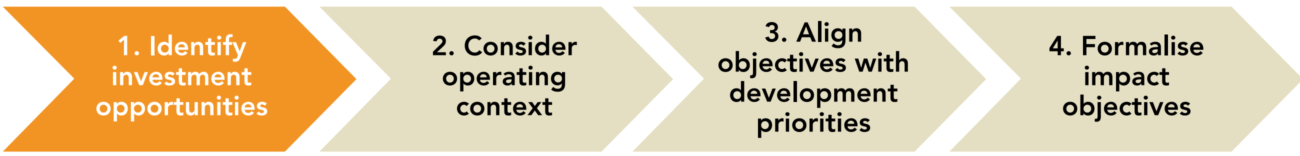
Investors that aspire to drive positive impact through their investments should begin their impact journey by seeking to be intentional about the impact they set out to achieve. This involves setting well-defined and realistic impact objectives to more effectively measure, manage and report on their organisation's impact to both internal and external stakeholders.

Setting robust impact objectives is central to becoming more intentional about impact and to effectively measuring and managing the intended positive impacts of investments. This will assist the pension fund in clearly articulating the impact it is seeking to achieve across its portfolio (or selected fund allocations), as well as allowing it to more effectively engage with both asset consultants and third party investment managers on these objectives. It will also enable pension funds to critically assess the extent to which set Impact objectives are being achieved, and the ability to incorporate learnings into subsequent iterations of its approach to Impact as this evolves .

The following steps should be undertaken when developing an Impact strategy to formalise impact objectives:

1. Identify investment opportunities
2. Consider operating context
3. Align objectives with national and international development priorities
4. Formalise impact objectives
5. Step 1: Identify suitable investment opportunities

Step 1: Identify suitable investment opportunities



When developing a strategy to formalise impact objectives, the first step is to ascertain what the universe of suitable investment opportunities looks like. The extent of a pension fund's intentionality around impact is partly determined by factors such as the fund's size and its core mandate. South Africa's impact investing industry is still in its infancy and therefore the impact investment pipeline could be relatively limited. At the same time, this presents a unique opportunity for funds to advocate for more impact investing opportunities, which should entice third party managers to design and develop such products to stay competitive in the domestic market.

A pension fund should consider the following factors when determining which investments (that are geared towards driving impact) are the best fit for the fund:

- How are the investments classified in terms of the spectrum of capital (e.g. do they have an ESG or impact focused mandate or neither)?
- What potential investment opportunities exist which are aligned to the fund's key sectors / thematic focus areas (e.g. infrastructure, clean energy, healthcare, transformation, etc.)?
- Which investments would resonate most strongly with the Board of Trustees / the mandate that has been set for the fund?
- Is there an opportunity to engage with third party managers or establish internal capacity and structures to develop new impact investing products?

When considering the available universe of impact opportunities and how this will translate into how the fund's portfolio is constructed, it will also be important to determine which investment strategy / asset class would afford the pension fund the greatest opportunity from an impact performance perspective. Table 1 provides an outline of Impact Measurement and Management (IMM) considerations across different asset classes which may inform which products are more suited to driving impact.

Table 1: IMM considerations across asset classes1

	Private Equity	**Private Debt**	**Listed (Debt/Equity)**	**Project Finance**
Investor's influence over the investee	Dependent on level of shareholding or structure	Dependent on relationship with management (& whether milestones /sculpted repayments have been used)	Debt: Dependent on access to management Equity: Via voting and engagement	Dependent on position in repayment waterfall
Investor's ability to provide flexible financing	Ability to offer flexible financing structures and terms (which can be linked to impact performance / conditions)	Ability to offer tailored financing structures and terms	Debt/Equity: Limited	Limited
Investor's ability to drive impact	Can have significant leverage to actively engage and influence performance – but only works with natural alignment	Significant leverage to actively engage, but limited ability to influence performance, unless milestone/tranche-based structure	Primary channel to exert influence is proxy voting. Limited capacity to actively engage and influence performance. Highlights the need for robust pre-screening	Stage of project is critical. Ability to drive impact depends on position within the financing structure of the project
Investment's potential to achieve and demonstrate impact	Data availability is good – as often there is direct access to intermediary / investee. Impact potential can be significant (and overwhelming if too much data is measured[2]) hence the need to adopt a suitably tailored and robust IMM system	Data availability is good – as often there is direct access to intermediary / investee. Impact potential can be significant (and overwhelming of too much data is measured) hence the need to adopt a suitably tailored and robust IMM system	IMM system is reliant on publicly available information (all information made available to all shareholders). Lack of consistent and robust publicly available Impact data makes measurement challenging. Reliance is often placed on third party ESG data solutions (i.e. MSCI, Sustainalytics, etc.) to access data more efficiently; however still limited in application[3]	Data availability is good – as often robust reporting systems in place for project sponsors. Impact potential is dependent on the different stages of the project. Need to assess the different potential impacts upfront and incorporate these into the IMM system
IMM monitoring and reporting requirements	Tailored monitoring and reporting can be achieved at the investee-level. Streamlined reporting is more effective at the intermediary-level	Tailored monitoring and reporting can be achieved at the investee and/or asset-level. Streamlined reporting is more effective at the intermediary-level	Limited monitoring and reporting requirements at the asset, investee and intermediary-levels	Monitoring and reporting requirements change according to the stage of the project at the asset and intermediary-levels

Step 2: Consider the pension fund's operating context

[6] It is important to note that blended finance covers different asset classes and will follow a thematic approach to IMM.

[7] There is a deluge of impact indicators available, which can be overwhelming. Funds have to ensure that they set ambitious yet realistic targets when selecting impact indicators and this can be achieved through the utilisation of a robust impact measurement and management system.

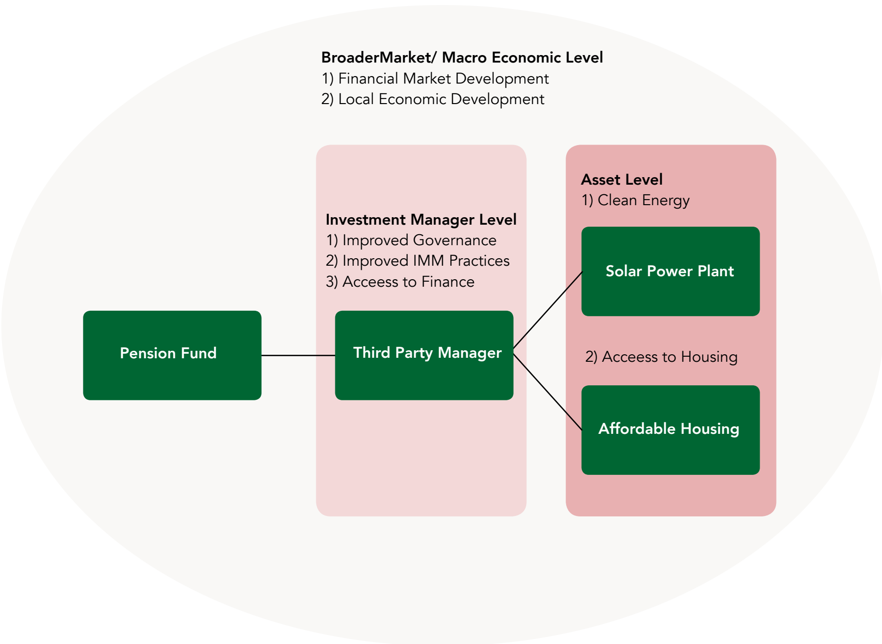
[8] There are still significant gaps in publicly available ESG / impact data, as publicly listed companies do not always report on the same ESG / Impact indictors or in the same format (particularly with regard to social performance indicators). The information is also packaged in different formats depending on the specific service provider and the rating methodology they use. Therefore, the format of the data is not always going to be in a relevant format for the fund or third party manager to use.

