Sustainable Finance initiative

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A Portfolio Approach Towards Impact Measurement and Management

About Sustainable Finance Initiative

Sustainable **F**inance **I**nitiative (SFi) is an investor-sponsored community with a mission to mobilise capital for positive impact and accelerate Asia's transition towards sustainable finance. Our vision is a world where sustainability is synonymous with finance. We deliver our vision by empowering People, Policy, Practice and Product.

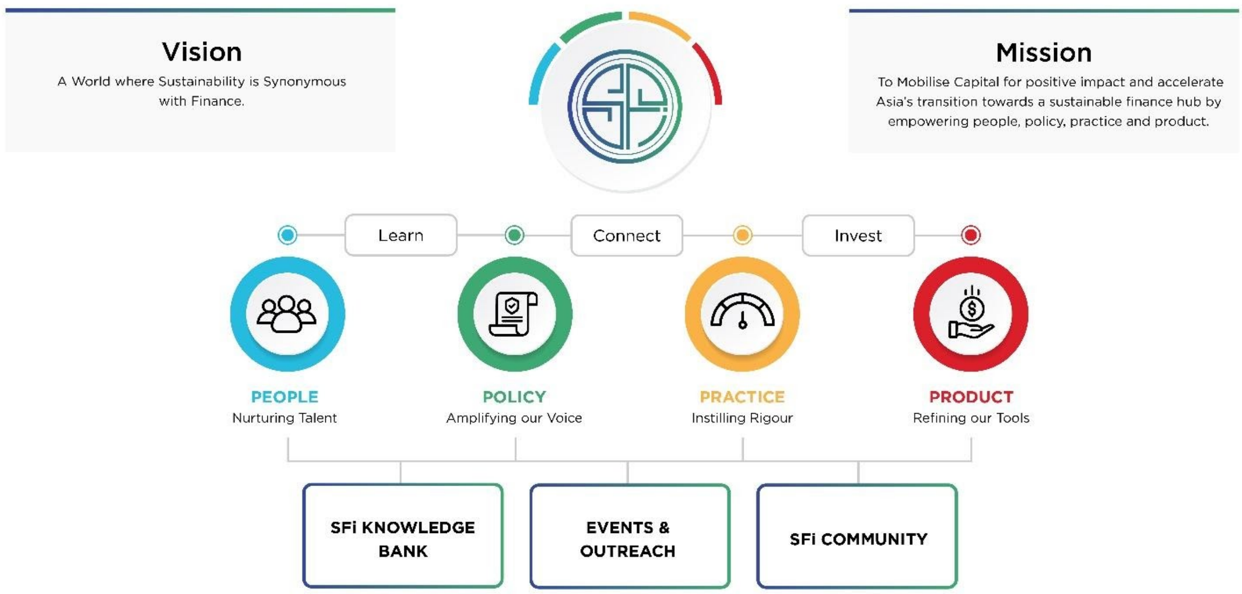
SFi was incubated by RS Group, a Hong Kong based family office and its direction was shaped by the Chair of RS Group, Annie Chen's vision:

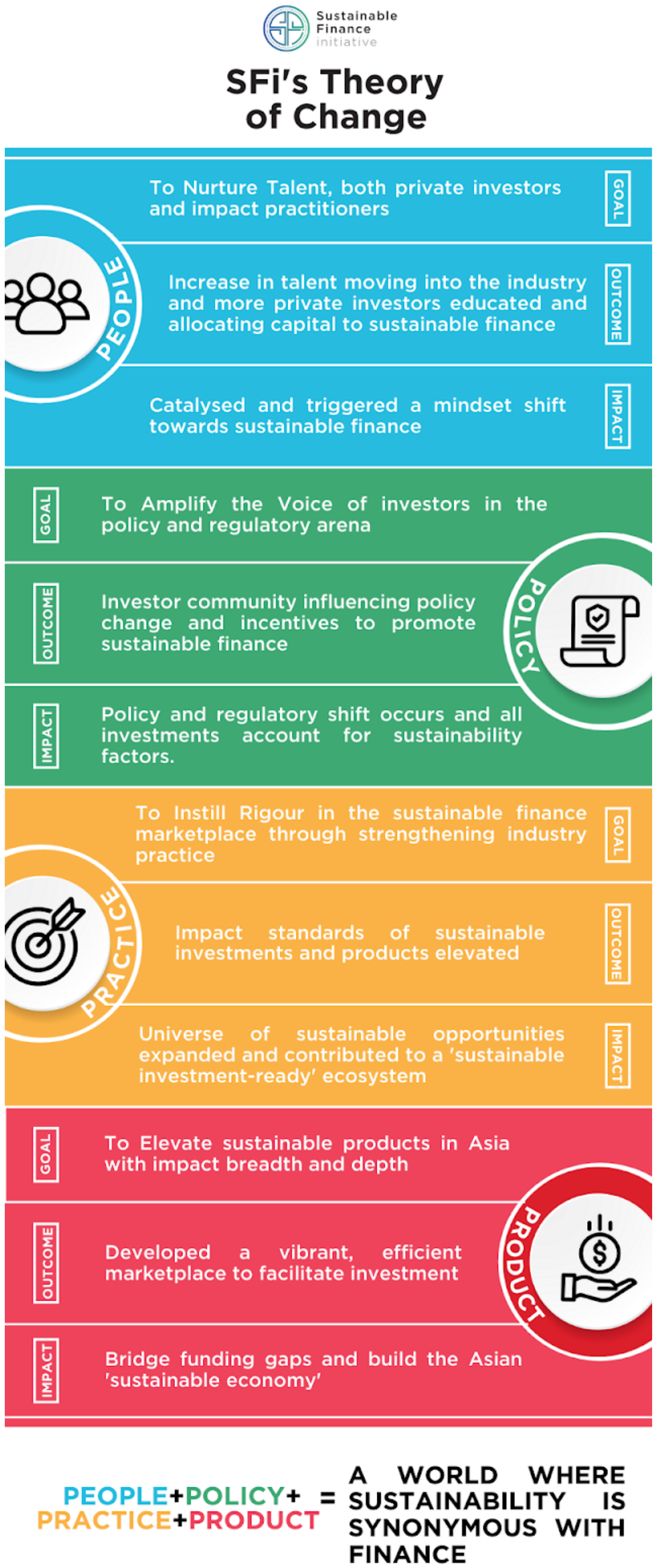
"I hope that SFi will shorten the time that other interested private investors need to get started on their journeys. SFi will also help bridge Hong Kong's knowledge gap on sustainable finance and serve as a catalyst to drive investor demand."

Armed with this vision, SFi officially launched in June 2018, and since then has grown an active community of wealth owners who believe in "Capital that Matters".

Foundational to SFi's model of operation is its Knowledge Bank, Events and Outreach with the sustainable finance community in Asia and around the world. Based on these foundational building blocks, SFi's works to actively advance the development of the sustainable finance ecosystem by focusing on significant market gaps - the four pillars – People, Policy, Practice and Product.

SFi's Model





SFi's interpretation of sustainable finance is an investment strategy or financial service integrating **E**nvironmental, **S**ocial and **G**overnance ("ESG") criteria into business and investment decisions, for the lasting benefit of investors and society at large. It is an inclusive term making no distinction between the concepts of sustainable investing, responsible investing, or socially responsible investing. Sustainable finance is concerned with investment, not charity. The terms "Sustainable Investing" or "Sustainable Finance" are used interchangeably in this article.

SFi's programmes, structured under the four-pillar framework, are designed to be action-oriented solutions to alleviate ecosystem gaps apparent today in the sustainable finance market in Asia. SFi's theory of change is that by addressing these gaps across people, policy, practice and product, we will trigger a mindset shift among wealth owners towards sustainable finance, creating a policy-enabling environment for sustainable investing in Asia, and ultimately contributing towards the building of the region's sustainable economy.

