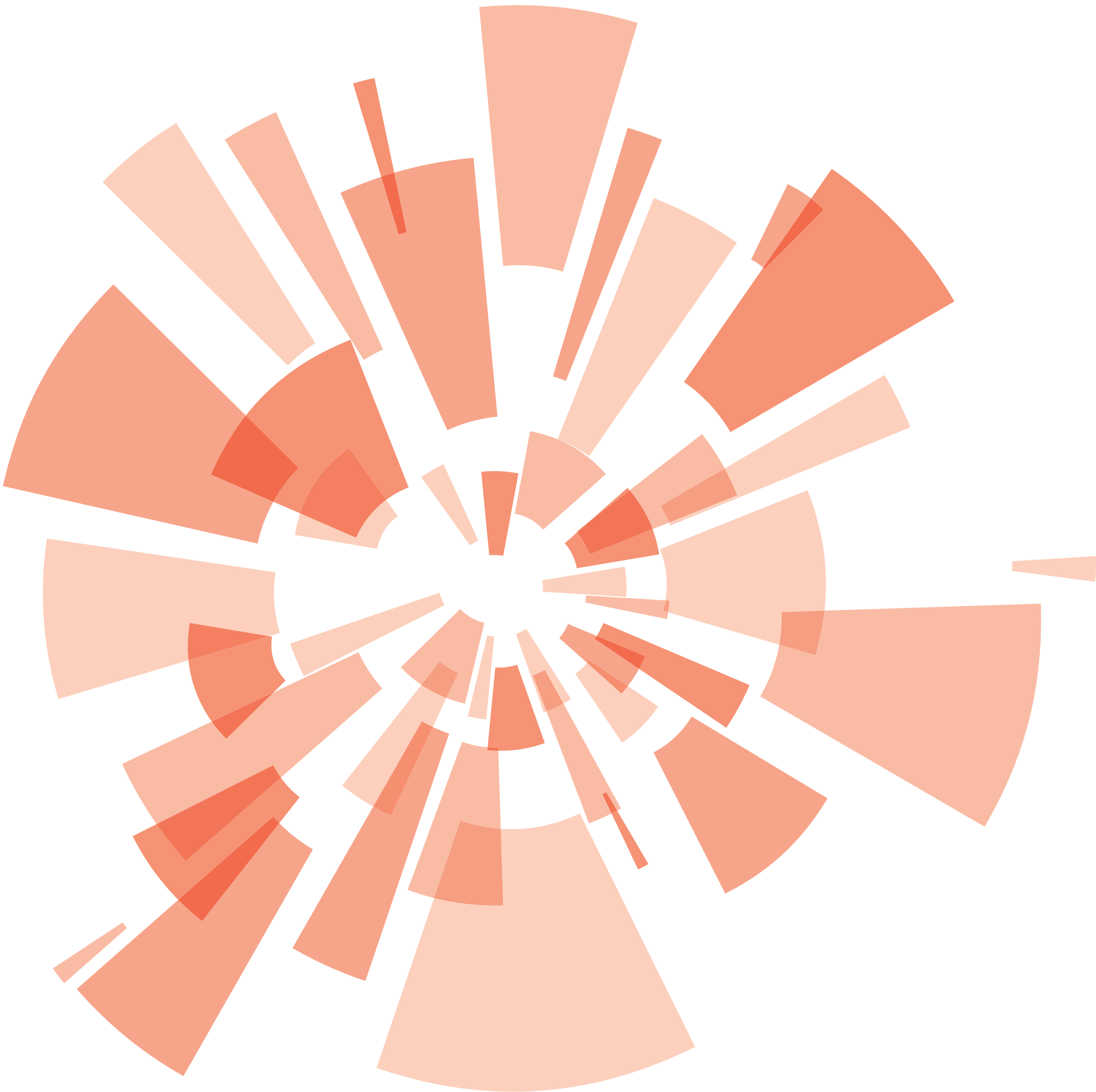
FINANCE FOR TOMORROW
by Paris Europlace

PARIS FINANCIAL CENTRE IMPACT TASK FORCE

DEFINITION OF IMPACT FINANCE



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EXECUTIVE SUMMARY

To achieve the Sustainable Development Goals and those of the Paris Climate Agreement, and provide answers up to the challenges, **our ways of thinking and acting must evolve because the ecological, energy and solidarity transition requires transforming the real economy: financial actors must use all the resources at their disposal to contribute to it.**

