Q4 2016

Impact Investing: Individual Investors Seeking New Opportunities

GREENWICH ASSOCIATES

American Century Investments®

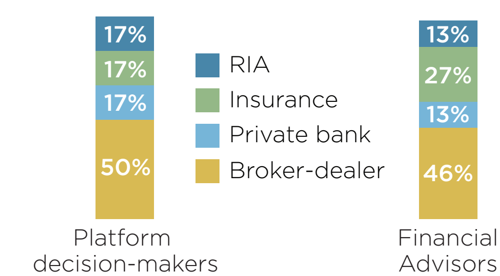
CONTENTS

Managing Director Andrew McCollum advises on the investment management market globally.

METHODOLOGY

Between January and March 2016, Greenwich Associates conducted 52 telephone interviews with intermediary platform decision-makers and an online study with 151 financial advisors to test their knowledge of and receptivity to various approaches to impact investing across the asset management industry.

RESPONDENT PROFILE



Note: May not total 100% due to rounding.

DESPITE THE CATEGORY'S RAPID GROWTH, IMPACT INVESTING IN THE U.S. REMAINS IN ITS EARLY STAGES

80% OF INTERMEDIARY ADVISORS AND 75% OF PLATFORM DECISION-MAKERS BELIEVE CLIENT ALLOCATIONS TO IMPACT INVESTMENTS WILL INCREASE OVER THE NEXT THREE YEARS

Executive Summary

Impact investments represent a fast-growing category among individual investors who access funds through the intermediary distribution platforms of broker-dealers, private banks, insurance companies, and registered investment advisors (RIAs). However, platform-level decision-makers and financial advisors disagree about nearly all aspects of impact investing, including the fundamental question of how to define the category.

To gain a better understanding of the rapidly expanding phenomenon, Greenwich Associates and American Century Investments® conducted research with more than 50 professional buyers at intermediary platforms and over 150 financial advisors that work with high net worth and individual investors.

- *Study participants cite two main benefits of impact investing: 1) the ability to achieve positive social benefit, and 2) the ability to align investments with personal or organizational values.*
- *The most striking difference between platform decision-makers and advisors is found in their viewpoints about investment returns. Forty-four percent of advisors would be willing to accept lower returns in order to achieve a positive social impact. Only 11% of platform decision-makers agree.*
- *Study participants report lukewarm levels of satisfaction with current impact investing efforts and see room for improvement in the amount of positive social impact achieved, the ability to measure societal impact, investment returns, and their own level of understanding in the category.*
- *Investing in screened separate accounts (funds that screen in or screen out particular investments) is the preferred way study participants access impact investments, followed by investing in screened commingled funds. They also invest directly in socially responsible deals and companies and with asset managers that financially support a designated cause.*

Despite the category's rapid growth, impact investing in the U.S. remains in its early stages. Impact investing definitions and best practices will take shape and solidify as the category continues to attract new participants and assets.

Doing Good While Doing Well

Growing numbers of individual and institutional investors are incorporating concerns about social impact into their investment decision-making. The notion first gained wide popularity in Europe, where investors began considering environmental, social, and governance (ESG) factors and experimenting with ideas like socially responsible investing (SRI) and "mission investing."

Investors of all types are embracing the belief that investments should align with personal values and societal goals.

As the idea of "doing good while doing well" with an investment portfolio has proliferated and taken root in North America, it has come to be known as "impact investing." This belief that investments should align with personal values and societal goals is being embraced by investors of all types, setting the stage for continued expansion of impact investing throughout global financial markets.

In Q1 2016, Greenwich Associates and American Century Investments jointly launched a study to better understand how the intermediary-sold market—through which many high net worth and individual investors access funds—views and treats impact investing. The firms interviewed 52 platform decision-makers and 151 financial advisors across channels including broker-dealers, private banks, insurance companies, and registered investment advisors (RIAs).

The study—along with a sister study among institutional investors—yielded two immediate and important findings:

1. **Impact investing is growing.** Three-quarters of decision-makers for intermediary platforms and 80% of intermediary advisors believe client allocations to impact investments will increase in the next three years.

