WORLD ECONOMIC FORUM

Private Market Impact Investing: A Turning Point

WHITE PAPER

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We have been heartened by the uptake, proliferation and increasing scale of impact funds in the private markets over the last five years. Working with the World Economic Forum, our two organizations have been seeking greater alignment between limited partners and general partners on expanding impact capital and practices throughout private markets for some time. The levels of market participation among the largest allocators and managers have been increasing dramatically, with positive knock-on effects in private market asset classes and society.

Forward-leaning allocators around the world have been demanding impact investment products that can accommodate large allocations. A mismatch between supply and demand has existed for years but we are pleased to observe that, while that mismatch remains, the gulf is not as wide as it was five years ago. More strategies are being launched by established general partners, and more limited partners are getting comfortable with committing to impact strategies, particularly those with track records and broad platforms to source and drive value creation across the investment life cycle.

This momentum owes a debt to many of the trailblazing organizations that paved the way and conclusively proved the thesis that impact investing can be done while simultaneously providing attractive risk-adjusted returns. These same firms today are incubating and scaling a number of impact strategies, including some focused on addressing important global challenges like climate change and the energy transition.

While achieving the Sustainable Development Goals by 2030 may seem daunting in the face of war in Ukraine, high inflation, bank liquidity issues, increasing inequality and the persistent challenge of climate change, we remain very optimistic and ready to do our part.

Preface

Christian Sinding
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I strongly believe that considering sustainability, both in the way businesses are run and through the products and services they offer, is vital to being a responsible and prudent investor. This entails examining a company's potential impact on society and the environment as long-term factors in potential financial success.

I am pleased to witness that this ethos is now being more widely embraced by the broader market. The characteristics inherent to private markets – long-term horizons, robust governance models, holistic approaches to value creation and an absolute focus on returns – mean that the industry has long been well-positioned to support companies that are delivering solutions to society's challenges. But today a greater number of private market firms are turning their attention towards impact investing, meaning we stand at an inflection point.

As this White Paper explores, the impact fund market is beginning to mature: the products on offer have increased, limited partner demand is accelerating, and the industry is beginning to converge on best practices and means of management and measurement. Impact strategies have the potential to act as lighthouse strategies, pushing frontiers and challenging traditional ways of thinking across the industry. In doing so, market players gather valuable learnings that can be leveraged on a global scale to make us better, smarter and more responsible owners.

I believe that impact funds have a vital role to play in our industry's future and we can seize the opportunity to do more, for both the potentially lucrative investment outcomes and the crucial beneficial outcomes for people and the planet.
To embrace this opportunity, industry leaders will have to think collectively about how to move faster, find and scale solutions the world needs, measure progress, and continue to enhance how we invest to meet the challenges we face. I am looking forward to this exciting challenge.

Executive summary

Over the last four years, the private market impact and energy transition fund ecosystem has evolved markedly. The market has become far more mainstream. More established and scaled general partners (GPs) have launched impact and energy transition funds, and more limited partners (LPs) have built up the knowledge base and become more comfortable with allocating capital to impact strategies.

Historically, these kinds of allocations and the LPs making them were more likely to be endowments and foundations that committed a significant percentage of the capital that went into private market impact funds. Today, a greater number of pension and sovereign wealth funds have created an additional and substantial new pool of capital that can drive greater impact and support energy transition funds from a much larger range of products now on offer from a number of established GPs with extensive track records.

Recognition is growing among market players that impact investing in private markets represents unique benefits. Firms can take a longer-term view compared to that taken in public markets. Company management teams can be proactively incentivized to pursue positive, measurable social and environmental impact alongside a financial return, and make more strategic moves to grow or reposition existing business models to maximize growth and beneficial impact simultaneously.

Many more large and mid-sized managers are launching impact funds today than a decade ago. Even five years ago, only a relatively few existed, mostly US-based and growth equity-oriented impact funds with funds large enough to accommodate large LPs. Today, far more GPs at the higher end of the market are launching impact and energy transition products across private market asset classes and strategies, including infrastructure, buyouts, venture, private credit and other real assets. That means more and larger investments are made in impact-focused businesses, enabling the transition to a low-carbon economy. These products now have unique and differentiated fund features, and the increased industry alignment on key impact standards and impact investment management and measurement practices is leading to a better understanding of what best practice looks like for these funds. These best practices in some cases are already making their way and are being adopted appropriately for use across those GPs' broader fund platform.

The broader range of products also means more opportunities for large LPs to deploy impact capital on a wider scale across diverse asset class allocations that can generate market rate returns. The secular tailwinds – the long-term economic trends that help feed market growth – in the impact and energy transition sphere are being understood by an increasing number of allocators. In addition, more and more LPs are creating different kinds of dedicated impact, energy transition or sustainable investment sleeves or mandates. This trend shows no sign of slowing down and demand for these scaled products still outstrips supply. This supply–demand imbalance is likely to persist for some time. The momentum and growth of scaled impact and energy transition investing has been noticeable and meaningful. Because of these dynamics, this evolution and virtuous circle are expected to continue and to accelerate in the coming years.

Introduction

Scaled private market impact funds have passed critical inflection points.

For years, large asset owners around the world sought to deploy capital into impact and climate solutions in private markets. However, a wide gap existed in the availability of fund strategies that could accommodate the capacity of capital they sought to deploy. Ten years ago, none of the major general partners (GPs) had an impact fund strategy. Fortunately, that dynamic has begun to change.

Over the last five years, starting in the United States, some of the largest private market GPs have begun to launch impact fund series that are now on their second or even third funds. They also found an eager client base of select large US pension funds that were seeking to join the ranks of more progressive impact-focused endowments, foundations and family offices. LPs and asset owners saw the secular tailwinds behind many of the themes these funds invest in that sought GPs that promised the same risk-adjusted returns they had been delivering for years in their flagship funds and with whom they had longstanding relationships. These earlier adopter GPs now have established impact track records and have laid to rest the misconceived notions that these strategies must be concessionary.

As with any innovation in private markets, success breeds greater market-level adoption. That has certainly been the case for impact and transition funds. More limited partners (LPs) are seeking compelling products in which to invest and GPs are launching new and ever more sophisticated products with compelling new fund features. New strategies are also being launched beyond the traditional growth private equity impact funds to include infrastructure energy transition, climate tech, impact private credit, impact co-investment and secondaries, and impact buyout funds. For asset owners that wish to build impact and climate solutions investing across private market asset classes, this last trend is critically important and is where the greatest opportunity lies for the industry to truly expand impact. At the end of 2021, the global investment manager and adviser Hamilton Lane analysed the number of funds and the target fund size for impact funds that were launched between 2019 and 2021. Over that period, Hamilton Lane "saw double the amount of impact funds being offered and triple the amount of capital that GPs were seeking to raise".[1] Research by the Global Impact Investing Network (GIIN) estimates the market size of impact investing at the end of 2021 at $1.16 trillion, having grown more than two times in three years (from $502 billion at the end of 2018).[2]

The industry has also seen greater alignment on industry standards such as the GIIN's IRIS+ metrics, the Operating Principles for Impact Management (OPIM), the Impact Management Project [Impact Norms/Frontiers], Article 9 of the EU Sustainable Finance Disclosure Regulation, and the SDI Asset Owner Platform. Before the industry began to align behind these widely adopted standards, asset owners and asset managers constructed their own frameworks of what impact meant and how to define, manage and measure it across portfolios. Those days are now gone and the more recent momentum towards independent third-party impact fund verification will only accelerate this alignment further.