The pension fund's unique operating context plays a key role in determining the kind of impact it can feasibly achieve and demonstrate to stakeholders. The following factors should be considered:

a. **The pension fund's sphere of influence.** In instances where the pension fund makes direct investments into operating assets or projects, the impact that the pension fund can achieve and demonstrate is mainly focused on the asset's activities and how its capital will benefit the end beneficiaries (businesses, consumers, public or the environment). In this case, the pension fund should focus on developing impact objectives that can be achieved through the underlying assets. Such direct investments typically comprise a small proportion of a pension fund's total investment and in most instances the pension fund is relatively far removed from the underlying asset it is invested into (i.e. pension funds mainly invest through financial intermediaries).

   For investments made into financial intermediaries or by financial intermediaries on behalf of the pension fund (i.e. third-party managers), the pension fund will have limited control of impact achieved at an underlying operating asset / project level and will need to focus on different impact objectives depending on where it is able to exert influence. This includes the pension fund's ability to signal its intent to the market through its selection of specific third-party managers and parameters aligned to its established impact objectives. Moreover, the pension fund should consider its ability to actively engage with the financial intermediaries to improve their impact focus and governance of such matters, thereby maximising its own potential impact. The setting of impact objectives should therefore be focused on activities within its control, including the role that it plays in funding / building local financial markets, as well as supporting third-party fund managers in developing more robust systems / approaches to measuring and manging impact (and how this may translate into increased impact on the ground and highlighting the role that the fund's capital played in the observed changes). In this context, the pension fund will need to consider objectives that reflect the impact it seeks to achieve at both a macroeconomic / market systems level and the investment manager-level, as well as the asset-level (where feasible).

Figure 3: Considering Impact Objectives at Different Levels



a. **Whether to apply a thematic / sectoral focus.** In instances where a pension fund has strategies focused on a specific sector or thematic focus, objectives can be easily selected and aligned to potential impacts linked to that specific sector. For example, low carbon transition (linked to renewable energy investments), financial inclusion (linked to financial services' investments), improved access to quality healthcare (linked to healthcare investments), etc. However, where a pension fund's mandate covers multiple sectors, it can be challenging to identify a realistic set of impact objectives (and finding the balance between having too many objectives or narrowing your focus to the extent where it limits all or many of the fund's available investment opportunities). These funds should focus on pursuing cross-cutting impact themes that are sector-agnostic and can be achieved across the investment portfolio, for example improved corporate governance or IMM systems, job growth and decent work, local economic development, gender equality, job quality, climate change, etc. These cross-cutting themes can be supplemented by a set of focused sector specific impact objectives that will only be applied as and when investments are made under relevant categories.

b. **Requirements and expectations of the Board of Trustees.** The pension fund's impact objectives should be developed in conjunction with the Board of Trustees to ensure that objectives are aligned to members' needs. A 2020 study found that the most important factors related to ESG for South African pension funds were fossil fuel exposure, directors' appointments and remuneration, board composition and governance, which suggests that these are some of the intentions that have been historically focussed on. Considering that the global narrative is increasingly focussed on climate change, we could see local pension funds adopt investment strategies that would underpin a "Just Transition" to ensure that climate issues are addressed in the context of South Africa's ongoing battle with unemployment, inequality, and poverty.

c. **The pension fund's size, market profile and position in the capital stack.** Pension funds should consider their influence in the South African asset management industry when developing objectives to ensure that the intended impact is maximised. Larger pension funds, for example, typically have more leverage when engaging with intermediaries and this should be optimally used to help promote innovation and product development in the domestic impact investing market. Some pension funds have established solid reputations and hence might be more influential than others when advocating for product and market development. The extent to which a pension fund can exert influence is also determined by its position in the capital stack or in relation to other investors, and for each potential investment this should be considered to ensure that investments are structured in a way which maximises the fund's ability to help achieve its desired impact.

d. **The fund's flexibility to allocate capital across vast and diverse portfolios.** By having access to a large pool of capital, pension funds can diversify portfolios in ways that enable it to pursue both financial and impact returns. For each investment, the pension fund will need to determine whether commercial considerations are prioritised over being an 'impact first' investor, since certain investments may lead to lower financial returns to generate a certain level of impact returns. This is mainly relevant in portfolios where the pension fund has specifically allocated funds towards driving impact.

Step 3: Align objectives with national and international development priorities

It is imperative that a clear distinction is drawn between alignment with specific ESG frameworks and selecting impact objectives that seek to address either national or international development needs or challenges. In terms of ESG frameworks, less than 50% of pension funds currently take guidance from initiatives such as the Code for Responsible Investing in South Africa (39%) and the Principles for Responsible Investment (19%). Other widely adopted frameworks in the international market which focus on specific issues include the UN Global Compact, IFC Performance Standards, the World Bank Environmental Health and Safety / Environmental and Social Standards (ESS), the International Labour Organisation's (ILO) Labour Conventions, the UN Guiding Principles on Human Rights, etc. A more comprehensive (yet not exhaustive) list of frameworks that are currently available can be found in **Appendix A.**

While these provide practical guidelines on integrating responsible and sustainable investing through an ESG lens (as depicted in **Figure 1**), the selection of impact objectives must be done in the context of the **development priorities** that are prevalent in the country that the fund operates in.

In the South African context, alignment with national priorities such as those outlined in the National Development Plan and the integration of more recent guidance documents, such as the Economic Reconstruction and Recovery Plan (2020), is essential. This is based on the fact that national and local development priorities can be very contextual in nature, and these priority areas must be considered to ensure that the impact investing strategy adopted by the fund is fitting for the market within which it operates.

Furthermore, funds (especially those that are investing outside of South Africa) should also consider regional and international priorities outlined in, for example, the African Union's Agenda 2063 Goals and Priority Areas, and the UNDP's Sustainable Development Goals. As is the case when aligning with national priority areas, incorporating relevant regional and / or international priority areas should aid in ensuring that the fund's impact objectives are appropriate. In addition, such alignment is important to ensure robustness in approach and consistency in indicators, to build on emerging impact practices and allow for comparability in performance across different regions (where this is relevant).

A lot of work has also been done in specific thematic impact areas and it will be important to draw on these resources to ensure that funds are not reinventing the wheel but are instead building on the existing knowledge base. Some of the key resources being used globally includes the following:

- 2X Challenge linked to Gender
- TCFDs linked to Climate
- ILO Decent Work Agenda linked to Decent Work / Job Quality

Recommended action

Consider developing impact objectives which align to local and national development priorities, in addition to any international development frameworks that might apply (i.e. alignment with Sustainable Development Goals).

Step 4: Formalise Impact Objectives

Once the pension fund has considered the above, it will need to clearly articulate the impact it seeks to achieve and its contribution to this impact by developing an impact policy. The impact policy should outline the pension fund's commitment to specific impact objectives and should also provide an indication of the degree to which the pension fund prioritises impact through its various investment activities. In addition, it should detail the pension fund's rationale for establishing these objectives, drawing on the findings which emerged during the steps followed above e.g. frameworks which the pension fund has chosen to align to, requirements provided by the Board of Trustees, etc. Finally, the pension fund should articulate how it intends on implementing, monitoring, and reporting on impact.