2. **Attitudes and perceptions about impact investments vary widely.** This is true not only among different channels within the intermediary market, but also between platform decision-makers and advisors. Those differences are clear even when defining the term "impact investing," and extend to critical measures of investors' levels of satisfaction with current impact investing efforts. Perhaps the most striking divergence is that while many advisors say they are willing to accept lower investment returns in order to achieve a positive social impact, platform decision-makers by and large reject that trade-off.

These findings show clearly that investor assets are flowing into a category that is yet to be defined. Despite the category's rapid growth, impact investing in the U.S. remains in its early stages. The definition and best practices of impact investing will take shape and solidify as the category attracts new participants and assets. During this maturation phase, investors will benefit by working with intermediaries and asset managers willing to help educate them about impact investing and define the proper role for the category within their portfolios.

What Is Impact Investing?

As a general description, participants in the study agreed that impact investments deliver both a financial return and a benefit to society. Platform decision-makers and advisors associate impact investing with other related terms, such as SRI. However, few respondents in either camp could identify specific criteria that would qualify an investment strategy or individual investments as "impact investing."

Platform decision-makers acknowledge this lack of precise definition. Nearly two-thirds of decision-makers in the study say impact investing lacks a consistent definition in the marketplace. In this belief, these decision-makers are in agreement with their institutional investor counterparts. More than three-quarters of the institutions participating in a separate but related study say that impact investing is not consistently defined in the industry.

Advisors disagree with both platform decision-makers and institutions. Fifty-eight percent of advisors say impact investing has a clear and consistent definition. However, the definitions offered by advisors actually varied widely:

> *Broad diversity, green products, indigenous people's rights, fair wages.*
>
> —BROKER-DEALER
>
> *Strategic investments for good will.*
>
> —INSURANCE COMPANY
>
> *Investing in products that are in line with values and attitudes.*
>
> —RIA
>
> *It's a form of socially responsible investing that serves as a guide for various investment strategies.*
>
> —BROKER-DEALER

Platform decision-makers also offered their own definitions of impact investing:

> *You can pretty much define it yourself. I do not think there is an industry standard.*
>
> —INSURANCE
>
> *My definition of impact investing is closely aligned to charitable giving as opposed to the conventional approach to SRI/ESG investing. The emphasis of impact investing should be placed on achieving a positive, measurable social outcome and not on financial returns.*
>
> —PRIVATE BANK
>
> *Impact investing is any type of investment that has some type of benefit to the client above and beyond the risk/return objective. It is social-benefit investing.*
>
> —PRIVATE BANK

These attempts make clear that the industry has yet to agree on a standard definition for impact investing. Given this lack of consensus, Greenwich Associates uses the following definition provided by the Global Impact Investing Network (GIIN), the closest thing the field has to a trade association: "Impact investments are investments made into companies, organizations and funds with the intention to generate measurable social and environmental impact alongside a financial return."

IMPACT INVESTMENTS are investments made into companies, organizations and funds with the intention to generate measurable social and environmental impact alongside a financial return.

—GLOBAL IMPACT INVESTING NETWORK

Why and How Are Intermediary Platforms Using Impact Investing?

One key goal of the study was to answer the question of why intermediary platforms are adopting impact investing and offering these products to their investors. Participants in the study say they are attracted by two main benefits:

1. **The ability to make a positive contribution to society**

2. **The ability to align investments with personal values**

Study participants described the following benefits of impact investing to their own organizations and to their clients:

Value alignment. I think impact investing allows people to feel better about their investments...It's not just a number they can retire on, but that they are making a difference and that makes them feel good and empowered.

—BROKER-DEALER PLATFORM DECISION-MAKER

First, it allows some clients the opportunity to place their money in a socially responsible product. Second, it not only helps the client, but helps us as an organization to stand behind our investments. It is more than just making money; we have a social conscience as an organization.

