The Impact Investing Roundtable
Co-hosted by
the Financial Services Agency of Japan
and
GSG NAB Japan

Achievements in the First Phase and Challenges Ahead

Ⅰ. Introduction

Established in June 2020, this Roundtable is aimed at deepening the understanding among public and private sector stakeholders who constitute the impact investing ecosystem and discussing the significance of, and challenges faced by, impact investing initiatives intended to address social and environmental challenges at home and abroad. Its participants include financial institutions, business companies, consulting firms, think tanks, and relevant organizations and ministries. At its first to third sessions, discussions were held under the following themes: definition and objectives of impact investing; initiatives being undertaken by participants and positioning thereof (views on the relationship among risk, return, and impact); challenges faced by the participants; and Impact Measurement and Management (hereinafter "IMM"[1]). As a result, it was made clear that different players have different perspectives towards impact investing, and that each asset class has distinctive features and its own characteristics. The succeeding fourth to sixth sessions focused on asset class specific themes to have more detailed discussions, namely, "impact investing in unlisted companies," "impact investing through listed equities and bonds," and "impact investing through loans and community finance." By joining the cross-industry forum offered through the Roundtable, participants acquired understanding about impact investing, IMM, and the characteristics specific to, and common to, respective asset classes. The forum also helped the participants to have a clear idea about common challenges that should be addressed for the promotion of impact investing and matters to be discussed constantly in the future. This paper is designed to summarize the results of the discussions at the Roundtable's sessions (June 2020 through September 2021) and outline the challenges to be dealt with henceforth.

Ⅱ. Key Discussion Topics

1) Discussions and issues common to all asset classes

First, attendees expressed two different types of views on impact investing: one group viewed impact investing as an extension of ESG and/or responsible investing; the other group considered that impact investing was different from ESG investing as the former was designed to pursue certain positive impacts. Characteristics of impact investing pointed out by attendees include: it is an investment or a loan intended (intentionality) to create impact and address social and environmental challenges; and impacts created through impact investing are subject to measurement and management.

In impact investing, great focus has been placed on the impact assessment (also called as social impact assessment), which aims to quantitatively and qualitatively assess impact created by a business and evaluate its social value. The attendees shared the following perspectives: in recent years, Impact Measurement and Management (IMM) has been recognized as the dominant approach; the term IMM is used to make a clear distinction from the term "impact assessment," which is used in the strict sense in the academic discipline of evaluation; and the aim of IMM is to make constant improvements to the impact generation by not merely monitoring the achievement of impact goals and determining the value thereof, but by

[1] IMM places its focuses not only on the measurement of impact but also on its management. The Global Impact Investing Network (GIIN) defines IMM as follows: "Impact measurement and management (IMM) includes identifying and considering the positive and negative effects one's business activities have on people and the planet, and then, it is a repeated process of figuring out ways to mitigate the negative impact and to maximize the positive impact in alignment with one's goals, and carrying out the ways."

improving the business and making decisions based on the information obtained therefrom.

It was also pointed out that management and engagement with investees with focus on the impact generation are important.

In performing IMM, it is important to integrate IMM across the investment/financing process as a whole. However, approaches for performing IMM are still under development. Financial institutions who had worked out their own way to perform IMM offered their practices to the attendees as case studies to share. Some mentioned the importance of performing IMM considering both the level of individual investee companies and the level of the portfolio. Issues raised in relation to the performance of IMM included the need to consider the design of the framework for specific products and/or investees, in addition to the development of in-house systems and human resources, costs, and so forth. There was another opinion that, in order to smoothly perform IMM, it would be important to obtain impact and other non-financial information held by corporations.

Furthermore, others opined that, in impact investing, while investors would be required to have a clear intention (intentionality) to create an impact, what's important for financial institutions to achieve the investors' intentionality is to include the "impact orientation" in their organizational raison d'etre (purpose) and have an intention of the management at the financial institutions for the achievement of impact, such as developing investment strategies, strengthening organizational structure by fostering human capital, and securing required resources.