SFi Impact Measurement and Management Portfolio Approach

The sustainable finance universe is vast and a long-standing challenge for wealth owners, particularly on both how to choose the "right" sustainable investment products for their risk, return and impact characteristics, and how to effectively integrate a sustainability lens into their portfolios. Over the years, SFi has developed its own approach towards designing a sustainable portfolio and an impact framework to assess sustainability performance.

Our **I**mpact **M**easurement and **M**anagement ("IMM") journey began in 2019, when SFi performed a first screening of our investor community to understand their risk, return and impact ambitions. The research 'An Investor Community – Ready for Action' highlighted investors' **S**ustainable **D**evelopment **G**oals ("SDGs") preferences, motivations and future investment goals. The results of this research guided SFi's IMM framework and since then we have been constantly evolving and iterating our approach.

SFi's IMM approach is applied across asset class, thematic and issue right from sourcing stage, to shortlisting, diligence and ownership stage. Our goal is not to reinvent methods and approaches already available in the IMM market, but to work with partners and networks to elevate existing methodologies and standards of practice. To facilitate SFi's measurement and management process internally, we developed a proprietary sustainable and impact due diligence tool, which draws on several stewardship codes, guidelines and principles.

In 1H 2020, SFi performed initial impact screening of 55 investment opportunities using our IMM approach, 43% of investments assessed were in venture capital or private equity; 33% in direct investments; 9% in private debts; and the remainder were capital market solutions (fixed income 7%, equities 4%, multi-asset/fund of funds 4%). Every investment is reviewed against SFi's pre-diligence impact criteria, while investments that pass this initial impact screening are subject to deeper impact diligence.

To strengthen the IMM tool, SFi designed key categories for assessing impact across asset class. These impact categories drive SFi's decision-making process in addition to our financial risk categories (liquidity/income profile, macroeconomic risk, manager/founder risk, portfolio risk and target return). Our key categories and focus questions are highlighted below:

Impact Category	**Focus Question**
Commitments	Are you a signatory of any ESG or any impact initiatives?
Policies	Have you an investment policy, code, framework addressing your investment beliefs?
Metrics & Reporting	What metrics are you using to measure ESG and what reporting frameworks are applied?
Strategy	What ESG or impact strategy is applied and how is it incorporated?

A minimum requirement matrix is applied against each impact category and recorded into a database with a simple interface for the SFi team. SFi's minimum requirement threshold and impact signals vary across asset class. For example, managers in the equity market can demonstrate their commitment to sustainable investment in several ways – a significant percentage have chosen to become signatories to the voluntary-based **U**nited **N**ations ("UN") **P**rinciples for **R**esponsible **I**nvestment ("PRI"). An assessment against SFi's policy category involves analysing the managers' commitments on how they intend to incorporate ESG or impact considerations into their investment processes – this is reflected in their investment policy statement and it should take into account the types of investment (asset class), legislation and international convention commitments they adhere to. Thirdly, managers can also demonstrate varying levels of reporting commitments and this is reflected in SFi's reporting category requirements. Using the equity fund's example again, we observe a number of leading managers are reporting against local stewardship codes and they demonstrate how they fulfil their stewardship responsibilities in their annual or quarterly reports – through publicly disclosing their responsible engagement policy for example. In addition, managers may report against standards such as the **S**ustainability **A**ccounting **S**tandards **B**oard ("SASB"), SDGs, The **T**askforce on **C**limate-related **F**inancial **D**isclosures ('TCFD"), **G**lobal **R**eporting **I**nitiative ("GRI"), **C**arbon **D**isclosure **P**roject ("CDP") and several others depending on the asset class and stakeholder audience. Finally, we recognise within the strategy category that the overarching sustainable investment approach adopted and the ways they are implemented will vary across asset class, for ease we categorise ESG and sustainable investing approaches into the below:

Asset Class	Strategy (at least one of the below strategies followed)	SFi Minimum Requirement & Impact Filter
Equity Funds	Exclusions/ negative screening Best-in-class Integration Active ownership Thematic	Requirements vary across strategy. In general, the equity fund must go beyond exclusions/ negative screening and conduct best-in-class, integration and/or active ownership and/or take a thematic approach.
Fixed Income Funds	Exclusions/ negative screening Integration Active ownership Thematic	Requirements vary across strategy and for corporate, sovereign, or sub-sovereign issuer. In relation to active ownership, we are aware that fixed income investors do not have voting rights - as such the minimum requirement is engagement through interaction with issuers individually or collaboratively with other investors on the issuer (corporate, government, or unions) when controversies arise.
Private Equity Funds	Integration	Impact must be integral to the fund and they must acheive a certain impact result set by SFi against our combined framework which utilises a) **I**mpact **M**anagement **P**roject ("IMP") framework and b) New Philanthropy Capital **I**mpact **R**isk **C**lassification ("IRC").
Direct Investments	Integration	The minimum requirements will vary by sector; however, impact or sustainability must be integral to the business/ enterprise focus.

SFi's interpretation of an exclusions or negative screening approach, is a strategy that looks to incorporate an investor's moral principles by excluding companies involved in certain activities or industries (e.g. alcohol, gambling and adult entertainment). Active ownership & voting involves actively engaging with the managers and boards of directors of investee companies on business strategy and execution, including specific sustainability issues and policies. Integration looks at investment decisions in a wider context than traditional financial analysis and explicitly includes analysis of a range of risks and opportunities related to ESG drivers. Finally, thematic focuses on specific trends and themes such as the housing, biodiversity and health and others.

An example of how we apply the SFi IMM framework in Private Equity Funds is detailed below.

Case Study: Leapfrog – Private Equity Fund Example

In 2019 SFi led the impact due diligence process of LeapFrog Emerging Consumer Fund III, LP (the "Fund") in collaboration with SFi's investor group. Each SFi investor evaluated the opportunity independently and was responsible for their final investment decision. SFi's impact diligence process followed the below stages of vetting.

Stage 1: Pre-diligence Impact Vetting

SFi's pre-diligence impact vetting process began with our team setting about collecting the relevant data on the fund in line with our impact and financial risk categories. A series of conference calls with the managers was held to examine the impact depth of the fund, making sure that it was robust enough for SFi requirements. The following impact evidence was gathered against our impact categories including commitments, polices, metrics/reporting and the fund's strategy:

Impact Category	Focus Questions to the managers	The Fund
Commitments	Are you a signatory of any ESG or any impact initiatives?	✓ Principles for Responsible Investment ✓ UN Global Compact ten principles ✓ International Labour Organisation's ('ILO') Declaration on Fundamental Principles and Rights at Work ✓ UN Universal Declaration of Human Rights
Policies	Have you an investment policy, code, framework addressing your investment beliefs?	✓ Responsible Investment Code ("RIC") published
Metrics & Reporting	What metrics are you using to measure ESG and what reporting frameworks are applied?	✓ An integrated impact framework aligns financial and social results with LeapFrog's FIIRM method (Financial, Impact, Innovation and Risk Management) ✓ IFC Operating Principles for Impact Management ✓ Impact Reporting Investment Standards (IRIS+) ✓ King Code ✓ SASB ✓ SDGs ✓ LeapFrog 2019 Annual Impact Report
Strategy	What ESG or impact strategy is applied and how it is incorporated?	✓ Integration - impact in integral to the fund and they achieved a certain impact result to pass stage one impact vetting set by SFi against the IRC

Stage 1 Strategy Results: SFi used the IRC framework as a light touch and practical tool to vet impact during stage one impact vetting. Using a combination of public information, annual reports and information gathered during manager calls, we were able to form an assessment of impact intention. It's important to note that the IRC does not measure the level of impact. It assesses how robust an organisation's evidence of impact is, and how much thought and focus the organisation has given to how it expects to generate impact. The IRC on its own is not a complete due diligence tool, as such we assessed other risk factors, alongside impact risk, such as leadership risk, execution risk and external factors to gain comfort that the fund was aligned with our goals. IRC provides a sense of the impact risk of the investment – that is, the risk of the intended impact being achieved or not.