All of this is good news for market participants. It will provide even greater comfort to LPs that may be contemplating committing to impact strategies for the first time and to GPs that may be looking to launch their first impact fund. This momentum is expected to build further and lead to greater maturity and expansion in the coming years. It will lead to more ambitious fund strategies with new fund features that will differentiate impact funds from one another. It will also lead to more best practices from impact funds that GPs may transfer to their flagship strategies as they gain experience identifying, assessing, underwriting, managing and measuring impact.

Impact definition

According to the GIIN, "**impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.**"[3]

1 Track records established

Prior impact fund-level track records provide additional comfort for larger and more meaningful levels of capital raised and deployed.

The market has witnessed certain initial private market impact fund strategies reach second or third funds, allowing investors to evaluate direct track records from prior funds when assessing an allocation to impact funds in the marketplace. This is good news, not only for the firms raising these vehicles but for the broader LP community, which can underwrite prior performance like it does for traditional funds. In addition, many firms that have raised their first impact funds[4] in the last one to two years should be returning to market for a second fund with track records in the next 12-18 months.

Table 1 provides an indication of the depth of the impact fundraising market, listing 25 asset managers raising $1 billion or more impact capital between 2017 and 2022, for a combined total of over $80 billion.

TABLE 1 **Impact fundraising of over $1 billion by select asset managers, 2017-2022**

General partner	Impact fundraising (2017-2022) US$ (million)
TPG	11,170
Actis	10,468
Brookfield Asset Management	9,852
Meridiam	8,808
Goldman Sachs Asset Management	6,240
Summa Equity	3,838
BlueOrchard	3,159
Mirova	2,860
Tikehau Capital	2,425
LeapFrog Investments	2,093
Vison Ridge Partners	2,043
KKR	2,012
Energy Impact Partners	1,990
Equilibrium	1,660
Hamilton Lane	1,496
responsAbility Investments	1,489
Trill Impact	1,276
Lightrock	1,216
Apollo Global Management	1,208
Renewable Resources Group	1,152
DWS	1,139
OGCI Climate Investments	1,100
Bain Capital	1,081
Bridges Fund Management	1,015
Generation Investment Management	1,000
Total impact capital raised	**81,790**

Source: New Private Markets, "Impact 30: New faces in the upper echelons of impact", 2022.

The maturation of these impact platforms with accompanying track records will allow larger funds to be raised and more LPs will see the benefits inherent in investing in these transformational impact and energy transition megatrends, much like people have gravitated towards technology-focused funds over the last 10-15 years. The amount of capital available to companies with impact-focused business models will also allow these companies to expand more quickly and reach more customers and stakeholders with solutions that drive positive and measurable social and environmental impact alongside proven risk-adjusted financial returns.

The result of these growing, follow-on funds launched with increased capacity is that they can accommodate the largest asset owners, who need to make larger allocations and, in some cases, have constraints associated with how much of any individual fund their organization's allocation can comprise.

As funds grow, GPs will also need to further develop their sourcing capabilities to identify, track and ultimately source companies for their portfolios that fit with their impact themes. GPs have oftentimes spent years building out the capabilities and relationships with management teams to source attractive investments in their traditional flagship funds. This same discipline applied to impact-focused businesses will allow them to rapidly scale their sourcing engines and will provide impact-focused companies with more opportunity to select capital providers that will allow them to increase their impact and grow their business.

KKR Global Impact

Launched in 2018, KKR Global Impact is a "dedicated lower-middle market private equity strategy seeking to help investors achieve meaningful financial outcomes by helping to solve unprecedented societal challenges. The Global Impact Fund invests around four core investment themes – climate action, lifelong learning, sustainable living, and inclusive growth – where [the firm] believes [it] can create value for investors and contribute meaningful solutions to the UN Sustainable Development Goals (SDGs)".[5]

The impact ecosystem's evolution and growth over the last decade has resulted in more companies to evaluate and underwrite that have achieved a level of success and size in which large-scale investors can deploy capital. At the same time, KKR has seen increased client interest in the impact sphere, as recognition has grown of the economic importance of solutions to structural challenges, such as the energy transition, circularity and responsible waste management, resiliency, and workforce development. Growth in the supply of impact investment opportunities and increased interest in investing in such companies are nurturing a more robust impact investing industry, which now ranges from venture capital to mid- and larger-cap buyout investing. KKR considers that developments in the regulatory environment, such as the Inflation Reduction Act and the EU Green Deal, are driving demand for solutions more broadly and accelerating private investment in the energy transition, which is productive for the impact investing industry as a whole.

The growing opportunities in impact investing mean large-scale investors like KKR can help the industry drive even more impact through investments in companies with broader reach. At the same time, the new possibilities have helped to attract a growing number of asset allocators and to make impact strategies investable for larger institutions. KKR Global Impact has been at the intersection of these trends over the last five years, demonstrating through experience that investors need not trade off returns for impactful outcomes.

While the virtuous circle of supply and demand growth benefits the industry's development, it will not be sustained without strong investment results. This is a key area in which larger-scale managers like KKR can contribute meaningfully to the impact private equity sphere: by demonstrating that, along with positive, measurable social and environmental impact, this approach can deliver investment outcomes consistent with more conventional strategies even at scale. These outcomes are positive not just for investors and allocators but for the broader industry, and KKR considers that they will lead to even greater market confidence in the impact investing industry in the years to come.

TPG Rise

In 2016, the private equity firm TPG set out to find ways to expand impact investing beyond the relatively small venture-capital-stage funds that were active in the market. The firm believed that progress towards the SDGs could be made beyond the world of philanthropy, governments and grants. It quickly became apparent that the large LPs that TPG had worked with for decades would not, and could not, invest without clear evidence that the investments made through Rise would be non-concessionary – that is, the companies could achieve real impact without sacrificing business performance or investment returns. The team introduced the "and" test for new investments: high impact *and* financial returns. According to The Rise Fund website, "Forecasting the social and environmental gains on an investment has historically been largely based on intuition and instinct",[6] so commitment to rigorous impact assessment has been TPG's focus since the launch of the first Rise Fund. TPG partnered with Bridgespan Social Impact and then built Y Analytics and a third-party consulting firm to "create a methodology to assess potential impact before a single dollar is committed. The new metric is called the Impact Multiple of Money (IMM)".[7] With the IMM, all Rise Fund investments receive the same level of rigour in impact underwriting as they do in their financial underwriting.

The impact assessment process is embedded through the full deal life cycle – from diligence to portfolio management to exit. The firm designed it as a decision tool to identify and expand impactful companies and to monitor and track impact realization after the investment is made through impact key performance indicators that the companies report on a quarterly basis. During the development of the IMM, the firm saw the opportunity to harness the large third-party research base that already existed to help channel investments to identify and scale impactful companies. The firm's impact assessment framework is grounded in Impact Frontiers' five dimensions of impact and is combined with a rigorous evidence base that allows TPG to quantify the societal impact per dollar invested. This helps to estimate the impact efficiency of investments. The firm is a signatory to the Operating Principles for Impact Management (OPIM) and uses third-party attestation to verify the impact created as part of the IMM process.

