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Driving impact in listed assets investments

Impact investing is emerging as a powerful way of delivering financial returns while also tackling the world's biggest social and environmental challenges.

In this document, we examine impact investing, our approach and five pillars, and how we implement the United Nations' Sustainable Development Goals.

Yo Takatsuki,
Head of ESG Research and Active Ownership

Ian Smith,
Fund Manager, Framlington Equities

Executive summary:

- Impact investing is emerging as a powerful way of delivering financial returns while also tackling the world’s biggest social and environmental challenges. This is framed around the urgent need to deliver on the United Nations’ Sustainable Development Goals by 2030.

- However, there is intense debate as to how impact investing can be effective when implemented via listed assets. Challenges remain, such as the low availability of clearly defined key performance indicators and the lack of industry-agreed impact investing standards in listed assets. Despite these hurdles, we believe that impact investing can be carried out robustly across all listed asset classes, and that we can play a leadership role in influencing an industry common standard.

- In this document, we introduce and outline AXA Investment Managers’ approach to impact investing in listed assets. This is the approach adopted by our core investment team, which consists of Framlington Equities, fixed income and multi-asset.

- We propose two key approaches in terms of driving impact by investing in listed assets: allocating capital to 'impact leaders' and effecting change in 'transitioning companies', through a programme of focused investor engagement.

Impact investing: a simple but powerful asset class

Impact investing aims to be a win-win concept: investors enjoy potentially attractive financial returns while simultaneously having a positive outcome for broader society and the environment.

In simple terms, it's about investing in prosperity for people and prosperity for the planet.

In 1998, AXA Investment Managers (AXA IM) launched its first societal impact mandate, tackling unemployment by investing in listed small and mid-cap companies creating sustainable jobs in France. We now manage impact funds ranging from private investments to green bonds and listed equities, aimed at providing solutions relating to healthcare, climate change and social issues.

Through impact investing, AXA IM wants to enhance long-term returns, and this is achieved through the allocation of capital to avail unmet sustainability-related opportunities within large addressable markets. Alongside this, we aim to drive impact by leveraging our investor rights, to influence companies through engagement.

Impact investing is an idea which has grown rapidly in recent years. The United Nations' Sustainable Development Goals (SDGs), which were established in 2015 to address key global challenges including poverty, inequality, climate and health, have played a vital role in driving the impact agenda. There has been widespread adoption of the SDGs by a wide range of stakeholders – governments, businesses, financial institutions and not-for-profits – as a framework to assess unmet societal needs.

There are 17 SDGs, with clearly defined objectives, as well as 169 underlying targets to be met by 2030.

United Nations' Sustainable Development Goals.

For illustrative purposes only.

The roots of impact investing have been in venture capital and private equity. But over recent years the concept has evolved to include the rapidly growing green bonds market. As this investment approach moves further into the mainstream, there has been considerable debate in the asset management industry around how impact can be truly achieved by investing in publicly-listed equities and corporate bonds. While the underlying concept may be simple to grasp, doing it in a robust and thoughtful manner is challenging.

AXA IM's five pillars to impact investing

Our approach to impact investing in listed assets is built on five pillars. These pillars are what characterise impact investing and differentiate it from other approaches to responsible investing. Here are our key areas of consideration:

1. Intentionality: We consider this to be a critical element of what defines impact investing and to be a key differentiation point from other approaches to responsible investing. The idea is that investments should be made with an upfront objective of having a specific positive social or environmental outcome.

Investment managers must have the intention to create impact, through the allocation of capital to companies which are generating, or have scope to generate, meaningful positive sustainability outcomes via their business activities. Therefore, a portfolio should have a clear identity that exhibits the fund manager's targetted societal goals.

The investment manager can also seek to utilise their influence as an investor, to engage companies, and seek to generate impact through change.

2. Materiality: Many companies generate some positive outcomes for society and the environment. However, not all impact is equal. Our position is to invest in companies where the positive outcomes are of material significance to the beneficiaries, the company, or to both. Ideally a firm's initiatives should be of strategic importance and make up a material proportion of the companies' overall commercial activities (what might be deemed "pure plays[1]").

However, there is also room for companies that are an important part of a solution, and so may affect significant change through a smaller part of their overall activities (what might be deemed 'decisive plays'[1]).

