TRUTH *in* CLIMATE IMPACT

A Tideline Guide to Best Impact Management and Labeling Practices

TIDELINE

OCTOBER 2022

ABOUT TIDELINE

Tideline is a women-owned, specialist consultant for the impact investing industry. Since 2014, Tideline has provided expert, tailored, and actionable advice to institutional asset managers and allocators deploying over $300 billion in impact investment strategies and solutions.

Learn more at www.tideline.com

ACKNOWLEDGEMENTS

This guide was made possible thanks to the lead authorship of Claudia Leon, Andrew Pemberton, and Ben Thornley. We also want to thank our BlueMark colleagues Tristan Hackett and Mya Stanislas for their important input on framework mapping, along with Dmitriy Ioselevich of 17 Communications and Dustin O'Neal of Great Jones Studio for their direction on writing and design.

We are grateful to the Tideline and BlueMark clients featured as case studies—Brookfield Global Transition Fund and British International Investment—and to the dozens of other investors that have helped inform and refine Tideline's approach to climate impact management in recent years.

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INTRODUCTION

Despite growing interest in addressing the climate crisis through capital markets, there remains widespread confusion about what it means to be a climate investor—that is, one whose investments result in the tangible avoidance or reduction of emissions, or support adaption. Yet the importance of understanding the real-world effects of climate impact investments cannot be overstated given the urgency of limiting global warming and its effects.

For the impact investing market, climate has become by far the dominant impact theme and, for those new to impact investing, the lens through which the integrity of the entire market will be judged. According to the Global Impact Investing Network (GIIN), over two-thirds of impact investors identify climate change as one of their core investment areas.[1] Campbell Lutyens estimated in 2022 that a total of $183 billion was either being raised or had already been raised for climate-focused private markets strategies since 2016.[2]

Industry groups, regulators, and investors alike are in search of the appropriate tools, frameworks, and legislation to bring more clarity to the frenzied growth of climate investment—especially as certain core, quantifiable metrics like company Scope 1 and 2 emissions have become table stakes for any investor making a climate investment (and increasingly for all investors). Recent debates around the validity of sustainable investment writ large bring to light some of the fundamental challenges at the forefront of the climate investment space: the broad scope of environmental "action" that can be taken, the heightened need for active management to reengineer entire economic systems, and the hyper-centricity and focus on select disclosures absent any context on the strategies in place to effect desired outcomes.

1 GIIN, Annual Investor Survey 2020.

2 Campbell Luytens, "The rise of specialist climate strategies in private capital" (2022).

Three necessary elements of climate investment remain particularly unsettled: robust integration of climate objectives pre-investment; discipline in measuring real-world emissions; and the attribution of emissions reductions to a particular investment or action. This has had the effect of confusing industry debate and regulatory action focused on the precise labeling of climate strategies, which presumes that a single investor type or methodology might qualify as a climate investment. In reality, the efficacy of a climate investment strategy should be evaluated on the quality and consistency of the principles and practices that managers employ throughout the investment process.[3]

As both new and more tenured managers try to navigate the dynamic climate investment space, there is an increasing need for consensus on how to manage for climate impact with integrity and accountability, and to exhibit real progress in achieving ambitious global climate goals. If climate investors are claiming the "impact" label, the question arises: what makes them any different from the broader universe of 'responsible investors' that are themselves growing in awareness of climate-related risks and opportunities?

Tideline's experience advising over 150 clients has shown us that investors differentiate their impact investing practices through varying levels of **intentionality** in their investment mandate, **contribution** to the impact of their portfolios, and active **measurement** and management to validate their results.[4] In this paper, we reflect on the market's shift toward more rigorous expectations for all three of these distinguishing factors, and zero in on how climate impact investors should respond to the added responsibility of being at the leading edge of both innovation in impact management and market formalization.

3 As discussed in previous Tideline work, managers need precision and balance across three key pillars to ensure they achieve impact integrity: identifying the impact characteristics of the target market in which a fund is investing; developing the capabilities to deliver and demonstrate impact; and—based on the first two pillars—choosing the most accurate positioning of the fund. For climate investment, this means managers should identify the distinct climate challenge they are trying to solve, the pathways for creating impact and relevant expertise needed, and —finally— the implications for Fund labeling.

4 To learn more about these three core pillars of impact investing, please see "Truth in Impact: A Tideline Guide to Using the Impact Investment Label." Available at https://tideline.com/truth-in-impact-a-tideline-guide-to-using-the-impact-investment-label/

CLASSIFYING CLIMATE INVESTMENT

Climate-related investment is a big tent. Setting aside the wide range of sectors and business models that reasonably fit within a climate impact mandate, there are also a number of approaches that investment managers use to build a climate focus into their funds. These distinctions are the focus of Tideline's research, since they are critical to discerning the real-world effects of climate strategies in achieving the necessary step change in emissions levels.