The firm's Rise Climate fund, a $7.3 billion impact fund focused on scaling climate solutions globally, exemplifies its growth and innovation in impact investing. TPG had invested in these solutions for some time with an established track record in Rise and elsewhere, but it had become apparent that the capital needed for the transition to a low-carbon economy necessitated dedicated pools of capital devoted to addressing the challenge. With a focus on renewable energy, decarbonizing transportation and sustainable materials and fuels, TPG Rise Climate looks to track the emissions equivalent mitigated or removed, and manages and assesses those outcomes. It takes key lessons and uses a similar process that has worked as part of prior Rise funds. TPG Rise Climate aims to pursue its goals on a wide scale to match the size of the opportunity that the firm sees in this area and drive the momentum behind addressing the transition to a low-carbon economy.

Temasek

Temasek is committed to significant positive impact, with COVID-19 having accelerated the company's sense of urgency and motivation to adopt a different approach from many of its global peers. Through its impact investing strategy, the firm seeks to achieve positive impact for underserved communities while delivering sustainable long-term returns. Its strategy focuses on key sectors, such as financial inclusion, healthcare, education, food and agriculture, and environment in emerging markets, for example in Asia, Africa and Latin America. The firm views environmental and social outcomes as highly interdependent, especially in the context of emerging markets, with factors that need to be addressed holistically. Temasek aims to accelerate its efforts using experience gained from tracking this area closely and investing in impact funds.

To achieve its goals, Temasek partnered with the pioneering impact investment firm LeapFrog Investments, which has a long track record of impact investing in emerging markets and has a well-developed impact management and measurement process. Temasek and LeapFrog launched a $500 million strategic partnership in 2021, which included Temasek taking a minority stake in LeapFrog. The partnership provided "growth capital to support the expansion of the LeapFrog team and investment capabilities across Asia and Africa".[8] Temasek's other strategic partner is ABC Impact, an impact investment firm in Asia that invests in companies that deliver societal and environmental benefits while achieving a compelling risk-adjusted return. Temasek has also invested in other leading impact funds, with direct results in emerging markets.

Temasek considers that the more asset owners can collaborate and foster these kinds of partnerships and adopt best practices, the more impact-focused capital will flow into both developed and emerging markets. The firm also contributes to thought leadership in the impact industry. To this end, Temasek and ABC Impact are strategic partners of the Centre for Impact Investing and Practices (CIIP), a non-profit entity located in Singapore, to study and "foster impact investing and practices in Asia and beyond".[9] CIIP was set up in 2022 by Temasek Trust, a steward of philanthropic endowments and gifts from Temasek.

Temasek is confident the market rate and increased private market impact investing undertaken by the largest asset owners and asset managers will lead to greater mainstreaming and more positive outcomes for underserved populations around the world.

2 Scaled product proliferation

The number and variety of impact and transition fund products have grown to encompass more asset classes more systematically.

Not only has the size of impact and energy transition funds grown,[10] but the number of options has increased across private market asset classes. Within infrastructure, for instance, the options historically have been for investors who wished to invest in renewable energy and in real estate with affordable housing. Recently, more diversified energy transition infrastructure funds incorporate not just renewable operating assets but storage, distribution, consumption infrastructure such as charging infrastructure and retrofitting, and grid modernization, for example. Similarly, within private equity, options are emerging not just for traditional impact growth private equity but for buyouts, climate venture tech, social housing within real estate, and impact co-investments, fund of funds and single asset continuation fund strategies. Also, new thematic impact funds exist within the private credit asset class, which has lagged behind the developments and uptake seen within private equity and infrastructure.

The availability of more products in asset classes will allow more overall capital to be deployed by LPs who wish to increase their commitment to positive impact but do not want to rely solely on private equity or on renewables within infrastructure. Scaled fund options for private credit, opportunistic investments and indirect private equity strategies widen the solution and option set for asset owners who may have greater capacity within one asset allocation than within others. This allows more asset owners' investment teams to understand how to source, conduct due diligence and underwrite impact funds, and comprehend the long-term economic trends feeding market growth and supporting these thematic investment strategies. It also offers the virtuous cycle of providing impact businesses with more aligned impact-focused capital solutions beyond the more traditional growth private equity, giving impact entrepreneurs more flexibility to grow their businesses in a way that makes the most sense for them.

Brookfield

Brookfield's flagship Global Transition Fund (BGTF) focuses "on investments that accelerate the global transition to a net-zero carbon economy".[11] Brookfield closed BGTF in June 2022 at $15 billion, making it the largest climate impact fund raised to date.

The fund's size along with Brookfield's position as one of the largest owners and operators of renewable energy worldwide are key to achieving BGTF's dual mandate of attractive financial returns and solutions for climate impact. The fund invests in three related impact strategies: transforming carbon intensive businesses, increasing low-carbon energy capacity and scaling sustainable solutions. With its long experience as an infrastructure operator, Brookfield can add value to all of its investments, drawing on the firm's capabilities in power marketing, renewable development, customer relationships and engineering.

In its first year of operation, Brookfield deployed or committed more than half of BGTF's available capital to a wide range of critical technologies, including renewables; battery storage; carbon capture, utilization and storage; nuclear services; recycling; and biofuels.

Ardian

As a diversified private market asset manager, Ardian drives positive impacts and supports the energy transition in three ways across its investment platform.

First, Ardian leverages its impact management methodology to monitor its private equity and infrastructure portfolio assets' contribution to the SDGs. The monitoring programme supports its management teams' engagement with portfolio assets, and helps identify progress and define targets at the asset level. Ardian's methodology is based on the Impact Management Project and Theory of Change, a measurement methodology meant to apply to a wide range of companies from various sectors to capture and support improvements in their social and environmental impact throughout their full value chain. In place at Ardian for the last four years, the methodology has demonstrated the real-world impact of the company's systematic engagement strategy. It also supports the firm's environmental, social and governance (ESG) integration efforts and has informed due diligence and the post-acquisition process.

Second, while Ardian considers that financing the traditional economy is essential to help companies transition and drive positive impact in a wide range of industries and geographies, it is also committed to launching dedicated funds to develop already mature and competitive technologies that will be necessary to meet 2030 climate objectives. The firm launched the Ardian Clean Energy Evergreen Fund, an infrastructure fund dedicated to financing the energy transition and renewable energy projects including solar, wind and hydropower, as well as biogas, biomass, storage and energy efficiency.

Third, Ardian recognizes that the needs of the energy transition will ultimately present significant opportunities resulting from new and rapidly spreading energy technologies that enable the shift to a low-carbon economy. Consequently, the firm is investing out of a $2 billion vehicle focused on clean hydrogen as part of a joint venture with FiveT Hydrogen. The new venture is the "world's largest investment platform focused on clean hydrogen infrastructure".[12] Its investors include many large industry players, with the objective to accelerate the growth of the clean hydrogen ecosystem worldwide.

The combination of these three strategies and programmes – the impact management and measurement programme within the firm's flagship funds; the dedicated energy transition fund; and the investment platform focused specifically on clean hydrogen – allows Ardian to address the energy transition and impact investing in a holistic and meaningful way. This approach provides a strong foundation for future additional process enhancements and potential additional dedicated transition and impact strategies.