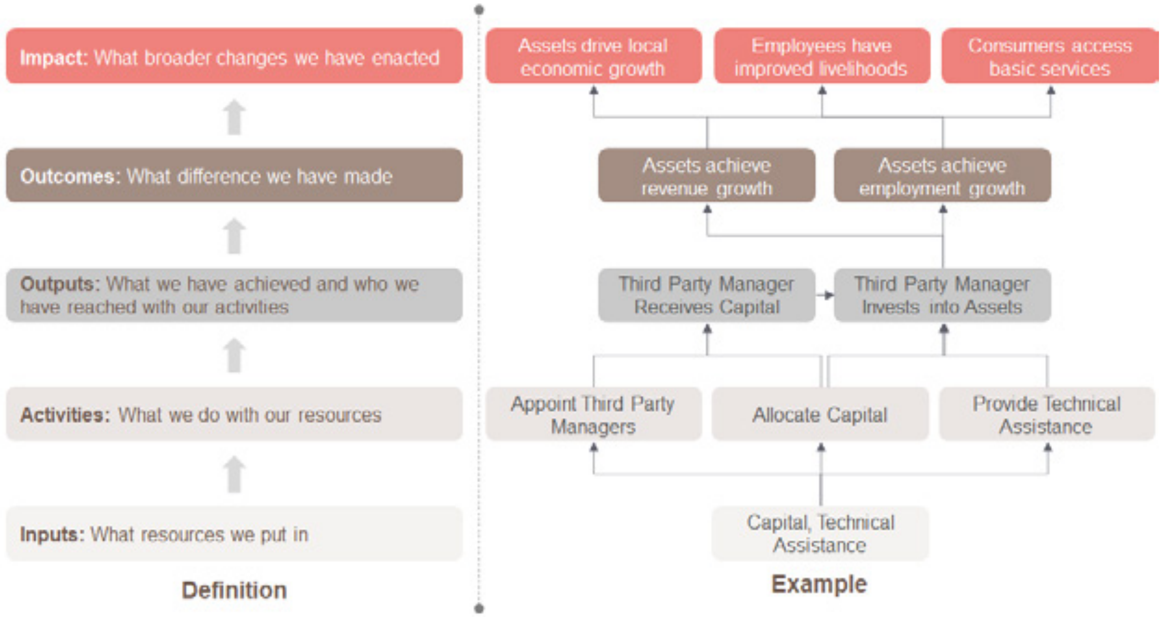
The impact policy will naturally have to be aligned to the pension fund's investment mandate and incorporated into the fund's Investment Policy Statement (IPS) when the latter is up for review. Integration of the impact policy into the IPS will not only ensure that all stakeholders stay informed about the fund's impact objectives, but also enhance the fund's compliance with reporting requirements under Regulation 28 (discussed further in Section 5).

1.2 Using a Theory of Change to Establish Impact Objectives

A commonly used tool to support investors in developing robust impact goals and objectives is the Theory of Change. A theory of change is a logical framework which describes the causal relationships between inputs and activities, demonstrating how these in turn lead to anticipated outputs and outcomes, and ultimately impact. It is focused on filling in the "missing middle" between what an investment does (its activities or interventions) and how these lead to the desired impact objectives being achieved.

A robust theory of change should be underpinned by a clear set of assumptions, some of which may be evidenced through existing research, and others which may be tested through the investment. These assumptions can critically influence whether the impact is achieved, and if so, the extent of the impact, meaning that it is important to clearly articulate the underlying assumptions, and revisit the theory of change on a regular basis to make sure it is still relevant.

Figure 4: An example of a theory of change



A theory of change can be developed either through a top-down approach i.e. beginning with a clear articulation of the intended impact objectives and determining what investments contribute to these objectives; or a bottom-up approach i.e. selecting the investment, and then determining what objectives can be achieved through that investment.

A top-down approach is more appropriate for pension funds who likely have a broad investment mandate and seek to identify opportunities for contributing to impact.

Recommended action

Theory of change (ToC) is a useful tool for pension funds to use when starting to consider potential impacts it will achieve through the investments it makes and in developing robust impact goals and objectives.

A pension fund can also expand the theory of change to focus on capturing the impact it intends to achieve with intermediaries as illustrated in Figure 5.

When effectively developed and used, a theory of change can support pension funds in communicating how specific investment-related activities contribute to its defined impact objectives to key stakeholders such as the

Board of Trustees and Principal Officers. Some of the questions to consider when developing a theory of change are outlined in Box 1 on the following page.

Box 1: Questions to consider when developing a theory of change

- How will the theory of change be developed?
- What support is needed to clearly articulate the theory of change?
- What assumptions underpin the theory of change?
- To what extent have these assumptions been tested (e.g. through external research)?
- What aspects of the theory of change is the fund most comfortable with?
- What aspects require additional research and testing?
- How will the fund ensure that the theory of change is updated and used regularly to ensure it reflects changes in the organisation's thinking, experience, and learning?
- How do the fund's impact objectives and theory of change relate to its investment goals?

2. Contribution

2.1 Determining contribution

Contribution is focused on the value added by the pension fund through various channels including the provision of capital, active engagement, signalling that impact matters, strategic decision making, or other influences. In essence, contribution seeks to answer how the pension fund's interactions contributed to the impact achieved; and what would have happened otherwise, in the absence of those efforts. Contribution acknowledges that impact occurs in a complex, dynamic ecosystem, and that any myriad of externalities and stakeholders can affect the impact trajectory and outcomes.

Contribution is important since it not only guides a pension fund's decision-making with respect to how its funding should best be allocated, but also supports the fund in understanding the ecosystem within which it is investing. This includes understanding key stakeholders that play a significant role, how these stakeholders interact and what levers the fund can use to try to influence positive change and avoid negative harm. The Impact Management Project's five (5) dimensions of impact performance can be used to support funds when classifying the impact it is achieving, namely:

- **What** outcomes people and the planet experience and how important those outcomes are to those experiencing them.
- **Who** experiences the outcomes and how underserved they were previously.
- **How Much** of the outcomes occur, in terms of how many stakeholders experience the outcome, what degree of change they experience, and how long they experience the outcome for.
- **The Contribution** that enterprises and investors make to the outcomes, relative to what would likely occur otherwise.
- **The Risk** that impact will be different than expected.