We pay attention to what proportion of a company's revenues contribute towards the SDGs. Importantly though, we will also consider a variety of other factors, such as the severity of the issue being addressed, the number of beneficiaries (particularly currently under-served people), or the extent to which a firm is a leading solutions provider relative to its peers. To help us compare materiality across companies we will consider the level of impact generated against the size of the investment being made, and the scale of the business e.g. against market capitalisation or corporate revenues.

3. Additionality: This is an idea originating from the philanthropic not-for-profit sector, where decisions on allocating donations were judged on the likely ability to resolve unmet environmental and social needs. Additionality – particularly whether it is possible in a listed asset context – has been a focus of much debate. We consider that additionality would be difficult to claim in the process of buying listed assets on the secondary market. This is because no new capital is being infused into the business in such circumstances.

At AXA IM, we consider additionality within a listed asset's context from a different standpoint. We principally focus on the extent to which a company is making its 'needed' products and services more accessible or commercially viable, for example through innovation and new technologies, lower prices, or better distribution. Such commercial strategies, if done profitably, can create long-term competitive advantages for those firms best able to exploit opportunities in satisfying unmet needs across potentially huge addressable markets. Importantly, we also assess the extent to which corporate practices, behaviour and operations are filling a void in terms of leading, influencing and shaping others' approaches.

4. Negative externality: A company's corporate practices, or products and services, may significantly undermine the positive impact it is generating elsewhere. For example, this could include involvement in controversies or the extensive use of coal in business activities. It is important that negative externalities, and a firm's commitment to address them, are fully considered alongside positive outcomes.

5. Measurability: There needs to be a clear methodology and commitment to measuring and reporting the social and environmental performance of investments. These need to be monitored over time. Impact is more difficult to measure than environmental, social and governance (ESG) factors because of the lower degree of data availability and standardisation. This also includes collating and checking the integrity of publicly available data and third-party research.

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[1] 'Pure plays' and 'decisive plays' are terms that we have borrowed from the Dutch investment community

Impact investing: How we assess companies

We are determined to ensure our research processes have a strong backbone and that they can stand up to scrutiny. We fundamentally believe that there is no substitute for sustained, in-depth analysis and hard work. We do not want to be reliant solely on third-party research methodologies and scores, but instead, to be at the forefront of data analysis and information.

We believe our methods, when it comes to impact investing, are distinct from other approaches we have to responsible investment. Nevertheless, we do harness our long- standing broader approaches to integrating ESG factors into our impact investment processes[2]. These include systematically incorporating an assessment of material ESG-related risks and opportunities into investment analysis. We also comply with AXA IM's ESG Standards Policy[3]. This may involve excluding investments in companies involved in certain industrial activities, such as controversial weapons production, or which are the subject of major controversies and breaches of international norms.

We approach impact investing through the themes outlined in the following table. These cover what we see as major global challenges or important solutions. We have identified a sub-set of the SDGs that we believe are being addressed through these investment themes. Naturally, this thematic framework will evolve over time to reflect the shifts in broader unmet societal and environmental needs.

Our impact investing themes and links to the SDGs[4]

Prosperity for people		Prosperity for the planet	
Public health	Empowering women	Low carbon transition	Recycling and waste reduction
Health innovation	Housing & infrastructure	Energy efficiency	Sustainable agriculture
Wellbeing & personal security	Human capital & livelihoods	Sustainable transport	Smart factories
Clean water & sanitation	Financial & tech inclusion	Responsible behaviour	Water preservation

Source: AXA Investment Managers. For illustrative purposes only.

AXA IM's approach to impact investing has been established with the purpose of delivering attractive financial returns, while also promoting positive change around key global challenges. Our impact research framework is built to identify the companies that can achieve these goals, and to monitor the sustainability-related impact of those businesses.

[2] At 31 December 2018 AXA Investment Managers had EUR 458 billion of ESG integrated assets under management
[3] AXA Investment Managers' Sector Investment Guidelines and ESG Standards Policy can be found at: https://www.axa-im.com/sector-investment-guidelines
[4] AXA Investment Managers

In our methodology, we aim to identify and track a range of company-relevant impact metrics or key performance indicators (KPIs), across five categories:

1. **Products and services**
2. **Research and development**
3. **Operations**
4. **Corporate social responsibility (CSR) initiatives**
5. **Negative externalities**

Below we outline some of these KPIs. Each is tracked, where possible, against company targets and linked to industry acknowledged catalogues, such as the Global Impact Investing Network's IRIS metrics catalogue.