Hamilton Lane

Hamilton Lane has raised two impact funds to date. The firm invests directly alongside its GP partners in impact co-investments, secondaries and impact fund of funds. It has thus directly witnessed how the impact and transition fund market has grown, evolved and matured in the last five years. The firm recognizes that many large-scale impact and transition fund managers have established attractive track records that are in line with what the GPs deliver in their flagship funds.

Hamilton Lane's clients, which include many of the world's largest pension funds, endowments, foundations and sovereign funds that are investing in private markets, have increased their investigations over the last few years into impact and climate solution funds. Trustees' demands for education and training sessions on the opportunities and benefits of market rate return impact and transition funds have risen significantly. LPs are increasingly looking at their entire portfolio with an environmental and social lens alongside returns, risk and other traditional factors they consider. The firm expects LP demand to continue to grow and evolve as allocators become more educated in this area, allocate to more impact and energy transition funds, and begin to develop their impact and transition fund investment programmes more broadly.

2.1 Benefits of scale

Among the benefits of size and variety are the ability to provide more capital within each investment to drive greater incremental impact per investment and to finance the type of impact and climate transition realignment capital that is needed to address the SDGs and the energy transition at the higher end of the market, where the ability of larger companies and assets to contribute to impact is greater. These scaled capital solutions will allow smaller impact-focused companies that benefit from capital solutions provided by smaller impact funds to continue on their impact journey. As these companies expand, they will not need to diversify away from an impact-focused investor base as they may have needed to do in the past.

3 Demand greater than supply

Asset owners' ambitions have been growing faster than private capital markets have been able to provide solutions.

Despite the progress outlined above in the market for impact investing and energy transition funds, demand from asset owners is still outstripping supply. According to many of the largest asset owners that have allocated to impact investing in the past or that are waiting for the market to mature further, scaled products across asset classes and different risk-return criteria and track records are still insufficient to meet the demands of these organizations.

Asset owners have been sending market signals for far longer than investment products meeting their needs have been available. In addition, they have become more discerning about impact and energy transition products as they observe more of these products coming to market and perceive the differential investing themes as well as the rigour of impact management and measurement. So the demand is not just for more impact fund products, but for products with greater ambition and alignment to drive positive impact while simultaneously reducing any negative externalities. The call to action to asset managers from the Net-Zero Asset Owner Alliance[13] (NZAOA) is a case in point of increasing demand for impact integration and is a clear driver for asset managers to develop decarbonization and climate-focused capabilities including product offerings.

As demand continues to grow and other asset owners and investment consultants become more familiar and comfortable with different types of impact funds, more capital from large asset owners is likely to enter the sphere to support even greater momentum towards impact fund formation. The engagement, underwriting and monitoring strategies asset owners deploy for their impact investments have also matured, as outlined by the GIIN in its January 2022 Issue Brief, "Institutional Asset Owners: Strategies for Engaging with Asset Managers for Impact".[14]

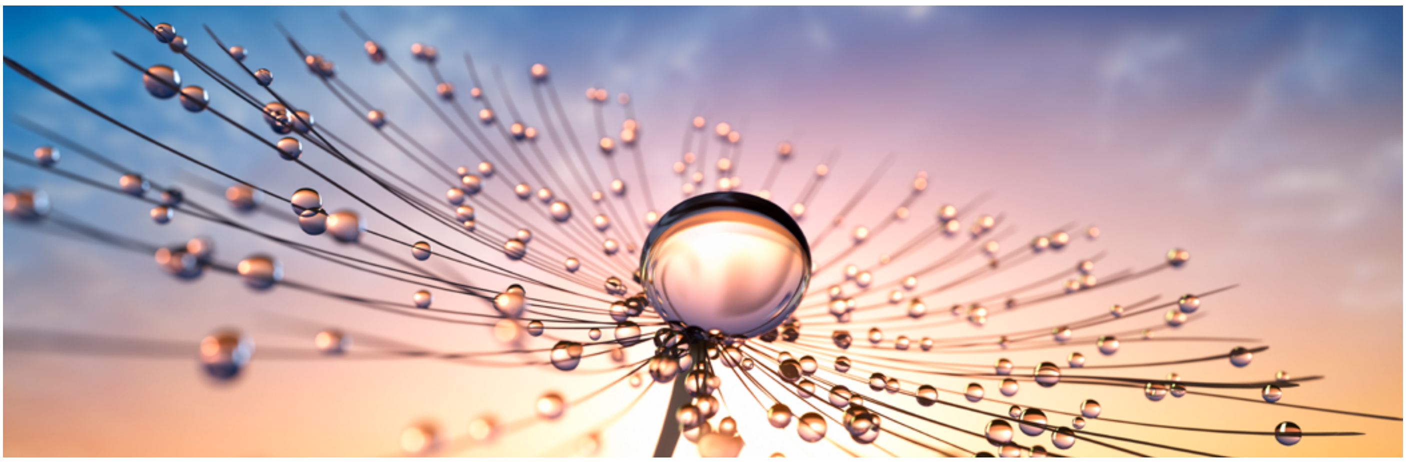
APG Asset Management

APG Asset Management has for many years had a robust ESG integration programme that involves ESG due diligence, investment committee assessments, and ESG sign-off for most investments, and that treats sustainability as one of four major perspectives on investment decision-making, along with risk, return and cost. On behalf of its pension fund clients, APG has also made a net-zero-by-2050 commitment. The firm seeks to do more by tracking the positive contribution its private capital is making to the SDGs. That is one reason why, in 2020, APG helped found the Sustainable Development Investments Asset Owner Platform (SDI AOP), initially primarily focused on capital markets.

APG and other members of the SDI AOP are investigating working with GPs to understand the revenues of the businesses in which managers invest that are making a positive contribution to the SDGs. The SDI taxonomy and other supporting systems and frameworks have increasingly been used by many GPs to report on SDG alignment across the funds in which APG invests. The current perception is that GPs are becoming accustomed to being questioned about SDG alignment and are developing mechanisms to track and report on the alignment. However, it is not the data on its own that APG is interested in but rather the real-world outcomes that its capital is creating in society. The firm has seen first-hand the mindset shift that has taken place because of this work and is heartened to see more of the funds in which it invests becoming increasingly rigorous in proactively seeking out these kinds of investments.

In the direct investments it makes, APG can be even more intentional and directed in sourcing and accelerating impact-focused companies and assets. That is particularly the case in the funds' infrastructure portfolio when the GPs have sole control or jointly controlled companies.

APG expects and will continue to encourage GPs to proactively seek out a greater proportion of impact-oriented investments in flagship funds and leverage the operational capabilities the GPs have to expand and accelerate impact businesses to make a greater contribution to achieving the SDGs.