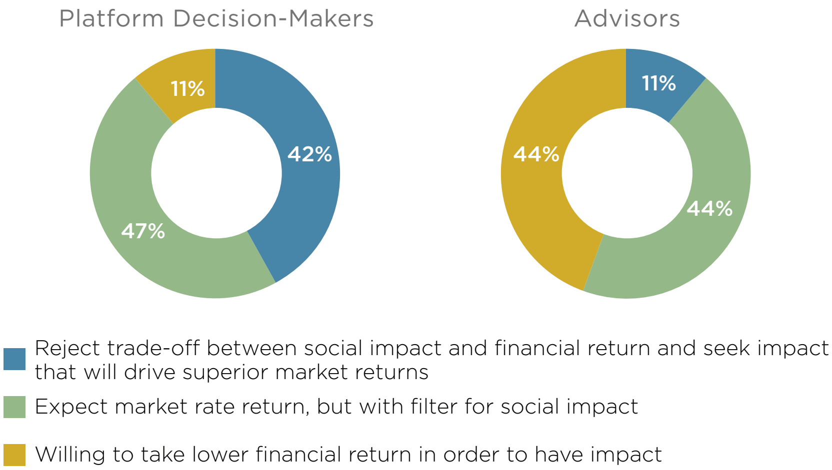
—INSURANCE PLATFORM DECISION-MAKER

Making a positive difference. Our firm donates 10% of its profits to benefit people who put in solar energy and things like that. It works when the benefits are socially responsible and help people in need.

—RIA PLATFORM DECISION-MAKER

Based in large part on these perceived benefits, 45% of platform decision-makers in the study say they make a conscious effort to include impact investing options on their platforms. At 71%, private banks are most likely to do so. In addition, 86% of advisors report that they include impact investments in client investment policy statements. Almost half say investment policy statements include stated objectives for impact investments, and almost 40% say their investment policy statements provide a required allocation.

TRADE-OFFS BETWEEN SOCIAL IMPACT AND INVESTMENT RETURNS



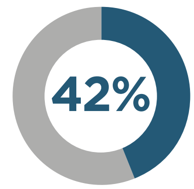
Note: May not total 100% due to rounding. Based on 45 professional buyers and 151 advisors.
Source: Greenwich Associates—American Century Investments 2016 Impact Investing Study

When it comes to the question of how impact investments should be treated within the portfolio, the study results again reveal some subtle differences between platform decision-makers and advisors. Platform decision-makers are divided, with roughly equal shares stating that impact investments should be viewed as 1) a stand-alone category within the portfolio, 2) a screen or filter applied by the organization across the portfolio, and 3) some combination of both approaches. Among advisors, a solid plurality of 44% say impact investments should be viewed as a discrete investment category, with 37% agreeing that the concept should be applied as a portfolio-wide filter.

The most striking difference between platform decision-makers and advisors is found in their viewpoints about investment returns. Forty-four percent of advisors in the study—including 57% of advisors working at broker-dealers—say they would be willing to accept lower returns in order to achieve a positive social impact. Only 11% of platform decision-makers agree. Rather, 42% of them say they reject altogether the notion that there must be some trade-off between social impact and financial returns, and say they seek impact investments that will deliver superior performance.

Are Platforms Satisfied With Current Impact Investment Efforts?

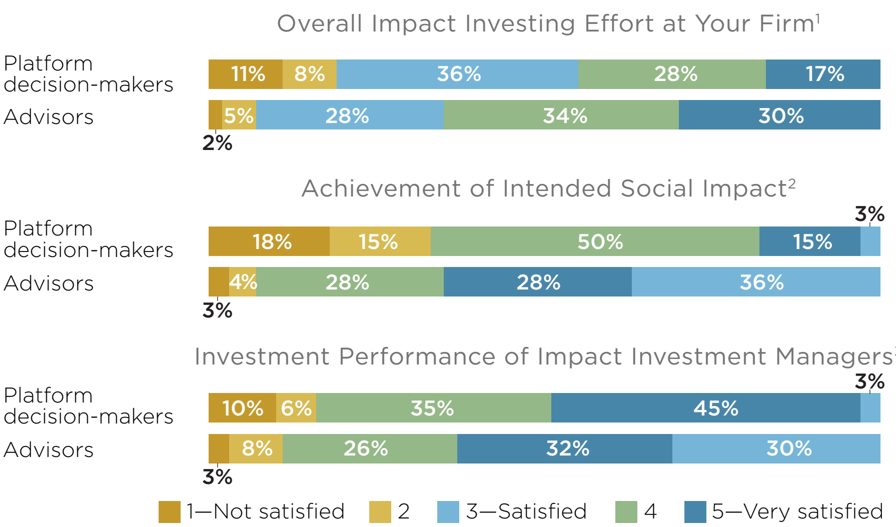
At first glance, intermediaries seem satisfied with the results of ongoing impact investing efforts. However, a closer look at the data reveals considerable room for improvement. In particular, although financial advisors are largely satisfied with the results of current impact investment programs, satisfaction levels among platform decision-makers are much lower.



of platform decision-makers are seeking impact investments that will deliver superior performance

Ninety-two percent of advisors say they are satisfied with existing offerings overall, and similar shares express high levels of satisfaction with the social impact and, separately, the investment performance of their impact investments and managers. In each of these categories, relatively large shares of advisors rate themselves as "very satisfied."