Our impact investing themes and links to the SDGs

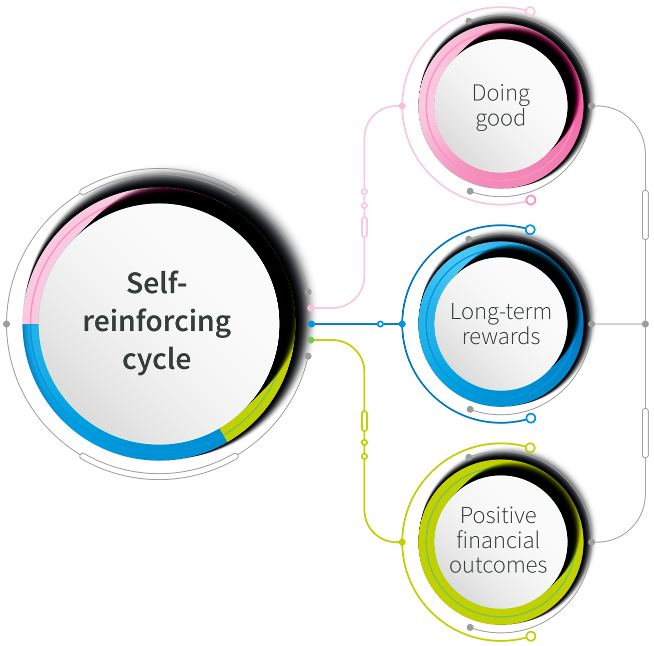
Theme	Primary SDG	Typical KPI	Source
Low carbon transition	7 AFFORDABLE AND CLEAN ENERGY	Renewable energy generated	IRIS: OI2496
Energy efficiency	7 AFFORDABLE AND CLEAN ENERGY	Avoided greenhouse gas emissions	IRIS: PI5376
Clean water and sanitation	6 CLEAN WATER AND SANITATION	Volume of water saved	IRIS: PD5786/PI2884
Clean water and sanitation	6 CLEAN WATER AND SANITATION	People with new access to clean water and sanitation	IRIS: PI2822
Public health	3 GOOD HEALTH AND WELL-BEING	Products under equitable pricing targeting and priority countries	Access to medicines index
Empowering women	5 GENDER EQUALITY	Women in management and on the Board	IRIS: OI571/OI8118
Human capital and livelihoods	8 DECENT WORK AND ECONOMIC GROWTH	Young people gaining vocational training	IRIS: PI8836
Financial and tech inclusion	8 DECENT WORK AND ECONOMIC GROWTH	Micro finance loans disbursed responsibly	IRIS: PI8381/FP9954/PI4733

Source: AXA Investment Managers. For illustrative purposes only.

Tracking these KPIs allows us to judge the societal contribution of companies and the progression of such contributions over time. As a result, we are better equipped to judge which businesses are contributing to the achievement of which SDGs, and by how much. KPI monitoring also helps to highlight obvious disclosure gaps of companies. When this tracking is done across a breadth of firms within a sector or impact theme, it also helps us to make comparisons and to see obvious areas for improvement. Accordingly, we can thoughtfully engage with companies around these disclosure gaps and highlight areas for improvement.

We believe our in-depth impact analysis, when integrated into our traditional company and financial analysis, is a powerful tool which can help us identify potential long-term winners. These are the companies that can enjoy a self-reinforcing relationship between generating outstanding societal and financial outcomes. Not all companies can achieve this, and we want to be invested in the ones that can.

The relationship between impact and financial returns



- An intent and ability to contribute towards the SDGs
  Operating in industries and countries where impact is maximised
  Doing extra – lower cost, better access
  CSR programs

- Brand and stakeholder loyalties
  Early mover into potentially huge addressable market
  Creating moats through innovation & efficiency, low prices and high customer touch

- Strong intangible value to help sustain margins and profitability
  Exposure to secular growth trends
  Risk mitigation
  Strong financial returns, and ability to reinvest into more impactful solutions

How we identify impact companies

Broadly, through our research, there are two categories of companies we aim to identify:

1. Impact leaders

Companies in this category are the highest rated in terms of the extent of net positive societal impact that they are generating and can sustainably generate into the future. Impact investors have traditionally focused on companies that generate positive outcomes through the provision of their goods and services (products and services impact leaders). This is also where we focus most of our research. However, we are of the conviction that there is also an important place within the impact landscape for exceptional companies bringing about positive change through their corporate practices, behaviour and operations (operational impact leaders).