Washington State Investment Board

According to its 2022 *Environmental, Social, and Governance (ESG) Report*, the Washington State Investment Board (WSIB) "invests most of its beneficiaries' assets through trusted partners and carefully researched investment managers. … Adequate assessment of the ESG capabilities of [private market] partners is critical and, therefore, has been the focus of the WSIB's ESG integration efforts … In addition, since the drivers of risk and return vary by asset class, each of WSIB's asset class teams is responsible for ensuring that their own investment process adequately addresses financially material ESG risks and opportunities. … During 2021, [the WSIB] continued to focus on ESG risks and opportunities during Investment Committee meetings as part of the comprehensive review of prospective new investments. The WSIB's Sustainability Officer plays an active role in these meetings to ensure ESG factors are sufficiently addressed as part of the consideration process for investment recommendations. … In 2022, the WSIB [began] to develop a Partner ESG Assessment tool that [supports] investment officers' efforts at due diligence and monitoring by systematically assessing the ESG integration capabilities across all managers/partners within an asset class and over time. This project [also helps] the WSIB increase consistency in how it defines materiality of ESG risks and opportunities across asset classes. … As part of a newly developed Climate Blueprint … the WSIB is working to develop a more comprehensive assessment of its climate risks and opportunities, beyond exposure to a single sector".[15]

In addition to the Climate Blueprint and Partner ESG Assessment tool, the WSIB has been allocating investments to impact funds that seek to capitalize on the attractive returns associated with the energy transition and broader sustainability themes. When considering those allocations, the WSIB performs the same extensive due diligence on these funds as it does with all prospective funds, including the risk–return profile of the fund, and the rigour and mechanisms it uses to evaluate the inclusion of different types of investments in its portfolio from a thematic perspective. Historically, impact investments were housed inside of WSIB's Innovation Portfolio, but they have now been transitioned into the relevant asset class portfolios. Future investments in impact funds may be considered by investment teams within each respective asset class.

As the energy transition continues and the world decarbonizes, large-scale investments designed to meet the need for capital in the economy may provide attractive market-rate returns. Further, established WSIB partners, using the same underwriting process they use in other funds, should provide opportunities for the WSIB to allocate capital across private market asset classes in line with its traditional commitment size.

New York City

Alongside the funds' net-zero-by-2040 commitment, the New York City Employees' Retirement System (NYCERS), Teachers' Retirement System of the City of New York (TRS), and New York City Board of Education Retirement System (BERS) (the "Systems") set goals to reach a total of $37 billion in climate solution investments by 2035, in line with a total of $50 billion across all of the Systems by that year. Climate solution investments in the Systems' portfolios have more than doubled in value since 2018.

As part of these commitments, the Systems have made allocations to private and public market funds consistent with both the climate solution goals and the Systems' objectives to achieve superior risk-adjusted returns, and they will continue to evaluate prudent opportunities to invest in climate change solutions in the future. The funds the Systems have committed to are underwritten by investment staff like any other fund the Systems commit to, and that same standard will apply to any funds the Systems may consider as part of their climate change solution investment goals.

Harvard Management Company

Harvard Management Company (HMC), the organization that invests Harvard University's endowment, has been part of the influx of new capital into impact and climate transition funds in the last few years. As an experienced and sought-after LP, HMC has access to many of the top asset managers entering this sphere.

HMC's climate investments to date have largely focused on private markets, including several venture fund investments it considers well-positioned to lead the transition to a low-carbon economy. As part of the proposition, HMC is seeking to harness the power of disruptive climate technologies to rapidly expand climate solutions while realizing outsized returns.

As GPs introduce more of these private market funds, HMC remains interested in evaluating differentiated opportunities from both established managers with strong, successful track records who have evolved their focus areas to include climate transition and emerging managers capitalizing on opportunities in the transition to a low-carbon economy.

4 Industry standard alignment and verification

LPs and GPs are adopting rigorous frameworks to verify impact fund due diligence, underwriting, and management and measurement processes.

Over the last several years, the LP/GP ecosystem has coalesced around frameworks and best practices for private market impact investing. While many of these tools have existed for some time, the uptake within the industry has been pronounced and has occurred relatively quickly. As examples, the SDGs and targets for theme development and the OPIM originally incubated by the IFC but now hosted by the GIIN have become industry standards for impact management and measurement. Similarly, the IRIS+ catalogue of metrics, the Impact Management Norms (formerly the Impact Management Project) from Impact Frontiers for impact assessment and disclosure, and the SDI Asset Owner Platform have provided a solid foundation for LPs to identify SDG-aligned investments in both impact and traditional funds.

The GIIN report on impact measurement highlighted most investors using multiple systems or frameworks in their impact measurement and management practice.

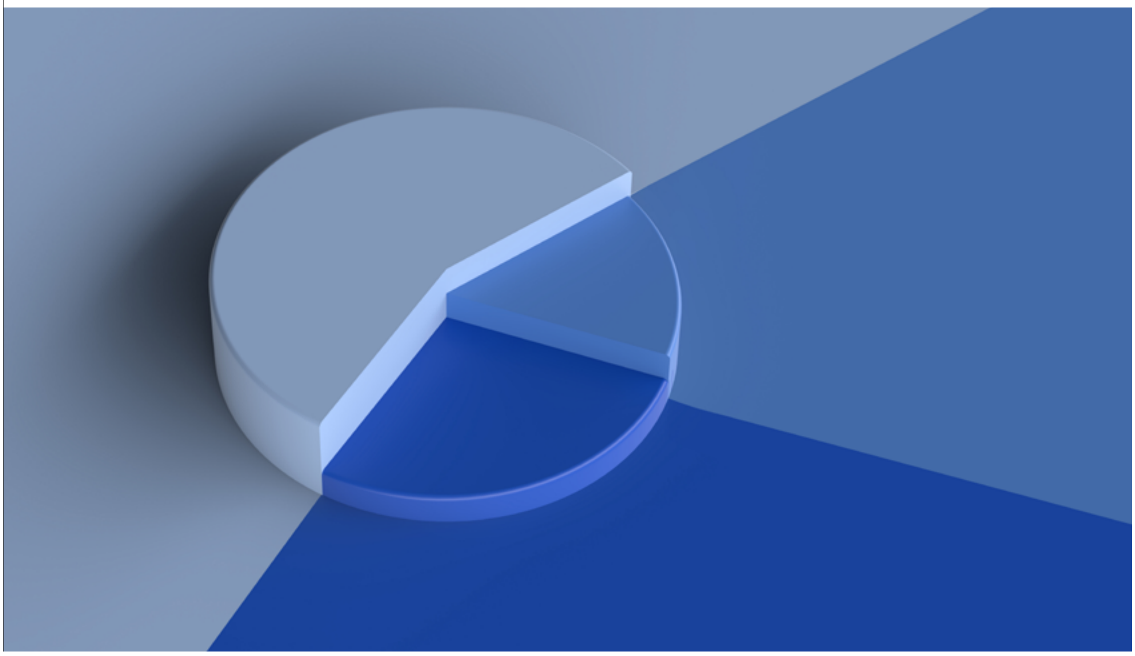
TABLE 2

Tools and frameworks used in impact measurement and management

Impact tools and frameworks	Respondents (%)
United Nations Sustainable Development Goals (SDGs)	72
IRIS Catalogue of Metrics	48
IRIS+ Core Metrics Sets	38
Impact Management Project (IMP) Five Dimensions	33
United Nations Principles for Responsible Investment (UNPRI)	30
IFC Operating Principles for Impact Management (OPIM)	26
B Analytics/GIIRS	21
Aeris CDFI ratings system	15
Sustainability Accounting Standards Board (SASB)	13
Global Reporting Initiative (GRI)	13
Harmonized Indicators for Private Sector Operations (HIPSO)	4
Global Alliance for Banking on Values (GABV)	3
Other	20

Note: n= 257; "Other" includes Social Performance Task Force/CERISE SPI4, Global Off-Grid Lighting Association (GOGLA) and Community Development Financial Institution (CDFI) certification systems.

