

Environmental and social themed investing

The PRI Initiative's Environmental and Social (E&S) Themed Investing Work Stream works with signatories to explore investment opportunities that deliver positive environmental and social impact within a fiduciary and market-return context.

Here we define what the PRI Initiative means by E&S themed investing and how this type of investing relates to responsible investment.

What does the E&S Themed Investing Work Stream cover?

A new world is emerging, one driven by megatrends such as climate change, population trends, rapid urbanisation, food security issues, poverty and loss of biodiversity. Investors are reacting to these changes by looking for investment opportunities that offer solutions to such challenges. These investments can generate positive environmental and social impacts as well as attractive financial returns.

Clean technology, including renewable energy, waste and water management, sustainable forestry and agriculture, inclusive finance and products and services to support global health are some of the investment areas included in PRI's work stream on E&S themed investing. Annex A provides a more detailed, although not exhaustive, list of investments that could be categorised as E&S themed investments.

Signatories invest in these themes for different reasons. For some investors, the environmental and social impact of investments might be integral to the mission of the fund and reflect what their beneficiaries want. Investors may also expect improvements to their overall risk/return profile and diversification benefits from these investments.

Investors may choose to dedicate a small percentage to investments in social and/or environmental areas, via a dedicated team. Alternatively, they may seek environmental and/or social themed opportunities across asset classes and investment teams. Allocations are usually small in comparison to investors' total assets under management. This is due to barriers such as:

- immaturity of some of the investment areas;
- lack of historical performance data, lack of track record of specialist funds / asset managers;
- lack of knowledge on the part of the investor;
- high levels of real or perceived risk;

- smaller average deal size, a particular barrier for larger asset owners; and
- lack of standardisation of metrics on environmental and social impacts and, connected to this, the burden of data collection.

E&S themed investing – an approach to responsible investing

E&S themed investing can form part of a responsible investment approach. Recognising global mega trends as risks and proactively seeking investment opportunities offering solutions to these issues is part of responsible investment practice. As with other forms of investing, a signatory to the PRI can apply the six principles to E&S themed investing. For example: :

- Principle 1: An investor in clean tech firms might consider corporate governance issues in their valuation of the company.
- Principle 2: An investor in wind farms might engage with the company on issues relating to the company workers' conditions and rights.
- Principle 3: An investor in social enterprises might ask for reporting on environmental, alongside social, metrics.

The link between E&S themed investing and impact investing

Impact investments are defined as:

“...investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending upon the circumstances. Impact investors actively seek to place capital in businesses and funds that can harness the positive power of enterprise.” (Global Impact Investing Network, 2012)

Within impact investing, a distinction is made between “financial first” and “impact first” investors. “Impact first” investors seek to optimise social or environmental returns while agreeing the minimum target financial returns (a financial ‘floor’) while “financial first” investors seek to optimise financial with a floor for social or environmental impact (Rockefeller Philanthropic Advisors, 2009).

This work stream focuses on investments that are financial first with the expectation that the investment will positively impact the environment or society. It also can involve tracking social and environmental metrics. E&S themed investing can therefore be seen as a sub-set of impact investing, that is, focusing on those impact investments that also have market-rate expected returns. Figure 1 below, taken from a report by Bridges Ventures, indicates an emerging spectrum of application of capital, from ‘traditional’ investing through to ‘philanthropy’, with ‘thematic investment’ included as a sub-set of impact investing.