To help distinguish and communicate the range of sustainable investment strategies in climate, Tideline has leveraged the work of our sister company, BlueMark, to create a consolidated mapping of climate investment strategies against a number of core frameworks, including Tideline's Framework for Impact Labeling, the Impact Management Platform (IMP)'s impact classes, Europe's Sustainable Finance Disclosure Regulation and the UK's companion Sustainability Disclosure Requirements, and the new classification framework recently proposed by the US Securities and Exchange Commission.

FIG. A

CLASSIFICATION OF CLIMATE-BASED THEORIES OF CHANGE BY REPORTING FRAMEWORK

IMP *Impact Goals*	AVOID HARM		BENEFIT STAKEHOLDERS	CONTRIBUTE TO SOLUTIONS
SEC (US) *Investment Process*	ESG Screened		ESG Integrated	ESG Focused
SDR (UK) *Portfolio Composition*	Responsible	Sustainable Focus	Sustainable Improvers	Sustainable Impact
SFDR (EU) *Reporting*	Article 8		Article 9	
Climate-based theory of change	Screen out companies engaged in harmful activities or responsible for negative externalities to encourage re-engineered business processes		Invest with an awareness of how companies affect the environment and accrue anciliary improvements or positive externalities through enhancements of practices and processes	Invest in businesses that sell a product or service that is directly addressing a climate challenge, typically reducing emissions/pollution outright or reducing the emissions intensity of a product or service

In these generally accepted and reductionist terms, climate-related investment strategies can fall within broad and often overlapping buckets. They may avoid causing harm through ESG-based screens; seek to benefit stakeholders through broad sustainability goals; or contribute to climate mitigating or adaptive solutions through specific objectives tied to underlying business models.

But this does not make them all climate *impact* investors. Even managers who today are eager to claim the IMP's "Contribute to Solutions" label should think more critically about the primary objectives of their investments. In Europe, this reckoning has already begun as SFDR comes into effect. Even inside Europe—and certainly outside of it—additional guidance and consensus-building is likely to be needed to ensure accurate fund labeling, clear process disclosure, and credible results measurement.