In addition to financial institutions, investees and loan recipients should also have the intentionality for the creation of impact. It was pointed out that, both sides need to engage in sufficient dialogue with each other about their intentionality and impact to be generated regardless of the asset class.

2) Discussions and issues by asset class

Impact investing in unlisted companies

Overview

The impact investment market has been led by private equity investments—specifically, impact investments through private equity funds and direct investments in unlisted companies. Case studies of the former reported at the fourth session were the "Triodos Food Transition Europe Fund" managed by Triodos Investment Management BV and the "Hataraku Fund" managed by Shinsei Corporate Investment; a case study of the latter was the implementation of direct investment into venture firms by the Dai-ichi Life Insurance Company, Ltd.

Key Discussion Topics

- Impact investing is premised on the intention (intentionality) of fund providers (investing bodies) to create impact. Some referred to the importance of managing the investment process as a whole based on designing the Theory of Change (ToC) and logic model[2] not only to monitor the achievement of impact goals set against KPIs and track records thereof, but to improve the impact generation process and enhance the quality and quantity of impact.

- From the perspective of impact generation by investee companies, the investee companies are also required to have the intention (intentionality) to generate impact. Accordingly, it is critical for both investors and investee companies to hold dialogue with each other and align their impact generation strategies and KPIs. Some opined that, in doing so, they should have a perspective of seeing impact as a source of generating mid- to long-term corporate value, as well as a perspective of taking the balance between impact and economic return.

- Ideas put forward to drive deal flows include: sharing case studies in which a positive cycle between economic returns and impact has been identified; considering a mechanism to attract diverse players such as buyout funds, foundations, and angel investors; finding measures to encourage venture investments and entrepreneurial ventures that may become a prospective investee; and exploring a mechanism for blended finance in which risks are shared by the public and private sectors.

- There was an opinion that, as an exit strategy for impact investing in unlisted companies, it would be important to design IPOs, M&As, and diverse exit scenarios in a way that could allow companies to maintain and increase impact even after the sale of shares.

Impact investing through listed equities and bonds

Overview

In recent years, impact investments into listed equities have been on an increasing trend compared to other asset classes. Similarly, the total amount of issuance of domestic green bonds, social bonds, and sustainability bonds has increased sharply year-on-year by 75% to over two trillion yen in 2020.[3] Case studies reported at the 5th session included “BlackRock Global Impact Fund,” an overseas listed equity impact fund by BlackRock, along with “Resona Local Impact Fund,” a domestic fund established in 2021 by Resona Asset Management Co., Ltd. for Japanese stocks, and SDGs bond initiatives by Daiwa Securities Co., Ltd.

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[2] According to the first edition of the “Guidebook for Impact Measurement and Management for Impact Investment,” which was published by the Japanese GSG National Advisory Board’s IMM Working Group in May 2021, the Theory of Change (ToC) is a comprehensive diagram that exhibits how and why desired changes are expected to occur in a particular context. The logic model is a systematic diagram of the path toward the achievement of changes and results a business or organization ultimately aims at; and a strategy of through what process the business intends to achieve its goals.

[3] Japan Securities Dealers Association

Key Discussion Topics

- Attendees opined that engagement with prospective investees must be promoted, as whether or not they have a social environmental impact perspective, the driving force to address social and environmental challenges, would be an important criterion when selecting portfolio companies for a listed equity impact fund.

- There was also a comment that, when engaging with listed companies, dialogues should be held between the fund manager and portfolio companies focusing not only on the impact generation perspective as mentioned above, but on the raison d'etre (purpose) and intention. (Some dialogues could prompt awareness of impact that are not intended by the portfolio company side.)

- While a significant global shift has been seen towards standardizing requirements for listed companies to disclose non-financial information, including impact generated through corporate activities, Japan is still in an under development stage with regard to the disclosure of listed equities' non-financial information. There was an opinion that it would be necessary to demonstrate the fact that impact generation is the source of improvement in future corporate value, by presenting hands-on examples.