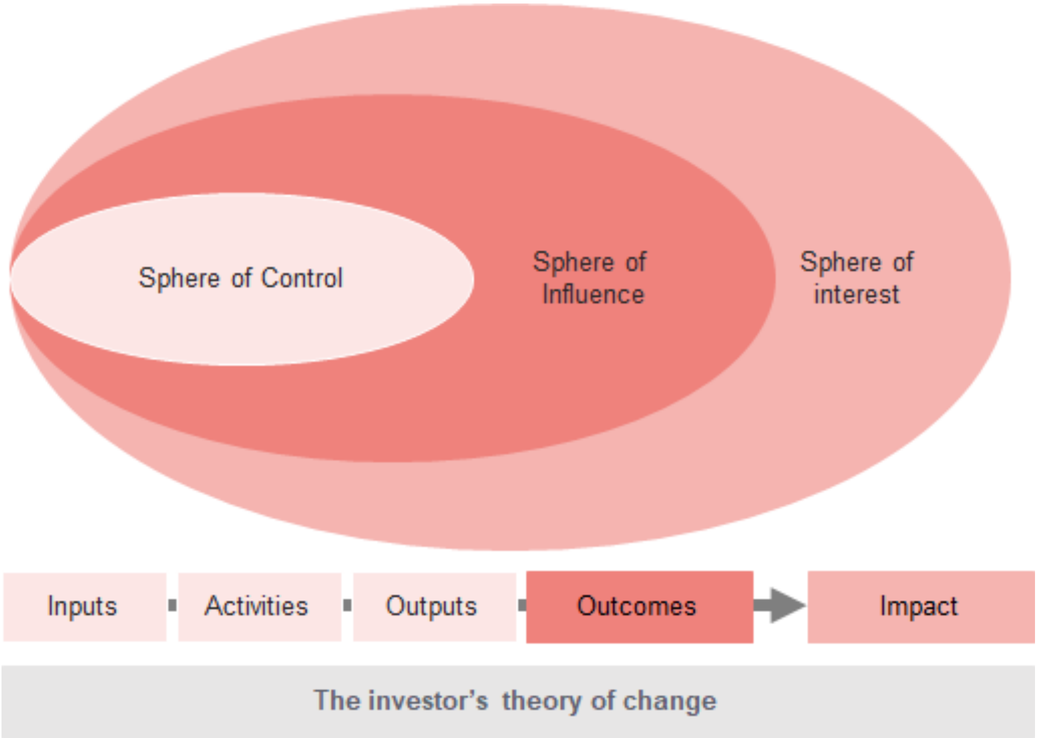
To unpack contribution even further, the pension fund can also seek to measure other variables that provide a view on their contribution to the broader impact achieved:

Figure 5: Measuring contribution

	Attribution	Deadweight	Drop-off	Displacement
Definition	How much of the change did the investor contribute to?	What would have happened in the absence of the investment?	How much does the impact of the investment drop off over time?	Did the investment result in unintended negative consequences?
Example	A pharmaceutical company's contribution to improving health in relation to the contribution of distribution partners, hospitals etc.	An education provider's contribution to improving access to education in relation to competitors	A decline in the number of jobs as the construction phase of a renewable power project ends	Microfinance can lead to an increase in the likelihood of clients becoming overindebted
Approach	Calculated as a percentage which provides an indication of the proportion of the outcome that is attributable to the investor.	Calculated as a percentage and is deducted from the total quantity of the changes observed.	Calculated by deducting a fixed percentage from the remaining level of outcome at the end of each year.	The risk of potential unintended negative consequences materialising, together with its potential magnitude differs by investment

Overall, while pension funds can demonstrate their contribution to achieving objectives, there are many factors and stakeholders that ultimately influence the impact that is realised. The multiple layers that exist between a pension fund and the asset on the ground means that the pension fund has limited control over the actual impact that is achieved, which highlights the importance of pension funds having a defined impact policy underpinned by a theory of change from the outset that supports their investment decision-making. A well-articulated impact policy supported by a robust theory of change ensures that the pension fund most effectively leverages the use of its inputs (sphere of control) to influence a set of outcomes (sphere of influence) which ultimately contribute to the achievement of the pension fund's objectives (sphere of interest). This is illustrated in **Figure 6** below:

Figure 6: The Investor's Spheres of Control, Influence and Interest



2.2 Strategies to enhance contribution

Pension funds can deploy various strategies to enhance their overall contribution. The Impact Management Project has identified four key strategies, which are outlined in the table below.

Signal That Measurable Impact Matters	Engage Actively
A commitment to factoring in the impact an enterprise has, such that – if all investors did the same – it would lead to a 'pricing in' of social and environmental effects by the capital markets. Often referred to as values alignment, this strategy expresses the investors' values and is an important baseline. But alone, it is not likely to advance progress on societal issues when compared to other forms of contribution.	Investors can use expertise, networks and influence to improve the environmental/societal performance of businesses. Engagement can include a wide spectrum of approaches – from dialogue with companies, to creation of industry standards, to investors taking board seats and using their own team or consultants to provide hands-on management support (as often seen in private equity). This strategy should involve, at a minimum, significant proactive efforts to improve impact.

Grow New Or Undersupplied Capital Markets	Provide Flexible Capital
This can be done by anchoring or participating in new or previously overlooked opportunities. This may involve more complex or less liquid investments, or investments in which some perceive risk to be disproportionate to return. Investments can trigger a change in the amount, cost or terms of capital available to an enterprise and/or a change in the price of the enterprise's securities.	Flexible capital recognizes that certain types of enterprises do require acceptance of lower risk-adjusted financial return to generate certain kinds of impact. An investor's constraints often dictate which of these strategies is employed. The diagram below illustrates a few examples of how intentions and constraints drive different combinations of strategies that investors use to contribute to impact.

Source: Impact Management Project

With regards to pension funds signalling their intention to pursue measurable impact, they can also encourage others to do the same given their level of influence as asset owners. There are three different types of signals that pension funds can indicate to the market:

- Direct investment signals: This is achieved by pension funds investing in a way that prioritises impact in their decision-making, including in the selection of asset consultants and third-party investment managers. By doing so, this influences how fund managers allocate capital or manage their portfolios which in turn influences impact performance.
- Indirect investment signals: This is achieved by pension funds communicating a clear intention to invest with an impact lens to the broader market. This can be captured in the pension fund's principles and policies which are communicated to internal and external stakeholders in various ways.
- Policy signals: In this case, pension funds can play a role in encouraging policy makers to adopt measures that support responsible investment.

The combined use of the various strategies as well as different signals can support the pension fund to maximise its contribution to impact by directly contributing through its own investments, and indirectly contributing by steering the market of asset consultants, fund managers and ultimately assets towards the better integration of IMM. This includes bolstering an improved understanding of concepts, competencies, and capacities, while helping to drive a more conducive policy environment for ESG and impact.

Recommended action

Formalise the funds impact intentions and commitments in the form of an Impact Policy plays a key role in signalling the fund's intention to different stakeholders and the market. Therefore it is important that fund impact goals and objectives are clearly articulated.

3. Pre-investment IMM Integration

3.1 Asset Consultant Selection

In most cases, pension funds will seek the support of an asset consultant to support the fund in developing and/or implementing its investment mandate. These consultants therefore play a key role in supporting pension funds in achieving the impact that the fund sets out to achieve. This can include providing support in setting up new products to target impact investments, as well as the process of screening and appointing third-party investment managers and selecting managers with existing investment mandates that are aligned with established impact objectives.

Given that the local impact investing market is in its nascency, pension funds may find that asset consultants' expertise related to impact investing is not particularly well-developed and hence there could be a skills gap among the limited pool of consultants to choose from. This naturally presents another hurdle to overcome, yet at the same time it is a unique opportunity for pension funds to signal to the market that it is placing growing emphasis on impact investing, which in turn will entice asset consultants to develop the required capabilities to support funds in their endeavours.

While this capacity building phase is likely to be underway for some time to come, it is nevertheless important that the asset consultant acquires a thorough understanding of the pension fund's impact objectives, as well as the broader impact investment universe in which the pension fund is seeking to operate. Over time, a dedicated and knowledgeable asset consultant will be able to build a pipeline or identify third-party investment managers that are representative of what the pension fund is seeking to achieve from an impact perspective.

Box 2 outlines some of the aspects that funds should consider when engaging with and selecting an asset consultant.