SFi assessed the fund's impact processes against IRC's five areas using information made available as at February 2019. The fund was scored from 0-3 in each area, including principles, purpose, outputs, outcomes and impact. The final score was 11/15, achieving an overall stage 3 score (see full results below) and further notes in the Resources section for IRC's fund scoring criteria.

	Expectations within IRC Framework	Score	Commentary
Principles	Fund's intentions in lock-step with impact goals. Impact drives business decisions. A learning organisation and/or leading good practice. rating or similar. Impact ethos reflected in mission lock or B Corp certification.	✓✓✓	Impact embedded investment strategy. All properties are third- party certified. Uses impact data to learn and improve. Contributes towards better impact practice in the field, i.e., LeapFrog Labs.
Purpose	Mission statement. Investing in organisations with better understanding of what effect, for whom.	✓✓	Mission statement outlined. Identifies who experiences the primary outcome at high level using IMP.
Outputs	A range of output data (3 or more key metrics, over at least 2 years if applicable) that clearly demonstrates quality and quantity of effect. Up to date (within last 12 months). Data in context, i.e., against targets, y/y trend analysis, against benchmarks.	✓✓✓	List of outputs detailed in quarterly reports with context and year on year comparisons.
Outcomes	Some outcome data and case studies demonstrating positive effect on people/ planet of the business. Starting to track duration of effect and any unintended consequences. Beginning to assemble the evidence base for the casual links.	✓✓	List of outcome data in quarterly reports for investee companies showcasing the positive effect on people through use of a case study. Duration of effect and Unintended consequences identified as areas for further diligence and analysis.
Impact	Some discussion/demonstration of additionality of the goods or service over what would have happened anyway. Scale of investment suggests it is additional, attracting new capital.	✓	Scale of investment suggests impact by empowering thousands to be their own agents of change and building financial resilience. Effect of the investment beyond what would have happened anyway/additionality effect identified as areas for further diligence and analysis.

	Overall IRC Score	11/15	Stage 3

Note: We note the fund's score may have increased since impact diligence conducted in February 2019.

Stage 2: Deep-diligence Impact Vetting

Once satisfied that the fund met the minimum impact and financial requirements in stage one, our team continued to refine and build out our analysis in subsequent rounds of impact diligence leading up to the investment recommendation to the SFi Investor group. This next stage of deep-diligence impact vetting was two-fold in nature and included a deeper examination of the fund's financial and impact risks.

a) Financial risks: investigated the fund's investment thesis, the team, strategy and track record, financials, the portfolio companies the fund invests in, their pipeline of investments and the competitive landscape.

b) Impact risks: although we had an initial indication of the fund's impact thesis from stage one, we wanted to get a deeper understanding of the fund's depth and breadth, and intentionality using an additional lens.

To achieve this, we combined the IRC framework used in stage one with the IMP framework. IRC and IMP together form a robust approach to assess how much impact is achieved. Thousands of practitioners, including SFi, have come together under IMP to agree on a shared understanding of impact on how to measure, compare and report impacts on environmental and social issues.

Under IMP an investment's impact is a function of:

1. the impact of the underlying enterprise/asset (x-axis), plus

2. the contribution that the investor makes to enable those impacts (y-axis).

Mapping x-axis:

The aim is to map the impact of the underlying enterprise/asset against IMP's five dimensions: What, How Much, Who, Contribution and Risk. Once the funds primary outcomes were assessed against these dimensions, we could then classify the overall impact into three categories: A – act to avoid harm, B – benefit stakeholders and C – contribute to solutions.