In this context, Impact Finance is experiencing significant development. There is a strong historical record in France, with pioneering actors in solidarity finance who have demonstrated their robustness. In its market assessment, FAIR (ex Finansol- iiLab) estimates that the French impact investment market reached 4.4 billion euros of assets under management as of December 31, 2019, with an annual growth of 9%. **Faced with the urgency of the ecological and social crisis, the current challenge is to find the levers that will allow the development of Impact Finance, across all financial asset classes.**

Finance for Tomorrow launched in March 2021 a Paris Financial Centre Task force dedicated to Impact Finance at the request of Minister Olivia Grégoire, Secretary of State in charge of the Social, Solidarity and Responsible Economy to the Minister of the Economy, Finance and Recovery. It now gathers more than 80 institutions from the Paris financial centre within four working groups focusing on (i) the definition, (ii) the measure, (iii) the conditions for development and removal of barriers, and (iv) the international promotion of the French vision of Impact Finance.

The first mission of the Paris Financial Centre Task force is to propose a vision of Impact Finance which would allow to expand its reach, without ever giving up on its integrity. **Work on the definitions and development of Impact Finance has been underway for several years in France. The objective of the tasks carried out by the Paris Financial Centre Task force under the aegis of Finance For Tomorrow is to bring together the Financial Centre visions and practices, but also to ensure the applicability of the definition to all types of financial products and asset classes, to unite players around a common ambition.** Finance for Tomorrow led the reflections of a working group dedicated to the definition of Impact Finance based on the reference work of the iiLab (now FAIR after the merger with Finansol) and the French Sustainable Investment Forum (FIR) with France Invest, whose publications have enabled concrete progress towards a common understanding of Impact Finance in France, by defining its characteristics and pillars.

This work was made possible by the engagement of the co-pilots Thierry Sibieude, Professor of the Entrepreneurship and Impact Innovation Chair at ESSEC and Caroline Neyron, Managing Director of Impact France; which were supported in their work on the one hand by the pilots of the Paris Financial Centre Task force, Philippe Taffin, Director of Investments of Aviva France and Xavier Ploquin, Chief of Staff of the Chairman and CEO of Meridiam, and on the other hand by the engagement of professionals from more than 25 institutions in the Paris Financial Centre who contributed to the discussions and shared their expertise to reach a consensus.

We believe that impact investing should be based on a definition that applies to all types of financial products explicitly committed to an impact approach, from solidarity finance to new entrants. This definition enables to position financial players with different levels of commitment. The nature of the funded assets, which determines an important part of how each investment / financing product can have a social or environmental impact, must be fully taken into account in assessing its potential beneficial effects. Considering the type of asset class, each investor / financing institution then has the responsibility to define its objectives in terms of social or environmental impact, to ensure the compatibility of the sought financial return with these objectives and to demonstrate the beneficial effects of the strategy implemented.

At the conclusion of the working group's discussions,
Finance for Tomorrow proposes the following definition:

Impact Finance is an investment or financing strategy that aims to accelerate the just and sustainable transformation of the real economy, by providing evidence of its beneficial effects.

It is based on the pillars of **intentionality, additionality and impact measurement,** to demonstrate:

1. The joint search, over time, for an ecological and social performance and a financial return, while controlling the occurrence of negative externalities;

2. The adoption of a clear and transparent methodology describing the causal mechanisms through which the strategy contributes to the targeted environmental and social objectives, the relevant period of investment or financing, as well as the measurement methods – according to the concept of theory of change.

3. The achievement of environmental and social objectives aligned with frameworks of reference, in particular the Sustainable Development Goals, defined at the international, national and local levels.

This definition is meant to be inclusive insofar as **it can be applied to all types of financial products engaged in an impact approach,** from pioneering solidarity finance actors to new entrants in this process. It can cover both listed or unlisted investments, but also financing and lending, subject to meeting the criteria of the definition. It is also ambitious, making it possible to position financial actors with different levels of commitments, in a clear and transparent manner.

The core of the definition of Impact Finance is the «just and sustainable transformation» of the real economy. It must anchor the challenges of sustainable development in all components of companies and projects and thus promote this transformation of the real economy. The transformation must necessarily be **demonstrated by evidence based on objectifiable and transparent elements.** In this regard, the definition explains the difference between responsible finance, which focuses on processes and risk management, and Impact Finance, which materializes in the **three pillars recognized by the market and anchored by the work of FIR / France Invest:**

— **intentionality**, which corresponds to the financial actor's willingness to contribute to generating a social and/or environmental benefit as well as the company that installed at the heart of its model of activity the achievement of one or more objectives of sustainable development ;

— **additionality**, which corresponds to the particular contribution of the financial actors allowing the beneficiaries of the investment/financing to increase the impact generated by their activities ;

— **measurement**, which refers to the assessment of environmental and social effects in the real economy on the basis of the objectives announced under intentionality.