Box 2: Questions to consider when selecting an asset consultant

- Does the asset consultant have competencies and capacity to provide sound advice on applicable impact matters? If not, does it have measures in place to develop the capacity to become well versed in impact investing?
- Is the asset consultant able to demonstrate any prior experience or have a basic understanding of impact investing and providing its clients' support on developing an impact investing policy?
- How does the asset consultant seek to consider impact type considerations in the advice that it provides to the fund?
- Does the asset consultant have a structured way of considering impact type aspects when providing advice to its clients?
- Are the asset consultant's senior management team and the business committed to impact investment type services (is this an area that they are looking to build additional capacity / resources in)?
- Does the asset consultant have the necessary data, systems and processes it needs to support the implementation of the pension fund's impact objectives?
- Does the investment consultant have the resources, competencies and experience it needs to support the implementation of the fund's ESG-related policies and principles?

3.2 Investment Manager Selection, Appointment and Oversight

Pension funds' investments are typically done through third-party investment managers. During the process of identifying suitable investment managers, the pension fund should be able to define the types of investment manager mandates that align to the pension fund's impact objectives since this will form a key input into the selection and on-going monitoring and oversight of an investment manager. The pension fund, while providing continuous oversight, should clearly communicate this to asset consultants that are involved in the identification, assessment and selection of prospective third-party managers.

Beyond this it is also important to understand the extent to which the investment manager is intentional about the impact it is looking to achieve and whether it has sufficient capacity and competencies to deliver on any established impact objectives to avoid instances of impact washing [1]. This is typically assessed through undertaking a detailed due diligence of the investment manager's IMM policies and systems – looking beyond established aims and objectives to the actual implementation or outcomes of these systems.

The due diligence process will likely involve direct engagement with the investment manager and will focus on its IMM approach, as well as how such considerations are incorporated into its investment process and decision making (including portfolio construction, screening and due diligence, deal structuring and approval and on-going monitoring and reporting).

Recommended action

Formalise the funds impact intentions and commitments in the form of an Impact Policy plays a key role in signalling the fund's intention to different stakeholders and the market. Therefore it is important that fund impact goals and objectives are clearly articulated.

Some key IMM questions to consider when selecting third-party managers are provided in Box 3 below. Further guidance on impact due diligence is provided in The Impact Due Diligence Guide (Pacific Community Ventures, 2019).

Box 3: Questions to consider during an investment manager due diligence process

Policy Alignment

- Does the manager have a formalised impact policy which outlines its established impact objectives?
- Does the manager have a defined theory of change?
- Have specific goals, objectives or targets been set for achieving impact?
- Is there alignment between the manager's impact objectives and that of the pension fund?

IMM Systems

- Does the manager have a formalised IMM process?
- What is the manager's approach to IMM and is it aligned with internationally accepted frameworks?

Organisational structure / Capacity / Competency / Commitment

- Is senior management actively involved in the execution and implementation of its impact policy?
- Does the manager have sufficient capacity and competencies to effectively implement all elements of its IMM systems?
- How successful has the assigned impact resources been in achieving objectives and targets and is this reflected in incentive-based and / or management performance frameworks?

[9] The Institute of Development Studies defines impact washing as a phenomenon where "a company or fund makes impact-focused claims in bad faith without truly having any demonstrable positive social or environmental impact".

Monitoring and reporting

- Does the manager collect and report on meaningful impact data that goes beyond outputs to demonstrate clear impact outcomes?
- Does the manager conduct third party verification against its IMM systems implementation?

Where the due diligence process identifies material gaps or areas of non-conformance with set pension fund requirements, the pension fund will need to consider whether there are potential opportunities it would like to pursue to exercise influence in helping the investment manager to formalise such objectives and/or IMM practices to become better aligned.

This could either be done through active engagement with the investment manager or incorporation of specific impact provisions into legal agreements. The inclusion of impact provisions into legal agreements aims to:

- Mitigate the risk of conflict between the pension fund and investment manager around expectations of IMM practices and on-going impact reporting;
- Ensure the pension fund and investment manager interests on impact matters are aligned;
- Contractually hold the investment manager accountable for impact monitoring and reporting requirements;
- Ensure investment managers have adequate financial and technical resources to comply with the terms set in the legal agreements; and
- Enhance the pension fund's leverage and oversight of the investment manager post appointment.

In addition to this, it will be important for pension funds to monitor the on-going performance of appointed investment managers, to confirm that they continue delivering against any impact commitments or actions, and to drive continual improvement and learnings. This could include periodic deep dive evaluations to assess why an investment manager may not be achieving its set goals or targets (and determine how it needs to be restructured, if at all, to do so), understanding the actual impact outcomes achieved and/or responding to the requirements of specific stakeholders.

3.3 IMM Integration For Direct Investments

Pension funds do not typically make direct investments and the process described in this section briefly details the process that would typically be followed by an investment manager when integrating IMM in a direct investment. Nevertheless, in some instance pensions funds do make direct investments therefore some guidance is provided on how impact considerations can be sufficiently integrated into the pre-investment process.

This should start as early as the deal origination stage and the pension fund should have a clear understanding of the impact objectives and any specific preferences or negative exclusions. The fund needs to adopt a robust process which qualifies the extent to which the conditions are likely to be satisfied through the investment, as well as how best to measure and manage outcomes linked to such objectives. Specific aspects to consider at each of the key pre-investment stages are outlined below in Figure 7.

Figure 7: Summary of Integrating IMM into the Investment Lifecycle for Fund Managers

1) Screening	2) Due Diligence	3) Deal Structuring & Approval
• High level assessment to establish alignment of investment against impact objectives • Establish if investment's potential impact aligns with core business activities and what the asset's appetite is to maximise impact. • Define scope of impact due diligence (where feasible)	• Validate the impact thesis • Evaluate the asset's potential for achieving impact • Assess the requirements needed to design and implement effective IMM • Identify specific opportunities to maximise impact	• Ensure alignment with the asset on impact focus • Obtain alignment on impact action plan • Obtain agreement on impact terms with all parties involved • Incorporate relevant impact provisions into legal agreements

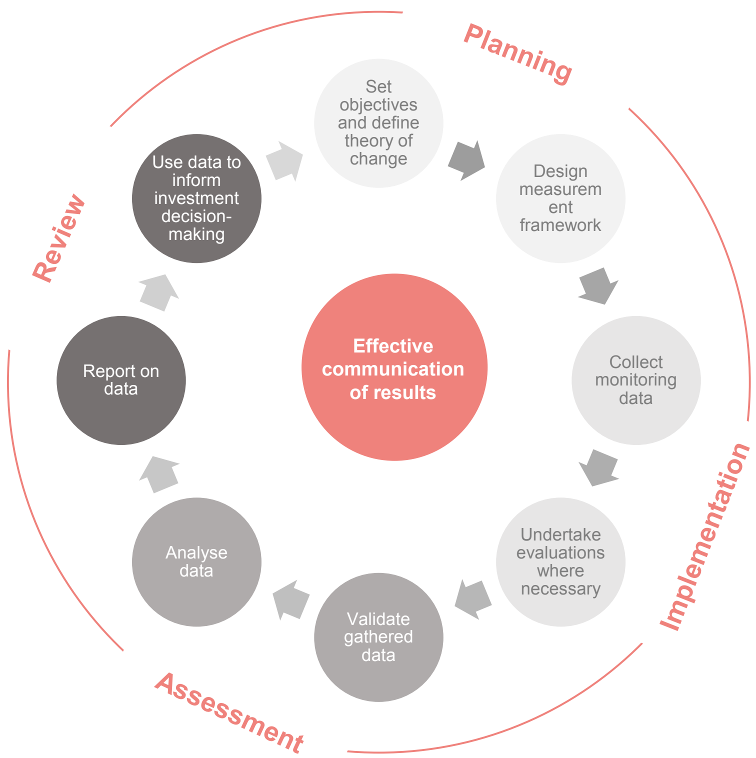
4. Measurement and Management

4.1 Establishing a measurement and management framework

When developing an impact policy, it is imperative that the defined strategic objectives are measurable. The pension fund must identify a set of indicators that are aligned to the objectives, which will be used to track progress towards the objective on an ongoing basis. Once indicators have been defined, targets should be established for indicators that the pension fund considers to be core to the investment strategy. This will enable the pension fund to track progress towards the achievement of these targets and will support in identifying potential barriers that are constraining progress towards the targets. This process is briefly outlined below.

