

Integrity through Verification

Tideline's approach to verifying alignment with
the International Finance Corporation's
Operating Principles for Impact Management

A Tideline Publication

September 2019

TIDELINE

Introduction

There is broad agreement that a core focus in impact investing must be “scaling with integrity.”¹ As the growth of the market accelerates with increasingly frequent announcements of ever-larger funds and the entrance of new asset managers, we must continue to re-emphasize the importance of discipline and authenticity in our approaches to impact – along with the need for clear standards and best practices as guidance.

The industry’s response has been multi-faceted, with investors benefiting from a range of shared frameworks, standards, certifications, methodologies, and metrics² intended to guide the practice of impact management. Taken together, these are the building blocks that make it possible for any impact investor to credibly pursue impact alongside financial objectives.

Launched in April of this year, the International Finance Corporation’s (IFC’s) Operating Principles for Impact Management (“the Principles”) are a valuable addition to the market, outlining the essential features of a robust impact management system in a way that is broadly applicable, complementary to other standards and resources, and practically oriented.

The following white paper provides an overview of the merits of the Principles, and introduces Tideline’s proprietary approach to verifying investors’ and managers’ alignment with those Principles – a mandated requirement for current³ and future signatories.

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1 Quote attributed to Amit Bouri, CEO of the Global Impact Investing Network (GIIN). <https://impactalpha.com/core-characteristics-and-operating-principles-to-help-impact-investing-scale-with-integrity>

2 Five Building Blocks for Impact Management. Co-authored between Franklin Real Asset Advisors and Tideline. March 2019. <https://tideline.com/five-building-blocks-for-impact-management>

3 Full list of signatories available here: <https://www.impactprinciples.org/signatories-reporting>

The Principles

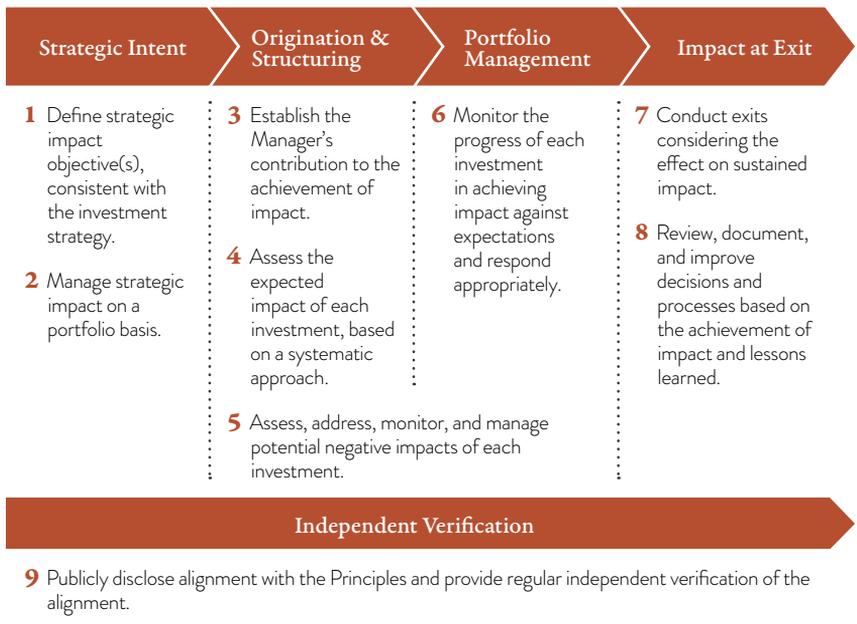
As the practice of impact management has matured, various tools and guidance have been developed for different stages of the investment process. The United Nations Sustainable Development Goals (SDGs) help at the goal-setting stage of investment, by providing a common articulation of impact objectives around which to align.

The important work of the Impact Management Project provides a clear methodology for articulating the characteristics of impact being targeted, which is particularly useful for measuring and reporting impact.

IRIS+ has become the leading standard for identifying impact metrics, making it possible to draw from a catalog of social and environmental outputs and outcomes that cuts across sectors.

For their part, the Principles developed by the IFC have filled a key gap by defining *how* investors should manage for impact, codifying the essential features of a robust impact management system. The guidance spans the full investment process and is composed of nine Principles (Figure 1).

FIGURE 1



SOURCE: IFC

The Principles are quickly gaining traction for three core reasons:

Accessibility Managing for impact can be challenging, as the range of guidance and tools can be overwhelming, especially for the many new entrants to impact investing. The Principles clearly and concisely lay out the fundamental features of effective impact management in a way that is practical and easy-to-understand. As early evidence of the Principles' accessibility and practicality, since the launch of the final framework in April 2019, the IFC has secured the support of 72 signatories thus far.

Adaptability The Principles codify a baseline level of best practice, but they also allow practitioners to implement them in ways that make sense for their particular investment strategies. They can accommodate both the wide variety of asset managers that are active in the impact investment market and the various requirements and preferences of asset owners that invest in impact strategies. Furthermore, the Principles are compatible with and complementary to other tools and resources in the market, as these can be readily incorporated into the process as relevant. The Principles are not prescriptive about which of these tools should be used within the system.