FROM CLASSIFICATION TO STRATEGY

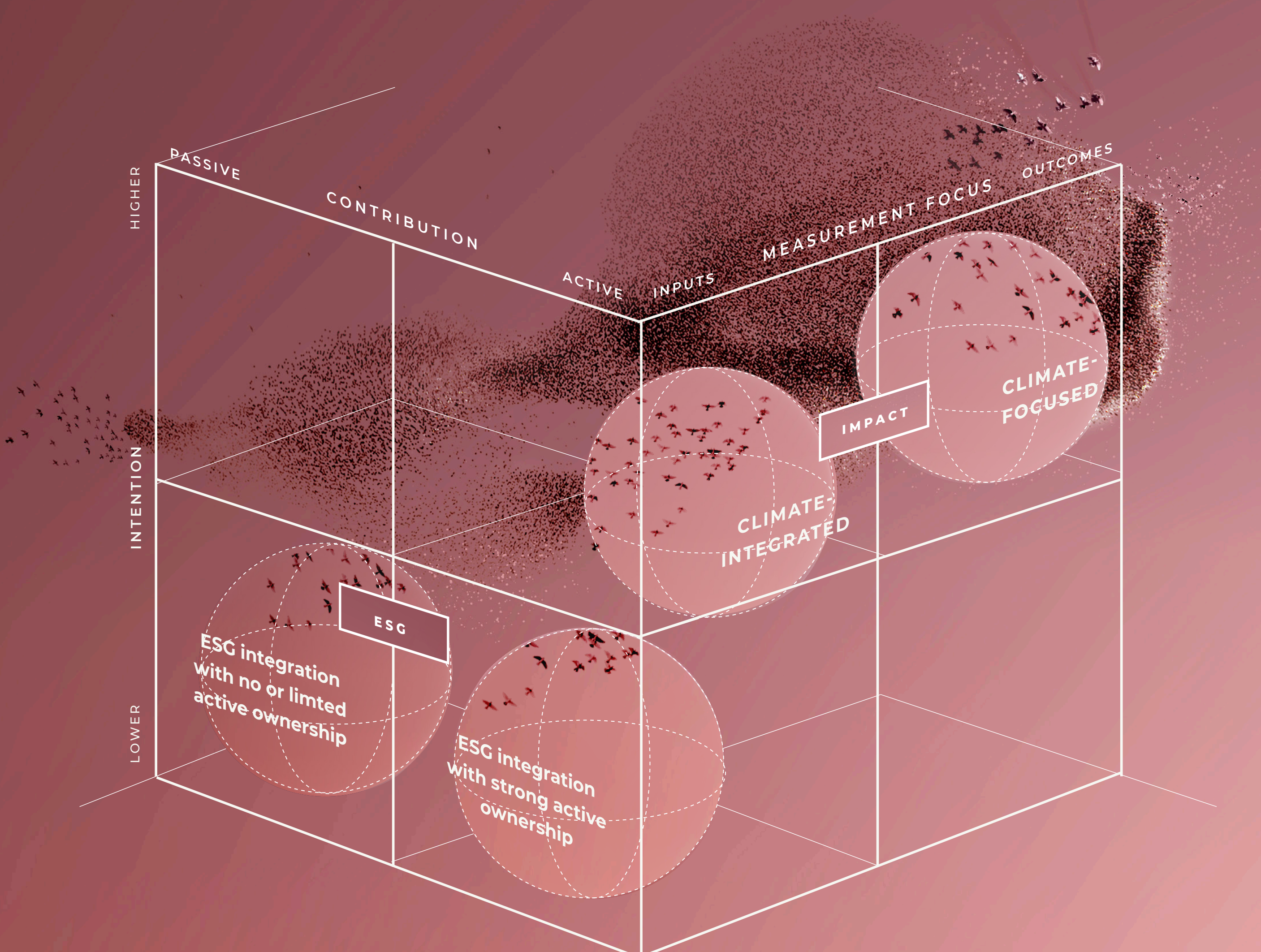
To be sure, the ubiquity of climate as a theme and growing focus for all investors complicates the labeling question. Tideline's work in climate suggests that the high bar for achieving the "impact" hurdle runs through two strategies: "climate-integrated" and "climate-focused" investing. Borrowing from the SEC's emerging naming convention, "climate-integrated" investors are likely to consider ESG inputs and outputs in their investment process and often have clearly articulated company- or portfolio-specific goals related to environmental action, but their investment universe is broad, emphasizing measurable benefits or avoidance of harmful activity. "Climate-focused" investors are likely to have a foundational ESG integration process in place too, but their primary concern is partnering with companies whose commercial success is fundamentally dependent on achieving improvements in climate-related targets. They are more likely to look beyond operational outputs to emphasize the intended outcomes of an investment and the ultimate beneficiaries.

Climate progress is complex and requires both the "integrated" and "focused" approaches to meet the goals of the Paris Agreement. Climate-focused investors can help bring about systemic change by providing the resources needed to leapfrog current solutions. Climate-integrated investors can slow the pace of additional damage in the interim while highlighting the challenge and opportunity areas for climate-focused investors, governments, and NGOs.

Considering these characteristics against Tideline's three pillars of impact strategy and labeling, it's clear that climate impact is decidedly three dimensional. The relatively higher level of intentionality and contribution that these funds must have place them squarely among impact investing fund peers and demands a concerted effort for ongoing and thoughtful results measurement. While climate-integrated funds most often have comprehensive outputs-based measurement protocols, their climate-focused counterparts are on the leading edge of measurement practices. They incorporate aspects like an outcomes-oriented lens, consideration for potential negative effects, and objectives tied to incentive structures. We depict the three-dimensional nature of climate impact strategies in the figure below.

FIG. B

TIDELINE'S CLIMATE IMPACT X-RAY



DISTINGUISHING CHARACTERISTICS OF CLIMATE IMPACT INVESTMENT

As demonstrated in Tideline's Climate Impact X-Ray, sustainable investment strategies can largely be identified by their approach to the three impact pillars of intentionality, contribution, and measurement. In this section, we explore how these pillars translate to a manager's investment strategy, and the similarities and differences in their application between responsible investors and climate impact investors.

INTENTIONALITY

Intentionality speaks to a manager's ability to capture and establish specific sustainability goals. The intentionality of a manager is linked both with the investment strategy itself and the investment process, as goals must be backed by actionable and well-considered plans for how to execute them. For this reason, intentionality serves as a logical starting point when considering if a strategy demonstrates true climate integrity and focus.