The development of a robust measurement and management framework that includes relevant indicators as well as ambitious but achievable targets is crucial to facilitating the implementation of effective impact monitoring and evaluation to inform decision-making. This in turn enables the pension fund to demonstrate the causal link between investment activities and the achievement of the strategic Impact objectives set, as outlined in Figure 8.

Figure 8: Guidelines for Building a Robust Impact Measurement Framework



Source: Adapted from Measuring Impact: Subject paper of the Impact Measurement Working Group, 2014 and the UNDP Handbook on Planning, Monitoring and Evaluating for Development Results

The process described above is referred to as the Results-Based Management Cycle Approach which aligns to the Seven Guidelines for Building a Strong Impact Measurement Framework, developed by the Impact Measurement Working Group (established under the UK's presidency of the G8).

4.2 Developing indicators

There are various internationally accepted frameworks which provide a list of pre-defined indicators aligned to different types of objectives. These include indicator databases that cover a range of focus areas such as the IRIS+ Metrics, the Sustainable Development Goals (SDGs) indicators, the Global Reporting Initiative (GRI), and the Sustainability Accounting Standards Board (SASB). In addition, frameworks that are focused on specific topic areas, such as the ILO's Decent Work Agenda (focused on job quality), the 2X Challenge (focused on women empowerment) or the Task Force on Climate-Related Financial Disclosures (TCFD) (focused on climate change), also exist.

Finally, National Treasury itself is in the process of developing a Green Taxonomy – a working draft of the taxonomy was publishing in June 2021 – which suggests forthcoming green disclosure requirements. The European Commission in April 2021 adopted its EU Taxonomy to help improve the flow of money towards sustainable activities across the European Union and adoption of the package is viewed as being instrumental in making Europe climate neutral by 2050[10]. The global impetus is shifting and alignment with these trends are necessitated to stay abreast of international best practice.

While some international frameworks cover a range of different types of objectives, the specific indicators may not be entirely suitable to a particular pension fund's strategy. As a result, there may still be a need to tailor some of the indicators to ensure they are relevant to the pension fund's objectives and support the underlying narrative on the pension fund's contribution to the defined impact objectives.

Recommended action

When measruing impact, selected impact indicators / metrics must be clearly defined to ensure relevance for chosen impact objectives and to avoid gathering unnecessary data for impact performance areas which the pension fund has limited influence over.

To facilitate the collection of and access to data against the defined indicators, the pension fund should embed relevant reporting requirements against indicators into investment agreements to manage the investment manager's expectations. This is particularly relevant in the case of a pension fund which has a minority stake, given its limited influence post-investment.

The pension fund should clearly communicate its intentions to measure and report on the set of indicators relevant to the specific manager on a regular basis, and ensure that the manager is able to meet this requirement by establishing appropriate systems and processes for gathering and consolidating the information from the various assets.

4.3 Impact Monitoring, Evaluation and Management

Having an established impact measurement and management framework in place is the first step towards effectively measuring, managing and reporting on impact. Operationalising the framework requires periodically gathering data, analysing the information, and reporting on it in a way that informs decision-making.

[10] European Commission. (21 April 2021). Sustainable Finance and EU Taxonomy: Commission takes further steps to channel money towards sustainable activities. https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1804

Impact data is usually gathered and used for two key purposes:

Ongoing Monitoring

- To assess progress against the achievement of objectives and targets. Requires the collection of data against a set of indicators

+

Evaluation

- To assess how well an investment was executed, what difference it made and waht lessons can be learned. Conducted at a specific point in time.

Impact monitoring and evaluation seeks to (i) gauge an investment's impact performance in relation to set objectives, (ii) monitor third-party managers' application of IMM policies and procedures (particularly in relation to any gaps or improvements identified), and (iii) provide the fund with a perspective on impact performance across its impact investment portfolio (to use as a basis for improving its own impact performance), as well as to inform future decisions with respect to the funds impact policy and/or portfolio composition (e.g. the fund may want to reduce exposure to certain sectors / third party managers that are not showing positive results / improvements to improve its own impact performance). The information gathered by the organisation and the conclusions reached by assessing that information may also be used in the preparation of impact reports (including annual sustainability/integrated reporting and public disclosures) to demonstrate fund performance to stakeholders (refer to Section 5).

It is important for funds to consult with the managers and / or investees and agree on the key performance indicators (KPIs) that will be used to monitor progress towards achieving impact objectives early on. These metrics can help to focus managers (or company management in the case of direct investments) on achieving established impact objectives, as well as building buy-in and commitment to track and analyse performance. Funds should focus on impact objectives and indicators that are applicable to both the fund and third-party managers, to avoid instances where third-party managers are collecting information that has no relevance to them or their investment mandate (which will erode credibility / level of buy-in). The fund should also ensure that practical reporting systems are in place to enable the managers / investees to regularly report on the KPIs and to revisit them occasionally to ensure that they are sufficiently tailored to the specific context and are practical to gather and use.

In the case of a pension fund, data can be gathered at the manager-level and asset-level, and streamlined processes and systems are required to ensure the data collection process is efficiently and effectively carried out. This can be done through the development of a centralised impact database which stores both manager-level and investee-level data against the developed KPIs and supports the fund in aggregating the information across assets and managers. The impact database should ideally be embedded into the pension fund's existing information management system to ensure that the pension fund can safely store the relevant data, and enable the fund to engage with the data on a regular basis.

Recommended action

To support the impact measurement process, it is important to manage the expectations of third party managers or direct investments upfront and to engage with them at an early starge in the process to determine what data can feasibly be gathered, the quality of this data and at what frequency.

When gathering data in relation to the impact measurement and management framework, pension funds, managers and assets should seek to align to the following principles to ensure data integrity and optimise data use:

Materiality	Reliability	Comparability	Contribution	Universality
Data should be relevant to understanding the extent to which the investment is achieving impact, as well as determining the manager's ability to influence decision-making processes in order to maximise impact	Data should be validated and appropriately referenced to ensure a high standard of integrity and traceability	Data gathering should align to consistent standards and practices, with the intention of supporting the pension fund and manager to compare investments	To the extent possible, data should be gathered in a way that seeks to inform and demonstrate the pension fund's contribution	Practices around data gathering should be based on internationally accepted standards and approaches that are applied consistently across markets, geographies, and sectors

It is important that the impact data collected is used as a basis for managing or influencing future impact performance at both a fund and third-party manager / investment level. In instances where the fund has direct control or access to management (i.e. owns a share of the company, sits on the company board or advisory committee, etc.) it may be possible to use such influence to incorporate specific actions into formalised plans or procedures to be adopted by the company (i.e. requiring an investment manager to develop its own impact measurement and management policies or procedures). In such instances it will be important to monitor on-going progress against any action items set and to regularly follow up with third party managers or projects to oversee and provide support on implementation.