Products and services impact leaders are firms that sell goods and services that are of critical importance and/or of notable value. However, this is just the starting point. The businesses in this category should generate significant 'additionality' by leveraging technology, scale, innovation and/or public-sector support, to make their goods and services accessible and commercially viable to a potentially highly-underserved market. Such firms create a competitive advantage – or protective 'moat' – as they establish leading positions in new growth markets.

Our expectation is that operational impact leaders cannot simply be good corporate citizens but must also aim to drive broader change through their corporate behaviour and practices. This would include companies with best-in-class approaches globally, but also those companies where practices are leading and shaping a country or a sector. Issues addressed may, for example, relate to supply chain management, or to empowering women in the workplace. We would need clear evidence of whether a firm is best-in-class, is setting genuinely ambitious operational targets, is vocally highlighting issues, is pioneering solutions through leadership or collaboration with peers, or is affecting the lives of many beneficiaries. This is how we address the additionality test.

Impact leaders will have a clear strategic intention – as articulated by the board and senior management – to

contribute to society and the environment while also aiming generate healthy financial returns. They should be able to clearly articulate how their societal contributions are also benefiting the business and its investors. This can be through stronger brands, increased loyalty from key stakeholders, or increased preparedness for a (potentially expensive) resource constrained future.

Impact leaders should be able to satisfy our materiality test. They need to generate significant positive impact through a large portion of their business activities (i.e. pure plays) or address critical issues for a notable group of beneficiaries through a smaller part of their business (i.e. decisive plays). Such firms can vary between more front-line activities (e.g. renewable energy generation), to enabling activities that are embedded within a supply chain and offer important services or technologies (e.g. semiconductors). Impact leaders can tackle a single SDG or multiple SDGs.

Impact leader status is to be awarded sparingly only to the leading companies, though this does not mean that such companies are perfect or without fault. There are no guarantees that they will be able to keep this rating over time. We will monitor the progress of such companies to ensure that they remain leaders. In some cases, where we believe that standards are no longer as exemplary from a relative standpoint, we may engage the company on key issues. Our responsible investment research committee will provide oversight by reviewing companies assessed by analysts to be impact leaders.

2. Transitioning companies

Transitioning companies are those which operate within the limits of today’s business realities but are exhibiting some ambition for significant transformation. In this regard, we are looking for a clear sign of intent to enact that change, and/or a likelihood that our engagement activities can affect corporate strategy for the better. It is very important that the prospective change is permanent in nature, and that it will enhance the long-term financial returns of the company.

Such transformational change will usually occur in one of three ways:

1. Plans for a dramatic change in the product mix of the company, which may take some time to materialise (e.g. coal-based to renewable energy generation)
2. Continuing to provide functional products that generate negative externalities but with plans to significantly reduce those negative externalities (e.g. high sugar or fat foods and beverages)
3. Making plans to dramatically improve the environmental or social outcomes from the company’s operations and setting aggressive targets.

When allocating capital to transitioning companies it is important to appreciate that there are no guarantees to success in relation to investor engagement initiatives. Accordingly, it is important to be selective when identifying candidate firms. A lot of consideration should go into which companies are already showing a willingness for significant change or will likely be open to engagement. Such an assessment is most easily done when there is already an established relationship with the company, and when the asset manager involved has a proven and well-resourced engagement process. In this way, investments and efforts can be made where meaningful positive change is a realistic goal.

There is considerable debate in the investment industry as to the exact strategy needed to maximise the potential impact from investing in listed assets. There are those that consider investing in companies which are already impact leaders to be most suitable. Then there are others which consider that effecting meaningful long-term change by leveraging investor engagement in transitioning companies to be the best approach.

AXA IM’s position is that there is an intellectual rationale to invest in both types. Further, we see scope for potentially attractive shareholder returns from each. We can aim to enjoy the compounding returns of impact leaders that are well-placed in growth markets, and which have already established a virtuous relationship between impact and returns. Likewise, we can also aim to benefit financially from a long-term investment in those experiencing the improved outlook and related valuation re-rating of transitioning companies.

For us, the key is to be explicit and transparent in what types of categories investee companies fall into and be able to clearly explain why they belong in an impact investment portfolio. Therefore, our assessment framework is designed to analyse companies so that we can identify opportunities for a range of impact investing strategies in listed assets.