In responsible investment, sustainability objectives are broad and may be positioned as a useful risk mitigation lever. Responsible investors often emphasize portfolio companies' efforts to reduce their own environmental impact, but fail to demonstrate a cohesive strategy for supporting investees in achieving those sustainability goals. In this way, responsible investors make best efforts to understand and consider potentially material environmental factors but stop short of making hard and fast commitments for the portfolio's ESG composition or performance. Indeed, a hallmark of responsible investment has become retroactive disclosures—the practice of looking back at environmental efforts or performance and reporting on results. This approach lacks the specific commitment up front that is needed to be consistent and transparent about climate goals, and often means there is a poor understanding of why a particular investment was successful in achieving climate progress and what should be done next to replicate it.

In contrast, climate impact investors have clearly defined commitments and are intentional about assessing an opportunity's ability to align their own climate goals up front. They have a clear connection between their pursuit of climate progress and the success of their strategy. Many climate impact investors often start with a particular climate challenge and work backwards to build an investment strategy around it. This isn't to say that every climate impact investor has a quantitative environmental target tied to their portfolio, but at a minimum they are likely to make principles-based commitments to ensure that each of their investments is pursued in support of an overarching climate goal and that, where possible, there is a process in place to set appropriate targets. Initiating the considerations for climate effects at the start of the investment process allows these investors to make more informed investment decisions, and helps arm them with higher quality, more consistent information to serve as a basis for continued learning and refinement.

CONTRIBUTION

The second practice that impact investing managers commit to is fulfilling their contribution to the achievement of intended impact. The notion of contribution emphasizes a manager's own distinct role enabling or accelerating the achievement of sustainability goals. Each manager brings to their strategy unique perspectives, team background and experience, platform capabilities, and other competencies. These add up to being a significant differentiator for impact investors from the broader set of institutional capital in the market, and serve as a key aspect of the unique value proposition that an impact investor can make to prospective portfolio companies.

Responsible investors typically create an operational and value creation plan for portfolio companies. We often see frameworks like 100-day plans or first-year onboarding goals that are prioritized when new investments are made. Responsible investors may work to understand how their differentiated capabilities can be deployed to create more impact than would have been achieved without their involvement. In addition, they may work with portfolio companies to find pathways for deepening the effects of impact or broadening its reach to new markets. Their limitation may come in to play in how broadly this commitment to action is made across the portfolio.

Climate impact investors adhere to these same principles. But they are distinct from responsible investors in two key areas. First, climate impact investors—especially those already active in the market prior to the recent influx of capital—have an extensive network of manager peers, entrepreneurs, scientific experts, and technical talent. This deep bench of knowledge serves as a constant resource from which to draw insight and inspiration when approaching growing pains with a new portfolio company. Climate impact investors' networks are vast and varied, which enables their second key strength: active management. Drawing on this network, climate impact investors leverage their time and prioritize speed of delivery for expert advice and support, allowing them to add more value in a shorter period. For climate-focused investors, emerging solutions can be at an early stage with high technology risk, while for climate-integrated investors, transitioning assets to greener operations or uses brings along outsized execution and reputational risk. It's no surprise, then, that climate impact investors do not limit themselves to 100-day plans—instead, they constantly look for what challenges or opportunities lie ahead and help their portfolio companies respond accordingly.

MEASUREMENT

The final key aspect that distinguishes impact investors is ongoing measurement and management of climate metrics. In practice, this means proactively identifying the specific metrics that make most sense for a portfolio company's commercial and impact success, and being thoughtful about establishing baseline measurements at the time of investment for those key performance indicators. From there, measurement is an ongoing practice that requires at least annual updates so the investor—together with the company management—can identify trends and opportunities and manage for success. It should be noted that, while quantitative metrics are necessary, so too are qualitative measures that provide additional detail and necessary context to make sense of those metrics. This allows investors to demonstrate, for example, a real understanding not only of what effect their investments are having, but also the relevance and magnitude of that effect on different stakeholder groups over time.

Responsible investors have these basics down. Established frameworks and guidelines like the Impact Management Platform (a successor to the Impact Management Project) and the GIIN's IRIS+ metrics and evidence base have helped best practice management and measurement principles proliferate. What's more, we are now seeing renewed and enhanced commitments made because of the widespread adoption of the Operating Principles for Impact Management. These industry-wide efforts have helped establish the state of play, align expectations among limited partners, and provide confidence to managers that they are aligned with industry standards. Moreover, broad coalescence has been forged on key disclosures and priority metrics, even for those investors whose core focus is not climate—namely, the adoption of GRI and TCFD reporting frameworks and the increased commitment to efforts like the ESG Data Convergence Project.

