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Responsible Investing

Impact Engagement Principles
Delivering on the UN Sustainable Development Goals

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Executive summary

- AXA IM believes that significant positive societal impact can be generated through listed assets investment strategies. This is the case for capital allocation into best-in-class companies, and for engagement with companies where there is scope for change.
- Engagement is an important route for investors in listed assets – public equities and corporate bonds in particular – to drive impact through their actions. When done right, intervention by investors can contribute to broader societal goals, such as those set out in the Paris climate agreement or in the United Nations' Sustainable Development Goals (SDGs).
- However, there is a risk of characterising business-as-usual environmental, social and governance (ESG) engagement as 'impact engagement' simply because there may be overlaps with the SDGs. We believe that this is not sufficiently ambitious.
- We believe that 'impact engagement' is a specific and distinct approach to active ownership. It is differentiated from broader and well-established approaches to ESG-related engagement.
- In this paper, we propose an approach to 'impact engagement' which is strategic in nature and has objectives that, if successfully achieved, will lead to meaningfully positive outcomes. It will often focus on how capital can be allocated to drive the future ambitions of the company's core activities, in line with the SDGs. It goes beyond gaining insights into a company's operational performance, mitigating risks of negative externalities or improving sustainability reporting.

> **“We have identified two ways of generating positive impact in listed assets. One approach involves identifying best in class companies while the second focuses on engagement”**

Impact investment has emerged as a distinct approach from sustainable investment in the past decade. It is defined as investments made with the intention to generate positive social and environmental impact alongside financial returns. This is often framed by the urgent need to deliver on the United Nations’ Sustainable Development Goals (SDGs) by 2030.

AXA IM established its framework for impact investment in listed assets in 2019 – for full details please refer to our report: “Driving impact in listed asset investments.”[1]

We identified two ways of generating positive impact in listed assets. One approach involves identifying best-in-class companies (which we categorise as ‘Impact Leaders’), while the second focuses on engagement.

In the first approach, allocation of capital to Impact Leaders supports capital raisings and contributes to market price signals for securities. This encourages Impact Leaders to sustain positive strategies, while creating an incentive for other companies to replicate those strategies.

The second approach centres on the role of investor as the change-agent through engagement. This is the focus of this paper. We believe that investors can generate positive impact in listed assets through engaging with companies to drive significant change. Companies do not need to be identified as Impact Leaders to be engagement targets – rather, positive impact is derived from the change that is encouraged by investor engagement.

Our five pillars of impact investment provide a framework for assessing impact across both approaches.

Intentionality

Investments should be made with an upfront objective of positive social or environmental outcomes. Companies can also demonstrate an intentional, strategic commitment to positive impact.

Materiality

Invest in companies where the positive outcomes are of material significance to the beneficiaries, the company, or to both.

Additionality

The extent to which a company is making its ‘needed’ products and services more accessible or commercially viable, for example through innovative new solutions or lower pricing.

Negative consideration

A company’s corporate practices, or products and services, may significantly undermine the positive impact it is generating elsewhere.

Measurability

There needs to be a clear methodology and commitment to measuring and reporting the social and environmental performance of investments.

[1] AXA Investment Managers: “Driving impact in listed asset investments”, Apr 2019

Engagement: Intentional, Additional, Material

We consider engagement to be a valid base for an impact investment strategy due to three distinct characteristics: additionality; intentionality; and materiality.

1. **Additionality – Theory of change:** Engagement initiatives are underpinned by the theory of change. The investor is undertaking an engagement strategy with a high degree of conviction that, if successful, it will result in various anticipated outcomes that will be of positive benefit to a particular group, or to society at large.

2. **Intentionality – Pre-defined objectives:** Engagement initiatives are wrapped in specific pre-defined objectives, whereby the realisation of those objectives will result in material positive change. Objectives can be modified as lessons are learned through the engagement process, although targeted change should always remain meaningful. Key performance indicators (KPIs) should be set to help monitor progress towards those objectives.

3. **Materiality – Strategic and long term:** Engagement initiatives should be seen as a strategic and long-term endeavour. Tensions with other corporate strategies, and related resistance from management teams, should be expected.

Engagement is a central aspect of our listed-impact strategies, especially for the inclusion of what we call "Transforming Companies"[2]. These are issuers where a constructive dialogue with investors could lead to a significant change. We also view companies where the impact-related strategy and practices could be enhanced as targets for engagement dialogue.