Accountability The Principles emphasize public disclosure and independent verification of the extent to which an investor is aligned with them (as defined in Principle #9), enabling the transparency that is fundamental for combatting "impact-washing" and confusion in the market.

Asset managers, asset owners, and advisors can each benefit significantly from the Principles, although the ways they use them may vary. For asset managers putting the Principles into action, the framework can provide an opportunity to distinguish themselves on the basis of the rigor of their approaches to impact management, supporting healthy competition along these lines. For asset owners or advisors that may invest in these managers, the Principles support efficiency in evaluating a manager's impact management practices, as verified by an independent assessor.

Accessibility, adaptability, and accountability make the Principles a standard that can and should be widely adopted moving forward. The Principles provide an anchor for effective impact management and, as a result, they significantly enhance market integrity.

Tideline's Approach to Verification of the Principles

Recognizing the value of the Principles, and the designated role for verification, Tideline has developed a proprietary approach that independently assesses impact management processes, building on the firm's deep experience in developing impact management strategies and systems for clients since the firm's founding in 2014. Our approach is grounded in four guiding tenets:

Rigor We break each of the nine standards into their component pieces and create corresponding ratings backed by clear and consistent guiding rubrics.

Innovation We recognize that practices considered best-in-class today may be surpassed tomorrow. We also remain open-minded to the need for different tools in different market contexts.

Learning Our approach is designed to provide not just an assessment, but also to support opportunities for improvement for investors. We share the detailed version of the assessment with asset owners and managers, providing visibility to signatories into exactly where and how they are currently well-aligned—and what it would take to strengthen their systems. Our ratings definitions (Figure 2) are reflective of this learning objective by emphasizing the level of enhancement needed.

Efficiency Our method is backed by a well-defined and tested process and a rigorously developed methodology with supporting documentation. To date, we have implemented two Principles verifications (KKR Global Impact Fund and LeapFrog Investments), each of which has been completed within approximately four weeks.

FIGURE 2

Low	Material enhancement is needed
Moderate	Meets threshold requirements, with several opportunities for enhancement
High	Selected enhancement opportunities available
Advanced	Limited need for enhancement

SOURCE: TIDELINE

Verification in Practice

Tideline’s approach incorporates three layers of assessment for each Principle:

- the **COMPLIANCE** of the system with a threshold level of practice;
- the **QUALITY** of the system’s design, in terms of its rigor and consistency;
- the **DEPTH** of particular sub-components of the system, focused on robustness.

A case study on one Principle highlights how Tideline’s methodology works in practice.

Principle #7 states:

When conducting an exit, the Manager shall, in good faith and consistent with its fiduciary concerns, consider the effect which the timing, structure, and process of its exit will have on the sustainability of the impact.

In Tideline’s methodology, there are different sub-criteria for each Principle (aligned to the **COMPLIANCE**, **QUALITY**, and **DEPTH** dimensions), which in the case of Principle #7 include:

- **Process (COMPLIANCE)** Does the Manager have any formal process or policies in place to stipulate how impact is considered at exit? [Yes/No]
- **Documentation (QUALITY)** Does the Manager capture this process using repeatable, standardized documentation? [Yes/No]
- **Process Thoroughness (DEPTH)** Which of the following components does the Manager’s process include? [Selecting all that apply from a detailed list of best practices]

Tideline’s team analyzes each of these sub-criteria based on documentation provided and discussions with the investor, and assigns the appropriate rating, which progressively improves as we move from the **COMPLIANCE** sub-criteria to the **DEPTH** sub-criteria. For example:

- If the Process sub-criterion in Principle #7 is a No, this would result in a **Low** rating; a Yes would imply **Moderate**.
- The Documentation and Process Thoroughness sub-criteria would determine if a **High** or **Advanced** rating was warranted, based on the degree to which the system is aligned with current best practices, recognizing these will evolve over time.

Principle #7 is in fact the simplest to assess among all the Principles. Although the others involve additional sub-criteria and detail, the methodologies follow a similar pattern. The final product of the verification is a detailed report on the findings, reviewed with the manager in a discussion facilitated by Tideline. A Disclosure Statement is also released, in compliance with Principle #9.

The Opportunity in Verification

Verification is the next critical step forward for impact investing. As Andrew Kuper, the founder and CEO of LeapFrog Investments, stated following the conclusion of Tideline's independent assessment: "The impact investing industry needs authenticity and accountability now more than ever."

There is a robust body of practice and clear standards for impact management to enable such verification. Tideline is committed to contributing to enhanced integrity during this important period of the market's development. We do so with a hunger for continuing to learn with the market, while sharing our experience and perspective along the way.



Tideline provides independent impact management verification services to asset owners, managers, and enterprises. Please contact info@tideline.com.

ABOUT TIDELINE

Tideline is a consulting firm that provides tailored advice to clients developing impact investing strategies, products, and solutions. Tideline has completed 85 projects since being founded in 2014, including many focused on impact management. Our clients for projects focused on the design, implementation, and verification of impact management systems include some of the most prominent asset owners and managers in impact investing. Tideline was an advisor to the Impact Management Project and helped design and launch SDG Impact, a standard-setting initiative at UNDP for SDG-enabling investments.