In instances where the pension fund has limited control or leverage to influence the fund or investee's impact investing policies or procedures, the biggest opportunity to influence impact performance is usually through formal or informal engagement practices. This includes building relationships with managers to promote a healthy dialogue and enhanced performance on key issues that are considered important to improve impact performance. The type of engagement will depend on specific context, however could include any of the following approaches:

- Short engagement sessions on setting impact goals and objectives;
- Formal meetings with senior management and relevant staff members e.g. chief investment officer, portfolio managers etc.;
- Sharing good practice examples or case studies from other funds;
- Sharing relevant impact investing research or reports on related topics;
- Providing formal training and / or capacity building workshops on international good practices;
- Supporting / funding / appointing a third-party specialist to carry out an assessment to provide guidance / research on a particular topics / training

The importance of ongoing engagement with managers (and investees for direct investments) can not be overemphasised. Whereas the monitoring and evaluation data collected will form the basis for measurement, the ongoing engagement will constitute the management of the overall impact and future impact that has been and can be achieved.

5. Impact Reporting

Impact reporting forms an integral part of closing the impact investing loop and is an essential requirement to ensure that the intentionality set out by the pension fund when the strategy was adopted is adhered to.

There are currently no mandatory requirements on impact reporting for the domestic market. That said, Guidance Notice 1 of 2019 of the Pension Funds Act[11] requests that funds report on the extent to which its investment policy statement reflects matters related to the sustainability of investments and assets. The guidance notice stipulates that the IPS should reflect the investment philosophy and objectives and how it seeks to ensure the sustainability of its assets, including but not limited to:

a. when the investment policy statement was approved and by whom;

b. how often the investment policy statement will be reviewed;

c. how the fund intends to monitor and evaluate the ongoing sustainability of the asset which it owns and which it is intending to acquire, including the extent to which ESG factors have been considered by the fund, and the potential impact thereof on the assets of the fund; and

d. its active ownership policy.

The minimum requirements around disclosure outlined in the guidance notice alludes to the need for transparency, accountability and the fair treatment of members, and in this context, funds are encouraged to be transparent in disclosing matters related to sustainability (which encompasses both negative and positive impacts associated with investments).

While there are no mandatory disclosure and reporting requirements in the domestic market yet, the international industry standards are developing rapidly. In 2020, some of the signatories of the IFC's Operating Principles for Impact Management published their inaugural annual Disclosure Statements[12] to enhance transparency of the impact investing industry.

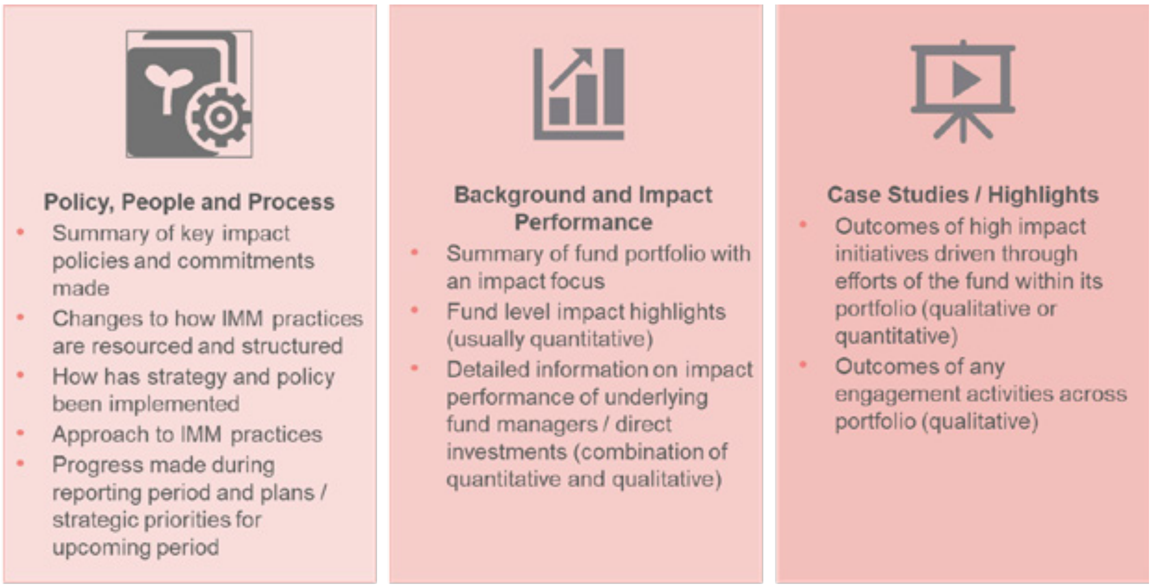
Local pension funds should therefore ensure that impact reporting is prioritised and that reporting is sufficiently robust to clearly communicate and evidence intentions on driving impact, including its impact objectives, theory of change and the IMM framework, and the extent to which defined impact objectives are being achieved.

In terms of practice, impact disclosures / information is currently being published through a number of different channels, including investor / stakeholder specific reports, annual reports, standalone annual impact or sustainability reports, integrated reports (e.g. combination of ESG, impact and financial information), corporate social responsibility (CSR) reports; websites, marketing materials and brochures (i.e. usually including case studies to highlight Impact good news stories). The type and quality of impact reporting is also varied depending on the size and nature of the fund in question, businesses interaction with its stakeholders, available internal resources dedicated to impact, and quality of impact data gathered, etc. Key themes being reported on are illustrated in Figure 10 below.

[11] Financial Sector Conduct Authority. (14 June 2019). Guidance Notice: Sustainability of Investments And Assets In The Context Of A Retirement Fund's Investment Policy Statement. https://justshare.org.za/wp-content/uploads/2019/07/FSCA-Guidance-Notice-1-of-2019-PFA-Sustainability-of-Investments-and-Assets.pdf

[12] International Finance Corporation. (2020). Growing Impact: New Insights into the Practice of Impact Investing. https://www.ifc.org/wps/wcm/connect/8b8a0e92-6a8d-4df5-9db4-c888888b464e/2020-Growing+Impact_FIN2-Web.pdf?MOD=AJPERES&CVID=na22Lop

Figure 10: Key Impact Themes Being Reported On



With the advent of increasing calls for transparency by authorities, regulators and industry bodies, with national standards being developed (i.e. Guidance Notes under Section 28) or in the process of being developed (National Treasury's Draft Green Taxonomy Standards) alongside international frameworks (e.g. Global Reporting Initiative, IIRC Integrated Reporting Framework, SASB, etc.) more funds are starting to report externally in the form of publicly available impact or sustainability reports, providing an overview of their ESG and impact performance at both a fund and portfolio level. This is an important development, as it will lead to further interrogation of such reports and the data contained therein, as well as specific approaches and/or reporting frameworks being adopted.

Recommended action

Robust impact reporting must be prioritised to clearly communicate and evidence the pension fund's intentions on driving impact. This should include details on the fund's impact objectives, its theory of change and approach to IMM, and the extent to which defined impact objectives are being achieved.

Over and above increasing regulatory drivers and stakeholder pressures, external impact reporting (and the process of collating and assessing gathered information) can also help funds to better measure and understand their performance in relation to their peers and to consider how practical established goals, objectives and targets are. It is also the key platform for communicating real-world impact – whether positive or negative and moving beyond theory to report on the practical outcomes of a fund's efforts on the ground.

In addition to this, it is also a key differentiating factor between those funds that are leading and those which are more reactive in this quickly evolving field. However, it is important to understand that effective reporting on impact performance requires clear processes (a good "control environment") for gathering, entering and collating data and this is something that takes time and does not materialise overnight (i.e. strong impact reporting can take several years to perfect). Therefore, the earlier funds start reporting on impact performance and developing robust reporting systems the better.