First, the definition emphasizes the joint pursuit of ecological and social performance, but also of a financial return greater than or equal to zero, with a minimum of capital preservation, in order to honor fiduciary responsibilities. Indeed, in the different definitions of Impact Finance, it is always indicated that these are neither donation operations nor philanthropy. Therefore, it is the responsibility of each investor/financier to define his objectives in terms of social or environmental impact, and to ensure the compatibility of the sought financial return with these.

The success of an Impact Finance strategy is also conditioned on **controlling negative externalities** to produce a positive «net impact». This logic is based on European regulations on sustainable finance in which the Do Not Significantly Harm (DNSH) principle is now the minimum required. No activity or investment can be considered to have a positive impact if it has significant negative impacts on another environmental or social criteria. The definition is thus fully consistent with the main principles of European regulations on Sustainable Finance (Green Taxonomy, SFDR, etc.).

Secondly, the definition recommends using the **"Theory of Change"** framework, which is a strategy for planning actions, linked by a causal chain from the initial decision of the financial actor to the impact for the final beneficiary. Certainly, the effectiveness of impact strategies and the additionality of the financial actor will depend on the chosen methods it uses to generate impact (engagement policy, adjustment of returns, development of new markets, etc.). These must be considered prior to the investment or financing decision, transparent, justified and regularly reviewed.

The financial actor must also assess what is **the most relevant investment or financing horizon with regard to the objectives he seeks to achieve** to ensure the materialization of impact. The idea is to **avoid a short-term view** and enable impact management throughout the investment or funding cycle. In this context, the adoption by financial actors of a long-term vision, capable of producing lasting beneficial effects, provides a guarantee to their economic partners and supports sustainable economic development. The holding time of assets by investors or the time it takes to finance a project are therefore key matters on which the financial actor must propose an approach consistent with the targeted objectives. The interests' alignment of the various stakeholders (funder/beneficiary of the investment or project leader/final beneficiaries/final savers) is therefore necessary to be able to respond to the different impact and profitability issues.

Finally, in a third step, the definition emphasizes **reference frameworks, including the Sustainable Development Goals and the shared horizon of the Paris Agreement.** Indeed, systemic objectives have been put in place, accompanied by quantified targets over defined time horizons which can only be achieved by a **global effort**. The impact objectives set by financial actors must meet the demands and therefore the international objectives, defined locally. The transition cannot be achieved by a single actor and can only be made possible through collective action and cooperation at every stage of the impact value chain. From this perspective, this vision of Impact Finance naturally calls for a stronger alignment of interest between political and civil actors, businesses and financial actors.

The aim is for French financial actors to adopt this vision in order to develop it in the practice. As a reference for the future work of Finance for Tomorrow, it allows to concretely express the common ambition for Impact Finance of the Paris Financial Centre actors.

This common vision of Impact Finance is:

— **Holistic**: the effects produced by each stakeholder on the entire value chain of the impact (investor/beneficiary of the investment or financing/final beneficiary) on all sustainable development issues are taken into account; negative (externalities are controlled) as well as positive (the financial actor determines and implements the actions necessary to achieve a certain level of transformation of the real economy).

— **Systemic**: the impact objectives pursued are part of collective reference frameworks understandable and accessible to all actors.