Mapping y-axis:

The aim is to then map the investors contribution the fund aims to make by investing in the underlying assets. IMP has developed a scale from 1-6 to assess the investor's contribution, ranging from 1 – signal that impact matters, 2 – signal that impact matters and engage actively, 3 – signal that impact matters and grow new/undersupplied capital markets, 4 – signal that impact matters, engage actively, and grow new/undersupplied capital markets, 5 – signal that impact matters, grow new/undersupplied capital markets, and provide flexibility on risk-adjusted return and 6 – all of the above.

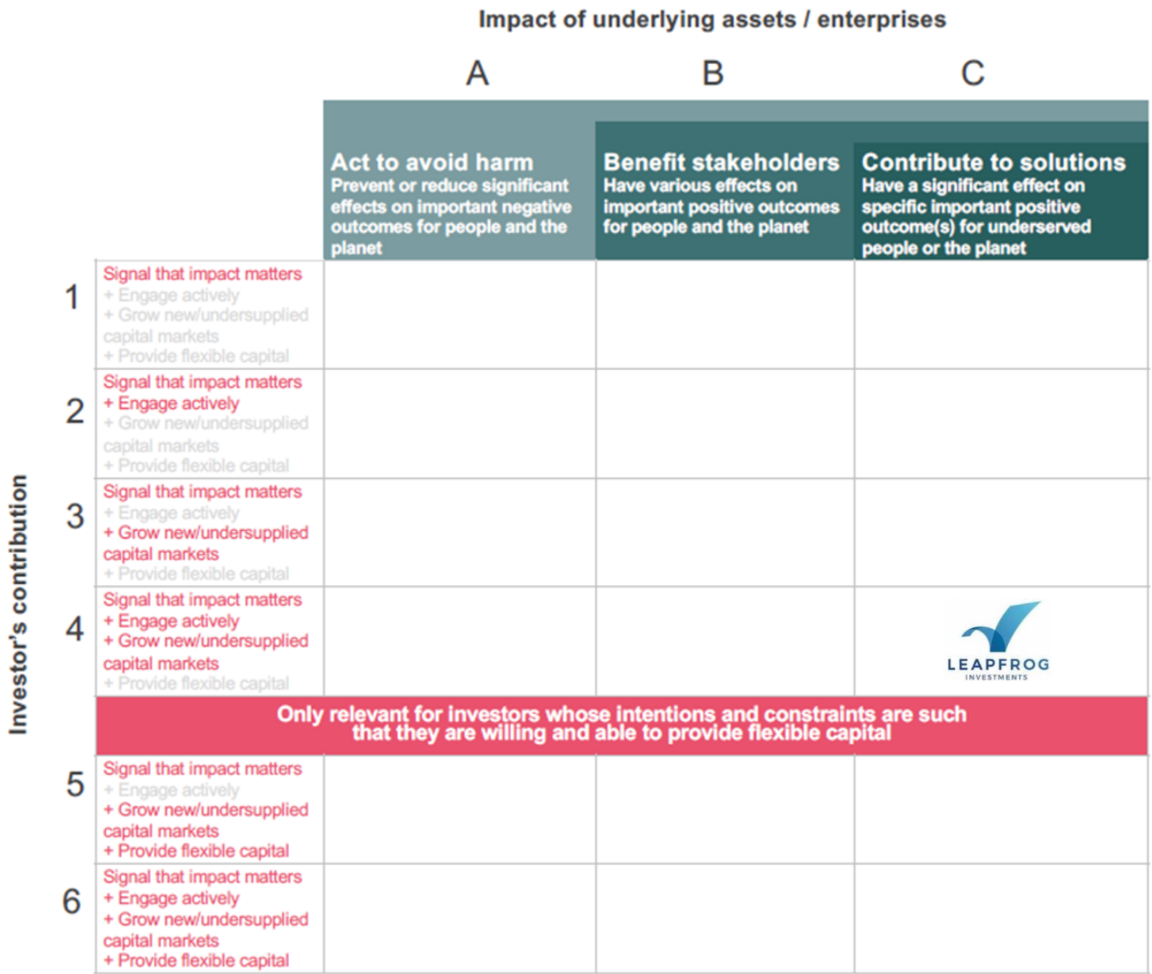
Investor contribution results (y-axis):