Climate impact investors, once again, have a slightly higher bar. Their target market and its expected impact have the added benefit of being one of the sectors with more accessible and quantifiable impact data, thanks to the same tools and frameworks elevating responsible investor measurement practices. This ups the ante for climate impact investors to establish the right targets, manage to those goals, and explain any delta. It also makes for a much more compelling impact case, as reported metrics can be supplemented by case studies, qualitative measures, and discussion of risks, underperformance, or unintended negative effects. These heightened expectations are borne out in the types of reporting required by limited partners and some regulators. With scrutiny seeming to increase by the day on climate investments, management and measurement will continue to play a key role in defending climate impact investors' track record and efficacy.

CASE STUDIES

Brookfield

CLIMATE IMPACT INVESTING **CASE STUDY**

Brookfield Global Transition Fund (BCTF)

The Brookfield Global Transition Fund ("BGTF") is the world's largest private fund dedicated to facilitating the decarbonization of the global economy by investing in the transformation of carbon-intensive businesses and developing new renewable power, while delivering attractive risk-adjusted returns to investors. BGTF was launched by Brookfield Asset Management, a leading global alternative asset manager, with an impact measurement and management (IM) system developed in partnership with Tideline.

When Brookfield began developing its impact strategy, the Firm's view was that a fund focused on advancing decarbonization and the transition to net zero, led by an organization with a longstanding track record in sustainable investing, proven decarbonization operating expertise, deep understanding of global power markets, and scale access to capital, would have the most impact in addressing climate challenges through greenhouse gas reduction.

To ensure the Fund meets its climate goals, all BGTF prospective investments must meet the requirements of its "4A Impact Criteria", meaning BGTF must **ALIGN** the investment with the goals of the Paris Agreement, **AVOID** or mitigate other related ESG risks, provide **ADDITIONALITY** to what would otherwise occur, and ensure there is **ACCOUNTABILITY** in emissions reporting.

INTENTIONALITY

BGTF's priority is to invest in opportunities that contribute to the transition to a net-zero global economy, in line with the Fund's "4A" framework for rigorously measuring and managing impact performance. Accordingly, the foundation of the Fund's IM strategy is predicated on ensuring that all investments: (1) have a business plan aligned with the goals of the Paris Agreement; (2) utilize comprehensive GHG reporting to demonstrate GHG reduction and/or avoidance; (3) set quantitative, transparent and verifiable targets based on scientific metrics; and (4) that the Fund is aligned with industry-leading climate reporting standards and impact frameworks.

CONTRIBUTION

BGTF develops an actionable strategy for achieving the impact targets for each investment, which is centered on adopting a Paris-aligned business plan. As part of the Fund's value creation and active asset management strategy, the Fund maintains an integrated approach to asset management, which is established prior to initial transaction execution. The Fund actively partners with management teams and take a hands-on operational approach with businesses and assets to enhance the value (both financial and impact) of the business to execute these plans.

MEASUREMENT

The BGTF investment strategy and underlying processes that support the Fund's IM approach have been designed to align with leading impact and climate reporting standards. Setting emission reduction targets for high-emitting businesses, alongside commercially viable plans and proper governance to achieve them, and consistent measurement of emissions to track progress are all fundamental aspects of the strategy. Currently, BGTF reports GHG emissions for all investments (Scope 1, Scope 2 and material Scope 3 emissions) in accordance with the Greenhouse Gas Protocol and emissions are audited on an annual basis. In addition, the TCFD recommendations are incorporated into the due diligence and asset management approach.

"The Fund has found that the implementation of the IM system has served to enhance the investment process by helping to identify opportunities and areas of value enhancement."

Brookfield believes that the disciplined integration of ESG principles, including decarbonization, is a fundamental component of creating long-term value and de-risking the Fund's investments. The Fund has found that the implementation of the IM system has served to enhance the investment process by helping to identify opportunities and areas of value enhancement, as well as operational and ESG value creation levers for all investments.

Furthermore, recognizing that the impact and climate ecosystems continue to evolve as these considerations have increasingly become a focal point for most organizations, BGTF has committed to align with the leading climate and impact standards, and as the landscape and guidance continue to advance, regularly engage with industry participants, thought leaders and standard setters to integrate updated best practices on impact reporting and metrics into its due diligence and ongoing asset management approach where appropriate.