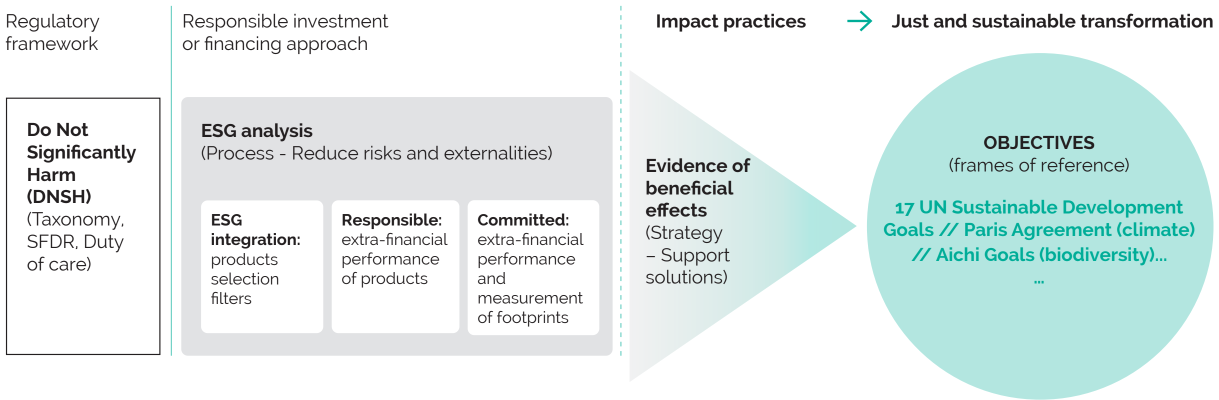
— **Dynamic**: impact strategies are managed throughout the investment/financing cycle in a logic of continuous improvement.

The objective of Finance for Tomorrow is thus to encourage the development of Impact Finance within the financial sector, to accelerate the just and sustainable transformation of the real economy. The challenge is to scale up impact finance, without ever giving up its integrity, based on a holistic, systemic and dynamic ambition, to respond effectively to ecological and social emergencies.

Finance for Tomorrow provides supporting material associated with the definition:

→ Schematic representation:

REPRESENTATION OF IMPACT FINANCE



Source: Finance For Tomorrow: visual based on the contribution scale proposed by iiLab, in the report «Investing for a sustainable transformation» and the reflections of the Paris Financial Centre Task force

→ Reading the schema:

— The ground of sustainable finance is now the European legal principle "**Do Not Significantly Harm**" (DNSH): significant negative externalities must be controlled.

— The gradation of sustainable finance practices expresses the **consistency needed between responsible practices and impact research.** Compliance with the regulatory framework, the analysis of extra-financial risks and the implementation of an **ESG analysis** are the necessary foundations supporting impact practices.

— The shift to impact is characterized by the **proof of beneficial effects** for society and the real economy. The **arrow illustrates an action**, which aims for effects (intentionality) to achieve **systemic environmental and social objectives** (additionality and measurability).

→ Introduction to the "Table of operational issues in Impact Finance":

In order to support financial actors looking to engage in an Impact Finance dynamic, and to help them position themselves according to their engagement level, the group also produced a summary table of Impact Finance's key issues. This table constitutes guidelines reminding the main principles of Impact Finance, according to the pre-established definition.

Based on the three pillars of impact, these guidelines present the main principles to be followed on the control of negative externalities, the place of impact in the financing and investment processes and finally to guarantee the performance of the just and sustainable transformation of the economy. It constitutes a means of operationalizing the previously-mentioned definition, and of clarifying for all stakeholders the key issues underlying the level of integration and involvement of each financial actor in this dynamic.