How we engage companies on the United Nations' Sustainability Development Goals

Engagement is a powerful way to change corporate practices and influence decision making. The proactive and effective use of investor rights and responsibilities is particularly relevant within the scope of the SDGs. The latest report by the United Nations[5] on achieving the SDGs by 2030 shows that *"progress is insufficient to meet the agenda's goals and targets by 2030"*. Therefore, there needs to be significant and rapid change if we are to stand a realistic chance of meeting the SDGs. Governments and supranational bodies alone cannot be expected to lift the burden or to effectively coordinate efforts. The listed corporate universe is clearly a vital agent for change. We estimate that listed equities globally represent approximately US$80 trillion of market capitalisation[6]. We consider engagement to principally be a tool for effecting change through this vast economic powerbase.

From 2019, AXA IM is rolling out a specific engagement programme with investee companies on the issue of the SDGs. The focus areas of the engagement include:

- **Board and management accountability:** Establishing clear expectations of board directors and senior executives with regards to their capacity to assess and profit from commercial opportunities related to the SDGs. This includes ensuring the right expertise on the board and the appropriate board-level processes and structures to ensure that new commercial opportunities related to sustainability can be identified.

- **Transparency:** Calling for transparency from companies around their strategic decision-making processes and capital allocation to commercial activities related to the SDGs. We are also pressing for this information to be disclosed publicly either in a report or verbally. We will question the extent to which a firm's SDG contributions are genuine and aligned with its broader corporate strategy.

- **Measurement:** Requesting details on internal methodologies that firms use to assess, on an ex-ante basis, the potential impact and additionality from their capital allocation to sustainability-related opportunities. This should lead to a framework, which companies can implement to measure key performance indicators on an ex-post basis.

- **Reporting:** Asking for the implementation of regular reporting on impact and SDG-related metrics.

We believe that these targets are sufficiently ambitious and consider these to be long-term engagement objectives. Currently very few (if any) companies globally are close to fulfilling all these engagement-related objectives right now. We are establishing short-term engagement milestones which will allow us to understand how companies are on the path to achieving the more ambitious long-term targets.

Over time this initiative will allow us to identify the leading practices among corporates around the SDGs. This will also inform future engagements and refine our ability to invest in companies which are genuinely able to deliver positive impact. Separately, we will also continue our involvement in appropriate industry initiatives for collaborative engagement and public-policy related dialogue. For example, AXA IM is the sole institutional investor represented on the Access to Medicine Index's Expert Review Committee[7]. This is an organisation of leading experts in global health, which consists of academic institutions, not-for-profits, government bodies and industry groups. Its role is to help develop and refine the assessment framework for pharmaceutical companies to be rated and ranked on the group's Index. We consider this engagement work to be an important component of contributing to SDG 3 – Good Health and Well-Being. It specifically seeks to meet targets 3.4 – reduce premature mortality from non-communicable diseases, and 3.8 – achieve universal health coverage.

We also collaborate with other global financial institutions to overcome some of the broader challenges of impact investing in listed assets. One of these obstacles includes the lack of industry-agreed impact investing standards and frameworks. AXA IM is a member of a working group at the United Nations' Environment Programme Finance Initiative (UNEPFI), which is aiming to develop and test a common standard for impact analysis of corporate investments. This is a platform from which we can lead, shape and influence the future direction of the impact investing industry. Other impact investing initiatives in which we play a role include the Impact Management Project, Principles for Responsible Investment[8] and the Global Impact Investing Network. We sit on the investor council for the latter.

We also are long-running participants in a broad range of working groups and public policy consultations which shapes the future trajectory of the impact investment industry. For example, these include supporting the Taskforce for Climate Related Financial Disclosures[9] and providing feedback to the European Commission's taxonomy for environmentally sustainable economic activities.

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5 The Sustainable Development Goals Report 2018
6 Source: FactSet, AXA Investment Managers
7 Yo Takatsuki, member of the Access to Medicine Expert Review Committee https://accesstomedicinefoundation.org/our-team/yo-takatsuki
8 Principles for Responsible Investing – Impact Investing Market Map
9 Taskforce for Climate Related Financial Disclosures Supporters: https://www.fsb-tcfd.org/tcfd-supporters/

Q&A: answering the big questions

Is there a trade-off between impact and financial returns?
We believe there can be a trade-off when companies implement strategies with a short-term mind-set, by looking for temporary uplift in financial returns or societal impact. For example, customers, suppliers or other stakeholders may suffer should companies seek to squeeze an extra few cents of earnings per share out of the current year, or margins may suffer when offering a one-off/ isolated product give-away.

When an intent to create positive impact is genuine and embedded into a company's offerings and practices, then we believe this promotes better corporate health. It can also potentially lead to improved long-term returns for investors.