Signal that impact matters – The fund targets to reach 80 million people with healthcare and financial tools, of whom 60 million are low-income emerging consumers. Similar targets on low income emerging consumer set for Fund I (25MM) & II (50MM) has been met. It is signalling to the market that the fund concerns impact.

Engaging actively –LeapFrog has a professional team with expertise in emerging markets, finance and healthcare, and therefore capable of driving hands-on operational engagement at and beyond the company board level. This is evidenced over the past 10 years on value creation in prior funds, ranging from designing new products, advising on pricing, building our systems infrastructure, to rapidly scaling new digital-based distribution channels.

Growing new & undersupplied capital markets – LeapFrog focuses on high-growth markets in Africa and South and Southeast Asia, that are home to over two billion emerging consumers. In LeapFrog's target countries today, approximately 66% of adults do not have access to bank accounts at formal financial institutions. Even those people who do have basic bank accounts lack access to a broad range of financial services, such as saving accounts, payment channels and insurance products. It is evidenced that the fund is taking more complexity than the market would usually.

Providing Flexible Capital – the fund does not incorporate this strategy in their investment approach.



The combined results of SFi's IMP and IRC assessment are shown below.

COMBINED IRC AND IMP ASSESSMENT RESULTS by SFi

WHO	WHAT
Well-served — Under-served Across the fund's target countries, there are estimated to be 2 billion low-income individuals who are willing and able to pay to critical products and services but are either entirely excluded or underserved by virtue of being low-income. The fund's investee companies fulfil this need and enable underserved households in building safety-nets for protection against risks.	Important negative — Important positive outcome  The fund invests in purpose-driven companies (enterprises) that aim to reach 60 million low-income people in Africa and Asia with critical financial and health tools. Enabling access to high quality, affordable products for financial and health inclusion aligns directly SDGs 1 and 3 and above goals.
HOW MUCH	**RISK**
low degree — high degree small scale — large scale short term — long term	**IMPACT RISK CLASSIFCAITON (IRC)– STAGE 3** Principles: ✓✓✓ / Purpose: ✓✓ / Outputs: ✓✓✓ / Outcomes: ✓✓ / Impact: ✓ Impact is embedded into the investment strategy. Mission statement is clear, and the target audience is identified. Outputs and outcomes mapped, and case studies provided in quarterly reports. Link of how the effect of the investment goes beyond what would have happened anyway/additionality effect found to be potential areas appropriate for further strengthening. **5 Dimensions Score = Contribute to Solutions**
CONTRIBUTION	**INVESTOR'S CONTRIBUTION**
much worse than what is likely to occur — much better than what is likely to occur	+ Signals that impact matters + Engages actively + Grows new/undersupplied capital markets (-) Does not provide flexibility on risk-adjusted returns **= Level 4** **OVERALL SCORE = 4 C**

IMPACT METRICS (as at 31 Dec 2019)	2019
Emerging consumers reached	23.0M
Underserved customers	13.0M
Remittances enabled (USD)	4.0 BN
Loans disbursed (USD)	192.6M
Total jobs supported	4,222
# of quality pharmaceuticals enabled	43.1M
# medical products and devices enabled	9.1M
# healthcare services provided	9.1K

Lessons learned and path forward

Based on our IMM framework, we have begun to map the impact product landscape based on perceived return-impact profile. As expected, there is a wide range of solutions with regards to impact strategy across each stage from intentions, design, implementation and reporting. SFi's sees the IMM process as on-going and iterative, we are constantly striving to strengthen and improve our approach to impact assessment, and are encouraged by efforts made in 2020 to increase compatibility and comparability of impact measurement approaches.