SATISFACTION WITH IMPACT INVESTING



Note: May not total 100% due to rounding. [1]Based on 36 professional buyers and 151 advisors. [2]Based on 34 professional buyers and 151 advisors. [3]Based on 31 professional buyers and 151 advisors.
Source: Greenwich Associates—American Century Investments 2016 Impact Investing Study

Although 81% of platform decision-makers say they are at least satisfied with existing impact investing efforts, study results show that support actually to be lukewarm at best. Most of the platform decision-makers in the positive camp rate their satisfaction level as a middling 3 out of 5, as opposed to the stronger levels of satisfaction expressed by advisors. A full two-thirds of platform decision-makers at RIAs say they are not satisfied with current impact investment offerings overall, and half are dissatisfied with the social benefits achieved by their impact investments.

The data points to several causes for relatively low levels of satisfaction:

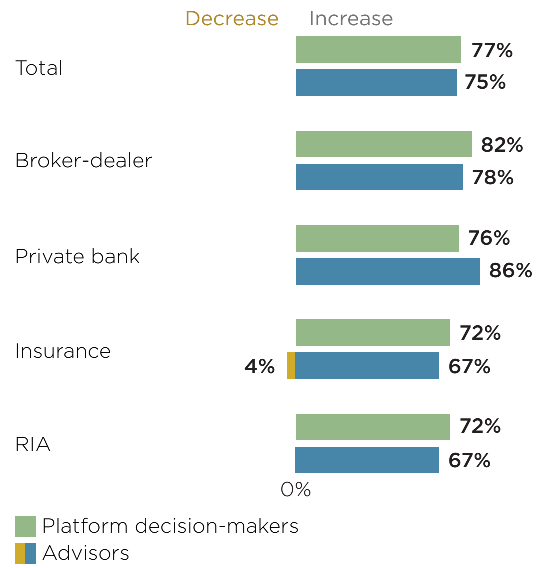
1. **Disappointment with investment returns**
2. **Disappointment with social impact**
3. **Difficulty measuring social impact**
4. **Lack of knowledge or understanding about impact investing**

Impact Investing: Where to From Here?

Despite any concerns among platform decision-makers about the efficacy of existing efforts, the study results suggest impact investments are poised for considerable growth on intermediary platforms. Three-quarters of platform decision-makers and 80% of intermediary advisors believe client allocations to impact investments will increase in the next three years. Not a single platform decision-maker and only 1% of advisors expect client allocations to fall. The most bullish group is platform decision-makers for private banks, 86% of which expect allocations to grow.

Most platform decision-makers expect client impact investment allocations to increase by 1%–10% during the period. Advisors are considerably more bullish. Almost half of them (47%) think client allocations will grow by more than 40% in the next three years.

EXPECTED CHANGE IN TARGET ALLOCATIONS FOR IMPACT INVESTING



Note: Based on 48 professional buyers and 151 advisors.
Source: Greenwich Associates—American Century Investments 2016 Impact Investing Study

Approaches to Impact Investing: Pros and Cons

One of the study's most important findings is the fact that advisors and platform decision-makers at various types of intermediary platforms have differing attitudes when it comes to goals and perceived trade-offs associated with impact investing. In response to those divergent views, asset managers have developed different ways of implementing impact investments into a portfolio. Among the most popular are:

COMMINGLED FUNDS 1

Investing in a commingled fund screened for impact investments

SEPARATE ACCOUNTS 2

Investing in a separate account customized to include prespecified impacting investing screens

DIRECT INVESTMENT 3

Investing directly in socially responsible deals/companies

IMPACT MISSION 4

Investing with a company that supports a designated cause as part of its mission and business model

Intermediary platform decision-makers rank investing in a separate account customized to include prespecified screens as their preferred approach for accessing impact investments, followed by investing in a commingled fund screened for impact investments. Advisors also name separate accounts as their preferred vehicle, followed by investing directly in socially responsible deals and companies.