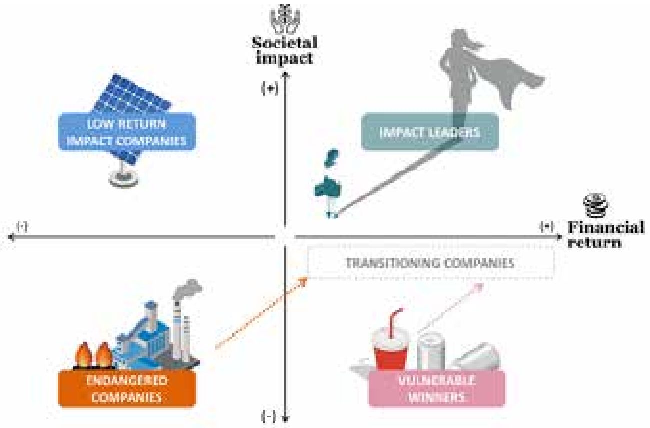
Companies that can profitably contribute towards the SDGs are not only helping society and the environment, we believe that they are also giving themselves a better chance at being among the long-term winners by:

- Focusing on the SDGs and addressing the unmet needs of society – they are more likely to be first movers into potentially large addressable markets
- Pioneering accessibility for their products and services – they can establish significant moats for their business
- Promoting solutions and acting responsibly – they are creating important loyalties among key stakeholders and are better preparing their business for a resource – constrained future.

Of course, many companies will never achieve this self-reinforcing impact and returns cycle. This may be due to the quality of management, poor oversight of the board, or the industry that they operate within. Some positively impactful industries are commoditised, highly competitive and/or capital intensive. Government influences can exacerbate these pressures by distorting capital allocation incentives. Parts of the solar panel manufacturing industry over the last ten years provide good examples of this.

The table below shows the spectrum of companies as we currently see it. The impact leaders in the top right quadrant are those that have best established positive causation and correlation between impact and returns. Our research is set up in such a way, to help us identify these companies.

The spectrum of companies



Source: AXA Investment Managers. For illustrative purposes only.

What role can third-party data providers play in establishing impact company universes?
Third-party research companies and index providers can offer a range of valuable data sets on impact and many have gone about creating impact company universes in different ways. Some are taking a pragmatic approach of using sector-based criteria by mapping certain SDGs to industries. Others are using databases of revenue composition of companies. Some types of revenue are put in 'positive' impact buckets (e.g. renewable energy generation or healthcare services) and others in 'negative' revenue buckets (e.g. sugary snacks or drinks). In addition, others are attempting to rate companies in a more granular fashion, by directly linking impact KPIs to the SDGs. The data sets that these firms provide, once their integrity has been established, can be insightful and powerful tools for asset managers. We can use them to help identify

opportunities, as an extra input in our company assessments, and to help us with reporting. The data sets will improve over time, and methodologies used by these businesses will become more sophisticated.

However, for the time being at least, we would question the merits of overly relying on such data sets or using them in isolation. The very subjective nature of what constitutes an impact company should logically impair the credibility of a tool that looks to systemise impact assessments across a broad range of thousands of companies. This issue is magnified when you consider the lack of standardised impact disclosures across many companies. Even with better disclosure it will still be the case that the most appropriate set of impact KPIs to judge one company may be completely different for another, even for two firms operating in the same industry. For example, some pharmaceutical companies should be judged on their drug pricing policies, while others should be assessed on the quality or focus of their research and development. Others should be judged on the number of beneficiaries or extension in access to drugs, diagnostics and treatments.

AXA IM's approach relies on in-depth analysis of businesses. We verify and use data from third parties and can leverage the information that this provides in relation to company revenue compositions, as well as ESG scores and assessments. However, we also consider many other factors. These include, the severity of the issue being addressed, the number of beneficiaries being positively affected, the extent to which beneficiaries are currently underserved/going without, and a company's additionality in driving down prices or improving accessibility for their needed products. We also consider how a company's actions in turn affects the behaviour of competitors or the industry at large. To do this effectively it is important to rigorously track KPIs and company behaviour within a focused list of companies. It is important that portfolio managers and analysts, who know the companies best, are involved in this business impact assessment process. It is vital that there is a forum for informed and data-dependent debate, around which firms are impactful and which ones are not.