6. Governance of IMM Practices

Pension funds need to ensure that investment managers, asset consultants, as well as the pension fund itself have adequate organisational structures, capacity and competencies in place to support the effective implementation of IMM practices and to facilitate the realisation of impact objectives in line with the pension fund's requirements. At the manager-level, pension funds need to have a clear understanding of who is responsible for developing, driving and overseeing the implementation of the IMM and who will participate in each element of its implementation. The development of communication mechanisms and disclosures between the pension fund and the manager also needs to be considered and mutually understood.

Recommended action

Adequate organisational structures, capacity and competencies are critical in supporting the effective implementation of meaningful IMM practices.

At the pension-fund level, it is essential to establish roles and responsibilities with regards to driving and managing impact with investment managers e.g. Board, Executive Management, Investment Professionals, Impact Resources, Marketing, Client Relations, etc. Each established committee should be governed by a terms of reference, and there should be effective communication mechanisms in place to support information sharing at all levels. The pension fund should also invest in training and capacity building to enhance awareness and buy-in around the concept of impact and what it means for the pension fund. This type of training and capacity building may be required at the manager-level as well.

While there is no universally accepted approach to guide the establishment of appropriate governance structures for impact, good practice governance arrangements for IMM are underpinned by the following considerations, which should be taken into account at the pension-fund level:

Clearly assign and document accountability for oversight and implementation of the impact policy to an executive manager or board member at the pension-fund level;

- Clearly assign and document responsibility of IMM systems implementation to one person within the pension fund with sufficient knowledge, commitment and decision-making authority to ensure its effective application. Cascade responsibilities through the investment team;
- Establish day-to-day working practices to ensure the IMM is implemented effectively e.g. tasks and responsibilities focused on ongoing engagement with investment managers to manage the use of IMM data;
- Ensure sufficient resources are in place and training is provided, particularly to those resources that have been assigned responsibilities for implementing IMM practices;
- Establish effective checks and balances to ensure adequate IMM implementation and to avoid conflicts of interest e.g. the development of appropriate structures and committees;
- Establish effective internal communication on impact to ensure wider team /organisational alignment with set impact objectives, as well as effective coordination and collaboration within and between different organisational functions;
- Establish effective external communication with investment managers to achieve and maintain an aligned understanding of the pension fund's impact objectives and expectations with regard to IMM implementation. This includes providing feedback to the manager on how well they are performing against the pension fund's policy, and how they can continuously improve their practices and processes.

- Develop a robust training and capacity building programme at both the pension-fund level and the manager-level to ensure sufficient understanding of impact and to facilitate and monitor continuous learning/improvement; and
- Define where impact responsibilities sit within the pension-fund's organisational structure, as well as what the responsibilities of the manager are in relation to the pension fund.

7. Managing ESG Risks and Negative Impacts

Over and above the pension fund's focus on driving positive impact, it is important to manage material ESG risks and any negative impacts that could affect the investment's financial performance or culminate in reputational damage. These are to be considered in combination with impact type considerations to ensure that pension funds are not undoing good work through other adverse impacts that may be causing harm or leading to unintended consequences.

Investments will be exposed to different levels of ESG risks and negative impacts depending on a number of factors, including the type and duration of the investment, the composition of managers' investment portfolios (including sector, size of businesses and stage of businesses maturity) and/or operating asset sector and geographic location, and managers' operational performance and historical track record. Therefore, it is not possible to adopt a single approach to managing ESG risk and negative impacts across an entire investment portfolio.

The most effective and realistic ESG policies and procedures are developed when pension funds have properly considered the types and significance of the ESG risks to which the pension fund and its portfolio will be exposed. This includes considering changing organisational priorities and expectations and aligning the direction of the pension fund's ESG policy and practices with those of key stakeholders and with changes to its operating environment (i.e. climate change, transitions to a green economy, digital transition, changing consumer preferences, etc.).

Recommended action

Funds should not only focus on measuring and managing positive impacts. ESG risks and potential negative impacts are still important and have the potential to expose funds to signficant financial and reputation liabilities, which may erode their credibility and the good work being done around impact.

There are several open-source resources that can be used when starting to consider exposure to key ESG risks and negative impacts. These include the following:

- The Responsible Investment and Ownership (RIO) Guide
- How Asset Owners Can Drive Responsible Investment (PRI, 2016)
- UN Global Compact
- Code for Responsible Investing in South Africa
- The Investor Guide to Climate Collaboration
- PRI Guidance and Investment Tools

Appendix A

South African and African Frameworks	
African Union	Agenda 2063
Department of Trade and Industry	B-BBEE Codes of Good Practice and Sector Charters
National Treasury	Regulation 28 of the Pension Funds Act
South African Development Community (SADC)	SADC Vision 2050
South African National Government	National Development Plan 2030
The Institute of Directors in Southern Africa	The Code for Responsible Investing in South Africa (CRISA)
International Principles	
Global Impact Investing Network (GIIN)	Core characteristics of impact investor
Institute of Directors in Southern Africa (IoDSA)	The King Code of Corporate Governance (King IV)
International Finance Corporation (IFC)	Operating Principles for Impact Management
OECD	Responsible Business Conduct for Institutional Investors
Principles for Responsible Investment (PRI)	UN-supported Principles for Responsible Investment
Social Value International	Social Value Principles
The Equator Principles Association	Equator Principles risk management framework
UN Environment Programme Finance Initiative (UNEP FI)	Principles for Positive Impact Finance
International Standards	
2X Challenge	2X Challenge Financing for Women
International Labour Organization	ILO's Decent Work Agenda
International Organization for Standardization (ISO)	ISO Social Responsibility Standards
Sustainability Accounting Standards Board (SASB)	Materiality Map
The Global ESG Benchmark for Real Assets	GRESB
United Nations Development Programme (UNDP)	UNDP SDG Impact Standards
World Benchmarking Alliance	Benchmarks
International Methodologies	
60 Decibels	Lean Data
Global Steering Group for Impact Investing (GSG)	Impact weighted accounts
Impact Management Project (IMP)	Impact Management Project (IMP) Five Dimensions
Impact Management project (IMP)	Impact Frontiers Collaboration
International Finance Corporation (IFC)	IFC Sustainability Framework
Sopact	Social Return on Investment (SROI)
The Balanced Scorecard Institute (BSI)	Balanced Scorecard
Toniic	SDG Framework
UN Environment Programme Finance Initiative (UNEP FI)	Positive Impact Initiative (PII)
United Nations	UN Sustainable Development Goals (Global Goals)

International metrics, indicators, and rating tools	
B Lab	GIIRS
Finnfund	Development Effect Assessment Tool
Global Impact Investing Network (GIIN)	IRIS Catalogue of Metrics
Global Impact Investing Network (GIIN)	IRIS+ Core Metrics Sets
Global Reporting Initiative	GRI Sustainability Reporting Standards
IFI Partnership	Harmonized Indicators for Private Sector Operations (HIPSO)
International Finance Corporation (IFC)	Anticipated Impact Measurement & Monitoring (AIIM) system
UNEP FI Positive Impact Initiative	Corporate Impact Analysis (CIA) Tool
UNEP FI Positive Impact Initiative	Portfolio Impact Analysis (PIA) Tool
International Disclosure	
CDP Global	The Carbon Disclosure Project
Integrated Reporting Council (IRC)	Integrated Reporting
Task Force on Climate-related Financial Disclosures	TCFD
United Nations	Paris Agreement
International Networks	
Impact Management Project (IMP)	IMP Structured Network
Global Impact Investing Network	GIIN Membership

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