Source: GIIN, *The State of Impact Measurement and Management Practice*, Second Edition, 2020, p. 37.



Before the widespread market adoption of industry standards and best practices, GPs and LPs operated in a highly fragmented ecosystem in which they were left to define what impact meant for them without guidance from standards organizations. Fortunately, this situation has changed and has led to greater maturity and predictability for LPs and GPs.

In addition, a more recent and positive phenomenon that has been gaining widespread market adoption is third-party verification[16] of impact fund adherence to the OPIM,[17] which is comprised of nine principles for impact investors to design and implement their impact management programmes. Having well regarded independent third parties verify a firm's impact investing process will promote greater rigour, accountability and best practices in the market, benefiting both LPs and the GPs managing impact funds.

LeapFrog

LeapFrog is an impact specialist with a focus on investing in Asia and Africa. The firm aims to invest in solutions that address the emerging consumer population in both geographies, defined as those that make under $11.20 per day on a purchasing power parity basis.

LeapFrog assesses investments during due diligence and works with companies post-investment to manage the businesses in an integrated fashion with profit and purpose integrated throughout the hold period. Impact targets are underwritten and further refined throughout the life of each investment using the firm's proprietary framework, which forms the core of the impact management and measurement system for driving financial returns and positive impact.

As part of its quarterly review process, LeapFrog integrates profit with purpose performance across the functions that review performance on an ongoing basis. The firm tracks and oversees the execution of incorporating purpose by implementing repeatable and impact-aligned processes as well as driving customized impact initiatives under specific impact themes.

5 Fund features

Competitive dynamics and a rising tide of best practices are leading to more rigorous and differentiated fund features.

As a greater number of impact and energy transition funds are launched, GPs seek to differentiate their platforms by adopting ever more robust and leading-edge fund features that aim to align incentives among GPs and underlying companies and to increase the adoption of impact management and measurement best practices.

Some of these features include impact-linked carried interest, longer fund lives and hold periods, enhanced data access rights, an even greater focus on collecting impact data and driving impact outcomes, and the memorializing of impact verification on an annual basis.

Alexandra Farmer, Head of ESG and Impact at Kirkland & Ellis, has observed that the industry "is seeing impact and transition fund features such as longer fund terms and impact-linked carried interest. Impact-linked carry in particular has become increasingly popular, though many aspects of these provisions can create complications if GPs are not receiving the right kind of advice to avoid issues down the line".[18]

On the topic of impact-linked carry, Simon Witney, Senior Consultant at Travers Smith, considers that the emerging trend to tie carried interest to impact performance has been an interesting development, "though it will take some time to see how those structures are implemented and tested as funds with impact-linked carry start to realize investments. The metrics used to inform those remuneration formulations are still disparate".[19]

Farmer has raised such questions as, "What percentage of carried interest is being put at risk? How many performance metrics are being tied to it and against what baseline? What targets are being set? How is reporting done across the fund? What occurs with the carry if targets are not met? If the GP decides to donate carried interest that is not achieved to a charity, then which one(s) should receive the proceeds and when is the charity determined?"[20] GPs are using all these types of fund features to differentiate their funds in the market.

The involvement of ESG and impact considerations at the fund formation stage has grown dramatically over the last three years. Farmer has also observed that, "while Article 8 or 9 categorization under the European Sustainable Finance Disclosure Regulation has become a frequent gating issue, the underlying focus of impact funds and the environmental and social products, services and business models of the companies in those portfolios is what distinguishes ESG from impact".[21] Witney also stated that regulation on impact investing, if properly designed and well-written, can "create a supportive environment for the private market impact and energy transition investment ecosystem. It can provide confidence to the LP community and can help standardize the reporting that investors receive from their GPs".[22] LPs want assurance that the reporting and the associated impact management and measurement that underlies it is done in a systematic and rigorous manner.

In addition, Farmer "has seen greater industry alignment around frameworks such as IRIS+, third-party verification of impact fund investment processes against the Operating Principles for Impact Management, and due diligence frameworks utilizing the five dimensions of impact within the impact management process".[23]

Finally, Witney considers that private market funds have a huge opportunity to drive greater impact outcomes due to how the asset class invests. "GPs are able to accelerate and report on impact in their portfolio companies given the nature of the private equity governance model and the strong relationships between GPs and LPs."[24] In the coming years, this should lead to greater appreciation and recognition in the market of many of the benefits of impact investing in private markets and the power that these new fund features can contribute to further accelerating impact outcomes.

Meridiam

As a dedicated infrastructure investor, Paris-based Meridiam invests to provide financial and extra-financial returns simultaneously. The impact key performance indicators the firm manages across its business are a subset of seven SDGs that are most relevant for infrastructure investments. Meridiam has integrated its extra-financial targets across all processes. The metrics focus on carbon emissions, employment, biodiversity preservation, wastewater treatment, renewable energy, circular economy and waste generation. Scores are developed using a questionnaire with over 200 questions (proprietary methodology called "Simpl").

Extra-financial return is embedded in investment criteria and in personal and team key performance indicators used for remuneration and, since the last generation of funds, the carried interest is aligned with impact targets and scores for a partial amount. Carried interest not earned by the firm is donated to a charitable foundation. The share of carried interest depending on extra-financial performance is increasing in France, with a growing share of the remuneration at stake. Current practice is around 10% and should grow to 25% or more in the coming years under the influence of the Paris Financial Center "Impact Charter" that is promoted across the French financial industry.

The firm also evaluates and analyses its entire portfolio against temperature-aligned pathways that go beyond setting Science Based Targets at the asset level. Meridiam invests heavily in emerging markets as part of its core strategy, including in Africa, which makes its impact more meaningful and drives outcomes for more underserved populations. And due to the firm's long-term hold period of 25 years, impact along the dimensions it focuses on can be driven and sustained over longer periods of time than a traditional 10-year infrastructure fund.

In terms of upcoming trends for the industry, Meridiam considers that additional focus will be needed on aligned investment team compensation, temperature-aligned portfolios where implied temperature ratings drop over time as decarbonization outcomes are achieved, longer-term holding periods during which more robust outcomes can be achieved, and increased capital flows into emerging markets.

6 Investment process best practices

With the advent of the Operating Principles for Impact Management in 2019, investment process and rigour have matured markedly.

GPs have begun to orient their impact investing processes towards the OPIM. The principles, now hosted by the GIIN, have driven greater industry alignment on repeatable best practices for impact screening, due diligence, company onboarding, management, measurement and the exit phases of each firm's investment process.

GPs starting new impact funds have taken on board the idea that these practices should be integrated into what are new impact assessment, management and measurement programmes. GPs with existing funds are also enhancing or aligning their investment processes to incorporate any aspects on which they may not have focused as intently in the past.

Impact due diligence and underwriting frameworks are becoming more robust and are leveraging tools such as the Impact Management Project's five dimensions of impact (What, Who, How Much, Enterprise Contribution and Impact Risk) more systematically.