Table of Operational Issues in Impact Finance

		Control negative externalities	Establish the place of IMPACT in the processes	Realize the performance of the just and sustainable transformation
Intentionnality	How to develop a strategic vision?	**Carry out a rigorous and exhaustive extra-financial analysis, based on ESG criteria** and a materiality analysis, with transparency on the methods used for the resulting investment / financing decisions.	**Ensure the place of impact in the investment thesis and in the strategic project of companies/projects supported** (setting of impact objectives and monitoring indicators). It requires compatibility between ecological and social performance and financial return. This can also be reflected in the search for official approval (status of company with mission, ESUS approval) or by the formalization of an internal charter for the company.	**Formulate objectives for the just and sustainable transformation of the real economy,** based on a clear and transparent methodology including a method for monitoring the achievements, results and impact of the financial vehicle and beneficiaries (Theory of Change).
	What frames of reference should be mobilized?	**Develop aligned CSR practices within the funder and the funded institutions:** compliance with international conventions, the PRI, European regulatory frameworks, in particular the "Do Not Significantly Harm" (DNSH) principle of the Taxonomy regulation and the main negative impacts (Principal Adverse Impact) of the SFDR regulation. The investor can also rely on a specific framework that he deems relevant (e.g. IMP, impact score, impact.gouv.Fr, etc.) to manage negative externalities.	Match investment/financing practices and policies to **regulatory frameworks** for sustainable finance. For example in Europe: "Sustainable Finance Disclosure Regulation" (art. 8-9) and environmental objectives of the European Taxonomy of sustainable economic activities	**Embed sustainable transformation goals in systemic international, national and local frameworks of reference.** Cf. Paris Agreements, Nagoya Agreements, UN Sustainable Development Goals, etc.
	How to manage the impact dynamically?	**Establish a governance dedicated to limiting negative externalities:** dashboards for monitoring relevant ESG indicators, objectives of remediation and improvement actions over time, awareness and training of management and employees on ESG issues.	**Set up an alignment of interests in the funder/funded relationship** (e.g. shareholders' agreement, financing agreements, etc.): transparency on objectives pursued and time horizons, rates of return on investment, sharing value and expected impacts; variable compensation is partly determined by impact criteria.	**Set up a governance for monitoring impact,** including various stakeholders solicited for the validation of objectives and monitoring of achievements, and planning commitment actions.
Additionality	How to develop a strategic vision?	**Ensure the control and/or reduction of negative externalities** by each beneficiary/issuer (in particular according to the 17 SDGs) and at the portfolio level.	**Analyze each financing/investment according to the objectives of sustainable transformation pursued** in order to provide appropriate assistance to support the potential of each beneficiary and implement a process to demonstrate the extent to which it contributes to this transformation. For example: providing flexible capital, issuing impact signals, adjusting the risk/return ratio, developing new markets, etc.	**Adopt a "portfolio vision":** commit all the assets in the portfolio to a positive impact approach.
	What frames of reference should be mobilized?	**Pilot the development of CSR practices of the asset management company and of each beneficiary/issuer** with the objectives of sustainable transformation of financial products, throughout the life cycle of projects.	**Include impact financing within recognized frameworks to guide investment policies.** E.g. - for financial vehicles: label funds (Greenfin, FAIR, EU Ecolabel), align with the french AMF 2020-03 doctrine, etc.; - for companies: CSR labels, mission statement, ESUS, etc.	**Mobilize sources** (for example, empirical demonstrations or clusters of indices) to illustrate and explain the effectiveness of the impact projects implemented, that is to say the tangibility of the sustainable transformation.
	How to manage the impact dynamically?	**Commit over the entire project cycle, up to the exit stage,** with transparency on the investment/financing horizons, over a period necessary to generate the desired impacts from a long-term management perspective.	**Establish a commitment policy in order to strengthen impact strategies,** in direct relation with the beneficiaries/issuers over the long term. For example: voting rights, active dialogue, listening to stakeholders, etc. Concerning private equity: with attention to the pursuit of impact research by the successor. Other asset classes: post-divestment commitments.	**Continuously improve the monitoring** and control of the implementation of development strategies or the just and sustainable transformation of funded projects (e.g. strategic plans, CapEx, territorial policies, decarbonization, ecological R&D, etc.).
Measuring	How to develop a strategic vision?	**Make the chosen monitoring indicators consistent** with the causal chain initially expected from the strategy, throughout the impact value chain.	**Monitor the effectiveness of the funder's actions** by consolidating the performance of portfolio assets (data collection according to the indicators defined in the strategy), by differentiating the results of the companies invested and the role of the investor/funder.	**Demonstrate the adequacy and ambition of the target values of each indicator** to measure the achievement of the sustainable transformation objectives pursued by the product.
	What frames of reference should be mobilized?	**Consolidate the overall product footprint** for each relevant indicator according to the initial strategy, with at least a carbon footprint (including: life cycle analysis, Scope 3 & avoided emissions) and monitoring of social issues (including: Professional Equality Index, Index Diversity, legitimate repositories, etc.).	**Monitor the achievements** and impacts of portfolio companies to ensure that the consolidated results and impacts at the portfolio level are consistent with the transformation objectives sought. To do this, the choices concerning the level of granularity, the data sources used and the methodologies for collecting and consolidating the data portfolio must be made explicit.	**Express the degree of success** of the sustainable transformation strategy compared to the objectives initially set, in consonance with the monitoring of indicators and according to the chosen reference framework, notably the SDGs.
	How to manage the impact dynamically?	**Develop transparent annual ESG reporting**, allowing to make public the control process for managing negative externalities and unexpected risks.	**Publish an annual impact report**, robust and genuine, useful to all stakeholders and expressing the effectiveness of the actions implemented by the product - in particular to justify any variable compensation for executives.	**Critical review by independent third parties**, ensuring in particular the consistency of strategies, results and contribution actions carried out, with what was planned in the supporting documents.

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