PRI Principles for Responsible Investment

UNEP Finance Initiative — Changing finance, financing change | United Nations Global Compact

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

PGGM

COUNTRY
The Netherlands

TYPE OF FUND/ORGANISATION
Pension fund administrator and investment manager

TOTAL ASSETS
€ 140 billion (US$ 186 billion) as at May 2013

"PGGM is one of the first large institutional investors to begin to systematically gather and structure information on the environmental and social impacts of its investments."

INTRODUCTION

PGGM is a pension fund administrator and investment manager that invests on behalf of five Dutch pension funds. Responsible investment is a central tenet of its investment philosophy. PGGM is guided by a comprehensive set of responsible investment policies[1] that it applies to all asset classes. It uses a variety of responsible investment approaches, including integration of environmental, social and governance (ESG) issues, voting and engagement, as appropriate. In addition, it has 20 investments that currently meet its definition for targeted ESG investments, totalling € 4.2 billion (US$ 5.6 billion).

In 2011, PGGM began a pilot project to understand the expected added societal value of its targeted ESG investments, based on an academic literature review - a ground-breaking exercise for an investor of its size and type. In 2012, it developed the first pilot report for its clients outlining the actual impacts of these investments.

This case study outlines how PGGM goes about understanding the direct and wider impacts of its targeted ESG investments, illustrated using examples of how it applies its approach to microfinance investments. It is one of a series of case studies produced by the PRI Initiative's Environmental and Social Themed Investing Work Stream.

KEY POINTS

- PGGM's impact measurement methodology is designed to assess whether and how its targeted ESG investments yield the positive impacts they were designed to deliver.
- It has developed a standard template, applicable to targeted ESG investments in all asset classes, to collate impact information and report to clients annually. The template has a clear logic: it establishes the global environmental and/or social challenge an investment is intended to address, sets out the process by which the fund expects to deliver the desired impacts (the 'theory of change'), and, based on the theory of change, defines investment-specific output metrics that each fund manager is asked to report on.
- The reporting template also covers: whether and how each investment has generated additional direct impacts and contributed to wider sector development; the policies and procedures the manager uses to manage ESG issues, including negative ESG effects and risks; and any potential issues of concern to PGGM and what the manager is doing about them.
- PGGM faces several challenges, most of which relate to the innovative and complex nature of what it is trying to do. But as it – and other asset owners and investment managers – gain experience and increasingly request and receive good impact information from their managers, demonstrating the real environmental and social contribution of these funds should become easier.

RATIONALE

PGGM and the pension funds whose money it invests share the belief that financial and social returns can go hand-in-hand. Investing responsibly delivers both high-quality pensions and a better future for PGGM's beneficiaries, through the contribution that these investments can make to solving the world's environmental and social problems.

PGGM invests according to several responsible investment policies, using a range of established strategies. It views ESG issues as potential sources of investment risk and opportunity, and factors them into all of its investment processes and activities.

1 www.pggm.nl/About_PGGM/Investments/Responsible_Investment/Policy/Policy.asp#0

TYPE AND STRUCTURE OF INVESTMENTS

In 2012, PGGM tightened its definition of targeted ESG investments. It now defines them as investments that meet standard financial criteria for their asset class and target clear and convincing measurable goals which address environmental and social challenges.

Twenty mandates in the infrastructure, microfinance, private equity, listed equity and real assets sectors meet the new criteria with a total value of € 4.2 billion (US$ 5.7 billion) or around 3% of its total assets under management.[2] PGGM's ambition is to increase this amount in the future.

APPROACH

PGGM is one of the first large institutional investors to begin to systematically gather and structure information on the environmental and social impacts of its investments. This case study focuses on how PGGM captures and reports this information to its clients.[3]

PGGM is rolling out its approach gradually, asset class by asset class, using a two-page template it has developed to collate information from its investee funds and companies. Each section of the template is described below, with examples drawn from microfinance to illustrate how it works in practice. The first three sections of the template are also used in the due diligence process for new targeted ESG investments.

1. **The global challenge the investment is designed to address:** PGGM first categorises each targeted ESG investment according to the global challenge or challenges it is designed to help to solve. These include climate change, resource scarcity, protection of human rights, provision of basic needs, and local social and economic development. PGGM's investments in microfinance funds are categorised as addressing the latter two challenges.

2. **Theory of change:** For each investment, be it a fund of funds, an individual fund or a project, PGGM explains how that investment is intended or expected to address the specified challenge(s). This means describing the outputs PGGM expects to be generated and sometimes the related outcomes (or impacts), although it is often not possible to capture outcomes. The theory of change is investment-specific and based on input from experts and academic research. A key element of this approach is that the theory of change makes it possible to identify proxy indicators. These indicators do not measure impact as such, but provide a practical way to track progress towards realising an intended impact. These proxy indicators fall more directly within the control of the fund or company than the actual impact (where external factors and dependencies also play a role).