In line with our views, engagement is increasingly establishing itself within the impact investment industry as a powerful tool for effecting change through the vast economic base that is the listed assets investable universe. We participate in discussions with industry peers through the Global Impact Investor Network (GIIN) where we are members of the Listed Equities Working Group and sit on the Advisory Committee overseeing this area.

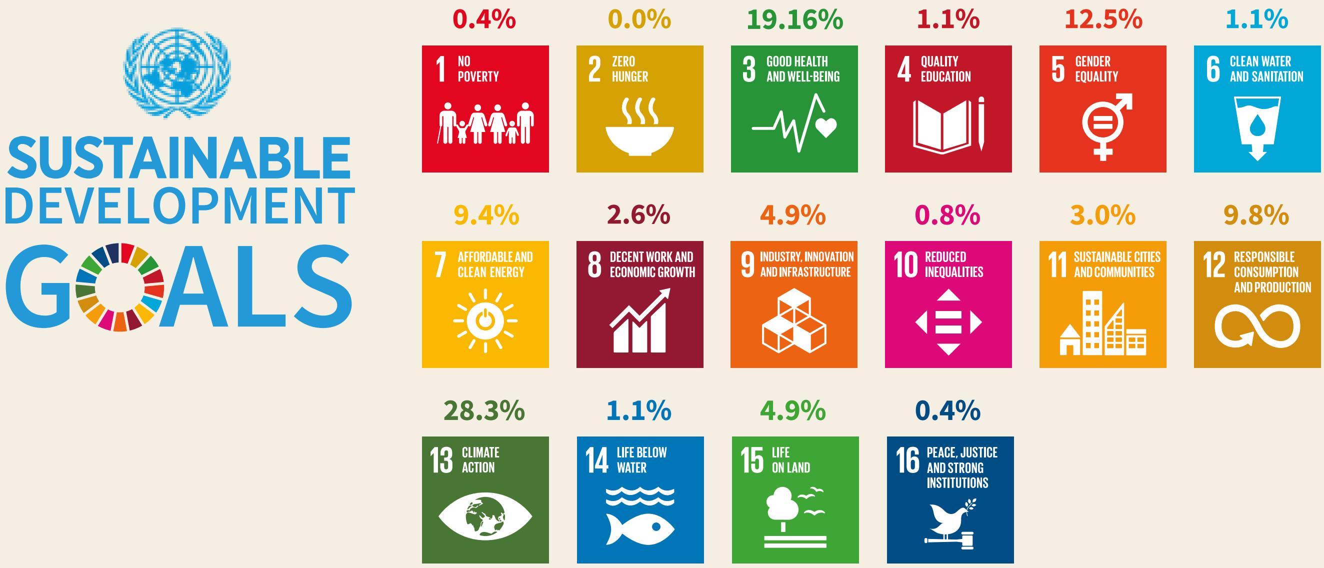
[2] Transforming Companies were previously labelled Transitioning Companies. We changed the name as the concept of Transition is very closely linked to climate change and the global economic shift out of fossil fuels.

Engagement on SDGs takes different forms

Engagement is the foundation for impact investing in listed assets. SDG-aligned engagement sets the pathway towards an impact investment mindset beyond issues related to environmental, social and governance (ESG) risks. There are a number of active ownership approaches which can be adopted with regards to SDG-related engagement.

1. **ESG engagements with SDG overlap:** This is what we commonly describe as business-as-usual ESG engagements, now well established in the industry. Many of these ESG issues have clear overlaps with specific SDG targets. Examples include engagements with emerging market companies on female employees' career progression (SDG5: Gender equality) or urging companies to commit to carbon emission reduction targets (SDG 13: Climate Action). We capture this information in our database and in H1 2020, our ESG engagements overlapped with SDGs as follows[3]:

More than 80% of our engagements in H1 2020 were linked to the United Nations Sustainable Development Goals. The breakdown of that portion is as follows:



2. **Reactive engagement – Controversies and norms-breaches:** In some cases, companies in which we are invested become involved in serious controversies which include breaches of international norms such as the UN Global Compact. These incidents undermine companies' sustainability credentials and our assessment of them as being impactful. Involvement in negative events detracts from a company's contribution to achieving the SDGs. We engage the company to assess its response to the controversy. Once again, these reactive engagements are long-established tactics in active ownership programmes.

3. **Impact engagement: This is the primary focus of this paper.** We propose this as a specific and distinct approach to active ownership that goes beyond the broader and well-established approaches to ESG-related engagement. It is strategic and driven by commercial opportunities. It principally focuses on how capital is allocated to drive the ambitions for the company's core activities in line with the SDGs. It goes beyond enhancing operational performance, mitigating risks of negative externalities or improving sustainability reporting.