RESOURCES

IRC SCORING CRITERIA: FUNDS

NPC

Score	Principles	Purpose	Outputs	Change or outcomes	Impact
	Evidence that impact is integral to the fund and its managers and drives decision-making.	Evidence of an impact thesis/theory of change or logic model, and understanding of how it will generate impact, and for whom.	Evidence that the fund collates and reports data from investees that demonstrates the depth and scale of their delivery.	Evidence that the fund collates and reports data from investees on the changes generated by activities—can include evidence of likelihood that outcomes flow from activities.	Evidence that the fund's activity creates additional effect beyond what would have happened anyway.
0	Fund's intentions not directly related to creating social/ environmental impact. Shows no awareness of impact, success factors not dependent on generating impact.	No clear mission/theory of change. Investing in orgs with no awareness/understanding of what effect, for whom. **Examples**: ESG risk mitigation, defensively screened investments.	No output data for target population.	No outcome data or data showing change for target population.	Not considered. Investment small-scale.
1	Fund's intentions have some overlap with impact goals. Demonstrates awareness of impact but business success factors not dependent on generating impact.	Vague mission. Investing in orgs with some understanding of what effect, for whom, but business activity not designed to address need. Trying to prevent negative social or environmental effects. **Examples**: move from defensive screening to actively integrating ESG factors into investment decisions.	Limited output data that only partially demonstrates impact, reported in an ad hoc format. No context or trend analysis. Output data that is out of date. **Examples of output data**: characteristics of users, how many people engaged/how often. ESG performance comparisons.	Limited outcome data or case studies demonstrating positive effect on people/planet. **Examples of outcomes data**: feedback on goods/services, changes in income, behaviour, knowledge etc due to goods/services.	Some discussion/demonstration of additionality of the goods or service over what would have happened anyway. Scale of investment suggests it is additional, attracting new capital. **Examples**: products or services addressing a market failure suggest delivery of outcomes.
2	Fund's intentions reflect impact goals. Business success factors depend on generating impact.	Mission statement. Investing in orgs with better understanding of what effect, for whom. **Examples**: investing in orgs where some of the business provides goods/services with intentional social/environmental impact. Divest/invest strategy.	Some output data (at least 2-3 key metrics) related to the quantity and quality of effect. Consistent format for year on year (y/y) comparison. Reasonably up to date (within the last 24 months). Some analysis of data in context, ie, against targets, y/y trend analysis, against benchmarks.	Some outcome data and case studies demonstrating positive effect on people/planet of the business. Starting to track duration of effect and any unintended consequences. Beginning to assemble the evidence base for the causal links.	Developing approach for understanding how the effect relates to what is likely to occur anyway, by benchmarking or reference to context in output/outcome data analysis. **Examples**: restoration or conservation projects; growing new or undersupplied markets.
3	Fund's intentions in lock-step with impact goals. Impact drives business decisions. A learning organisation and/or leading good practice. GIIRS rating or similar. Impact ethos reflected in mission lock or B Corp certification.	Clear mission statement/theory of change. Investing in orgs with good understanding of what effect, for whom. **Examples**: Investing in orgs where most or all of the business provides goods/services with intentional social/environmental impact.	A range of output data (3 or more key metrics, over at least 2 years if applicable) that clearly demonstrates quality and quantity of effect. Up to date (within last 12 months). Data in context, ie, against targets, y/y trend analysis, against benchmarks.	Outcome data demonstrating the size and duration of positive effect on people/planet of the business. High quality case studies that support this. Tracking unintended consequences. An evidence base for the causal links between business activity and outcomes.	Robust tools for understanding how the effect relates to what is likely to occur anyway. **Examples include**: development of counterfactual, using control or comparison group to measure what activity might have happened otherwise.

Source: NPC, 2020

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