3. **List of output (or outcome) metrics:** Based on appropriate existing ESG measurement frameworks, as described above, PGGM then defines around five to ten high-level ESG output or outcome metrics that it asks each fund manager to report on. With respect to its microfinance investments, PGGM draws its metrics from well-established social performance reporting frameworks such as those developed by the Social Performance Task Force.[4] These include output measures such as the total number of active clients that a microfinance institution has supported, the total number of active borrowers, and the percentage of clients who live in urban and rural areas and/or are classified as poor or very poor and/or are women. Specific outcome measures, such as the number or percentage of clients' daughters who attend primary school as a result of their mothers receiving the microfinance loan, are not requested by PGGM. The proxy indicators are designed to provide an adequate understanding of whether the investment is on track in achieving its outcome measures, as formulated in the theory of change.

4. **Additional impacts:** In addition to the key metrics, PGGM also aims to capture important additional impacts generated by each investment. With respect to microfinance, these could include an improvement in the quality of the products and services offered by a microfinance institution the fund invests in, its contribution to building capacity in the sector through educating such institutions, or the empowerment of beneficiaries.

5. **How investment leads to development in the sector:** This section is more qualitative. It outlines wider positive impacts the investment has led to. In the microfinance field this might include contributing to the development of sector standards and principles (e.g. the Principles for Investors in Inclusive Finance (PIIF)[5]; transferring knowledge to clients; or providing in-kind support to a microfinance institution, perhaps by contributing to new product development (e.g. micro-insurance or sanitation loans).

6. **Procedures and management systems:** This section of the template sets out the manager's standard policies, procedures and systems for addressing ESG

2 Responsible Investment Annual Report 2012, PGGM
3 In 2011, PGGM worked with the Erasmus Centre for Strategic Philanthropy (ECSP) at Erasmus University Rotterdam in a first attempt to get insight into the expected societal value of its targeted ESG investment, based on existing academic research, see "Measuring the impact of targeted ESG investments, ECSP Insight, 3rd Quarter 2012."
4 http://www.sptf.info/
5 www.unpri.org/piif

issues overall, including, importantly, ESG risks. While these funds are designed to deliver certain positive environmental and social impacts, they can also generate negative impacts and present ethical and governance issues. PGGM wishes that these funds manage all such issues and impacts effectively. With respect to microfinance, the report might capture whether the manager is a signatory to the PIIF or uses a standard social performance platform to collate impact measures and/or additional internal systems.

7. **Potential issues:** The final part of the template outlines any potential ESG issues the manager or PGGM foresees, any discussions that PGGM has had with a manager about these concerns and how the manager is responding to them. For each sector or asset class this generally focuses on topics covered by relevant international standards. For microfinance, this might be the Smart Campaign's Client Protection Principles in Microfinance[6] relating to over-indebtedness, excessive interest rates, fraud risk and tax avoidance.

CHALLENGES

Impact measurement relies on fund managers' capability and cooperation: PGGM does not yet include in its Investment Management Agreements the requirement to report on ESG impacts, as the approach outlined above is still in its pilot phase. This means that PGGM has to rely on discussions with managers to secure their agreement to report this information. Moreover, ESG data provided by managers may be limited at first. PGGM expects that, over time, as all parties become familiar with the impact reporting concept and template, data quality and completeness will improve.

Measuring the impact of large and/or diversified funds: Investments in individual projects or in concentrated portfolios lend themselves more easily to ESG impact measurement. But identifying a core set of measurements for highly diversified funds, funds with a large number of holdings or a fund of funds is more difficult. In the private equity sector, for example, there is no agreed framework for measuring ESG impacts. PGGM is responding to this challenge by devoting a significant amount of its large internal responsible investment team's time to identifying an appropriate set of ESG impact metrics for such funds. It then plans to communicate clear expectations to the relevant fund managers of what they should report. Over time, PGGM hopes to move towards defining appropriate standardised measurements for each type of fund.

How much social return on investment is sufficient? PGGM has already noticed a big difference in the social impact achieved by different investments of the same size: some generate more social impact or 'social return on investment' than others. It could be argued that the amount of impact does not matter as long as the investment is delivering the positive expected impacts outlined in the 'theory of change'. But an argument could also be made that investment should be directed towards entities that deliver the greatest positive impact – the biggest 'social bang for the buck'. This is a challenge PGGM is debating, but it does not expect a clear answer to emerge soon.

Delineating impacts: While PGGM is starting to report the environmental and social impacts of its targeted ESG investments to its clients, a key question is 'whose impact is it reporting?' PGGM is in fact reporting selected impacts of a whole project, fund or company (depending on what the underlying investment is). PGGM is typically only one of multiple investors in a company or fund, and its ability to influence the nature and magnitude of the impact of each one varies considerably. For example, PGGM may hold 2% of the free float of a listed company and have relatively little influence over the impacts generated. But where PGGM is the sole investor in forestry or farmland assets, it can exert significant influence over how these resources are managed and the positive (or negative) impacts generated. Disentangling PGGM's influence from that of others is a particularly thorny problem – and one that is faced by all investors working to understand and advance the field of impact measurement.

6 http://www.smartcampaign.org/