[3] For further details please refer to our AXA IM H1 2020 Active Ownership Report .

Impact Engagement

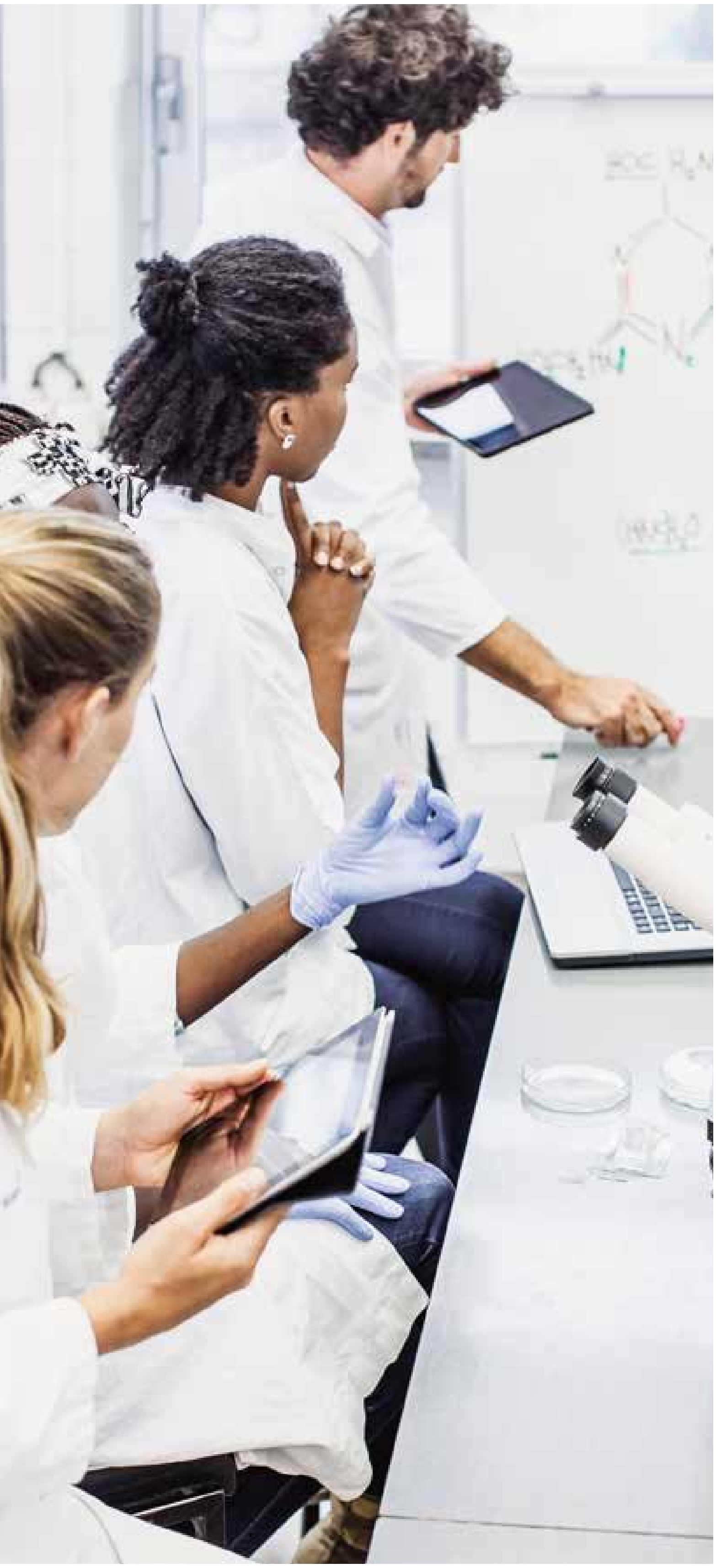
Impact engagement constitutes an important sub-section of wider SDG engagement, centred on nuanced and focused objectives for specific impact outcomes. Impact engagement is **opportunity rather than risk-management focused.** Engagement objectives outline how companies can actively contribute to positive impact (aligned to the SDGs), rather than simply managing material ESG risks.

Impact engagement relates principally to **the revenues or capital allocation** of businesses. For example:

- Transforming the business mix from harmful to low or positive impact activities (e.g. from coal-based to renewable energy power generation – **SDG 7**)
- Enhancing the quality of the product, such that it is dramatically less harmful or even positive to consume (e.g. cutting the sugar content of food & beverages – **SDG 3**)
- Improving the accessibility of needed products to the underserved (e.g. introducing progressive pricing strategies for essential medicines – **SDG 3**)
- Deploying capital and expertise to make investments into solutions (e.g. R&D into medicines covering rare diseases, EV battery recycling solutions or carbon capture technologies – **SDGs 3, 12 or 13**).