CLIMATE IMPACT INVESTING **CASE STUDY**

British International Investment (BII) Climate Change Strategy

British International Investment (BII) is the UK's development finance institution, 100% owned by the UK Government, focused on investing patient capital to create productive, sustainable and inclusive economies. The organization recognizes that Climate Action, SDG 13, is essential to building net zero and resilient economies but also underpins other SDGs such as No Poverty (SDG 1), Zero Hunger (SDG 2), Reduced Inequalities (SDG 10) and Affordable and Clean Energy (SDG 7), making the urgency for climate action greater than ever. BII is committed to supporting investments that change how economies work, reorienting them to embrace new and emerging climate-friendly technologies and embedding reduced emissions and increased resilience to climate shocks into business models and behaviors across all sectors.

BII's impact management approach is grounded in the Operating Principles for Impact Management and supports the organization's aim to maximize impact through the entire investment process, from setting clear objectives, to managing and monitoring impact during portfolio management, and all the way to realizing responsible exits. BII's climate ambition is clearly embedded in its broader 2022-2026 strategy, which sets out three strategic impact objectives – to invest in productive, sustainable, and inclusive development. The sustainable objective centers on accelerating economic transformation in two ways: first, investing in "Climate Finance" opportunities that make an active contribution to climate action; and second, ensuring that all investments reduce emissions and improve resilience.

INTENTIONALITY

BII's climate change strategy consists of two commitments: Paris alignment (defined by the three building blocks of Net Zero, Just Transition and Adaptation and Resilience) and implementation of the Taskforce on Climate related Financial Disclosures (TCFD) key recommendations. The organization's Paris alignment approach will be accomplished through increased investment in climate. Over the 2022-2026 period, at least 30 percent of the organization's total new commitments by value will qualify as Climate Finance, and BII will no longer invest in sectors that are misaligned to the goals of the Paris agreement as defined by its fossil fuel policy. Other investments which are 'conditionally' aligned will be assessed for Paris alignment and supported to transition to less emissive and more resilient business practices.

'Aligning the impact scoring approach with the objectives of the climate strategy means that climate and sustainability impact are a core part of the investment decision-making process.'

The organization's climate objectives have also been embedded in BII's impact scoring system, which was designed as a tool to manage strategic impact on a portfolio basis. Every investment made from 2022 onwards is scored against each of BII's three strategic impact objectives. The Sustainable score signals to what extent an investment is contributing to the transition to net zero and climate-resilient economies. Climate considerations are further integrated into the Impact Dashboards developed for each individual investment at the ex-ante stage. Aligning the impact scoring approach with the objectives of the climate strategy means that climate and sustainability impact are a core part of the investment decision-making process.

CONTRIBUTION

At a transaction level, BII's work with investees on climate impact goes hand-in-hand with the organization's ESG processes and toolkits. A robust ESG approach serves as the basis for any further action needed by BII on climate change. This can include supporting investees in setting net zero targets, advising them on measures to reduce emissions or improve resilience to climate shocks, putting in place appropriate climate governance through the TCFD recommendations, or starting to assess climate-related physical and transition risks. For investments that are not classified as Climate Finance, actions to decrease emissions and improve resilience are given recognition through higher scoring when the organization re-assesses investments post-investment.

A prime example of BII's partnership on climate action is the mangrove restoration project at Zephyr Power, in which BII worked with Zephyr to restore the local tidal and coastal environment of the investee's wind farm, ultimately building more environmental resiliency and generating economic vitality for the local community. BII has also worked as part of the 2X Collaborative to create the 2X Green toolkit, which provides resources for investors looking to increase their delivery of gender smart climate finance. Finally, BII's technical assistance facility, BII Plus, provides grant capital to deepen the impact of the organization's investments, including for climate-related risks and opportunities.

MEASUREMENT

Post-investment, BII monitors whether Climate Finance investments deliver on the Climate Finance deployment ambitions—and for non-Climate Finance investments, how investments perform relative to sector and country-specific emissions pathways. BII is committed to implementing the recommendations of the TCFD in its climate change strategy, and the organization publishes TCFD-aligned disclosures in its annual accounts. To assess and track Climate Finance performance, BII uses the MDB / IDFC Common Principles for climate mitigation and adaptation finance and reports progress against corresponding targets. Since 2017, BII has delivered over $1.7 billion in Climate Finance. To measure the emissions associated with investments, BII uses the standard by the Partnership for Carbon Accounting Financials (PCAF)'s guidance. In addition, the organization is considering market leading frameworks for developing its net zero transition strategy, as well as enhancing its approach to physical risk management. Any fund or asset-specific targets BII considers reflect these best practice methodologies and tools.