The ambiguities around what constitutes an impact company or fund are unlikely to be resolved anytime soon. As such, it will be a challenge to establish credible and widely acknowledged universes or indices of impact companies. Therefore, impact investment asset managers need to maintain high levels of transparency with clients, to justify their portfolio decisions, and to collaborate with peers to establish and adhere to best practices.

How should impact investors deal with poor and inconsistent disclosures of impact-related performance indicators by companies?

A lot of discussion around impact investment focuses on the availability – or lack thereof – of backward-looking performance measures. There is no doubt these can represent important evidence of past actions and signs of how a firm has genuinely performed against promises. However, good disclosure alone does not resolve global issues around climate change, water scarcity or lack of healthcare provision.

We recognise that there are differing expectations in local markets with regards to transparency and some companies, as a result, may not be not leaders in disclosure from a global standard. Sometimes these are due to reasons around commercially sensitive data, evolving internal methodologies in measurement or the disclosure burden for smaller companies. Accordingly, we do not believe that disclosure alone should be an impediment to investing in firms which can otherwise be assessed to be impact leaders.

Nevertheless, we still expect the following from impact leaders:

- A clear willingness to implement the monitoring and disclosure of relevant impact-related performance data, with an understanding of their links to the SDGs. This is a good sign of a company management's intent to generate positive outcomes for society. Management teams need to understand what contributions – both positive and negative – their companies are making, and what more they can do to improve performance.
- An understanding from management teams that strong practices around disclosure can influence disclosure practices across the broader corporate landscape. They should understand the rationale behind establishing ambitious and stretched targets.
- An openness to engage with investors on this issue and responding positively to recommendations for better disclosure.

We also recognise that impact investors need to be accountable to their clients. This requires a clear system for measuring whatever useful data is available, and a commitment to encourage better disclosures from portfolio companies. Leading investors in this field have an important role in shaping the future of this industry. The current absence of standards and frameworks as well as the scarcity of impact data is an issue which affects all financial industry

(...)Q&A: answering the big questions

participants. For us, we seek to lead the discussion and influence developments through industry groups and collaborative initiatives. In this manner, we can have an impact in other ways beyond our investment-related activities.

Are impact investments just another way to package emerging and frontier market strategies?
Many of the SDGs have a clear focus on targeting challenges for low income countries. SDGs 1, 2 and 10 are focused on eradicating poverty, hunger and inequality while others seek to improve access for poorer people to basic infrastructure and services (SDGs 3, 4, 6, 7, 9).

The United Nations Conference on Trade and Development world investment report for 2014 estimated that an annual US$5-7 trillion investment would be required to meet the SDG 2030 goals. Approximately two thirds of this would need to be invested into the developing world. Hence it is not surprising that the 169 underlying targets of the SDGs have a clear focus on meeting the economic development challenges in low income countries.

Emerging market listed companies represent around 12% of the MSCI All-Country World Index (MSCI ACWI). However, it is worth noting that investing in developing market listed companies is not the only way to have exposure to business activities in low income countries. Presently, nearly a quarter of the revenue from MSCI ACWI listed firms is earned in emerging markets[10].

It is also important to note that everyone globally benefits from the advancement of solutions that address chronic health issues, climate change and resource scarcity – whether it comes from a developed or emerging market company.

Many of the SDGs and targets do not appear investible – how do you deal with this?
Many of the SDGs can be easily addressed directly by listed companies through the provision of goods and services – for example SDG 3 – ensure healthy lives and promote well-being for all at all ages. Other SDGs are more likely to be addressed indirectly or as a result of company activities. For example, SDG 10 – reduce inequality within and among countries. When you delve into the targets it is apparent that it is difficult to align many of them with the activities of listed companies. Some targets are very broad, such as SDG target 1.1 – by 2030

eradicate poverty for all people everywhere. Some targets may need to be facilitated by governments rather than companies, for example target 5.2 – eliminate all forms of violence against all women and girls in the public and private spheres, or target 16.3 – promote the rule of law at national and international levels and ensure equal access to justice for all.

Our assessment is that approximately 50 of the targets can be directly addressed by investment-related activities. Other targets might be better addressed by governments and other stakeholders such as not-for-profits.

The important point is that the alignment or mapping of company activities with the SDGs cannot be treated as an exact science. The SDGs are very broad and hence very adaptable to a changing world. However, despite there being 17 goals and 169 targets, not every important global need could have been foreseen or covered by the framework. Accordingly, some flexibility and creative licence is required when targeting the SDGs through investment. We recommend that investors use the SDG targets that ‘fit best’, rather than ‘fit exactly’. If there are no targets that can serve a purpose, then investors should be guided by the over-arching aims of the SDG in question. Companies that can visibly deliver SDG solutions as a bi-product of their activities should not be ruled out. Perfect taxonomy should not be the enemy of the good.