- Attendees also discussed the importance of additionality, i.e. the perspective of whether or not an impact is generated if the business or investment would have not been undertaken. An opinion was expressed that it would be important to pursue not only the additionality offered by portfolio companies by creating impact that satisfies needs that cannot be satisfied by other companies or the government, but also the additionality provided by investors by encouraging companies, through engagements, to perform IMM and promote impact so that the investors themselves can contribute to the generation of impact.

- An attendee opined that, with regard to IMM for bonds, Japan had not reached that level in terms of dialogue with issuers, and therefore, the priority should be placed first on reaching agreement with issuers on the purpose and intention of issuance.

- Attendees expressed various opinions concerning the way of bond structuring including the appropriateness of, as an incentive for investors, the mechanism designed to increase a sustainability link bond's interest rate if the issuer fails to meet their sustainability performance targets (SPTs), although they could understand the use of mechanism as an incentive for the issuer to achieve its SPTs.

- There was an opinion that in order to expand impact investing in listed equities, it would be important to find new individual investors, develop a mechanism to reflux funds from the elderly to the younger generation, improve the quality of information dissemination, and engage with investors.

- An attendee commented that it would be important for listed companies to disclose non-financial information including impact, in order to reduce the cost of IMM in impact investment (in equities/bonds) products for listed companies.

Impact Investing through Loans and Community Finance

Overview

With the dissemination of the concept of Positive Impact Finance (PIF) by UNEP FI,[4] the impact perspective has been rapidly introduced to the banking sector through the Principles for Positive Impact Finance and the Principles for Responsible Banking.[5] In Japan, against the background of progress in the ESG regional finance, regional financial institutions are actively engaged in initiatives to address regional issues through finance.[6] At the 6th Roundtable session, some case studies of impact-oriented loans and community finance were reported. Specifically, they include an overseas initiative launched by Calvert Impact Capital, as well as domestic examples implemented by Sumitomo Mitsui Trust Bank, a major financial institution, and those undertaken by two regional financial institutions, namely, Dai-ichi Kangyo Credit Cooperative and Shizuoka Bank.

Key Discussion Topics

- Some attendees remarked as follows: Loan is regarded as a very important tool considering Japan's overall flow of funds. There exist certain differences between large financial institutions and regional banks, Shinkin banks and credit associations in terms of their goals—the former aims to address social and environmental challenges on a global scale, while the latter intends to contribute to the solution of regional and community issues. However, impact investing through loans and regional finance could play a very important role in increasing corporate value and building a sustainable society.

- Local financial institutions play a significant role in revitalizing local economy that faces the challenge of declining population, including the issue of business succession at small and medium-sized enterprises that serve as a local employment platform. Accordingly, local financial institutions can make use of their position by emphasizing their contributions to the revitalization of regional economy as their track record of impact generation. Attendees opined that it would be important to promote initiatives bearing this advantage in mind, in collaboration with the government and regional organizations along with other players across the region including specialized institutions, such as universities and local employers' association.

- Some expressed concerns over the issues associated with PIF, in terms of the way of measuring and managing impact and incorporation thereof into the examination criteria. An opinion was expressed that a realistic approach should be applied when providing, in particular, regional finance, considering attributes of financial institutions involved and constraints faced by borrowers.

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[4] Finance in alignment with the Principles for Positive Impact Finance Principles established by UNEP FI (United Nations Environment Program and Financial Initiative), a close partnership between UNEP (United Nations Environment Program) and more than 200 banks, insurance and securities companies worldwide. The Principles for Positive Impact Finance consist of four principles: Definition, Frameworks, Transparency, and Assessment. They are common financial principles that lead financial institutions' efforts to increase positive impacts on economy, environment, and society towards the achievement of SDGs.

[5] Principles formulated by UNEP FI in September 2019 to ensure that banks are in alignment with the vision set forth by society for the future in the Sustainable Development Goals and the Paris Climate Agreement.

[6] Discussions at the "ESG Regional Finance Task Force" established under the ESG Finance High Level Panel set up by the Ministry of the Environment.