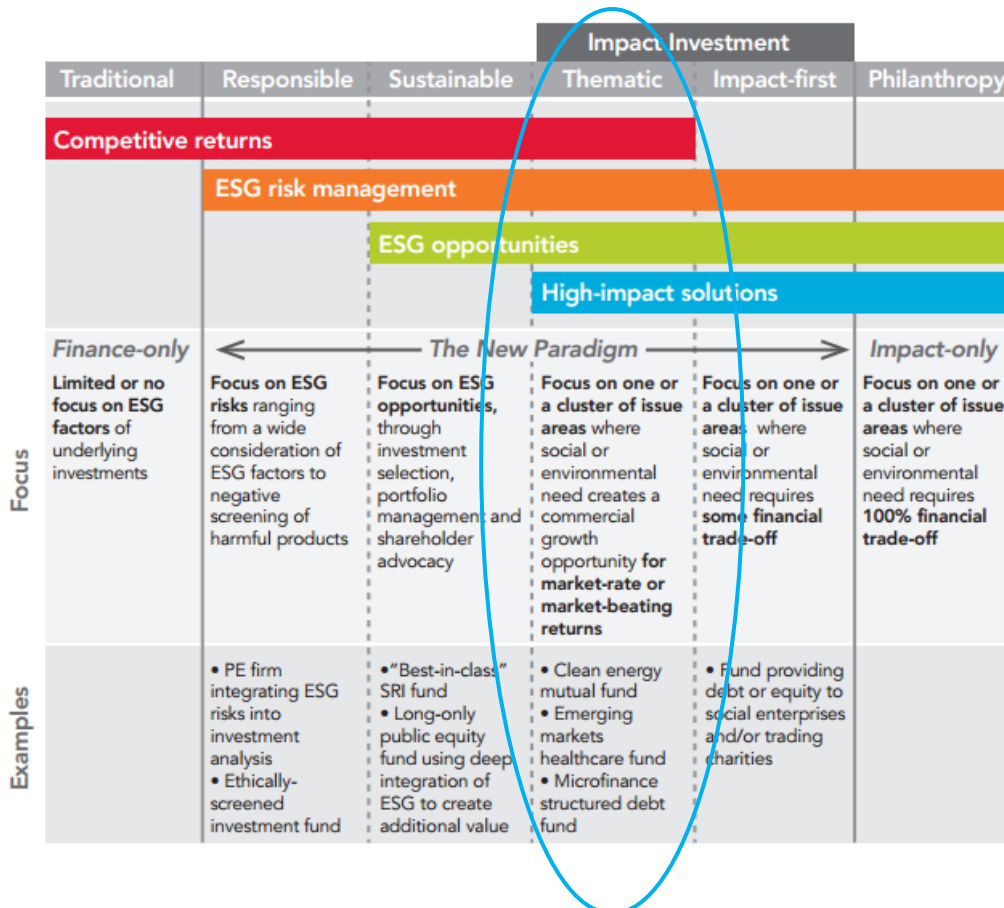


Figure 1: The Spectrum of Capital, Bridges Ventures (2012)

The PRI E&S Themed Investing Work Stream

The preamble to the Principles for Responsible Investment states:

“As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society.”

In actively seeking investment opportunities that offer solutions to global challenges, E&S themed investing offers investors one way to explicitly align their activities with the broader objectives of society. Through the E&S themed investing work stream, the PRI Initiative will support signatories in exploring E&S themed investments. The aim of the work stream is to promote responsible investment practices in environmental and social themed investing. To deliver this aim, the work stream will look at investment opportunities in this area, focusing on specific themes (see Annex A). This includes looking at large-scale public-private impact investment within a fiduciary context, and cross-cutting issues such as measuring and reporting on social and environmental outcomes.

Signatories can find more information at the [E&S themed investing page](#) of the PRI extranet.

Annex A: Examples of environmental and social themed investments

Theme	Definition	Asset class characteristics
Cleantech	Investments in companies that offer products, services or processes aimed at reducing or eliminating the consumption of natural resources and achieving higher energy efficiency with lower cost. Cleantech is present in the energy, agriculture, transport, manufacture, air and water quality sectors. Cleantech companies work in some of the following industries: Renewable energy, energy efficiency, waste management and materials recycling. (PRI)	Infrastructure, private equity, listed equities, fixed income.
Green buildings	Green building is the practice of creating structures and using processes that are environmentally responsible and resource-efficient throughout a building's life-cycle from siting to design, construction, operation, maintenance, renovation and deconstruction. This practice expands and complements the classical building design concerns of economy, utility, durability, and comfort. A green building is also known as a sustainable or high performance building. http://www.epa.gov/greenbuilding/pubs/about.htm	Listed and unlisted real estate.
Sustainable forestry	Investment strategies that focus on sustainable forestry investments that enshrine the protection of local economic, social and natural interests. The sustainable management of the forests may be certified by bodies like the Forestry Stewardship Council (FSC). (PRI)	Unlisted real estate, private equity, listed equities, fixed income, commodities.
Sustainable agriculture	There is no universally accepted definition of sustainable agriculture, but one commonly cited is from the Sustainable Agriculture Initiative: <i>"Sustainable agriculture is a productive, competitive and efficient way to produce safe agricultural products, while at the same time protecting and improving the natural environment and social/economic conditions of local communities."</i> http://www.saiplatform.org/sustainable-agriculture/definition	Unlisted real estate, private equity, listed equity, fixed income, commodities.
Microfinance	Investment strategies that involve debt or equity investments in microfinance institutions. The microfinance institutions provide financial services such as loans, savings, insurance and other basic services to low-income clients who run productive activities and who traditionally lack access to banking and related services. (PRI)	Private equity, fixed income.

SME financing	SME financing here refers to providing financial services to small- and medium-sized enterprises that would not normally have access to banking and related services.	Private equity, fixed income.
Social enterprise/ community development	<p>Social enterprise development is defined as creating and nurturing businesses that aim for positive social or environmental outcomes while generating financial returns. http://unglobalcompact.org/docs/issues_doc/development/Framework_Social_Enterprise_Impact_Investing.pdf</p> <p>Community development investments are similarly designed to specifically benefit lower-income neighbourhoods and populations, for example by providing access to affordable housing, supporting small businesses, and, by extension, job creation. http://www.federalreserve.gov/communityaffairs/cdi/default.htm</p>	Private equity, fixed income.
Affordable housing	Affordable housing has different definitions depending on the country, but can be broadly categorised as that which is affordable to the <i>average</i> household. It covers a spectrum from emergency shelters, through to non-market rental (also known as social or subsidised housing), formal and informal rental and ending with affordable home ownership.	Listed real estate, unlisted real estate, private equity, listed equities, fixed income.
Education	Investments in education include investments in schools, social enterprises and any other industries related to the advancement of education.	Private equity, listed equities, fixed income, infrastructure.
Global health	Investment strategies that focus on the healthcare market and health systems, e.g. pharmaceuticals, biotechnology, healthcare services and medical technology/suppliers with the objective to decrease the global burden of diseases, including non-communicable diseases (cancer, diabetes, and cardiovascular diseases) and/or communicable diseases (e.g. HIV/AIDS, tuberculosis, and malaria) in both (developed and in emerging and developing countries). This may also include investments that improve the global access to healthcare services and/or with products/services with potential and interest to improve global health. (PRI)	Private equity, listed equities, fixed income.