Energy transition funds are more systematically not only tracking emissions and setting targets at company and asset levels but are also setting Paris-aligned business plans and delivering decarbonization solutions more widely across their portfolios.

The impact measurement of how many underserved customers are reached and outcomes are delivered to specific communities is becoming more widespread.

All this development and maturation will lead to greater comfort for LPs evaluating impact strategies. It also allows LPs to have a more regimented and consistent view of what practices should look like across the maturity spectrum as they underwrite blind pool impact funds. In addition, it provides an important signal to GPs that aim to launch their first impact fund, or a second or third fund where some of these practices may not have been in place when they launched the initial fund. This increased formalization and systematization is welcome and beneficial for the broader ecosystem.

Universities Superannuation Scheme

Since the Universities Superannuation Scheme (USS) announced its net-zero ambition in 2021, the UK private pension scheme has continued to embed ESG financial factors into the ongoing asset management of privately held investments, and to evolve its internal investment strategy to deploy new capital in the impact and energy transition sphere. In 2022, the Private Markets Group (PMG) conducted its first annual ESG survey of portfolio companies and put practices in place to provide alignment with third-party managers on a recurring basis.

As a large investor in the renewables space for multiple years, PMG carved out the investment strategy for renewables as a standalone strategy in 2022, highlighting the continuous focus in the sector. In addition, in 2021, USS announced a new £500 million Sustainable Growth mandate, with a focus on investing worldwide directly and through funds in "high growth, privately-owned businesses that are developing technologies and services that will help companies and the broader economy to decarbonise".[25] The new mandate has been seeded with a new commitment to an impact fund with whom USS has had a long-term relationship.

As the energy transition develops, USS will continue to explore attractive impact and energy transition secular trends that will generate long-term, attractive risk-adjusted returns for its members.

LeapFrog

LeapFrog's Responsible Exits Framework sets out a systematic method on how impact is considered, leveraged and positioned at exit. The process covers all impact factors and is presented as part of an exit note submitted to the firm's Investment Committee for approval.

The framework assesses whether the investment has met both its financial and impact targets and lays out the impact rationale behind the timing of a potential exit and the selection of a prospective buyer. LeapFrog's exit framework concentrates on aligning a potential buyer with the emerging market consumer focus of the portfolio company. In addition, the protection of employee rights and at-risk stakeholders are considered as well in order to attain long-term social impact. The potential partner at exit must align on these aspects, as well as on other quality indicators, for the exit to proceed.

Brookfield

Brookfield has developed a comprehensive impact management and measurement framework for BGTF. The framework guides activity across the full range of investing, from due diligence to operations and eventually sale.

As described by the Glasgow Financial Alliance for Net Zero, during the due diligence phase, “BGTF deploys four measures to ensure the investment meets the impact criteria for the Fund. For BGTF to invest, it must be able to align the investment to a sectoral emissions pathway consistent with the goals of the Paris Agreement; the investment (either through capital or operations) must provide additionality to what would otherwise occur; there must be accountability in emissions reporting enabling BGTF to track process against the plan; and the investment must be able to avoid or mitigate other related ESG risks.”[26]

During the ownership phase, Brookfield deploys a range of metrics to guide management activity towards the desired impact goals. For each investment, interim and long-term targets are set, and a business plan aligned with the goals of the Paris Agreement is developed incorporating the targets. Targets are identified using a credible methodology for the business or asset including, where available, the relevant sector decarbonization pathways. Regular reports on each investment outline progress against the plan and targets, GHG emissions and other investment-specific metrics identified in the screening phase and aligned with BGTF’s impact goals.

BGTF uses recognized standards and frameworks for measurement and reporting and is also a signatory to the OPIM. It publicly discloses its impact strategy and progress under that framework.

Consistent with its objectives, BGTF intends to create positive impact that is sustained beyond the fund’s ownership of assets and will look to invest in companies for which impact is intrinsically linked to sustainability at exit. Core to the firm’s transition investing thesis is that decarbonization and value creation can be aligned as the world accelerates towards net zero and greater energy security.

GIC

GIC, Singapore’s sovereign wealth fund, views the investment opportunities presented by the low-carbon transition as highly attractive. These include both companies with credible plans to shift from present carbon-intensive business practices to more sustainable business models as well as innovative climate solution providers enabling these firms – and the wider economy – to make the transition.

GIC’s climate tech investments focus on technologies likely to generate long-term value, including accelerating the energy transition or supporting industry decarbonization efforts through solutions such as energy storage, green hydrogen, carbon capture and storage or green steel. While GIC aims to identify opportunities to fund the adoption and expansion of these promising solutions early on, the fund considers that it is equally critical to actively engage companies on their transition plans.

As described by GIC on its website, in 2020, it “established the Sustainable Investment Fund (SIF) – a dedicated investment portfolio coordinated across the public and private market investment groups – to accelerate sustainability integration across all asset classes and to invest in sustainability-related opportunities that would generate good returns over time. SIF has since helped to catalyse additional department-led efforts in sustainability”.[27] This has enabled GIC to invest in decarbonization solutions across the capital structure and at different stages of growth through public and private asset classes.