Having an impact management approach in place which embeds impact at each stage of the investment process has allowed BII to take a holistic approach. Despite the nascency of some tools, there are already clear signs that the ones in use to date (complemented by portfolio-level targets) have increased the alignment of origination efforts with BII's strategic priorities, including its climate ambition. The impact management process provides visibility into the climate impact of investments across all levels, and across multiple leadership forums at BII. Identification, management and risk mitigation related to climate issues happens not only at the transaction level, but also at the portfolio level to ensure that portfolio construction reflects BII's climate strategy.

As BII continues to build out its frameworks and processes, the organization aims to share and help others in the industry advance their own impact systems—and encourages others to do the same.

OPERATIONALIZING CLIMATE IMPACT INVESTMENT

As the work of BGTF and BII demonstrate, intention, contribution, and measurement are brought to life by climate impact investors through robust "impact management". The Operating Principles for Impact Management, a leading standard incubated by the IFC and now housed by the GIIN, defines the practice as the systems and processes used for "managing investments into companies or organizations with the intent to contribute to measurable positive social, or environmental impact, alongside financial returns."[5]

Whereas responsible investment might entail a more passive approach to achieving sustainability objectives, climate impact investors need to demonstrate their ability to integrate climate objectives into the way they source, diligence, manage, and monitor deals. This is brought to bear through the ex-ante identification and assessment of impact objectives, an active approach to identifying, planning, and executing contribution to the achievement of impact, and ongoing commitment to a considered measurement and management framework.

In this section, we provide guidance on the foundational aspects required to operationalize a climate investment strategy. For each of the three impact pillars we identify key focus areas that every climate investor must master to withstand market scrutiny and maintain a position as a leader in the fight to address climate change.

INTENTIONALITY

Investment thesis development: Climate impact investors are encouraged to build impact into their investment thesis from its earliest stages. While many responsible investors create an impact thesis to sit alongside their investment strategy, climate impact investors cannot divorce the two. Instead, they should make explicit the connection between their investment universe, their goals as investors, and the expected outcomes they intend to achieve through their portfolio companies. Whether the strategy is climate-integrated or climate-focused, a well-developed thesis grounded in a credible evidence base of research will set the stage for success, aligning internal objectives and managing external expectations.

5 Operating Principles for Impact Management, https://www.impactprinciples.org/sites/default/files/2021-06/Impact%20Principles%20Brochure%20Revised.pdf

Investment process integration: Climate impact investors put their thesis into action throughout each step of the investment process. They go beyond screening checklists and risk assessments to consider the potential impact every step along the way, including both positive and negative potential effects. The constant presence of climate considerations serves as a reminder to the investment team of a climate impact investor's dual mandate and helps keep objectives aligned as decisions are made about terms, action plans, and exit strategies. Some may go so far as to include incentive alignment tied in part to climate objectives for investment team performance reviews or compensation.

CONTRIBUTION

Network curation: Climate impact investors should build their network at every opportunity. Part of the value that climate impact investors can offer is specialized technical advice and a more nuanced understanding of climate issues than any one team or entrepreneur could manage alone. Networks are critical to supplementing a manager's own knowledge for how to measure and address climate challenges, and how to build partnerships and coalitions that can have multiplying effects. It's important to remember that networks are also a two-way exchange. Climate impact investors should seek out industry affiliations and climate-specific bodies where they can share ideas with peers and learn from those on the leading edge of the field. The more active and engaged a manager is in their network, the more likely it will be that their portfolio companies—and the planet—benefit.

Active management: Climate impact investors must play an active role in engaging with portfolio companies to drive their commercial and impact objectives. This is especially true when the investment is made with a climate transition thesis, necessitating an 'environmental turnaround' of the business or asset. Climate impact investors have the unique opportunity to advance impact outcomes by influencing the scale and pace of innovation, and helping to ensure that the benefits reach those who are most affected. Notably, climate impact investors recognize asset management as a value creation lever rather than solely a means for risk mitigation. Therefore, active ownership should go beyond operational optimizations and consider strategic value drivers as well.

MEASUREMENT

Measurement system: Fully-integrated climate impact investment requires proactive and rigorous impact measurement. Identification of key impact metrics should be built-in from day one of any potential investment, as an investor needs to know what the key value and impact drivers are and how they can help optimize for them. Having a data management system is paramount and should enable investors to see asset-level and portfolio-level metrics that indicate the scale, depth, and magnitude of impact. The metrics selected should help investors hold their portfolio companies accountable to specific targets, without overlooking any potential social or environmental negative effects that may occur as a result of optimizing for any particular climate outcome. More importantly, metrics should reflect the specific objectives of the investment strategy. For instance, decarbonization strategies should have a clear focus on setting science-based targets, whereas clean energy strategies should capture the quantity of electricity generated.