To what extent should negative externalities rule out companies as candidates for inclusion in an impact portfolio?
Negative externalities should be considered for all investments. It is very difficult to reconcile net positive and negative outcomes, especially if in different areas. For example, how do we weigh the fact that a business may be driving adoption of insect repellent use in India but may also be reliant on palm oil in its production. Or a healthcare

[10] Source: FactSet GeoRev database, AXA Investment Managers

business that is rolling out a new cure for a disease at a price point that may lower the overall cost burden to society, but nevertheless at a price that may appear eye-wateringly high. The electric vehicle (EV) industry is fraught with debate given the reliance on coal-based power generation and exhaustible raw materials, though the end goal is clearly worth striving for – better technologies, powered by renewable energy, increased equipment standardisation and recycling.

We believe that the assessment of net societal outcomes cannot be done through an equation. It is a matter of judgement. Arriving at opinions and verdicts need to be backed by data and be well documented. Negative externalities clearly need to be analysed. How these are dealt with during the portfolio construction and engagement processes is ultimately a matter of judgement. The asset manager's approach to evaluating negative externalities should be clearly articulated to clients.

Which listed asset funds deserve an impact label, and which funds don't?

This is as vital a question for those wanting to allocate capital to listed impact funds, as it is for asset managers wanting to establish new impact strategies. But presently there is no regulatory oversight policing impact labels. In addition, there is no broad agreement within the asset management industry on what defines an impact fund. However, there are initiatives looking at agreements around taxonomy and minimum standards within the sustainable investment world. These include the European Commission's High-Level Expert Group on sustainable finance. Overall such projects should help promote better understanding and common terminology – this could eventually lead to definitive classifications for impact funds. For the time being it is important that asset managers collaborate or pay attention to changing industry norms. We aim to be an important voice in these developments.

We have outlined what we believe are the five fundamental pillars of what constitutes a listed asset impact strategy (see page five). We also believe that while this framework is demanding, it provides sufficient space for the broad church of views around how positive societal change can be galvanised through an investment strategy. For example:

- Some strategies will prioritise investment into impact leaders, where positive change will likely continue to accrue because of a companies' existing model. Others will prioritise investing and engaging with transitioning companies, where significant positive change can materialise as firms' strategies change – and where investor-led additionality is easier to demonstrate.
- Strategies focused on narrow objectives (e.g. water scarcity) may have the scope to be more relaxed about negative externalities outside their areas of focus. Meanwhile broader-themed impact portfolios, with a wider spectrum of targetted net positive outcomes, may be required to take a firmer line on minimising negative externalities, even at the expense of excluding companies that can demonstrate strong positive contribution to some of the SDGs.
- Some strategies may focus more on a company's operations (e.g. related to human resources) than on products and services. Such impact strategies may distinguish themselves from other responsible investment funds because of the clearer identity of the fund in promoting positive change around specific issues. We believe, with such portfolios, that the fund manager should consider whether the portfolio companies are providing leadership with respect to the identified issues and solutions.
- There may be varying degrees of commitment between strategies to the extent of data needed to justify the inclusion of companies within an impact portfolio. Some strategies may commit to gathering data on all portfolio companies to clearly link each firm's activities to impact themes or to the SDGs. While others may give themselves some defined flexibility – for example, say some 10% to 20% of assets under management can be allocated to companies where the impact theme or SDG alignment is not yet firmly established or easily tracked through KPIs.

Regardless of the nuances between different listed asset impact strategies, we believe that an impact fund will be on firm ground if it can clearly demonstrate adherence to our five pillars and provide sufficient reporting transparency. Those looking to allocate capital into listed impact strategies should hopefully also find our five pillars as a useful guide to distinguish between asset managers. Other considerations will also be of critical importance; including the commitment of the asset management organisation to responsible investing and the track record of the fund manager at delivering best-in-class investment solutions against client needs and guidelines. Along these lines, AXA IM, supported by AXA Group, is committed to being a trusted partner and industry leader in the listed impact space.

For further information on AXA IM's approach to responsible investing and impact investing please visit **www.axa-im.com/en/responsible-investing** or contact your local sales representative.

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AXA Investment Managers
Tour Majunga - La Défense 9 - 6, place de la Pyramide 92800 Puteaux - France
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