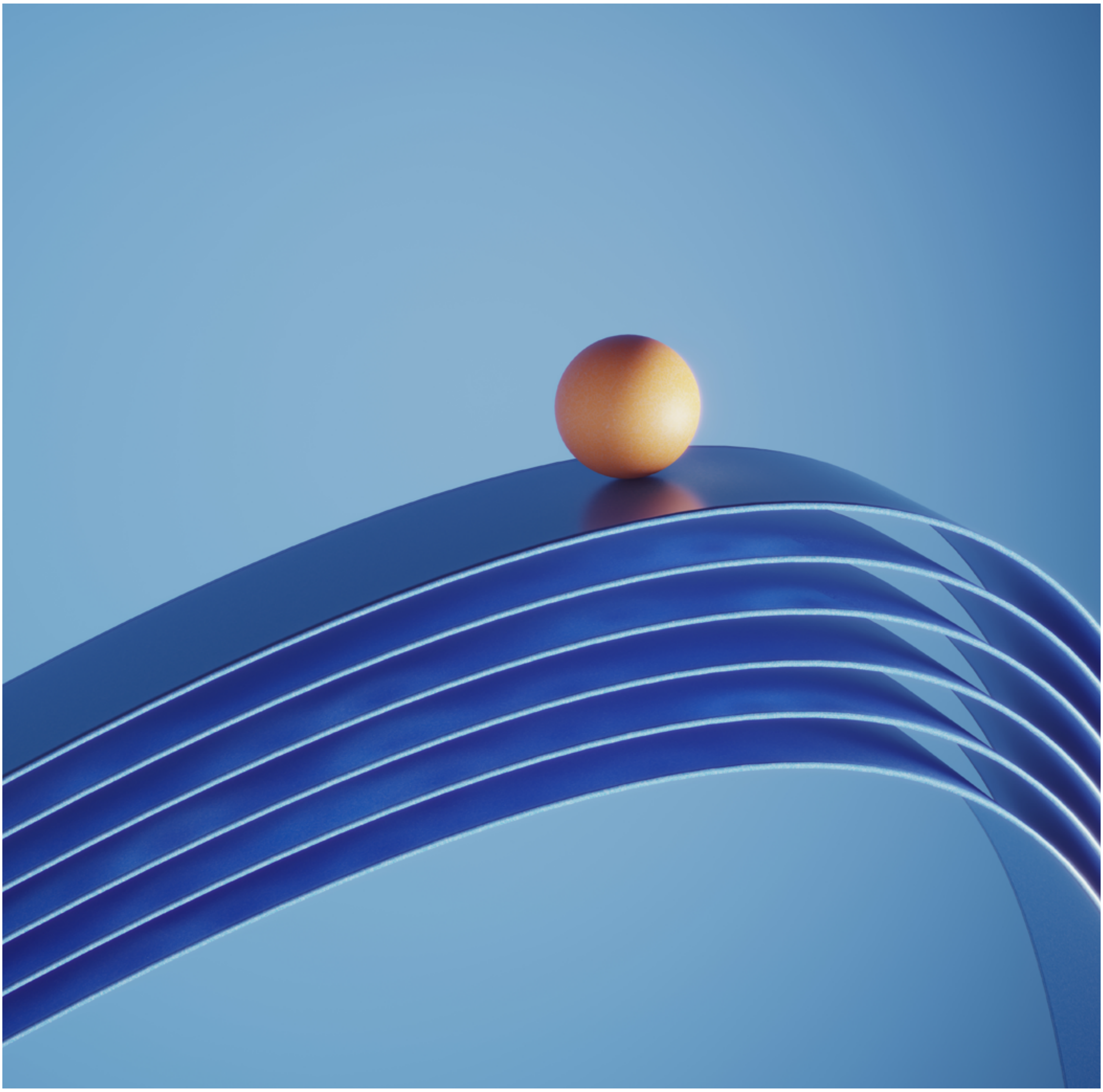
In its report on the management of the government’s portfolio, GIC states that its “Private Equity department established … a global portfolio of funds and direct and co-investments that provides exposure to early-stage energy transition opportunities. [It] focuses on innovations that accelerate the transition to sustainable energy, covering themes such as increasing electrification, enhancing energy and resource efficiency, and new decarbonisation solutions. … In parallel, the department has also made sizable commitments to climate-focused and impact funds with proven performance track records and established frameworks to measure and monitor their impact on the real economy”.[28]

GIC considers that every lever and every actor has a role to play in financing and driving decarbonization outcomes on a wide scale, including regulators, the private sector and consumers. GIC is cognizant of the fact that the decarbonization pathways will differ across sectors, industries and region as it evaluates future investment opportunities.

7

Impact and ESG interplay and transferability

Impact and ESG integration best practices are informing each other and being shared across GPs' traditional and impact platforms.



Many GPs with impact investing funds and businesses have used the rigour and lessons from their impact investing programmes and processes to inform and enhance their ESG integration efforts in their more traditional flagship funds. This usually takes the form of identifying ESG opportunities for specific companies and proactively examining ways to reposition select company business models to have more impact on people and the planet. The rigour of integrating impact throughout the investment life cycle from the earliest stages of diligence all the way to exit has inevitably led GPs to ask themselves what they can learn and incorporate from their impact experiences that could enhance their ESG integration programmes.

At the same time, ESG integration practices related to reducing negative externalities as well as focusing even more on managing ESG risks have also informed how impact investors can be more sensitive to material ESG risks that could negatively affect their impact underwriting or limit the positive impact that companies in their portfolio can provide over time. The focus around maximizing "net" impact has had the effect of embedding ESG integration best practices more robustly into impact due diligence and impact management and measurement processes.

Similarly, LPs have been looking at how they can foster more positive impact best practices into the traditional fund investments they make. The SDI Asset Owner Platform, in some respects, was designed for that very purpose and has seen even broader uptake beyond the original asset owners who sponsored that initiative.

Ultimately, more of this cross-pollination is likely to occur, and many of the fund features and best practices and the incorporation of impact into more traditional private market funds are inevitable and will likely continue apace in the next few years. In fact, it has become a hallmark for many GPs, even those that do not have impact funds but nevertheless wish to incorporate some elements of impact into their broader businesses.

EQT Future

EQT Future is an impact-driven fund focused on addressing global challenges to achieve impact on a wide scale while delivering attractive returns for investors. By applying the fund's Impact Toolbox, including impact value creation tools and the use of Impact Advisors and the fund's Mission Board, the fund invests in line with two specific impact themes: climate and nature, and health and well-being. In particular, EQT Future seeks to engage directly with portfolio companies via two pathways that are integral to generating net positive impact: identifying and incentivizing a pivot from the existing market offering at the time of investment towards products and services with a measurable positive impact; and/or expanding existing impactful products and services for greater reach and effect. Strong alignment also exists in the form of ESG-linked carried interest.

EQT is actively applying best practices from its Future Fund to enhance the work the firm is doing in other funds across its private capital platform. That includes provisions relating to ESG-linked financing, the assurance of ESG data, and more standardized use of ESG key performance indicators. EQT Future also intends to become a signatory to the OPIM, adding an additional layer of third-party verification specific to its impact systems and processes.

EQT Future is an example of how the firm places substantial focus on its work on ESG and impact outcomes. It considers that data collection by itself does not lead to future-proofed companies but that the measurement of outcomes will be increasingly important to reaping the benefits of sustainability integration and impact value creation work when looking to exit an investment. Ultimately, the firm aims to harness all the learnings and best practices deployed in EQT Future and deploy them across its broader platform in the future.

Conclusion

Despite exciting developments and a strong trajectory, far more work as well as momentum and alignment are needed to meet the challenge of the SDGs.

Despite the many positive developments in the area of private market impact and transition investing over the last several years, much work remains to drive more capital to address the SDGs and accelerate the transition to a low-carbon economy. Asset owners need to further understand and develop convictions about the long-term secular tailwinds and favourable trends these opportunities present. Likewise, GPs need to further develop their track records and attract even more impact and transition investing talent to expand their capabilities in these areas and raise larger pools of capital over time.

Many of these components will take time to build and cannot be accomplished overnight. Each asset owner and asset manager will develop their own views and build capacity in different ways and at different speeds. Any broader market slowdown could also marginally hold back progress. Developing and launching new products is not a decision that GPs take lightly; multiple years of work and discussions both internally and with clients can be required before enough comfort is established to launch a new impact or transition fund. Similarly, LPs that have never made an impact or transition fund investment need to observe and evaluate many potential fund offerings across asset classes from GPs they know well, and assess track records, prior portfolio construction, portfolio fit and many other criteria before they can take a fund investment to their investment committee. Finally, a steady flow of impact and energy transition-focused companies and assets are needed that can accept and deploy the proceeds of investment capital provided by GPs to profitably scale their companies and asset base. These components must be accelerated at the same time in order for the ecosystem to function and grow responsibly.

Nevertheless, both the supply and demand sides of the impact and transition investing equation have been moving in the right direction over the last five years and continue to accelerate. Regulatory drivers, such as the Sustainable Finance Disclosure Regulation in Europe, have increased demand and alignment on product standards and features. More established impact and transition investing franchises from more GPs with LPs that have supported multiple funds in a specific series will enable greater uptake in this ecosystem, which will be accretive to fund investors and will drive real-world improvements with a positive impact on people and the planet.

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