- A comment was raised that, in order to further promote PIF in the future, banks would need to revise their criteria for corporate value measurement, by incorporating, for example, impact-related aspects into the assessment criteria. Such efforts would probably lead to the innovation of regional financial institutions' business model. At the same time, banks should not stick only to the evaluation of financial risks and returns based on the company's past business performance, as was done in the conventional banking operations.

- A remark was raised that engagement and impact management should be conducted from both perspectives of the entire portfolio (for example, analysis of sectors with significant impact) and individual portfolio companies. Furthermore, given that some companies operate in multiple sectors, the engagement process must be proceeded in a scrupulous manner by taking the business's whole picture into account.

III. Achievements So Far and Challenges Ahead

In this and previous sessions, attendees were provided with overseas up-to-date cases and practical examples of impact assessment. They also exchanged information and views about the importance of linking impact assessment to business improvement. As a result, they succeeded in acquiring a certain level of understanding on the fundamental significance of impact investing.

While we have seen an increasing balance of impact investments in Japan, there are some challenges that must be overcome to ensure a full-scale expansion of impact investing in the future.

The first challenge is the lack of widespread awareness that there are some cases where impact generation and financial returns are correlated. As a result, we have not yet established a virtuous cycle in which investors actively evaluate impact investments, in response to which companies carry out impact assessments (even at an additional cost) and disclose them to investors for their evaluation. In the next phase, we will therefore need to share and disseminate more information about good practices.

The second challenge is to increase such good practices by creating more investable projects and exploring a mechanism to attract more diverse players. Including asset owners who act as institutional investors and individuals who are the ultimate asset owners, overseas investors are widely known for their strong impact consciousness. They demand both impact generation and financial return from the standpoint of a pension or insurance holder. In Japan, asset owners and individuals still have only a limited awareness of impact investing. We will therefore need to increase their awareness and promote understanding. Furthermore, we have seen more investment activities that are intended to contribute to the sustainability of the global environment and economic society and are designed to monitor and manage the progress thereof, although the term "impact investing" has not been used by these investors. Considering this, it would be crucial to take them into consideration by seeking, for example, collaboration opportunities.

The third challenge is that the degree of development and required procedures of the IMM and other impact investment approaches differ depending on the asset class. Therefore, in the next phase, we must deepen our discussions by asset class for further advancement of impact investing practices. Given that IMM has a different degree of development depending on the asset class, we will need to embrace international frameworks and methodologies while widely sharing, within Japan, successful case studies in which the frameworks and methodologies have been incorporated into specific practices.

When incorporating them into specific practices, it would be important to: promote IMM and put it in place by providing IMM knowledge to financial institutions and related organizations that are already engaged in substantial impact investment activities; and use the knowledge obtained therefrom to deepen IMM. Furthermore, it would be necessary to continue discussions on how to develop the environment required for the smooth implementation of IMM. In particular, there has been significant progress in the international initiatives that encourage listed companies' disclosure of impact and other non-financial information. Japanese companies have also been making gradual progress in their voluntary efforts. Under these circumstances, we will need to investigate challenges we currently face and discuss the appropriate way of IMM for listed companies.

The fourth challenge is to participate in international discussions. Discussions are currently underway in an international scale about numerous guidelines, frameworks, indicators, relating to impact investing and financing. Japanese financial institutions are therefore encouraged to actively participate, at the practitioner level, in these discussions and gather information. At the same time, they will be expected to disseminate information about the Japanese impact investment market to international communities and play an active role in the rule-making process. We are committed to addressing these challenges as we did in the first phase. In the future, the public and private sectors must collaborate further in order to advance impact investing. Public authorities will need to implement initiatives to mobilize private funds. Examples of these initiatives include blended finance and the development of financing schemes in collaboration with local municipal governments. In the next phase, we will showcase the latest examples of these initiatives.

Impact investing is still in its early stages in Japan; however, it is one of the mechanisms developed to achieve a sustainable society by mobilizing private funds and thereby overcoming social and environmental challenges. We expect that, based on the debates held in the Roundtable, discussions and practices will be advanced for further development of impact investing. In the second phase, we will continue to discuss challenges identified and issues left unaddressed at the first phase of the Roundtable.

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