Disclosure protocol: Finally, climate impact investors must have a plan for regular disclosure of comprehensive results and an explanation of the strategy and methodology deployed to achieve them. Disclosure expectations are still highly contingent on geography, with European regulators leading the charge in transparency. Best practice is to align reporting with industry frameworks like the EU Taxonomy, TCFD, and ESG Data Convergence Project.. To get there, managers should seek to build reporting processes that allow for consistency and continuity in data reported, transparency in data sources and calculation methodologies, and interoperability with evolving standards and regulations. That's a tall order, but one that climate impact investors must fulfill to maintain their license to operate in such a highly scrutinized niche.

LOOKING AHEAD

With a flurry of new capital being targeted for climate-related investments, commitments to Net Zero being made from every corner of the economy, and a tumultuous period of regulatory evolution across geographies, it can be tough for climate impact investors to keep up with the pulse of the market. And more change is ahead. SFDR will come into full effect over the next two years, the SEC may provide additional guidance or oversight following the recent proposal of new fund naming and disclosure rules, and industry experts—as well as some in the political sphere—are sure to continue spirited debate around the topic.

Climate impact investors are best positioned to cut through much of that noise and serve as a beacon for other impact investors, as well as the broader spectrum of asset owners and managers seeking to understand how climate risk and opportunity relate to their investment strategies. With clear impact objectives, strong correlation with commercial success, and more readily available data, climate impact investors have the luxury of being able to test and iterate approaches quickly, allowing their learnings to emanate throughout the market.

Investors in the climate impact space will be subject to increased pressure in coming years, but also increased interest from new LPs. Tideline believes they will be better positioned to withstand the former and capitalize on the latter if they take seriously their responsibility to invest with intention, make authentic contributions to impact achievement, and manage and measure for climate action success.

APPENDIX

UNPACKING THE ESG DEBATE

As ESG has increasingly entered the mainstream, there has been a predictable backlash by those who say ESG goes too far and those who say ESG doesn't go far enough. Critics and skeptics alike are attacking ESG as greenwashing or "woke capitalism". While there is room for healthy debate on the merits and shortcomings of ESG, much of the recent vitriol is aimed at sowing confusion about what ESG is or isn't in order to block what some feel is a rogue ideological agenda. Given the focus of this paper is on how to differentiate climate impact investing from more generalized climate investing, we felt some clarification was needed.

WHAT ESG IS:

The simplest way to think about ESG is as a framework for assessing relevant risks and opportunities. These risks and opportunities may be related to how a company is affected by climate change (E), how a business treats its workers (S), or how a corporation is governed (G). The main driving force behind ESG is enhancing transparency on these issues via corporate disclosures, whether through regulation, investor pressure or market expectations. Notwithstanding disagreement on what should be considered "relevant" or "material" to decision-making, ESG in practice is about gathering more quantitative and qualitative data. This democratization of information is mutually beneficial for both companies and investors. Companies use ESG to develop a stronger understanding of risks to their business model and can therefore better adapt to take advantage of future opportunities. Meanwhile, investors use the analysis of ESG factors to identify attractive investment opportunities and better manage their portfolios. Just as traditional financial metrics like revenues and expenses can provide valuable insights into a company's financial prospects, ESG metrics like carbon emissions and workforce diversity can provide a critical lens into how well a company is positioned given constantly evolving market expectations.

WHAT ESG ISN'T:

ESG often gets conflated with terms like sustainable investing, impact investing and system-level investing. While ESG is an important component of those concepts, ESG by itself is rarely enough to motivate companies to change their practices in one way or another. Much of the recent field-building in ESG has been driven by voluntary frameworks (e.g., B Impact Assessment, SASB, TCFD), industry standards (e.g., GRI, ISSB) and regulatory requirements (e.g., EU taxonomy, SFDR, SEC's climate rule). What each of these efforts have in common is a focus on the power of standardized information, whether through disclosure by a company, an investor, or any other organization. ESG disclosures provide insights on how a company is performing on certain metrics, and whether that performance has improved or worsened over time. What investors or any other stakeholders do with this information is their prerogative, although investors with a fiduciary duty are expected to at least consider the implications. ESG investing only becomes impact investing when an investor intentionally targets a specific outcome they want to affect via their contributions as an investor, including by supplying capital, engaging with management, or providing strategic counsel and networks.

The double-bottom line: Companies have always been expected to manage risks and opportunities. ESG provides a framework for expanding the universe of information that companies and others can have at their fingertips. Increased disclosure leads to improved transparency, and stronger accountability leads to healthier markets.


TIDELINE