These are, indeed, the most common and widely accepted approaches within the industry. Both separate and commingled accounts allow investors to direct their assets to investments that align with their own values and beliefs. Separate accounts allow for a much higher degree of customization in terms of impact investing screens, but with the trade-off of significantly higher fees. Of course, investors can tailor their entire portfolios according to impact investing goals by making direct investments.

Potential Drawbacks and Concerns

However, all four of these approaches include elements perceived as potential drawbacks. The first and most important of these: concerns about overall performance due to the limited universe of investment opportunities.

As documented earlier in this report, a surprising number of financial advisors are willing to accept lower investment returns in exchange for positive social impact. Nevertheless, all study participants view some level of acceptable investment performance as a prerequisite for impact investing. The practice of excluding some potential investments from the portfolio through the use of screens could therefore prove problematic over the long term—if this exclusion has a negative impact on performance. Managers that employ this approach to impact investing must use their impact screens to add alpha, rather than simply exclude selected categories.

Commingled funds and separate accounts that use screening as their primary means of implementing impact investing raise another important concern: difficulty measuring the true “impact” of the investment. While such screening can ensure that portfolio investments are aligned with platform decision-makers’ and advisors’ values on important social issues, the diffuse nature of the approach makes it hard, if not impossible, to quantify the social benefit these efforts achieve.

Adding to these concerns is the potential for conflicts of interest or even perceived conflicts of interest on the part of asset managers or consultants setting the parameters for the screen and choosing which specific industries and investments will be included and excluded.

The use of separate accounts and direct investments for impact investing raises another key concern for intermediary platforms: worries about added complexity and cost. Setting up a separate account imposes costs of resources and management attention, and often requires the use of an investment consultant. Making direct investments in socially responsible companies and deals brings with it obvious costs and demands in terms of deal sourcing, due diligence, and monitoring.

> Investors will increasingly seek approaches that reject the trade-off between strong investment performance and meaningful and measurable societal benefit.

The fourth approach to impact investing—investing with an asset manager that financially supports a designated cause—alleviates several of these concerns. Because the approach does not screen or exclude investments for social impact, portfolio managers within the asset management organization have full discretion in working to maximize investment performance. Furthermore, as the investment process is not changed in any way by the impact investment commitment, the interests of investors and shareholders are fully aligned with the desired social benefit. In other words, higher returns not only benefit clients and shareholders, but provide greater financial support for the designated cause.

For investors, there is no added cost, complexity, or due diligence requirements and no potential for conflicts of interest in the exclusion of investments. Finally, the fact that a portion of the returns is earmarked for a single cause concentrates the impact of allocated dollars and makes the process transparent and, therefore, relatively easy for investors to assess the actual social benefit generated by their investments.

However, that level of concentration can also be seen as a potential drawback. Using this approach, investors cannot set impact investing screens or otherwise direct their investment dollars. On the contrary, if the asset manager financially supports a single cause, investors with other impact investing goals might find the proposition limiting.

Conclusion

There is a clear and growing desire among high net worth and individual investors to use their investment portfolios to support both personal financial and societal goals. Given the expanding appeal of impact investing among individual investors today and the emphasis placed on societal considerations by a range of investors—from millennials to the Silent Generation—we believe that this movement is still in its early stages, both in North America and around the world.

As the category grows, the industry's definition of "impact investing" will solidify. While there is no one approach to impact investing that is right for everyone, investors will increasingly seek approaches that reject the trade-off between strong investment performance and meaningful and measurable societal benefit.

The data reported in this document reflect solely the views reported to Greenwich Associates by the research participants. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Greenwich Associates compiles the data received, conducts statistical analysis and reviews for presentation purposes in order to produce the final results. Unless otherwise indicated, any opinions or market observations made are strictly our own.

Commingled funds consist of assets from several accounts that are blended together. Separate accounts are owned by one investor, follow a defined strategy, and have their own cost basis. Alpha is defined as the excess returns relative to the return of a benchmark index. An Investment Policy Statement (IPS) is a document that outlines the general goals and objectives of a client and describes the strategies that the investment manager should employ to meet those objectives.

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