Global trends create tailwinds for impact investing

Dr Andreas Nilsson and Tim Ickenroth, Golding Capital Partners

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Impact investing is gaining importance among institutional investors as sustainable technologies become competitive and regulatory support grows. Funds of funds also enable Article 9 classifications outside the EU. This opens up global opportunities.

Impact investing is attracting growing interest from insurance companies and other institutional investors. The idea is to use the invested capital to generate a measurable positive impact on well-defined sustainability goals – in addition to an attractive and market-rate financial return. Many German insurers are pioneers in setting sustainability targets and demonstrating these, for example, by participating in the United Nations convened Net-Zero Asset Owner Alliance.

The timing now seems favourable for a breakthrough for impact investing across the board: demand is currently meeting a kaleidoscope of potentially attractive investment opportunities. Many sustainable technologies are on the verge of entering the market. This is especially true when sustainability is expanded to include topics beyond climate protection.

The growing importance of sustainable private equity investments

There are further reasons why insurers want to consider impact investing in their investment strategy to a greater extent than in the past, particularly in the area of private equity.

The United Nations Climate Change Conference COP28 in Dubai in December, for example, will have an impact on impact investing. 200 countries signed a joint agreement there calling for a 'transition away from fossil fuels'. It is the first time that a global call has been made explicitly for a reduction in oil, gas and coal consumption. To achieve this goal, new regulations will have to fundamentally change existing economic practices. The urgent need for international action was demonstrated last year: 2023 was the hottest year ever recorded. In fact, the ten hottest years on record have all occurred since 2010. According to measurements by the German Weather Service (DWD), 2023 was the warmest year in Germany in more than 140 years.

Investors see the potential: in 2023, the share of investments in climate technologies in the private equity asset class increased to 11 percent worldwide. In Europe, the share already reached 27 percent.

Regulatory implementation of sustainable investment products

The big question is how and according to which regulatory framework corresponding investment products will be implemented in practice. Sustainable financial products that also stand up to critical scrutiny are a broad and complex field that requires specific expertise. One possible guideline is the EU Sustainable Finance Disclosure Regulation (SFDR). This can be used to build – based on transparent and reliable criteria – a diversified portfolio of specialised impact funds that invest in promising companies and business models and are ideally classified as Article 9 funds under the SFDR.

However, the range of Article 9 target funds is limited. According to a survey by Golding Capital Partners, only 30 percent of all impact target funds worldwide are classified as Article 9 – even though they achieve measurable impact and meet strict sustainability criteria.

Impact funds of funds combine international opportunities and European standards

In theory, all funds – including funds outside the EU – can be classified at the European level in accordance with the SFDR. But in practice very few do so, not least because it involves a considerable amount of work. Should investors therefore refrain from investing in a global pioneer – for example, a precision fermentation platform for the production of significantly cheaper and more sustainable natural food colours – just because the fund is based outside the EU and thus ignore considerable opportunities? Not at all. Because of their own due diligence processes, impact funds of funds enable investors to meet the requirements for an Article 9 classification for the individual target funds in their portfolio. To do so, the target fund must provide the fund of funds with information in these three categories:

1. Sustainable investment objectives
The investments of each target fund have formal sustainability objectives.

2. Do No Significant Harm
The activities of the investee companies have no significant negative impact on the environment or society.

3. Minimum safeguards
The portfolio companies meet minimum standards in areas such as anti-corruption, labour rights, fair competition and respect for human rights.

With such an Article 9 shadow process, impact funds from outside the EU can also be included in the Article 9 classification through a fund of funds structure.

Transparency as the key to the Article 9 classification

If a non-EU target fund or a fund without an Article 9 classification internally anchors these processes, it can regularly pass the relevant information on to the fund of funds. The fund of funds checks whether this data meets the requirements of the EU Disclosure Regulation. If it can use a transparent process to demonstrate that its target funds meet the criteria for an Article 9 classification, there is nothing to prevent it from being classified as an Article 9 fund itself.

In this endeavour, funds of funds can provide important support to their target funds. This requires the asset manager to have in-depth expertise in impact strategies, the SFDR system, measurement and reporting procedures, and cooperation with international target fund managers. With such a global strategy, investors also participate in impact opportunities in North America or emerging markets that are unfamiliar with the EU transparency requirements of the SFDR.

Sustainable technologies are becoming competitive

Impact investing has become an important part of the private equity market. The shift from a so-called 'green premium' to a 'green discount' shows that sustainable technologies are increasingly becoming economically more attractive and competitive. This development is driven by achieving cost parity, where the cost of sustainable products falls below the cost of conventional products. At this tipping point*, the 'green premium' turns into a 'green discount' and technologies achieve broad market readiness in every sector of our economy. In many industries, we are already at the 'green discount' and other sectors will follow. The potential for impact investing lies in the fact that many of these tipping points will occur between now and 2030, which investors with an impact focus take into account in their investment decisions.

Conclusion – global opportunities for impact investing

In summary, four factors are contributing to the tailwind for impact investing:
1. Investments in response to pressure from customers, employees and competitors

2. Growth capital from investors
3. New, cost-effective technologies
4. Regulatory support

Impact investing is experiencing a lasting tailwind and benefiting from global developments such as the COP28 climate summit and the growing range of climate technologies in the private equity market.

The timing for impact investing is favourable, especially since an Article 9 shadow process will also allow impact funds outside the EU to be included in the Article 9 classification via a fund of funds structure. This requires in-depth expertise and a broad network of international target fund managers. With a global strategy, investors can participate in impact opportunities in North America or emerging markets where the EU transparency rules of the SFDR do not apply. This opens up a wide range of opportunities for future growth and sustainable investment worldwide.

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*The term goes back to Malcolm Gladwell's bestseller: The Tipping Point. How Little Things Can Make a Big Difference, 2000