There are also rarer cases where it can be related to the **cost and operational** side of the business. But we do not view this as Impact Engagement unless highly ambitious, market-leading sustainability methods are established which can improve industry best practice benchmarks and can also deliver strong commercial returns for the company.

> “Impact engagement is opportunity rather than risk-management focused”



Impact Engagement in Practice

Our engagement objectives seek to provide benefits by encouraging the company to gain long-term competitive advantages by addressing unmet needs in large potential markets while also generating a significant positive societal impact.

Our enhanced engagement approach allows us to identify certain companies with potential for impact. We then seek to guide them towards significant strategic commercial success using best-in-class approaches to achieving the SDGs.

We have identified those best-in-class behaviours across our five pillars of impact investment described above, and this analysis guides our engagement approach. We have provided examples of KPIs which we can use to measure progress against the five pillars, and plan to have in-depth conversations with a number of companies over the coming months to further refine our thinking.

Intentionality

We believe that companies should demonstrate intentionality through a long-term strategic commitment to generate positive impact in core business products and services. Impact Leader companies have a strong strategic commercial alignment with delivering on the SDGs. We do not accept that positive impact is a fortunate, minor by-product of commercial activities (which is more akin to impact washing) but rather the hard-won result of a strategic commitment by the business to deliver the win-win of good returns and sustainability outcomes. Our engagement would encourage companies to adopt the SDGs as a core tenet of corporate strategy.

Engagement KPI example:

- Board-level oversight of positive impact commercial initiatives and setting strategic targets aligned to the SDGs – e.g. a corporate commitment by a healthcare company to roll out sophisticated intra- and inter-market tiered pricing models and supporting distribution approaches to ensure treatments could be accessed by all in a sustainable and profitable fashion.

Materiality

Impact Leader companies will make a material contribution to a pressing societal issue. This could mean a majority of the firm's commercial activities contribute to the SDGs or a company is the leading provider in relation to peers. Therefore, engagement strategies may centre around encouraging companies to allocate capital to business lines which are considered the most materially impactful.

Engagement KPI example:

- Increasing the percentage of revenue contributing to the SDGs, ideally externally audited.

Additionality

When assessing a company's impact, we consider additionality principally in terms of making vital products and services more accessible and commercially viable. Innovation is also key, with investment in R&D facilitating the creation of solutions that accelerate global development. Therefore, impact engagement objectives will aim to make products accessible to those who require them most and encourage the provision of innovative solutions.

Engagement KPI example:

- Increasing the percentage of products covered by equitable pricing strategies or accessed by low-income/ target groups

Negative consideration

Impact Leader companies manage negative externalities arising from products and services in an industry-leading fashion. As Impact Engagement will primarily focus on products and services, apart from in exceptional circumstances, negative consideration will focus on management of the negative effects arising from products and services.

Engagement KPI example:

- Introduction of innovative approaches to significantly reduce negative impacts, e.g. pioneering a packaging solution to significantly reduce plastic consumption

Measurability

Effectively measuring impact is central to guiding investment decisions and allowing companies to monitor their own contribution to the SDGs. We plan to continue our collaboration with industry bodies to develop impact measurement further.

Engagement KPI example:

- The introduction of uniform, year-on-year reporting with clear methodologies, baselines and targets.

Conclusion

Impact Engagement is strategic in nature. It principally relies on theories of change and has objectives that, if successfully achieved, will lead to meaningfully positive impact. Impact Engagement encourages companies to adopt strategies that address the commercial opportunities presented by society's ambition to achieve the SDGs. It will often focus on how expenditure or capital can be allocated to drive the company's future ambitions in line with the SDGs. It goes beyond gaining insights into a company's operational performance, mitigating risks of negative externalities or improving sustainability reporting.

In H1 2020, we have started to conduct Impact Engagement in the approach detailed in this document. We are furthering our strategic dialogue at Board and Executive Committee level. Our goal in these dialogues is to make the case that company performance will increasingly require an understanding of societal purpose and its connection to measurable positive outcomes – linked to the SDGs – for investors, consumers and, in the future, regulators. In a post COVID-19 world, we have high conviction that the companies that embrace this dynamic will prove more resilient and relevant in a rapidly shifting business context.

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